



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

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

20 November 2015



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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 Data¹ 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 provisions² 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.

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.

¹ Personal data means personal information as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

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.

Introduction and Executive Summary

Background

1. The regulation of automated trading services (**ATS**) was first introduced in 2003 under the Securities and Futures Ordinance (**SFO**), which provides two regimes for regulating ATS providers.
 - (a) **Part V ATS licence/registration** – Under Part V of the SFO, persons may seek a licence/registration to provide ATS. The Part V regime is appropriate where the provision of ATS is incidental to the performance of a dealing function (such as dealing in securities). Such ATS providers (**Part V ATS providers**) are typically intermediaries that provide dealing services, and offer ATS as an added facility to their clients.
 - (b) **Part III ATS authorization** – Under Part III of the SFO, persons may seek an authorization to provide ATS. The Part III regime, which is the focus of this paper, is appropriate where the provision of ATS is a core function. Such ATS providers (**Part III ATS providers**) typically offer facilities that are similar to those of a traditional exchange or clearing house.
2. Over the last 12 years, we have seen a gradual increase in the number of entities seeking a Part III ATS authorization.³ They are pre-dominantly operators of overseas regulated exchanges and trading facilities, including financial futures exchanges, stock exchanges, commodity futures exchanges and equity or fixed income trading facilities. As the market develops further, and with the implementation of the regulatory regime for over-the-counter (OTC) derivatives (discussed under paragraph 4(a) below), we expect the number of Part III ATS providers to increase further.

ATS Guidelines

3. The ATS regime under the SFO is supplemented by the SFC's *Guidelines for the Regulation of Automated Trading Services* (**ATS Guidelines**) which set out principles, procedures and standards governing the provision of ATS in Hong Kong. The ATS Guidelines also explain in more detail the differences between a Part III ATS authorization and a Part V ATS licence/registration, and which should be opted for in what circumstances.
4. The ATS Guidelines have not been amended since they were first introduced in 2003. A review is needed in light of regulatory and other developments over the last 12 years, and to take into account the SFC's experience of regulating ATS. In particular, amendments are needed in light of the following.
 - (a) **Regulation of OTC derivatives market:** In line with global efforts to reform the OTC derivatives market, the Securities and Futures

³ There are currently 31 ATS providers that have been authorized under Part III of the SFO. They come from around the world, including Australia, Germany, Japan, mainland China, Singapore, the United Kingdom and the United States.

(Amendment) Ordinance 2014 (**Amendment Ordinance**) was enacted in March 2014 to provide a framework for regulating the OTC derivatives market in Hong Kong. Among other things, the Amendment Ordinance introduces the following changes.

- (i) It expands the definition of ATS so that it covers not only services for the trading or clearing of securities or futures contracts, but also services for the trading or clearing of OTC derivatives. As the clearing leg of the expanded ATS definition is expected to come into effect in 2016, central counterparties (**CCPs**) (including those based overseas) who currently provide, or market, clearing services for OTC derivative transactions to persons in Hong Kong will need to be authorized as Part III ATS providers. Amendments are needed to the ATS Guidelines to cater for this expanded definition and provide guidance on seeking such authorization.
 - (ii) The new regime for OTC derivatives also envisages the introduction of a mandatory clearing obligation whereby certain standardized OTC derivative transactions will have to be cleared through a designated CCP that is either a recognized clearing house (**RCH**) or an ATS provider authorized under Part III of the SFO. It is expected that the first phase of mandatory clearing will be introduced in mid-2016⁴, and that overseas CCPs may therefore seek to become authorized ATS providers so that they may serve as designated CCPs for the purposes of the mandatory clearing obligation. In view of this, amendments are needed to provide guidance on the regulation of ATS providers that also serve as designated CCPs.
- (b) **Improved alignment with international standards and practices:** Separately, there have been major changes in the international regulatory standards and best practices since the publication of the ATS Guidelines in 2003. One prominent example is the publication of the Principles for Financial Market Infrastructures (**PFMI**) by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (**CPSS-IOSCO**) in April 2012. We propose to expand and enhance the core standards of practice embodied in the ATS Guidelines so that they are more in line with relevant PFMI requirements.
- (c) **Codification of practices:** The design and operation of ATS have evolved over the last decade, as have their uses. The SFC's understanding of, and experience in regulating, these operations have also enhanced over the years. An update of the ATS Guidelines to take into account such developments and experience would help codify our practices and provide better transparency for the market.
- (d) **Housekeeping changes:** Lastly, we propose a few housekeeping changes to streamline the ATS Guidelines, and bring them up-to-date.

⁴ See the [Consultation paper on introducing mandatory clearing and expanding mandatory reporting](#) issued jointly by the SFC and the HKMA in September 2015.

5. The proposed changes to the ATS Guidelines are discussed in greater detail below, and a draft of the revised ATS Guidelines (**draft revised Guidelines**) is at the **Appendix**.

Timeline

6. Interested parties are invited to submit comments, in writing, by **31 December 2015**. Subject to completion of this consultation, the SFC is working towards implementing the revised ATS Guidelines at the same time that the subsidiary legislation for mandatory clearing is implemented, which is currently expected to be mid-2016.

Key Changes Proposed

A. Implementation of the mandatory clearing and trading obligations for OTC derivative transactions in Hong Kong

7. In the wake of the 2008 global financial crisis, the G20 leaders committed to a global reform of the OTC derivatives market. Among other things, the reform advocated that standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms and cleared through CCPs. Major jurisdictions, including Hong Kong, have been working towards implementing the G20 recommendations.
8. In Hong Kong, the Amendment Ordinance was enacted in March 2014 to establish, under the SFO, a regulatory framework for the OTC derivatives market. Among other things, the Amendment Ordinance introduces the following changes to the SFO.
 - (a) It expands the definition of ATS under the SFO to include services for the trading or clearing of OTC derivatives. This expands the scope of both ATS that may be authorized under Part III of the SFO, and the scope of ATS that may be licensed/registered under Part V of the SFO.
 - (b) It expands the licensing regime under the SFO to cover activities in the OTC derivatives market. In particular, the expanded definition of ATS means the scope of Type 7 regulated activity (providing ATS) is expanded; Type 9 regulated activity (asset management) is also expanded to cover the management of portfolios that include OTC derivatives; and two new regulated activities are introduced, namely Type 11 regulated activity (dealing in and advising on OTC derivative products), and Type 12 regulated activity (providing client clearing services for OTC derivative transactions).
 - (c) The Amendment Ordinance also envisages –
 - (i) the introduction of a mandatory clearing obligation, whereby certain OTC derivative transactions (as are stipulated in subsidiary

- legislation) will have to be centrally cleared through designated CCPs that are either a RCH or a Part III ATS provider; and
- (ii) the introduction of a mandatory trading obligation, whereby certain OTC derivative transactions (as are stipulated in subsidiary legislation) may only be traded on designated trading platforms that are either a recognized exchange company (**REC**) or a Part III ATS provider.
9. As the OTC derivatives regime is intended to be implemented in phases, not all amendments will take effect at the same time. In particular, the current intention is to implement mandatory clearing first, and only for a limited scope of persons and products.⁵ Mandatory trading, and the expanded licensing regime, will be introduced at a later stage.
10. In view of the above, only the clearing leg of the expanded definition of ATS will be implemented first (i.e. paragraph (d) of the definition); and it will be implemented at the same time that mandatory clearing is implemented (which is currently targeted for mid-2016). The trading leg of the expanded definition (i.e. paragraphs (ab) and (ba) of the definition) will be implemented at a later stage, i.e. either when mandatory trading is introduced, or when the expanded licensing regime under the SFO comes into effect.
11. The implementation of mandatory clearing and the expanded clearing leg of the ATS definition will mean market participants who currently provide ATS for clearing OTC derivative transactions will need to become authorized ATS providers if they wish to continue providing such services. Additionally, overseas CCPs who wish to provide services as a designated CCP for the purposes of the mandatory clearing obligation will also need to become authorized ATS providers under Part III of the SFO.
12. We accordingly propose to amend the ATS Guidelines to provide more specific guidance on the application requirements and procedures applicable to CCPs offering clearing services for OTC derivative transactions, including those that are also seeking CCP designation for the purposes the mandatory clearing obligation – see paragraphs 55(b) and 62 to 64 of the draft revised Guidelines.

B. Improved alignment with international standards and practices

13. The SFC has had regard to international standards and best practices when regulating ATS. These include the regulatory principles, standards and practices recommended by IOSCO, and the Committee on Payments and Market Infrastructures (**CPMI**). They may also include best practices adopted by leading markets.
14. In April 2012, CPSS-IOSCO published new standards for financial market infrastructures, i.e. PFMI. The PFMI provides regulatory standards for financial market infrastructures (**FMI**), including CCPs, and is designed to ensure that FMIs

⁵ Our proposals for implementing mandatory clearing are discussed in the [Consultation Paper on Introducing Mandatory Clearing and Expanding Mandatory Reporting](#), which was issued jointly by the SFC and the HKMA in September 2015.

are robust and thus well placed to withstand financial shocks. Since then, the SFC has required that persons seeking to become an RCH or an authorized ATS provider should demonstrate compliance with the PFMI. The SFC has already formalized this requirement in the case of RCHs by the publication in 2013 of the SFC's *Guidelines on the application of the CPSS-IOSCO PFMI*. We propose to do likewise in the case of ATS providers by amending the ATS Guidelines to make it clear that overseas CCPs are expected to comply with the PFMI – see paragraph 16(c) of the draft revised Guidelines.

15. Additionally, we propose that the existing seven standards of practice be expanded and reorganized into nine core standards of practice as summarised below.
 - (a) We propose having separate core standards for “financial resources” and “risk management” to better reflect the importance of each – see paragraphs 14 and 18 to 23 of the draft revised Guidelines. The standard on financial resources (core standard 1) would then focus on requiring an ATS provider to have sufficient financial resources for the proper performance of its operations, functions and obligations; while the standard on risk management (core standard 2) would focus on requiring an ATS provider to ensure that risks associated with its business and operations are managed prudently.
 - (b) We propose to amend core standard 3 on “operational integrity” to “system integrity” to better reflect the features of ATS – see paragraphs 14 and 24 to 25 of the draft revised Guidelines.
 - (c) We propose having a new core standard on “governance” (core standard 4) which incorporates the earlier standard on “fitness” – see paragraphs 14 and 26 to 27 of the draft revised Guidelines. The revised standard focuses on the management and decision-making processes rather than merely on the suitability or qualifications of any particular personnel or shareholder.
 - (d) We also propose to add a new core standard on “access and participation” (core standard 5) – see paragraphs 14 and 28 of the draft revised Guidelines. This standard reflects the importance of having open and fair access to ATS, and having clear and objective criteria for such access. The standard is particularly critical given the upcoming implementation of mandatory clearing as it will be important for an ATS provider that serves as a designated CCP to have objective, risk-based and transparent criteria for participation, and requirements which permit fair and open access.
16. The proposed amendments will better align our core standards for ATS regulation with relevant PFMI requirements for CCPs, and thereby better provide for the regulation of ATS providers offering clearing services. Other amendments to the nine core standards of practice are also proposed. These largely aim to clarify the regulatory requirements given the SFC's experience of regulating ATS in the past years.

C. Codification of practices

Operations similar to an exchange or CCP

17. Apart from the ATS regime under Part III of the SFO, there is a separate regulatory regime for persons operating stock markets, futures markets and clearing houses (i.e. the regime for RECs and RCHs under the SFO). As the provision of ATS may, in certain circumstances, also constitute the operation of a “stock market”, “futures market” or “clearing house” (as defined in Schedule 1 to the SFO), the ATS Guidelines provide guidance on the SFC’s expectations in such circumstances. We propose to expand these further to clarify as follows.
 - (a) Persons proposing to provide services or facilities for trading securities should take into account the restrictions, under section 19 of the SFO, on who may operate a stock market. They may also be required to provide a legal analysis on why their proposed operations do not contravene such restrictions – see paragraph 44 of the draft revised Guidelines.
 - (b) Persons proposing to provide services or facilities for trading futures contracts may apply to become an REC or an authorized ATS provider, but should take into account the differences between the two regimes when deciding which application to pursue – see paragraph 45 of the draft revised Guidelines.
 - (c) Persons proposing to provide services or clearing facilities similar to those of a CCP should note that the insolvency override protections accorded under the SFO (and which are critical to a CCP’s default management process) are largely applicable to RCHs only. Hence, unless such persons are already regulated as CCPs in their home jurisdiction and enjoy adequate insolvency override protections under the laws of that jurisdiction, they should apply to become an RCH rather than a Part III ATS provider – see paragraph 46 of the draft revised Guidelines.

Pragmatic approach

18. In regulating ATS providers, the SFC generally takes a pragmatic approach, such that the level of regulation is commensurate with the functions performed and the risks posed, and that a level playing field will be sought so that similar regulation is applied in respect of similar functions. Reference is also generally made to international standards and best practices. The SFC proposes to continue with this approach going forward. The draft revised Guidelines reflect this – see paragraph 16. They also go on to note that, in view of this approach, the level of regulation of a domestic ATS provider may even, in appropriate cases, be akin to that of an REC – see paragraph 47 of the draft revised Guidelines.

Exchange recognition vis-à-vis ATS authorization

19. As mentioned in paragraph 17 above, persons wishing to operate an exchange-like platform may apply to become an REC or an authorized ATS provider, but

should take into account the differences between the two regimes when deciding which application to pursue.

20. We note however that the differences between the REC regime and the regime for ATS providers under Part III of the SFO may not be readily apparent. This point was also observed by the International Monetary Fund (IMF) when it conducted the Financial Sector Assessment Programme in respect of Hong Kong's securities and futures markets in 2013. In its assessment report, the IMF recommended that a more formal and transparent policy be established to guide potential applicants.
21. In view of the above, we propose to add a new section clarifying the key differences between the regulatory requirements applicable to an REC and those applicable to an authorized ATS provider – see paragraph 48 of the draft revised Guidelines. The section identifies five major regulatory differences between an REC and an authorized ATS provider. As these differences are fairly significant and fundamental to the set-up of an operation, their inclusion in the ATS Guidelines should help prospective applicants better assess which of the two regimes would be more suited to their intended business model.

Impact of the regulation of offers of investments under Part IV of the SFO

22. Under Part IV of the SFO, offers of investments, including offers of structured products and interests in collective investment schemes (CIS), may be subject to certain authorizations by the SFC. These requirements may apply notwithstanding that the investment in question is listed on an overseas market.
23. An ATS provider should ensure that its provision of ATS complies with Part IV of the SFO. The draft revised Guidelines includes a new section highlighting the need to ensure such compliance – see paragraphs 49 to 51 of the draft revised Guidelines. In particular, the ATS provider will be expected to take such measures as may be necessary or appropriate to ensure that neither it, nor its members contravene Part IV of the SFO, including putting in place appropriate controls and safeguards.

D. Housekeeping amendments

Removal of sections on application procedures for Part V ATS

24. Under Part V of the SFO, ATS constitutes one of the regulated activities (Type 7 regulated activities) and hence all of the provisions affecting intermediaries will normally apply. Currently the ATS Guidelines contain a section concerning the procedures for licensing ATS providers under Part V of the SFO. In view of the fact that a comprehensive set of regulation and procedures are already in place for the respective licensing or registration requirements of Part V ATS, the SFC proposes to remove the section concerning the procedures for applying Type 7 regulated activities under Part V of the SFO from the ATS Guidelines. Detailed information on the licensing procedures for Part V ATS are set out in the SFC's Licensing Information Booklet, which can be accessed on the SFC's website.

Updating of illustrative examples

25. The ATS Guidelines include a number of examples illustrating how they would apply in practice. These have been expanded and updated to provide further guidance. In particular, examples have been included in respect of ATS for trading or clearing OTC derivatives, interests in CIS and structured products – see paragraphs 74 to 81 of the draft revised Guidelines.

Comments sought and way forward

26. The SFC welcomes any comments from the public and the industry on the proposed changes to the ATS Guidelines. Please submit your comments to the SFC in writing **by no later than 31 December 2015**.
27. The SFC aims to conclude this consultation and finalize the ATS Guidelines by the first quarter of 2016. We will then work towards implementing the revised ATS Guidelines at the same time that the subsidiary legislation for mandatory clearing is implemented, which is currently expected to be mid-2016.

Appendix

A draft of the revised ATS Guidelines



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Guidelines for the Regulation of Automated Trading Services

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Guidelines for the Regulation of Automated Trading Services

A. INTRODUCTION

1. These Guidelines are published by the Securities and Futures Commission (SFC) under sections 95(6) and 399(1) of the Securities and Futures Ordinance (SFO). They set out principles, standards and procedures in relation to the SFC's regulation of automated trading services (ATS), including the authorization, registration and licensing of persons providing such services.
2. These Guidelines do not have the force of law and should not be interpreted in any manner which would override the provisions of any applicable law, codes or other regulatory requirements. However, a failure to follow the spirit of these Guidelines may reflect adversely on the fitness and properness of persons to be, or to continue to be, authorized, registered or licensed to provide ATS.
3. Terms defined in the SFO bear the same meaning when used in these Guidelines.

Definition of ATS

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

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

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

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

- (b) *persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of securities or futures contracts in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market;*
- (ba) *persons are regularly introduced, or identified to other persons –*
 - (i) *in order that they may negotiate or conclude OTC derivative transactions in a way that forms or results in a binding transaction in accordance with established methods; or*
 - (ii) *with the reasonable expectation that they will negotiate or conclude OTC derivative transactions in such a way;*
- (c) *transactions –*
 - (i) *referred to in paragraph (a);*
 - (ii) *resulting from the activities referred to in paragraph (b), or*
 - (iii) *effected on, or subject to the rules of, a stock market or futures market,**may be novated, cleared, settled or guaranteed; or*
- (d) *transactions –*
 - (i) *referred to in paragraph (ab); or*
 - (ii) *resulting from the activities referred to in paragraph (ba),**may be novated, cleared, settled or guaranteed,*

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

Two regimes for regulating ATS under the SFO

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

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

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

Regulation of Part III ATS providers

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

Regulation of Part V ATS providers

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

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

B. PRINCIPLES FOR THE REGULATION OF ATS PROVIDERS

13. In general, the regulation of ATS should be consistent with or promote: the regulatory objectives of the SFC under section 4 of the SFO; the functions of the SFC under section 5 of the SFO; and the matters that the SFC is required to have regard to under section 6(2) of the SFO in pursuing its regulatory objectives and performing its functions. Accordingly, the SFC shall, when regulating ATS providers, consider whether the services provided by them are, as far as reasonably practicable, consistent with the following:
 - (a) promoting and maintaining the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
 - (b) promoting understanding by the public of the operation and functioning of the securities and futures industry and of the benefits, risks and liabilities associated with investing in financial products;
 - (c) securing an appropriate degree of protection for members of the public investing in or holding financial products, having regard to their degree of understanding and expertise in respect of investing in or holding financial products;
 - (d) reducing systemic risks in the securities and futures industry;

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

C. CORE STANDARDS OF PRACTICE FOR ATS

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

Standard 1: Financial Resources

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

Standard 2: Risk Management

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

Standard 3: System Integrity

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

Standard 4: Governance

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

Standard 5: Access and Participation

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

Standard 6: Transparency

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

Standard 7: Surveillance

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

Standard 8: Record Keeping

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

Standard 9: Reporting

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

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

Pragmatic approach

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

potential effect on market participants, and especially if systemic risks might arise, the more that will be expected of the ATS provider.

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

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

Standard 1: Financial Resources

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

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

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

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

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

Standard 2: Risk Management

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

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

Standard 3: System Integrity

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

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

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

Standard 4: Governance

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

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

Standard 5: Access and Participation

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

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

Standard 6: Transparency

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

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

Standard 7: Surveillance

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

31. For the purposes of this standard, surveillance carries the meaning of careful watch, and supervision for the purposes of influencing, managing or directing the proper use of its ATS. The level of surveillance expected of an ATS provider will vary depending on the nature of the ATS involved. The ATS provider may also be required to provide access to the SFC to enable the SFC to perform its surveillance functions.
32. Where an ATS provider provides trade execution services for products that trade in multiple markets, situations routinely arise where, for example, trading may be suspended in the primary market pending release of important price-sensitive information. In these circumstances, the SFC may consider it important for the ATS provider to also suspend trading in co-ordination with the primary market.
33. Depending on the nature of the ATS, there may be situations where unusual activity may create a disorderly or unfair operating environment. For example, an ATS platform for trading derivative products may experience transaction prices that deviate in the extreme from price parameters that would normally be expected in relation to the price of the underlying product. The SFC may require there to be mechanisms in place to detect such anomalies and investigate the reasons behind them.

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

Standard 8: Record Keeping

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

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

Standard 9: Reporting

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

36. An ATS provider is expected to keep the SFC informed of its activities and operations. The SFC will normally require a Part III ATS provider to submit certain information on a regular basis, certain information on request, and certain information upon the occurrence of something or upon the ATS provider becoming aware of something. Information to be provided periodically will normally include, but not be limited to, the ATS provider's annual financial statements. Other information required may include information concerning the ATS provider's operations and material changes to those operations. Such other information will normally include information about the following:
- (a) the ATS provider's company structure, business plan and marketing plan;
 - (b) the electronic facilities to be used for providing ATS;
 - (c) the contractual documentation relevant to its members/users in Hong Kong;
 - (d) the criteria for admitting persons in Hong Kong as members/users or for revoking such membership, prior to the changes taking effect; and

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

D. ADDITIONAL CONSIDERATIONS APPLICABLE TO PART III ATS

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

Regulatory co-operation arrangements

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

Competition and level playing field

41. In regulating ATS providers and their activities, the SFC generally (and as required by section 6(2) of the SFO) takes into account the principle that competition among persons carrying out activities regulated by the SFC should not be impeded unnecessarily. However, competition considerations must be weighed against other

factors, including the SFC's various functions, duties and regulatory objectives under the SFO.

42. In the context of ATS, competition considerations may be outweighed by concerns about regulatory arbitrage and market fragmentation. For example, the products or services of an overseas exchange, CCP, or electronic platform may compete directly with products or services offered by a local exchange or CCP. In some cases, products traded on an overseas exchange/electronic platform and on a Hong Kong exchange may even be fungible. While such competition may increase efficiencies and investor choice, it may also cause market fragmentation, or raise concerns about market orderliness, efficiency and stability. The SFC may therefore impose specific conditions on the ATS authorization of an overseas exchange, CCP, or electronic platform to address such concerns. Conditions will be crafted with a view to achieving as fair and level a playing field as possible, while also taking into account the specific facts and circumstances of each case.

Operations of a stock market, futures market, or CCP

43. There may be circumstances where the provision of ATS may also constitute the operation of a “stock market”, “futures market” or “clearing house”/CCP (as those terms are defined in Part 1 of Schedule 1 to the SFO). Persons intending to provide such ATS should take into account the following matters.
44. In the case of a “stock market”, section 19(1)(a) of the SFO currently prohibits any person, other than the Stock Exchange of Hong Kong Limited (or its holding company or fellow subsidiary) from operating a stock market in Hong Kong.³ The term “stock market” does not include the office of an exchange participant of an REC, and so this restriction does not apply to Part V ATS providers who are also exchange participants. However, persons seeking authorization to provide ATS (i.e. applicants for Part III ATS authorization), and whose ATS are for the trading of securities, should consider whether their proposed services might contravene section 19(1)(a) of the SFO. They may also be required to provide a legal analysis supporting their view in this regard.
45. In the case of a “futures market”, section 19(1)(b) of the SFO prohibits a person from operating a futures market unless the person is an REC. However, by virtue of section 19(9) of the SFO, a person who is licensed or registered to provide ATS under Part V of the SFO, or authorized to provide ATS under Part III of the SFO, will not be regarded as contravening section 19(1)(b) if the person's licence, registration or authorization (as applicable) permits it to engage in activities that constitute operating a futures market. It follows that there are essentially two options available for persons

³ The prohibition is reflected in section 19(1)(a) of the SFO. The terms “Stock Exchange Company” and “relevant recognized exchange controller” (both of which are used in section 19(1)(a)) are defined, respectively, in Part 1 of Schedule 1 to the SFO and section 18(1) of the SFO.

seeking to operate a futures market in Hong Kong, i.e. they may either apply to become an REC or they may apply for authorization to provide ATS under Part III of the SFO.⁴

46. In the case of a “clearing house”/CCP, the SFO provides two options, i.e. persons seeking to operate a CCP here may either apply to become an RCH or apply for authorization to provide ATS under Part III of the SFO. A main difference between the RCH regime and the Part III ATS regime is that the former provides for a wide range of insolvency override protections while the latter provides limited protection only⁵. Insolvency override protections are critical to the smooth operation of a CCP because they prevent transactions cleared through the CCP from being unravelled by the application of insolvency law in the event of a default by any of the members of the CCP or by the CCP itself. The insolvency override protections under the SFO are conferred by sections 45 to 54. These largely apply only to transactions and activities conducted through an RCH. Transactions and activities conducted through the facilities of an ATS provider are accorded limited protection under the SFO, and only if the ATS provider is a designated CCP. In view of this, the SFC will generally expect CCPs based in Hong Kong to apply to become an RCH, rather than a Part III ATS provider. The ATS route will only be available to overseas CCPs that enjoy the necessary insolvency override protections under the laws of their home jurisdiction.

Domestic ATS

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

⁴ Although persons licensed or registered to provide Type 7 regulated activity may also operate a futures market, as discussed under paragraph 6(b) above, this regime is intended for intermediaries whose main business is to provide dealing services. As such, we do not view this as an alternative route for establishing a futures market.

⁵ The Securities and Futures (Amendment) Ordinance 2014 extended some (but not all) of the insolvency override protections to Part III ATS providers which are designated CCPs. This was achieved by expanding the definition of “market contract” to cover certain contracts entered into by a Part III ATS provider which is also a designated CCP. Designated CCPs are discussed in section F.

Exchange versus ATS

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

- (a) *Application process:* The application process for becoming an REC is much more rigorous in that it requires a public consultation, and consultation with the Financial Secretary (FS). This reflects the significance of an REC application, and the potential impact of its activities to the market and public as a whole.
- (b) *Ownership restrictions:* There are restrictions on the ownership or control of an REC, which do not apply in the case of a Part III ATS provider. In particular:
 - (i) Under section 59 of the SFO, the controller of an REC must (unless exempted under section 62) be recognized by the SFC (with the consent of the FS) as a recognized exchange controller (RXC), and will thereafter be regulated as an RXC under Part III of the SFO. The controller of an REC is essentially anyone who, either alone or with others, controls 35% or more of the voting power at meetings of the REC, or anyone in accordance with whose directions or instructions, the directors of the REC are accustomed or required to act. Changes in a controller's interest in an REC must also be approved by the SFC under section 60 of the SFO.
 - (ii) Minority controllers of an REC also require SFC approval. Under section 61 of the SFO, persons holding or controlling an interest of 5% or more in an REC must be approved by the SFC (after consultation with the FS). That section also requires that any increase in a minority controller's interest must be approved by the SFC (after consultation with the FS).
- (c) *Management restrictions:* The SFO also requires certain approvals in respect of the appointment of key personnel of an REC and the RXC that controls it. In particular:
 - (i) Section 26 of the SFO requires that the chief executive of an REC must be approved by the SFC.

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

Regulation of offers of investments under Part IV of the SFO

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

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

SFC levies

52. As mentioned in paragraph 16(b) above, the SFC endeavours to seek a fair and level playing field so that similar regulation is applied to similar functions. In this regard, the SFC notes, for example, that section 394(1) of the SFO enables the Chief Executive in Council to impose a levy, payable to the SFC, on securities or futures contracts traded on a stock or futures market operated by an REC, or on securities or futures contracts traded by means of ATS. Based on principles of fairness, cost recovery, and “user pays”, and considerations of whether the ATS is solely or primarily regulated by the SFC, the SFC will assess, on a case-by-case basis, the level of its resources devoted to regulation of the ATS and the nature and extent of the ATS business operations and consider whether a levy should be imposed.

Investor Compensation

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

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

54. The SFC notes that the nature, scope and impact of ATS may vary substantially from one ATS provider to the other. As noted under paragraph 16 above, the SFC will take

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

Application requirements

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

(a) Sufficient information and documents demonstrating:

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

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

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

- (i) sufficient information and documents to demonstrate that they will be able to comply with the mandatory reporting obligations imposed on Part III ATS providers under the Securities and Futures (OTC Derivative Transactions—Reporting and Record Keeping Obligations) Rules (**Reporting Rules**); and

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

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

Fees

56. An application fee is payable on submitting an application for Part III ATS authorization. Successful applicants are thereafter required to pay an annual fee. These fees are prescribed in Schedules 3 and 1, respectively, of the Securities and Futures (Fees) Rules.⁶ The application fee should be paid when the ATS application is submitted. The annual fee should be paid on the anniversary of the Part III ATS authorization. In both cases, fees paid are not refundable.

⁶ The application fee and annual fee are currently set at HK\$10,000 each.

Other matters relating to the application process

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

Withdrawal of authorizations

60. Under section 98 of the SFO, the SFC may withdraw a Part III ATS authorization if it is satisfied that it is appropriate to do so in the interest of the investing public or in the public interest. As required by section 98(4) of the SFO, the SFC will give the ATS provider an opportunity to be heard before withdrawing its authorization. Specifically, the ATS provider will be informed of the SFC's concerns and reasons for proposing to withdraw the authorization. The ATS provider will also be given an opportunity to address the SFC's concerns and to make any other representations as to why its authorization should not be withdrawn. Any representations made will be taken into account before a final decision is made. Where an authorization is withdrawn, notice of the fact of such withdrawal will be published in the Gazette, as required by section 98(5) of the SFO.

Appeals

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

<u>SFO provision</u>	<u>SFC decision</u>
section 95(2)	refusal to grant an authorization or imposition of any condition
section 97(1)	amendment or revocation of any condition, or imposition of any new condition
section 98(1)	withdrawal of an authorization

F. DESIGNATED CCPs

Applicants seeking CCP designation

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

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

More frequent reporting expected of designated CCPs

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

Fees

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

Procedural matters relating to designation and designated CCPs

- 67. *Approval of an application for designation:* Where an application for CCP designation is approved, the notice of designation will generally specify: (i) the classes of OTC derivative transactions for which the designation is granted; (ii) the conditions of the designation (if any); and (iii) the time from when the designation is to take effect. Where an application is refused, the applicant will be informed in writing of this, and of the reasons for the refusal. These matters are provided for in section 101J of the SFO and Part 4 of the Clearing Rules.
- 68. *Refusal of an application for designation:* Where the SFC is minded to refuse an application for CCP designation, it will, as required by section 101J(5) of the SFO,

inform the applicant in writing of this and give it a reasonable opportunity to be heard (the process for which will be similar to that described under paragraph 59 above). Any representations received from the CCP will be taken into account before a final decision is made in respect of the application.

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

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

Exercise of SFC’s powers in respect of designated CCPs

73. A final point to highlight is that while decisions in respect of a Part III ATS authorizations are made entirely by the SFC, decisions in respect of a CCP designation (including whether a designation should be granted, whether it should be withdrawn, what conditions (if any) should be imposed, and whether any conditions

should be amended or revoked) may only be made by the SFC with the Hong Kong Monetary Authority's consent and after consultation with the Financial Secretary.

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

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

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

75. Section 95 of the SFO prohibits persons from providing ATS, or offering to provide ATS unless authorized, licensed, or registered to do so under Part III or Part V of the SFO. Section 95(8) provides that a person offers to provide ATS if the services are actively marketed to persons in Hong Kong. In addition, section 95(9) states that a person is not regarded as offering ATS if the offer is made to existing clients to whom the person already provides any financial services, including ATS. Overseas persons intending to provide ATS to persons in Hong Kong should consider if their activities might breach section 95 of the SFO, even if though they are providing their services from outside Hong Kong.

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

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

Example 3: A person provides telecommunications or software services or is an Internet service provider and these telecommunications or software facilities are used by other persons to provide ATS.

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

Example 4: A person provides electronic facilities whereby offers to buy or sell foreign currencies or goods or services are made, transactions are concluded, and settlement is effected.

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

Example 5: A person provides electronic facilities whereby offers are regularly made to buy or sell fixed income instruments, transactions are concluded using established methods, and settlement is effected.

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

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

80. Overseas CCPs intending to provide services in Hong Kong for the clearing and settlement of OTC derivative transactions, or to market such services to persons in Hong Kong, should apply for a Part III ATS authorization in accordance with the procedures and requirements discussed under Section E above.

81. A Part III ATS authorization is not currently required if the overseas person is only providing, or marketing, services for the trading of OTC derivatives. This is because paragraphs (ab) and (ba) of the definition of ATS are not fully effective yet. However, once those provisions are fully effective, such persons will need to apply for a Part III ATS authorization – see also footnote 1 above.

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

The operator of such exchange or platform will require a Part III ATS authorization. However, as the offering of CIS and structured products is subject to the offers of investments regime under Part IV of SFO, the SFC is unlikely to grant such ATS authorization unless the operator is able to demonstrate that the provision of its facilities, and their use by its members, is in compliance with Part IV of the SFO.