

**CONSUMER COUNCIL
RESPONSE TO A CONSULTATION PAPER ON
DRAFT GUIDELINES FOR THE REGULATION OF
AUTOMATED TRADING SERVICES**

INTRODUCTION

1. The Council welcomes the Securities and Futures Commission's (SFC) initiative to undertake a public consultation on the Draft Guidelines for the Regulation of Automated Trading Services (ATS).

COUNCIL COMMENT ON THE GUIDELINES

2. As a natural development of an increasingly global market, ATS activities provide Hong Kong investors with wider choice of access to a variety of overseas exchanges and products, through electronic facilities, in addition to the local exchange. However, together with this increase in choice comes the possibility of increased opportunity for consumer loss through either the unscrupulous behavior of service providers, or a lack of adequate due care in provision of the service.
3. The Council therefore supports the move by SFC in bringing ATS activities under its regulatory net, as a means of protecting investors in Hong Kong. In particular, as noted in paragraph 37 of the guidelines, the Council is pleased to note that ATS activity will be brought into the scope of the investor compensation arrangements if the activity involves trading in financial products in Hong Kong. As expressed in its submission on the proposed New Investor Compensation Arrangements, improved investor compensation arrangements will bring about an important element of certainty for retail investors as far as compensation arrangements are concerned, thereby benefiting the industry and consumers as a whole.
4. Given that ATS activities will come under the regulatory mechanism established for the investing public generally, and that this mechanism has improved the environment for retail investors, the Council's focus in this submission is to draw attention to those aspects of ATS activities that fall within the general scope of electronic commerce.
5. In this regard, the Council has been involved in a number of activities that seek to improve the electronic commerce environment worldwide. The first activity concerns the work of the International Marketing Supervision Network (IMSN). IMSN is an organisation of consumer protection agencies worldwide that seeks to improve the standard of electronic commerce, and provide an accessible resource for consumers to lodge complaints with the appropriate agency in the country in which a web site is located. IMSN have conducted a number of 'Internet Sweep Days' in which the collective resources of consumer protection agencies, councils and associations have been used to search the Internet for sites that do not meet generally accepted standards. In one Sweep Day sites

were searched for general observation of good electronic commerce practice. A copy of the checklist used in the sweep is attached at Attachment A. Second, the Council has also been involved in assisting in the development of guidelines through its membership of Consumers International, which in turn had a role in developing the OECD Guidelines on Electronic Commerce. A summary of the OECD guidelines is at Attachment A.

6. The Council would like to take this opportunity to explore the means by which the principles in the OECD Guidelines, and those in the IMSN Sweep Day Checklist can be applied in practical terms, as a means of
 - (a) improving the safeguards already established in securities and futures legislation; and
 - (b) catering for the distinctive concerns that arise through the use of online information and transaction services.
7. In addition, the Council would also like to explore the means by which the principles that are currently in place, by virtue of the various guidelines that SFC has issued for using the Internet, are given practical application. For example, as noted in paragraph 40, the various Internet or electronic guidance issued by the SFC as well as the SFC Fit Proper Criteria, Code of Conduct, and Internal Control Guidelines.

Consumer Protection Principles in Electronic Commerce

8. There are a number of principles in the OECD guidelines and IMSN Checklist that have practical application for ATS activities, even though they also cover the trading of goods, in addition to services. For example, two major principles concern online disclosures in relation to identification of the trader, and transparency on the site operation, i.e.:
 - to enhance identification of the business and the jurisdictions within which it operates, sufficient online disclosure must be given to enable consumers to establish the identity of the business, contact details, jurisdiction, and where to lodge complaints; and
 - to ensure transparency of information for decision-making, business should provide clear, unambiguous and easily accessible information on the goods and services so that consumers can make an informed choice before effecting a transaction
9. In respect of the first point, important identification information for consumers should not only be the registered name of the ATS and contact details, but should also include a clear indication of what the status of the ATS trader is under legislation. For example, whether the trader:
 - (a) is a person licensed by the SFC for ATS activity; or
 - (b) is a person who is an authorized financial institution exempt under Clause 118 of the Securities and Futures Bill; or

- (c) is a person authorized by the SFC under Part III, clause 95 for ATS activity.
10. The reason for this is that different conditions may apply in respect of the extent to which legislative remedies apply for each category.
 11. In respect of the second point, the SFC could require all ATS providers (i.e. authorised or licensed persons) to observe the following principles in web site design.
 - Web sites should provide a basic explanation of securities trading, including definitions of each of the terms used on the firm's order entry page that are accessible from the trading screen;
 - Web sites should use plain language explanations of key investing terms and concepts, such as the differences between the various types of orders that may be placed. For example a market order, limit order, a stop limit order.
 - Provide a glossary or help screen that explains investment terms to their clients that is easily accessible.
 - Investors should be informed of any alternative means of placing orders in the event of systems delays or outages, and the effect of delays or outages on executing orders.
 - How market volatility can affect customers' orders.

Setting Operational Standards

12. The Council is aware that the Securities and Exchange Commission in the United States publishes statistics regarding online trading complaints on its web site <http://www.sec.gov>. Those statistics provide an insight into the sort of problems that investors can face when entering into ATS transactions.
13. For example, complaints have been made concerning failures/delays in processing orders, difficulty in accessing accounts, errors in processing orders. The reasons for these complaints occurring can be traced to either procedural failure, or inadequate operational capability within the ATS providers' software, hardware, and communications facilities.
14. The Council suggests that a matter for SFC's consideration could be to examine what standards should be put in place for an appropriate ATS provider to provide an adequate service to investors. These are in addition to ensuring that not only procedures on matters such as security and privacy are adequately followed (which are generally covered in the SFC's general principles in the Code of Conduct) but that certain standards as to operational capability are achieved.
15. In order to achieve a satisfactory standard in the trading service, minimum standards would need to be achieved by an ATS provider to avoid the sort of processing problems, summarized in paragraph 13, that give rise to investor complaints. For example, an appropriate benchmark for processing orders could be set by the SFC setting an appropriate time limit for the execution of orders. The specific time limit could be set against industry best practice that exists at

any point in time, that would be subject to review in line with current standards in software, hardware and communications capability.

Investor Information

16. The Council welcomes the establishment of the SFC's Investor Resource Centre as an initiative that can assist Hong Kong in understanding the various issues that arise through investing in equities and futures.

Information on acceptable standards

17. The Council would like to suggest that the service provided through this facility could be enhanced by disseminating information on such matters as acceptable standards for ATS providers, and the hazards that can arise. For example, by constructing a check list, based on similar principles to those found in the OECD Guidelines, that investors could have regard to when examining ATS provider web sites. The checklist could be used to gauge the extent to which ATS providers meets the basic principles of good web practice set by the SFC.

Information on complaints statistics

18. In addition, complaints statistics, along the lines published by the United States SEC could also be published on the Investor Resource Centre web site. This would give investors a concept of the pitfalls that may arise in using ATS. Equipped with this knowledge, investors will therefore be in a better position to seek assurances from ATS providers as to what their guarantees are concerning such matters as the processing of orders and remedies for errors in processing orders.

Online redress mechanisms

19. Given that the use of ATS facilitates transactions across international borders, investors can increasingly be expected to have as a major consideration, whether they have a reliable and simple online redress mechanism available to them. Online redress means an online form of alternative dispute resolution (ADR) where the entire ADR service is available via electronic means, such that neither party need leave their home in order to take advantage of the service. ADR is increasingly becoming popular as a means for electronic traders to assure consumers that they can have confidence in using that particular web site. The ADR services are commonly tied to a particular certification program offered by an industry or professional association or other third party.
20. Consumers International is currently in the process of producing a report on online dispute resolution systems in which it examines aspects of various existing online ADR systems. The Council suggests that the SFC's Investor Resource Centre could provide a checklist, based on the following principles, which are the preliminary findings of the above report, for consumers to consider when assessing an ATS provider's offer of an ADR service. The principles could also be considered by SFC as a means of determining appropriate standards for ATS providers, in circumstances where they offer an ADR service.
 - (a) **Independence/Impartiality**: ADR is neither credible nor effective unless it is conducted by individuals who are truly independent and impartial with respect to the disputing parties.

- (b) **Transparency**: An essential criteria is that information on all aspects of the service be readily available to potential users of the service. Such transparency is also needed so that outside researchers, as well as potential users, can assess the independence and effectiveness of the service on an ongoing basis. Publication of past rulings is important in this respect.
- (c) **Availability**: The ADR service should be as widely available as possible, such that any consumer in a cross-border dispute with an online trader can take advantage of its services.
- (d) **Visibility**: The ADR service, to be useful, should be well-publicised, such that interested consumers and businesses can become aware of it when the need for ADR arises. The website of the ADR service should be easily found via Internet search engines, and should be publicised by the businesses that use it.
- (e) **Affordability**: The service should, optimally, be free to the consumer. Any consumer charge, or a “loser pays” rule will deter consumers from using the service. If there is a user fee charged to the consumer, it should be low relative to the amount in dispute, and should be refundable to the consumer in the event that the consumer prevails in whole or in part.
- (f) **Speed/Timeliness**: In order to provide an effective alternative to courts, ADR systems should be made available to disputants in a timely fashion, and should resolve disputes quickly.
- (g) **Competence of ADR Officers**: Those conducting the dispute resolution must have sufficient skills and training to fulfil the function in a satisfactory manner. While formal legal training is not required, they should be familiar with basic legal concepts.
- (h) **Accessibility/Ease of use**: The ADR service should be easily accessible, non-intimidating, and convenient to use. For example, providing guidance in filling in and filing submissions. Where the service is offered in different languages (and the more languages offered, the more accessible it will be to consumers generally), all information on aspects of the service should be available in that language.
- (i) **Security**: The ADR service should take measures to ensure that any confidential communications in the context of ADR are appropriately secure from unauthorised access, and to authenticate the identity of the parties in the process of online communications.
- (j) **Enforceability**: In the case of trustmark programs which offer, or require participation in ADR programs, it would be expected that failure by a business member to comply with an ADR decision should be grounds for expulsion and/or denial of future services, where appropriate.
- (k) **Due Process**: As with all adversarial processes, online ADR services should provide both parties with a reasonable opportunity to make their case, and to hear and respond to the opposing party’s arguments. The average consumer should not need legal representation in order to use the process effectively, but should not be precluded from being represented.

- (I) **Legality/Liberty**: Notwithstanding the difficulties associated with taking legal action, participation in ADR should be a truly voluntary option for consumers and should not impinge in any way on their right to legal redress if dissatisfied with the results of ADR. Importantly, consumers' use of ADR services should not in any way limit their right to lodge complaints or share information with government agencies. Nor should it prevent law enforcement authorities, code enforcers, or other consumer protection bodies from bringing law enforcement actions or from using the consumer's complaint in legal actions or other efforts to stop unfair or deceptive business practices.

Consumer Council
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