New Regulations on Programme Trading in the Chinese Securities Market

Shanghai YaoWang Law Firm has published a regulatory update on New Regulations on Programme Trading in the Chinese Securities Market.

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On 11 May 2024, China Securities Regulatory Commission (CSRC) officially released the "Regulations on the Management of Programme Trading in the Securities Market" (hereinafter referred to as “Programme Trading Rules”), after one month’s consultation process and without any material changes made to the consultation draft issued in April 2024. The Programme Trading Rules will become effective on 8 October 2024.

On top of the following recap of the key points in the Programme Trading Rules, we have also some relevant market intelligence to share, which may be of interest:

- The Programme Trading Rules indicate that eligible brokers may re-activate direct market access (“DMA” for external clients to gain direct access to the exchange via the broker’s trading counter) once further technical details are promulgated, which can be a substantial breakthrough to quantitative players. As an up-graded version of DMA, co-location may also be legally possible in the future for securities trading in China (whilst it is now only open to international players for acquiring market data and trading of futures contracts). We understand that Securities Association of China, securities exchanges, the subsidiary of Shanghai Securities Exchange (SSETech) among others are devoting time and efforts to push forward the issuance of further details to re-activate DMA.

- The current criteria to determine whether a strategy constitutes HFT largely follows the exchange standard, i.e. maximum number of order placements or cancelations reaching or exceeding 300 per second or 20,000 per day. That said, we understand that the exchanges may issue more comprehensive criteria to measure whether a strategy constitutes HFT, which may cover aspects of not only high speed, but also turnover rates, order-to-trade ratio, trading tools etc.

- Furthermore, it is likely that a tiered fee standard associated with higher frequency message may also be formulated and issued together with the upgraded standard of HFT. Specifically, it is likely that for those players who issue a high number of order message requests but have proportionally less % of execution of the total messages sent, an extra service charge may apply to those meeting the high frequency message criteria.

Kindly note that this client alert is produced by jointly Simmons and YaoWang Law Offices. YaoWang was established by all Simmons alumni as a PRC alliance firm of Simmons. It shares all the same value and is seen by Simmons as an extension of its businesses in China. One of the primary reasons why YaoWang is established is that, under China's laws and policies, no international law firms have licence to represent clients in court or issue official PRC legal opinion, whilst YaoWang as a local law firm can. Establishing an alliance law firm like YaoWang is a practice that has been adopted by many other international law firms and is supported by the government for international law firms to eventually gain full local law capabilities.

This regulatory development aims to address the increasing complexity and impact of programme trading in the Chinese securities market, echoing the fairly recent enforcement cases targeting Chinese domestic fund managers (please see our webinar on this topic via here) and following securities exchanges' filing requirements on programmatic traders issued in September 2023 here.

Legislative Intent

According to the CSRC, the legislative intent behind these Programme Trading Rules is to address several key objectives:

1. Market Stability and Integrity: With the proliferation of programme trading, there is a growing concern about its potential impact on market stability and integrity. Whilst the CSRC indicates that it decides to embrace rather than suppress the development of programme trading, these Programme Trading Rules seek to establish clearer guidelines and standards to prevent market manipulation, excessive volatility, and systemic risks associated with programme trading activities.

2. Investor Protection: The Programme Trading Rules aim to enhance investor protection by promoting transparency, fairness and accountability in programme trading.

3. Risk Management: Recognising the inherent risks of programme trading, including algorithmic errors and technology failures, the Programme Trading Rules mandate market participants to implement robust risk management systems and controls.

Key Provisions and Analysis

1. Definition and Scope

The Programme Trading Rules provide a comprehensive definition of programme trading, i.e., automated generation or execution of trading orders via computer programmes with respect to "securities trading via securities exchanges" is all deemed as programme trading. The Programme Trading Rules apply to private fund managers, retail fund managers, securities firms, insurance companies and other investors required by the securities exchanges (which we believe may possibly include certain prop trading firms). Overseas investors trading Chinese securities markets via QFI and Connect Programs are all in-scope entities. They don't apply to CIBM or futures markets.

2. Registration and Disclosure Requirements

Market participants engaged in programme trading are required to register with securities exchanges and make disclosures on the following:

- basic information of the accounts;
- source of funds and source of leverage as well as leverage ratio;
- type and key components of trading strategy, means of order execution, maximum rate of order submission, maximum declaration volume on any single trading day;
- name, version and developer of the trading software; and

- other information stipulated by securities exchanges, such as information of the brokers, name of contact person, and contact details of such contact person.

Disclosed information is subject to validation by the securities exchanges and any subsequent changes of the disclosed information requires filing. What is worth noting is that the CSRC no longer requires the disclosure of source code of the investors' algorithms (which they once attempted back in 2015 when issuing a similar draft rule on programme trading), which is a pleasing development.

3. Risk Control Measures

To mitigate risks associated with programme trading, the Programme Trading Rules mandate market participants to establish comprehensive risk management systems and mechanisms. Securities exchanges would specially monitor the following behaviours:

(a) orders placed but cancelled within a relative short time period or intra-day reaching certain level;
(b) large, continuous or dense orders placed and filled, causing obvious abnormality to the pricing or trading volume of multiple securities;
(c) large, continuous or dense orders placed and filled, causing obvious abnormality to the securities market; and
(d) other circumstances as deemed necessary by the securities exchanges.

Existing market abnormality rules have quantifiable criteria with respect to most of the market abnormality such as wash trades, frequent order cancellations, large order cancellation, circumventing position limits or limits on holding periods. In the recent enforcement cases, the securities exchanges notably invoked a non-quantifiable criteria of market abnormality which is programme trading causing market disruption. Following those enforcement cases, domestic quant fund managers were also warned that "orders filled in large volume and within a short time period, taking up a significant portion of the orders filled within the same time period and causing a substantial volatility of the major stock indexes " may be subject to special monitoring.

It looks like the above mentioned limbs b) and c) also unveil a consistent school of thoughts from the regulators, though we believe that regulators and exchanges would exercise such power very cautiously not arbitrarily. More background of why we believe so can be found in our webinar.

Furthermore, the Programme Trading Rules prohibit brokers from providing any co-location arrangement to investors who A) have committed frequent abnormal trading behaviours B) have major technical failure of their programme trading systems, C) violate the exchange rules, and D) trade securities via swaps (with Item D) implicated). They also allow securities exchanges to charge higher fees if the number and frequency of orders placed and cancelled reach certain level.

4. HFT (High Frequency Trading)

For the first time regulators have attempted to define high frequency trading which refer to programme trading with the following characteristics:

(a) The number and frequency of order placement and order cancelation within a short period of time is relatively high;
(b) The number of orders placed and cancelled intraday is relatively high;
(c) Other characteristics identified by the securities exchanges.

The CSRC has deferred to securities exchanges to come up with more detailed explanations and parameters on HFT, which timeline is yet unknown.

5. Market Surveillance and Supervision

The CSRC will enhance market surveillance and supervision of programme trading activities through advanced monitoring technologies and data analytics. This includes real-time monitoring of trading activities, market data analysis, and surveillance of order flows to detect and investigate irregularities, market abuse, and manipulative behaviours.

Conclusion

In conclusion, the Programme Trading Rules were created during a time with down market, high volatility and regulators' strong will to boost the stock market. It somewhat tells that, although legislators are not yet fully prepared on the technical side, they now pay higher attention on the programme trading activities focusing on market stability, investor protection, and risk management.

Should you have any questions or require further assistance regarding the Programme Trading Rules, Please contact Yuying Wang at Simmons & Simmons, Melody Yang or Sherry Si at YaoWang if you have any questions. Thanks.