



# Part III of Securities & Futures Ordinance

## **Exchange Companies, Clearing Houses, Exchange Controllers, Investor Compensation Companies and Automated Trading Services**

Stanley Ng

Senior Manager, Supervision of Markets

24 August 2002



# Overview

- ◆ Exchange Companies (Div. 2)
- ◆ Clearing Houses (Div. 3)
- ◆ Exchange Controllers (Div. 4)



# Overview

## 概覽

- ◆ Investor Compensation Companies (Div. 5)
- ◆ General (Div. 6)
- ◆ Automated Trading Services (Div. 7)



## Relevant Subsidiary Legislation for Part III

- ◆ S & F (Transfer of Functions - Stock Exchange Company) Order - S.25(1)
- ◆ S & F (Contract Limits & Reportable Positions) Rules - S.35



## Relevant Subsidiary Legislation for Part III

- ◆ S & F (Stock Market Listing) Rules - S.36(1)
- ◆ S & F (Investor Compensation; IC - Compensation Limits; Transfer of Functions - ICC; IC - Miscellaneous) Rules - S.80



## Division 7 - Automated Trading Services (ATS)

- ◆ All new provisions and should be read with the Guidelines for Automated Trading Services.
- ◆ Only authorized or licensed firm can offer ATS in HK. The SFC can authorize firms to provide ATS with certain conditions or requirements. Can also withdraw the authorization.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ SFC will keep a register of authorized persons and will make rules to provide information, standards of conduct and to avoid conflicts.
- ◆ Persons who provide ATS without authorization will be penalized.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Definition of ATS – SFO Schedule 5
- ◆ “**automated trading services**” means services provided by means of electronic facilities, not being facilities provided by a recognized exchange company or a recognized clearing house, whereby –



## Division 7 - Automated Trading Services (ATS) (cont'd)

- (a) offers to sell or purchase securities or futures contracts are regularly made or accepted in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market;



## Division 7 - Automated Trading Services (ATS) (cont'd)

- (b) persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of securities or futures contracts in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market; or



## Division 7 - Automated Trading Services (ATS) (cont'd)

(c) transactions –

(i) referred to in paragraph (a);

(ii) resulting from the activities referred to in paragraph (b), or

(iii) effected on, or subject to the rules of, a stock market or futures market, may be novated, cleared, settled or guaranteed,

but does not include such services provided by a corporation operated by or on behalf of the Government.



# Division 7 - Automated Trading Services (ATS) (cont'd)

## The Guidance Note for ATS

- ◆ Can license under Part 5 or authorize under Part 3.
- ◆ Sets principles for the regulation of ATS.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ SFC intends to take a pragmatic approach to the regulation of ATS in HK - flexible and applied on a case by case basis.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Greater the activities, the potential effects on market participants, retail investors involved, & systemic risks = greater regulation.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ If the ATS is like a REC or RCH, then a level playing field will be sought.
- ◆ Will take into account international standards.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Standards of practice for ATS also set:
  - Standard 1 : Financial Resources & Risk Management
    - ❖ Policies should comply with appropriate prudential and operational standards
    - ❖ Few international standards - case by case basis to be used



# Division 7 - Automated Trading Services (ATS) (cont'd)

## – Standard 2 : Operational Integrity

- ❖ Maintain electronic facilities with adequate security, capacity, and contingency arrangements
- ❖ If part 5 - use existing regulatory requirements
- ❖ ATS is greater risk or affect to market, then higher levels of operational integrity expected.
- ❖ If Part 3 - use international best practices and may have independent reviews



# Division 7 - Automated Trading Services (ATS) (cont'd)

## – Standard 3 : Fitness

- ❖ Fit and Proper as established by an authority in HK or elsewhere
- ❖ Key persons must have experience and qualifications
- ❖ Substantial shareholders to be supplied, possible background checks



# Division 7 - Automated Trading Services (ATS) (cont'd)

- Standard 4 : Record Keeping
  - ❖ Keep full records of its operations and audit trails of ATS activity. Part 5 will comply with existing codes & regs.
  - ❖ Part 3 - SFC on case by case basis to require records to be kept and retention period.



# Division 7 - Automated Trading Services (ATS) (cont'd)

- Standard 5 : Transparency
  - ❖ Provide appropriate levels of transparency in operations, traded products including order processing arrangements, transaction execution, settlement and operational requirements or rules.
  - ❖ Part 3 & 5 - make available to its users information concerning how the ATS operates & transparency.



# Division 7 - Automated Trading Services (ATS) (cont'd)

## – Standard 6 : Surveillance

- ❖ Surveillance to be performed by the ATS, regulatory authority (including SFC), or another competent person. Such surveillance should be consistent with relevant market regulations / practices in HK and elsewhere.
- ❖ SFC to have access and use case by case basis to determine.
- ❖ Monitoring and have mechanisms to suspend trading, detect and remedy malfunctions, detect anomalies and investigate.



# Division 7 - Automated Trading Services (ATS) (cont'd)

- Standard 7 : Reporting
  - ❖ Keep relevant regulatory authorities informed of operational and material changes to those operations.
  - ❖ Part 3 & 5 to report periodically or on request. The SFC may require the ATS to consult obtain the prior approval of the SFC before making material system changes.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Sets procedures for licensing ATS activities under Part 5.
  - Most on-line brokers will fall into this category license - type 7.
  - Will probably have other license types (i.e. Types 1 & 2).
  - Licensing to start in fourth quarter with new applications.
  - Normal licensing application process.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Sets procedures for authorising ATS under part 3.
  - Very few companies will fall into this category.
  - Possible example.
  - Light regulatory touch.



# Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Authorisation process.
  - Application.
  - Can impose conditions, notified in writing, gazetted.
  - If refused, must give hearing.
  - Can withdraw authorisation.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Identify entities that fit definition and will invite them to apply under Part 3. Existing dealers & approved Overseas Exchanges who fit Part 3, will be invited to apply.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Fees for Licensing under Part 5
  - If have existing license type 1 or 2, then 7 is free and annual fees are free.
  - See fees rules and consultation paper to be released.



# Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Fees for Authorization under Part 3
  - If new applicant - HK\$10,000
  - Yearly renewal - HK\$10,000



# Division 7 - Automated Trading Services (ATS) (cont'd)

## ◆ Overseas Exchanges.

- Also authorised - similar/formalised process as what is currently in place.
- Overseas exchanges to undertake to do certain things.
- Should have a MOU in place.
- Key Principle - prevent regulatory arbitrage and to avoid the fragmentation of the local markets.



## Division 7 - Automated Trading Services (ATS) (cont'd)

- ◆ Operation of a stock market, futures market or a clearing house.



# Questions & Answers