



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

## **Consultation Paper Concerning the Regulation of Alternative Liquidity Pools**

27 February 2014



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## Foreword

The Securities and Futures Commission (**SFC**) invites market participants and interested parties to submit written comments on the issues discussed in this consultation paper, or to comment on related matters that may have a significant impact on those issues, **by not later than 25 April 2014**. Persons wishing to comment should provide details of any organisation whose views they represent. The questions raised for consideration in this consultation paper have been reproduced in **Appendix D** for ease of reference.

All submissions received before the expiry of the consultation period will be carefully considered, following which consultation conclusions will be published.

The names of respondents to this consultation paper and the contents of their submissions may be published on the SFC website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement in this consultation paper. If you do not want your name and/or submission to be published, please state this when you make your submission.

Written comments may be sent -

By mail to: Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

Re: Consultation Paper Concerning the Regulation of Alternative  
Liquidity Pools

By fax to: (852) 2501 0375

By on-line submission to: <http://www.sfc.hk>

By email to: [alpconsultation@sfc.hk](mailto:alpconsultation@sfc.hk)

Securities and Futures Commission  
Hong Kong

27 February 2014



## Personal information collection statement

1. This Personal Information Collection Statement is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. It sets out the purposes for which your Personal Data<sup>1</sup> will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (**PDPO**).

### Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes –
  - (a) to administer the relevant provisions<sup>2</sup> and codes and guidelines published pursuant to the powers vested in the SFC;
  - (b) in performing the SFC's statutory functions under the relevant provisions;
  - (c) for research and statistical purposes;
  - (d) for other purposes permitted by law.

### Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC during the consultation period or at its conclusion.

### Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submissions on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

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<sup>1</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

<sup>2</sup> Defined in Schedule 1 of the Securities and Futures Ordinance (Cap. 571) (SFO) to mean the provisions of the SFO and subsidiary legislation made under it; and the provisions of Parts II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate, directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares, etc.



## **Retention**

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

## **Enquiries**

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer  
Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.



## Consultation concerning the regulation of alternative liquidity pools

### Introduction

1. The evolution and continuous growth of electronic trading platforms for securities and other financial products has recently given rise to concern and debate among regulators, market participants and the investor community. As a result of rapid technological advancement, it has become possible for financial institutions to offer their traditional securities trading services in more innovative and efficient ways, including the facilitation of electronic order-matching and trade execution outside traditional venues such as stock exchanges. Furthermore, financial institutions are also able to take advantage of modern communication technology to facilitate their cross-border operations and to allow them to provide securities trading services in overseas markets.
2. One innovation in this area has been the development of the alternative liquidity pool (**ALP**). ALPs are also known by other names such as electronic “alternative trading systems” and, in Hong Kong, the operation of an ALP requires a broker-dealer operator to be licensed under the Securities and Futures Ordinance (**SFO**) to carry on the business of providing “automated trading services” (**ATS**). ALPs are also commonly known as “dark pools”. In this consultation paper, references to “ALPs” are intended to be references to electronic systems through which the crossing or matching of orders is conducted anonymously without any pre-trade transparency, including systems designed and developed in-house or by third party service providers. ALPs are operated by broker-dealers and allow buyers and sellers to cross or match listed securities outside traditional exchange operated stock markets, thereby creating anonymity and eliminating the pre-trade transparency that is central to exchange trading. In this consultation paper, an **ALP operator** means a licensed or registered person which operates an ALP.
3. It is generally recognized that market participants and investors (and more particularly institutional investors) can benefit from their trades being effected through ALPs. The advanced technology utilized by ALP operators can serve to expand sources of liquidity, reduce transaction costs and mitigate market impact when large orders are executed. Furthermore, ALPs often provide more flexible trading and execution mechanisms than those available on traditional exchanges. Anonymity is an example of this. Accordingly, ALPs can expand investors' options in choosing the trading venue that best suits their needs for particular transactions. While clearly it is potentially beneficial for institutional investors wishing to conduct large trades to have the option of conducting these through ALPs, the potential benefits to “retail” investors wishing to buy or sell relatively small numbers of securities would seem to be rather more open to question.
4. While acknowledging the benefits that ALPs can bring, some market observers have expressed concerns that the growth of ALPs could weaken the price discovery function that is typically provided by traditional stock exchanges and adversely affect the competitiveness of smaller broker-dealers.
5. Global regulators have also identified various potential issues to which the growth of ALPs might give rise under existing regulatory regimes. For example, ALP operators which use technology and new business models to deliver services in an innovative manner, might blur the line between the functions traditionally performed by exchanges and those performed by market intermediaries such as broker-dealers. By offering new combinations of services that do not fit neatly within existing regulatory models, ALP operators might well pose regulatory challenges and create uncertainty due to less clear delineation



between the functions performed by exchanges and those performed by market intermediaries.

6. In May 2011, the International Organization of Securities Commissions (IOSCO) published a final report, titled “Principles on Dark Liquidity”, which sets out principles for addressing the regulatory concerns arising from dark liquidity and which are designed to –
  - minimize the adverse impact of the increased use of dark pools and dark orders in transparent markets on the price discovery process, by generally promoting pre-trade and post-trade transparency and encouraging the priority of transparent orders;
  - mitigate the effect of any potential fragmentation of information and liquidity, by generally promoting pre-trade and post-trade transparency and the consolidation of such information;
  - help to ensure that regulators have access to adequate information to monitor the use of dark pools and dark orders for market monitoring/surveillance purposes and to enable an appropriate regulatory response to market developments; and
  - help to ensure that market participants have sufficient information so that they are able to understand the manner in which orders will be handled and executed.
7. Internationally, jurisdictions such as the United States (**US**), Canada, Australia and the European Union (**EU**) have introduced regulatory responses to alternative trading systems, including dark pools. For example, the European Commission announced in late 2010 a series of proposals to revise the Markets in Financial Instruments Directive (**MiFID**). These proposals consist of strengthening the existing regulation of organized trading platforms to ensure that all trading venues are required to observe the same transparency rules and that conflicts of interest are mitigated. In August 2013, the Australian Securities and Investments Commission (**ASIC**) released its market integrity rules on dark liquidity, which are designed to improve the transparency and integrity of crossing systems.
8. In Hong Kong, the concept of licensing those carrying on the business of providing ATS was first introduced when the SFO came into effect in 2003. It was recognized that individual ATS could operate very differently from each other, depending on accessibility, target investor group, product range, services provided, size of transactions, total trading volumes, etc. Accordingly, a flexible approach was adopted by which ATS, and those operating them, are regulated under Part III and Part V of the SFO.
9. Under the current regulatory regime, a corporation which is licensed under Part V of the SFO to carry on the business of dealing in securities (Type 1) and which intends to provide ATS, such as “dark” and “lit” pools and other types of alternative trading venues like odd-lot trading and pre-IPO trading platforms, is also required to be licensed under Part V to carry on the business of providing ATS (Type 7). Since an ALP is regarded as a type of ATS, ALP operators are generally required to hold licences permitting them to conduct both Type 1 and Type 7 regulated activity.
10. There were 25 corporations licensed for Type 7 regulated activity in Hong Kong as at 31 December 2013. Of these Type 7 licensed corporations, 16 are ALP operators. Unlike some other markets, the position in Hong Kong is that trading in ALPs represents only a small market share. The reported volume of trades executed in ALPs in Hong Kong currently accounts for approximately 2% of the total market turnover.
11. The current policy of the SFC is to impose conditions on the licences of ALP operators, pursuant to section 116(6) of the SFO -



- Restricting access to ALPs to institutional investors only.
  - Requiring ALP operators to provide information to the users of their ALPs concerning the manner in which their systems operate.
  - Concerning conflicts of interest arising out of both agency and proprietary orders being conducted on their ALPs.
  - Concerning the level of visibility of trade information that is granted to the staff of ALP operators.
  - Concerning internal controls governing trading and IT matters.
  - Concerning record keeping and reporting obligations.
12. Starting in October 2012, ALP operators, which are exchange participants of The Stock Exchange of Hong Kong Limited (**SEHK**), have been required under SEHK Rules to report and flag to SEHK all transactions conducted on their ALPs. Such reporting is required to be completed within one minute after trade execution.
13. In light of the evolving market in which ALPs operate, global regulatory concerns and responses to the emergence of ALPs, and the unsuitability of regulating ALP operators by imposing licensing conditions on their licences on a case by case basis, the SFC intends to refine and standardize the regulatory obligations imposed on all ALP operators licensed in Hong Kong. The SFC intends to do this by including in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) a uniform set of requirements with which all ALP operators will be obliged to comply. The SFC's proposals, as described in this consultation paper, deal with a range of issues relevant to the operation of ALPs, including, in particular, the following –
- Restricting user access to ALPs.
  - Enhancing the level of disclosure to users of ALPs.
  - Ensuring user order priority over the proprietary orders of ALP operators and their affiliates.
  - Restricting the level of visibility of trading information that is available to the staff of ALP operators.
  - Enhancing control, record keeping and reporting requirements.

### **Scope and applicability of the proposals**

14. In light of the lack of pre-trade transparency in ALPs and their impact on the price discovery function in the securities market, there is widespread and justified concern that ALPs, and those operating them, should be subjected to consistent, appropriate and effective levels of regulation. The proposals discussed in this consultation paper principally recommend the imposition of specific obligations on ALP operators. In addition, however, the proposals also recommend the imposition of some obligations on other licensed or registered persons which, on behalf of their clients, conduct transactions in ALPs operated by third parties.
15. The SFC proposes to incorporate into the Code of Conduct a new paragraph 19 and a new Schedule 8, which will extend the existing regulatory requirements under the Code of Conduct, but with specific reference to the operation of ALPs in Hong Kong. Drafts of the proposed paragraph 19 and Schedule 8 are annexed to this consultation paper as **Appendix A** and **Appendix B** respectively. In formulating the proposals referred to in this consultation paper, the SFC has paid close attention to overseas regulatory models governing the conduct of ALPs and, in particular, has considered recent developments in this area in comparable foreign jurisdictions. For reference purposes, a comparison table,





which in broad terms compares the SFC's current approach to the regulation of ALPs in Hong Kong and the approaches adopted in other jurisdictions, is annexed to this consultation paper as **Appendix C**.

16. It is noteworthy that the SFC issued its *Consultation Paper on the Regulation of Electronic Trading* in July 2012, in which it proposed regulatory requirements for licensed or registered persons conducting electronic trading, including internet trading, direct market access and algorithmic trading. The SFC's *Consultation Conclusions on the Regulation of Electronic Trading (Conclusions Report)*, which was published on 22 March 2013 following that consultation exercise, proposed the introduction of various measures including the following general requirements –
  - Management and supervision.
  - Adequacy of system.
  - Record keeping.
17. The Conclusions Report noted that the proposed regulatory measures would apply to the operators of ATS/ALPs to the extent that orders are transmitted to ATS/ALPs by their electronic trading systems, including via the internet. However, they would not apply to the operators of ATS/ALPs to the extent that these are merely trading platforms. Although ALPs also include the operation of different kinds of internalized matching processes and therefore raise different regulatory concerns, numerous licensed broker-dealers operate their ALPs while also providing electronic trading services. In addition, various general requirements are equally important and relevant to all licensed ALP operators. Accordingly, with a view to developing a more consistent and effective regulatory approach to the entire range of electronic trading and matching, the SFC proposes to introduce certain general requirements set out in the Conclusions Report in relation to ALPs. These are more particularly detailed in the following paragraphs.

### **Management and supervision (Code of Conduct – Paragraph 19.3 / Paragraphs 3 to 6 of Schedule 8)**

18. An ALP is typically an electronic system designed with pre-determined parameters to effect the automatic matching and crossing of orders sent to it. It is therefore important that an ALP operator has adequate resources to assign qualified and experienced staff or third party service providers to ensure the integrity of the design and operation of its ALP.
19. The SFC proposes that an ALP operator should effectively manage and adequately supervise the design, development, deployment and operation of the ALP it operates. Specifically, the ALP operator is expected to establish and implement written internal policies and procedures on 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 effectively manage the risk associated with the operation of the ALP.
20. For resources devoted to the business, the SFC proposes that an ALP operator should assign adequately qualified staff, expertise, technology and financial resources to the design, development, deployment and operation of its ALP.

### **Question**

**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?**

### **Access to ALPs**

#### **(Code of Conduct – Paragraph 19.4 / Paragraphs 7 and 8 of Schedule 8)**

21. Given that some ALPs have complex execution or order processing methodologies, the SFC is concerned that retail investors might find it difficult to understand the operation of, and the risks associated with, these crossing networks. Lack of understanding by retail investors, as well as the opaqueness and potential conflicts of interest inherent in these ALPs, might well place this group at greater risk than more sophisticated investors. One of the SFC's primary concerns is whether ALP operators can properly and sufficiently inform their retail clients concerning the operation, risks and procedures associated with trading in their ALPs. Of equal concern, is the issue of whether adequate internal control measures can be put in place to ensure that retail orders, which are typically smaller than the orders of institutional investors, are transacted fairly. A factor that is commonly advanced by ALP operators to justify the utility of their ALPs, and to attract users, is the promise of "price improvement". It is price improvement which is most likely to attract retail investors. From the perspective of a retail investor, this will mean that he will be expecting his transactions to be conducted in an ALP at prices that are better than exchange prices.
22. The SFC has the following concerns:
- (a) as will be discussed in paragraphs 29 to 32, the SFC proposes that transactions in listed or traded securities may be conducted in ALPs at any time. If a transaction involving securities listed or traded on SEHK is effected in an ALP outside SEHK trading hours, it will not be possible for the ALP operator to deliver genuine price improvement in the sense that a retail investor will be anticipating (as described in the preceding paragraph); and
  - (b) even if a transaction is conducted in an ALP during SEHK trading hours, the process of ascertaining whether price improvement has been achieved is likely to be difficult and beyond the ability of most retail investors. This being so, the SFC believes that retail investors would be at risk of not benefitting from the price improvement that they are expecting and of not being able to readily ascertain this.

The SFC considers risk factors to be less an issue of concern for institutional investors because they are more sophisticated and have more influence, they are more likely to be able to recognize and tolerate risk, and because factors other than price improvement (eg, anonymity and mitigating market impact) are more likely to influence their wish to conduct transactions in ALPs than they are to influence retail investors.



23. Adequate understanding of how ALPs operate, and in particular how orders are handled and matched in an ALP, is essential to promote investor confidence and to reduce the potential for trading malpractice. Lack of information or understanding concerning the operations of an ALP may result in market participants, and more particularly retail investors, making uninformed decisions regarding whether, or how, to trade in an ALP. This could undermine confidence in the operation, efficiency and integrity of the market.
24. Accordingly, there is a need to assess the overall risks and benefits before deciding whether all investors should have access to trading in ALPs. In support of the position that access to ALPs should be unrestricted, there is a view that the benefits which accrue to investors from trading in ALPs should be available to all investors and that, in the interest of fairness, retail investors should not be excluded. In major overseas markets, notably the US, EU, Australia and Canada, there is no specific prohibition on retail participation in alternative trading venues, including ALPs. The SFC is not currently convinced that this model is right for Hong Kong and initially prefers to adopt a cautious approach, by specifically excluding retail participation in ALPs. It is noteworthy that in Canada, for example, there are restrictions on the size of orders that may be transacted in ALPs, apparently in an attempt to minimize retail participation. In Australia, ASIC is keeping the issue of imposing minimum order restrictions under consideration while it assesses the impact of the “meaningful price improvement rule”. This was imposed in 2013 with the objective that it would cause smaller orders to be transacted in the lit markets rather than in ALPs.
25. While the effects of these measures remain unclear, the SFC does not currently favour their implementation in Hong Kong. The SFC views Hong Kong as being different from most other jurisdictions in that we have significant retail participation in stock market trading (24%), and believes that this active retail segment requires protection from the risks mentioned in the preceding paragraphs. While the effects of the measures adopted in other jurisdictions, and those proposed for Hong Kong, remain unclear, the SFC considers that a cautious approach to retail participation in ALPs is required. If the objective is to restrict such participation, then it is preferable to specifically address this issue rather than to introduce other measures which might have this effect, but which might also give rise to other complications. For example, introducing minimum sized orders is challenging from a definitional perspective and also from the perspective of striking the correct balance when setting the minimum level. Restrictions of this type might have an effect on liquidity levels, thereby affecting the viability of ALPs in Hong Kong. They might also have an effect on the practice of splitting large orders into multiple smaller orders, which might be prohibited if minimum order size restrictions were to be imposed.
26. After carefully balancing the relevant considerations, the SFC proposes, at least at this stage, that only institutional investors should be allowed access to ALPs. The expression “institutional investor” is defined in draft paragraph 19.2 of the Code of Conduct. The SFC considers that while the benefits offered by ALPs, such as anonymity and reducing the impact on the market of large orders, can be viewed as justifying the access of institutional investors to ALPs, these factors are much less relevant to, and compelling in support of, allowing retail participation. Combined with the other factors already highlighted, and in particular the SFC’s doubts as to whether ALPs can consistently be relied upon to deliver genuine price improvement to retail investors, the SFC prefers to restrict access to ALPs to institutional investors only. The SFC does not rule out the future possibility of retail investors being permitted to become users of ALPs. This might be possible by treating retail and institutional investors differently. For example, retail participation in ALPs might be restricted to transactions in listed or traded securities and only during exchange trading



hours. This, combined with a meaningful price improvement requirement resembling that which is in place in Australia, might result in an ALP operator being obliged to ensure that the orders of retail investors are transacted in the lit markets unless genuine price improvement can be achieved in the event of a transaction being effected in an ALP.

27. The SFC recognizes that behind an institutional investor conducting transactions in an ALP, there might well be retail clients for whom the institutional investor is acting. The SFC proposes to address this by imposing an obligation on ALP operators to **ensure** that their clients and the clients of their group companies do not conduct transactions in ALPs unless they are institutional investors. The SFC is aware that some ALP operators consider this obligation to be unnecessarily onerous. While recognizing that this obligation might be inconvenient, the SFC believes that it can be met by ALP operators, with the active assistance of their group companies. Moreover, the SFC considers this obligation to be essential in order to prevent ALP operators from attempting to circumvent the spirit of the proposed user restrictions by the positioning of a group company between the ALP operator and the person ultimately responsible for the placing of an order and then treating the group company as its client and turning a blind eye to the identity of the person ultimately responsible for the order.
28. In recognition that it is more difficult for an ALP operator to secure the same level of information from an intermediary that is not a group company, the SFC proposes that, in those circumstances, the same obligation to **ensure** that the person ultimately responsible for initiating an order on an ALP should not apply to the ALP operator. However, the ALP operator should still be obliged to act reasonably in the circumstances and should have an ongoing obligation to take reasonable steps to prevent transactions from being conducted on its ALP other than those of, or originated by, institutional investors. The SFC also proposes a new paragraph 19.4(b) of the Code of Conduct requiring that persons licensed or registered under the SFO may only route or relay orders to ALPs that are initiated or originated by institutional investors.

### **Questions**

- 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?*
- 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?*
- 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?*



## **Operation of ALPs (Code of Conduct – Paragraph 19.5)**

29. When considering the parameters within which ALPs should be permitted to operate, it is necessary to address the nature of the transactions that may be conducted in them. More specifically, consideration must be given to –
- (a) whether transactions involving all types of exchange listed or traded securities, including funds and stocks, should be permitted in ALPs, or whether these should be restricted to transactions involving securities listed or traded on SEHK; and
  - (b) the hours during which ALPs should be permitted to operate.
30. The SFC's current policy, is to restrict the transactions that may be conducted in ALPs to those involving securities which are listed on SEHK, and to restrict the hours of operation of ALPs to the same periods that trading is conducted on SEHK. These particular licensing conditions, which the SFC has more recently been imposing on newly licensed ALP operators, do not currently apply to some Hong Kong ALP operators which were licensed some years ago. The SFC understands that although a significant majority of the transactions that are currently conducted in ALPs in Hong Kong involve securities that are listed on SEHK, some of the longer licensed ALP operators, which are not restricted from doing so by the conditions imposed on their licences, allow some transactions to be conducted on their ALPs involving securities that are listed or traded on overseas markets. The imposition of a common set of requirements on all ALP operators in Hong Kong will address this inconsistency. The issue for determination is whether the SFC's current policy of restricting the transactions that may be conducted in ALPs, to those involving securities which are listed on SEHK, should be preserved, or whether there should be some relaxation in this area.
31. The SFC favours an adjustment to its current policy to bring the regulation of ALPs in Hong Kong into line with other significant financial centres by permitting transactions to be conducted in ALPs in Hong Kong involving different types of securities, irrespective of whether they are listed or traded on SEHK or on other overseas markets. Accordingly, the SFC proposes that the regulatory regime governing ALPs in Hong Kong be brought generally into line with those existing in other comparable markets by allowing transactions in securities listed or traded in Hong Kong and elsewhere to be conducted in ALPs in Hong Kong. In reaching this view, the SFC has been influenced by the fact that it proposes to restrict access to Hong Kong ALPs to institutional investors who, the SFC believes, should have the knowledge and sophistication required to conduct this broader range of transactions.
32. In relation to the hours when transactions may be conducted in ALPs, the SFC is also inclined to relax its current position and to no longer impose the restriction that transactions must only be conducted during the same periods that trading is conducted on SEHK. This would also bring Hong Kong into line with other major jurisdictions. There are two principal reasons for allowing this change. First, the existing restriction on the hours of operation of ALPs would become impracticable in the event that transactions in all listed or traded securities, irrespective of where they are listed or traded, are permitted in ALPs operating in Hong Kong. Secondly, allowing transactions in securities that are traded on SEHK to be effected outside SEHK trading hours would merely recognize and sanction the practice that has long existed, albeit without the involvement of electronic crossing or matching



systems, of transactions being entered into after normal trading hours and reported to SEHK the following day.

### **Questions**

- 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?*
- 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?*

### **Order priority (Code of Conduct – Paragraph 19.6)**

33. An issue of some concern in relation to ALPs is whether ALP operators should be permitted to allow their proprietary order flows to trade in their ALPs alongside the orders of their clients and, if so, the implications in relation to order priority. This issue has led to debate in Europe in the latest MiFID review, with concerns being expressed over potential conflicts of interest and the possibility of the operators of trading venues of this type having unfair access to trade information. The European Commission, in the proposed draft law under MiFID II, is calling for a prohibition to be imposed on proprietary orders being conducted in these trading venues.
34. A majority of the ALP operators in Hong Kong allow their proprietary order flows to trade in their ALPs and have assured the SFC that their proprietary traders do not have access to information concerning agency order flows. Notwithstanding such assurances, the SFC is of the view that there is good reason to provide clients with some protection within the context of ALPs and therefore considers that their orders should have priority over proprietary orders. The SFC recognizes that client facilitation and proprietary orders are often intertwined and that it can be difficult for regulators to differentiate between the two in any particular case. In view of this, the SFC proposes that ALP operators be obliged to ensure that the orders of the users of their ALPs, other than orders which are for –
- (a) the account of the ALP operator trading as principal;
  - (b) the account of any user of the ALP, which is a company within the same group of companies as the ALP operator, trading as principal;
  - (c) any account in which the ALP operator, or any user of the ALP which is a company within the same group of companies as the ALP operator, has an interest; or
  - (d) the account of any employee or agent of the ALP operator or of any user of the ALP which is a company within the same group of companies as the ALP operator,



have priority over the orders referred to in the preceding sub-paragraphs (a) to (d) (**proprietary orders**). For the avoidance of doubt, the SFC further proposes that client facilitation orders are to be considered as proprietary orders.

35. In a situation where an ALP operator receives an order from a user of its ALP and a proprietary order for the same securities, the SFC proposes that the user order should have priority over the proprietary order whenever the user order and the proprietary order are being transacted in the ALP at the same price, irrespective of when these orders were received by the ALP operator.

### **Question**

**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? If not, why not?*

### **Information for users (Code of Conduct – Paragraph 19.7 / Paragraphs 9 to 12 of Schedule 8)**

36. In view of the different crossing methodologies and operational arrangements of different ALPs, the SFC considers it important for the users of each ALP to be properly informed as to the manner in which the ALP operates, and any risks associated with its operations, before they may place any order to be transacted in the ALP.
37. Major overseas markets have either adopted, or proposed, requirements for their alternative trading venue operators to publish on their websites or inform their users / clients of the operation and risks of trading in such venues. In Australia, ASIC has also required alternative trading venue operators, as from November 2013, to give their users / clients the choice to opt out of participation in their trading venues to allow more flexibility for users / clients to exercise choice as to the manner in which their orders are executed.
38. The SFC proposes that ALP operators should, in relation to the provision of ALP services, prepare and publish on their websites comprehensive and accurate guidelines concerning their ALPs (**ALP Guidelines**), which must properly and fairly provide guidance to the users of their ALPs concerning their operation, including details relating to –
- (a) trading and operational matters;
  - (b) user restrictions;
  - (c) user priority, order routing and execution methodology;
  - (d) transaction pricing;
  - (e) order cancellation;
  - (f) the internal control procedures that have been put in place to ensure the fair and orderly functioning of the ALP and to address potential conflict of interest issues;
  - (g) the potential risks associated with transactions conducted in its ALP in respect of which the users of the ALP should reasonably be made aware;
  - (h) the transaction of proprietary orders in the ALP;
  - (i) whether the orders of different users of the ALP may be aggregated; and



- (j) the identity of each member of the staff of the ALP operator (by title and department) who is permitted access to trading information concerning orders placed, and transactions conducted, in the ALP and the reasons for such access being permitted.
39. Additionally, the SFC considers that each ALP operator should ensure that its ALP Guidelines remain comprehensive, accurate and current and must, as soon as reasonably practicable after any revision of its ALP Guidelines, publish the revised or updated ALP Guidelines on its website and circulate them to the users of its ALP.
40. The SFC is of the view that in order to ensure that all ALP users are aware of the information contained in the ALP Guidelines relevant to them, the ALP operator in question should bring its ALP Guidelines to the attention of each prospective user of its ALP, and obtain formal acknowledgements from it that the ALP Guidelines have been brought to its attention and that it consents to its orders being transacted in the ALP. Only after these requirements have been met, should ALP operators be permitted to allow the orders of a user to be transacted in its ALP.
41. The SFC further proposes that each ALP operator be required to provide a copy of its ALP Guidelines, and any subsequent revision of them, to the SFC forthwith upon their publication on the ALP operator's website.
42. The SFC takes the view that it is essential to ensure that investors are properly informed of the features of an ALP before deciding to use any ALP service. As many intermediaries route the agency orders of their clients to ALPs that are operated by third party ALP operators, the SFC also proposes to require licensed or registered persons intending to route such orders, to ensure that their clients have formally acknowledged that the ALP Guidelines have been brought to their attention and that they consent to their orders being transacted on the ALP, before their orders may be routed to the ALP.

## **Questions**

- 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? If not, why not?**
- 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?**





## **Adequacy of system (Code of Conduct – Paragraph 19.8 / Paragraphs 13 to 20 of Schedule 8)**

43. As mentioned in paragraph 17, numerous ALP operators in Hong Kong also provide electronic trading services to their clients. In some cases, their ALPs and electronic trading services rely on the same or a related infrastructure system. Logically, this gives rise to a need for the same general requirements to be met, in each case, concerning matters of system adequacy, including system reliability, security and capacity, and contingency measures, as are proposed in the Conclusions Report. The SFC considers that it is appropriate for all ALP operators to be obliged to meet these same general requirements in the interest of ensuring the integrity of their ALPs.
44. In addition, due to the nature of ALPs, which involve internalized matching / crossing processes, and the fact that information concerning orders sent to an ALP is not displayed for public viewing before their execution, the SFC considers that ALP operators should have controls in place to ensure fair and orderly trading in their ALPs. The SFC is of the view that this can be assisted by ALP operators being required to restrict access to trading information in their ALPs to staff members strictly as necessary to enable their ALPs to operate satisfactorily and efficiently, and to prohibit those involved in the placing of proprietary orders in an ALP from having access to the trading information in the ALP.

### System controls

45. The SFC further considers that ALP operators should put in place control measures to enable them, where necessary, to immediately prevent transactions from being conducted in their ALPs.

### System reliability

46. Given that the reliability of ALPs is vital, the SFC believes that it is necessary for ALP operators to take appropriate steps to ensure that their ALPs operate properly. The SFC considers regular testing to be a critical part of evaluating and maintaining the reliability of an ALP. It is therefore proposed that ALP operators should be obliged to ensure that their ALPs, and any modifications to them, are adequately tested before deployment and that they are regularly reviewed to ensure optimal reliability. It is further proposed that ALP operators be required to promptly report to the SFC any service interruption or other significant issues of concern relating to their ALPs.

### System security

47. The SFC proposes that ALP operators must employ adequate and appropriate security controls to protect their ALPs from being compromised or abused. At a minimum, the security controls should include –
- (a) reliable techniques to ensure that access to an ALP is restricted only to persons whose access 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, or security breach or attack; and
- (d) appropriate measures to raise the awareness of an ALP operator's staff concerning the importance of security and the strict observance of security in connection with the ALP.

48. Where an ALP is developed by a third party vendor, the operator should make arrangements with the service provider to ensure that all applicable security requirements are met, for instance, with respect to the protection of the confidentiality and integrity of information, and the prevention and detection of unauthorized intrusion, or any security breach or attack.

#### System capacity

49. Insufficient capacity is often a cause of system delay or failure. To prevent this, the SFC proposes that ALP operators should ensure that –
- (a) the usage capacity of their ALPs is regularly monitored and appropriate capacity planning is conducted. As part of the capacity planning, ALP operators should determine, monitor and maintain the required level of spare capacity;
  - (b) the capacity of their ALPs is regularly stress tested to establish system behaviour under different simulated market conditions, with the findings of the stress tests and any actions taken to address those findings being carefully documented;
  - (c) their ALPs have sufficient capacity to handle any foreseeable increase in business volume and market turnover; and
  - (d) they have in place contingency arrangements, the details of which have been communicated to the users of their ALPs:
    - (i) to facilitate the handling of orders when the capacity of their ALPs is exceeded; and
    - (ii) by which alternative means of executing orders are available and offered to the users of their ALPs.

#### Information security

50. Information of transactions conducted in ALPs is, by design, not displayed for public viewing before execution. In order to ensure fair and orderly trading in ALPs which do not provide trading information for public viewing, it is important to strictly limit access to such information. The SFC proposes that an ALP operator should –
- (a) only permit members of its staff to have access to trading information concerning orders placed, or transactions conducted, on its ALP and only to the extent necessary to enable the ALP to operate satisfactorily and efficiently, and at all times keep the SFC 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 had 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 its ALP, other than confirmation of the eventual outcome of the order.

#### Contingencies

51. To ensure adequate contingency measures are in place for ALPs, the SFC proposes that an ALP operator should establish a written contingency plan to cope with emergencies and disruptions related to the operation of its ALP. At a minimum, the contingency plan should include –
- (a) a suitable backup facility which will enable the ALP operator to operate its 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.

#### Questions

**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?**

**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?**

**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?**



## **Record keeping (Code of Conduct – Paragraph 19.9 / Paragraphs 21 to 23 of Schedule 8)**

52. General requirements governing the keeping of records are set out in the Securities and Futures (Keeping of Records) Rules. The SFC proposes to build on these general requirements by making more specifically clear the types of records that should be kept by ALP operators.
53. The objectives of these proposals are to ensure that –
- (a) the transaction and system activities of all ALPs are traceable for risk management and compliance purposes;
  - (b) there is readily available information to explain the design, development and risk management controls of an ALP should there be regulatory concerns; and
  - (c) relevant records and documents are retained in relation to all transactions conducted in ALPs.
54. The SFC proposes that an ALP operator should keep proper records concerning the design, development, deployment and operation of its ALP. The records in question are as follows –
- (a) comprehensive documentation of the design and development of the ALP, including any testing, reviews, modifications, upgrades or rectifications of the ALP; and
  - (b) comprehensive documentation of the risk management controls of the ALP.
- An ALP operator should retain this documentation for a period of not less than two years after the ALP ceases to operate.
55. The SFC further proposes that an ALP operator should keep proper records concerning all transactions conducted in its ALP, including details of authorized traders (ie, individuals authorized by the users of an ALP to place orders into the ALP on their behalf). More particularly, the SFC proposes that an ALP operator should –
- (a) keep 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 SFC 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) keep 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 SFC 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.

## **Questions**

**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?**

**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?**

**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?**

## **Risk management**

### **(Code of Conduct – Paragraph 19.10 / Paragraphs 24 to 27 of Schedule 8)**

56. There are risks associated with the operation of ALPs, of orders being erroneously crossed or of transactions being improperly concluded. These types of occurrences are perhaps more likely in the case of electronic crossing systems offering no pre-trade transparency and could disrupt the fair and orderly operation of the market and be potentially damaging to the integrity of the market. The SFC therefore proposes that an ALP operator should have measures in place to ensure that its ALP operates in a fair and orderly manner.



57. The SFC proposes that an ALP operator should ensure that it has effective controls to monitor and prevent the crossing of orders in its ALP which may be erroneous, interfere with the operation of a fair and orderly market, or be in breach of any legal or regulatory obligations.
58. The SFC further proposes that an ALP operator should conduct regular post-trade reviews of transactions conducted in its ALP to identify any suspicious market manipulative or abusive activities, any market events or system deficiencies, such as unintended impact on the market, which call for further risk control measures, and any breaches, whether actual or potential, of any requirements relating to fair and orderly trading in its ALP or which might constitute market misconduct.
59. Upon becoming aware of any breach, whether actual or potential, of any legal or regulatory obligations referred to in paragraph 57 or any requirement referred to in paragraph 58, an ALP operator should notify the SFC of the matter and provide the SFC with such additional assistance in connection therewith as it might request.
60. With respect to suspected market manipulative or abusive trading activities, it is proposed that an ALP operator should be required to take immediate steps to prevent these activities from continuing.

### **Question**

**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?*

### **Reporting and notification obligations (Code of Conduct – Paragraph 19.11 / Paragraphs 28 and 29 of Schedule 8)**

#### Reporting obligations

61. Since October 2012, ALP operators have been required, under SEHK Rules, to report to SEHK all transactions conducted in their ALPs. Such reporting is required to be completed within one minute after trade execution. The SFC supports this requirement and considers that ALP operators should have additional reporting obligations to the users of their ALPs and to the SFC. The SFC therefore proposes that an ALP operator should have appropriate arrangements in place to ensure that –
  - (a) transactions conducted in its ALP are reported to SEHK 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 an 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 in the ALP; and



- (d) it provides the SFC 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 SFC.

#### Notification obligations

62. To assist the SFC in monitoring ALP operations, the SFC proposes that an ALP operator should –
- (a) notify the SFC of any proposed change to the following which might affect the operation of its ALP or the users of its ALP, and provide the SFC 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 SFC of any breach of relevant regulatory obligations or the ALP Guidelines forthwith upon its occurrence;
  - (c) notify the SFC 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 SFC with any updated review report concerning its ALP forthwith upon it becoming available.

#### **Question**

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

#### **Conclusion**

63. In the quest to achieve better or most efficient execution for securities trading, investors and market intermediaries have long explored various means, including the use of trading venues outside exchanges. In recent years, the rise of electronic alternative trading venues has challenged the long established dominant position of stock exchanges. In the US and EU, these trading venues account for a significant percentage of daily trading volumes. In Asia, however, these developments have not gathered the same pace, with some Asian exchanges, including SEHK, enjoying a monopoly status (actual or de facto) in their home markets. As the international debate concerning issues arising from the spread of alternative trading venues continues, Hong Kong, as an international financial centre, cannot ignore these developments. Accordingly, Hong Kong must examine and reflect



upon its existing regulatory model and must, to the extent that this is appropriate, adopt an accommodative approach towards innovation in this area.

64. It is important, in Hong Kong, to strike the right balance between market development, market integrity and investor protection. In an effort to achieve this, the SFC seeks public comments concerning the proposals discussed in this consultation paper, with the objective, in due course, of implementing suitable regulatory responses to the rise of alternative trading venues. Such responses will need to be effective and proportionate in achieving a suitably regulated market in which there is an appropriate balance between benefiting and protecting investors, on the one hand, and, on the other, introducing changes that are not unnecessarily onerous from the perspective of market intermediaries wishing to operate alternative trading venues. The SFC hopes that this public consultation will result in this objective being achieved.





## Appendix A

### Draft 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.

- (g) “user” means an institutional investor whose orders are placed into or whose transactions are conducted in an ALP, and includes any institutional 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 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 an institutional 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 routing any order to an ALP on behalf of a client, 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 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.

#### **19.9 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.

#### **19.10 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.

#### **19.11 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 and the Commission.
- (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 B

### Draft 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 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 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 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) user priority, order routing and execution methodology;
  - (d) transaction pricing;
  - (e) order cancellation;
  - (f) 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) 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) the transaction of proprietary orders in its ALP;
  - (i) whether the orders of different users of its ALP may be aggregated; and
  - (j) 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. 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. 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. 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. 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. 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. 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. 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. 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. 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. 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. An ALP operator should retain the documentation referred to in paragraph 21(a) and (b) for a period of not less than two years after the ALP ceases to operate.
23. 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. 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. 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. Forthwith, upon becoming aware of any breach, whether actual or potential, of any legal or regulatory obligation referred to in paragraph 24(c) or any requirement referred to in paragraph 25(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. 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. 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. 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.



**Table summarising global approaches to the regulation of alternative trading systems <sup>1</sup>**

	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
<b>Registration/ Licensing requirement <sup>3</sup></b>	Yes	Yes	Yes	Yes	Yes	Yes
<b>Regulatory requirements</b> 1. Restricted access for retail investors	Yes Only “institutional investors” are permitted access to dark pools.	No	No	No However, the imposition of the “meaningful price improvement rule” by ASIC appears to have caused a decline in dark liquidity and to have increased the average size of trades in dark pools.	No However, there is a minimum size requirement for dark pool orders.	Yes There is a minimum threshold for crossed trades on the Singapore Exchange (SGX).

<sup>1</sup> The table contains general summaries of the requirements imposed in relation to the operation of alternative trading systems in the specified jurisdictions. “Dark pools” are a type of alternative trading system.

<sup>2</sup> The regulatory requirements specified in the “Hong Kong” column reflect the requirements that have most recently been imposed by the SFC on corporations that have been granted licences permitting them to operate dark pools.

<sup>3</sup> In the US, dark pool operators can be registered as national securities exchanges, or registered as broker-dealers and required to comply with additional regulatory requirements. Broker-dealers are also required to be members of the Financial Industry Regulatory Authority (FINRA).  
 In the EU, dark pool operators can be investment firms or regulated markets. They may operate as multilateral trading facilities (MTF) in some cases. They may also fall under a new category of trading venue known as an “organised trading facility” (OTF) under the revised Markets in Financial Instruments Directive (MiFID II), the implementation of which is expected by 2015.  
 In Canada, dark pools are generally regulated as alternative trading systems, which are a type of marketplace as defined under National Instrument 21-101 *Marketplace Operation*.  
 In Australia, dark pool operators are required to hold an Australian Financial Services Licence. All dark pool operators in Australia are participants in licensed markets, making them subject to the market integrity rules.  
 In Singapore, dark pool operators are generally regulated as recognised market operators.  
 In Hong Kong, dark pool operators are required to hold Type 1 (dealing in securities) / Type 2 (dealing in futures contracts) and Type 7 (providing automated trading services) licences.



	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
2. Trading and hours of operation						
(a) Trading hours restricted to coincide with exchange trading hours	Yes	No	No	No Trading outside normal business hours is permitted in certain prescribed circumstances.	No	No
(b) Restriction on trading securities listed/traded on foreign markets	Yes	No	No An investment firm/market operator operating an MTF or OTF has to establish rules stipulating the criteria by which the financial instruments that can be traded under its system are determined.	No	No Trading limited to exchange traded securities, corporate debt securities, government debt securities and foreign exchange-traded securities.	No



	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
3. Priority of “client” over “proprietary” orders	Yes	Yes Alternative Trading System (US ATS) operators, also being broker-dealers, are subject to FINRA Rules. Under FINRA Rules, there is a prohibition against trading ahead of customer orders, subject to a number of exceptions such as large order and institution account exceptions, no knowledge exception and riskless principal exception.	No <ul style="list-style-type: none"> <li>Under MiFID II, an investment firm/market operator operating an MTF is required to have arrangements to identify clearly, and manage, the potential adverse consequences of any conflict of interest.</li> <li>An investment firm/market operator operating an OTF has to establish arrangements preventing execution of client orders in an OTF against proprietary capital of the investment firm/market</li> </ul>	No ASIC requires market participants to deal with their clients fairly and in due turn.	No A marketplace is only required to establish and maintain policies/procedures that identify and manage any conflicts of interest arising from the operation of the marketplace. Such policies should take into account the use of the marketplace to trade against client order flows.	No



	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
			operator operating the OTF.			
4. Information to users	Yes Dark pool operators are required to publish on their websites, user Guidelines concerning the operation of their dark pools. The Guidelines include details such as trading and operational matters, user restrictions and user priority.	Yes US ATS operators must file Form ATS to the Securities and Exchange Commission (SEC) (prior to commencing operation as a US ATS operator), including a copy of the subscriber's manual.	Yes Appropriate information should be provided to clients or potential clients concerning the services, execution venues, costs and associated charges.	Yes Crossing system operators are required to publicly disclose information on their websites concerning their crossing systems, such as the identity of the operator, types of financial products traded and access criteria.	Yes A marketplace must publicly disclose on its website information of its operation/service. Information such as fees charged, order types, access requirements, how orders are entered, interacted and executed, and policies to manage/identify any conflicts of interest.	Yes Recognised market operators are required to publish (or provide upon request) information concerning their services, products and fees.



	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
5. Consent from users prior to their orders being transacted	Yes Dark pool operators have to ensure, prior to the first order being placed by a user, that the user has provided it with a formal consent to his orders being transacted in the dark pool.	No	No	No Crossing system operators must permit a user to opt out of having his orders sent to the crossing system.	No	No
6. Trading controls	Yes Dark pool operators are required to establish a trading methodology that facilitates fair and orderly trading in their dark pools and ensure compliance with all relevant legal and regulatory obligations.	Yes US ATS operators are required to establish reasonable current and future capacity estimates, conduct periodic capacity stress tests of critical systems and establish adequate contingency and disaster recovery plans. They are also required to perform an independent	Yes <ul style="list-style-type: none"> <li>▪ Investment firms and market operators operating MTF/OTF are required to establish transparent rules and procedures for fair and orderly trading.</li> <li>▪ They should monitor transactions undertaken by</li> </ul>	Yes <ul style="list-style-type: none"> <li>▪ Crossing system operators are required to monitor the use of their crossing systems for compliance with their user obligation and operating procedures.</li> <li>▪ They must notify ASIC of all significant breaches</li> </ul>	Yes A marketplace must ensure its operation does not interfere with a fair and orderly market.	Yes A recognised market operator is required to have sufficient financial, human and system resources to operate a fair and orderly market.





	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
		review of their controls annually.	<p>their clients under their systems to identify breaches of rules, disorderly trading conditions or conduct that may involve market abuse.</p> <ul style="list-style-type: none"> <li>▪ They need to report significant breaches of their rules, disorderly trading conditions and conduct that may involve market abuse.</li> </ul>	<p>identified during such monitoring. They must also report to ASIC any suspicious activities that have occurred in their crossing system.</p>		
7. Access controls over trading information	<p>Yes</p> <p>Dark pool operators should only permit their staff members to have access to trading information in relation to their dark pools as is necessary to enable them to operate</p>	<p>Yes</p> <p>US ATS operators are required to establish procedures to protect subscribers' confidential trading information, including procedures to limit access by employees responsible for operating the US</p>	<p>Yes</p> <p>Investment firms and market operators operating MTF/OTF have to establish, publish and maintain transparent rules, based on objective criteria governing access to its facility.</p>	<p>Yes</p> <p>Market participants are required to take reasonable steps to ensure their officers and employees do not use or disclose information concerning the orders/transactions of participants, except under certain circumstances.</p>	<p>Yes</p> <p>A marketplace must implement procedures and safeguards to protect the order/ trade information of its participants, including limiting the access to participants' order/trade information by</p>	<p>Yes</p> <p>A recognised market operator is obliged to ensure that access to participation in its facility is subject to criteria that are fair and objective.</p>



	<b>Hong Kong <sup>2</sup></b>	<b>United States (US)</b>	<b>European Union (EU)</b>	<b>Australia</b>	<b>Canada</b>	<b>Singapore</b>
	satisfactorily and efficiently. They must keep the SFC informed at all times as to: (a) the identify of each such staff member and the information to which he has access; (b) the basis upon which such access is permitted in each case; and (c) any change to such access and the basis for the change.	ATS or for compliance with its rules.			employees of the marketplace or by persons/companies retained by the marketplace to operate the system or to be responsible for compliance with securities legislation.	



	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
8. Adequacy of System	Yes Appropriate business continuity and disaster recovery plans are required to be put in place.	Yes US ATS operators are required to establish adequate contingency and disaster recovery plans.	Yes Under MiFID II, investment firms or market operators operating MTF/OTF should have arrangements for sound management of technical operations, including the establishment of effective contingency arrangements.	Yes ASIC has issued guidance concerning adequate resourcing for crossing system operators during stressed market conditions, including disaster recovery and capacity management.	Yes A marketplace must develop and maintain reasonable business continuity plans.	Yes A recognised market operator is required to have sufficient financial, human and system resources to meet contingencies or disasters.
9. Transparency of trading information	Yes <ul style="list-style-type: none"> <li>Dark pool operators, which are exchange participants of SEHK, are required under SEHK Rules to report and flag all transactions conducted in their dark pools to SEHK.</li> </ul>	Yes Dark pool trades must be reported to FINRA within 10 seconds of execution.	Yes All trades executed on a dark pool are required to be made public by the operator of the dark pool in real time. Deferred publication is available in the EU for transactions above a certain size and where the transaction is between an intermediary dealing for its own account and a client account.	Yes	Yes <ul style="list-style-type: none"> <li>A marketplace must provide accurate and timely trade information executed on the marketplace to an information processor.</li> <li>It must file a quarterly report of its marketplace activities within 30 days.</li> </ul>	Yes Crossing networks are required to submit regular reports to the Monetary Authority of Singapore. They have to report each trade to the SGX.



	Hong Kong <sup>2</sup>	United States (US)	European Union (EU)	Australia	Canada	Singapore
	<ul style="list-style-type: none"> <li>Dark pool operators should have appropriate arrangements in place to ensure specified transaction reports/analyses are provided to SEHK, its dark pool users and the SFC.</li> </ul>					
10. Record keeping requirements	Yes	Yes	Yes	Yes	Yes	Yes



	<b>Hong Kong <sup>2</sup></b>	<b>United States (US)</b>	<b>European Union (EU)</b>	<b>Australia</b>	<b>Canada</b>	<b>Singapore</b>
11. Regulatory reporting requirements	Yes	Yes	Yes	Yes	Yes	Yes

*Recent regulatory developments:*

- In September 2013, FINRA proposed rules to require each US ATS to report to FINRA the aggregate weekly volume of transactions and number of trades within the US ATS by security. FINRA will make the reported information for equity securities publicly available on a delayed basis. The new rules were approved by the US SEC in January 2014.
- In January 2014, the European Parliament and the Council of the European Union reached an agreement in principle on updated rules for MiFID II, including a proposal for a double volume cap mechanism for equities to limit the use of reference price waivers and negotiated price waivers, together with a requirement for price improvement at mid-point.



## Appendix D

### List of questions

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