GETCO

COMMENTS: CONSULTATION PAPER ON THE REGULATION OF ELECTRONIC TRADING

GETCO ASIA (Hong Kong) Limited

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About GETCO

GETCO is a global liquidity provider. GETCO was founded in Chicago in 1999, and the firm now employs over 400 people worldwide. The firm provides liquidity on over 50 markets in North and South America, Europe and Asia. The liquidity GETCO supplies allows individual and institutional investors to immediately transfer the risk often associated with financial instruments while saving money on trading costs. As a liquidity provider, we do this by:

- increasing liquidity;
- reducing market volatility;
- facilitating price discovery; and
- promoting competition among market centres.

In these ways, GETCO plays an important role in making financial markets more efficient, lowering the cost of capital for businesses and reducing trading costs for investors. Our strategy is to align our business with the values we believe best serve the market and investors: efficiency, transparency, reliability and competition. GETCO maintains a long-term view on the markets, which means that we understand the importance of stable, well-regulated markets.

From offices in London, Chicago, New York, Hong Kong and Singapore, the firm transacts business in cash, futures and options products across four asset classes: equities, fixed income, currencies and commodities.

Since 2007, GETCO has traded the Asian markets through GETCO Asia Pte Ltd. (GETCO Asia), located in Singapore. GETCO Asia acts as a high volume liquidity provider in the Asian markets and has established itself as one of the leading proprietary trading firms in the Asia region. GETCO Asia (Hong Kong) Limited was recently licensed by SFC to deal in securities and futures and is a trading member of the Hong Kong Exchange in both the cash and derivatives markets. It serves as the agency broker for GETCO Asia.

Full details of GETCO's responses to regulatory consultations world-wide can be found on our website at www.getcollc.com

GETCO's Comments: Consultation Paper on the Regulation of Electronic Trading

GETCO supports the Securities and Futures Commission's (SFC) review of the regulatory requirements for intermediaries to manage and mitigate the risks that arise from trading in an automated environment, and its efforts to provide a more coherent and comprehensive regulatory framework for electronic trading. GETCO has a strong interest in well-regulated markets and supports regulatory initiatives to protect the stability and integrity of the markets. Robust risk management controls by all market participants promote fair and orderly markets.

We appreciate the opportunity to comment on the SFC's proposals, which set forth a well-thought through approach to the regulation of electronic trading. The SFC's proposals are an important contribution to efforts by regulators in many jurisdictions to provide clarity on the risk management obligations of market participants and the comments sought in the Consultation Paper will enable SFC to further solidify its proposed approach.

I. Requirements on Electronic Trading

Key Points

- *GETCO supports SFC's view that an intermediary should be ultimately responsible for the orders sent to the market through its electronic trading platform and for the compliance of the order with applicable regulatory requirements.*
- *GETCO supports the general requirements on electronic trading, which create common expectations across all members firms around a minimum compliance framework for electronic trading.*

The proposal would require a licensed or registered person to be ultimately responsible for orders sent to the market through its electronic trading system and for the compliance of the orders with applicable regulatory requirements and to effectively manage and adequately supervise the design, development, deployment and operation of the electronic trading system it uses or provides to clients.[1] More specific requirements are proposed in Draft Schedule 7 to the Code of Conduct. These specific requirements detail that an intermediary that uses or provides to clients for use an electronic trading system must:

- establish, document and maintain a system of risk management controls and supervisory procedures regarding electronic trading;
- ensure the adequacy of its electronic trading system, including controls designed to ensure reliability, security, adequate capacity and management of contingencies; and
- keep proper records on the design, development, deployment and operation of its electronic trading system.

1 Draft Paragraphs 18.3 and 18.4.

GETCO agrees that an intermediary should be ultimately responsible for the orders sent to the market through its electronic trading system and for compliance of the orders with applicable regulatory requirements. We also support the specific proposals that market participants that use, or provide to clients, electronic trading systems: i) effectively manage and adequately supervise their electronic trading systems, including implementing written policies and procedures on the design, development, deployment and operation of such systems;, ii) ensure that its electronic trading systems are reliable, secure, and have sufficient capacity, and iii) are have adequate contingency measures in place. These controls are an important part of ensuring an adequate risk framework for electronic trading and can only be achieved where the exchange member intermediary is ultimately responsible for the orders sent through its systems.

II. SPECIFIC REQUIREMENTS ON INTERNET TRADING AND DMA

Key Points

- *GETCO supports SFC's requirements on internet trading and Direct Market Access (DMA).*

The SFC's proposal would require that a licensed or registered person providing internet trading or DMA services ensure that all client orders are transmitted to its infrastructure and subject to automated pre-trade controls and regular post-trade monitoring.[2] In addition, DMA clients would have to meet minimum requirements established by the licensed or registered person.[3] GETCO generally supports these types of risk controls, which are consistent with regulatory requirements in other jurisdictions in which we trade.

Pre-trade Controls

GETCO believes that pre- and post-trade risk management controls are important tools in limiting financial market risk. Those participants with market access should only be able to trade if their orders being subjected to effective pre-trade financial and regulatory risk management controls and supervisory procedures and post-trade monitoring.

We believe such controls are prudent risk management for the firm and help to preserve fair and orderly markets. In particular, GETCO's systems: (i) include filters with position and credit limits and have functionality to handle orders rejected by these filters, (ii) maintain comprehensive order records and audit trails of orders and trades; and , (iii) allow for order routing software to be immediately disabled.

[2] Draft Schedule 7, Paragraph 2.1.
[3] Draft Schedule 7, Paragraph 2.2.

III. Specific Requirements On Algorithmic Trading

Key Points

- *GETCO seeks clarity that an algo developed by a client and used by that client to generate orders that are sent to the intermediary for execution are not within the scope of the requirement.*
- *GETCO believes that it is difficult to prevent "manipulative or abusive" market practice through pre trade controls and suggest that SFC provide more clarity around the conduct it views as undesirable so that post trade monitoring can be more effective.*

GETCO fully supports SFC's goal of having common expectations for all marketplace participants of the Hong Kong Exchange around electronic trading. As described more fully below, we ask the SFC to provide more clarity around certain of its proposed rules.

Client Algorithms/Testing

SFC proposes that intermediaries be required to test all order algorithms before use, document their underlying logic, and have test plans for order algorithms. The proposal seems to envision scenarios where a client trades through its broker's system using its broker's off-the-shelf algorithms. Many algorithms, however, are not developed by intermediaries, but rather by the market participants themselves. We seek clarification that an algo developed by a client and used by that client to generate orders that are sent to the intermediary for execution are not within the scope of the requirement.

We are also not clear how the SFC is defining an algorithm in the testing context. We ask that SFC consider in its definition that many algorithmic traders (like GETCO) engage in what some in the industry refer to as "grey box" trading. This means that traders interact with their algorithms throughout the trading day, adjusting parameters in response to market and other conditions. As with traditional floor traders, it would not be practical for these traders to test each parameter change prior to making such change – the market will have moved and the change no longer appropriate.

GETCO believes it is important for the SFC to clearly limit any prior testing requirement to changes in order placement software that, if implemented, would materially alter the way in which a market participant sends, modifies, and cancels orders on markets. It is this software that, if it were to malfunction, could have a large market impact, and is what is really automated for algorithmic traders. Making the distinction between order placement software and real-time trading decisions by traders is essential to preserve the ability of traders to react to the market in a dynamic manner.

Manipulative Behaviours

The SFC proposes to require a licensed intermediary to ensure that it has effective controls to, among other things, monitor and prevent the generation and passing of orders to the market that may be "manipulative or abusive."[4] GETCO worries this regulation is too abstract. We would suggest that the SFC provide clear examples of the specific behaviours within the scope of "manipulative or abusive." Further clarity on prohibited behaviours would allow for better monitoring and surveillance capabilities on a pre-trade basis.

Applying a pre-trade filter to prevent manipulative or abusive conduct is challenging. Such conduct reveals itself by a pattern of order activity and not simply within the context of a single order. For this reason, in addition to the SFC providing further clarity around the market behaviours it considers manipulative or abusive, we believe that post trade-monitoring and surveillance would be a more appropriate and effective place to have controls related to manipulation and abuse.

GETCO believes that the focus of preventing manipulative and abusive activity be on the strategies employed by investors, rather than on the technologies that are used. Some market participants fear and misunderstand fast-moving technology. The technological revolution in trading methods has confused some traditional investors – both retail and professional- and has led some of them to raise concerns that new trading technologies are market integrity issues. We would hope that any regulation designed to prevent manipulation and abuse be equally applicable to all investors regardless of their order entry methodology.

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4 Proposed Schedule 7, paragraph 3.3.1.