



24 September 2012

Securities and Futures Commission
8/F, Chater House
8 Connaught Road Central
Hong Kong

Dear Sir/Madam

Re: Consultation on the regulation of electronic trading

The Hong Kong Association of Online Brokers (“HKAOB”) welcomes the consultation being conducted by Securities and Futures Commission (“SFC”). As industry participants, we are aligned with the regulators to keep Hong Kong securities market fair, transparent and to protect investors at large. We have vested interest in promoting Hong Kong as an international financial centre.

However, in the consultation paper on the regulation of electronic trading, we take the view that aside from licensed or registered persons, other stakeholders such as the Hong Kong Stock Exchange should meet the same requirements in the proposal. As the only Exchange operator in Hong Kong, Hong Kong Exchanges and Clearing Limited, is in fact acting as Broker to match Buy and Sell orders for other intermediaries. In that sense, Hong Kong Stock Exchange’s roles and functions are no different from the licensed or registered persons that the regulation of electronic trading intends to apply to.

We find the whole consultation paper is incomprehensive as other stakeholders are not represented or included to fall under the same regulations as intermediaries. It shifts all the burden of compliance on our members. In our view, an integral solution involving collaboration from all stakeholders will be more superior and robust than the one that focuses solely on licensed intermediaries to address an industry wide concern on market integrity and investor protection. Control and measures put in place by the Exchange will avoid the duplication of efforts, reduce the time and

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money spent by all members to comply with the recommendations proposed. We feel SFC should revise the consultation paper and to restart the consultation process.

In the meantime, we have offered our response to questions in the consultation paper which we disagree or strongly disagree. On the other hand, our response to the other questions, while not listed below, should not be construed as agreement or acceptance since we have reservation on the ways and means for compliance.

Q1. Do you agree that the proposed scope of the regulation of electronic trading is appropriate in terms of

- (i) the types of electronic trading, which include internet trading, DMA and algorithmic trading?**
- (ii) the types of products primarily covered by these proposals namely securities and futures contracts that are listed or traded on an exchange?**
- (iii) the persons to whom the proposals apply**

We disagree that the requirements should be incorporated in the Code of Conduct in one step. We would prefer the requirements be incorporated in a set of new guidelines first through the replacement of the existing Guidelines on Internet Regulation. This would give the regulators and market practitioners an adaptation period so that necessary fine-tuning can be made before incorporating them into the Code of Conduct. In addition, we would like to seek the Commission' confirmation on the scope and definition of DMA as well as algorithmic trading.

Q2. Do you agree that an intermediary should be ultimately responsible for the orders sent to the market through its electronic trading system and for the compliance of the orders with applicable regulatory requirements?

If not, why not?

We strongly disagree. The proposed paragraph 18.3 to the Code of Conduct which states that "a licensed or registered person is ultimately responsible for orders sent to the market through its electronic trading system and for the compliance of the orders with applicable regulatory requirements" is simply too broad, sketchy, vague and ambiguous for inclusion into any legislation and/or regulation. In our view, an ambiguous policy would definitely hamper the operation efficiency of the

intermediary and distract resources of the intermediary which shall be put into better use in daily operation.

Q4. Do you agree that an intermediary should ensure the integrity of the electronic trading system it uses or provides to clients for use, including the system's reliability, security and capacity, and have appropriate contingency measures in place?

If yes, are the proposed requirements sufficient? If not, why not?

We disagree with the contention in paragraph 32 of the consultation paper that an intermediary should put in place control measures to enable it to prevent the system from generating and sending orders to the market that may be erroneous or not compliant with the applicable regulatory requirements. Although the consultation paper said that an intermediary should put in place control measures to enable it to prevent the system from generating and sending orders to the market that may be erroneous or not compliant with the applicable regulatory requirements, the proposed paragraph 18.5 to the Code of Conduct and paragraph 1.2.1 of Schedule 7 appear to be acceptable.

Para. 18.5 – A licensed or registered person should ensure the integrity of the electronic trading system it uses or provides to clients for use, as may be appropriate in the circumstances, including the system's reliability, security and capacity, and have appropriate contingency measures in place.

Para. 1.2.1, Sch. 7 – A licensed or registered person should ensure that the electronic trading system it uses or provides to clients for use has effective controls to enable it, where necessary to: (a) immediately prevent the system from generating and sending orders to the market; and (b) cancel any unexecuted orders that are in the market.

Q5. Do you agree that an intermediary should keep, or cause to be kept, proper records on the design, development, deployment and operation of its electronic trading system?

If not, why not?

We disagree the intermediary is held accountable for putting control measures to reject orders that are not in compliant with the applicable regulatory requirements for reasons stated in Q4 above.

Q7. Do you agree that, in providing internet trading or DMA services, the proposed pre-trade controls should be put in place by an intermediary?

We disagree with the contention in paragraph 44 of the consultation paper that an intermediary should establish and implement automated pre-trade controls that are reasonably designed to prevent the entry of orders that are not in compliance with the regulatory requirements since the requirement is too broad. In this regard, we disagree with the proposed requirements in paragraph 2.1.1(a)(iv) of draft Schedule 7 of the Code of Conduct. However, we will accept, rather than in specific details, placing the appropriate pre-trade measures in place.

Q8. Do you agree that, in providing internet trading 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?

We disagree as an intermediary, who only has knowledge on transactions conducted by itself, often does not have sufficient information to identify any order instructions and transactions which may be manipulative or abusive in nature. We would counter that, instead of a general statement, we would invite the Commission to provide more specific guidelines to standardize and quantify the requirements such that intermediary could carry out the assessment more efficiently and objectively.

Q9. Do you agree that an intermediary should establish minimum client requirements for its DMA services and assess whether each client meets the requirements before granting DMA services to a client?

If not, why not?

We disagree as intermediaries are not in a position to judge as there is no basis for the criteria to accept a client for DMA services. We would counter that, instead of a general statement, we would invite the Commission to provide more specific guidelines to standardize and quantify the requirements such that intermediary could carry out the assessment more efficiently and objectively.

Q10. Do you agree that an intermediary should not allow its client to sub-delegate the DMA services to another person unless the client is a licensed or registered person or an overseas securities or futures dealer? Do you agree with the proposed definition of “overseas securities or futures dealer”?

If not, why not?

We disagree that an intermediary should not allow its client to sub-delegate the DMA services to another person unless the client is a licensed or registered person or an overseas securities or futures dealer.

Q11. 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?

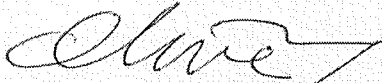
If not, why not?

We disagree as the selection of persons is a business decision and subjective in nature. The knowledge required in the design, development and use of the trading algorithms also depends on the complexity of the trading algorithms. It is simply impracticable to establish an acceptable standard for the purpose of regulation. There is no need to regulate the suitability of the persons involved in the design and development of, or approved to use its algorithmic trading system and trading algorithms.

Q17. What is your view on requiring an intermediary to make arrangements with a service provide for the purpose of meeting the proposed requirements on record keeping?

We disagree as the service provider is not regulated by SFC. An intermediary is not in a position to impose such condition on the service provider. Unless the service provider is also regulated and the same obligation is imposed on the service provider by the SFC, an intermediary may not be able to impose such condition on and guarantee the performance of the service provider.

Yours faithfully,



Oliver Ng

Chairman

The Hong Kong Association of Online Brokers