



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

Consultation Conclusions on Proposed Amendments to the Guidelines for the Regulation of Automated Trading Services

1 March 2016



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Executive Summary

1. On 20 November 2015, the Securities and Futures Commission (**SFC**) issued a Consultation Paper inviting comments on its proposed amendments to the *Guidelines for the Regulation of Automated Trading Services (Revised ATS Guidelines)*. The proposals stem from regulatory and market developments that have taken place since the guidelines were first published in 2003, including in particular changes to international regulatory standards and practices, and the development of a regulatory regime in respect of the over-the-counter (**OTC**) derivatives market. The proposed amendments also aim to codify the SFC's existing practices in regulating automated trading services (**ATS**), for better transparency.
2. The consultation period ended on 31 December 2015. The SFC received 15 written submissions. A list of respondents is set out in **Appendix A**. In general, the respondents were supportive of the Revised ATS Guidelines, although there were also requests for further clarification on certain matters.
3. The key comments received, and the SFC's response to these are discussed in the section below. Some drafting changes have also been made to the Revised ATS Guidelines in light of the feedback received, as shown in **Appendix B**. This conclusions paper should be read in conjunction with the Consultation Paper issued on 20 November 2015.
4. The SFC intends to implement the Revised ATS Guidelines (in the form at Appendix B) with effect from the date when subsidiary legislation introducing mandatory clearing for OTC derivatives (**Clearing Rules**) is implemented in Hong Kong. This was previously expected to be in mid-2016 and is now expected to be on 1 September 2016.¹

Comments Received and Our Responses

A. Assessment on compliance with international regulatory standards and practices

Public comments

5. Several respondents indicated their support for the SFC's pragmatic approach in regulating the provision of ATS in Hong Kong. They agreed that the regulatory approach for ATS should be adaptive and appropriate regulatory requirements be applied on a case-by-case basis. Some respondents sought further clarification on how to demonstrate compliance with international regulatory standards and the documents to be provided in this connection, particularly for the purposes of demonstrating compliance with the Principles for Financial Markets Infrastructures (PFMI) requirements for central counterparties (**CCPs**) as this could be done in different ways.

The SFC's response

6. The *PFMI Disclosure Framework*, published by the Committee on Payment and Settlement Systems (**CPSS**) (now the Committee on Payments and Market Infrastructures (**CPMI**)) and the International Organization of Securities Commissions

¹ The relevant subsidiary legislation (referred to here as the "Clearing Rules") is the *Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules*, which were introduced into the Legislative Council for negative vetting on 17 February 2016.



(IOSCO) in December 2012, and self-assessment report are the two main documents that the SFC will normally require for the purpose of determining compliance with the PFMI requirements. It will not suffice to provide only one of these two documents. This is because it is important for an applicant to explain how it meets each of the principles under the PFMI, and highlight to the SFC any potential gaps identified in its self-assessment report. Additionally, when considering an application, the SFC will also take into account information published by the applicant in accordance with the CPMI-IOSCO's February 2015 *Public Quantitative Disclosure Standards for Central Counterparties* and any relevant report released by International Monetary Fund's Financial Sector Assessment Program. Applicants are encouraged to provide as much relevant documentation as possible as that will enable the SFC to review and process the application more effectively and efficiently.

B. Implementation timeline and transitional period

Public comments

7. As stated in the Consultation Paper, the Revised ATS Guidelines will be implemented at the same time that the Clearing Rules are implemented. Some respondents requested that sufficient time be given to them to prepare their application(s) and obtain the necessary authorization and designation. They also asked whether a transitional period or no-action period would be provided so that they may continue to provide clearing services to market participants in Hong Kong without disruption.

The SFC's response

8. Similar concerns were raised during the SFC's consultation on the Clearing Rules². As a result of these and other considerations, the timeline for implementation of the Clearing Rules has been deferred such that, subject to the legislative process, those rules are now expected to be implemented on 1 September 2016. This should allow sufficient time for interested CCPs to prepare their application(s) and for such applications to be processed by the SFC. Interested CCPs are encouraged to contact the SFC and submit their application(s) to the SFC as soon as possible. Additionally, CCPs interested in obtaining ATS authorization or CCP designation in time for implementation of the Clearing Rules should ensure that their application(s), with full and complete information and documentation, reach the SFC by 29 April 2016.
9. As for the provision of a transitional or no-action period, we would note that the current legislation does not empower the SFC to grant any such concession. In any event, we believe such a concession may no longer be necessary as the deferred implementation of mandatory clearing will effectively achieve the same result.

C. Two regimes for regulating ATS – Part III and Part V of the SFO

Public comments

10. One respondent suggested that a common set of standards should be adopted for Part III and Part V ATS providers.

² See the HKMA and SFC's joint [Consultation Conclusions and Further Consultation on Introducing Mandatory Clearing and Expanding Mandatory Reporting](#) (issued on 5 February 2015).



The SFC's response

11. As explained in the Revised ATS Guidelines, the SFO provides two regimes for regulating ATS. Providers of ATS may either be authorized to provide ATS under Part III, or licensed or registered for Type 7 regulated activities under Part V. Part III ATS providers provide ATS as a core function and typically offer facilities that are similar to those of a traditional exchange or a clearing house/CCP, while Part V ATS providers are typically intermediaries that provide dealing services, and offer ATS as an incidental facility or service only. The two are also subject to different regulatory requirements and obligations under the SFO. In particular, the Part V regime focuses more on intermediaries and their dealings with clients, while the Part III regime allows for a greater focus on the system used to provide ATS. As a result, we consider that a common set of standards for both Part III and Part V ATS providers would not be appropriate.

D. Others comments

a) Application of the Revised ATS Guidelines to existing ATS providers and others

Public comments

12. Some respondents enquired whether the Revised ATS Guidelines would be applied to existing authorized ATS providers. One respondent also asked whether the Revised ATS Guidelines would be applicable to market participants such as middleware providers and others who provide services that connect the ATS provider and its participants/members.

The SFC's response

13. The Revised ATS Guidelines are intended to apply to both new applicants as well as those who are already authorized. Existing ATS providers who have concerns about complying with the Revised ATS Guidelines should approach the SFC as soon as practicable to see how their concerns might be addressed.
14. As to whether the Revised ATS Guidelines apply to middleware providers and others providing services that connect an ATS provider and its participants/members, this will depend on whether the specific services provided constitute ATS (as defined in the SFO). If they do, then the guidelines will apply. Market participants who are unsure whether their services constitute ATS should seek independent legal advice to clarify their position. Where legal advice has been obtained but there is still doubt or uncertainty, market participants may approach the SFC for further discussion.

b) Core standards of practice applicable to Part V ATS providers

Public comments

15. Paragraph 15 of the Revised ATS Guidelines indicates that the core standards of practice are generally intended to apply to all ATS providers including Part V ATS providers subject to relevant SFO provisions. One respondent sought clarification on which core standards of practice would not be applicable to Part V ATS providers as they are otherwise captured by applicable SFO provisions.



The SFC's response

16. The ATS Guidelines (published in 2003) state that Part V ATS providers will normally meet the standards by complying with applicable SFO provisions. Similarly, Part V ATS providers will normally meet the core standards in the Revised ATS Guidelines (which are largely the same as those in the current ATS Guidelines) by complying with applicable SFO provisions.
17. In view of the comment received, we have refined paragraph 15 of the Revised ATS Guidelines to provide clarity on this.

c) Insolvency protection

Public comments

18. One respondent supported the proposal of not extending the finality protection under the SFO to Part III ATS providers but was worried that Hong Kong investors would then need to rely upon the protection afforded by foreign regulators and be exposed to insolvency claw back risks in the event of a member default.

The SFC's response

19. The robustness of an applicant's default management procedures (including its effectiveness in the event of a relevant insolvency) is one of the SFC's key considerations when reviewing an application. In the case of an overseas CCP, the SFC will consider the sufficiency of finality provisions in its home jurisdiction, taking into account the CCP's proposed arrangements for providing ATS to persons in Hong Kong. Where necessary, a legal analysis may be requested.

d) Investor compensation

Public comments

20. One respondent suggested that the SFC should consider including ATS transactions under the investor compensation scheme to enhance investor protection.

The SFC's response

21. We do not believe there is a need to extend the investor compensation scheme to ATS transactions at this time given the kinds of ATS providers that currently operate in our market, or are likely to operate here in the near future. That said, and as indicated in the Revised ATS Guidelines, such an extension will be considered as and when the need arises. Relevant factors in this regard will include the size and level of activity conducted through ATS, and the impact they have on the Hong Kong markets.

e) Fees charged by recognized exchanges vs ATS providers

Public comments

22. Under Section 76 of the SFO, the fees of a recognized exchange controller, a recognized exchange company (**REC**) and a recognized clearing house (**RCH**) have to be approved by the SFC before they come into effect. One respondent suggested that, in order to ensure a level playing field, the fees charged by ATS providers should also be subject to SFC approval unless they are already subject to regulation in their home jurisdiction.



The SFC's response

23. We do not consider that it is appropriate for the fees of all ATS providers to be subject to SFC approval. The activities of ATS providers may differ greatly, as may the nature of their operations in Hong Kong. Moreover, an ATS provider's operations in Hong Kong may be very limited compared to its operations overseas. It is not appropriate therefore to have a uniform requirement on fee approval.
24. In contrast RECs and RCHs are based in and operate primarily in Hong Kong. Their activities and fees therefore have a much greater impact on the Hong Kong market and investors here. Moreover, in reviewing the fees of an REC or RCH, the SFC takes into account, among other things, similar fees charged by major overseas exchanges and CCPs. We do not therefore consider that an unlevel playing field arises as a result of ATS providers not having to seek SFC approval in respect of their fees.

f) Comments on Core Standard 3: System Integrity

Public comments

25. In respect of the SFC's requirement to have an independent assessment of the integrity of the electronic facilities used for the provision of ATS under Core Standard 3 under the Revised ATS Guidelines, one respondent suggested that a similar examination or assessment conducted by an ATS provider's home regulator should be regarded as sufficient to meet the requirement.

The SFC's response

26. The main concern is that the assessment or examination should be conducted by an independent party. This may, include the ATS provider's home regulator. To provide better clarity on this point, a footnote has been added to paragraph 25 of the Revised ATS Guidelines to explain what "independent assessment" is intended to mean.

g) Comments on Core Standard 4: Governance

Public comments

27. Core Standard 4 under the Revised ATS Guidelines relates to governance. One respondent commented that although this standard incorporates the existing standard of "fitness", the "fitness" standard deserves to be a separate standard and could be renamed "competence". The respondent further noted that it could include elements from the SFC's Guidance Note on Competence and contain key concepts such as professional standards and appropriate technical training.

The SFC's response

28. The new Core Standard 4 on governance states that "*an ATS provider should have robust, well-defined and transparent governance arrangements to properly oversee its management and manage the decision-making process.*" It goes on to elaborate that "*a critical component of a robust governance structure is having qualified personnel. Key personnel of an ATS provider are therefore expected to possess the necessary qualifications and experience for ensuring the proper and continued functioning of the ATS.*" We believe it should be clear from this that the new Core Standard 4 embodies fitness and competence requirements. However, in view of the comments received, we have amended the wording in paragraph 27 of the Revised ATS Guidelines to reflect this more clearly.



h) Comments on Core Standard 5: Access and Participation

Public comments

29. Core Standard 5 under the Revised ATS Guidelines states that an ATS provider is expected to have objective, risk-based and transparent access criteria which permit fair and open access. One respondent opposed the adoption of mandatory open access between CCPs and execution venues.

The SFC's response

30. Core Standard 5 is not concerned with access or participation between CCPs and execution venues. Rather, it concerns access and participation as between members of an ATS provider. The objective is to ensure that an ATS provider has transparent criteria which permit fair and open access and participation by all members who have met its prescribed admission requirements, and that members are not accorded selective or different treatment.

i) Comments on Core Standard 7 : Surveillance

Public comments

31. In respect of Core Standard 7 under the Revised ATS Guidelines, one respondent considered that an ATS provider should not be required to carry out activities or obliged to take actions that go further than, or which conflict with, its obligations to its home regulator. Consequently, where the SFC proposes certain actions be taken, it may be appropriate for the SFC to direct these through the home regulator to ensure that there is no inconsistency.
32. Another respondent commented that an overseas CCP which is authorized as an ATS provider and conducts surveillance as required in its home jurisdiction should be deemed to meet this standard. The respondent also commented that it was highly uncommon for a foreign regulator to expect access to an offshore CCP for the purpose of surveillance.

The SFC's response

33. Currently there are 31 ATS providers that have been authorized under Part III of the SFO. They come from all over the world including Australia, Germany, Japan, Mainland China, Singapore, the United Kingdom and the United States. We appreciate that most, if not all, of these ATS providers are regulated by regulators in their respective home jurisdictions and have to comply with their respective laws and regulations. However, as ATS providers are authorized by the SFC to provide services in Hong Kong, or to persons in Hong Kong, the SFC has a responsibility to impose and enforce applicable requirements where appropriate so as to safeguard the interests of the investing public and wider market here. That said, we have a longstanding relationship and have both bilateral and international arrangements with many overseas regulators regarding information exchange and enforcement cooperation. In the event of any matter involving an ATS provider, we will continue to work closely with the relevant home regulator.
34. Furthermore, the SFC also has its own surveillance functions to discharge and expects ATS providers to assist in the performance of such functions. This is reflected in paragraph 31 of the Revised ATS Guidelines which states (among other things): "*The ATS provider may also be required to provide access to the SFC to enable the SFC to perform its surveillance functions.*" This does not however detract from the fact that, as



reflected in Core Standard 7, the primary duty of conducting surveillance rests with the ATS provider itself. It follows therefore that we do not expect surveillance assistance to be required frequently.

j) Comments on Core Standard 9 : Reporting

Public comments

35. The regular reporting obligation under Core Standard 9 requires a Part III ATS provider to submit certain information on a regular basis. One respondent commented that such reporting should be required no more than quarterly.

The SFC's response

36. The reporting requirement is critical to enabling the SFC to obtain relevant information in a timely manner for supervisory purposes. Currently, authorized Part III ATS providers are generally required to provide information to the SFC on a monthly or quarterly basis. The differences in frequency may depend on various matters including the level of the ATS provider's activity in Hong Kong. We believe the current arrangements are fair and reasonable, and that they do not create an undue burden on ATS providers. They have also worked well. We do not therefore propose limiting this requirement. Nevertheless, we will make reference to the relevant reporting requirements imposed on an applicant by its home regulator prior to making a decision on the reporting requirement for its ATS authorization.

Conclusions and Way Forward

37. We are grateful for the comments and suggestions submitted in response to the consultation on the proposed amendments to the ATS Guidelines. Having considered the submissions received, the SFC concludes that the Revised ATS Guidelines be adopted as set out in **Appendix B**. Some drafting revision to paragraphs 7, 15, 25 and 27 of the Revised ATS Guidelines have also been made following the consultation exercise.
38. As indicated previously, the Revised ATS Guidelines will be implemented with effect from the day that the Clearing Rules are implemented. This is currently expected to be on 1 September 2016.
39. For CCPs who wish to provide mandatory clearing services for OTC derivatives from the day mandatory clearing is implemented, they should ensure that their applications for ATS authorization and CCP designation, with full and complete information and documentation, reach the SFC on or before 29 April 2016.
40. Please note that the quality of information and documentation submitted will affect the processing time of an application. We welcome interested parties to contact the SFC for discussion should there be any questions regarding the application(s). The application procedures, required documentation/information and the fees involved are set out in the Revised ATS Guidelines.



41. Again, the SFC would like to take this opportunity to thank all respondents for their submissions.



Appendix A - List of Respondents

(in alphabetical order)

1. Asia Securities Industry & Financial Markets Association
2. ASX Limited
3. CME Group Inc.
4. CompliancePlus Consulting Limited
5. Futures Industry Association Asia
6. Intercontinental Exchange, Inc.
7. International Swaps and Derivatives Association, Inc.
8. Law Society of Hong Kong, The
9. Tradeweb Europe Limited
10. Anonymous – 6 respondents requested that its identity not be published



Appendix B - The Revised ATS Guidelines

Draft



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

Guidelines for the Regulation of Automated Trading Services

September 2016

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Guidelines for the Regulation of Automated Trading Services

A. INTRODUCTION

1. These Guidelines are published by the Securities and Futures Commission (SFC) under sections 95(6) and 399(1) of the Securities and Futures Ordinance (SFO). They set out principles, standards and procedures in relation to the SFC's regulation of automated trading services (ATS), including the authorization, registration and licensing of persons providing such services.
2. 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 persons to be, or to continue to be, authorized, registered or licensed to provide ATS.
3. Terms defined in the SFO bear the same meaning when used in these Guidelines.

Definition of ATS

4. Part 2 of Schedule 5 to the SFO defines ATS¹ as follows:

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

- (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;*
- (ab) *offers to enter into OTC derivative transactions are regularly made or accepted in a way that forms or results in a binding transaction in accordance with established methods;*

¹ The definition of ATS was expanded by the Securities and Futures (Amendment) Ordinance 2014 to cover services for the trading or clearing of OTC derivative transactions. The expanded trading limb is reflected in paragraphs (ab) and (ba) of the definition, while the expanded clearing limb is reflected in paragraph (d) of the definition. As at [date], only paragraph (d) of the definition (i.e. the expanded clearing limb) was implemented in full, while paragraphs (ab) and (ba) of the definition (i.e. the expanded trading limb) were only implemented partially – see [the Securities and Futures (Amendment) Ordinance (Commencement) Notice 2016].

- (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;*
- (ba) *persons are regularly introduced, or identified to other persons –*
 - (i) *in order that they may negotiate or conclude OTC derivative transactions in a way that forms or results in a binding transaction in accordance with established methods; or*
 - (ii) *with the reasonable expectation that they will negotiate or conclude OTC derivative transactions in such a way;*
- (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; or*
- (d) *transactions –*
 - (i) *referred to in paragraph (ab); or*
 - (ii) *resulting from the activities referred to in paragraph (ba),**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 or any excluded services.”

Two regimes for regulating ATS under the SFO

- 5. Providers of ATS may either be:
 - (a) authorized to provide ATS under Part III of the SFO (**Part III ATS providers**); or
 - (b) licensed or registered for Type 7 regulated activity under Part V of the SFO (**Part V ATS providers**).
- 6. In general:
 - (a) An ATS authorization under Part III (**Part III ATS authorization**) is appropriate where the provision of ATS is a core function, rather than incidental to the performance of a dealing function. Such ATS providers

typically offer facilities that are similar to those of a traditional exchange or a clearing house/central counterparty (**CCP**).

- (b) An ATS licence or registration under Part V (**Part V ATS licence or registration**) is appropriate where the provision of ATS is incidental to the performance of a dealing function, such as dealing in securities, futures contracts or OTC derivative products. Such ATS providers are typically intermediaries that provide dealing services, and offer ATS as an added facility.

Regulation of Part III ATS providers

- 7. Where a person is seeking or granted a Part III ATS authorization, the provisions of sections 95 to ~~100~~101 of the SFO will apply. These provide for a range of matters including requirements and processes relating to the application for a Part III ATS authorization, the granting or withdrawal of such authorization, and the imposition, amendment or revocation of conditions attached to such authorization. The provisions also enable the SFC to make rules (i.e. subsidiary legislation) relating to the provision of ATS, and require that the SFC maintain a register of Part III ATS providers. Section E below elaborates on the application requirements and procedures for a Part III ATS authorization.
- 8. As noted above, the facilities of a Part III ATS provider are similar to those of a traditional exchange or CCP. The definition of ATS therefore expressly excludes facilities provided by a recognized exchange company (**REC**) or a recognized clearing house (**RCH**), as these are regulated under a separate regime under Part III of the SFO. Paragraph 48 below highlights the major regulatory differences between the regime for RECs and RCHs, and the regime for Part III ATS providers. Persons intending to provide facilities similar to those of a traditional exchange or CCP should take these differences into account when deciding whether to apply to become an REC or RCH, or to apply for a Part III ATS authorization.

Regulation of Part V ATS providers

- 9. Under Part V, the provision of ATS constitutes one of the regulated activities (i.e. Type 7 regulated activity). Section 114 generally prohibits a person from carrying on a business in a regulated activity unless:
 - (a) the person is licensed by the SFC under section 116 for that regulated activity;
 - (b) the person is an authorized financial institution registered under section 119 for that activity; or
 - (c) the person is authorized by the SFC under section 95 to provide ATS.

10. Where a person is licensed under Part V, all of the provisions of the SFO (including subsidiary legislation under the SFO) affecting intermediaries will normally apply. These include, for example, provisions and requirements relating to the licensing of representatives, the maintenance of financial resources, the keeping of books and records, the conducting of audits, the protection of client assets, and compliance with relevant codes for business conduct. For general licensing requirements, a Licensing Information Booklet is available on the SFC's website.
11. Where a person is licensed as a Part V ATS provider, section 118(1)(c) empowers the SFC to require the person to apply to become a Part III ATS provider. If this is not complied with, the SFC may revoke the licence under section 195(2). This might be used, for example, where the SFC believes that it would be inappropriate to apply all of the Part V requirements (e.g. licensing of representatives) to the ATS 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 regulate it as a Part III ATS provider.
12. The next two Sections of these Guidelines set out the SFC's principles for the regulation of ATS providers, and its core standards of practice for providing ATS.

B. PRINCIPLES FOR THE REGULATION OF ATS PROVIDERS

13. In general, the regulation 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 that the SFC is required to have regard to under section 6(2) of the SFO in pursuing its regulatory objectives and performing its functions. Accordingly, the SFC shall, when regulating ATS providers, consider whether the services provided by them are, as far as reasonably practicable, consistent with the following:
 - (a) promoting and maintaining the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
 - (b) promoting understanding by the public of the operation and functioning of the securities and futures industry and of the benefits, risks and liabilities associated with investing in financial products;
 - (c) securing an appropriate degree of protection for members of the public investing in or holding financial products, having regard to their degree of understanding and expertise in respect of investing in or holding financial products;
 - (d) reducing systemic risks in the securities and futures industry;

- (e) promoting, encouraging and enforcing proper conduct, competence and integrity of persons carrying on activities regulated by the SFC;
- (f) adopting appropriate internal controls and risk management systems by persons carrying on activities regulated by the SFC;
- (g) 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;
- (h) the desirability of facilitating innovation in connection with financial products and activities regulated by the SFC; and
- (i) the principle that competition among persons carrying on activities regulated by the SFC should not be impeded unnecessarily.

C. CORE STANDARDS OF PRACTICE FOR ATS

14. In addition to the principles set out above, the SFC has identified core standards of practice for the regulation of ATS. A person providing ATS is generally expected to meet the following core standards, as appropriate, to the satisfaction of the SFC.

Standard 1: Financial Resources

An ATS provider should have sufficient financial resources for the proper performance of its operations, functions and obligations.

Standard 2: Risk Management

An ATS provider should ensure that risks associated with its businesses and operations are managed prudently.

Standard 3: System Integrity

An ATS provider should set up and maintain electronic facilities to achieve a high degree of reliability, availability and security in respect of its systems, data and networks, and incorporate adequate capacity and contingency arrangements.

Standard 4: Governance

An ATS provider should have robust, well-defined and transparent governance arrangements to properly oversee its management and manage the decision-making process.

Standard 5: Access and Participation

An ATS provider should have objective, risk-based and transparent criteria for participation, which permit fair and open access.

Standard 6: Transparency

An ATS provider should provide appropriate transparency in relation to its ATS operations, products, and transactional information, including where relevant: its arrangements for order processing and for transaction execution or clearing and settlement (as applicable); the list of products that may be traded or cleared through its facilities; and its rules and operational requirements.

Standard 7: Surveillance

Proper surveillance of activity conducted via the ATS 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 8: Record Keeping

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

Standard 9: Reporting

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

15. These core standards overlap to some extent with provisions in the SFO dealing with the regulation of intermediaries (e.g. provisions relating to the record-keeping obligations of intermediaries). As such, although the core standards are generally intended to apply to all ATS providers, their application to Part V ATS providers will be subject to relevant SFO provisions. Part V ATS providers will normally meet the core standards by complying with applicable SFO provisions.

Pragmatic approach

16. The SFC intends to take a pragmatic approach to regulating the provision of ATS in Hong Kong. ATS operations are diverse as they may include traditional exchanges and CCPs, and other electronic trading or clearing platforms. Some operations may also be based overseas and primarily regulated by an overseas regulator, while others may be based in Hong Kong and regulated solely by the SFC. Some ATS providers may just want to market their services, while others may also want to offer direct membership access to their trading/clearing services. The regulatory approach will be appropriately adapted and applied on a case-by-case basis, taking into account all relevant facts and circumstances. In general –
 - (a) *Regulation to be commensurate with functions and risks:* The level of regulation of an ATS provider will be commensurate with the functions it performs and the risks it poses. The SFC will consider, among other things, the nature and scope of the ATS, 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 scope of the ATS and its potential effect on market participants, and especially if systemic risks might arise, the more that will be expected of the ATS provider.

- (b) *Level playing field:* A fair and level playing field will be sought so that similar regulation is applied to similar functions. In particular, where the ATS provided are similar in all the circumstances to the services of an exchange or CCP, a level playing field will be sought. In addition, and where relevant, the SFC will take account of the degree to which an ATS provider is already regulated by an overseas authority. An overseas exchange, CCP, or other electronic platform providing similar services, will typically be subject to regulation in its home jurisdiction. The SFC will consider whether such regulation meets the above core standards.
- (c) *International standards and practices:* The SFC will have regard to international standards and best practices in considering the regulation of ATS. These include regulatory principles, standards and practices recommended by the International Organization of Securities Commissions (**IOSCO**), and the Committee on Payments and Market Infrastructures (**CPMI**), such as the Principles for Financial Market Infrastructures² (**PFMI**) in the case of ATS facilities that are similar to those of a CCP. Reference will also be made to best practices adopted in leading markets and other international financial centres.

17. The following paragraphs discuss each of the core standards of practice for ATS in greater detail.

Standard 1: Financial Resources

An ATS provider should have sufficient financial resources for the proper performance of its operations, functions and obligations.

18. An ATS provider is expected to have the financial resources needed for the proper performance of its operations, functions and obligations. The resources should be sufficient to enable the ATS provider to provide services on an on-going and continuous basis, such as to minimize the probability of its failure and any consequential adverse impact on market participants and investors.
19. In the case of ATS providers who operate as a CCP, the SFC will also expect the ATS provider to have sufficient financial resources to ensure a recovery or orderly wind-down of its critical operations and services. In considering this, the SFC will, among other things, take into account the functions performed by the ATS provider, its level

² Financial market infrastructure is defined as a system that facilitates the clearing, settling, or recording of payments, securities, derivatives or other financial transactions. CCPs are one of main financial market infrastructures.

of activities in Hong Kong, and the risks that such activities pose, including potential risks to the financial stability of Hong Kong.

20. Currently, there are international standards (e.g. PFMI) and widely accepted practices for ensuring the financial integrity of CCPs. These standards and practices will be taken into account when assessing the sufficiency of the financial resources of an ATS provider that offers CCP-type facilities. However, for ATS providers whose facilities are similar to those of an exchange or electronic platform, there are currently no similar international standards and practices in place. The SFC will therefore adopt the approach described in paragraph 16 above when assessing if such ATS providers meet the standard on financial resources.

Standard 2: Risk Management

An ATS provider should ensure that risks associated with its businesses and operations are managed prudently.

21. An ATS provider is expected to have a sound risk management framework that enables it to identify, measure, monitor and manage the range of risks that are borne by it.
22. In general, the SFC will expect the ATS provider to have policies and procedures in place to ensure that risks associated with its businesses and operations are properly identified and prudently managed.
23. An ATS provider whose facilities are similar to those of a CCP will be expected, among other things, to demonstrate to the SFC's satisfaction that it complies with the PFMI. An assessment on compliance with the PFMI will also be expected.

Standard 3: System Integrity

An ATS provider should set up and maintain electronic facilities to achieve a high degree of reliability, availability and security in respect of its systems, data and networks, and incorporate adequate capacity and contingency arrangements.

24. The electronic facilities used for the provision of ATS are expected to be designed to provide a high degree of reliability, availability and security in respect of the systems, data and networks used, and to incorporate adequate capacity and contingency arrangements. Among other things, appropriate policies, procedures and controls should be in place to ensure that such high degree of reliability, availability and security are assured and maintained at all times. Proper documentation and change management for the system hardware, software and network configuration are also expected. An ATS provider should also have sufficient backup and recovery facilities as well as documented business continuity plans to ensure the rapid recovery and resumption of business in the event of a major system disruption. These facilities and documentation should be tested, reviewed and modified on a regular basis to ensure their suitability and effectiveness.

25. The SFC may, on a case-by-case basis, require an independent assessment³ of the integrity of the electronic facilities used for the provision of ATS. In assessing the need for such assessment, the SFC will take into account any past system performance, as well as the potential systemic risks and market significance of the ATS to the Hong Kong market.

Standard 4: Governance

An ATS provider should have robust, well-defined and transparent governance arrangements to properly oversee its management and manage the decision-making process.

26. An ATS provider is expected to have robust, well-defined and transparent governance arrangements. Such governance arrangements should include, among other things, clear lines of reporting, effective processes to review operational and business performance, proper arrangements to handle conflicts of interest and adequate internal control procedures. Sufficient checks and balances should be introduced in the decision-making process and stakeholders' interests should be sufficiently taken into account.
27. A critical component of a robust governance structure is having qualified personnel. Key personnel of an ATS provider are therefore expected to possess the necessary professional qualifications and technical experience for ensuring the proper and continued functioning of the ATS. In the case of ATS that are viewed as being systemically important in Hong Kong, the SFC will also expect the governance arrangements to take into account the impact of their operations on the Hong Kong market, the public interest and the financial stability of Hong Kong.

Standard 5: Access and Participation

An ATS provider should have objective, risk-based, and transparent criteria for participation, which permit fair and open access.

28. An ATS provider is expected to have objective, risk-based and transparent access criteria, and requirements which permit fair and open access where circumstances permit. This should help ensure the orderly, efficient and legitimate use of the ATS. The criteria and requirements should also be monitored and enforced on an ongoing basis. This is particularly important where continued access to the ATS by non-qualified users may adversely affect other market participants, and consequently, affect the efficiency and integrity of the ATS.

Standard 6: Transparency

³ Independent assessment refers to any formal review, assessment or examination conducted by a party which is independent from the relevant ATS provider and possesses the necessary skills and expertise to conduct such assessment.

An ATS provider should provide appropriate transparency in relation to its ATS operations, products, and transactional information, including where relevant: its arrangements for order processing, and for transaction execution or clearing and settlement (as applicable); the list of products that may be traded or cleared through its facilities; and its rules and operational requirements.

29. An ATS provider is expected to make available to its members/users information concerning how the ATS operates. This should be done both as a part of the admission application process and on an on-going basis. Where relevant, the information provided should include information concerning: the systems for order processing and execution; the list of products that may be traded or cleared through the ATS; the rules or other operating requirements relating to the use of the ATS; the clearing and settlement arrangements; margin or other collateral requirements; and all fees and charges. The ATS provider is also expected to provide sufficient information to enable its members/users to understand the risks and responsibilities of participation, in particular the rights and obligations of a member/user following an operational disruption or the failure of another member/user.
30. An ATS provider is also expected to make available trading and clearing information in appropriate cases depending on the nature of the ATS. In most equity and derivatives trading systems, the international best practice is to provide some level of pre- and post-trade transparency including bid/ask prices, related quantities, and details of completed transactions. For clearing and settlement services, information on volumes of trades cleared for each asset class in relevant currency is normally expected to be provided.

Standard 7: Surveillance

Proper surveillance of activity conducted via the ATS 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.

31. For the purposes of this standard, surveillance carries the meaning of careful watch, and supervision for the purposes of influencing, managing or directing the proper use of its ATS. The level of surveillance expected of an ATS provider will vary depending on the nature of the ATS involved. The ATS provider may also be required to provide access to the SFC to enable the SFC to perform its surveillance functions.
32. Where an ATS provider 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 provider to also suspend trading in co-ordination with the primary market.

33. 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 platform for 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 require there to be mechanisms in place to detect such anomalies and investigate the reasons behind them.
34. In the case of an ATS provider that is an overseas exchange, CCP or electronic platform providing similar services, the SFC will normally require that it co-operate where the SFC has a need to investigate a situation involving the ATS. Such an ATS provider will also be expected to perform the surveillance functions required of it in its home jurisdiction. In the case of an overseas exchange, the SFC may in certain circumstances (such as the circumstances described in paragraph 32 above) seek a co-ordinated trading suspension.

Standard 8: Record Keeping

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

35. In general, the SFC will seek a level playing field (as described in paragraph 16(b) above) by taking into account the record-keeping requirements of exchanges and CCPs (in the case of a Part III ATS provider) and the record-keeping requirements of intermediaries (in the case of a Part V ATS provider). Hence, for example, the SFC will likely require that records relating to an ATS provider and activities conducted via its ATS be provided to the SFC on request, and that the SFC also have on-site and timely access to such records. The SFC may also specify, on a case-by-case basis depending on the nature of the ATS, the records that must be kept and the retention period to apply.

Standard 9: Reporting

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

36. An ATS provider is expected to keep the SFC informed of its activities and operations. The SFC will normally require a Part III ATS provider to submit certain information on a regular basis, certain information on request, and certain information upon the occurrence of something or upon the ATS provider becoming aware of something. Information to be provided periodically will normally include, but not be limited to, the ATS provider's annual financial statements. Other information required may include information concerning the ATS provider's operations and material changes to those operations. Such other information will normally include information about the following:
 - (a) the ATS provider's company structure, business plan and marketing plan;

- (b) the electronic facilities to be used for providing ATS;
 - (c) the contractual documentation relevant to its members/users in Hong Kong;
 - (d) the criteria for admitting persons as Hong Kong members/users or for revoking such membership, prior to the changes taking effect; and
 - (e) in some cases, the new products that it intends to offer to persons in Hong Kong.
37. The information to be provided and the frequency of reporting will, in each case, be tailored to the impact of the activities of the ATS provider in Hong Kong. The SFC will not normally require any approval of the fees and charges of the ATS provider (as such matters are generally subject to commercial considerations) but may do so if the SFC considers that any fees or charges imposed raise regulatory concerns about the ATS provided, and its impact on the market and market participants in Hong Kong.
38. Additionally, the SFC will normally also require a Part III ATS provider to periodically report to the SFC:
- (a) the location of its members/users in Hong Kong; and
 - (b) statistics on the trading, clearing and settlement activities, as applicable, carried out in Hong Kong.

D. ADDITIONAL CONSIDERATIONS APPLICABLE TO PART III ATS

39. In the context of persons that are applying for, or that have been granted, authorization to provide ATS under Part III of the SFO, the SFC will take into account the further matters discussed below.

Regulatory co-operation arrangements

40. In considering ATS applications from the operator of an overseas exchange, CCP, or electronic platform, the SFC will assess whether the operator is subject to regulation in its home jurisdiction, and whether such regulation is comparable to the regulatory regime in Hong Kong and consistent with international standards and best practices. The SFC will also generally require there to be a Memorandum of Understanding, or other information sharing and regulatory co-operation arrangement, between the SFC and the home regulator of the overseas exchange, CCP, or electronic platform concerned.

Competition and level playing field

41. In regulating ATS providers and their activities, the SFC generally (and as required by section 6(2) of the SFO) takes into account the principle that competition among persons carrying out activities regulated by the SFC should not be impeded unnecessarily. However, competition considerations must be weighed against other factors, including the SFC's various functions, duties and regulatory objectives under the SFO.
42. In the context of ATS, competition considerations may be outweighed by concerns about regulatory arbitrage and market fragmentation. For example, the products or services of an overseas exchange, CCP, or electronic platform may compete directly with products or services offered by a local exchange or CCP. In some cases, products traded on an overseas exchange/electronic platform and on a Hong Kong exchange may even be fungible. While such competition may increase efficiencies and investor choice, it may also cause market fragmentation, or raise concerns about market orderliness, efficiency and stability. The SFC may therefore impose specific conditions on the ATS authorization of an overseas exchange, CCP, or electronic platform to address such concerns. Conditions will be crafted with a view to achieving as fair and level a playing field as possible, while also taking into account the specific facts and circumstances of each case.

Operations of a stock market, futures market, or CCP

43. There may be circumstances where the provision of ATS may also constitute the operation of a "stock market", "futures market" or "clearing house"/CCP (as those terms are defined in Part 1 of Schedule 1 to the SFO). Persons intending to provide such ATS should take into account the following matters.
44. In the case of a "stock market", section 19(1)(a) of the SFO currently prohibits any person, other than the Stock Exchange of Hong Kong Limited (or its holding company or fellow subsidiary) from operating a stock market in Hong Kong.⁴ The term "stock market" does not include the office of an exchange participant of an REC, and so this restriction does not apply to Part V ATS providers who are also exchange participants. However, persons seeking authorization to provide ATS (i.e. applicants for Part III ATS authorization), and whose ATS are for the trading of securities, should consider whether their proposed services might contravene section 19(1)(a) of the SFO. They may also be required to provide a legal analysis supporting their view in this regard.
45. In the case of a "futures market", section 19(1)(b) of the SFO prohibits a person from operating a futures market unless the person is an REC. However, by virtue of section

⁴ The prohibition is reflected in section 19(1)(a) of the SFO. The terms "Stock Exchange Company" and "relevant recognized exchange controller" (both of which are used in section 19(1)(a)) are defined, respectively, in Part 1 of Schedule 1 to the SFO and section 18(1) of the SFO.

19(9) of the SFO, a person who is licensed or registered to provide ATS under Part V of the SFO, or authorized to provide ATS under Part III of the SFO, will not be regarded as contravening section 19(1)(b) if the person's licence, registration or authorization (as applicable) permits it to engage in activities that constitute operating a futures market. It follows that there are essentially two options available for persons seeking to operate a futures market in Hong Kong, i.e. they may either apply to become an REC or they may apply for authorization to provide ATS under Part III of the SFO.⁵

46. In the case of a "clearing house"/CCP, the SFO provides two options, i.e. persons seeking to operate a CCP here may either apply to become an RCH or apply for authorization to provide ATS under Part III of the SFO. A main difference between the RCH regime and the Part III ATS regime is that the former provides for a wide of insolvency override protections while the latter provides limited protection only⁶. Insolvency override protections are critical to the smooth operation of a CCP because they prevent transactions cleared through the CCP from being unravelled by the application of insolvency law in the event of a default by any of the members of the CCP or by the CCP itself. The insolvency override protections under the SFO are conferred under sections 45 to 54. These largely apply only to transactions and activities conducted through an RCH. Transactions and activities conducted through the facilities of an ATS provider are accorded limited protection under the SFO, and only if the ATS provider is a designated CCP. In view of this limitation, the SFC will generally expect CCPs based in Hong Kong to apply to become an RCH, rather than a Part III ATS provider. The ATS route will only be available to overseas CCPs that enjoy the necessary insolvency override protections under the laws of their home jurisdiction.

Domestic ATS

47. The SFC intends to take a pragmatic approach to the regulation of domestic ATS providers. The regulatory approach will be appropriately adapted and applied on a case-by-case basis, taking into account all relevant facts and circumstances. In line with paragraph 16 above, the level of regulation of a domestic ATS provider will be commensurate with the functions it performs and the risks it poses. Hence, reference will be made to, among other things, the nature and scope of the ATS, the market participants that might be affected by the provision of such ATS, and whether any systemic risks might arise. Generally, the greater the scope of the ATS and its

⁵ Although persons licensed or registered to provide Type 7 regulated activity may also operate a futures market, as discussed under paragraph 6(b) above, this regime is intended for intermediaries whose main business is to provide dealing services. As such, we do not view this as an alternative route for establishing a futures market.

⁶ The Securities and Futures (Amendment) Ordinance 2014 extended some (but not all) of the insolvency override protections to Part III ATS providers which are designated CCPs. This was achieved by expanding the definition of "market contract" to cover certain contracts entered into by a Part III ATS provider which is also a designated CCP. Designated CCPs are discussed in section F.

potential effect on market participants, and especially if systemic risks might arise, the more that will be expected of the domestic ATS provider. In appropriate cases, the level of regulation may be akin to that of an REC.

Exchange versus ATS

48. As noted above, a person wishing to operate an exchange-like platform may apply to become an REC or a Part III ATS provider. Under the SFO, there are clear and separate regimes for regulating RECs and Part III ATS providers. The SFC takes into account a range of factors when considering whether a prospective operator is more suited to being regulated as an REC or as a Part III ATS provider. These include, among other things, five major regulatory differences between the two regimes which the SFC has identified. These are set out below:

- (a) *Application process:* The application process for becoming an REC is much more rigorous in that it requires a public consultation, and consultation with the Financial Secretary (FS). This reflects the significance of an REC application, and the potential impact of its activities to the market and public as a whole.
- (b) *Ownership restrictions:* There are restrictions on the ownership or control of an REC, which do not apply in the case of a Part III ATS provider. In particular:
 - (i) Under section 59 of the SFO, the controller of an REC must (unless exempted under section 62) be recognized by the SFC (with the consent of the FS) as a recognized exchange controller (RXC), and will thereafter be regulated as an RXC under Part III of the SFO. The controller of an REC is essentially anyone who, either alone or with others, controls 35% or more of the voting power at meetings of the REC, or anyone in accordance with whose directions or instructions, the directors of the REC are accustomed or required to act. Changes in a controller's interest in an REC must also be approved by the SFC under section 60 of the SFO.
 - (ii) Minority controllers of an REC also require SFC approval. Under section 61 of the SFO, persons holding or controlling an interest of 5% or more in an REC must be approved by the SFC (after consultation with the FS). That section also requires that any increase in a minority controller's interest must be approved by the SFC (after consultation with the FS).
- (c) *Management restrictions:* The SFO also requires certain approvals in respect of the appointment of key personnel of an REC and the RXC that controls it. In particular:

- (i) Section 26 of the SFO requires that the chief executive of an REC must be approved by the SFC.
 - (ii) Section 70 of the SFO requires that the chief executive and chief operating officer of an RXC must be approved by the SFC.
 - (iii) Section 69 of the SFO requires that the chairman of an RXC must be approved by the Chief Executive of the Hong Kong Special Administrative Region.
- (d) *Immunity from civil liability:* The statutory immunity granted to an REC (under sections 22 and 380 of the SFO) is wider than that granted to a Part III ATS provider (under section 380 only). Essentially, an REC has immunity in respect of not only things done or omitted in the performance of functions under the SFO, but also things done or omitted in the performance of functions under the REC's rules. An ATS provider however only has immunity in respect of things done or omitted in the performance of functions under the SFO. In both cases however, the immunity is only from civil liability and not criminal liability.
- (e) *Other restrictions and obligations:* There are a number of other restrictions and obligations under the SFO which apply to RECs but not to Part III ATS providers. For example, RECs have greater disclosure powers, are subject to statutory duties, and the SFC may issue directions, restriction notices and suspension orders to them. Also, the current investor compensation regime in Hong Kong only covers products listed or traded on an REC, but not those traded through any ATS. Although these restrictions and obligations apply only to RECs, they can be extended to ATS providers by being imposed as conditions of their authorization. The SFC will consider all relevant facts and circumstances of each case before determining whether and which of these restrictions and obligations should be imposed as authorization conditions. A pragmatic approach will be taken in this regard, in line with that discussed under paragraph 16 above. The SFC will also invite the ATS provider to comment on proposed conditions before finalizing them.

Regulation of offers of investments under Part IV of the SFO

49. Under Part IV of the SFO, offers of investments may be subject to certain authorizations by the SFC. Specifically, section 103 of the SFO prohibits any person from issuing, or having in his possession for the purposes of issue, whether in Hong Kong or elsewhere, an advertisement, invitation or document which to his knowledge is or contains an invitation to the public to invest in, among other things, an interest in a collective investment scheme (CIS) or a structured product, unless the issue is authorized by the SFC under section 105(1) or one of the exemptions under section

103 applies (e.g. where the offer is made solely to professional investors as defined under Part 1 of Schedule 1 to the SFO).

50. While a Part III ATS authorization would permit an ATS provider to offer and market its trading or clearing services to persons in Hong Kong, any products traded in the markets operated by an ATS provider would still be subject to the offers of investments regime under Part IV of the SFO. A point to note is that although the Part IV regime includes certain exemptions in respect of listed products, these apply only in respect of products listed on a market operated by an REC, and would not therefore (for example) cover products listed on an overseas market.
51. An ATS provider should ensure that it complies with the offers of investments regime under Part IV of the SFO. In particular, if interests in a CIS and/or structured products are available through any ATS, the SFC will expect the provider of such ATS to take all appropriate and necessary measures to ensure that the ATS provider itself and its members ensure compliance with Part IV of the SFO. To this end, the ATS provider will be expected to put in place appropriate controls and safeguards, taking into account the particular design, structure and features of its ATS and the systems and facilities used to provide the ATS.

SFC levies

52. As mentioned in paragraph 16(b) above, the SFC endeavours to seek a fair and level playing field 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 securities or futures contracts traded on a stock or futures market operated by an REC, or on securities or futures contracts traded by means of ATS. Based on principles of fairness, cost recovery, and “user pays”, and considerations of whether the ATS is solely or primarily regulated by the SFC, the SFC will assess, on a case-by-case basis, the level of its resources devoted to regulation of the ATS and the nature and extent of the ATS business operations and consider whether a levy should be imposed.

Investor Compensation

53. Parts III and XII of the SFO provide for an investor compensation regime. The regime does not currently apply in respect of transactions conducted through any ATS. Depending on the operation of the ATS provider and the impact of its activities on the Hong Kong market, the SFC will assess whether legislative amendments should be introduced to extend the compensation regime so that it applies in respect of transactions conducted through any (or any particular) ATS.

E. APPLICATION REQUIREMENTS AND PROCEDURES FOR A PART III ATS AUTHORIZATION

54. The SFC notes that the nature, scope and impact of ATS may vary substantially from one ATS provider to the other. As noted under paragraph 16 above, the SFC will take a pragmatic approach to regulating the provision of ATS in Hong Kong, which will be adapted and applied on a case-by-case basis commensurate with the functions performed and risks posed by the ATS. To achieve this, it is necessary for the SFC to have a thorough understanding of the facilities and services proposed to be offered by prospective ATS providers, and to be kept informed of material changes thereafter. The application process will thus be a crucial first step in this process. The paragraphs below provide guidance on the specific application requirements for persons seeking a Part III ATS authorization, and in particular applicants who intend to offer facilities or services similar to those provided by exchanges, CCPs or electronic platforms. The SFC also encourages potential applicants to contact the SFC for a meeting to discuss their proposed services and facilities before submitting a formal application as this may facilitate the application process and help identify more specifically the information and documents needed.

Application requirements

55. An application for Part III ATS authorization should be submitted by the person intending to provide ATS (i.e. by the prospective ATS provider), and should be accompanied by the information and/or documents specified below.

- (a) Sufficient information and documents demonstrating:
- (i) why the applicant's proposed provision of the ATS may be regarded as being consistent with and promoting the principles set out under Section B above; and
 - (ii) how the ATS provider will ensure compliance with the core standards of practice set out in Section C of these Guidelines if its application for a Part III ATS authorization is granted.

The above should include, in the case of applicants that intend to provide CCP-like facilities or services and that have conducted an assessment (whether a self or third party assessment) on compliance with any international standards or best practices, a copy of the latest assessment report if it is not already publicly disclosed on its website.

- (b) In the case of applicants that intend to provide services for clearing OTC derivative transactions:

- (i) sufficient information and documents to demonstrate that they will be able to comply with the mandatory reporting obligations imposed on Part III ATS providers under the Securities and Futures (OTC Derivative Transactions—Reporting and Record Keeping Obligations) Rules (**Reporting Rules**); and
 - (ii) details of any arrangements for facilitating the reporting of OTC derivative transactions by its members/users or their clients to the Hong Kong Monetary Authority under the Reporting Rules (and whether by acting as their agent or otherwise).
- (c) Particulars of the applicant, including its name, its addresses in Hong Kong and elsewhere (if any), and contact details in Hong Kong and in its home jurisdiction (including the names and contact details of persons to be contacted in connection with the application).
- (d) Particulars of the directors and other persons involved in the management of the applicant, and of key employees that will be involved in the provision of ATS, including their names, biographies, qualifications and experience.
- (e) Information about the applicant's organizational structure and governance. This should include a description of the reporting lines and control functions, details of all substantial shareholders and, where a substantial shareholder is a corporation, details of the directors and substantial shareholders of that corporation.
- (f) The applicant's latest financial statements (or other financial information if no recent financial statements are available) and, in the case of an applicant that is a CCP, financial statements relating to any guarantee funds or similar arrangements if such funds or arrangements are accounted for separately.
- (g) A detailed description of the services and facilities for which a Part III ATS authorization is sought, and of any other businesses carried on or intended to be carried on by the applicant.
- (h) A detailed description of the system infrastructure to be used in providing ATS. This should include information on the hardware, software, network infrastructure and other technology, including backup and recovery arrangements, testing plans and business continuity plans, to be used in providing ATS, together with a schematic diagram of the system infrastructure which provides an overview of the transaction process flow.
- (i) Information about the types of products that may be traded or cleared through the ATS by members/users in Hong Kong, together with a detailed list of the

products and in the case of futures contracts/derivatives, their contract specifications, if applicable.

- (j) Criteria, requirements or rules governing access to the ATS. These should include:
 - (i) a description of the intended members/users of the ATS in Hong Kong;
 - (ii) the terms on which Hong Kong members/users will be allowed to access its markets/facilities through the ATS;
 - (iii) the class(es) of participants that a Hong Kong member/user may apply for;
 - (iv) the basis on which persons will be admitted or refused admission as members/users, and on which their membership/use may be suspended; and
 - (v) copies of related contractual documentation which members/users of the ATS in Hong Kong will enter into for using the ATS.
- (k) Copies of the rules, regulations, procedures, and other documentation governing the use of the ATS, and in the case of a CCP, these should include copies of its risk management policies and procedures, as well as its default rules and procedures.
- (l) Description of the fees and charges, and transaction-related taxes or duties applicable to Hong Kong members/users for using the ATS.
- (m) Description of the investor compensation arrangements (if any) applicable to Hong Kong members/users and/or investors.
- (n) Information to demonstrate to the SFC's reasonable satisfaction that appropriate levels of information disclosure and co-operation will be provided to the SFC for the purposes assisting the SFC in the performance of its functions under the SFO, including for the purposes of any supervision or investigation of activities or matters relating to the provision or use of the applicant's ATS in Hong Kong, and including information about particular transactions conducted through the ATS, particular ATS members/users, and their clients.

Fees

56. An application fee is payable on submitting an application for Part III ATS authorization. Successful applicants are thereafter required to pay an annual fee.

These fees are prescribed in Schedules 3 and 1, respectively, of the Securities and Futures (Fees) Rules.⁷ The application fee should be paid when the ATS application is submitted. The annual fee should be paid on the anniversary of the Part III ATS authorization. In both cases, fees paid are not refundable.

Other matters relating to the application process

57. *Information that may be taken into account:* By virtue of section 96 of the SFO, the SFC may, when considering an application for Part III ATS authorization, have regard to any information in its possession whether provided by the applicant or not. The SFC may also require the applicant to submit further information and particulars as reasonably required.
58. *Authorization and conditions:* If the SFC decides to authorize an applicant to provide ATS, it will notify the applicant in writing, and publish notice of such fact in the Government Gazette, as required by section 95(2) and (3) of the SFO. If the authorization is granted subject to conditions, these will be specified in the notice. Conditions imposed may be subsequently amended, added to or revoked. Applicants will be generally given an opportunity to comment on any proposed conditions, and their comments and concerns will be taken into account, before conditions are finalized. This applies in respect of both conditions proposed to be imposed at the time of authorization and any subsequent additions or amendments.
59. *Refusal of an authorization:* If the SFC is minded not to grant a Part III ATS authorization, it will, as required by section 95(4) of the SFO, inform the applicant of this and give it a reasonable opportunity to be heard. Specifically, the applicant will be informed of the SFC's concerns and reasons for being minded to refuse the application. The applicant will also be given an opportunity to address the SFC's concerns and to make any other representations as to why the application should not be refused. Any representations made will be taken into account before the SFC makes a final decision in respect of the application.

Withdrawal of authorizations

60. Under section 98 of the SFO, the SFC may withdraw a Part III ATS authorization if it is satisfied that it is appropriate to do so in the interest of the investing public or in the public interest. As required by section 98(4) of the SFO, the SFC will give the ATS provider an opportunity to be heard before withdrawing its authorization. Specifically, the ATS provider will be informed of the SFC's concerns and reasons for proposing to withdraw the authorization. The ATS provider will also be given an opportunity to address the SFC's concerns and to make any other representations as to why its authorization should not be withdrawn. Any representations made will be taken into

⁷ The application fee and annual fee are currently set at HK\$10,000 each.

account before a final decision is made. Where an authorization is withdrawn, notice of the fact of such withdrawal will be published in the Gazette, as required by section 98(5) of the SFO.

Appeals

61. The following decisions of the SFC concerning a Part III ATS authorization are “specified decisions” under Part 2 of Schedule 8 to the SFO, and may therefore be appealed against, under section 217 of the SFO, to the Securities and Futures Appeals Tribunal:

<u>SFO provision</u>	<u>SFC decision</u>
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

F. DESIGNATED CCPs

Applicants seeking CCP designation

62. Section 101C of the SFO mandates the clearing of certain OTC derivative transactions through a CCP that has been designated under section 101J(1) of the SFO (**designated CCP**). A prerequisite to becoming a designated CCP is that the CCP must be an RCH or a Part III ATS provider.
63. While there is no such limitation in the legislation, the SFC expects that overseas CCPs seeking to become designated CCPs will generally apply to become a Part III ATS provider rather than an RCH. The SFC also expects that such CCPs may wish to apply for ATS authorization and CCP designation at the same time. The SFC has no objection to CCPs submitting these applications simultaneously, i.e. there is no need for applicants to have successfully completed their ATS authorization process before submitting an application to become a designated CCP. However, because the CCP designation is conditional upon the applicant being an RCH or a Part III ATS provider, it follows that if the ATS authorization fails, the application for CCP designation will fail as well.
64. Applications for CCP designation should include the following further information:
- (a) Details of any jurisdictions in which the applicant carries on business as a CCP and is recognized (or, if applicable, exempted from having to be recognized) as a CCP through which transactions may be cleared for the

purposes of fulfilling any mandatory clearing requirements in force in that jurisdiction; and details of the regulator in each such jurisdiction that regulates its activities as a CCP.

- (b) The classes of OTC derivative transactions in respect of which the applicant is seeking to be designated, together with details of the applicant's experience and track record in clearing such transactions.
- (c) Sufficient information as may be required by the SFC to show that persons clearing OTC derivative transactions through its facilities will be able to do so in compliance with relevant requirements under the Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (**Clearing Rules**), and details of any arrangements to facilitate such compliance (e.g. notifications to members/users of any failure to clear transactions submitted for clearing, arrangements for clearing products during holidays and contingency situations, etc).
- (d) Such other information as the SFC may reasonably require.

More frequent reporting expected of designated CCPs

- 65. Persons designated as CCPs will generally be required to provide information and statistics on a more frequent basis than CCPs that are only authorized to provide ATS but not designated for the purposes of mandatory clearing, so as to enable the SFC to monitor their activities and performance as a designated CCP, including their ability to facilitate compliance with the Clearing Rules.

Fees

- 66. Similar to Part III ATS authorizations, an application fee is payable on submission of an application for CCP designation, and thereafter an annual fee is payable by successful applicants. The fees are prescribed in Schedules 3 and 1, respectively, of the Securities and Futures (Fees) Rules. The fees are, in each case, additional to the application fee and annual fee payable in respect of the Part III ATS authorization or application for such authorization.

Procedural matters relating to designation and designated CCPs

- 67. *Approval of an application for designation:* Where an application for CCP designation is approved, the notice of designation will generally specify: (i) the classes of OTC derivative transactions for which the designation is granted; (ii) the conditions of the designation (if any); and (iii) the time from when the designation is to take effect. Where an application is refused, the applicant will be informed in

writing of this, and of the reasons for the refusal. These matters are provided for in section 101J of the SFO and Part 4 of the Clearing Rules.

68. *Refusal of an application for designation:* Where the SFC is minded to refuse an application for CCP designation, it will, as required by section 101J(5) of the SFO, inform the applicant in writing of this and give it a reasonable opportunity to be heard (the process for which will be similar to that described under paragraph 59 above). Any representations received from the CCP will be taken into account before a final decision is made in respect of the application.
69. *Conditions of designation:* Conditions may be imposed when a CCP is designated, and these may be amended, added to or revoked subsequently as appropriate. The CCP will generally be given an opportunity to comment on any proposed conditions, and its comments and concerns will be taken into account before conditions are finalized.
70. *Revocation of designations:* A CCP designation may be revoked if: (i) it is appropriate to do so in the interests of the investing public or in the public interest; or (ii) if the CCP in question requests the revocation. In the case of (i), the revocation notice will set out the reasons for the revocation. As with refusals, and as required by section 101J(5) of the SFO, the SFC will give a designated CCP an opportunity to be heard (similar to that described in paragraph 60 above) before revoking its designation.
71. *Consequences of a revocation:* Transactions cleared through a CCP after its designation is revoked will not fulfil the mandatory clearing obligation under the Clearing Rules. As for transactions that were accepted for clearing by the CCP before the revocation, the SFC generally expects to leave it to the relevant transaction counterparties to decide whether these transactions should be withdrawn from, or left in, the CCP's system after the revocation. However, in extreme situations, the SFC may direct how such transactions should be handled. Any such directions will, as required under Part 4 of the Clearing Rules, be set out in the revocation notice.
72. *Appeals:* The following decisions relating to CCP designation are “specified decisions” under Part 2 of Schedule 8 to the SFO, and may therefore be appealed against, under section 217 of the SFO, to the Securities and Futures Appeals Tribunal:

<u>SFO provision</u>	<u>SFC decision</u>
section 101J(1)(b)	refusal to designate
section 101J(5)(a) to (c)	amendment or revocation of any condition, or imposition of any new condition
section 101J(5)(d)	revocation of a designation

Exercise of SFC's powers in respect of designated CCPs

73. A final point to highlight is that while decisions in respect of a Part III ATS authorizations are made entirely by the SFC, decisions in respect of a CCP designation (including whether a designation should be granted, whether it should be withdrawn, what conditions (if any) should be imposed, and whether any conditions should be amended or revoked) may only be made by the SFC with the Hong Kong Monetary Authority's consent and after consultation with the Financial Secretary.

G. EXAMPLES ILLUSTRATING HOW THE ATS GUIDELINES MAY BE APPLIED IN PRACTICE

74. This section discusses how the provisions of Part III of the SFO and the ATS Guidelines might be applied in practice. The ATS operations described below are hypothetical and used as illustrative examples to facilitate discussion. Ultimately, each case will be considered on its own merits and on the basis of its own facts and circumstances.

Example 1: An overseas person provides ATS from an overseas location to persons in Hong Kong either as an exchange, or a CCP via electronic facilities.

75. Section 95 of the SFO prohibits persons from providing ATS, or offering to provide ATS unless authorized, licensed, or registered to do so under Part III or Part V 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 to whom the person already provides any financial services, including ATS. Overseas persons intending to provide ATS to persons in Hong Kong should consider if their activities might breach section 95 of the SFO, even if though they are providing their services from outside Hong Kong.

Example 2: An overseas exchange, CCP or electronic platform providing similar services places electronic facilities in Hong Kong or offers direct or remote access rights to intermediaries or investors in Hong Kong via electronic facilities.

76. The SFC takes the view that such entities should apply for a Part III ATS authorization.

Example 3: 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.

77. The SFC would not normally regard persons providing telecommunications, software, or Internet services as providing ATS.

Example 4: 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 is confined to facilities for trading or clearing securities, futures contracts or OTC derivative transactions. Electronic facilities for trading in spot foreign currencies or goods and services that do not constitute securities or futures contracts or OTC derivatives transactions will not be caught by the ATS definition.

Example 5: 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. The provision of such electronic facilities will constitute providing ATS if the fixed income instruments constitute securities, futures contracts or OTC derivatives transactions. The level of regulation applied in respect of such facilities will be set by reference to the principles and core standards described in Sections B and C above. If the instruments fall within the definition of “securities”, questions may arise as to whether the activity also amounts to the operation of a stock market as discussed under paragraph 44 above. In such circumstances, the SFC will likely require the ATS provider to submit a legal analysis on why the proposed activities should not be regarded as constituting the operation of a stock market.

Example 6: An overseas person provides clearing and trading of OTC derivative transactions.

80. Overseas CCPs intending to provide services in Hong Kong for the clearing and settlement of OTC derivative transactions, or to market such services to persons in Hong Kong, should apply for a Part III ATS authorization in accordance with the procedures and requirements discussed under Section E above.
81. A Part III ATS authorization is not currently required if the overseas person is only providing, or marketing, services for the trading of OTC derivatives. This is because paragraphs (ab) and (ba) of the definition of ATS are not fully effective yet. However, once those provisions are fully effective, such persons will need to apply for a Part III ATS authorization – see also footnote 1 above.

Example 7: The operator of an overseas exchange or any platform providing similar services offers to provide trading access to intermediaries or investors in Hong Kong to trade CIS and/or structured products through its electronic facilities.

The operator of such exchange or platform will require a Part III ATS authorization. However, as the offering of CIS and structured products is subject to the offers of investments regime under Part IV of SFO, the SFC is unlikely to grant such ATS

authorization unless the operator is able to demonstrate that the provision of its facilities, and their use by its members, is in compliance with Part IV of the SFO.

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