TO: Securities and Futures Commission ("SFC")

FROM:

DATE: September 24, 2012

SUBJECT: Proposed Electronic Trading Rules Response

I. INTRODUCTION

Almost every intermediary is facing the issue of balancing growing regulatory pressure and business profitability in today's very competitive marketplace. Intermediaries are already facing increased costs from complying and keeping up with constant new regulations and greater regulatory scrutiny while dealing with shrinking profit. It is becoming increasingly difficult for securities firms to strike a balance between compliance and managing a profitable business. It is equally difficult for compliance professionals to manage risks, ensuring a sound control environment while dealing with intense regulatory scrutiny as companies are faced with increased global economic uncertainty and stagnant markets. Given these conditions and constraints, it is challenging to build a monitoring system that meets all the obligations set out in the consultation. We believe that if the proposed electronic trading rules are implemented, the cost of compliance will quickly outweigh the benefits of conducting business. As a response to the proposals described in the SFC's Consultation Paper on the Regulation of Electronic Trading, we have included our views towards each proposal below. In Section II we state each of the questions for which we have a response, followed by our response to each respective question.

II. RESPONSES

a. **Question 2: Do you agree that an intermediary should 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? Why or why not?**

does not believe that an intermediary should 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. We find it unfair and unrealistic to hold an intermediary ultimately responsible for trading activity over which the intermediary has no discretion or control. We believe that an intermediary is responsible for its part in the trading process, which is to act as a conduit between the client and the broker. An intermediary adds value to the trading process as a means to best execution, does not have any control over the trading decisions of the client, and in most cases does not see, or does not have knowledge of, the entire trading activity of the client for which the SFC is recommending the intermediary be ultimately responsible. We conduct due diligence on all of our clients before account opening and regular monitor our client accounts, but we do not believe we should be ultimately responsible for the activity of those accounts.

b. **Question 7: Do you agree that, in providing internet trading or DMA services, the proposed**

pre-trade controls should be put in place by an intermediary? If yes, are the proposed requirements appropriate? If not, why not?

does not agree that all of the proposed pre-trade controls should be put in place by an intermediary. We do believe that establishing credit, trading and financial limits are appropriate measures to be taken by an intermediary for internet trading and DMA services. We also believe that an intermediary should take reasonable steps to prevent erroneous orders. However, the 4th bullet point under section 44 on page 13 proposes that intermediaries are required to "prevent the entry of orders that are not in compliance with the regulatory requirements". We believe that more information and clarification is required from the SFC in order to assess the viability of completing this proposed requirement. Without more detailed guidance, we are unable to ascertain the costs of establishing an infrastructure to fulfill this requirement.

Additionally, as stated in our response to Question 2, we do not believe that an intermediary should be held ultimately responsible for the orders generated by its clients. Therefore, although we do believe that certain, but not all, of the proposed pre-trade controls should be put in place, we do not believe that an intermediary should be held responsible for those orders.

c. <u>Question 8:</u> **Do you agree that, in providing internet or DMA services, an intermediary should conduct post-trade monitoring to reasonably identify any order instructions and transactions which may be manipulative or abusive in nature? If not, why not?**

agrees that an intermediary should conduct post-trade monitoring to reasonably identify any order instructions and transactions which may be manipulative or abusive in nature. However, as stated in our response to Question 2, we do not believe that an intermediary should be held ultimately responsible for the orders generated by its clients.

Additionally, we believe it would be beneficial for the SFC to provide additional guidance as to what is expected of the intermediary in conducting post-trade monitoring, including a more detailed definition for the term 'reasonably identify'.

d. <u>Question 9:</u> **Do you agree that an intermediary should establish minimum client requirements for its DMA services and assess whether each client meets the requirement before granting DMA services to a client? If not, why not.**

agrees that an intermediary should establish minimum client requirements for DMA services. However, believes that all Professional Investors should be allowed to utilize DMA services.

e. <u>Question 11:</u> **Do you agree that an intermediary should establish and implement effective policies and procedures to reasonably ensure that persons involved in the design and development of, or approved to use its algorithmic trading system and trading algorithms are suitably qualified? If not, why not?**

agrees that an intermediary should establish and implement effective policies and procedures to reasonably ensure that persons involved in the design and development of or approved to use its algorithmic trading system and trading algorithms are suitably qualified. We take into account the qualifications of each person involved in the design and development of our algorithmic trading system in the normal course of business and believe that no additional compliance requirements are necessary. Additionally, we believe that any Professional Investor is suitably qualified to use the algorithmic trading system.

f. **<u>Question 13:</u> Do you agree that an intermediary should have effective controls to ensure the integrity of its algorithmic trading system and trading algorithms and that they operate in the interest of the integrity of the market? If yes, are the proposed requirements of risk management sufficient? If not, why not?**

agrees that an intermediary should have effective controls to ensure the integrity of its algorithmic trading system and trading algorithms and that they operate in the interest of the integrity of the market. also believes the proposed requirements of risk management are sufficient. However, as stated in our response to Question 2 above, we do not believe than an intermediary should be held ultimately responsible for the trading activity of its clients.

g. **<u>Question 16:</u> Do you agree that where an electronic trading system is provided by third party service provider, an intermediary should perform appropriate due diligence to ensure that the intermediary meets the proposed requirements set out in paragraph 18 of and Schedule 7 to the Code of Con duct in its use of the system? If not, why not?**

agrees that it is reasonable to require an intermediary to conduct appropriate due diligence on a third party service provider in order to use it's products or services. However, we do not believe an intermediary should be held ultimately responsible for the products or services obtained from a third party if a sufficient level of due diligence has been conducted by the intermediary. We believe that conducting an appropriate level of due diligence should waive the intermediary of the ultimate responsibility for the third party products and services. Additionally, much of the information relating to third party algorithms and electronic trading systems will be proprietary to the third party. Therefore, an intermediary utilizing these services will not be able to obtain, review or provide to the SFC such proprietary information. As this information will be held exclusively with the third party, the intermediary utilizing these services should not be held ultimately responsible.

h. **<u>Question 17:</u> What is your view on requiring an intermediary to make arrangements with a service provider for the purpose of meeting the proposed requirements on record keeping?**

agrees that an intermediary should make arrangements with a service provider for the purpose of meeting the proposed requirements on record keeping. As many of the records relating to the services and products obtained from third party service providers will contain proprietary information, an intermediary will, in most cases, not be able to obtain or provide this information on its own. By entering into an agreement with the third party service provider to provide records relating to the products and services provided, the intermediary will be meeting its regulatory obligations. That being said, also believes that an intermediary should not be ultimately responsible for the third party products or services as those products and services are proprietary to the third party. By conducting an adequate level of due diligence, an intermediary is absolving itself of responsibility for those products and services.

III. CONCLUSION

Overall, we believe that the level of increased regulatory and compliance requirements proposed in the consultation paper on July 24, 2012 is too high for intermediaries to efficiently conduct business while also keeping in compliance with increasing securities rules and regulations. While we agree that an intermediary should monitor the trading activity running through its electronic trading system, we do not believe that an intermediary should be held ultimately responsible for those orders. We believe that there is no need for over-regulation in the electronic trading DMA and algorithmic trading space. As costs increase, the number of intermediaries will decrease and the competition and attractiveness of the Hong Kong markets will suffer. Intermediaries are already facing a very high cost of compliance relative to the risks associated with conducting their securities business. Profit margins, as well as overall industry profits, are shrinking due to lower volumes in the marketplace, decreasing numbers of clients and increasing costs of conducting business. With each new securities regulation, it is becoming increasingly difficult for small- to mid-size intermediaries to conduct business and stay profitable. In an environment of low volumes and low revenues, intermediaries are already struggling to stay afloat, and an increase in compliance and regulatory costs will only prolong the stagnant economic environment.