

## SFC fines BNP Paribas Securities (Asia) Limited \$15 million for dark liquidity pool-related failures

3 Aug 2015

The Securities and Futures Commission (SFC) has fined BNP Paribas Securities (Asia) Limited (BNPP Securities Asia) \$15 million for failures in relation to its dark liquidity pool trading services (Note 1).

The disciplinary action follows an SFC investigation into BNPP Securities Asia's dark liquidity pool trading services, known as the BNP Internal Exchange (BIX). The SFC found that:

- BIX did not operate as represented in materials provided to clients. In effect, BNPP Securities Asia represented that orders would be executed in accordance with order price priority, e.g. a buy order with higher price would have priority over a buy order with a lower price. In reality, BIX failed to give priority to higher priced orders and treated all orders as having equal priority with allocations on a pro rata basis between November 2009 and April 2011. This potentially affected all BIX auctions with two or more orders at different order prices and did affect some BIX auctions (Note 2);
- BNPP Securities Asia suspended BIX services in April 2011 upon the discovery that order matching was not conducted according to order price priority. BIX services were not fully restored until seven months later and the SFC was not informed of the suspension until 21 months later in January 2013. This constitutes a breach of BNPP Securities Asia's licensing condition (Note 3);
- BNPP Securities Asia's business plan for its licence application for providing automated trading services stated that client consent would be obtained before their orders were placed to the BIX for matching. However, client orders intended for execution on the Stock Exchange of Hong Kong were automatically enabled on the BIX without BNPP Securities Asia seeking positive client consent. The SFC was not notified about the change of BNPP Securities Asia's business plan as required (Note 4); and
- BNPP Securities Asia failed to: (i) maintain sufficient trade records relating to BIX that identified the specific auction in which each order participated; and (ii) coherently document the matching logic, to explain the matched trades. This means it is difficult to calculate the precise impact of the failure to implement a trade execution process where order priority is based on price (Note 5).

Mr Mark Steward, the SFC's Executive Director of Enforcement, said "No one should dive into dark water without knowing what is hidden. Operators must have clear rules and procedures in place for operating dark pools, and equally important, they should operate consistently with representations to clients whose consent to enter the dark pool is clear and well-informed."

In determining this disciplinary action, the SFC took into account that:

- BNPP Securities Asia co-operated with the SFC in resolving the SFC's concerns;
- Since 2012, BNPP Securities Asia has obtained consent from clients before allowing their orders to be matched in the BIX;
- BNPP Securities Asia had taken steps to rectify the matching logic in the BIX in 2011;
- BNPP Securities Asia agreed to engage an independent reviewer to conduct a forward-looking review of the operation of the BIX (Note 6); and
- BNPP Securities Asia has an otherwise clean disciplinary record in relation to its business in Type 7 regulated activities.

End

Notes:

1. BNPP Securities Asia is licensed under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 6 (advising on corporate finance), and Type 7 (providing automated trading services) regulated activities.
2. As a licensed corporation, BNPP Securities Asia has to exercise due skill, care and diligence in conducting its business in regulated activities and to act in the best interests of its clients under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct). (See also Note 5)
3. Among the licensing conditions imposed on BNPP Securities Asia's Type 7 regulated activities, BNPP Securities Asia was required to notify the SFC of any incident of material service breakdown or disruption of the operations of BIX affecting its users.
4. Section 4 of the Securities and Futures (Licensing and Registration)(Information) Rules provides that a

licensed corporation shall give notice in writing to the SFC where there is a significant change in its business plan provided to the SFC under Part V of the SFO within seven business days after the change. According to General Principle 7 and paragraph 12.1 of the Code of Conduct, BNPP Securities Asia was required to comply with all applicable laws and regulations.

5. As a result, the SFC is unable to calculate the exact number and extent to which BIX auctions were affected.
6. The enhanced regulatory regime on alternative liquidity pools will come into force on 1 December 2015.

[A copy of the Statement of Disciplinary Action is available on the SFC website](#)

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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (“**SFC**”) has fined BNP Paribas Securities (Asia) Limited (“**BNPP Securities Asia**”) HK\$15 million pursuant to section 194 of the Securities and Futures Ordinance (“**SFO**”).
2. The disciplinary action is taken according to an agreement pursuant to section 201 of the SFO dated 27 July 2015 in relation to BNPP Securities Asia’s failures to ensure that its dark liquidity pool trading services, i.e. the BNP Internal Exchange (“**BIX**”), comply with General Principles 2 & 7 and paragraph 12.1 of the Code of Conduct<sup>1</sup>, its licensing condition<sup>2</sup> and section 4 of the Securities and Futures (Licensing and Registration)(Information) Rules (“**Licensing Information Rules**”).
3. BNPP Securities Asia is licensed under the SFO to carry on business in Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 6 (advising on corporate finance), and Type 7 (providing automated trading services) regulated activities.

### Summary of facts

#### *Failure to ensure BIX operated as intended*

4. The SFC found that the BIX did not operate as intended. BNPP Securities Asia stated in the business plan of its licence application to the SFC for Type 7 regulated activities (“**Business Plan**”) that orders in the BIX would be matched and executed according to order price priority. The same representation was also made to its clients. Nevertheless, the BIX was found to have allocated executions pro rata, based on order sizes. As a result, some orders which should have been fully executed if order price priority was applied, i.e. a buy order with higher order price or a sell order with lower order price, were only partially executed, and some orders which should not have been executed if order price priority was applied were partially or fully executed. The operation of this unintended matching logic potentially affected all BIX auctions with two or more orders at different order prices and did affect some BIX auctions.<sup>3</sup>
5. As a licensed corporation, BNPP Securities Asia was required to act with due skill, care and diligence in conducting its business in regulated activities and to act in the best interests of its clients. Best interests of its clients were affected when BNPP Securities Asia represented that orders would be matched according to order price priority but in fact the BIX matched orders based on

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<sup>1</sup> Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

<sup>2</sup> Among the licensing conditions imposed on BNPP Securities Asia’s Type 7 regulated activities, BNPP Securities Asia was required to notify the SFC of any incident of material service breakdown or disruption of the operations of BIX affecting its users.

<sup>3</sup> The SFC is unable to calculate the exact number and extent to which BIX auctions were affected.

order sizes. In particular, some clients who placed better priced orders into the BIX believing those orders would receive execution priority were affected because despite the fact that they were willing to pay for higher order prices, their orders did not receive execution priority.

*Failure to report on the disruption of BIX services*

6. The SFC found BNPP Securities Asia failed to report to it the disruption of BIX services. In April 2011, the unintended order priority issue of the BIX was discovered after a query was made by a client and BNPP Securities Asia took immediate steps to disable client access to the BIX. BIX's operations were suspended for 13 days and partially resumed thereafter, with services fully restored in December 2011.
7. Among the licensing conditions imposed on its Type 7 regulated activities, BNPP Securities Asia was required to notify the SFC about incidents of material service breakdown or disruption of the operations of the BIX affecting its users. However, in breach of this licensing condition, no report was made to the SFC about the suspension of services until 21 months later. BNPP Securities Asia explained it had overlooked the licensing condition in deciding whether or not to report to the SFC when the disruption took place.

*Failure to notify the SFC of a significant change to its business plan*

8. The Business Plan stipulated that client consent to use the BIX would be obtained before their orders were placed to the BIX for matching. However, the SFC found that client orders intended for execution on the Exchange were automatically enabled on the BIX without BNPP Securities Asia seeking positive client consent. BNPP Securities Asia explained it had, in this respect, inadvertently overlooked the Business Plan.
9. BNPP Securities Asia is obliged to comply with all applicable laws and regulations. The Licensing Information Rules requires a licensed corporation to give notice in writing to the SFC where there is a significant change in its business plan provided to the SFC for licence application within seven business days after the change. BNPP Securities Asia's failure to notify the SFC is a breach of the Licensing Information Rules.

*Failure to maintain sufficient trade records relating to BIX and to document the BIX*

10. The SFC's investigation reveals that BNPP Securities Asia failed to: (i) maintain sufficient trade records relating to BIX that identified the specific auction in which each order participated; and (ii) coherently document the matching logic of the BIX, to explain the matched trades. This means it is difficult to ascertain the precise impact of BNPP Securities Asia's failure to implement the intended match logic.
11. The coherent documentation of the matching logic of the BIX is also essential for the understanding of how the BIX operates and the transparency of the operations of BIX. Without proper documentation, the SFC considers that clients could not be made adequately aware of how their orders would be executed in the BIX. Clients are entitled to know how the BIX operates so that they can make an informed decision as to whether or not to use the services.

**Conclusion**

12. As a licensed corporation, BNPP Securities Asia should carry on its business in compliance with, among others, the Code of Conduct, the Licensing Information Rules and the licensing conditions imposed on it. BNPP Securities Asia should pay special attention to the general principles under the Code of Conduct. In particular, it is obliged:
  - (a) to act with due skill, care and diligence in conducting its business activities; and
  - (b) to ensure compliance with all applicable laws and regulations.
13. It is apparent that BNPP Securities Asia had failed to comply with its duties as set out above. In particular, given the use of dark liquidity pool for trading is on the rise in recent years, it is imperative that BNPP Securities Asia, as a dark liquidity pool trading service provider and operator, must ensure BIX users are provided with sufficient information to enable them to understand how their orders are handled and executed in the BIX.
14. In the circumstances, the SFC considers the fine of HK\$15 million is commensurate with the gravity of BNPP Securities Asia's misconduct after taking into account BNPP Securities Asia's cooperation with the SFC in resolving the SFC's concerns.