

## CB(1)1221/12-13(02)

1. The SFC has submitted a paper responding to enquiries from members which gives a general overview of how we regulate Automated Trading Services, or “ATS’s”. These enquiries have been prompted by the recent closure of HKMEx’s operations as an ATS. I just want to spend a few minutes to clarify some important issues about regulation arising from that case, bearing in mind that I am not able to talk about specifics because investigations are on foot.
2. HKMEx ceased providing trading services because its available financial resources became insufficient to support its trading platform. You will have read that all client money was returned to all investors after their contracts were closed out.
3. This was not a high impact event for financial stability. Trading volumes were small and there were no systemic risks. Nevertheless, and for understandable reasons, the level of public commentary about HKMEx has eclipsed the fact that a start up trading platform used by few investors and with few transactions closed down without creating any ripples in our financial markets. But in light of some of this commentary I would like to make absolutely clear that ever since HKMEx’s authorisation the SFC has operated objectively and independently in relation to HKMEx and strictly in accordance with its statutory obligations. The SFC is a fiercely independent regulator putting the interests of investors and market quality above all else. We operate without fear or favour regardless of who or what may be the subject of regulatory supervision or action.
4. You will also have read that on 15<sup>th</sup> May we commenced an investigation into suspected financial irregularities at HKMEx. The following day we involved the police and arrests were made the following week. Our investigation is continuing. This, understandably, has also fuelled extensive media coverage.
5. So it is important that you are able to separate in your own minds the reality that a start up trading platform had to close from the inevitable public interest in HKMEx generated by other factors, including the ongoing investigation.
6. ATS’s come in various shapes and sizes. But the most important thing to understand is that in all cases we are asked to authorise an automated

trading platform to which investors connect electronically. They are not brokers or banks, and therefore regulation is targeted at the different risks they pose. The platform is the interface with the investors we are charged to protect, and if it has problems investors can be harmed. This is why ATS regulation is laser focussed on the stability, transparency and operational integrity of the platform itself.

7. It is also important that an ATS has sufficient financial resources to sustain its trading operations. This does not mean that it must be profitable: startups rarely are and initial operating costs are often funded by debt or equity. As made clear in our ATS guidelines “... *there are relatively few international examples of financial or prudential regulation for market operators, unlike the well developed financial regulation of dealers and banks. This is no doubt partly because market operators typically do not act as trading counterparties nor hold client’s securities and funds.*”.
8. So, the closure of HKMEx’s futures market was not like the failure of a broker. HKMEx did not hold client assets that needed to be protected by more draconian actions as sometimes happens when brokers fail. As a trading platform, not a broker, HKMEx did not hold or deal with any client money. All financial obligations arising from trades in HKMEx futures were handled by a separately authorised clearing house in London which is completely independent of HKMEx. This means the regulatory treatment of HKMEx was markedly different to cases where client assets may be at risk. Instead, our focus was on orderly – by which I mean panic-free – wind down and closure of positions, bearing in mind that market participants, investors and many other parties are also affected.
9. With this background I should also tell you something about our attitude when an ATS appears to be running short of funding. Again, our overriding concern relates to investors and the integrity of the trading system. Financial sufficiency conditions that may have been required when an entrepreneurial ATS is first set up in the expectation of high projected trading volumes or more products may no longer be relevant if the actual level of trading or the product range falls short. If low revenue and declining net assets mean that the viability of an ATS becomes uncertain our job is to make sure that there is still a sufficient financial buffer to ensure that if operations cease investors

who use the platform are protected. We may also take other action, including insisting on a market exit plan to deal with a potential closure, more frequent reporting of financial information and halting the authorisation of new product launches. We deploy these supervisory tools exercising reasonable judgement and expertise based on information given to us by the management of an ATS, who are obliged under law and regulation to be honest and open when reporting to us. A proportionate and specific response to a regulated firm or platform in financial difficulties does not denote flexibility or favouritism; on the contrary we direct far greater supervisory intensity at the situation. And I can confirm that we acted no differently towards HKMEX.

10. I can also tell you that if we suspect serious financial irregularities we do not hesitate to take immediate action to protect the public. We have done so on numerous occasions in the past and HKMEX was no different.
11. I would also like to deal with the process of withdrawal of HKMEX's authorisation. First, the SFC was obliged to give HKMEX procedural fairness or notice of its intention to withdraw the authorisation before doing so. This is not unwarranted flexibility. It is a legal obligation. Secondly, on 16<sup>th</sup> May we decided irrevocably to withdraw HKMEX's authorisation. We gave it no choice because it had failed to comply with requirements to maintain sufficient financial resources. HKMEX decided not to dispute our decision, which was clearly the most desirable outcome. It meant HKMEX would be able to plan its handling of the consequences of the decision, including its communications with brokers, investors and its clearing house in a more orderly fashion. And in fact this is what happened. The withdrawal notice was served the next day, which was a public holiday, and announcements were made before HKMEX's market was due to reopen the following Monday. I should be clear that our withdrawal of the ATS authorisation does not affect any enforcement action we may take; our investigations into suspected financial irregularities continue. Neither does the fact that HKMEX did not contest the withdrawal mean that it can "automatically" reactivate its ATS authorisation in future. If it reappplies it would be treated on the same basis as any other applicant.
12. I should also like to touch on our communications with the Government. As a market regulator we of course keep the Government informed of matters that may affect policy objectives and financial stability, or which may have public

interest or policy implications. However I would like to make clear that at no stage did the SFC receive any direction or instruction from the Government as to how to handle any issues concerning HKMEx. We acted independently throughout and continue to do so.

13. I hope that this clears up some misconceptions about how we deal with ATS regulation and why this is important to a proper appreciation of the principles we applied as regulator of HKMEx. We would be happy to answer questions, bearing in mind that we cannot disclose information that might affect continuing investigations into the affairs of HKMEx.