



# Asia Pacific Exchanges and Regulatory Subcommittee & Asia Pacific Technical Subcommittee

## HK – SFC – Recording consent to facilitate trades

23 September 2019

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Proposal Status: Approved

**For Global Technical Committee Governance Internal Use Only**

Submission Date	March 21, 2019	Control Number	EP251
Submission Status	Approved	Ratified Date	Sep 25, 2019
Primary Contact Person	APAC Technical Subcommittee, Daniel Shek	Release Identifier	FIXLatest

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## Document History

Revision	Date	Author	Revision Comments
0.1	8 Mar 2019	Daniel Shek FlexTrade	Initial draft
0.2	21 Mar 2019	Hanno Klein FIX GTC	Formatting and layout changes
0.3	22 Mar 2019	Hanno Klein FIX GTC	Updates based on feedback from GTC call on March 21
0.4	24 May 2019	Hanno Klein FIX GTC	Disposition of public review comments
0.5	23 Sep 2019	Ed Mangles, Hanno Klein FIX GTC	Update and more extensive elaboration of the proposed solution from APAC group consultations (no change to the extension, only clarification of the usage).  Addition of issues and discussion points.

## 1 Introduction

The Hong Kong SFC (Securities and Futures Commission) published a circular to the industry last year regarding the need to disclose to clients and getting the client prior consent before client facilitation activities.

The sell side in Hong Kong would like to consider whether improvements can be made to the current verbal process of giving consent by using FIX tags to automate.

- Ensure the process is timely and efficient
- Current process of storing consent recorded on tapes does not seem to provide an easy way to retrieve results, does not have an easy time stamp and does not give visibility to the buy side head of desk when consents are given.
- Where sell side cannot record consent, the liquidity cannot be provided.

## 2 Business Requirements

In February 2018, the SFC released a Circular to license corporations on client facilitation.

<https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC11>

### Relevant sections of the SFC Circular

“Typically, clients use facilitation services to obtain liquidity or achieve a guaranteed execution price. As the nature of the client relationship may change in a facilitation transaction due to the fact that LCs assume a risk-taking principal position rather than an agency position, conflicts of interest may arise.

The SFC emphasises that such conflicts of interest are a recurring regulatory concern. In 2014, the SFC held a Supervisory Briefing Session to draw the industry’s attention to common deficiencies and vulnerabilities associated with client facilitation. More recently, a number of inconsistent practices were identified in routine inspections.

LCs are reminded that the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) requires that a licensed or registered person should act in the best interests of clients, disclose conflicts of interest and take all reasonable steps to ensure fair treatment of clients if conflicts of interest cannot be avoided<sup>[2]</sup>.”

Later in the report relating to consent, the requirement for LCs is detailed here:

### “3. Consent and disclosure

As LCs assume a risk-taking principal position against clients in client facilitation activities, the nature of the trades should be disclosed to clients and their prior consent obtained<sup>3]</sup> so that they are fully aware of the inherent conflicts of interest.

The parties responsible for obtaining client consent should be clearly defined. Where either client-facing staff who handle client facilitation orders or the client facilitation desk are located in Hong Kong<sup>[4]</sup>, client consent is required.”

## 2.1 Proposed Solution

After several rounds of discussion amongst market players from both the buy-side and sell-side, other industry associations and the SFC, we want to implement the proactive buy-side to sell-side (one-way) workflow using a new value for FIX field ExecInst(18). In order to offer a few more explicit instructions than simply “Allow Facilitation”, combinations of the new value with some of the existing values of the FIX field ExecInst(18) are also proposed.

These values will only cover simple scenarios that most users require; they are not designed to catch all workflows. The reason we opt for this simplified approach is that it will be easier for vendors and in-house teams to implement in a short period of time (the SFC circular has been floating for more than a year now).

The new proposed value (‘z’) and selected combinations with existing ExecInst(18) values will indicate that the buy-side is “proactively” giving the consent, as defined below:

1. ExecInst(18) with **an absence of a ‘z’ value** means there is no information in the message re facilitation, regardless of any other ExecInst(18) values which can be combined with the ‘z’ value. It does not indicate that facilitation is not allowed. If facilitation / risk is to be used, the broker would need to have a bilateral communication out-of-band with the client and their pre-trade consent obtained and evidence retained using other means (parties need to satisfy themselves of SFC rules compliance).

*NOTE:* an absence of a facilitation instruction, i.e. a ‘z’ value in a modification instruction, also indicates No Information, meaning that before facilitation / risk is to be used, an explicit consent would need to be sought out-of-band. When modifying ExecInst(18) values in a replacement order, it is necessary to re-declare all ExecInst(18) values in the OrderCancelReplaceRequest(35=G) message. ExecInst(18) values will not be carried forward from the original order to the replacement unless re-declared. If facilitation / risk is to be used, the broker would need to have a bilateral communication out-of-band with the client and their pre-trade consent obtained and evidence retained using other means (parties need to satisfy themselves of SFC rules compliance).

It is recommended that if the buy-side wants to remove the consent from the original order, the buy-side should send an OrderCancel(35=F) message, and then a NewOrderSingle(35=D) message including ExecInst(18) with an absence of the ‘z’ value.

- 2 . ExecInst(18) = z indicates facilitation allowed within the specifics of the order which should include price being at a clearly observable benchmark (parties need to satisfy to themselves SFC rules compliance)

3. ExecInst(18) = **z i** indicates facilitation allowed for 'order completion imbalance only', which would include odd lots and residuals, as long as they adhere to other aspects of the order instruction (e.g. limit) and include price being at a clearly observable benchmark. In some cases, this may require pre-arranged clarification with clients of 'order completion' / 'odd lot' / 'residual' definitions and limits.
4. ExecInst(18) = **z W** indicates facilitation allowed with price pegged to a guaranteed price / benchmarked order types (e.g. GVWAP and GMOC), as long as the order instruction is accompanied by a request to provide a price guarantee pegged to a specific level.

The buy-side system implementation can optionally add logic to "pre-populate" this value providing that the additional logic complies with the SFC's guidance, e.g. based on daily consent or basket level consent.

## **2.2 Discussion of Alternate Proposals**

This section captures the discussion within the subcommittee on its way to the final proposal. A number of different solutions were discussed and mapped to FIX based on specific questions. None of these are put forward to the GTC for implementation.

Q1: How can consent records be automated?

Scenario 1: Consent is "one way", i.e. the buy side offers consent before the sell side has asked

- If YES: Buyside sends order message to broker, through OMS/EMS with an ALLOW FACIL check box marked.

In the FIX message NewOrderSingle(35=D), propose **Tag 1031 – CustOrderHandlingInst** (Values: **FA – No Cross** or **FB – Cross OK**), with **1031=FB** "Cross OK" feeding from the marked ALLOW checkbox, meaning facilitation consent –

Scenario 2: Sell side has to ask for the buy side to answer, i.e. to allow facilitation

- Buyside sends order message to broker
- Broker sends request message to client, that references the submitted order identifier and requesting acknowledgement that the order can be executed by the facilitation desk.

In FIX, this request could be a new FIX message modeled on the **PartyRiskLimitCheckRequest(35=DF)**

- Buyside sends acknowledgement message to either consent or not consent to facilitation.



Q2: If pre-set consent is permitted, how could the buy side OMS field be pre-populated based on the consent of the fund, in line with other specific order instructions such as limits. What if the OMS field could be altered on a per trade basis, does that mean although pre-populated it is still an active choice per order?

Scenario 3: Similar to scenario 1: Buyside sends order message to broker, through OMS/EMS with an ALLOW FACIL check box **pre-populated** as checked. If a specific fund does not ALLOW facilitation, then uncheck box for the order.

Scenario 4: Broker sends Order Acknowledgement to buyside client, marked and timestamped as consent obtained (pre-trade). Using FIX, this acknowledgement could be a new FIX message modeled on **PartyRiskLimitCheckRequestAck(35=DG)**

Q3: How should the Hong Kong desk represent the fills?

A3: Broker sends **ExecutionReport(35=8)** message, that may contain consent indicator and timestamp field for the consent, (separate from the TransactTime(tag 60) field), and also indicating that the broker's capacity is as "principal" via the **LastCapacity(tag 29)** field set to **4** (Principal) or **5** (Riskless principal).

## 3 Issues and Discussion Points

### 3.1 *Standardizing workflows in jurisdictions outside Hong Kong*

In the interest of standardizing workflows and implementing best practice across the Asia Pac region, firms could consider adopting the proposed workflow in jurisdictions that do not explicitly require client consent for the use of facilitation services.

### 3.2 *LastCapacity(29) values are NOT affected*

Firms are reminded that the provision of client consent for facilitation services does not change their LastCapacity reporting requirements and the associated standard values commonly accepted in Asia Pacific markets

### 3.3 *Clarifying terminology: Proactive vs Unidirectional*

**Proactive:** The use of FIX field ExecInst(18) is based around the buy-side *Proactively* sending consent without prompting from their broker. This is acceptable as the buy-side (and only the buy-side) can provide consent or withdraw consent as they require.

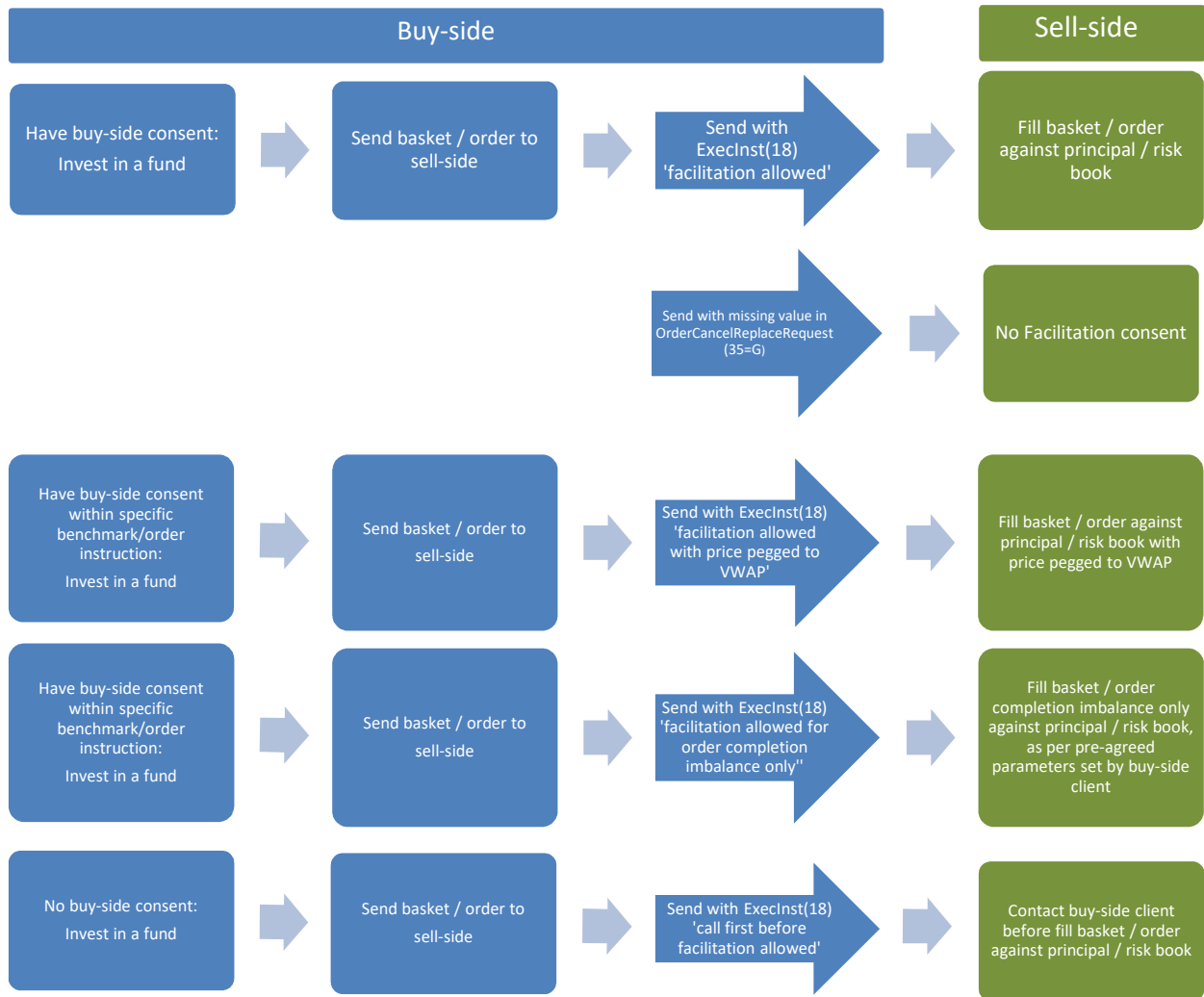
**Unidirectional:** A broker should not unilaterally give a *Unidirectional* statement to their buy-side client that they will use Facilitation solutions. Brokers must get explicit consent from their buy-side clients, prior to using any form of facilitation.

### ***3.4 Potential for phase 2 of FIX support for facilitation consent***

Following FIX Global Technical Committee approval of this extension, a suggestion has been raised for a 'Phase 2' discussion to look into creation of a new FIX field (or a new component) that would allow for greater granularity of instructions for allowing facilitation. If there is broad demand / support by FIX members, Phase 2 discussions will start following approval of the current proposal.

## 4 Proposed Message Flow

The workflows are depicted below:



## 5 FIX Message Tables

No changes.

## **6 FIX Component Blocks**

No changes.

## **7 Category Changes**

No changes.

## Appendix A - Data Dictionary

Tag	FieldName	Action	Datatype	Description	FIXML Abbreviation	Add to / Deprecate from Message type or Component block
18	ExecInst	CHANGE	Multiple CharValue	<p>Instructions for order handling on exchange trading floor. If more than one instruction is applicable to an order, this field can contain multiple instructions separated by space.</p> <p>New valid value:</p> <p>z = Allow facilitation                      [Elaboration: Express explicit consent to receive facilitation services from the counterparty. Facilitation services are when an institutional client allows a broker to assume a risk-taking principal position rather than an agency position, to obtain liquidity or achieve a guaranteed execution price on the client's behalf. Interpretation of absence of this value needs to be bilaterally agreed, if applicable. In the context of Hong Kong's SFC, this can be used to comply with SFC regulations for disclosure of client facilitation.]</p>	@ExecInst	



## Appendix B - Glossary Entries

Term	Definition	Field where used

## Appendix C - Abbreviations

Term	Proposed Abbreviation	Proposed Messages, Components, Fields where used

## Appendix D - Usage Examples

[Examples may be entered below this line]

## Appendix E – Disposition of Public Comments

Public comments (C) from **Sourabh, Rathi** from BAML, responses (R) below from **Ed Mangles**, Regional Director – FIX Trading Community:

On behalf of BAML, we welcome the APAC Client Facilitation Proposal submitted by the committee. We are broadly supportive of adding new value in existing FIX tag ExecInst (18) for buy side to explicitly provide the facilitation consent on FIX ticket. As stated in the proposal, we agree that using an existing FIX tag that supports multiple character value is simplified approach to implement consent for both buy side vendors and sell side.

After going through the proposal, we would like to submit our feedback and questions as below:

1. Allow facilitation

C: Is the expectation that this tag/value pair is used to initiate a facil request or confirm an agreement? If it is to confirm the agreement, the value 'Allow Facilitation' can be misinterpreted as it doesn't sufficiently represent the agreement. Ideally, facilitation is marked to indicate a handshake as opposed to a one-sided value published on new order or amend.

R: This FIX proposal does not replace any established systems that firms have in place to comply with the SFC rules, but will offer an alternative/complimentary system using FIX, that firms can deploy as they need.

2. Consultation and explicit agreement with SFC on implementation

C: Can you confirm that the proposed solution has been already reviewed by SFC and given in principle confirmation for industry to implement tag 18 instruction as explicit client consent? Are there any further guidance on the level of details to be additionally captured in consent over and above the FIX tag instruction?

R: A cross industry group including reps from FIX, ASIFMA and ATF met with the SFC to explain this proposal and while they are not able to give explicit approval (as a regulator), the SFC response was supportive, as this proposal could offer the industry an efficient solution, that also complies with SFC rules. In due course, we will be going back to the SFC to update them on this initiative.

3. Tag 29 (Last capacity)

C: We suggest that proposal should state explicitly that there is no change to the tag 29 (last capacity) on facilitation trades to the client. This will continue to follow the industry practice (for APAC at least) of sending value = "3" i.e. cross as principal, when trade is facilitated.

R: That's a great point. We can add your suggestion to a 'Recommended Practices Doc' that can be circulated to industry participants, e.g. "Voluntary adoption of this proposal in jurisdictions outside Hong Kong - in the interest of standardizing workflows and implementing best practice



across the Asia Pacific region, firms could consider adopting the proposed workflow in jurisdictions that do not explicitly require client consent for the use of facilitation services.”

#### 4. Solution Market scope

C: We recommend that proposal of sending facilitation instruction should not be limited/confined to HK market; however, extended as general practice for other markets. Given most of the sell side firms staff are based in Hong Kong, guidance would be in general applicable for APAC markets traded out of HK.

R: Agreed. We can make this point in the circulated Recommended Practices doc, e.g. “LastCapacity(29) values are NOT affected - firms are reminded that the provision of client consent for facilitation services does not change their LastCapacity(29) reporting requirements and the associated standard values commonly accepted in Asia Pacific markets.”