



香港聯合交易所有限公司
(香港交易及結算所有限公司全資附屬公司)

THE STOCK EXCHANGE OF HONG KONG LIMITED
(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

CONFIDENTIAL

Our Ref.: MSM/EQA/INS/008/17

28 April 2017

By Post & By Email

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Haitong International Securities Company Limited

33/F, Infinitus Plaza
199 Des Voeux Road Central
Hong Kong

Attention: Mr. Lo Yam Pui, Eric – Responsible Officer

Dear Sirs,

NOTIFICATION OF INSPECTION LETTER

Re: Inspection of Haitong International Securities Company Limited

We refer to the information sharing session on the Annual Attestation and Inspection Programme ("Programme") held at the Exchange's office on 24 February 2017. The purpose of this letter is to provide you with details of the onsite inspection and to request for information for pre-inspection review.

Objective

The objective of the inspection is to evaluate your compliance with the SEHK Rules in the priority areas, namely: (1) Flagging of Short Selling Orders; (2) Manual Trade Reporting; and (3) China Connect Rules.

Timeline

The tentative timeline of onsite inspection is expected as follows:

Key Event	Date
1. Submission of Pre-inspection Information	26 May 2017
2. Notification of inspection agenda / schedule	16 June 2017
3. Commencement of Onsite Inspection	26 June 2017

Pre-inspection Information Request

Please submit all information specified in the enclosed pre-inspection information request list by 26 May 2017. Your submission of clear, complete and relevant information will facilitate our understanding of your internal controls and procedures and enable us to carry out the onsite inspection in an efficient manner.

Upon receipt of the requested information, we will provide you with further details on the onsite inspection process, including the inspection agenda and schedule, at least 7 days prior to the onsite inspection.

If you have any questions regarding the inspection, please email to surveillance@hkex.com.hk or contact the Lead Inspector – William Chen at 2211-6339 or the undersigned at 2840-3622.

Yours faithfully,
For and on behalf of
Hong Kong Exchanges and Clearing Limited



Kelvin Chu
Vice President
Market Surveillance and Monitoring

Enclosure:
Pre-inspection Information Request

PRE-INSPECTION INFORMATION REQUEST

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Review Period

Information is requested for the period 1 January 2016 to 31 December 2016 (the "Review Period") unless otherwise noted.

Review Scope

Activities in Manual Trade, Short Selling and Northbound Trading of China Connect Securities (the "Priority Areas") during the Review Period. Please refer to the Appendix for the relevant SEHK Rules.

Submission Guidelines

1. Information provided should be clear, complete and relevant to your activities in each of the Priority Areas.
2. Please label the information in accordance with the item number in this request list.
3. Where a policy or procedure is requested under a particular item, please provide the relevant extracts or specify the relevant section(s) if a full version of the policy or procedure is submitted.
4. If any request item does not apply to your business, please indicate "N/A" (not applicable).
5. Please submit your response and the requested information to us by email surveillance@hkex.com.hk no later than 26 May 2017.

Information Request

Part A: General Information

I. Overview of Business

1. A group ownership chart showing the Exchange Participant's ultimate holding company and including the relevant affiliates / subsidiaries involved in the Exchange Participant's activities in the Priority Areas. Please indicate if the entity is:
 - a) a member/participant of other stock exchange or futures exchange in Hong Kong or overseas
 - b) a licensed bank, restricted license bank or deposit taking company in Hong Kong or overseas
 - c) a listed company in Hong Kong or overseas stock exchange and name of the exchange
2. A description of how the entity(ies) within the group involved in the Exchange Participant's activities in each of the Priority Areas, including details in relation to the activities or business conducted by the respective entities and the capacity in which the Exchange Participant carried out the activities.

II. Organization and Personnel

3. A description of the Exchange Participant's organization structure, including the following:
 - a) an organization chart with key departments, approximate size and positions in those departments
 - b) a list of key staff members responsible for supervising, conducting and monitoring the activities in the Priority Areas, and their respective titles and responsibilities

III. Governance Overview

4. Policies and procedures governing the review and update of policies and internal control procedures.
5. Policies and procedures on handling of non-compliance incidents relating to the Priority Areas, including the process details of and the functions responsible for the following areas:-
 - a) Regulatory reporting
 - b) Escalation process
 - c) Implementation of corrective actions and preventive measures

- d) Handling of recommendation or advice given by regulator(s)
- 6. Record of any non-compliance of SEHK Rules during the Review Period and the respective action taken as a result of such non-compliance (including corrective actions and preventive measures). Please also indicate if the measure(s) has been implemented.
- 7. Details of the Exchange Participant's framework on identification, assessment and mitigation of compliance risks and the documentation regarding the application of such framework.
- 8. Record of any client complaints relating to the Priority Areas during the Review Period, and information about the process for handling client complaints.
- 9. Details of the most recent internal audit carried out on activities in each of the Priority Areas (including the relevant findings and remedial action(s) taken (if any)).
- 10. Details of how staff members are kept informed of regulatory changes and developments.
- 11. Details of the most recent training courses on the Priority Areas provided to the staff members listed in 3 (b) and specify if the course was mandatory or optional.

Part B: Manual Trade Reporting

- 12. Process flow diagram to illustrate the steps involved in Manual Trades reporting process commencing from conclusion of the trade, and indicate the timeframe between each step. Please provide examples to support the above process.
- 13. Policies and procedures governing the reporting of Manual Trades (including ATS Trades (Dark Pool/ALP Trades) as stated in SEHK Rules 501E(2), 501F(1)-(2), 520(1)-(2), 523, 526(1)-(2), 528(1) for own accounts and client trades, including the following details:
 - a) Controls to ensure the accuracy and timely reporting of Manual Trades
 - b) Process to review the reported Manual Trades
 - c) Reporting to SEHK of any errors, discrepancies and late reporting

Part C: Short Sell Flagging

- 14. Policies and procedures to ensure compliance with the Eleventh Schedule, Fourteenth Schedule, Fifteenth Schedule and Eighteenth Schedule of the SEHK Rules on short selling, including:
 - a) Process for handling long and short sell orders
 - b) Process to ensure that documentary assurance is obtained before the short sell order is placed

- c) Method to identify, record and input short sell order
- d) Method to ensure the subject security is eligible for short selling
- e) Method to ensure short sell order is input during the Continuous Trading Session
- f) Method to ensure the short sell order is flagged with the correct indicator
- g) Process to ensure the accuracy and completeness of short sell order inputted in AMS
- h) Process on passing the short sell orders to another person for execution
- i) Post-trade review process
- j) Reporting of any errors and discrepancies identified to SEHK
- k) Record keeping for the complete audit trail for short sell order
- l) Any monitoring and review of short sell orders
- m) Relevant training materials
- n) Any documentation to demonstrate that internal controls are properly implemented

Part D: China Connect

- 15. A sample client agreement covering northbound trading of China Connect Securities (including trading of ChiNext stocks) and specify the relevant clauses or provisions as required under SEHK Rule 14A10 and 14B10.
- 16. Samples of client notifications or representations signed by client relating to the following aspects of northbound trading in China Connect Securities:-
 - a) The trading and settlement arrangements
 - b) The restrictions, requirements and conditions applicable to Margin Trading
 - c) The restrictions, requirements and conditions applicable to Stock Borrowing & Lending
 - d) The restrictions, requirements and conditions applicable to Short Selling
 - e) Investor eligibility requirement for trading in ChiNext shares
- 17. A description of the trade monitoring and surveillance framework applicable to the northbound trading of China Connect Securities, including details of the monitoring methodology to detect and prevent
 - a) quota hogging

- b) other types of market misconduct or breach of Shanghai Stock Exchange (SSE)/ Shenzhen Stock Exchange (SZSE) / SEHK trading rules
- 18. An outline of the pre-trade checking process, including details of the arrangements or controls in place to prevent turnaround trading and money/securities settlement failure.
- 19. Details of controls or process to ensure non-trade transfer are only carried out for the purposes prescribed under Rule 14A12(2) and 14B12(2).
- 20. Policies and procedures to ensure staff members report non-trade transfer referred to in SEHK Rule 14A12(2)(b) to the Exchange.
- 21. Details of procedures and monitoring arrangements to
 - a) ensure the Exchange Participant and its client would comply with the 10% individual shareholding limit
 - b) ensure the Exchange Participant and its client would comply with the 5% shareholding disclosure obligation
 - c) alert clients to comply with the 10% individual shareholding limit and 5% shareholding disclosure obligation
 - d) alert clients of the 30% aggregate shareholding limit and the forced-sale arrangement

Please specify the function conducting the monitoring, includes the details of the monitoring methodology and the escalation process.
- 22. Policies and procedures governing the handling of Margin Trading clients and their orders.
- 23. An outline of the process in place to keep track of the List of Eligible SSE/SZSE Securities for Margin Trading and the volume of Margin Trading activities of each of the SSE/SZSE Securities.
- 24. Policies and procedures governing the stock borrowing and lending activities.
- 25. Function responsible for the submission of the report as required under Rule 14A16(12) and 14B16(12) and the internal checking and controls in place to ensure the accuracy and timely submission of report.
- 26. Policies and procedures governing short selling activities.
- 27. Details of controls to prevent naked short selling, misflagging of short sale order and violation of the price restriction requirement.
- 28. An outline of the process in place to keep track of the List of Eligible SSE/SZSE Securities for Short Selling , the Short Selling ratio limit and total open short position of each of the SSE/SZSE Securities.

29. Details of the arrangements to monitor open short position executed for proprietary account or client account. Please include details of the monitoring methodology and specify the function conducting the monitoring.
30. Function responsible for the submission of the reports as required under Rule 14A17(17)-(20) and Rule 14B17(17)-(20) and the internal checking and controls in place to ensure the accuracy and timely submission of reports.
31. Details of controls or measures to ensure your client (including the underlying client of your intermediary client) is an Institutional Professional Investor (IPI) before accepting its instruction to buy ChiNext stocks. Please also specify the frequency of reviewing your client's IPI status.
32. Where your client is an intermediate broker acting as agent on behalf of its underlying client, please provide a copy of the assessment record or the type of information obtained from your client during the Know-Your-Client process before accepting its instruction to buy ChiNext stocks.

Appendix: SEHK Rules Reference

Manual Trade Reporting

Manual Trades

- **Duty of Exchange Participant to report Manual Trades within 15 minutes of trade execution on T, and not later than 9.45 a.m. on T+1**
(SEHK Rules 501(E)(2), 501(F)(1)-(2), 520(1)-(2), 526(1)-(2))
- **Duty of buying Exchange Participant to review details of Manual Trades within the trading session**
(SEHK Rules 501E(3), 523)
- **Duty of every Exchange Participant to perform day-end review of both sales and purchases journals including Manual Trades**
(SEHK Rule 528(1))

Dark Pool / ALP Trades

- **Duty of Exchange Participant to report ATS transactions (Dark pool / ALP trades) within 1 minute of trade execution**
(SEHK Rules 501(F)(1), 526(1))

Short Sell Flagging

- **Short selling**
(SEHK Rules 11th Sch. Regs. (3), 5(a)-(b))
- **Securities Market Maker Short Selling**
(SEHK Rules 14th Sch. Regs. 23, 24)
- **Designated Index Arbitrage Short Selling**
(SEHK Rules 15th Sch. Regs. 3, 4, 15, 16, 20)
- **Stock Futures Hedging Short Selling**
(SEHK Rules 15th Sch. Regs. 22, 29, 31, 32)
- **Structured Product Hedging Short Selling**
(SEHK Rules 15th Sch. Regs. 34, 40, 41)
- **Options Hedging Short Selling**
(SEHK Rules 15th Sch. Regs. 44, 50, 51, 52)
- **Structured Product Liquidity Provider Short Selling**
(SEHK Rules 18th Sch. Regs. 15, 16)

China Connect

- **Daily Quota**
(SEHK Rule 1428(1))
- **Turnaround trading**
(SEHK Rules 14A06(4), 14B06(5))
- **Pre-trade checking**
(SEHK Rules 1421(2) & 1424, 14A06(5)-(10), 14B06(6)-(12))
- **Foreign investors shareholding limit**
(SEHK Rules 14A08, 14B08)
- **5% shareholding disclosure requirement**
(SEHK Rules 14A09, 14B09)
- **Off-Exchange trades or transfers prohibited**
(SEHK Rules 14A12, 14B12)
- **Risk disclosure requirements**
(SEHK Rules 14A10, 14B10)
- **Margin Trading**
(SEHK Rules 14A15, 14B15)
- **Stock borrowing and lending**
(SEHK Rules 14A16, 14B16)
- **Short selling**
(SEHK Rules 14A17, 14B17)
- **Investor eligibility requirement for trading in ChiNext shares**
(SEHK Rules 14B06(16)-(18))