

CFTC Letter No. 00-75**June 9, 2000****No-Action****Division of Trading & Markets**

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1440 New York Avenue, N.W.
Washington, D.C. 20005-2111

Re: Sections 5 and 5a - Hong Kong Futures Exchange Ltd.; Request for No-Action Relief from Contract Market Designation Requirement

Dear Mr. Johnson:

This is in response to your letter dated July 16, 1999 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("CFTC" or "Commission").^[1] By this correspondence, you request, on behalf of Hong Kong Futures Exchange Ltd. ("HKFE" or "Exchange"), that the Division grant no-action relief to permit HKFE to make its electronic order matching system, known as the Hong Kong Automated Trading System ("HKATS"), available to Exchange Participants^[2] in the United States^[3] ("No Action Request"). Specifically, HKFE wishes to make HKATS available to: (i) Exchange Participants who wish to trade for their proprietary accounts^[4] through HKATS in the United States; (ii) Exchange Participants who are registered with the Commission as futures commission merchants ("FCMs") or who are exempt from such registration pursuant to Rule 30.10 ("Rule 30.10 Firms")^[5] and who wish to submit the orders of United States customers^[6] for transmission to HKATS; and/or (iii) Exchange Participants who are registered with the Commission as FCMs or who are Rule 30.10 Firms who wish to accept orders from United States customers through automated order routing systems ("AORs")^[7] for submission to HKATS. You request that the Division confirm that it will not recommend enforcement action to the Commission against HKFE or its members if HKFE does not seek designation as a contract market pursuant to Sections 5 and 5a of the Commodity Exchange Act, as amended ("Act" or "CEA"),^[8] or comply with those Commission regulations that specifically relate to contract markets, in connection with the installation and use of HKATS in the United States.

As you know, on March 24, 1999, the Commission published proposed rules that would have governed the circumstances under which foreign futures exchanges could be accessed from electronic trading devices in the United States.^[9] On June 2, 1999, the Commission issued an order that withdrew those proposed rules and directed the Commission staff to begin considering requests from foreign exchanges for interim no-action relief to allow them to place trading systems in the United States on a temporary basis until the Commission itself promulgates rules or guidelines in this area ("June 2 Order").^[10] In accordance with this instruction, the Division has reviewed HKFE's No-Action Request and the

materials submitted in support thereof.

In connection with its No-Action Request, HKFE forwarded the following information to the Division:

- General information regarding HKFE (*e.g.*, a description of its location, organization, and activities in the United States);
- HKFE's Rules, Regulations and Procedures;
- HKCC's[\[11\]](#) Rules and Procedures;
- A description of the contracts traded on HKFE;
- An HKFE Subscription and License Agreement;
- An HKATS User's Guide;
- An OM CLICK Trade User's Guide;
- A description of the regulatory regime in Hong Kong applicable to the operation of HKFE and HKATS, transactions executed on HKFE and HKATS, and HKFE and HKATS participants;
- Copies of the Commodities Trading Ordinance ("CTO") and subsidiary legislation, and the Securities and Futures Commission[\[12\]](#) Ordinance ("SFCO") and subsidiary legislation (collectively, the "Ordinances");
- Information regarding HKFE's linkage agreement with the New York Mercantile Exchange ("NYMEX");[\[13\]](#) and
- Copies of certain applicable information-sharing arrangements.

Representations made by HKFE regarding HKFE's activities in the United States, HKFE's membership criteria, HKATS, the relevant regulatory regime in Hong Kong, and the information-sharing arrangements applicable to HKATS are summarized in Sections I - VI below. For purposes of its response to the No-Action Request, the Division has relied upon HKFE's representations and has not conducted an independent review to confirm their accuracy.[\[14\]](#)

I. GENERAL INFORMATION REGARDING HKFE

HKFE is a for-profit, derivatives exchange that was incorporated under the Companies Ordinance of Hong Kong ("Companies Ordinance") in 1976 and licensed as an Exchange Company by Hong Kong's

Governor in Council during the same year.^[15] HKFE currently offers trading in futures and option contracts on individual stocks,^[16] equity indices,^[17] interest rates, and currencies. Originally, all trading on HKFE was conducted through an "open outcry" auction process. In 1995, HKFE began listing certain contracts on an earlier version of HKATS.^[18] The current version of the system became operative in April 1999. HKFE converted to a fully-computerized exchange on June 5, 2000.

HKFE's principal place of business is in Hong Kong. HKFE represents that it does not maintain any office or staff in the United States and that no trade processing or clearing functions are performed by the Exchange in the United States. Although HKFE representatives occasionally visit the United States for promotional and regulatory purposes, the Exchange represents that such persons do not provide investment advice nor solicit, receive, or direct orders with respect to the products traded on HKFE in the United States.

II. EXCHANGE PARTICIPANTS

Every person that intends to trade on or through HKFE must apply for and receive approval from the Exchange to exercise its Trading Rights. To obtain such approval, and thereby become an Exchange Participant, an applicant must: (i) be: (a) an entity that has been incorporated in Hong Kong pursuant to the Companies Ordinance, or (b) a natural person that is a resident in Hong Kong and at least 18 years of age; (ii) execute a prescribed undertaking in the application form in which the applicant agrees to be bound by HKFE Rules; (iii) be registered as a dealer pursuant to the Ordinances or exempt from the registration requirement;^[19] (iv) fulfill the applicable minimum capital requirements; (v) pay to HKFE the amount of any deposit that HKFE is required to make on behalf of the applicant towards the Compensation Fund;^[20] (vi) acquire at least one share of HKEC stock and the concurrent Trading Rights; and (vii) comply with any other requirements established by the Exchange's Board of Directors ("Board"). HKFE further restricts its membership to bona fide commodity professionals. In its sole discretion, the Board may refuse any application to become an Exchange Participant or approve any such application subject to conditions. Exchange Participants are required to comply with the Exchange Participant criteria for the duration of their Exchange Participant status. The Board is empowered to suspend or revoke the Exchange Participant status of any Exchange Participant that fails to comply with HKFE Rules.

HKFE has established four categories of Exchange Participants: (i) Traders, (ii) Brokers, (iii) FCMs,^[21] and (iv) Merchant Traders. Traders may trade only for their own account. Brokers are permitted to trade for their own account or to act as another Exchange Participant's agent for the sole purpose of concluding trades. FCMs are permitted to trade for their own account, the accounts of other Exchange Participants, or the accounts of other persons. Merchant Traders are "substantial merchants in their own right in the financial or commodity fields" who are permitted to trade solely for their own account.^[22]

All Exchange Participants trading on or through HKFE must be: (i) General Clearing Members or Clearing Members of HKCC that clear their trades through HKCC, or (ii) Clearing or Non-Clearing Members of HKCC who have procured the clearing of their trades through an HKCC General Clearing

Member. HKCC's General Clearing Members may clear their own contracts, the contracts of Clearing Members, and the contracts of those Non-Clearing Members with which they have entered into a clearing arrangement. Clearing Members may clear their own contracts and, with the permission of HKCC,[\[23\]](#) contracts entered into by other Clearing Members.

HKFE and HKCC have combined capital requirements. All Exchange Participants must maintain a debt to equity ratio of no greater than 2:1. HKCC General Clearing Members are required to have paid-up capital of at least HK\$25,000,000 (US\$3,213,368) and adjusted net admissible assets in excess of the greater of: (i) HK\$12,500,000 (US\$1,606,684), or (ii) four percent of the amounts required to be segregated for customers' accounts. HKCC Clearing Members must have paid-up capital of varying amounts depending upon their category of membership. Specifically, they are required to maintain paid-up capital of at least: HK\$5,000,000 (US\$642,674), if an FCM or Merchant Trader; HK\$2,500,000 (US\$321,337), if a Broker; and HK\$2,000,000 (US\$257,069), if a Trader. HKCC Clearing Members also must have adjusted net admissible capital of no less than the greater of: (i) four percent of the amount required to be segregated for customers' accounts, or (ii) HK\$2,500,000 (US\$321,337), if an FCM or Merchant Trader; HK\$1,250,000 (US\$160,668), if a Broker, and HK\$1,000,000 (US\$128,534), if a Trader. All HKCC Non-Clearing Members must have paid-up capital of at least HK\$2,500,000 (US\$321,337), if an FCM or Merchant Trader, or HK\$500,000 (US\$64,267), if a Broker or Trader. HKCC members are required to notify the HKCC if their adjusted net admissible assets fall either: (i) below one hundred fifty percent of the amount applicable to that member, or (ii) to a level that is twenty percent lower than the level previously reported to HKCC. HKCC members are required to submit financial returns to HKFE and HKCC to demonstrate ongoing compliance with their financial obligations.

III. OVERVIEW OF HKATS

At the outset, the Division notes that the description of HKATS included herein is based upon representations made by HKFE or its representatives. The Division has not conducted an independent assessment of the security or soundness of the system.

A. Technical Aspects of HKATS

1. Introduction

HKATS is a version of the CLICK Exchange Trading System ("OM CLICK") developed by OM Gruppen AB and its affiliates.[\[24\]](#) HKFE represents that HKATS underwent comprehensive business and technical testing before it was declared operational. The American Stock Exchange, the Athens Stock Exchange, the Australian Stock Exchange, the Italian Derivatives Market, the OM London Exchange, and the OM Stockholm Exchange currently use OM CLICK to trade and to match orders electronically.

The HKATS architecture consists of three tiers: (i) the Back-End Servers, (ii) the Network, and (iii) the Front-End Clients. Exchange Participants use Front-End Clients to access CLICK or the OMnet

Application Program Interface ("OMnet API") which, in turn, provides access to the Network. The Network, in turn, provides access to the Back-End Servers. HKATS provides the Back-End Servers and either CLICK or the OMnet API. Exchange Participants are responsible for acquiring Front-End Clients.

2. HKATS Architecture

a. Back-End Servers

The Back-End Servers are maintained in Hong Kong. They have five modular sub-systems: (i) Central Data Base ("CDB"), (ii) Information Dissemination ("ID"), (iii) Marketplace, (iv) Deal Capture, and (v) Market Supervision.[\[25\]](#) Each of these subsystems is linked together by the Network and can be accessed by HKFE and Exchange Participants through CLICK and the OMnet API.

The CDB sub-system provides the central database for the standardized information used in HKATS, including contract specifications, margin requirements, and other Exchange-specific rules and information. Only HKFE personnel may modify the information contained in the CDB. The information is accessible via the ID and Marketplace sub-systems. The CDB also contains the central security server which provides the means for the authentication, configuration, and integrity of HKATS.

The ID sub-system retrieves real-time information from the Marketplace sub-system and from other external information providers, stores such information in its internal database, and distributes the information to Exchange Participants on a subscription or query basis. Automated Trading System Exchange Participant Representatives ("ATS Exchange Participant Reps")[\[26\]](#) may receive continuous access to up-to-date price information regarding the five best bid and ask prices, total volume, closing and opening prices, high and low prices, last volume, and the underlying indices of traded index futures or options. ATS Exchange Participant Reps may request real-time pricing information on a query basis. At the conclusion of each trading day, the ID sub-system gathers historical trading information that may be used to generate reports summarizing the day's trading activity. ATS Exchange Participant Reps may request on a query basis a standardized historical trading report that has been generated by the sub-system or subscribe to specifically-tailored trading reports.

The Marketplace sub-system facilitates trading on HKFE. It performs all of the order processing functions of HKATS (*i.e.*, supervises and records all orders, validates requests for order modifications and cancellations, matches orders, processes the order book, operates the HKATS bulletin board,[\[27\]](#) provides real-time marketplace information to the ID sub-system, and, where appropriate, activates and inactivates orders).

The Deal Capture sub-system acts as a gateway from the Marketplace sub-system to HKCC. It receives input from the order book on a real-time basis; produces trade confirmations and sends them to Exchange members; and delivers trade information in real-time via CLICK or the OMnet API to the counterparties, HKCC, and the back offices of Exchange Participants' sites. The Deal Capture sub-system also retains historical information about each trade (*e.g.*, the participants, price, quantity, order

number, trader identification, trading time, and trading date).

b. Network

The Network effectuates the interaction between the Back-End Servers and the Front-End Clients. It routes incoming and outgoing messages between the various sub-systems and the trading applications installed on the Front-End Clients.

c. Front-End Clients

Front-End Clients are the external devices used by the individual ATS Exchange Participant Reps of Exchange Participants to access HKATS. An Exchange Participant may obtain a license for a pre-packaged workstation containing trading applications developed by OM Gruppen that can communicate with CLICK or the OMnet API. In the alternative, an Exchange Participant may assemble its own Front-End Client and access CLICK or the OMnet API via a proprietary trading application developed either in-house or by a third party vendor. Front-End Clients must adhere to prescribed levels of processing speed, RAM memory, imagery, and disc capacity.

3. Access to HKATS

Access to HKATS is limited to the ATS Exchange Participant Reps of Exchange Participants holding relevant trading subscriptions[28] that have been registered with HKATS.[29] The staff members of Exchange Participants also may access HKATS, provided they confine their activity to non-trading technical and support functions and are registered with HKFE for that purpose.[30] An ATS Exchange Participant Rep must: (i) be nominated by an Exchange Participant and approved by HKFE; (ii) be an employee of an Exchange Participant; (iii) be a registered dealer representative; (iv) complete a training program conducted by the Exchange; and (v) have passed all competency tests required by HKFE. ATS Exchange Participant Reps are responsible for executing orders, reconciling orders sent by Exchange Participants with orders confirmed by HKATS, and ensuring that all orders comply with HKFE Rules. Former ATS Exchange Participant Reps are subject to disciplinary action by the SFC and HKFE for their actions undertaken while authorized throughout the applicable statute of limitations period in Hong Kong. A person's status as an ATS Exchange Participant Rep may be suspended or revoked without notice as a result of disciplinary action taken under HKFE Rules.

HKATS includes security mechanisms designed to prevent unauthorized access to the system. Once an Exchange Participant obtains a license for or assembles its Front-End Client, it is assigned a network processor node by the Exchange. Only those processor nodes with valid hardware addresses that have been registered with the Exchange may communicate with HKATS. An Exchange Participant must receive written consent from the Exchange before changing the location of its processor node. In addition, an ATS Exchange Participant Rep must enter its unique username and password in order to gain access to HKATS. HKATS also uses software encryption to prevent data and communications protocols from being compromised.

4. Audit Trail

HKFE represents that the Ordinances and HKFE Rules require that transactions executed through HKATS produce a clear audit trail. Although each order sent to HKATS is registered and time-stamped by the system itself, HKFE Rules require ATS Exchange Participant Reps to immediately record and time-stamp each order received from a customer on a time-stamping machine that is unique to the ATS Exchange Participant Rep. Order tickets must be time-stamped again if the order is altered, executed, or cancelled by the customer, or if the order is transmitted to another location before being sent to the market. Order tickets for transactions entered into on HKATS must include all of the information necessary to identify the transaction, including a contract identifier, the order date, the side (buy or sell), the price, the quantity, an order stipulation (*e.g.*, limit, etc.), whether the transaction is made on behalf of an Exchange Participant or a customer, and, in the case of options, the type of option and the strike price. Order details must be kept for at least seven years. The Ordinances further require Exchange Participants to complete a “contract note” for every futures and option contract entered by an Exchange Participant as an agent for a client no later than the end of the next trading day and deliver the contract note to the client within five days of the transaction date. The contract note must include, where applicable: the name of the client; the name and principal place of business of the Exchange Participant; the name of the Exchange; the name of the agent executing the contract; whether the contract is a new contract or a contract for settlement; whether the contract is by way of purchase, sale, or exchange; the commodity; the trading unit of the commodity; the price per trading unit; the number of trading units; the date on which the contract is to be performed; and the rate or commission payable.

Each Exchange Participant also must maintain records that are adequate to explain the transactions executed on HKATS, reflect the financial position of the commodity futures and option business of the Exchange Participant, and enable true and fair profit and loss accounts and balance sheets to be prepared. Separate accounts must be kept with respect to each customer and all orders must be given a unique and clearly identifiable reference. Specifically, each Exchange Participant must maintain records that: (i) detail all amounts received and paid by the Exchange Participant, including amounts paid to and disbursed from a segregated account; (ii) detail all purchases and sales of futures and option contracts made by the Exchange Participant, and the charges and credits arising from them; and (iii) distinguish transactions entered into on the Exchange Participant's behalf from those transactions entered into on behalf of customers. Each Exchange Participant also must maintain, for at least two years, a copy of each futures or option contract that is: (i) made out by him as agent of a customer, or (ii) received by him or made out to himself as principal. In addition, all Exchange Participants are required to provide confirmation statements and monthly account statements to their customers.

The above-referenced records must be kept: (i) in writing; (ii) in English (or in such a manner as to enable them to be readily accessible and readily converted into written form in English); (iii) in such a manner as will enable them to be audited conveniently and properly; and (iv) for at least seven years. Records may be maintained in electronic form. Finally, all telephone conversations with customers regarding order reception, submission, and confirmation must be conducted upon audio-logged lines. Each Exchange Participant is required to maintain audio tapes of such conversations for at least three

months.

HKFE has full access to the audit trail information described above in order to satisfy itself that Exchange Participants have enacted appropriate procedures and controls with respect to the business conducted on the Exchange.^[31] In addition, HKFE can, at any time, require its Exchange Participants to provide the Exchange with relevant information regarding their trading on HKATS. Exchange Participants have a duty to respond to HKFE's requests for information. Any Exchange Participant who contravenes the above-referenced record requirements without reasonable excuse is subject to disciplinary action by HKFE or the SFC, including fines and imprisonment. Any Exchange Participant who willfully: (i) enters, records, or stores falsified information; (ii) destroys, removes, or falsifies any matter that is entered, recorded, or stored; or (iii) fails to enter, record, or store any matter with the intent to falsify the records or any part thereof, also is subject to fines and imprisonment.

5. Order Processing

HKATS accepts several types of orders for execution, including single,^[32] standard combination,^[33] non-standard combination,^[34] and cross-trade orders.^[35] Currently, all orders must be limit orders.^[36] Upon the completion of an upgrade to the HKATS, market orders^[37] will be permitted. Order volume parameters may be specified. For limit orders, cancellation parameters also may be specified. Immediate and cancel orders are executed against any existing orders, and any unfilled portion of the order is cancelled immediately. Good until cancelled orders, rather than being cancelled automatically at the end of the trading session, are held until an optionally specified date (unless withdrawn by the ATS Exchange Participant Rep) or until the contract month which they relate to expires. Fill-or-kill orders must be filled in their entirety against any existing orders; otherwise, the order is cancelled. Fill-and-kill orders must be filled with as much quantity as possible; the unfilled portion of the order is cancelled. The priority of an order is unaffected by a reduction in quantity of the order, or a change in the validity time or the account number of the order. All other order modifications, however, result in the deletion of the existing order and the entry of a new order with a new order number.

The principle underlying the matching and ranking of orders processed by HKATS involves the application of strict price/time priority methodology. More specifically, HKATS prioritizes orders first by the best price and second by the time the order is processed. The price of incoming orders is compared to the price of orders already in the order book. To match single orders, HKATS uses the following rule: close as much quantity as possible for the order book order, take help from the same side (or the other side, depending upon block sizes) to close as much as possible for the first order in the order book, and continue with the second incoming order, and so on. To match combination orders, HKATS uses the following matching rule: close as many contracts as possible at the best price in both the combination and the single order book, and if the price is equal, use the orders in the single order book. Non-standard combination orders are matched according to the following rule: the whole non-standard combination order must be closed in the single order book, and no matching takes place in the combination order book. Once two orders are matched, the information regarding the transaction is forwarded to the Deal Capture sub-system.

HKATS calculates price parameters throughout the trading day during each contract month and will reject attempts to enter orders for prices outside these limits. Exchange officials can update the price limits at any time.

6. Clearing

HKCC is the clearinghouse that reconciles and matches all trades made on HKFE; marks-to-market the daily obligations of each HKCC member; demands margin funds, in its discretion, on an intra-day basis; [38] imposes capital-based position limits; and guarantees the financial obligations of each HKCC member. Once matched orders are recorded in a particular file of HKATS (the “log b” file), HKCC assumes the market obligations of its participants through the process of “novation” (for each futures or option contract effected on HKFE, HKCC is substituted as the buyer to each original seller and the seller to each original buyer). Absent default, HKCC's obligations are met from the payments made to HKCC by the parties on the other side of each contract. HKCC has established specific procedures to remedy a default by one of its members.

7. System & Network Response Time

HKFE represents that the hardware configuration of HKATS has been designed and sized to deliver response times of fewer than five seconds for 99.9% of the trading day, when loads are at three times their historical daily peak trading volume. HKFE further represents that when HKATS is made available outside of Hong Kong, the system will be constructed to ensure that no one network is disadvantaged over another and will provide equitable order executions to all participants. HKFE also represents that HKATS will be designed to detect timing differences, and that the Exchange will monitor for such differences and take corrective action.

8. Reliability and Failure Recovery

HKFE represents that its network is operated to achieve 99.9% availability and that the availability and the capacity of the network are monitored in real time by a system implemented by the operation center in Hong Kong. However, HKATS is built on fully redundant system architecture that has automatic recovery capability. In the event that there is a failure of any HKATS machine, process, subsystem, or network component, a backup site automatically assumes responsibility for all necessary operations. ATS Exchange Participant Reps can determine whether any interruption is due to the failure of a network connection or other HKFE equipment (as opposed to the hardware or software provided by the Exchange Participant for whom he trades) by opening certain system windows. In the event that HKFE cannot communicate to ATS Exchange Participant Reps via HKATS, the Exchange will contact Exchange Participants individually by telephone, facsimile or other appropriate means.

HKFE has identified certain areas in which the HKATS system may fail and has adopted specific remedial procedures to address them. System operators can replace faulty HKATS components on-line

without shutting down the system. In the event of an HKATS component failure, Exchange Participants may encounter delays of up to three minutes. HKFE will not cancel outstanding orders on behalf of ATS Exchange Participant Reps during this recovery process. However, ATS Exchange Participant Reps may telephone the HKFE SOS Centre in Hong Kong during this time and request that the Exchange cancel all outstanding orders immediately. During the recovery period, ATS Exchange Participant Reps are required to clarify the status of any outstanding order before confirming any order execution to a customer. HKFE will notify all ATS Exchange Participant Reps when the recovery process has been completed.

In the event that an HKATS system failure cannot be recovered immediately, HKFE may suspend trading activities temporarily until the system is capable of providing satisfactory service to all ATS Exchange Participant Reps. During a system failure of this magnitude, HKFE will cancel all outstanding orders on behalf of all ATS Exchange Participant Reps. Once the failure has been resolved, HKFE will broadcast the opening schedule of all markets via the HKATS market messages window.

In the event that an Exchange Participant individually suffers from a network or hardware failure, the ATS Exchange Participant Rep must contact the HKFE SOS Centre and advise the Exchange as to whether the ATS Exchange Participant Rep would like to cancel all outstanding orders or keep such orders activated. The ATS Exchange Participant Rep may continue its trading activities on backup terminals located in the HKFE SOS Centre. Alternatively, an ATS Exchange Participant Rep may arrange to have other Exchange members handle its orders during a personal system failure. Any ATS Exchange Participant Rep who fails to provide instructions to HKFE within ten minutes after the interruption of the system will have its orders inactivated.

9. Market Supervision and Surveillance

HKFE continuously monitors transactions conducted on HKATS to ensure that trades are executed in compliance with HKFE Rules. For this purpose, HKFE has created its Market Supervision and Market Surveillance Teams.

Among other things, the Market Supervision Team: (i) ensures that HKATS systems and equipment are in working order; (ii) provides assistance to Exchange Participants regarding the operations of HKATS; (iii) implements HKATS procedures; (iv) monitors the daily trading activity of HKATS markets; (v) produces reports that monitor the performance of certain Exchange Participants; (vi) informs the Market Surveillance Team of any suspected trading irregularities; (vii) implements error trade rules to rectify any trade errors caused by human error; (viii) updates and maintains statistical records for HKATS markets; and (ix) would implement the HKFE's Business Continuity Plan in the event that HKATS suffers a breakdown.

Among other things, the Market Surveillance Team: (i) investigates all incidents referred from the Market Supervision Team and complaints from other sources; (ii) monitors the price level, volatility, and large trades in each market during the market-opening period for any irregularities; (iii)) monitors

real time market conditions for irregularities; (iv) reviews real time information relating to the open positions of Exchange Participants that are subject to trading restriction orders; (v) reviews large positions held in house or customer accounts to identify any major changes in these positions, potential over-concentrations of positions, potential breaches of customer position limits, and the potential risk of default; (vi) uses computer applications to identify potential pre-arranged trades or front-running activities; (vii) reviews daily reports of cross trades for irregularities; (viii) reviews trade registers that it receives on the business day immediately following a trading session that reflect all trading activity for that session, including information about each order entered into HKATS and order modifications and cancellations; (ix) reviews the internal allocation of trades between house and customer accounts to identify potential abuses of the cross trade procedures or improper transfers of positions; (x) reviews error trade corrections made by Exchange Participants after trading hours; and (xi) investigates such trades.

Both the Market Supervision and Market Surveillance Teams use the applications available in the Market Supervision sub-system to perform their duties. In addition, the Market Surveillance Team employs software programs that have been developed in-house. These applications provide authorities with transparency over each order placed and executed on HKATS. They also permit authorities to analyze the trading behavior of many ATS Exchange Participant Reps in numerous markets, analyze irregularities in the market, and conduct investigations into member trading. The Market Supervision and Market Surveillance Teams and other staff also conduct routine and event-triggered visits to Exchange Participants in which they review and audit the Participants' trading to ensure that they comply with Exchange Rules. If the Market Supervision Team or the Market Surveillance Team identify sufficient evidence of non-compliance with HKFE Rules, a disciplinary panel of the Exchange sets and imposes appropriate sanctions. The SFC also performs on-site inspections of Exchange Participants. These visits include the inspection of Participants' books and records and order tickets and the evaluation of the controls and procedures employed by Exchange Participants in the administration of their business.

B. Adherence to IOSCO Principles

HKFE represents that it employed the expertise of industry specialists during the design, building, and implementation of HKATS to ensure that the resulting system infrastructure would follow best industry practice and quality standards. HKFE also represents that, in developing and operating HKATS, it has adhered to, and will continue to adhere to, the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products developed by the Technical Committee of the International Organization of Securities Commissions ("IOSCO Principles").[\[39\]](#)

As a member of the Technical Committee, the SFC endorsed the IOSCO Principles in 1998. In connection with the SFC's exercise of its oversight of HKFE as an Exchange Company, HKFE has satisfied SFC that the arrangements for HKATS and its use of the technology employed by that system are satisfactory.

C. Demarcation of Responsibility and Liability

HKFE operates HKATS to the point where the Network enters the Exchange Participants' Front-End Clients, excluding the installation of the Network and the operation of the OMnet API. HKFE places the onus on the Exchange Participant to ensure that all persons on the Exchange Participant's staff sufficiently understand the manner in which HKATS operates to perform their assigned roles effectively. Exchange Participants and certain persons on their staff also are responsible for ensuring that: (i) the arrangements for conducting HKATS business are consistent with HKFE Rules, and (ii) all business conducted by way of such arrangements is consistent with HKFE Rules. HKFE may institute disciplinary action against and impose sanctions upon both Exchange Participants and/or their ATS Exchange Participant Reps should they fail to perform these duties. As set forth in the HKFE Subscription and License Agreement, neither HKFE nor its officers, employees, agents, or representatives may be held liable to any Exchange Participant or customer for any loss or damage resulting from or in connection with the occurrence of a suspension or closure of HKFE or a disruption in HKATS service, regardless of cause.

IV. OVERVIEW OF THE REGULATORY STRUCTURE IN HONG KONG

A. Introduction

HKFE is subject to a comprehensive regulatory regime in Hong Kong. This regulatory structure includes, among other things: financial and other fitness criteria for industry participants; reporting and recordkeeping requirements; procedures governing the treatment of customer funds and property; sales practice and other conduct of business standards; provisions designed to protect the integrity of the markets; and statutory prohibitions on fraud, abuse, and market manipulation. Responsibility for legislation in Hong Kong lies with the Hong Kong Legislative Council. Responsibility for regulating the conduct of investment business and for providing investor protection in Hong Kong rests with the SFC. The principal legal provisions for investor protection in Hong Kong's financial services sector are contained in the Ordinances, which are enforced by the SFC. Violations of any of the Ordinances are criminal offenses that are punishable by fine or imprisonment.

Oversight of the Exchange and Exchange Participants is as follows: HKFE primarily is responsible for the enforcement of trading rules and practices, monitoring large client positions carried by Exchange Participants, and monitoring the financial positions of Exchange Participants for HKCC's risk management purposes. Investigations are performed where necessary. Where there is evidence of trading malpractices or other Exchange Rule violations by an Exchange Participant, HKFE's Compliance Department will institute disciplinary proceedings against the Exchange Participant pursuant to HKFE Rules. If the trading malpractice or Rule violation warrants immediate action, HKFE Rules permit the Exchange's Chief Executive to summarily suspend any or all of the rights of the Exchange Participant or take any other summary action as the Chief Executive may think fit, if he has reason to believe that: (i) the Exchange Participant is or may be in such financial or operational difficulty that it may not be permitted to continue to do business safely with clients, other Participants, HKFE, or HKCC; (ii) such

action is necessary to protect the interests of HKFE or HKCC; or (iii) such action is necessary to ensure the orderly trading of the markets of HKFE or the operation of HKCC. The SFC is responsible for ensuring Exchange Participants' compliance with financial requirements, internal control requirements, and the SFC's Code of Conduct. For these purposes, the SFC reviews the financial returns of Exchange Participants and performs routine inspections and investigations. The SFC is authorized to take such emergency actions that are necessary to maintain or restore an orderly market, including terminating or suspending trading on HKFE or through HKCC and imposing trading restrictions.

B. Regulation of HKFE as an Exchange Company

HKFE is a licensed Exchange Company under the CTO. As part of the licensing process, HKFE was required to satisfy certain statutorily-prescribed criteria. HKFE must continue to fulfill these obligations in order to maintain its license. Among other things, the HKFE is required to: (i) operate its markets with due heed to the protection of investors; (ii) ensure that trading is conducted in an orderly and fair manner; (iii) maintain suitable arrangements for trade reporting; (iv) maintain an adequate and properly equipped place of business; (v) retain specified financial resources; (vi) guarantee fulfillment of futures and option contracts through one or more authorized clearinghouses; (vii) maintain Exchange Rules that deal with the default of Exchange members; and (viii) monitor compliance with and enforce Exchange Rules. The SFC monitors HKFE to ensure its continuing compliance with the licensing criteria and is authorized to revoke the Exchange's license for its failure to comply with these requirements. HKFE also is required to obtain SFC approval for any amendments to its Constitution or Rules. Where the SFC is satisfied that it is in the public interest or appropriate for the protection of investors or the proper regulation of HKFE or HKCC, the SFC, by written notice, may require HKFE or HKCC to: (i) amend, withdraw, or revise any provision of its Memorandum, Articles of Association, Rules, or other instrument, or (ii) take such action relating to the management, conduct, or operation of its business as may be specified in a restriction notice. HKFE has never been found to be in breach of its regulatory responsibilities. HKCC, a "Recognized Clearinghouse" under Hong Kong law, also is subject to oversight by the SFC.

C. Regulation of Exchange Participants

Because trading on HKFE constitutes carrying on the business of trading in commodity futures contracts, Exchange Participants, with limited exceptions, must be registered as dealers with the SFC and are subject to SFC oversight.[\[40\]](#) An applicant for dealer registration must submit to the SFC a registration form and a statement, which includes personal information regarding the applicant's employment history and business affiliations, prior disciplinary actions taken by HKFE or other exchanges that involve the applicant, and any litigation that involves the applicant.[\[41\]](#) The applicant also must provide the SFC with written notice of the location of the premises at which any record or other document relating to the business in which the applicant will be registered will be maintained. The applicant may be required to deposit HK\$100,000 (US\$12,853) with the Exchange which, in turn, is obligated to deposit the funds with the SFC. The SFC maintains all applicant deposits until the application is rejected or until a dealer ceases operations. The SFC will issue a certificate of registration

authorizing the applicant to carry on a business as a dealer if it determines that the applicant: (i) has provided the necessary background and business information; (ii) is not an undischarged bankrupt and has not committed the act of bankruptcy within the meaning of the Hong Kong Bankruptcy Ordinance; and (iii) satisfies the minimum capital requirements set forth in the SFCO. As dealers, all Exchange Participants are subject to the oversight of the SFC and must comply with its Code of Conduct. The SFC is charged with ensuring that all Exchange Participants continue to satisfy the dealer registration requirements and with enforcing the Code of Conduct. The SFC also is authorized to suspend or revoke dealer registration. Violations of the Code of Conduct may result in disciplinary action.

V. EXCHANGE RULES

In addition to the regulatory requirements set forth above, Exchange Participants are required to comply with comprehensive rules promulgated by HKFE's Board and approved by the SFC. HKFE Rules are applicable to trading on HKATS without regard to jurisdictional boundaries because the obligations thereunder arise by virtue of the contractual relationship between HKFE and Exchange Participants. HKFE Rules are designed to enable the Exchange to fulfill its obligations as a licensed Exchange Company, including the requirement that HKFE ensure that its markets are fair and orderly and operated with due regard to the protection of investors. Exchange Participants and each of their respective ATS Exchange Participant Reps and staff are subject to disciplinary action for failure to comply with HKFE Rules, which may result in fines, suspension, or expulsion. All disciplinary actions are undertaken by the SFC based upon referrals from the Exchange or the SFC's own investigations. Firms that cease to be members of HKFE and persons who are de-registered as ATS Exchange Participant Reps remain subject to HKFE's disciplinary jurisdiction.

The rules promulgated by HKFE and HKCC contain both substantive provisions relating to HKFE Exchange Participant and HKCC membership criteria and trading and procedural requirements. Among other things, these rules require HKFE Exchange Participants and HKCC members to: (i) comply with the Ordinances; (ii) generally prohibit fraud and market manipulation; (iii) satisfy minimum capital requirements; (iv) observe high standards of integrity, fair dealing, and market conduct; (v) act with due skill, care, and diligence; (vi) avoid or manage conflicts of interest; (vii) calculate the margin liability for each customer with respect to open positions on its books each day; (viii) promptly collect the margin liability of customers, in cash or in prudently-valued collateral; (ix) record all details of customer orders, execute customer orders promptly (except where otherwise permitted), and submit the details of customer trades for registration and clearing; (x) maintain proper accounting and other records sufficient to create an audit trail with respect to HKFE business; (xi) submit financial statements on a regular basis; and (xii) ensure that the appropriate procedures and controls are in place with respect to the business the Exchange Participant conducts. They also include rules designed to protect the integrity of the market, such as rules regarding best execution, customer order priority and customer order allocation, restricting the offer of illiquid or off-market investments, prohibiting Exchange Participants from trading ahead or opposite customers, and prohibiting the churning of accounts and the switching of contracts, and imposing position limits and large trader reporting requirements on trading in specific contracts. Exchange Participants are further required to provide each of their clients with monthly account statements setting forth the client transactions and related dealings. HKFE and HKCC Rules

also generally prohibit any Exchange Participant from committing any act or engaging in any conduct likely to bring either entity into disrepute. HKCC Rules include default rules which set forth, among other things, the circumstances which it may take action in the event of default, the actions that it may take, the type of resources that it may use to satisfy the default of members' obligations, and the sequence in which such resources may be used.

VI. INFORMATION SHARING

Pursuant to the terms and conditions of the no-action relief provided herein, and as set forth more fully below, the Division will be entitled to receive certain specified information regarding HKATS directly from HKFE. Additional information relevant to HKATS and HKATS participants will be available to the Commission and its staff through certain information-sharing arrangements to which both the Commission and the SFC are parties. These include, without limitation: the *Memorandum of Understanding Concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws*, dated October 5, 1995; the

Declaration on Cooperation and Supervision of Cross Border Managed Futures Activity, dated October 5, 1995; and the *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations*, as amended, March 1998 (commonly known as the "Boca Declaration").

VII. CONCLUSION

Consistent with the Commission's June 2 Order,[\[42\]](#) the Division has reviewed and considered HKFE's No-Action Request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by HKFE indicate that the Exchange does not maintain any office or staff in the United States;[\[43\]](#) provide investment advice, solicit orders, or direct trading from the United States; or maintain any order matching or clearing facilities in the United States. The materials also indicate that HKATS is a licensed Exchange Company under the laws of Hong Kong; that the HKFE, HKATS, and HKFE market participants are subject to oversight in Hong Kong by legitimate regulatory authorities that are responsible for ensuring their compliance with an extensive regulatory regime; HKATS adheres to the IOSCO Principles; and the CFTC and the SFC are parties to various information-sharing arrangements applicable to HKATS participants and activities involving HKATS. [\[44\]](#)

Based specifically upon these and other representations made by HKFE in support of its No-Action Request, the Division has determined that granting no-action relief to HKFE and its Exchange Participants, pending the adoption by the Commission of rules or guidelines regarding access to foreign boards of trade from electronic trading devices in the United States, would not be contrary to the public interest. Accordingly, subject to compliance with the terms and conditions stated herein, the Division will not recommend that the Commission institute enforcement action against HKFE or its Exchange Participants solely based upon HKFE's failure to obtain contract market designation pursuant to Sections 5 and 5a of the CEA, if: (i) Exchange Participants trade for their proprietary accounts through HKATS

in the United States; (ii) Exchange Participants who are registered with the Commission as FCMs or who are Rule 30.10 Firms submit orders from United States customers for submission to HKATS; and/or (iii) Exchange Participants who are registered with the Commission as FCMs or who are Rule 30.10 Firms accept orders through United States AORSs from United States customers for submission to HKATS.

The Division's no-action position is applicable only to the contracts described below, and shall become effective with respect to such contracts as follows:

(i) The relief is effective immediately with respect to the following contracts:

- HKFE Taiwan Index futures and options thereon,[\[45\]](#)
- One-month Hong Kong Interbank Offered Rate futures,
- Three-month Hong Kong Interbank Offered Rate futures,
- One-day rolling currency futures on the British Pound,
- One-day rolling currency futures on the Deutschemark,
- One-day rolling currency futures on the Yen,
- One-day rolling currency futures on the Euro, and
- Hang Seng Index futures and options thereon.[\[46\]](#)

(ii) The relief will become effective with respect to the following contracts upon receipt of a no-action position from Commission staff that would permit the offer and sale of futures contracts on such foreign stock indices within the United States:

- Hang Seng China-Affiliated Corporations Index futures and options thereon,[\[47\]](#)
- Hang Seng 100 futures and options thereon, and
- Hang Seng Properties Sub-Index futures and options thereon.

If additional contracts or products become available for trading through HKATS and the HKFE wishes to make such contracts or products available in the United States through the system, HKFE must request in writing and receive supplementary no-action relief prior to offering such contracts. In the event that a supplemental request for relief is made by HKFE, it will not be required to submit materials

already received by the Division in connection with the No-Action Request addressed herein, unless there has been a material change in the structure, operation, or regulation of HKFE or HKATS such that the information that already has been provided to the Division no longer remains accurate. Any supplemental request for expanded no-action relief to cover different HKFE products need only be accompanied by a certification to the effect that material information previously submitted to the Division remains accurate and by a description of the contracts or products available for trading on HKATS to which HKFE wishes to extend the Division's no-action relief.

The scope of the Division's no-action position is restricted to providing relief from the requirement that HKFE obtain contract market designation pursuant to Sections 5 and 5a of the CEA and regulatory requirements that flow specifically from the contract market designation requirement if the above-referenced contracts are made available in the United States through HKATS, in the manner set forth herein. The Division's no-action position does not extend to any other provision of the CEA, any other Commission regulations, or any National Futures Association ("NFA") rules, and does not excuse either HKFE or its members from compliance with any applicable requirements thereunder. Nor does the no-action position alter, restrict, or expand the coverage of existing Commission exemptions for particular products.

The Division specifically notes that its no-action position does not alter the requirement that a firm operating pursuant to the no-action relief provided herein must be a registered FCM or be operating pursuant to Rule 30.10 relief to engage in the offer or sale of a foreign futures contract or a foreign options transaction for or on behalf of a United States foreign futures or foreign options customer. For example, nothing in this letter is intended to alter current Commission rules and staff interpretations that require generally that any foreign firm that clears trades on a fully-disclosed basis on behalf of United States persons (including where the United States person is a non-clearing member of a foreign board of trade trading solely for its proprietary account) be a registered FCM or a Rule 30.10 Firm unless the foreign firm solely carries accounts on behalf of United States customers that are proprietary accounts (as defined in Rule 1.3(y)) of the foreign firm.[\[48\]](#) If the foreign firm is either a member of the relevant foreign board of trade or is a foreign affiliate of a registered FCM in the United States and its sole contact with a United States customer is that it carries the FCM's omnibus account, then that firm need not register under Rule 30.4.[\[49\]](#)

Moreover, the Division's no-action position does not amend, revise, or negate the obligations of FCMs and Rule 30.10 Firms under the CEA, Commission regulations, or Rule 30.10 orders. For example, Rule 30.10 Firms continue to be prohibited from maintaining a presence in the United States. Thus, Rule 30.10 firms cannot provide direct access to HKATS in the United States (although they would be permitted to accept orders overseas from customers located in the United States that submit such orders by telephone or through an AORS located in the United States). FCMs or Rule 30.10 Firms who solicit or accept orders from United States customers for trading on HKATS remain responsible for, among other things, complying with risk disclosure, the handling and allocating of customer orders, and the segregation of customer funds.

The Division's no-action position does not affect the Commission's ability to bring appropriate action for fraud or manipulation. The Division specifically notes that the use of AORSs to transmit orders to HKATS would be subject to all existing Commission rules and regulations and to any future rules, regulations, or guidelines promulgated by the Commission or the Division. Finally, this letter does not address issues that might arise under the Securities Act of 1933, the Securities Exchange Act of 1934, and other applicable federal securities laws or rules promulgated thereunder.

The Division's no-action position is subject to compliance with the following conditions:

- HKFE will continue to satisfy the criteria for licensure as an Exchange Company under the applicable laws of Hong Kong with respect to transactions effected through HKATS.
- The laws, systems, rules, and compliance mechanisms of Hong Kong applicable to HKFE will continue to require HKFE to maintain fair and orderly markets, prohibit fraud, abuse, and market manipulation, and provide that such requirements are subject to the oversight of appropriate regulatory authorities.
- HKFE and HKATS will continue to adhere to the IOSCO principles as updated, revised, or otherwise amended.
- Only Exchange Participants will have direct access to HKATS (*i.e.*, not through an AORS) and HKFE will not provide, and will take reasonable steps to prevent, third parties from providing such access to HKFE to persons other than Exchange Participants.[\[50\]](#)
- All orders that are transmitted through HKATS by an Exchange Participant of HKFE that is operating pursuant to the no-action relief provided herein and that is not registered with the Commission as an FCM or that is not a Rule 30.10 Firm will be solely for "proprietary accounts," as defined herein, of such Exchange Participant.
- All orders for United States customers accepted through an AORS and/or transmitted by Exchange Participants through HKATS will be intermediated by an Exchange Participant that is either registered with the Commission as an FCM or is a Rule 30.10 Firm.
- HKFE will require each current and future Exchange Participant that is not registered with the Commission as an FCM to file with HKFE a written representation, executed by a person with the authority to bind the Exchange Participant, stating that as long as the Exchange Participant operates pursuant to the no-action relief provided herein, the Exchange Participant agrees to and submits to the jurisdiction of the Commission with respect to activities conducted pursuant to the no-action relief. HKFE will obtain the foregoing representation before it permits the relevant Exchange Participant to operate pursuant to the no-action relief and will maintain the representation as long as the relevant Exchange Participant is operating pursuant to that relief. HKFE will make such representations available to the Commission upon the request of a Commission representative.

- HKFE will require each current and future Exchange Participant that is not registered with the Commission as an FCM to file with HKFE a valid and binding appointment of a United States agent for service of process in the United States pursuant to which the agent is authorized to accept delivery and service of "communications" [\[51\]](#) that are issued by or on behalf of the Commission. HKFE will obtain the foregoing appointment before it permits the relevant Exchange Participant to operate pursuant to the no-action relief and will maintain the appointment as long as the relevant Exchange Participant is operating pursuant to such relief. HKFE will make such appointments available to the Commission upon the request of a Commission representative.
- HKFE will require each current and future Exchange Participant that is not registered with the Commission as an FCM to file with HKFE a written representation, executed by a person with the authority to bind the Exchange Participant, stating that, as long as the Exchange Participant operates pursuant to the no-action relief provided herein, the Exchange Participant will provide, upon the request of the Commission, the United States Department of Justice, and, if appropriate, NFA, prompt access to original books and records maintained at its United States offices as well as to the premises where HKATS is installed or used in the United States. HKFE will obtain the foregoing representation before it permits the relevant Exchange Participant to operate pursuant to the no-action relief and will maintain the representation as long as the relevant Exchange Participant is operating pursuant to that relief.
- HKFE will file with the Division a valid and binding appointment of a United States agent for service of process in the United States, pursuant to which the agent is authorized to accept delivery and service of "communications," as defined above, that are issued to HKFE by or on behalf of the Commission. HKFE will maintain the foregoing representation as long as HKFE or HKATS operate pursuant to that relief.
- HKFE will maintain the following updated information and submit such information to the Division on at least a quarterly basis, and at any time promptly upon the request of a Commission representative:
 - For each contract available to be traded through HKATS, the total trade volume originating from electronic trading devices providing access to HKATS in the United States (including volume originating from AORs that route orders to HKATS) compared with the total trade worldwide volume for such products that is traded through HKATS and the total worldwide trade volume for such products that is traded on HKFE generally.
 - A listing of the names, NFA ID numbers (if applicable) and main business addresses in the United States of all Exchange Participants that have access to HKATS in the United States.
 - HKFE will promptly provide the Division with written notice of the following:
 - Any material change in the information provided in its No-Action Request, including any

information contained in the documents submitted in support thereof.[\[52\]](#)

- Any material change in HKFE's Rules or the laws, rules, and regulations in Hong Kong relevant to futures and options.
- Any matter known to HKFE or its representatives that, in HKFE's judgment, may affect the financial or operational viability of HKFE, including, but not limited to, any significant system failure or interruption.
- Any default, insolvency, or bankruptcy of any Exchange Participant known to HKFE or its representatives that may have a material, adverse impact upon the condition of HKFE, HKCC, or upon any United States customer or firm.
- Any known violation by HKFE or any Exchange Participant of the terms or conditions of the no-action relief provided herein.
- Any disciplinary action taken by HKFE against any Exchange Participant of HKFE operating pursuant to the no-action relief provided herein that involves any market manipulation, fraud, deceit, conversion or that results in suspension or expulsion and that involves the use of HKATS or an AORS to submit orders to HKFE.
- Satisfactory information-sharing arrangements between the Commission and the SFC will remain in effect.
- The Commission will be able to obtain sufficient information regarding HKFE and its Exchange Participants operating pursuant to the no-action relief provided herein necessary to evaluate the continued eligibility of HKFE or its Exchange Participants for the relief, to enforce compliance with the terms and conditions of that relief, or to enable the Commission to carry out its duties under the CEA and Commission Regulations.
- HKFE will provide directly to the Commission information necessary to evaluate the continued eligibility of HKFE or its Exchange Participants for the relief, to enforce compliance with the terms and conditions of that relief, or to enable the Commission to carry out its duties under the CEA and Commission regulations.
- HKFE employs reasonable procedures, to be determined by HKFE, for monitoring and enforcing compliance with the terms and conditions of the no-action relief provided herein.

This no-action position is taken by the Division only and does not necessarily reflect the views of the Commission or any other unit or member of the Commission's staff. It is based upon the information and representations contained in HKFE's No-Action Request and the materials submitted in support thereof. Any materially different, changed, or omitted facts or circumstances may render this letter void. The

Division specifically notes that it will examine the trade volume information submitted as a condition to the no-action relief provided herein as well as any changes in the nature or extent of HKFE's activities in the United States to ascertain whether HKFE's presence in the United States has increased to a level that might warrant reconsideration of the no-action relief.

As with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion. Finally, the Division wishes to emphasize that the no-action position set forth herein is intended to provide immediate, interim relief to HKFE and its Exchange Participants, pending any adoption of rules or guidelines by the Commission regarding the use and placement in the United States of automated trading systems or AORSs that provide access to the products of foreign boards of trade. Thus, this letter will cease to be effective in the event that the Commission or its staff adopts generally applicable rules or general guidelines regarding the issues addressed herein, and HKFE will be subject to those rules or guidelines in that event.

If you have any questions regarding this correspondence, please contact me or Andrew V. Chapin at (202) 418-5430.

Very truly yours,

John C. Lawton
Acting Director

cc: Daniel A. Driscoll, Vice President, Compliance, NFA
Henry J. Matecki, Division, Chicago Regional Office

[1] Letter from Philip McBride Johnson, Skadden, Arps, Slate, Meagher & Flom LLP, to I. Michael Greenberger, Director, Division of Trading and Markets, Commodity Futures Trading Commission (July 16, 1999).

[2] For the purpose of the No-Action Request and the relief provided herein, the term "Exchange Participants" shall mean those persons who have acquired "Futures Exchange Trading Rights" ("Trading Rights"), satisfy the Exchange Participant criteria set forth in Section II of this letter, have been approved by HKFE to exercise their respective Trading Rights, and are exercising such Rights. References to the Exchange Participants shall include any "affiliate" of any Exchange Participant who has been granted access by the Exchange Participant to HKATS. An "affiliate" of an Exchange

Participant shall mean any person that: (i) owns 50% or more of the member; (ii) is owned 50% or more by the member; or (iii) is owned 50% or more by a third person that also owns 50% or more of the member. HKFE represents that, as a condition of access to HKATS, such affiliates will be required to comply with all HKFE Rules and the Exchange Participant will remain responsible to HKFE for ensuring its affiliates' compliance. For the purposes of the No-Action Request and the relief provided herein, the term "HKFE Rules" shall include HKFE's Rules, Regulations and Procedures; HKFE Clearing Corporation Ltd.'s ("HKCC's") Rules and Procedures; the HKFE Subscription and License Agreement; the HKATS User's Guide; any circulars, notices or similar instructions issued by HKFE; and any other documents governing HKFE or its members.

[3] For the purposes of the No-Action Request and the relief provided herein, the term "United States" shall include the United States, its territories and possessions.

[4] For the purposes of the No-Action Request and the relief provided herein, the term "proprietary account" shall have the same meaning set forth in Commission Rule 1.3(y). Commission rules referred to herein are found at 17 C.F.R. Ch. I (1999).

[5] Rule 30.10 permits a person affected by any of the requirements contained in Part 30 of the Commission's rules to petition the Commission for an exemption from such requirements. Appendix A to the Part 30 rules provides an interpretative statement that clarifies that a foreign regulator or self-regulatory organization ("SRO") can petition the Commission under Rule 30.10 for an order to permit firms that are members of the SRO and subject to regulation by the foreign regulator to conduct business from locations outside of the United States for United States persons on non-United States boards of trade without registering under the Commodity Exchange Act, based upon the person's substituted compliance with a foreign regulatory structure found comparable to that administered by the Commission under the Act. HKFE has not petitioned the Commission for relief pursuant to Rule 30.10.

Among the issues considered by the Commission in determining whether to grant Rule 30.10 relief to a foreign regulatory or self-regulatory authority are the authority's: (i) requirements relating to the registration, authorization, or other form of licensing, fitness review, or qualification of persons through whom customer orders are solicited and accepted; (ii) minimum financial requirements for those persons that accept customer funds; (iii) minimum sales practice standards, including risk disclosures, and the risk of transactions undertaken outside of the United States; (iv) procedures for auditing compliance with the requirements of the regulatory program, including recordkeeping and reporting requirements; (v) standards for the protection of customer funds from misapplication; and (vi) arrangements for the sharing of information with the United States. *Interpretative Statement with Respect to the Commission's Exemptive Authority Under § 30.10 of its Rules*, 17 C.F.R. pt. 30, Appendix A (2000).

[6] For the purposes of the No-Action Request and the relief provided herein, the term "United States customers" shall have the same meaning as the term "foreign futures and options customers" as it is defined in Commission Rule 30.1(c).

[7] For the purposes of the No-Action Request and the relief provided herein, the term "AORS" shall be defined to include any system of computers, software or other devices that allows entry of orders through another party for transmission to a board of trade's computer or other automated device where, without substantial human intervention, trade matching or execution takes place.

[8] 7 U.S.C. §§1 *et seq.* (1994).

[9] *Access to Automated Boards of Trade*, 64 Fed. Reg. 14159 (March 24, 1999), *withdrawn*, June 2, 1999.

[10] *Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade*, Release No. 4274-99 (June 2, 1999).

[11] HKCC, a wholly-owned subsidiary of HKFE, is the clearinghouse for all futures and option contracts traded on HKFE.

[12] As described in more detail in Section IV, the Securities and Futures Commission ("SFC") is the authority that has been charged by the Hong Kong Legislative Council with enforcing the Ordinances.

[13] On June 5, 1997, the Commission approved a request from NYMEX to provide Exchange Participants with direct trading access to NYMEX products through NYMEX ACCESS®, NYMEX's electronic trading and order matching system. Letter from Jean S. Webb, Secretary, Commodity Futures Trading Commission, to Ronald S. Oppenheimer, Executive Vice President and General Counsel, New York Mercantile Exchange (June 5, 1997). As a condition of its approval, the Commission specifically prohibited the trading of HKFE products by NYMEX members through the linked access arrangement. The Division notes that nothing in the no-action relief provided herein expands, abrogates, or otherwise alters the terms and conditions of the Commission's prior approval of the linked access arrangement. Accordingly, the trading of HKFE products by NYMEX members through this arrangement remains prohibited.

[14][14] As stated below, the no-action relief provided herein is contingent upon the accuracy of the representations made by HKFE in support of the No-Action Request. Any materially different, changed, or omitted facts or circumstances may render the no-action relief void or cause the Division, in its discretion, to condition further, modify, suspend, terminate, or otherwise restrict the relief.

[15][15] On March 6, 2000, HKFE and the Stock Exchange of Hong Kong ("SEHK") merged. The newly-formed organization, known as the Hong Kong Exchanges and Clearing Limited ("HKEC"), is a private company incorporated in Hong Kong. HKFE and SEHK became wholly-owned subsidiaries of HKEC as a result of the merger. HKCC remains a wholly-owned subsidiary of HKFE.

Immediately upon the merger becoming effective, shares in both HKFE and SEHK were cancelled in

exchange for freely-transferable shares in HKEC. Two shares in HKEC were issued to the Financial Secretary Incorporated. (The Financial Secretary Incorporated is the regulatory body responsible for performing the duties of the Financial Secretary, which include, among other things, consultation with respect to the appointment of the Chief Executive, the Chief Operating Officer, and all of the Comptrollers of HKFE and HKCC). Each HKEC share was accompanied by Trading Rights rendering the holder eligible to trade on HKFE if such person satisfies the Exchange Participant criteria and has been approved by HKFE to trade on or through the Exchange.

[16] HKFE acknowledges that the CEA prohibits the offer and sale of futures contracts on individual stocks to United States customers and that the No-Action Relief provided herein does not alter that prohibition. However, futures contracts on individual stocks may be offered to non-United States customers, and these contracts are currently available to non-United States customers through HKATS.

[17] Receipt of a no-action position from Commission staff is a necessary prerequisite to the offer and sale of foreign futures contracts on foreign stock indices within the United States. However, foreign futures contracts on foreign stock indices may be offered and sold to persons located outside of the United States absent a no-action position, and such contracts are available on HKATS to persons located outside of the United States.

[18] An overview of HKATS is set forth in Section III.

[19] Recognized clearinghouses and persons who trade solely for their own account through registered dealers generally are not required to become registered as dealers themselves. Principals of corporations and partnerships that are registered as dealers are themselves required to be registered as dealers only if they are actively involved in the dealing business.

[20] The Compensation Fund is an investor guarantee program that has been established by the SFC. The SFC requires HKFE to make a contribution to the Compensation Fund in the amount of HK \$100,000 (US\$12,854) on behalf of every Exchange Participant. In addition, HKFE must pay to the Compensation Fund, on a monthly basis, a contract levy for each contract bought or sold on the Exchange. Any investor sustaining a pecuniary loss as the result of a default committed in the course of or in connection with commodity futures trading business transacted on HKFE by an Exchange Participant may make a claim against the Compensation Fund.

For informational purposes only, the Division has noted the United States dollar equivalent of any sum of Hong Kong dollars referenced herein, based upon the exchange rate of June 6, 2000 (HK\$7.78:US \$1). The Division notes that the financial requirements imposed upon HKFE and HKCC members, including minimum capital requirements, are not linked in any way to the United States dollar equivalents that are provided herein.

[21] The term "FCM" generally has the same meaning under HKFE Rules as it does under the CEA and

the Commission's regulations.

[22] HKFE represents that only one Exchange Participant is currently registered as a Merchant Trader.

[23] HKCC must approve the relationship between one Clearing Member and any other HKCC member for whom it intends to clear.

[24] HKFE represents that the technical aspects of OM CLICK and HKATS are fundamentally the same.

[25] The Market Supervision sub-system is discussed in Section II.A.9. below.

[26] Only those persons that have been approved as ATS Exchange Participant Reps by HKFE are permitted to access HKATS. The criteria for becoming an ATS Exchange Participant Rep is discussed in Section III.A.3.

[27] The Bulletin Board is used to seek interest and to trade combination orders which may or may not be tradable in the central order book. HKATS does not match orders in the Bulletin Board with the orders in the central order book.

[28] Where approval for trading any futures or option contract on HKFE has not been obtained from HKFE or any relevant regulator, HKFE will prohibit an Exchange Participant and its ATS Exchange Participant Reps from trading such contracts and from accessing information about those markets. Accordingly, Exchange Participants and their ATS Exchange Participant Reps that are located in the United States will not be able to access products from electronic devices providing access to HKATS which are located in the United States unless they are authorized to do so pursuant to the no-action relief provided herein.

[29] An ATS Exchange Participant Rep must submit all orders in the name of the Exchange Participant for whom it is trading. Each ATS Exchange Participant Rep must trade, at all times, in the name of, and on behalf of, the sponsoring Exchange Participant. The sponsoring Exchange Participant is responsible for all orders and other instructions entered and all trades made by its ATS Exchange Participant Reps on HKATS from any HKATS Front-End Client that is located at the Exchange Participant's premises or any other premises agreed upon by the Exchange. All trades on HKATS by an Exchange Participant's ATS Exchange Participant Rep or through an HKATS Front-End Client to which the Exchange Participant has access are binding upon the Exchange Participant, regardless of whether the trade was authorized by the Exchange Participant or is permitted by HKFE Rules. The Exchange Participant also may be held accountable financially for the behavior of its ATS Exchange Participant Reps in executing such trades and may be subject to disciplinary action for failure to procure compliance with HKFE Rules.

[30] Although such staff members are provided with passwords that enable them to access HKATS for the purpose of providing technical support, they do not receive usernames that enable them to access the systems trading functions.

[31] HKCC has delegated its disciplinary authority to HKFE. Accordingly, HKFE has full access to information maintained by HKCC.

[32] Single orders are solitary bid or ask orders for a specific future or option series.

[33] Standard combination orders consist of up to four single orders on the same underlying instrument that, in the aggregate, comprise a unique contract series that has been pre-defined by HKFE in the CDB.

[34] Non-standard combination orders consist of up to ten single orders on the same underlying instrument that, in the aggregate, do not comprise a unique, pre-defined contract series. Non-standard combination orders must be filled in their entirety, otherwise, the order is cancelled completely.

[35] HKFE understands that cross trade orders will be executed in a manner similar to the way in which they are executed on Globex, although the designated time during which the market must be shown both the buy and sell side of the order and during which either side may be traded is shorter on HKATS than it is on Globex.

[36] Limit orders trade at the price stated or better. Unless otherwise specified, any residual volume is retained in the central order book until it is withdrawn, traded, or automatically cancelled at the end of day.

[37] Market orders trade at the best price(s) available. In the case of partial execution, the unfilled contracts are cancelled.

[38] HKCC margins Exchange Participants separately for house and customer positions.

[39] Eight jurisdictions participated in the Working Party 7 of IOSCO ("Working Party") whose mandate included, among other things, the identification of issues related to screen-based trading systems for derivative products. In considering the special concerns for screen-based trading systems, the Working Party identified and addressed the following issues: transparency, order execution algorithms, operational issues, security and system vulnerability, access, financial integrity, disclosure, and the role of system providers. The Working Party considered these issues and articulated for each a broad principle to assist regulatory authorities in overseeing screen-based trading systems. The IOSCO Principles were adopted by IOSCO on November 15, 1990 and set out in broad terms the international consensus as to the regulatory considerations to be addressed in reviewing mechanisms for cross-border screen-based trading. The Commission adopted the IOSCO Principles as a statement of regulatory policy for the oversight of screen-based trading systems for derivative products on November 21, 1990.

Policy Statement Concerning the Oversight of Screen-Based Trading Systems, 55 Fed. Reg. 48670 (November 21, 1990).

[40] Generally, persons who are exempt from the dealer registration requirements are "authorized institutions" that are subject to the oversight of the Hong Kong Monetary Authority.

[41] In considering the fitness of a dealer registration applicant that is a partnership or corporation, the SFC evaluates the matter with respect to the entity's principals, directors, officers, employees, and substantial shareholders, as might apply.

[42] *Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade*, Release No. 4274-99 (June 2, 1999).

[43] The Division notes that HKFE would not be prohibited from having a representative office in the United States with a staff that is limited in both size and scope of activities in a manner similar to the United States office staff of other foreign exchanges that have received like no-action relief.

[44] The Division notes that the foregoing is not intended as an exhaustive list of the factors relevant to its decision to grant the no-action relief requested by HKFE nor of the factors that the Division might consider when analyzing no-action requests from other exchanges. No-action requests, by their nature, require case-by-case evaluation and the Division's conclusion regarding any no-action request will be based upon the facts and circumstances presented at the time of its review of that particular request.

[45] HKFE has received a no-action position from Commission staff permitting it to offer and sell HKFE Taiwan Index futures within the United States.

[46] HKFE has received a no-action position from Commission staff permitting it to offer and sell Hang Seng Index futures within the United States.

[47] HKFE applied for no-action relief to permit the offer and sale of Hang Seng China-Affiliated Corporations Index futures in the United States in 1997, but subsequently withdrew the request. Letter from Philip McBride Johnson, Skadden, Arps, Slate, Meagher & Flom LLP, to Harold Hardman, Office of the General Counsel, Commodity Futures Trading Commission (May 4, 2000).

[48] See CFTC Interpretative Letter No. 88-15, Comm. Fut. L. Rep. (CCH) ¶24, 296 (Aug. 10, 1988).

[49] See CFTC Interpretative Letter No. 87-7, Comm. Fut. L. Rep. (CCH) ¶23,972 (Nov. 17, 1987).

[50] "Exchange Participants" includes those persons identified in footnote 2 for the purposes of this no-action letter and the conditions imposed upon the relief provided herein.

[\[51\]](#) For purposes of these conditions, "communications" is defined to include any summons, complaint, order, subpoena, request for information, or notice or any other written or electronic documentation or correspondence issued on behalf of the Commission.

[\[52\]](#) The Division notes that "material" changes in the information provided to it in support of this No-Action Request would include, without limitation, a modification of: HKFE's Exchange Participant criteria; the location of the management, personnel, or operations of HKFE (particularly changes that may suggest an increased nexus between HKFE's activities and the United States); the basic structure, nature, or operation of HKATS; or the regulatory or self-regulatory structure applicable to HKFE, HKATS, or HKATS participants.