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SECURITIES AND FUTURES ORDINANCE (Chapter 571)

Pursuant to sections 95(6) and 399(1) of the Securities and Futures Ordinance, the Guidelines for the Regulation of Automated Trading Services is hereby gazetted by the Securities and Futures Commission.

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Guidelines for the Regulation of Automated Trading Services

A. INTRODUCTION

1. These Guidelines, published under sections 95(6) and 399(1), of the Securities and Futures Ordinance (SFO), set out principles, procedures, and standards in relation to authorization, registration, and licensing of persons by the SFC for providing “automated trading services” (ATS).
 - (a) These Guidelines are effective upon commencement of the SFO, in particular Part V and Part III, Division 7. These Guidelines are not exhaustive.
 - (b) As ATS in Hong Kong continue to evolve, the SFC will revise and update its regulatory approach. These Guidelines do not have the force of law and should not be interpreted in any manner which would override the provisions of any applicable law, codes or other regulatory requirements. However, a failure to follow the spirit of these Guidelines may reflect adversely on the fitness and properness of licensed, registered or authorized persons to continue to be licensed, registered or authorized.
2. The SFO’s Schedule 5, Part 2 defines ATS as follows:

“**automated trading services**” means services provided by means of electronic facilities, not being facilities provided by a recognised exchange company or a recognised clearing house, whereby –

 - (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;

- (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
- (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.

Part V of the SFO

3. **The SFO provides for the regulation of ATS in Part V and Part III. Under Part V, ATS constitute one of the nine regulated activities (i.e. Type 7). Section 114 generally prohibits a person from carrying on a business in a regulated activity unless:**
 - **the person is licensed by the SFC under section 116 for that regulated activity;**
 - **the person is an authorized financial institution registered under section 119 for that activity; or**
 - **the person is authorized by the SFC under section 95, Part III to provide ATS.**
4. Where a person is licensed under Part V, all of the provisions of the SFO affecting intermediaries will normally apply. These include, for example, licensing of representatives, financial resources, books and records, audit and protection of client assets requirements, and codes for business conduct. The SFC may also attach conditions to a licence, including a licence to provide ATS. **Procedures for licensing ATS activity under Part V are discussed in Section D of these Guidelines.**
5. In relation to registration for ATS activity under section 119, authorized financial institution means an authorized institution under the Banking Ordinance (e.g. banks). Where an authorized institution is a registered

institution under the SFO, it falls within the definition of “intermediary”, and some selective provisions of the SFO will apply to it (e.g. section 148 (and subsidiary legislation made under it) relating to client securities and collateral held by intermediaries, and section 151 (and subsidiary legislation made under it) concerning the keeping of accounts and records by intermediaries). The SFC may also attach conditions to a registration to provide ATS. Under the SFO, the Hong Kong Monetary Authority (HKMA) will be the front-line regulator of authorized financial institutions who are registered for regulated activities. **Procedures for registering ATS activity under Part V are discussed in Section E of these Guidelines.**

Part III of the SFO

6. **Part III provides for SFC authorization of ATS rather than licensing. Part III generally prohibits a person from providing ATS unless the person is:**
 - **an intermediary licensed or registered for ATS activity under Part V; or**
 - **authorized by the SFC to provide ATS under Part III.**
7. Where a person is authorized by the SFC to provide ATS under Part III, the provisions of sections 95 to 100 will apply. These are relatively brief compared to the more extensive provisions of the SFO that apply to intermediaries. They include procedural matters for application for and withdrawal of authorization. They also enable the SFC to impose conditions to authorization under section 95(2), to make rules for the regulation of ATS under section 100 and under section 99, to maintain a register of authorized ATS. **Section F of these Guidelines provides procedures for authorizing an ATS under Part III.**
8. The definition of ATS excludes facilities provided by a recognized exchange company or a recognized clearing house. Part III provides a separate regulatory regime for recognized exchange companies who operate a stock market or futures market and for recognized clearing houses. In some circumstances (discussed in Section G of these Guidelines) questions may arise as to whether the provision of ATS may also constitute operation of a stock market, futures market, or a clearing house.
9. The next two Sections of these Guidelines set out the SFC’s principles for the regulation of ATS and its standards of practice for ATS.

B. PRINCIPLES FOR THE REGULATION OF ATS

10. In general, the provision of ATS should be consistent with or promote: the regulatory objectives of the SFC under section 4 of the SFO; the functions of the SFC under section 5 of the SFO; and the matters the SFC shall have regard

to under section 6(2) of the SFO in pursuing its regulatory objectives and performing its functions. In particular, this includes the following principles:

- (a) the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- (b) understanding by the public of the operation and functioning of the securities and futures industry and of the relative benefits, risks and liabilities of investing in financial products;
- (c) securing an appropriate degree of protection for members of the public investing in or holding financial products;
- (d) the reduction of systemic risks in the securities and futures industry;
- (e) the supervision, monitoring and regulation of activities carried on by persons regulated by the SFC and of such of the activities of registered institutions as are required to be regulated by the SFC;
- (f) promotion, encouragement and enforcement of proper conduct, competence and integrity of persons carrying on activities regulated by the SFC;
- (g) adoption of appropriate internal controls and risk management systems by persons carrying on activities regulated by the SFC;
- (h) the international character of the securities and futures industry and the desirability of maintaining the status of Hong Kong as a competitive international financial centre;
- (i) the desirability of facilitating innovation in financial products and activities regulated by the SFC;
- (j) the principle that competition among persons carrying on activities regulated by the SFC should not be impeded unnecessarily; and
- (k) the principle that, as far as practicable and appropriate, bodies performing similar functions in the market place should be regulated in a similar way, so as to provide a fair and level playing field between market operators.

C. STANDARDS OF PRACTICE FOR ATS

11. In addition to the general principles set out above, the SFC has identified core standards of practice for the regulation of ATS. A person providing ATS will generally be expected to meet the following standards to the satisfaction of the SFC.

Standard 1: Financial Resources and Risk Management.

The financial resources and risk management policies of an ATS provider should comply with appropriate prudential and operational standards.

Standard 2: Operational Integrity.

An ATS provider should maintain electronic facilities with adequate security, capacity, and contingency arrangements.

Standard 3: Fitness.

An ATS provider should be a fit and proper person, as established by an authority in Hong Kong or in its home country.

Standard 4: Record Keeping.

An ATS provider should keep full records of its ATS operations, including audit trails of ATS activity.

Standard 5: Transparency.

An ATS should provide appropriate levels of transparency in relation to ATS operations and traded products, including where relevant order processing arrangements, transaction execution, settlement arrangements, and operational requirements or rules.

Standard 6: Surveillance.

Surveillance of ATS activity should be performed by the ATS provider, a regulatory authority (including potentially the SFC), or another competent person, and such surveillance should be consistent with relevant market regulation practices in Hong Kong and internationally.

Standard 7: Reporting.

An ATS provider should keep relevant regulatory authorities informed of its ATS operations and traded products and of material changes to those operations.

12. The SFC intends to take a pragmatic approach to the regulation of ATS in Hong Kong. ATS operations are diverse and likely to grow more so. The regulatory approach will be flexible and applied on a case-by-case basis. In general, the level of regulation of an ATS will be commensurate with the functions it performs and the risks it poses. In addition, a fair and level playing field will be sought so that similar regulation is applied to similar functions.
13. The SFC will consider, among other things, the nature and extent of each ATS activity, the market participants that might be affected by the ATS, whether retail investors may be involved, and whether any systemic risks might arise. Generally, the greater the extent of activity and its potential effect on market participants, and especially if systemic risks might arise, the more that will be expected of the ATS. Where the ATS activity is similar in all the circumstances to that of an exchange company or clearing house, a level playing field will be sought.

14. The SFC will have regard to international standards and best practices in considering the regulation of ATS. These include practices recommended by the International Organization of Securities Commissions, the International Securities Services Association, and the Bank for International Settlements. They also include the practices of regional markets and of other international financial centres. In addition, and where relevant, the SFC will take into account the degree to which an ATS provider is already regulated by an overseas authority (e.g. overseas exchanges). The following paragraphs discuss each of the standards of practice for ATS in greater detail.

Standard 1: Financial Resources and Risk Management.

The financial resources and risk management policies of an ATS provider should comply with appropriate prudential and operational standards.

15. An ATS licensed or registered under Part V will normally meet this standard by complying with existing prudential and conduct regulations that apply to licensed dealers and authorized financial institutions. We believe exceptions to this might be appropriate, for example, for an ATS that involves the novation of settlement obligations and provision of settlement guarantees, in which case the SFC will seek to apply international best practices to such activity.
16. An overseas exchange authorized under Part III will normally meet this standard by complying with the regulatory regime in its home country. As discussed in Section F, the SFC will consider whether the overseas exchange is subject to home regulation consistent with international best practices.
17. For other ATS authorized under Part III the SFC will apply this standard on a case-by-case basis. At this time, there are relatively few international examples of financial or prudential regulations for market operators, unlike the well-developed financial regulation of dealers and banks. This is no doubt partly because market operators typically do not act as trading counterparties nor hold clients' securities or funds. In addition, market operators of exchanges are typically subject to relatively extensive regulation even though the regulations typically do not set specific financial resources requirements. In determining the application of this standard, the SFC will follow the analysis mentioned in paragraphs 12 and 13 above. The SFC will wish to ensure that the ATS provider has the resources needed for the proper performance of its business activities.

Standard 2: Operational Integrity.

An ATS provider should maintain electronic facilities with adequate security, capacity, and contingency arrangements.

18. An ATS licensed or registered under Part V will normally meet this standard by complying with existing regulatory requirements of the SFC or the HKMA, which will apply to the ATS activity as well. To the extent that the ATS activity poses systemic risk or might affect a significant number of market participants, higher levels of operational integrity may be expected. An overseas exchange authorized under Part III will be expected to meet

international best practices of operational integrity imposed in its home jurisdiction.

19. For other ATS authorized under Part III the analysis described in paragraphs 12 and 13 will apply. This will normally mean compliance with international best practices applicable to regulated financial institutions. The SFC will also consider the need for independent assessments of the ATS operational integrity as is required in certain circumstances for intermediaries' systems and of recognized exchange companies and clearing houses. In this regard, the SFC will take into account potential systemic risks and the market significance of the ATS.

Standard 3: Fitness.

An ATS provider should be a fit and proper person, as established by an authority in Hong Kong or in its home country.

20. An ATS licensed or registered under Part V or an overseas exchange authorized under Part III typically will have had its fitness and properness established already by competent regulatory authorities. There may, however, be instances where the personnel responsible for ATS were not specifically scrutinised by the relevant regulatory authority. In such circumstances, the SFC will seek to ensure that the ATS-related personnel have qualifications and experience necessary for the reliable operation of the ATS. The SFC will have regard to its Guidance Note on Competence, but this will not be rigidly applied.
21. For authorization under Part III the procedures discussed in Section F will require the ATS provider in its application for authorization to demonstrate to the SFC that it and its key personnel are fit and proper persons to provide ATS. Information will also normally be sought on the substantial shareholders of the ATS provider. Although the process will not be the same as that for obtaining a licence under Part V, the SFC will have regard to the standards it already uses in the licensing process and as described in the SFC's Fit and Proper Criteria, but these will not be rigidly applied. These include consideration of, among other things, financial integrity, qualifications and experience, reputation, character, and reliability. In addition, the SFC may undertake background checks and liaise with overseas regulators, including those that have entered into information-sharing arrangements with the SFC.

Standard 4: Record Keeping.

An ATS provider should keep full records of its ATS operations, including audit trails of ATS activity.

22. As with the standards discussed above, ATS licensed or registered under Part V and an overseas exchange authorized under Part III will likely comply with much of this standard by virtue of existing codes and regulations. There may be instances where the record-keeping requirements for intermediaries or do not focus specifically on important aspects of the ATS operation. This might include, where relevant, details (e.g. time, identities, price, quantity) of order

entry or transaction conclusion. In such cases, the SFC will likely require records of these matters to be captured and retained.

23. For other ATS authorized under Part III the SFC will specify on a case-by-case basis the records that must be kept and the retention period to apply. This will vary with the nature of the ATS. The SFC will have regard to the record-keeping requirements of intermediaries, exchange companies and clearing houses and seek the level playing field described in paragraphs 12 and 13. For example, the SFC will most likely require that ATS records be provided to the SFC on request and that the SFC has on-site access to the records of the ATS provider.

Standard 5: Transparency.

An ATS should provide appropriate levels of transparency in relation to ATS operations and traded products, including where relevant order processing arrangements, transaction execution, settlement arrangements, and operational requirements or rules.

24. An overseas exchange authorized under Part III is likely to meet this standard by virtue of complying with the requirements in its home country and with the matters described in Section F. There may be special circumstances where additional transparency considerations arise in relation to providing ATS in Hong Kong, but for the typical provision of electronic trading facilities in Hong Kong the transparency provided in the home jurisdiction is likely to be sufficient. Dealers in Hong Kong who provide local investors with access to overseas exchanges are already expected to assist local investors in obtaining information about relevant overseas exchanges.
25. For other ATS licensed or registered under Part V or authorized under Part III, the ATS provider will be expected to make available to its users information concerning how the ATS operates as a part of the application and on-going requirements. Where relevant and among other things, this will likely include information concerning: order processing and execution systems; the rules or other operating requirements; settlement arrangements; fees and charges; and margin requirements and product specifications for derivatives products. This is what is already expected of intermediaries concerning providing information about their operations.
26. In addition to transparency of the ATS operations, the SFC will also consider transparency of trading information. The requirements will depend on the type of ATS involved. In most equity and derivatives trading systems, international best practice is to provide for some level of transparency of bid/ask prices, related quantities, and details of completed transactions. Less transparency typically exists internationally for OTC markets and fixed income markets. This aspect of transparency will be considered on a case-by-case basis with reference to the type of ATS and relevant international best practices.

Standard 6: Surveillance.

Surveillance of ATS activity should be performed by the ATS provider, a regulatory authority (including potentially the SFC), or another competent person, and such surveillance should be consistent with relevant market regulation practices in Hong Kong and internationally.

27. In this standard, surveillance carries its meaning of careful watch, supervision for the purposes of direction or control, and superintendence. The level of surveillance the SFC will expect of an ATS will vary depending on the nature of the ATS involved. The SFC may also expect the ATS provider to give access to the SFC to enable the SFC to perform surveillance. The SFC will apply the analysis described in paragraphs 12 and 13 to determine the nature and extent of the surveillance functions that will apply to each ATS. Some examples are provided in the following paragraphs.
28. Most ATS providers will have access requirements to determine who may use the ATS. These may take the form of, among other possibilities, financial and credit standards, operational requirements, contractual requirements, or institutional requirements. Depending on the type of ATS involved, the SFC will likely expect the ATS to have access requirements to help to ensure the orderly and legitimate use of the ATS. The SFC will expect these to be transparent and to be monitored and enforced. This is particularly important for an ATS where continued access to the ATS by non-qualified users may adversely affect other market participants, for example a user who acts as a trading counterparty and becomes the subject of a winding up or bankruptcy proceeding.
29. Another surveillance example concerns an ATS that provides trade execution services for products that trade in multiple markets. Situations routinely arise where, for example, trading may be suspended in the primary market pending release of important price-sensitive information. In these circumstances, the SFC may consider it important for the ATS to also suspend trading in co-ordination with the primary market.
30. The SFC will expect that the main operations of an ATS be monitored continuously to ensure their smooth and reliable operation. The SFC will expect that arrangements are in place to promptly detect and remedy any malfunction in the ATS operations.
31. Depending on the nature of the ATS, there may be situations where unusual activity may create a disorderly or unfair operating environment. For example, an ATS trading derivative products may experience transaction prices that deviate in the extreme from price parameters that would normally be expected in relation to the price of the underlying product. The SFC may expect there to be mechanisms in place to detect such anomalies and investigate the reasons behind them.
32. In considering this standard, the SFC will have regard to its Money Laundering and Terrorist Financing: Revised Guidance Notes Issued by the Securities and Futures Commission. Where an ATS performs functions

similar to those covered in the Guidance Notes, the SFC will expect the ATS provider to comply with the Guidance Notes.

33. For an overseas exchange authorized under Part III, the SFC will seek its agreement to co-operate with the SFC where the SFC has a need to investigate a situation involving the ATS, as described in Section F. An overseas exchange ATS will also be expected to perform the surveillance functions required of it in its home country. The SFC may in special circumstances seek more, for example a co-ordinated trading suspension in circumstances described in paragraph 29 above.

Standard 7: Reporting.

An ATS provider should keep relevant regulatory authorities informed of its ATS operations and of material changes to those operations.

34. In some circumstances, an ATS licensed or registered under Part V will be subject to existing arrangements to inform regulatory authorities of ATS operations and material changes to them. Where this is not the case, the SFC is likely to require that the ATS make reports periodically or on request concerning its ATS operations and material changes to those operations. The requirement in each case will be tailored to the nature of the ATS. In some circumstances, the SFC may require the ATS provider to consult with or obtain the prior approval of the SFC before making material system changes. Material changes might include, for example, implementation of an ATS system architecture upgrade. These same considerations will apply to ATS authorized under Part III. The SFC also expects that it will require at least annual financial statement reports from ATS providers authorized under Part III. The SFC would not normally require any approval of the fees and charges of the ATS provider.
35. For an overseas exchange authorized under Part III, the SFC will normally seek an arrangement for the overseas exchange to make periodic reports to the SFC of the locations where their ATS are provided in Hong Kong. The SFC will also normally seek periodic statistics on the trading activity originating from Hong Kong as discussed further in Section F.

Additional considerations

Levies

36. As mentioned in paragraphs 12 and 13, the SFC will seek a fair and level playing field for ATS so that similar regulation is applied to similar functions. In this regard, the SFC notes, for example, that section 394(1) of the SFO enables the Chief Executive in Council to impose a levy, payable to the SFC, on transactions on a recognized stock or futures market or traded by means of ATS. This is a means by which the SFC is funded by market users. The SFC will assess the level of its resources devoted to regulation of ATS and the nature and extent of ATS business operations to determine whether (based on principles of fairness, cost recovery, and the "user pays" principle) to recommend to Government that a levy be recommended to the Chief Executive in Council under section 394 for ATS. A levy would not be recommended where transactions are already subject to existing levies.

Fees

37. Similarly, intermediaries pay annual fees, which contribute to the SFC's funding. An application and annual fee for ATS providers has been prescribed in the Securities and Futures (Fees) Rules.
38. Parts III and XII of the SFO provide for the Investor Compensation Fund and enable the creation of investor compensation arrangements.

D. PROCEDURES FOR LICENSING ATS ACTIVITY UNDER PART V

39. As a general principle, the SFC intends that ATS providers who also perform traditional dealer functions (like agency broking, principal trading, market making, holding of clients' securities or funds, and securities borrowing and lending) should apply, under Part V, to be licensed for all relevant regulated activities including ATS. Part V is specifically designed for most of these activities whilst Part III is not. For further information on licensing, a Licensing Information Booklet can be obtained from the SFC.
40. The regulations that would apply here are the normal ones applied to licensed or registered persons. We believe these are sufficient for regulating the electronic ATS-type services provided by most dealers. For example, the various Internet or electronic trading guidance notes or codes issued by the SFC will apply as well as the Fit and Proper Criteria, Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, and the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.
41. Under the existing regulations, the SFC will expect, among other things, that ATS-type services will be overseen and operated by competent personnel. Under the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, the SFC will expect, among other things, operational integrity. Equally important is the general principle of acting in the best interests of clients. Obtaining a license to provide ATS will not be automatic. The firm must be a fit and proper person to provide ATS.
42. Where a person is licensed for ATS activity, section 118(1)(c) provides the SFC with a power to require the person to apply for authorization under Part III within a specific time. If this is not complied with, the SFC may revoke the licence under section 195(2). This enables the SFC in special circumstances to require an ATS provider to apply to be authorized under Part III rather than licensed under Part V. This might be used, for example, where the SFC believes it is inappropriate to apply all of the Part V requirements (e.g. licensing of representatives) to the provider, because it does not handle clients' securities and funds or where the nature of the ATS provider's business as a market operator makes it appropriate to subject it to rules under Part III.

43. Special circumstances. In some special circumstances, the SFC may seek to impose conditions that go beyond or that differ from the normal regulations under Part V for licensees providing ATS. Some of the special circumstances and related conditions were discussed above in Section C of these Guidelines. Finally, as discussed in Section G, the overall activity of the firm may amount to the operation of a stock market, futures market, or clearing house.
44. Firms who provide mainly ATS services and do not provide traditional dealer services will normally be considered for authorization under Part III. However, if they later wish, for example, to perform dealing functions they would be required to be licensed under Part V. This is discussed in more detail in Section F.

E. PROCEDURES FOR ATS UNDER A PART V REGISTRATION

45. Authorized financial institutions who intend to enter the business of providing traditional dealer functions and ancillary ATS, should apply for registration under Part V. The process will generally follow that for intermediaries except that the SFC will consult, and have regard to advice given by, the HKMA in respect of an application for registration from an authorized financial institutions. As with other intermediaries, a registration may be subject to reasonable conditions which the SFC may impose.
46. Some authorized financial institutions may have been performing services that had previously not required registration, but may arguably fall within the new ATS regulated activity. For example, many authorized financial institutions provide a range of securities processing services such as money payment for securities transactions, custody, and nominee services. The SFC believes that most of these services as traditionally provided do not constitute ATS. But the overall activity of an authorized financial institution or the introduction of non-traditional services has the potential to fall within the ATS definition. Authorized financial institutions who have any questions concerning their operations should seek clarification from the HKMA or the SFC.
47. Other authorized financial institutions may wish to introduce new services that do clearly constitute ATS. An example is an authorized financial institution who intends to provide to investors or other market participants an electronic trading system for securities or futures contracts.
48. In these circumstances, it is possible for a registration to be granted under Part V or authorization to be given under Part III. The decision as to which process to follow will be made on a case-by-case basis and in consultation with the HKMA. Firms who wish to obtain further guidance on this matter should contact the SFC or HKMA.
49. These Guidelines do not cover the many other procedural and substantive aspects of granting or refusing to grant licences or registrations under Part V or the review of the SFC's decisions. Interested persons may refer to Part V of the SFO and the SFC's Licensing Information Booklet for further information.

F. PROCEDURES FOR AUTHORIZING AN ATS UNDER PART III

50. The SFC expects that there may be a wide variety of ATS that fall within the scope of authorization of ATS under Part III. As explained, the regulation of these ATS will be considered on a case-by-case basis. We have, however, set out in the latter part of this section specific guidelines for ATS provided by a stock exchange or futures exchange outside Hong Kong.
51. As explained in paragraph 39, persons who provide ATS and traditional dealer functions should seek a Part V licence for their activities, including ATS. Persons who provide ATS, but do not also engage in traditional dealer activities, should seek authorization under Part III.
52. An application under Part III should be accompanied by the information specified below. The SFC also encourages potential applicants to contact the SFC to arrange a meeting to discuss the application process with SFC staff.
 - (a) Name, address(es) and contact details of the corporation(s) to provide ATS.
 - (b) Names and biographies of corporate directors and key employees. The qualifications and experience of key personnel should be included.
 - (c) Information about the company structure, any substantial shareholders and, where a substantial shareholder is a corporation, the directors and substantial shareholders of that corporation.
 - (d) Financial statements or other financial information for the corporation(s) mentioned above.
 - (e) Description of the services and facilities the corporation(s) intends to provide under the ATS authorization and of any other businesses it carries on or intends to carry on.
 - (f) Description of the hardware, software and other technology, including back up arrangements and testing plans, to be used in providing ATS.
 - (g) Description of the intended users of the ATS, how users will be approved or disapproved, and suspended and copies of related contractual documentation.
 - (h) Copies of rules, procedures, and any other documentation governing use of the ATS.
 - (i) Description of the fees and charges for using the ATS.

- (j) Description of why the ATS is consistent with or will promote the principles set out in Section B and how the ATS will comply with the standards of practice set out in Section C of these Guidelines.

The application should also be accompanied by an application fee specified under the Securities and Futures (Fees) Rules.

53. In considering an application for authorization under Part III, the applicant is likely to be asked to submit further information and particulars as the SFC may reasonably require (section 96). The SFC may also have regard to any information in its possession whether provided by the applicant or not (section 96(3)).
54. If the SFC decides to authorize an applicant to provide ATS it will notify the applicant in writing. The authorization may be subject to conditions and these will be specified in the notice. Any conditions being considered by the SFC will be discussed first with the applicant. The authorization will be published in the Gazette. Under section 97, the SFC may, by notice in writing to a person authorized under Part III, amend or revoke any conditions or impose new conditions where it is satisfied that it is appropriate to do so. Where the SFC is considering to amend or revoke an existing condition or to impose a new condition, the authorized ATS provider will be given a reasonable opportunity to be heard before a decision is made. The SFC will normally give a deficient ATS provider a reasonable period to improve its operations.
55. If the SFC is minded not to grant an authorization, it will first give the applicant a reasonable opportunity of being heard before the decision is made.
56. Under section 98, the SFC may withdraw an authorization granted where it is satisfied that it is appropriate to do so in the interest of the investing public or in the public interest. The SFC would give the person a reasonable opportunity of being heard before exercising this authority. Notice of the withdrawal would be published in the Gazette.
57. Certain decisions of the SFC concerning authorization as an ATS may be appealed to the Securities and Futures Appeals Tribunal (SFAT) under Division 2, Part XI of the SFO. Schedule 8, Part 2 of the SFO provides that the following relevant decisions may be appealed to the SFAT:

section 95(2)	Refusal to grant an authorization or imposition of any condition.
section 97(1)	Amendment or revocation of any condition, or imposition of any new condition.
section 98(1)	Withdrawal of an authorization.

Overseas exchanges

58. One type of ATS provider eligible for authorization under Part III will be a stock exchange or futures exchange outside Hong Kong wishing to provide ATS in Hong Kong. From our experience, we expect the typical provision of ATS by an overseas exchange to involve the placement of their dedicated

trading terminals in Hong Kong or the provision of technical specifications and support services to enable Hong Kong institutions to make computer-to-computer connections to the overseas exchange's systems.

59. In this regard, overseas exchanges have always been accessible to Hong Kong investors, either through Hong Kong financial intermediaries or overseas intermediaries. Whilst historically trading by Hong Kong persons may have been effected through the telephones, fax, or telex it is today often done through computer linkages, the Internet, and Extranets.
60. As mentioned above, the SFC believes that authorization of an overseas exchange under Part III should be based on an assessment by the SFC that the overseas exchange is subject to regulation in its home country comparable to the regulation of exchanges in Hong Kong and consistent with international standards. Through its own regulatory benchmarking and participation in international regulatory forums such as the International Organization of Securities Commissions, the SFC will often be in a position to make this assessment without requesting detailed information from the overseas exchange. If not, the SFC will need to request information from the overseas exchange to assist it in making this assessment.
61. In general, an overseas exchange seeking authorization under Part III should contact the SFC to arrange a discussion with SFC staff. We will typically request a summary information package about the exchange's most recent operations and a full description of the ATS to be provided in Hong Kong.
62. The SFC will normally expect the overseas exchange to provide, in addition to the matters in paragraph 52 above, the following :
 - (a) information regarding the products to be traded through the ATS in Hong Kong;
 - (b) periodic statistics of the nature and volume of such trading in Hong Kong (if applicable);
 - (c) copies of any documentation which users of the ATS in Hong Kong will enter into concerning the ATS;
 - (d) information concerning the identity and location of persons using the ATS in Hong Kong;
 - (e) satisfy the SFC that appropriate levels of information disclosure and co-operation will be made available to the SFC concerning any specific requests or investigations in relation to the ATS in Hong Kong, including information about particular transactions, ATS users, and ATS users' clients;
 - (f) the application fee;

And undertake to :

- (g) provide periodic statistics (quarterly) of the nature and volume of such trading in Hong Kong ;
 - (h) provide information on any later changes to the matters set out in paragraph 52 and paragraph (a) to (e) above relating to the ATS provided in Hong Kong; and
 - (i) limit use of the ATS in Hong Kong to persons licensed or registered with the SFC under Part V of the SFO, unless the SFC agrees otherwise.
63. The SFC will normally wish to see that a Memorandum of Understanding or other information sharing and co-operation arrangement has been entered into between the SFC and the home regulator of the overseas exchange. The SFC will also take into consideration whether the home country of the overseas exchange allows Hong Kong persons to access its markets through ATS facilities and if so the terms on which access is allowed.
64. The general principle that the SFC will adhere to is to prevent regulatory arbitrage and to avoid the fragmentation of the local markets. If the overseas exchanges are in direct competition with the Hong Kong exchanges and may cause fragmentation of the local markets, or their activities may have a significant impact on the local markets, the SFC may take action or impose conditions on the overseas exchange in order to resolve the situation.
65. In some special circumstances, additional issues may arise with ATS of overseas exchanges, for example, where similar or fungible products are traded on the overseas exchange and on a Hong Kong exchange. These (and other special circumstances) will be addressed on a case-by-case basis and with a view to achieving a fair and level playing field in all the circumstances.

G. OPERATION OF A STOCK MARKET, FUTURES MARKET, OR A CLEARING HOUSE

66. As explained in previous sections, there may be circumstances where the operations of an ATS may fall within the definition of a “stock market”, “futures market” or “clearing house”. As there is a separate regulatory regime for these, it may be necessary for an ATS provider to consider whether the ATS is operated touches on the following matters.
67. Schedule 1 of the SFO defines “stock market”, “futures market”, and “clearing house”. As mentioned above, there are various implications to falling within these definitions which may be relevant to the provision of ATS.
68. In the case of “stock market”, section 19(1)(a) prohibits a person from operating a stock market unless the person is (i) the Stock Exchange Company, (ii) a recognized exchange company of which a relevant recognized exchange controller is the controller, or (iii) a relevant recognized exchange controller which is itself a recognized exchange company. Section 18(1) defines

“relevant recognized exchange controller” as a recognized exchange controller, which is the controller of the Stock Exchange Company. In the current circumstances, this effectively limits the persons who may be recognized to operate a stock market to Hong Kong Exchanges and Clearing Ltd and its subsidiaries which are recognised exchange companies. The definition of stock market does not include the office of (a) an exchange participant of a recognized exchange company or (b) a recognized clearing house.

69. In the case of “futures market”, section 19(1)(b) prohibits a person from operating a futures market unless the person is a recognized exchange company. Section 19(2) enables the SFC to recognize a company as an exchange company, where it is satisfied of the matters mentioned in section 19(2)(a) and (b) and after consultation with the public and the Financial Secretary. The SFC may also attach conditions to recognition as an exchange company. Section 19(9) provides that a person licensed or registered for ATS activity under Part V or authorized for ATS under Part III will not be regarded as contravening section 19(1)(b) if the person is permitted to engage in the activities that constitute operating a futures market. Division 2 of Part III of the SFO provides the overall regulatory regime for recognized exchange companies.
70. Section 37 of the SFO enables the SFC to recognize a company as a clearing house where it is satisfied of the matters mentioned in section 37(1)(a) and (b) and after consultation with the Financial Secretary. There is no prohibition provision similar to section 19(1) against operating a clearing house without recognition. The SFC may also attach conditions to recognition as a clearing house. Division 3 of Part III of the SFO provides the overall regulatory regime for recognized clearing houses and includes special provisions relating to the law of insolvency.

H. EXAMPLES OF THE LIKELY APPLICATION OF THE ATS GUIDELINES IN PRACTICE

71. This section provides hypothetical ATS operations and the likely application to them of the ATS Guidelines. It is without prejudice to the SFC’s actual decisions to be made in any future case.

Example 1. A person is licensed or registered for Type 1 regulated activity of dealing in securities and Type 7 regulated activity providing ATS. The person provides comprehensive Internet trading and related services.

72. As explained in Section D, it is not the SFC’s intention to impose additional ATS-specific regulations or requirements on the customary operations of most dealers, including Internet dealing. The regulations that would apply would be the same as the usual regulations applied to intermediaries. For example, these include the SFC’s Guidance Note on the Regulation of Electronic Offering and Trading of Securities and Futures Contracts, the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, and the Management, Supervision and Internal Control

Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.

Example 2. An overseas person provides ATS services from an overseas location either as a dealer or as a market or an exchange, including via the Internet.

73. Section 95 of the SFO prohibits persons from providing ATS and offering to provide ATS unless licensed, registered or authorized to do so under Parts V and III of the SFO. Section 95(8) provides that a person offers to provide ATS if the services are actively marketed to persons in Hong Kong. In addition, section 95(9) states that a person is not regarded as offering ATS if the offer is made to existing clients whom the person already provides any financial services, including ATS. In the SFC's view, an overseas person will require authorization or a licence to provide ATS if, for example, the person actively markets ATS services by sending e-mails or correspondence, or making telephone calls, to Hong Kong residents who are not existing clients or users of the person's services. Such active marketing does not require authorization or a licence for ATS activity if it is only directed to Hong Kong persons who are existing clients of the ATS provider or users of the ATS services. The SFC also takes the view that operation of a website overseas does not itself amount to active marketing to persons in Hong Kong. Further, acceptance of Hong Kong clients who seek out the ATS does not in our view amount to active marketing.

Example 3. An overseas exchange provides for the placing of its trading terminals in Hong Kong or offers direct, remote access rights to intermediaries or investors in Hong Kong via electronic facilities.

74. The SFC takes the view that the overseas exchange should apply for authorization under Part III as explained in Section F.

Example 4. A person provides over the Internet or other electronic facilities a "bulletin board" service over which persons post indications of interest to buy or sell securities or futures contracts. The person does not provide services to conclude or settle transactions.

75. The SFC does not believe this amounts to providing ATS. Paragraphs (a) and (b) of the ATS definition require the use of established methods for the negotiation or conclusion of transactions and such established methods are typically not provided by bulletin board services.

Example 5. A person provides telecommunications or software services or is an Internet service provider and these telecommunications or software facilities are used by other persons to provide ATS.

76. The SFC would not normally take the view that the person providing telecommunications, software, or Internet services was providing ATS.

Example 6. An authorized institution (e.g. a bank) or trust company provides securities custody services, including transaction settlement related services.

77. As explained in Section E, the SFC would not normally take the view that the person is providing ATS.

Example 7. A person provides electronic facilities whereby offers to buy or sell foreign currencies or goods or services are made, transactions are concluded, and settlement is effected.

78. The ATS definition applies to securities or futures contracts. Electronic facilities for trading in spot foreign currencies or goods and services that do not constitute securities or futures contracts are not caught by the ATS definition.

Example 8. A person provides electronic facilities whereby offers are regularly made to buy or sell fixed income instruments, transactions are concluded using established methods, and settlement is effected.

79. If the fixed income instruments constitute securities, the SFC would view this as providing ATS. If the ATS provider did not perform traditional dealing functions as described in Section D, the ATS would be considered for authorization under Part III. The level of regulation to apply would follow the principles and standards as described in Sections B and C. Questions might arise as to whether the activity also amounts to the operation of a stock market as discussed in Section G. In those circumstances, the SFC would likely ask the ATS provider to submit a legal analysis to the SFC indicating why the activities do not constitute as the operation of a stock market.

Example 9. An exchange participant licensed for Types 1 and 7 regulated activities provides ATS for collective investment schemes. Transactions are not effected through or reported to the Stock Exchange or Futures Exchange. The collective investment schemes are provided to the retail investing public.

80. Although the exchange participant is licensed under Part V, the provision of an electronic trading service to the investing public would need to be analysed under the standards described in Section C, in particular paragraphs 12 and 13. A level playing field in all the circumstances and in terms of investor protection and regulation would be sought.

APPENDIX - TRANSITIONAL ARRANGEMENTS

Registered and exempt dealers under the Securities Ordinance and Commodities Trading Ordinance

1. Prior to the commencement of the SFO, some ATS providers may have also provided securities or futures dealing services. They would have been registered as a dealer with or declared an exempt dealer by the SFC under the Securities Ordinance or the Commodities Trading Ordinance.

2. Registered and exempt dealers who have been providing ATS immediately before the commencement of the SFO will be deemed, upon SFO commencement, to have been licensed or registered for Type 7 regulated activity. The SFC will issue a circular to all registered and exempt dealers to request information on whether they have been providing ATS.
3. Considering the definition of ATS and the extensive use of electronic facilities in the securities and futures industry, we believe that the services provided by many existing registered or exempt dealers will technically fall within the definition of ATS. However, it is not the SFC's intention to impose additional, ATS specific regulations or requirements upon the customary operations of most dealers.
4. For example, many of the existing registered securities or futures dealers who are also exchange participants provide electronic services to enable clients to trade at the exchanges and may also provide various other services through electronic facilities such as clearing and settlement or Internet trading. Upon commencement of the SFO, in addition to requiring a licence for Type 1 or Type 2 regulated activity, a licence for Type 7 regulated activity may also be required. In such a case, an additional licensing fee for Type 7 regulated activity may not be required (as provided in the Securities and Futures (Fees) Rules).
5. Schedule 10 of the SFO sets out the detailed transitional arrangements.

ATS providers not currently regulated under the pre-SFO regulatory regime

6. There may be some ATS providers which did not offer services other than ATS and may not therefore have been registered with the SFC prior to the commencement of the SFO. These persons should apply to the SFC to be authorized under Part III of the SFO (if they do not carry out other regulated activities). Schedule 10 also sets out the transitional arrangements for these ATS providers who are not currently regulated by the SFC.