

SECURITIES AND FUTURES ORDINANCE (Chapter 571)

Pursuant to section 169(1) of the Securities and Futures Ordinance, the Securities and Futures Commission publishes the following amendments to the Codes of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“Code of Conduct”). These amendments shall become effective on 1 December 2015.

1. Add the following paragraphs after paragraph 18.11 of the Code of Conduct:

“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 to the SFO.
- (e) “proprietary order” means an order which is for:
 - (i) the account of a licensed or registered person operating an ALP, trading as principal;
 - (ii) the account of any user, which is a company within the same group of companies as the licensed or registered person operating an ALP, trading as principal;
 - (iii) any account in which a licensed or registered person operating an ALP, or any user which is a company within the same group of companies as the licensed or registered person, has an interest; or
 - (iv) the account of any employee or agent of a licensed or registered person operating an ALP or of any user which is a company within the same group of companies as the licensed or registered person.

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

- (f) “qualified investor” means:
 - (i) a person falling under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the SFO; or
 - (ii) a person within the meaning of sections 3(a), (c), (d)(i), (d)(iii) or (d)(iv) of the Securities and Futures (Professional Investor) Rules.
- (g) “user” means a qualified investor whose orders are placed into or whose transactions are conducted in an ALP, and includes any qualified investor who/which is ultimately responsible for originating the instruction in relation to an order placed into, or a transaction conducted in, an ALP.

19.3 Management and supervision

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

19.4 Access to ALPs

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

19.5 Operation of ALPs

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

19.6 Order priority

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

19.7 Information for users

- (a) A licensed or registered person operating an ALP should, by means of ALP Guidelines, provide sufficiently comprehensive information to the users of the ALP to ensure that they are fully informed as to the manner in which the ALP operates.
- (b) Prior to routing any order to an ALP on behalf of a client for the first time, a licensed or registered person should ensure that the ALP Guidelines have been brought to the attention of the person placing or originating the order.

19.8 Opting out of ALP

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

19.9 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.

19.10 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.

19.11 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.

19.12 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, exchanges, the Commission and other regulators.
- (b) A licensed or registered person operating an ALP should keep the Commission informed of any change in relation to the operation of its ALP and any breach arising out of its operation.”

2. Add the following Schedule after Schedule 7 to the Code of Conduct:

“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 qualified investors are permitted to be the users of ALPs. Subject to paragraph 8 of this Schedule, an ALP operator should take all reasonable steps to ascertain that the users of its ALP are qualified investors.
8. An ALP operator should have in place measures which **ensure**:
 - (a) that all of its clients, and all of the clients of any other company within the same group of companies as the ALP operator, who/which are users of its ALP, are qualified investors; and
 - (b) that it will be able to comply with the requirements of the Commission, as revised from time to time, concerning “client identity” (including the identity, address and contact details of the users of its ALP).

Information for users

ALP Guidelines

9. An ALP operator should prepare and publish on its website comprehensive and accurate ALP Guidelines concerning its ALP, including (but not limited to) details relating to:
 - (a) trading and operational matters;
 - (b) user restrictions;
 - (c) opt-out arrangement;
 - (d) user priority, order routing and execution methodology;
 - (e) transaction pricing;
 - (f) order cancellation;

- (g) the internal control procedures that have been put in place to ensure the fair and orderly functioning of its ALP and to address potential conflict of interest issues;
 - (h) the potential risks associated with transactions conducted in its ALP in respect of which the users of its ALP should reasonably be made aware;
 - (i) the transaction of proprietary orders in its ALP;
 - (j) whether the orders of different users of its ALP may be aggregated; and
 - (k) the identity of each member of its staff (by title and department) who is permitted access to trading information concerning orders placed into, and transactions conducted in, its ALP and, in each case, the reason(s) why such access is necessary.
10. A licensed or registered person should provide a copy of its ALP Guidelines to the Commission forthwith upon their publication on its website.

Revision of ALP Guidelines

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

Adequacy of system

System controls

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

System reliability

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

System security

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

System capacity

15. An ALP operator should ensure that:
 - (a) the usage capacity of its ALP is regularly monitored and appropriate capacity planning is conducted. As part of the capacity planning, an ALP operator should determine, monitor and maintain the required level of spare capacity;
 - (b) the capacity of its ALP is regularly stress tested to establish the system behaviour under different simulated market conditions, with the findings of the stress tests and any actions taken to address those findings being documented;
 - (c) its ALP has sufficient capacity to handle any foreseeable increase in business volume and market turnover; and

- (d) its ALP has contingency arrangements, the details of which have been communicated to the users of the ALP:
 - (i) to facilitate the handling of users' orders when the capacity of the ALP is exceeded; and
 - (ii) by which alternative means of executing orders are available and offered to users.

Information security

16. An ALP operator should:

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

Contingencies

17. An ALP operator should establish a written contingency plan to cope with emergencies and disruptions related to the operation of its ALP. The contingency plan should at least include:
 - (a) a suitable backup facility which will enable the ALP operator to operate the ALP in the event of an emergency;
 - (b) arrangements to ensure user and transaction databases and servers are backed up in an off-line medium, with off-site storage being subject to proper security measures; and
 - (c) trained staff being available to deal with user and regulatory enquiries.
18. An ALP operator should ensure that the contingency plan to deal with potential emergencies and disruptions is periodically tested and that the plan is viable and adequate.
19. An ALP operator should, in the event of a material system delay or failure, in a timely manner:
 - (a) ensure that the delay or failure is rectified; and
 - (b) inform users of its ALP of the causes, or possible causes, of the delay or failure and the manner in which their orders will be handled.

Record keeping

20. An ALP operator should keep, or cause to be kept:
 - (a) comprehensive documentation of the design, development, deployment and operation of its ALP, including any testing, reviews, modifications, upgrades or rectifications of the ALP; and
 - (b) comprehensive documentation of the risk management controls for the ALP.
21. An ALP operator should retain the documentation referred to in paragraph 20(a) and (b) for a period of not less than two years after the ALP ceases to operate.
22. An ALP operator should keep:

- (a) for a period of not less than seven years, the following records in respect of transactions conducted in its ALP in such manner as will enable them to be readily accessible in written form in the Chinese or English language (and, if necessary, immediately convertible into such written form), and provide any such records to the Commission upon request:
 - (i) details of the users of its ALP, including their registered names and addresses, dates of admission and cessation, authorized traders and related details, and client agreements;
 - (ii) details of any restriction, suspension or termination of the access of any user to its ALP, including the reasons for this;
 - (iii) all notices and other information, whether written or communicated through electronic means, provided by the ALP operator to the users of its ALP, whether individually or generally; and
 - (iv) routine daily and monthly summaries of trading in its ALP, including:
 - (I) the securities in respect of which transactions have been executed; and
 - (II) the transaction volume, expressed in numbers of trades, numbers of securities traded and total settlement value; and

- (b) for a period of not less than two years, time-sequenced records of orders and any other actions or activities conducted in its ALP, as particularized below, in such manner as will enable them to be readily accessible in written form in the Chinese or English language (and, if necessary, immediately convertible into such written form), and provide any such records to the Commission upon request:
 - (i) the date and time that any order was received, executed, modified, cancelled or expired (where applicable);
 - (ii) the identity, address and contact details of the user and authorized trader initiating an entry, modification, cancellation or execution of an order;
 - (iii) the particulars of any order and any subsequent modification and execution of the order (where applicable), including but not limited to, the securities involved, the size and side (buy or sell) of the order, the order type, and any order designation, time and price limit or other

conditions specified by the user responsible for originating the order;
and

- (iv) the particulars of the allocation and re-allocation (where applicable) of an execution.

Risk management

- 23. An ALP operator should have controls that are reasonably designed to monitor and prevent the crossing of orders in its ALP which may:
 - (a) be erroneous;
 - (b) interfere with the operation of a fair and orderly market; or
 - (c) be in breach of any legal or regulatory obligations.
- 24. An ALP operator should regularly conduct post-trade reviews of transactions conducted in its ALP to identify any:
 - (a) suspicious market manipulative or abusive activities;
 - (b) market events or system deficiencies, such as unintended impact on the market, which call for further risk control measures; and
 - (c) breaches, whether actual or potential, of any requirements relating to fair and orderly trading in its ALP or which might constitute market misconduct.
- 25. Forthwith, upon becoming aware of any breach, whether actual or potential, of any legal or regulatory obligation referred to in paragraph 23(c) or any requirement referred to in paragraph 24(c), an ALP operator should notify the Commission of such matter and provide the Commission with such additional assistance in connection therewith as it might request.
- 26. An ALP operator should, upon identification of any suspected market manipulative or abusive trading activities, take immediate steps to prevent these activities from continuing.

Reporting and notification obligations

Transaction reporting

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

Notification to the Commission

28. An ALP operator should:
- (a) notify the Commission of any proposed change to the following which might affect the operation of its ALP or the users of its ALP, and provide the Commission with an explanation for the proposed change, prior to its implementation:
 - (i) corporate structure and governance arrangements;
 - (ii) business plans or operations;
 - (iii) the trading rules, trading sessions and operating hours, the system operator, hardware, software, and other technology of its ALP, and all system interfaces between its ALP and other ALPs or other electronic trading platforms;

- (iv) the ALP operator's contractual responsibilities in relation to the users of its ALP;
 - (v) the criteria for approval or disapproval of the users of its ALP; and
 - (vi) the contingency plan in relation to its ALP;
- (b) notify the Commission of any breach of any relevant regulatory obligations or the ALP Guidelines forthwith upon its occurrence;
 - (c) notify the Commission of the causes, or possible causes, of material delay or failure to the operation of its ALP affecting the users of its ALP forthwith upon its occurrence; and
 - (d) provide the Commission with any updated review report concerning its ALP forthwith upon it becoming available.”

29 May 2015

Ashley ALDER *Chief Executive Officer,
Securities and Futures Commission*