



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions Concerning the Regulation of Alternative Liquidity Pools

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Consultation conclusions concerning the regulation of alternative liquidity pools

Introduction

1. On 27 February 2014, the Securities and Futures Commission (SFC) issued a consultation paper (Consultation Paper) concerning the regulation in Hong Kong of alternative liquidity pools (ALPs) (commonly known as “dark pools” as they do not provide, unlike a “lit” venue, for pre-trade price and volume transparency). As discussed in the Consultation Paper, the SFC seeks to impose a uniform set of requirements set out in the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) and with which all ALP operators and licensed/registered persons who route orders to ALPs will be obliged to comply.
2. The SFC’s proposals deal with a range of regulatory issues relevant to the operation of ALPs, which include:
 - (a) Restricting user access to ALPs to “institutional investors”;
 - (b) Enhancing the level of disclosure to users of ALPs;
 - (c) Ensuring user order priority over the proprietary orders of ALP operators and their affiliates;
 - (d) Restricting the level of visibility of trading information that is available to the staff of ALP operators;
 - (e) Not restricting the hours of operation of ALPs;
 - (f) Allowing ALPs to transact overseas listed securities as well as Hong Kong listed securities;
 - (g) Ensuring the system adequacy of ALPs by addressing issues such as system controls, reliability, capacity, security and contingency measures; and
 - (h) Enhancing risk management control, record keeping and reporting requirements.
3. The public consultation ended on 25 April 2014. The SFC received a total of 59 written submissions. They were submitted by licensed corporations (including ALP operators), industry associations, a professional body, a statutory organization and individuals. Of the 59 respondents, two requested that their names and comments not be published and 36 requested that their submissions be published without disclosing their names. Accordingly, 57 submissions are available on the SFC’s website at <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/responses?refNo=14CP3>, and a redacted list of respondents is set out in **Appendix A**. We thank all respondents for their feedback and comments.



Latest developments

4. Since the publication of the Consultation Paper, there have been a number of key regulatory developments in various jurisdictions, as summarised below.

Australia

5. In 2013, the Australian Securities and Investments Commission (ASIC) implemented various measures to address the trend in dark pools of an increasing proportion of “below block size trades” (trades falling below a certain dollar threshold). The measures include tightening the pre-trade transparency exemption¹ by introducing block tier thresholds² and a “meaningful price improvement” rule. In May 2014, ASIC published the report on the review of the 2013 rule changes, concluding that the rule changes were satisfactory.

European Union (EU)

6. In June 2014, the Markets in Financial Instruments Directive II (MiFID II) and Regulation on Markets in Financial Instruments (MiFIR) were published in the EU Official Journal. The new rules are to be implemented by EU Member States with effect from January 2017. One of the requirements is that trading venues, including dark pools, will have to publish their current bid and offer prices (thus improving pre-trade transparency). Waivers may be granted (i.e. trading without publication of current bid and offer prices) subject to a volume cap mechanism.³

¹ A market operator may be exempted from publishing certain pre-trade information (including order time, product identifier, order side, quantity, price and currency) as set out in Rule 4.1.4 of the ASIC Market Integrity Rules (Competition in Exchange Markets) if it meets the criteria under Rule 4.2 of the ASIC Market Integrity Rules (Competition in Exchange Markets).

² Under Rule 4.2.1 of the ASIC Market Integrity Rules (Competition in Exchange Markets), block trade tiers allow a transaction to be executed without pre-trade transparency where the consideration for the transaction is not less than:

- (a) AUD 1 million or more for Tier 1 equity market products;
- (b) AUD 500,000 or more for Tier 2 equity market products; and
- (c) AUD 200,000 or more for Tier 3 equity market products

The products that fall within each tier will be published on the ASIC website and will take effect from 20 business days following the date of publication.

³ Under the volume cap mechanism:

- (a) the percentage of trading in a financial instrument on a trading venue (under the waivers) is limited to 4% of the total volume of trading in that instrument on all EU trading venues; and
- (b) overall EU trading in a financial instrument (under the waivers) is limited to 8% of the total volume of trading in that financial instrument on all EU trading venues.



United States (US)

7. In January 2014, the Securities and Exchange Commission (SEC) approved changes to the relevant rules of the Financial Industry Regulatory Authority (FINRA), which require US operators of alternative trading systems (ATS) to report to FINRA their aggregate weekly volume of transactions and number of trades in relation to equity and debt securities. This new reporting requirement came into effect in May 2014. FINRA has since June 2014 published weekly reports on the equity volume traded in ATS, in order to enhance market transparency.
8. The SEC Chair said in June 2014 that the SEC was considering rule proposals with a view to enhancing transparency of the operation of ATS.
9. Recently, the SEC and other US regulatory agencies have taken regulatory actions against certain dark pool operators concerning ineffective operational controls and inappropriate business practices such as failure to safeguard confidential trading information, and undue priority/preference towards high frequency trader clients.

Hong Kong

10. As of 30 April 2015, the number of licensed ALP operators remained at 16. From August 2013 to April 2015, trades executed in ALPs declined from 2.3% to 0.9% of the total market turnover.

Summary of major issues raised by the respondents

11. The respondents generally welcomed our proposals to enhance the regulation of ALPs and to create a level playing field for all ALP operators in Hong Kong. However, respondents expressed very diverse opinions. For example, one respondent submitted that some of the proposals would amount to over-regulation, given the relatively low trading volume in ALPs in Hong Kong and our proposal that only institutional investors would be allowed to access ALPs. On the other hand, another respondent took the view that there should be an outright ban of ALPs in Hong Kong because of their lack of transparency and potential conflicts of interest.
12. Regarding whether individual investors should be allowed to access ALPs, one respondent commented that the complex and opaque nature of ALPs may place such investors at a greater risk than institutional investors. Nevertheless, a number of respondents considered that it would be unfair to individual investors (particularly if such individuals are wealthy, sophisticated and/or experienced in making investment decisions) and their investment vehicles/family offices, if they are denied potential benefits of participating in ALPs.
13. A number of respondents were concerned that the treatment of client facilitation orders as proprietary orders, which would be required to receive lower trade priority than orders



from ALP users, may reduce liquidity in ALPs available for the fund management industry.

14. Some respondents considered that the proposed opt-in requirement for ALP users (set out in paragraphs 40 and 42 of the Consultation Paper) would be burdensome and unnecessary if participation in ALPs is confined to institutional investors. It was submitted that such investors are sophisticated and capable of taking care of their own interests as regards their participation in ALPs.
15. Regarding the other proposals, such as those relating to ALP system adequacy, record keeping and reporting obligations, the majority of the respondents supported them or did not take issue with them.

Comments received and the SFC's responses

Q1 *Do you agree that the proposed requirements are sufficient to ensure that an ALP operator effectively manages and adequately supervises the design, development, deployment and operation of the ALP it operates? If not, why not?*

Public comments

16. The respondents overwhelmingly supported the proposed requirements. One respondent added that the regulatory obligations of ALP operators should be in line with those of exchange controllers under section 63 of the Securities and Futures Ordinance (SFO), such as acting in the interest of investors and ensuring market integrity. However, another respondent suggested that ALP operators' senior management should not be held responsible for the overall management and supervision of ALPs since they may not possess sufficient knowledge of sophisticated IT systems.

SFC's response

17. All ALP operators are licensed or registered under Part V of the SFO and must therefore comply with applicable requirements under the SFO and relevant rules, codes and guidelines. The SFC takes the view that introducing the duties set out in section 63 of the SFO is unnecessary since such duties are already reflected in the existing requirements and the proposed measures. For example, General Principles 1 and 2 of the Code of Conduct state that a licensed or registered person should act in the best interests of their clients and safeguard the integrity of the market.
18. Regarding the responsibility of senior management, the SFC continues to take the view that senior management may engage others to assist them to manage and supervise ALPs operated by their respective firms, but they remain ultimately responsible for the operation of the systems and the firms' compliance with relevant regulatory standards.



Q2 Do you agree that only the orders of institutional investors should be permitted to be transacted in ALPs? If not, why not?

Q3 Do you think that the definition of “institutional investor” set out in the draft paragraph 19.2 of the Code of Conduct is appropriate? If not, why not?

Public comments

19. These two questions concern user restrictions. Respondents had differing views on this topic.
20. A number of respondents expressed concern that the high level of complexity and the opaque nature of ALPs may place individual investors at a greater risk than sophisticated institutional investors. Other respondents asserted that it would be unfair if individual investors are barred from enjoying potential benefits of participation in ALPs, which may include price improvement and quicker execution.
21. Some respondents indicated that prohibiting retail participation would reduce the overall liquidity available in ALPs, thereby making ALP trading by funds and other institutional investors less effectual. In addition, most major jurisdictions do not specifically exclude individual investors from trading in alternative trading venues.
22. It was also commented that if there is no restriction as to who may trade in ALPs, the potentially time-consuming and resource-intensive exercises of (i) ascertaining which entity is ultimately responsible for initiating a trade, and (ii) categorizing such entity as retail or otherwise, could be eliminated.
23. One respondent suggested that individual investors should be allowed access to ALPs upon (i) receiving appropriate risk and information disclosure and (ii) passing an appropriate suitability assessment, which would be an approach equivalent to that taken in respect of the distribution of structured products to retail and private wealth management clients.
24. Instead of having a complete prohibition of retail trading in ALPs, the respondent proposed that the SFC adopt requirements concerning (i) price improvement, (ii) minimum order size and/or (iii) opt-in participation, so as to limit individual investors' participation and/or their risk exposure.
25. To widen the range of potential users under the proposed user restriction policy, one respondent submitted that the definition of “institutional investor” should be expanded to corporations or partnerships that fulfil the requirements under section 3(c) of the Securities and Futures (Professional Investor) Rules (PI Rules), whereas some respondents suggested that “institutional investor” in the proposed rules should be replaced by “professional investor” as defined in Schedule 1 to the SFO and the PI Rules.



SFC's response

26. Paragraphs 22 to 28 of the Consultation Paper explain the rationale for the proposed exclusion of individual investors from trading in ALPs, which include:
- (a) Given that some ALPs have complex execution and/or order processing methodologies, the SFC is concerned that individual investors might find it difficult to understand the operation of, and the risks associated with, these crossing networks. The possible lack of complete understanding of the complex methodologies and risks of ALPs by individual investors, as well as the opaqueness and potential conflicts of interest inherent in ALPs, would place this group at a greater risk than sophisticated investors.
 - (b) It is unclear how ALP operators can properly and sufficiently inform their individual clients concerning the operation, risks and procedures associated with trading in their ALPs.
 - (c) It is uncertain whether adequate internal control measures can be put in place to ensure that individual investors can be treated fairly in the ALPs.
 - (d) The benefit of “price improvement” is commonly advanced by ALP operators to justify the utility of their ALPs and to attract users (including individuals). However, it remains uncertain whether ALP operators are capable of delivering and proving genuine price improvement in the sense that individual investors may anticipate. Accordingly, individual investors would be at risk of (i) not benefitting from genuine price improvement and (ii) being unable to readily ascertain this.
27. To better understand the price improvement rules implemented in Australia and Canada, the SFC studied how the rules operate, as well as their perceived benefits and problems. The price improvement rules implemented in Australia and Canada essentially define “improved price” as any price between the best available bid and offer prices on lit venues. This gives buyers and sellers a potential opportunity to obtain a better price than the best price quoted on the lit venues. However, the price need not be the exact mid-point. Accordingly, one of the parties (buyer or seller) may enjoy greater price improvement than the other. This could give rise to conflicts of interests (particularly in the case of proprietary trading) where the dark pool operator favours one party over the other.
28. To protect investors and promote the retention of order flows on lit exchanges, overseas regulators do not solely rely on price improvement requirements for dark pool trades. They have also imposed requirements such as block trade thresholds (that is, a minimum dollar amount per trade), minimum order sizes, and caps on the percentage of total trades across all trading venues that may be executed without pre-trade price transparency. We consider that requirements of this nature are currently unnecessary in Hong Kong given the relatively low proportion of trades that are routed to ALPs.



29. After balancing all relevant considerations (including responses to the Consultation Paper, our study of overseas regulations and recent developments in other markets), the SFC maintains its original proposal that individual investors (including those who are professional investors by virtue of meeting portfolio threshold tests under section 3(b) of the PI Rules) should not be allowed to participate in ALPs at this stage. Individuals' investment holding corporations will also be prohibited from using ALPs, unless those corporations are themselves professional investors meeting portfolio or asset threshold tests referred to in paragraph 30 below.
30. The SFC accepts that it is appropriate to relax the user restriction policy to allow ALPs to be used by corporations and partnerships with either a portfolio of not less than \$8 million or total assets of not less than \$40 million, and their wholly owned investment holding corporations (i.e. corporations and partnerships falling under sections 3(c), (d)(iii) and (d)(iv) of the PI Rules). Whether a corporation meeting portfolio or asset threshold tests is owned by an individual, or multiple shareholders, will be irrelevant. That is because the SFC takes the view that these corporations should generally be able to manage the trading risks associated with ALPs (referred to in paragraph 33 below).
31. To effect this revision, the term "institutional investor" used in draft paragraph 19 and Schedule 8 of the Code of Conduct has been replaced by "qualified investor", defined as:
- (i) a person falling under paragraphs (a) to (i) of the definition of "professional investor" in section 1 of Part 1 of Schedule 1 to the SFO; or
 - (ii) a person within the meaning of sections 3(a), (c), (d)(i), d(iii) or d(iv) of the PI Rules.
- Relevant provisions in paragraph 19 and Schedule 8 of the Code of Conduct (paragraph 19.2 in particular) have been revised accordingly.
32. These revisions to the Code of Conduct are distinct from amendments to the professional investor regime under paragraph 15 of the Code of Conduct (Enhanced PI Regime)⁴ that relate to products and markets, as opposed to trading platforms. With effect from 16 March 2016, the Enhanced PI Regime will include structure, knowledge and experience assessment requirements for corporate professional investors before intermediaries can be exempted from certain provisions of the Code of Conduct (such as the requirement to ensure the suitability of a recommendation or solicitation in relation to those particular corporate professional investors).
33. By contrast, to ensure market integrity and safeguard investors against trading risk, the ALP regime relies on measures such as trading controls, system adequacy and information disclosure. Accordingly, the SFC has decided not to apply any suitability requirement to the ALP regime. That is because a suitability requirement is more

⁴ See the Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements, published by the SFC on 25 September 2014.



appropriate to the *purchase* of an investment (given its monetary and risk nature) rather than the *means or method* of purchasing that investment. This reflects the distinction between investment risk (for which a suitability requirement is appropriate) and trading risk (for which the above measures are more appropriate).⁵

34. The SFC reaffirms that it has no intention to rule out the future possibility of individual investors and their investment holding corporations being allowed to participate in ALPs. In particular, when the outcomes of the relevant regulatory measures imposed in other major jurisdictions (that impact on the protection of individual investors) have become clearer, the SFC may consider revisiting its policy on user restriction for ALPs.

Q4 Do you agree that ALP operators should be obliged to ensure that all orders placed with them by their group companies originate from institutional investors before they may be transacted in their ALPs? If not, why not?

Public comments

35. While many respondents to this question agreed, some respondents had concerns regarding the difficulties that ALP operators may encounter when seeking to comply with this proposed requirement.
36. Some respondents suggested that a standard of reasonableness should apply to the obligation, given that the relevant orders may originate from clients of overseas group companies with which an ALP operator may not have direct legal relationships.
37. One respondent was concerned that, in the context of participation in ALPs by collective investment schemes, ALP operators and/or fund managers might have an obligation to ensure that the ultimate beneficiaries of investment funds (i.e. the fund investors) are all institutional investors before trading in ALP may occur.

SFC's response

38. The SFC understands that some ALP operators consider this proposed obligation to be burdensome since they may have to seek assistance from local and/or overseas group companies to ascertain the nature of the entities ultimately responsible for the orders to be transacted in their ALPs. Nevertheless, the SFC takes the view that this obligation can be met with reasonable efforts and that it is imperative for this requirement to be put in place to avoid possible circumvention of the spirit of the user restriction requirement.
39. In response to the suggestion that a standard of reasonableness should apply for the compliance with this requirement, the SFC notes its intention to take a reasonable and

⁵ This differentiation is seen also in other major jurisdictions and is consistent with the Final Report on Principles for Dark Liquidity published by the International Organization of Securities Commissions (IOSCO) in May 2011, which did not recommend any suitability requirement in relation to dark pools. For example, MiFID II exempts EU investment firms which provide "execution only" services relating to shares traded on regulated markets or multilateral trading facilities (such as dark pools) from a suitability requirement.



holistic approach in considering whether the measures established and implemented by an ALP operator are appropriate and effective for the purpose of ensuring that all the orders placed with it by its group companies actually originate from qualified investors.

40. Regarding the concern that fund investors may be considered as ALP users under this regulatory regime, the SFC confirms that it did not propose in the Consultation Paper to “look through” to the underlying fund investors. Since fund investors are not the entities which place orders on a fund’s behalf, they would not be regarded as users of ALPs (but fund managers would be).

Q5 Do you agree that a licensed or registered person who routes orders to an ALP on behalf of its clients should be obliged to ensure that such orders originate from institutional investors only? If not, why not?

Public comments

41. Many respondents to this question supported the proposed requirement. Some respondents, however, commented that the obligation would be onerous if the relevant licensed/registered person has no direct contractual relationships with the order placing entities (as clients of other brokers). In this situation, the licensed/registered person should only be expected to obtain undertakings from the intervening brokers to confirm the non-retail nature of the order placing entities. It can therefore be envisaged that a chain of undertakings would arise if an order has to pass through a number of brokers.
42. Several respondents considered that a standard of reasonableness should be adopted for the compliance with this requirement.

SFC’s response

43. The SFC does not see any room for further refining this proposal. Draft paragraph 19.4(b) of the Code of Conduct does not prescribe the approaches that licensed/registered persons should take to ensure that only orders placed or originated by qualified investors are routed to ALPs. In any event, it is important that the measures that such persons choose to implement are reasonable and effective for compliance with this requirement.

Q6 Do you agree that ALP operators should be allowed to conduct transactions in their ALPs in all types of exchange listed or traded securities, irrespective of whether they are listed or traded in Hong Kong or elsewhere? If not, why not?



Public comments

44. Most respondents to this question supported the proposal. One respondent noted that investors in Hong Kong are currently free to trade in overseas stocks through local brokers having connections with overseas ones, and there are no obvious reasons as to why ALPs cannot be used to facilitate onshore trading in overseas stocks. Nevertheless, another respondent raised concern that the secondary listing process of foreign-listed securities on Hong Kong markets might be effectively disabled by the creation of an unintended backdoor to the liquidity pool in Hong Kong.

SFC's response

45. Most other major jurisdictions do not explicitly restrict or prohibit trading of overseas securities in alternative trading venues within their jurisdictions. Consistent with this international practice, and given our intention to allow only qualified investors to use ALPs, the SFC has decided that the proposal should be retained provided that ALP operators comply with relevant overseas rules and regulations. For example, under the Shanghai-Hong Kong Stock Connect program, Stock Exchange of Hong Kong (SEHK) Participants are not allowed to trade China Connect Securities outside the SEHK.⁶ However, the SFC will continue to monitor the situation and may revisit its policy in future, where necessary.

Q7 Do you agree that ALP operators should be allowed to conduct transactions in their ALPs in securities listed or traded on overseas markets / exchanges without restriction as to the time when they may do so? If not, why not?

Q8 In respect of transactions conducted in ALPs involving securities which are listed on SEHK, do you agree that ALP operators should be allowed to conduct these transactions in their ALPs during the periods that trading is conducted on SEHK and also at other times when trading is not being conducted on SEHK? If not, why not?

Public comments

46. Most respondents to these questions welcomed the proposals, under which there will be no time restrictions for trading in local and overseas securities in ALPs.
47. As market prices provided by stock exchanges would not be available after exchange trading hours, one respondent expressed concern that misconduct such as market manipulation or abuse may occur.

⁶ See Rules of the SEHK 14A12 for details.



SFC's response

48. As discussed under Q6 above, the SFC intends to allow ALP operators to conduct transactions in their ALPs in all types of exchange listed or traded securities, irrespective of whether they are listed or traded in Hong Kong or elsewhere, provided that the ALP operators comply with relevant overseas rules and regulations. It would be impracticable for ALPs to conduct transaction in securities listed or traded in some overseas markets if transactions could only be conducted during the same periods that trading is conducted on SEHK. On the other hand, ALP operators will be required under the Code of Conduct to have controls in place to monitor the trading activities in their ALPs and to ensure their ALPs operate in the interests of the integrity of the market.
49. In view of the above, the SFC has decided to maintain the original proposal that no restrictions on the trading hours of ALPs will be imposed, although this is subject to possible review in due course.

Q9 Do you agree that orders received from the users of ALPs should have priority over proprietary orders of the types referred to in paragraph 34 of the Consultation Paper? If not, why not?

Public comments

50. While the majority of the respondents to this question agreed, some took the view that all proprietary orders should be excluded from ALPs because of potential conflicts of interest. On the other hand, several respondents suggested that client facilitation orders should be carved out from the definition of "proprietary order" under draft paragraph 19.2(f) of the Code of Conduct.
51. One respondent commented that an outright ban on proprietary trading, and/or the treatment of client facilitation orders as proprietary orders, may undermine the liquidity within ALPs to the detriment of the fund management industry.
52. Another respondent submitted that a more effective approach would be to ensure that all ALP Guidelines state clearly the manner in which all orders in an ALP are to be handled (including the prioritization of different types of orders) and that all ALP users are to be treated equally and fairly. The respondent also proposed that order priority should depend only on the time that the order is received regardless of the identity of the originating entity.

SFC's response

53. As discussed in paragraph 34 of the Consultation Paper, a majority of the ALP operators in Hong Kong allow their proprietary order flows to trade in their ALPs. However, because of the inherent conflicts of interest in this arrangement (i.e. the possibility of ALP operators and/or their group companies making use of the confidential trade information obtained from the ALPs to their unfair advantage), they have assured the



SFC that their proprietary traders do not have access to information concerning agency order flows.

54. Despite such assurances and upon considering the respondents' comments above, the SFC's concern on the potential conflicts of interest has not been dispelled, particularly in light of recent regulatory actions against certain dark pool operators. The SFC has therefore decided that the original proposal should be maintained, such that agency orders must have priority over proprietary orders.
55. Furthermore, the SFC remains of the view that client facilitation orders and proprietary orders are often inextricably intertwined, so it can be very difficult to differentiate between the two. Client facilitation orders should therefore be treated as proprietary orders in determining order priority in ALPs.

Q10 Do you agree that ALP operators should be obliged to provide prospective users of their ALPs with ALP Guidelines that are comprehensive and accurate and that their ALP Guidelines must include the matters referred to in paragraph 38 of the Consultation Paper? If not, why not?

Public comments

56. Most respondents to this question supported the proposal in the interests of better investor protection. Nevertheless, some respondents submitted that institutional investors (being the only type of investors allowed to use ALPs under the original proposal) are highly sophisticated, and therefore do not need to be advised of the potential risks associated with trading in ALPs.
57. Some respondents opposed the requirement to disclose in ALP Guidelines the identity of certain staff members of ALP operators since (i) such information does not provide any added value to clients or prospective clients, (ii) the obligation to revise ALP Guidelines upon staff changes is overly burdensome and (iii) in any event, disclosure of details of back office staff (e.g. compliance and settlement staff who may only access post-transaction information) should not be required.

SFC's response

58. To ensure that ALP users are properly and sufficiently informed, the SFC has decided to maintain its original proposal in respect of the contents of ALP Guidelines. This is consistent with the "Principles for Dark Liquidity" published by IOSCO, and with the global regulatory trend to improve operational transparency and risk disclosure concerning alternative trading venues. We also note that no matter how sophisticated a qualified investor is, it would still be crucial for the investor to be provided with comprehensive and accurate ALP Guidelines for the assessment of the risks and features of an ALP. However, the proposed opt-in requirement will be relaxed (as discussed under Q11 to Q13 below).



59. Furthermore, the SFC recognises the importance of disclosing in ALP Guidelines the identity of each member of the staff of the ALP operator (by his/her title and department only, not name) who is permitted access to trading information, regardless of whether the person has a front-office or a back-office role. The reason is that ALP users should always be provided with an up-to-date and comprehensive overview of the flow and availability of trade information within the relevant ALP operator to allow them to assess whether their trade information is sufficiently secure and suitably ring-fenced. The conclusion of such an assessment could be a factor for users to determine whether to continue trading in the relevant ALP. Any exemption provided to a certain group of staff (e.g. back-office staff) would only reduce transparency and may become a loophole for information leakage and misconduct.

Q11 Do you agree that ALP operators should bring their ALP Guidelines to the attention of all prospective users of their ALPs? If not, why not?

Q12 Do you agree that an ALP operator should be obliged to obtain formal acknowledgement from prospective users of its ALP that its ALP Guidelines have been brought to their attention and that they consent to their orders being transacted in the ALP, before such transactions are permitted to occur? If not, why not?

Q13 Do you agree that a licensed or registered person which, on behalf of its clients, routes agency orders to an ALP operated by a third party ALP operator should be obliged to ensure that its clients have formally acknowledged that the ALP Guidelines have been brought to their attention and that they consent to their orders being transacted in the ALP, before their orders are routed to the ALP? If not, why not?

Public comments

60. Respondents had diverse views on these issues. Some of those who supported the proposals submitted that the trading arrangements of ALPs lack the fairness, integrity, transparency and/or protection available for trading in a stock exchange. Therefore, prospective and existing users of ALPs should be protected by the proposed acknowledgement and consent procedures.
61. Some respondents, however, took the view that institutional investors invariably have the sophistication to understand the execution arrangements of ALPs and should not be required to formally opt-in before being allowed to transact in ALPs. In addition, they noted that mandatory opt-in requirements are inconsistent with the practice in other major jurisdictions and would create significant administrative burden and cost, which would be borne by ALP operators, order-routing licensed/registered persons and ALP users.
62. One respondent was concerned that since ALP operators may not have direct client relationships with prospective users, it would be overly burdensome for ALP operators to



bring ALP Guidelines to the attention of such users through one or more brokers and then to seek the required consent. Furthermore, several respondents mentioned that institutional investors may use multiple ALPs for trading, and possibly several aggregators as well. If the proposed requirements are put in place, such institutional investors would have to opt-in before using those ALPs that they directly deal with. They may also have to opt-in to other ALPs used by their aggregators, which means that they may have to sign multiple acknowledgement/consent forms in order to use (or continue to use) their preferred ALPs and aggregators.

63. Instead of requiring formal acknowledgement and express consent, a number of respondents considered it sufficient for institutional investors to be (i) notified in writing that their orders may be transacted in ALPs and (ii) given an option to opt-out from the relevant execution arrangements. Relevant ALP Guidelines should also be provided to them for information.

SFC's response

64. The SFC accepts the view that an opt-out procedure would offer a more reasonable balance between investor protection and operational efficiency for the following reasons:
- (a) the practical difficulties noted in the respondents' comments above;
 - (b) the user restriction to be imposed (i.e. only qualified investors will be allowed to transact in ALPs); and
 - (c) consistency with other major jurisdictions which do not mandate an opt-in procedure.
65. The proposed Code of Conduct amendments (paragraph 19.7 and paragraphs 9 and 11 of Schedule 8) have been revised accordingly, and a new paragraph 19.8 (i.e. opting out of ALP) has been added to reflect the requirement that ALP operators should permit their users to opt-out of having their orders transacted in ALPs.

Q14 Do you agree that an ALP operator should adopt measures to ensure the integrity and/or system adequacy of its ALP and have appropriate contingency measures in place? If so, are the proposed requirements sufficient? If not, why not?

Public comments

66. Almost all respondents to this question supported the proposal. Regarding contingency arrangements, some respondents remarked that an ALP should not be obliged to keep particular operating hours, unlike an exchange, which has an obligation to provide an orderly stock market. If an ALP is unable to operate for any period of time, the exchange nevertheless will generally provide an alternative means of executing orders.



SFC's response

67. The SFC considers that a requirement for appropriate contingency measures is necessary and reasonable. While the SFC recognizes that ALP operators may, in appropriate situations, route orders to the exchange for crossing when their ALPs' services are unavailable, paragraphs 17 to 19 of Schedule 8 to the Code of Conduct specify additional measures that will be required, such as the preparation of a plan for communication with clients in case of emergency.

Q15 Do you agree that an ALP operator should keep the SFC informed as to the identity of its staff having access to trading and other information relevant to its ALP, the basis upon which such access is permitted, and any change made in relation to the staff to whom such access is permitted and the basis for such change? If not, why not?

Public comments

68. The majority of the respondents to this question supported the proposal, although some respondents were of the view that staff members of ALP operators who would only have access to post-trade information (e.g. settlement and compliance staff) should be excluded from these notification requirements.
69. Another respondent was concerned that since ALP operators may outsource certain functions to system vendors which are independent of the ALP operator, it may be administratively difficult to comply with these requirements. On the other hand, the respondent proposed that access to trading information by staff of group companies and consultants of ALP operators should be permitted where appropriate, subject to providing proper disclosure to clients and implementing appropriate controls in line with the relevant requirements.

SFC's response

70. As discussed in paragraph 50 of the Consultation Paper, the SFC takes a firm view that restrictions to access to trading information must be strictly observed by ALP operators in order to ensure fair and orderly trading in the opaque environment of ALPs. Accordingly, suggestions by a minority of respondents to relax the proposed requirements on the scope of notification and the personnel who may gain access to trading information are not accepted.

Q16 Do you agree that the person responsible for originating a proprietary order in an ALP should be restricted from access to trading information or data concerning orders placed, or transactions conducted, in the ALP? If not, why not?



Public comments

71. Nearly all the respondents to this question supported the proposed requirement. One respondent, however, counter-proposed that order visibility should only be restricted prior to the reporting of a matched trade to the exchange. Once reported, persons responsible for proprietary trading in their associated ALP should be allowed access to the relevant transaction information.

SFC's response

72. The SFC disagrees with this counter-proposal and reaffirms that persons engaging in proprietary trading in an ALP must not be placed in a position which enables them to gain any unfair advantage over other ALP users or market participants. Since information on an ALP transaction would not be available in the public domain immediately upon the reporting of such trade by the ALP operator to the exchange, it is possible that proprietary traders would gain an advantage (which may prejudice other ALP users or market participants) if such transaction information is released to the proprietary traders by their associated ALP operator at the same time that the information is reported to the exchange.

Q17 Do you agree that an ALP operator should keep proper records concerning the design, development, deployment and operation of its ALP? If not, why not?

Public comments

73. Although a majority of respondents did not object to this proposal, one respondent was concerned that the proposed requirement concerning "comprehensive" documentation of the design, development, deployment and operation of ALPs may be too broadly worded, which would create an excessive documentation burden for ALP operators.

SFC's response

74. The SFC recognizes that ALP operators would have substantial responsibility to keep proper records of the design, development, deployment and operation of their ALPs. Such records, however, may be critically important should regulatory concerns arise. Accordingly, the SFC has decided to maintain the proposed requirement, which is consistent with the record keeping requirements concerning electronic trading systems set out in Schedule 7 to the Code of Conduct.

Q18 Do you agree that an ALP operator should keep proper records concerning all transactions conducted on its ALP, including details of authorized traders? If not, why not?



Public comments

75. While respondents to this question generally agreed with this proposed requirement, several raised concerns because large institutional clients sometimes change traders without informing ALP operators. In addition, under current practice, ALP operators often do not receive from their clients details of the individual trader for each trading instruction.

SFC's response

76. The SFC is aware that these record keeping requirements will create additional workload for ALP operators. However, given the importance that we place on the completeness of transaction records for regulatory purposes, the SFC takes the view that information on authorized traders is indispensable (especially when the need to trace and identify a certain order placing entity arises during investigation and/or surveillance). Accordingly, the proposed requirement will be adopted.

Q19 Are the records that the SFC proposes be kept by ALP operators in relation to the transactions conducted in their ALPs sufficient and appropriate? If not, why not?

Q20 Do you agree with the proposed periods for the keeping of these records? If not, why not?

Public comments

77. Although most respondents to these questions supported the proposals, one respondent disagreed with the proposed requirement that all notices and other information, whether written or communicated through electronic means, provided by the ALP operator to the users of its ALP be kept for seven years (as prescribed under the original draft paragraph 23(a)(iii) of Schedule 8). The respondent considered that this requirement is unnecessary and may pose a very heavy burden on ALP operators.

SFC's response

78. The records may prove critical should regulatory concerns arise. The SFC therefore considers the proposed record retention period is appropriate. It is also consistent with the requirements set out in section 10 of the Securities and Futures (Keeping of Records) Rules.

Q21 Do you agree that the proposed requirements for risk management and post-trade reviews of transactions conducted in ALPs are sufficient to maintain the fair and orderly operation of the market? If not, why not?



Public comments

79. The majority of respondents to this question supported the proposed requirements. Some respondents, however, took the view that ALP operators' compliance with paragraphs 12.5(a) and (f) of the Code of Conduct should be sufficient to fulfil the notification requirement under the original draft paragraph 26 of Schedule 8.

SFC's response

80. The original draft paragraph 26 of Schedule 8 is related to possible breaches of obligations or requirements discovered through (i) monitoring of order crossing in ALPs and (ii) conducting post-trade reviews of ALP transactions. Recognizing the significance of these risk management measures and the necessity for ALP operators to report any such breach, the SFC considers it necessary to clearly set out the relevant notification requirement in the Code of Conduct to oblige ALP operators to alert the SFC in appropriate circumstances.

Q22 Are the proposed reporting and notification requirements appropriate? If not, why not?

Public comments

81. The respondents to this question generally supported the proposed reporting and notification requirements.
82. Several respondents sought clarification as to the forms and contents of regular transaction analyses and reports on the ten largest users of an ALP to be prepared by ALP operators.
83. On the other hand, some respondents were concerned that the proposed requirements in the original draft paragraphs 29(a)(ii) and (iii) of Schedule 8 to the Code of Conduct are too broadly worded, which may necessitate the preparation and submission of numerous notifications even on routine and immaterial changes to, for example, ALPs' business operations and system hardware. To mitigate this possible issue, the respondents proposed that a materiality threshold be applied to such notification requirements.

SFC's response

84. Regarding regular transaction analyses and reports on the ten largest users of an ALP, the SFC intends to publish templates for reference by ALP operators before the effective date of this regulatory regime.
85. The SFC has decided not to introduce a materiality test, as that would be a matter of subjective judgement and would bring uncertainty to the requirement and the enforcement of it.



Implementation timeframe

86. An industry association suggested that an implementation period of at least six months should be adopted to provide sufficient time for ALP operators to make changes to internal procedures and IT systems and to provide relevant staff training.
87. The SFC has decided to accept this suggestion. Accordingly, the effective date of the new provisions of the Code of Conduct (attached hereto as Appendices B and C) will be no less than six months from the gazettal date of the new provisions.

Way forward

88. The rise of alternative trading venues is one of the key changes affecting global equity markets over the past several years. Although ALPs in Hong Kong operate on a relatively smaller scale and account for a less significant volume of trades, international experience suggests that these trading venues could in time have a huge impact on market functionality. In the SFC's view, the current regulatory position is not sufficient for effectively regulating our ALP operators. Accordingly, the SFC will continue to monitor market and regulatory developments in alternative trading venues both in Hong Kong and overseas, and anticipates that further policy refinements and rule changes may be necessary in future in order to maintain an appropriate balance between market innovation and investor protection.



Appendix A

List of respondents

Respondents with no objection to publication of their names (in alphabetical order)

1. Abraham YUEN
2. Asia Securities Industry & Financial Markets Association
3. CHENG Chui Hung
4. Consumer Council
5. David M. WEBB
6. Enzo MICHELANGELI
7. Hong Kong Investment Funds Association
8. Hong Kong Securities & Futures Professionals Association
9. Hong Kong Securities Association Limited
10. I-Access Investors Limited
11. ICI Global
12. Julian GALVIN
13. Liquidnet Asia Limited
14. Nicholas MAWDSLEY
15. Optiver Trading Hong Kong Limited
16. Professor David C. DONALD
17. Richard HARRIS
18. The Alternative Investment Management Association Limited – Hong Kong Branch
19. The Hong Kong Society of Financial Analysts
20. The Law Society of Hong Kong
21. Yea Tann Simon TSAO

In addition, 36 respondents requested that their submissions be published on a "no-name" basis.

Two respondents requested that both their names and submissions be withheld from publication.



Appendix B

New Paragraph 19 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Alternative liquidity pools

19.1 Application

This paragraph applies to a licensed or registered person who:

- (a) operates an alternative liquidity pool; or
- (b) routes client orders to an alternative liquidity pool for execution.

19.2 Interpretation

For the purposes of this paragraph:

- (a) “ALP Guidelines” means the guidelines that are required to be prepared by a licensed or registered person operating an alternative liquidity pool, for the purpose of providing guidance to the users of the alternative liquidity pool concerning its operation.
- (b) “alternative liquidity pool” (hereafter referred to as ALP) means an electronic system operated by a licensed or registered person through which the crossing / matching of orders involving listed or exchange traded securities is conducted with no pre-trade transparency. It includes a system designed and developed in-house or by a third party service provider.
- (c) “authorized trader” means an individual who is authorized by a user to place orders into an ALP. For the avoidance of doubt, a licensed or registered person operating an ALP is not an authorized trader in relation to orders placed into its ALP.
- (d) “group of companies” has the same meaning as in Part 1 of Schedule 1 of the SFO.

~~(e) “institutional investor” means:~~

~~(i) a “professional investor” within the meaning of paragraphs (a) to (i) (inclusive) of the definition of “professional investor” contained in Part 1 of Schedule 1 of the SFO; or~~

~~(ii) a trust corporation within the meaning of section 3(a), or a corporation that is wholly owned by a trust corporation within the meaning of section 3(d)(i), of the Securities and Futures (Professional Investor) Rules.~~

~~(f)~~ “proprietary order” means an order which is for:



- (i) the account of a licensed or registered person operating an ALP, trading as principal;
- (ii) the account of any user, which is a company within the same group of companies as the licensed or registered person operating an ALP, trading as principal;
- (iii) any account in which a licensed or registered person operating an ALP, or any user which is a company within the same group of companies as the licensed or registered person, has an interest; or
- (iv) the account of any employee or agent of a licensed or registered person operating an ALP or of any user which is a company within the same group of companies as the licensed or registered person.

For the avoidance of doubt, client facilitation orders are to be treated as proprietary orders.

(f) “qualified investor” means:

- (i) a person falling under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the SFO; or
- (ii) a person within the meaning of sections 3(a), (c), (d)(i), d(iii) or d(iv) of the Securities and Futures (Professional Investor) Rules.

- (g) “user” means an ~~institutional~~ qualified investor whose orders are placed into or whose transactions are conducted in an ALP, and includes any ~~institutional~~qualified investor who/which is ultimately responsible for originating the instruction in relation to an order placed into, or a transaction conducted in, an ALP.

19.3 Management and supervision

A licensed or registered person operating an ALP should effectively manage and adequately supervise the design, development, deployment and operation of its ALP, as may be appropriate in the circumstances.

19.4 Access to ALPs

- (a) All licensed or registered persons should establish and implement measures to ensure that only ~~institutional~~qualified investors are permitted to be users of an ALP.
- (b) A licensed or registered person should only route orders to an ALP on behalf of clients where such orders are placed or originated by a person who is a ~~n~~ ~~institutional~~qualified investor.



19.5 Operation of ALPs

A licensed or registered person operating an ALP may allow transactions to be placed into, and transacted in, its ALP at such times as it considers appropriate.

19.6 Order priority

Irrespective of the time when orders are placed, a licensed or registered person operating an ALP should ensure that the orders of users which are not proprietary orders have priority over proprietary orders when such orders are being transacted at the same price.

19.7 Information for users

- (a) A licensed or registered person operating an ALP should, by means of ALP Guidelines, provide sufficiently comprehensive information to the users of the ALP to ensure that they are fully informed as to the manner in which the ALP operates.
- (b) ~~Before~~ Prior to routing any order to an ALP on behalf of a client for the first time, a licensed or registered person should ensure that the ALP Guidelines have been brought to the attention of the person placing or originating the order ~~and that such person has complied with the requirements of paragraph 11(b) and (c) of Schedule 8 to this Code.~~

19.8 Opting out of ALP

A licensed or registered person operating an ALP should permit the users to opt out of matching or crossing their order in its ALP.

19.89 Adequacy of system

A licensed or registered person operating an ALP should ensure the integrity of the ALP as may be appropriate in the circumstances, including the controls, reliability, security and capacity of the ALP, and have appropriate contingency measures in place in case of any failure.

19.910 Record keeping

A licensed or registered person operating an ALP should keep, or cause to be kept, proper records concerning the design, development, deployment and operation of its ALP.

19.4011 Risk management

A licensed or registered person operating an ALP should have controls that are reasonably designed to ensure:

- (a) the integrity of its trading methodology; and



- (b) that its trading methodology operates in the interest of preserving the integrity of the market.

19.4112 Reporting and notification obligations

- (a) A licensed or registered person operating an ALP should have procedures in place to ensure that information concerning transactions conducted on its ALP is appropriately reported or made available to its users, ~~The Stock Exchange of Hong Kong Limited exchanges, and~~ the Commission and other regulators.
- (b) A licensed or registered person operating an ALP should keep the Commission informed of any change in relation to the operation of its ALP and any breach arising out of its operation.



Appendix C

New Schedule 8 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Schedule 8 Additional requirements for licensed or registered persons operating alternative liquidity pools

Introduction

1. Paragraph 19 of the Code stipulates the general principles that apply to licensed or registered persons operating an alternative liquidity pool (“ALP”) or routing client orders to an ALP. This Schedule stipulates, in more detail, the requirements that should be observed by a licensed or registered person operating an ALP (“ALP operator”).
2. Unless otherwise stated, the terms defined in paragraph 19.2 of the Code shall have the same meaning when used in this Schedule.

Management and supervision

3. An ALP operator should establish and implement written internal policies and procedures concerning the design, development, deployment and operation of its ALP to ensure that:
 - (a) there is at least one responsible officer or executive officer responsible for the overall management and supervision of the ALP;
 - (b) there is a formalized governance process, with input from risk and compliance functions;
 - (c) there are clearly identified reporting lines, with supervisory and reporting responsibilities assigned to appropriate staff members; and
 - (d) there are managerial and supervisory controls that are designed to manage the risks associated with the operation of the ALP.
4. An ALP operator should conduct regular reviews to ensure that its internal policies and procedures are in line with changing market conditions and regulatory developments and should promptly remedy any deficiencies identified.
5. An ALP operator should assign adequately qualified staff, expertise, technology and financial resources to the design, development, deployment and operation of its ALP.
6. An ALP operator should effectively manage and adequately supervise the design, development, deployment and operation of its ALP, as may be appropriate in the circumstances.

Access to ALPs

7. Only institutional-qualified investors are permitted to be the users of ALPs. Subject to paragraph 8 of this Schedule, an ALP operator should take all reasonable steps to ascertain that the users of its ALP are institutional-qualified investors.
8. An ALP operator should have in place measures which **ensure**:



- (a) that all of its clients, and all of the clients of any other company within the same group of companies as the ALP operator, who/which are users of its ALP, are institutional-qualified investors; and
- (b) that it will be able to comply with the requirements of the Commission, as revised from time to time, concerning “client identity” (including the identity, address and contact details of the users of its ALP).

Information for users

ALP Guidelines

9. An ALP operator should prepare and publish on its website comprehensive and accurate ALP Guidelines concerning its ALP, including (but not limited to) details relating to:
 - (a) trading and operational matters;
 - (b) user restrictions;
 - (c) opt-out arrangement;
 - ~~(e)~~(d) user priority, order routing and execution methodology;
 - ~~(e)~~(e) transaction pricing;
 - ~~(e)~~(f) order cancellation;
 - ~~(f)~~(g) the internal control procedures that have been put in place to ensure the fair and orderly functioning of its ALP and to address potential conflict of interest issues;
 - ~~(g)~~(h) the potential risks associated with transactions conducted in its ALP in respect of which the users of its ALP should reasonably be made aware;
 - ~~(h)~~(i) the transaction of proprietary orders in its ALP;
 - ~~(i)~~(j) whether the orders of different users of its ALP may be aggregated; and
 - ~~(j)~~(k) the identity of each member of its staff (by title and department) who is permitted access to trading information concerning orders placed into, and transactions conducted in, its ALP and, in each case, the reason(s) why such access is necessary.
10. A licensed or registered person should provide a copy of its ALP Guidelines to the Commission forthwith upon their publication on its website.

~~Communication of ALP Guidelines to Users~~

- ~~11. In respect of an institutional investor seeking to become a user of an ALP which is operated by an ALP operator, the ALP operator should have appropriate arrangements in place, either itself or in conjunction with a group company, to ensure that prior to the first order being placed into its ALP by or on behalf of such institutional investor:~~
 - ~~(a) the ALP Guidelines are brought to his/its attention;~~
 - ~~(b) the ALP operator is provided with a formal acknowledgement from him/it that the ALP Guidelines have been brought to his/its attention; and~~
 - ~~(c) the ALP operator is provided with a formal consent from him/it permitting his/its orders to be transacted in the ALP.~~



Revision of ALP Guidelines

~~12.11.~~ An ALP operator should revise or update its ALP Guidelines as necessary to ensure that they remain comprehensive, accurate and current, and should, as soon as reasonably practicable thereafter, publish the revised or updated ALP Guidelines on its website and circulate them to the users of its ALP, identifying the amendments that have been made and providing an explanation for the making of such amendments. An ALP operator should provide a copy of the revised or updated ALP Guidelines to the Commission, identifying the amendments that have been made and providing an explanation for the making of such amendments, forthwith upon the publication of the revised or updated ALP Guidelines on the ALP operator's website.

Adequacy of system

System controls

~~13.12.~~ An ALP operator should ensure that its ALP has effective controls to enable it, where necessary, to immediately prevent transactions from being conducted in the ALP.

System reliability

~~14.13.~~ An ALP operator should ensure that its ALP, and all modifications to its ALP, are tested before deployment and are regularly reviewed to ensure that the ALP and its modifications are reliable.

System security

~~15.14.~~ An ALP operator should employ adequate and appropriate security controls to protect its ALP from any type of abuse. The security controls should at least include:

- (a) reliable techniques to ensure that access to its ALP is restricted to persons whose access to the ALP is essential and whose access has been approved by the ALP operator;
- (b) effective techniques to protect the confidentiality and integrity of information concerning transactions conducted in the ALP that is passed between internal and external networks;
- (c) appropriate operating controls to prevent and detect any unauthorized intrusion, security breach and security attack; and
- (d) appropriate measures to raise the awareness of the ALP operator's staff concerning the importance of security and the strict observance of security in connection with the ALP.

System capacity

~~16.15.~~ An ALP operator should ensure that:

- (a) the usage capacity of its ALP is regularly monitored and appropriate capacity planning is conducted. As part of the capacity planning, an ALP operator should determine, monitor and maintain the required level of spare capacity;



- (b) the capacity of its ALP is regularly stress tested to establish the system behaviour under different simulated market conditions, with the findings of the stress tests and any actions taken to address those findings being documented;
- (c) its ALP has sufficient capacity to handle any foreseeable increase in business volume and market turnover; and
- (d) its ALP has contingency arrangements, the details of which have been communicated to the users of the ALP:
 - (i) to facilitate the handling of users' orders when the capacity of the ALP is exceeded; and
 - (ii) by which alternative means of executing orders are available and offered to users.

Information security

17.16. An ALP operator should:

- (a) only permit members of its staff to have access to trading information concerning orders placed, or transactions conducted, in its ALP and only to the extent necessary to enable the ALP to operate satisfactorily and efficiently, and at all times keep the Commission informed as to:
 - (i) the identity of each such staff member (by title and department) and the information to which he/she has access;
 - (ii) the basis upon which it is necessary, in each case, for such access to be permitted; and
 - (iii) any change made in relation to the staff members to whom such access is permitted and the basis for such change;
- (b) maintain an adequate access log that records the identity and role of the staff members who have access to its ALP, the information that has been accessed, the time of access, any approval given for such access and the basis upon which such access was permitted in each case;
- (c) have adequate and effective systems and controls in place to guard against, and detect, information leakage or abuse by members of its staff in relation to the trading information concerning orders placed and/or transactions conducted in its ALP to which they have access; and
- (d) have appropriate measures in place to ensure that any person responsible for originating the instruction in relation to a proprietary order in its ALP, does not have access, whether directly or indirectly, to any trading information or transaction data concerning orders placed, or transactions conducted, in the ALP, other than confirmation of the eventual outcome of the order.



Contingencies

18.17. An ALP operator should establish a written contingency plan to cope with emergencies and disruptions related to the operation of its ALP. The contingency plan should at least include:

- (a) a suitable backup facility which will enable the ALP operator to operate the ALP in the event of an emergency;
- (b) arrangements to ensure user and transaction databases and servers are backed up in an off-line medium, with off-site storage being subject to proper security measures; and
- (c) trained staff being available to deal with user and regulatory enquiries.

19.18. An ALP operator should ensure that the contingency plan to deal with potential emergencies and disruptions is periodically tested and that the plan is viable and adequate.

20.19. An ALP operator should, in the event of a material system delay or failure, in a timely manner:

- (a) ensure that the delay or failure is rectified; and
- (b) inform users of its ALP of the causes, or possible causes, of the delay or failure and the manner in which their orders will be handled.

Record keeping

21.20. An ALP operator should keep, or cause to be kept:

- (a) comprehensive documentation of the design, development, deployment and operation of its ALP, including any testing, reviews, modifications, upgrades or rectifications of the ALP; and
- (b) comprehensive documentation of the risk management controls for the ALP.

22.21. An ALP operator should retain the documentation referred to in paragraph **21.20**(a) and (b) for a period of not less than two years after the ALP ceases to operate.

23.22. An ALP operator should keep:

- (a) for a period of not less than seven years, the following records in respect of transactions conducted in its ALP in such manner as will enable them to be readily accessible in written form in the Chinese or English language (and, if necessary, immediately convertible into such written form), and provide any such records to the Commission upon request:
 - (i) details of the users of its ALP, including their registered names and addresses, dates of admission and cessation, authorized traders and related details, and client agreements;
 - (ii) details of any restriction, suspension or termination of the access of any user to its ALP, including the reasons for this;



- (iii) all notices and other information, whether written or communicated through electronic means, provided by the ALP operator to the users of its ALP, whether individually or generally; and
 - (iv) routine daily and monthly summaries of trading in its ALP, including:
 - (I) the securities in respect of which transactions have been executed; and
 - (II) the transaction volume, expressed in numbers of trades, numbers of securities traded and total settlement value; and
- (b) for a period of not less than two years, time-sequenced records of orders and any other actions or activities conducted in its ALP, as particularized below, in such manner as will enable them to be readily accessible in written form in the Chinese or English language (and, if necessary, immediately convertible into such written form), and provide any such records to the Commission upon request:
- (i) the date and time that any order was received, executed, modified, cancelled or expired (where applicable);
 - (ii) the identity, address and contact details of the user and authorized trader initiating an entry, modification, cancellation or execution of an order;
 - (iii) the particulars of any order and any subsequent modification and execution of the order (where applicable), including but not limited to, the securities involved, the size and side (buy or sell) of the order, the order type, and any order designation, time and price limit or other conditions specified by the user responsible for originating the order; and
 - (iv) the particulars of the allocation and re-allocation (where applicable) of an execution.

Risk management

24.23. An ALP operator should have controls that are reasonably designed to monitor and prevent the crossing of orders in its ALP which may:

- (a) be erroneous;
- (b) interfere with the operation of a fair and orderly market; or
- (c) be in breach of any legal or regulatory obligations.

25.24. An ALP operator should regularly conduct post-trade reviews of transactions conducted in its ALP to identify any:

- (a) suspicious market manipulative or abusive activities;
- (b) market events or system deficiencies, such as unintended impact on the market, which call for further risk control measures; and
- (c) breaches, whether actual or potential, of any requirements relating to fair and orderly trading in its ALP or which might constitute market misconduct.

26.25. Forthwith, upon becoming aware of any breach, whether actual or potential, of any legal or regulatory obligation referred to in paragraph 24.23(c) or any requirement referred to in paragraph 25.24(c), an ALP operator should notify the Commission of such matter and



provide the Commission with such additional assistance in connection therewith as it might request.

27-26. An ALP operator should, upon identification of any suspected market manipulative or abusive trading activities, take immediate steps to prevent these activities from continuing.

Reporting and notification obligations

Transaction reporting

28-27. An ALP operator should have appropriate arrangements in place to ensure that:

- (a) transactions conducted in its ALP that are required to be reported to The Stock Exchange of Hong Kong Limited (“SEHK”) are properly reported in the manner and within the time limit prescribed by the rules and regulations of SEHK;
- (b) transactions conducted in its ALP that are required to be reported to any exchange or regulator outside Hong Kong are properly reported in the manner and within the time limit required by such exchange or regulator;
- (c) regular transaction analyses are made available to the users of its ALP concerning the transactions that are conducted on their behalf in the ALP; and
- (d) it provides the Commission with a report recording the volume of trades conducted by each of the 10 largest users of its ALP on a calendar monthly basis within 10 business days after the end of each calendar month, or as otherwise requested by the Commission.

Notification to the Commission

29-28. An ALP operator should:

- (a) notify the Commission of any proposed change to the following which might affect the operation of its ALP or the users of its ALP, and provide the Commission with an explanation for the proposed change, prior to its implementation:
 - (i) corporate structure and governance arrangements;
 - (ii) business plans or operations;
 - (iii) the trading rules, trading sessions and operating hours, the system operator, hardware, software, and other technology of its ALP, and all system interfaces between its ALP and other ALPs or other electronic trading platforms;
 - (iv) the ALP operator’s contractual responsibilities in relation to the users of its ALP;
 - (v) the criteria for approval or disapproval of the users of its ALP; and
 - (vi) the contingency plan in relation to its ALP;
- (b) notify the Commission of any breach of any relevant regulatory obligations or the ALP Guidelines forthwith upon its occurrence;



- (c) notify the Commission of the causes, or possible causes, of material delay or failure to the operation of its ALP affecting the users of its ALP forthwith upon its occurrence; and
- (d) provide the Commission with any updated review report concerning its ALP forthwith upon it becoming available.