

Press release

LCQ10: Electronic trading system for securities

Wednesday, June 2, 2010

Following is a question by Dr Hon Samson Tam Wai-ho and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (June 2):

Question:

In early May this year, the stock market of the United States dropped drastically, recording the largest point drop since February 2009. According to the analysis by members of the financial market, the incident may be related to the setting of electronic trading systems. Although it has been reported that the Hong Kong Exchanges and Clearing Limited indicated that there are preventive measures in Hong Kong, some experts have pointed out that it is difficult to guarantee that the situations similar to the above can be avoided completely. Moreover, securities firms and banks in Hong Kong have also offered programme trading to their clients in recent years. In this connection, will the Government inform this Council:

(a) of the authorities' measures currently in place to monitor programme trading, and whether they have provided relevant guidelines to banks, securities firms, stock traders and investors;

(b) whether it knows if the Securities and Futures Commission and the Hong Kong Monetary Authority have regularly reviewed the risk management mechanisms of electronic trading systems, and whether they have assessed the safety of the current electronic trading systems; if so, of the details; and

(c) what preventive measures the authorities have to avoid similar incidents from occurring in Hong Kong?

Reply:

President,

My replies to the sub-questions are as follows –

(a) The electronic trading system for securities is operated by the Hong Kong Exchanges and Clearing Limited (HKEx), which is in turn regulated by the Securities and Futures Commission (SFC). Both SFC and HKEx have real-time surveillance systems to monitor securities trading activities in our markets.

SFC has set out specific requirements and guidance on the operational capabilities of licensed or registered persons. Licensed or registered persons should handle and transmit orders for execution promptly. Their computer systems should have sufficient operational integrity and address issues of security, reliability, capacity and contingency. SFC also expects intermediaries to have a periodic review programme to comprehensively plan, test and monitor their computer systems' security, reliability and capacity. SFC also stresses the importance of maintaining a complete audit trail, prompt execution and fair allocation of orders, trade confirmation to clients and safeguard of confidential information transmitted over the Internet.

SFC closely monitors international regulatory developments and standards pertinent to Direct Electronic Access (DEA) to markets and assesses the implications for the Hong Kong market. The International Organisation of Securities Commissions (IOSCO) launched an international consultation on possible principles pertinent to DEA in February 2009, and may publish consultation conclusions and principles on the use of DEA in the next few months. SFC will keep in view the latest developments.

(b) SFC has regular meetings and discussions with HKEx to understand the management and operation of its trading systems.

As regards connections between HKEx's systems and market participants' systems, HKEx has processes and procedures for testing new systems and trial run before they are launched. HKEx also has contingency measures in place to manage risks arising from system failures or defects.

As regards market participants' systems, SFC has ongoing discussions with market participants to understand their use of electronic execution of equity trades in Hong Kong. SFC regularly reviews the operational integrity of market participants. In March 2010, SFC issued a circular to licensed corporations reminding them to pay attention to certain potential deficiencies in information technology management and suggesting some control techniques and procedures.

(c) The US Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) are still at a preliminary stage of reviewing the market events of May 6, 2010. While there has been no conclusive finding, we understand that SEC and CFTC are currently focusing their investigations on a number of areas, including in particular the linkages between markets and liquidity mismatch.

Unlike the US market which is more fragmented, the Stock Exchange of Hong Kong is the major trading venue in Hong Kong and as a result, the issue of complications arising from disparate practices among different trading venues does not exist here. Nevertheless, we are following the US review closely and will consider areas that we can learn in order to strengthen the Hong Kong market structure.

We would also note that there are pre-trade and post-trade control measures within the third generation of HKEx's Automatic Order Matching and Execution System.

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