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ASSOCIATION
OF
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香港銀行公會

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By post and email to electronic_trading@sfc.hk

Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Attention: Consultation on the regulation of electronic trading

Dear Sirs

Consultation Paper on the Regulation of Electronic Trading – 24 July 2012 (Consultation Paper)

We refer to the above Consultation Paper and would like to provide the comments of the Hong Kong Association of Banks (HKAB) for the consideration of the Securities and Futures Commission (SFC).

We appreciate the intention of the SFC to provide greater clarity to intermediaries on the standards that they are expected to meet in terms of internal controls and risk management which are commensurate with the nature, size and complexity of their electronic trading business. On behalf of HKAB members who engage in electronic trading as intermediaries, we would like to seek clarification on specific proposals set out in the Consultation Paper as follows:

Page 9, Paragraphs 25 to 28 – Responsibility for orders

We agree that an intermediary should not be held liable for all market misconduct or other transgressions that involve orders that go through its electronic trading system. In addition to the example quoted in paragraph 28, we suggest that an intermediary should also not be held responsible for any market misconduct or erroneous input of its customers which are out of the reasonable control of the intermediary as long as the intermediary has put in place reasonable control mechanisms and procedures for its trading system.

Furthermore, we would ask the SFC to review the proposed requirement that *an intermediary should be ultimately responsible for the compliance of the orders with applicable regulatory requirements* (see paragraph 25). Users of electronic trading systems may be subject to various regulatory requirements which the intermediary cannot control or monitor (e.g. disclosure requirements) in practice. Given these constraints, we believe that as a practical matter, the SFC will allow such compliance to be facilitated through legally binding contracts between the intermediary and users of its electronic trading systems setting out inter alia respective parties' obligations including compliance with applicable regulatory requirements.

Our above comments on "applicable regulatory requirements" are also relevant in the context of paragraph 32.

<u>Page 10, Paragraph 34 – System reliability</u>

We note that *an intermediary should ensure that the electronic trading system and all modifications to the system are adequately tested before deployment and are regularly reviewed to ensure that the system and modifications are reliable.* We agree that it is appropriate not to mandate how frequently such review should be conducted but to allow individual intermediaries to decide, having regard to the nature, size and complexity of their electronic trading business. However, we would like to seek clarification on "regular testing". In normal circumstances, stress test will only be conducted before major system enhancements are launched. We suggest that this be reflected more clearly in the guidance to be provided to intermediaries.

Further, we note the proposal of the SFC to require an intermediary to promptly report to the SFC any material service interruption or other significant issues related to the system. It is the current practice of HKAB members as Authorised Institutions (AIs) to report these incidents via the Hong Kong Monetary Authority. We believe that this arrangement has worked well and suggest that this be continued, without requiring the AIs to also report the incident to the SFC.

<u>Page 13, Paragraph 44 – Pre-trade Controls</u>

We wish to seek clarification on the proposed pre-trade control (third bullet point) which should be *reasonably designed to alert the user to the entry of potential erroneous orders and prevent the entry of erroneous orders.* We believe that the words "reasonably designed" are deliberate to take into account practical circumstances where an intermediary may not be able to detect erroneous orders and hence prevent the entry of such orders. For example:

- The customer input the stock code wrongly but the 2 stocks are with similar trading prices.

- The customer input the buy order quantity wrongly (e.g. from 1,000 shares to 10,000 shares) but has sufficient funds in his settlement account to pay for such order.

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ASSOCIATION
OF
BANKS
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Both of these orders will be processed as normal by the intermediary's electronic trading system.

More importantly, we would like to raise members' concerns with regard to the proposed pre-trade control (fourth bullet) which is *reasonably designed to prevent the entry of orders that are not in compliance with the regulatory requirements*. Despite the words "reasonably designed", our members are concerned that this is not implementable in practice. While HKAB members conduct Know-Your-Customers due diligence checking on their customers, given that electronic trading is almost instantaneous without significant human intervention, it would be impossible to determine in practice whether a particular order is in compliance with regulatory requirements. Further, given the depth of the forex market (with a daily turnover of approximately USD4 trillion), it is extremely difficult if not impossible to identify orders or instructions which may be manipulative or abusive in nature. Given these constraints, we believe that as a practical matter, the SFC will allow such compliance to be facilitated through legally binding contracts between the intermediary and users of its electronic trading systems setting out inter alia respective parties' obligations including compliance with applicable regulatory requirements.

Lastly, we wish to add that automatic electronic trading has increased the efficiency of our markets, benefiting both market participants and investors while maintaining Hong Kong's competitiveness. In that regard, we recognize that appropriate investor education (including the benefits of electronic trading, investors' responsibilities etc) is as important as the regulation of electronic trading in enhancing investor protection and the integrity of the market. We believe therefore that the SFC will continue to support the industry in investor education going forward.

We hope the above comments are useful to the SFC in finalizing the requisite regulatory guidance on electronic trading. For any questions relating to this submission, please feel free to contact the Secretariat (Ms Florence Ng at 2537-3220).

Yours faithfully

P.P. Ronie Mak
Secretary