Part B   Consultation Questions – Volatility Control Mechanism

Please indicate your preference by checking the appropriate boxes and provide reasons to support your views. Where there is insufficient space, please attach additional pages as necessary.

1. Do you support the introduction of an instrument-level VCM based on a dynamic price limit model in Hong Kong?

    ☒   Yes

    ☐   No

    Please give reasons for your view.

    > A VCM provides additional protection at the market level to ensure that potential errors do not disrupt the overall market. Presently there is a reliance on individual market participants to operate controls to prevent this, however there is a requirement for the Exchange to also protect the market centrally, as is the case in all other comparable stock exchanges

2. Do you agree that the proposed VCM model should only be applied to the HSI and HSCEI constituent stocks in the <u>securities</u> market?

    ☐   Yes

    ☒   No

    Please give reasons for your view.

    > VCM is required for all cash securities and not limited to a sub-set. It may be that a phased implementation of securities in a reasonable period of time accomplishes this over time. It is also noted that the price band will need to be considered where less liquid securities are included

3. Do you agree that the proposed VCM model should only be applied to the HSI, HHI, MHI & MCH (spot month and the next calendar month) index futures in the <u>derivatives</u> market?

    ☐   Yes

    ☒   No

    Please give reasons for your view.

> **VCM is required for all securities and not limited to a sub-set. It may be that a phased implementation of securities in a reasonable period of time accomplishes this. Is it also noted that the price band will need to be considered where less liquid securities are included**

4. Do you agree that the market should have a 15-minute uninterrupted trading period before the end of the last continuous trading?

    ☒ Yes

    ☐ No

    Please give reasons for your view.

    > **The Price Discovery process must process up to the close to ensure that the close reflects market prices**

5. Do you agree with the proposed reference price for the <u>securities</u> market, namely the price of last trade 5 minutes ago? If not, what would you prefer?

    ☒ Yes

    ☐ No, I would prefer: _____

    Please give reasons for your view.

    > **A look back for the reference price is required to reflect market conditions whilst still providing protection against disruptive price movements. This may need to be assessed as less liquid securities are included**

6. Do you agree with our proposed reference price for the <u>derivatives</u> market, namely the price of last trade 5 minutes ago? If not, what would you prefer?

    ☒ Yes

    ☐ No, I would prefer: _____

    Please give reasons for your view.

    > **See response above**

7. Do you agree with the proposed triggering level for the <u>securities</u> market, namely <u>10%</u> from the reference price across the proposed instruments covered by the VCM? If not, what level would you prefer?

☒ Yes

☐ No, level that I would prefer: _____

Please give reasons for your view.

> **10% appears to create limited trading halts whilst protecting the market**

8. Do you agree with the proposed triggering level for the <u>derivatives</u> market, namely <u>5%</u> from the reference price across the proposed instruments covered by the VCM? If not, what level would you prefer?

☐ Yes

☒ No, level that I would prefer: _10%_

Please give reasons for your view.

> **To ensure consistency and reduce possible confusion during investor education the limit for both cash and derivative should be consistent, however note the earlier point of potentially different limits depending on the liquidity of securities**

9. Do you agree that a maximum of two VCM triggers per trading session per instrument should be imposed to minimise market interruption?

☐ Yes

☒ No, I would prefer: _Unlimited triggers_

Please give reasons for your view.

> **The principal should be for unlimited triggers i.e. the number of triggers are based on market events and are not artificially constrained. However we do see a need to potentially set a limit to start with and regularly assess**

10. Do you support trading within a price limit during the cooling-off period? If not, do you prefer another approach?

☒ Yes

☒   No, another approach that I prefer: _____

Please give reasons for your view.

> **We recommend assessing the potential use of an auction period as a potential future enhancement to VCM**

11.   After the cooling-off period, do you support resuming the same dynamic price limit monitoring mechanism (i.e. ±10% (±5%) from the last trade 5 minutes ago in the securities (derivatives) market)? If not, do you prefer another approach?

☒   Yes

☐   No, I would prefer: _____

Please give reasons for your view.

> **As stated above**

12.   Do you have any other suggestions on enhancing the resumption procedures?

> **We recommend assessing the potential use of an auction period as a potential future enhancement to VCM**

13.   Do you agree that the duration of the cooling-off period should be 5 minutes for both the securities and derivatives markets? If not, what would you prefer and why?

☒   Yes

☐   No, I would prefer: _____

Please give reasons for your view.

> **5 minutes is a commonly used period in comparable stock exchanges / mechanisms**

14.   Do you agree with the additional market data dissemination for the proposed VCM model? If not, what would you propose and why?

☒ Yes

☐ No, I would propose: _____

Please give reasons for your view.

> **Market participants will require market data to inform their decisions in the time surrounding a VCM halt**

15. If a VCM is triggered for a given instrument, should trading of related instruments (e.g. futures contract of different contract months) on the same underlying continue as normal?

☒ Yes

☐ No

Please give reasons for your view.

> **Yes however with the caveat that consistent treatment is required between the cash security and derivative contract equivalent for the same underlying security. Market making rules and obligations will need to reflect this i.e. potentially waived. Where non-solo derivative or other products are affected (e.g. index futures, ETF's) the decision should rest with the market maker**

16. If a VCM is triggered for a given instrument, should trading of derivatives (e.g. single stock options or warrants) of that instrument continue as normal?

☐ Yes

☒ No

Please give reasons for your view.

> **See 15**

17. Do you have any other comments on the VCM proposal?

Given the dynamic nature of VCM, HKEx must centrally control the start and end time of the cooling off period to avoid any potential time gap between HKEx and EPs/banks/brokers. It is also important that clear order reject message be communicated to EPs/banks/brokers such that clear message can be relayed to retail customers on a timely basis to facilitate investment decision.

Sufficient Testing/Market Rehearsals must be available to EPs/banks/brokers to ensure thorough testing before launch

Comprehensive Investor education by HKEx before launch is also key to ensure retail investors are familiarized with the mechanism for better retail investors protection.

Part C Consultation Questions – Closing Auction Session

18. Do you support the introduction of the new CAS model in the Hong Kong securities market?

  ☒ Yes

  ☐ No

Please give reasons for your view.

> **Hong Kong is presently out of step with global developed financial markets in that the Exchange does not have a closing auction, and as such exposes investors of all types and sizes to an unacceptably high level of price volatility during market events, as well as creating unorderly market conditions in the time period leading up to the market close**

19. Do you agree that the new CAS model should only be applied to the major index constituent stocks (i.e. Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index constituents as well as other Stock Connect Securities for Southbound trading)?

  ☒ Yes

  ☐ No

Please give reasons for your view.

> **The principal should be for CAS to apply to all securities and not to artificially limit to certain index securities only. It may be that a phased implementation of all securities in a reasonable period of time accomplishes this, and therefore starting with index securities initially may be a practical approach on the proviso that the intention is to expand to include all securities.**

20. Do you agree that the new CAS model should be applied to ETF? If yes, which type of ETF should be applied?

  ☒ Yes

      ☒ (i) Apply to all ETFs

      ☐ (ii) Only apply to ETFs with Hong Kong stocks as underlying

  ☐ No

Please give reasons for your view.

> **The principal should be for CAS to apply to all securities and not to artificially limit to certain securities only**

21. Do you agree that at a later stage, the new CAS model should be expanded to other equity securities and funds as proposed? If so, when should the CAS be rolled out to these securities and funds?

☒ Yes, roll out time should be: As soon as prudent and practical, minimal delay

▨ No

Please give reasons for your view.

> **The principal should be for CAS to apply to all and not to artificially limit to certain cash securities only. We also need to be cautious of creating two 'classes' of securities**

22. Do you agree that that the new CAS model should exclude structured products, equity warrants and debt securities?

☒ Yes

☐ No

Please give reasons for your view.

> **Exchange traded derivative and bond products have different characteristics from cash equities, generally do not have closing type execution requirements from investors.**

23. Do you support introducing a price limit during the CAS?

☒ Yes

▨ No

Please give reasons for your view.

> **A price limit is sensible however care must be taken to set the limit at a practical level – if the level is too low or too high it will undermine the effect of the auction**

24. Do you support a price limit of 5% during the Order Input Period for all CAS Securities?

☐ Yes

☒ No

Please give reasons for your view.

> **We recommend an initial price limit of no less that 7.5%, this being to ensure that the closing auction is efficient by ensuring high order completion rates, to reduce price volatility in the period leading up to the auction. Assessment of closing auction mechanisms used by other stock exchanges could provide supporting information as to the level to initially be decided. Analysis can also be undertaken to simulate market efficiency and reduction in price volatility by assessing past high volume trading days. Finally it may be appropriate to allow for a process within the future rules of the exchange to undertake a periodic review and adjustment of the price limit based on anecdotal data**

25. Do you agree that a further price limit within the best bid and best ask should be applied during the No-Cancellation Period and Random Closing Period?

☐ Yes

☒ No

Please give reasons for your view.

> **This would constrain price discovery and reduce liquidity rather than improve volatility**

26. Do you agree that at-auction limit orders should be allowed throughout the CAS?

☒ Yes

☐ No

Please give reasons for your view.

> **Both liquidity and the price discovery process for all investors is improved by providing at auction limit orders**

27. Do you think short selling orders with a tick rule should be allowed during the CAS?

☒ Yes

☐ No

Please give reasons for your view.

> **Short sell orders are a legitimate expression of investor demand and improve both liquidity and price discovery. There are many external reports and studies that support the positive role that short sell orders bring to a market and all market participants. To exclude short sell orders from the auction will have the effect of reducing how the auction reflects the overall market**

28.   If short selling order is to be allowed, should it be at or higher than the reference price?

☐ Yes

☒ No

Please give reasons for your view.

> **It should be based on the uptick rule. There is no clear need to introduce additional constraint**

29.   Do you agree that order amendment and cancellation should be disallowed during the No-Cancellation Period and Random Closing Period?

☒ Yes

☐ No

Please give reasons for your view.

> **We recommend this is reviewed after an initial period of CAS operating**

30.   Do you agree that random closing be adopted in the CAS to prevent gaming?

☒ Yes

☐ No

Please give reasons for your view.

> A random close is a widely accepted approach to defend against gaming

31. If random closing is to be adopted, should it be over a period of up to 2 minutes or would you prefer a different duration?

☐ Up to 2 minutes

☒ A different duration: 30 or 60 seconds

Please give reasons for your view.

> 30 or 60 seconds is sufficient. Two minutes is longer than necessary

32. In the absence of a final IEP, do you agree that the reference price should be used as the closing price and for trade matching?

☒ Yes

☐ No

Please give reasons for your view.

> **Whilst a VWAP reference would be technically better, using the existing 5 print model will reduce complexity and development, and is already well understood by current market participants and investors**

33. What would be the preferred duration of the CAS?

(i)   Same as the proposed model, i.e. 7-minute Order Input Period to end the CAS at 16:12

(ii)   5-minute Order Input Period to end the CAS at 16:10

(iii)   Others, please specify:

☒ Approach (i)

Approach (ii)

☐ Approach (iii), please specify:

Please give reasons for your view.

> **7 minutes is sufficient for order placement and change**

34. Do you agree that some features of the new CAS model may also be beneficial for the POS and/or the Trading Halts? If so, which feature(s)?

☒ Yes, the feature(s): The auction itself

☐ No

Please give reasons for your view.

> **The auction should be beneficial for the open as well as the close**

35. Do you agree that any enhancements for POS and/or the Trading Halts should be implemented later rather than during the introduction of the new CAS?

☒ Yes

☐ No

Please give reasons for your view.

> **We believe the CAS is the highest priority for market integrity and for investors, with other changes still important but of a lower priority.**

36. Do you foresee any issues with your day end processing such as margin calls in the cash market due to the extended trading time for 12 minutes? If yes, how may the issue be resolved?

☐ Yes, suggested solution: _____

☒ No

Please give reasons for your view.

37. To maintain the 45 minutes break before the start of AHFT, do you agree that the start time of AHFT to be changed from 17:00 to 17:15? If not, what time do you prefer?

☒ Yes

☐ No, time that you prefer: _____

Please give reasons for your view.

Part D   Consultation Questions – Implementation Approach and Timeline

38.   Which implementation approach for the securities market would you prefer:

(i)   the development and testing of the VCM, CAS and Trading Halts functionalities are to be implemented together on the AMS/3.8 platform and be rolled out one by one; or

(ii)   (1) the development, testing and rollout of VCM and CAS are to be implemented together on the AMS/3.8 platform, and (2) Trading Halts proposal is to be introduced as part of the Exchange's next-generation trading system, the Orion Trading Platform-Cash; or

(iii)   Others, please specify.

☐   Approach (i)

☒   Approach (ii)

☐   Approach (iii), please specify: _____

Please give reasons for your view.

> CAS is the more urgent priority, with VCM second and SSTH last, VCM being important to improve the market protection however so far we have not had any serious market issue. For SSTH we see no immediate priority, and will require a significant amount of time and cost to adapt systems and processes, and to educate investors

39.   What should be the implementation priority among the three initiatives (i.e. VCM, CAS and Trading Halts) in the securities market?

Please give reasons for your view.

> From an institutional investors perspective Hong Kong has fallen behind the world's stock exchange in that it does not have a CAS mechanism that protects investors from unacceptable price volatility and the related impact and frictional costs associated with the lack of a CAS and therefore CAS is the first priority
>
> However from our retail broker perspective VCM is the first priority
>
> In either case Should VCM be delayed for any reason we recommend to proceed to implement CAS on its own i.e. without waiting for VCM.
>
> In all cases SSTH is a low priority

40. How long do you need to prepare for the rollout starting from the issuance of the specification for each initiatives:

(i) VCM:

☐ a). under 3 months;

☐ b). 4-6 months;

☒ c). 7-12 months

☐ d). >12 months

Please give reasons for your view.

> Given that our changes are required for both institutional and retail customer groups we anticipate that systems and process changes, and sufficient time to provide customer education
>
> If both VCM and CAS are to be launched at the same time this may require >12 months, depending on the volume and complexity of change and investor education required
>
> Note that this scheduling must also take into account other changes that are anticipated for the market over the same time period; For example additional rollout of Stock Connect changes (such as addition of Shenzhen) must be taken into account – it cannot be assumed that market participants, related parties and investors can absorb the cost and effort of multiple concurrent changes

(ii) CAS:

☐ a). under 3 months;

☐ b). 4-6 months;

☒ c). 7-12 months

☐ d). >12 months

Please give reasons for your view.

Given that our changes are required for both institutional and retail customer groups we anticipate that systems and process changes, and sufficient time to provide customer education

If both VCM and CAS are to be launched at the same time this may require >12 months, depending on the volume and complexity of change and investor education required

Note that this scheduling must also take into account other changes that are anticipated for the market over the same time period; For example additional rollout of Stock Connect changes (such as addition of Shenzhen) must be taken into account – it cannot be assumed that market participants, related parties and investors can absorb the cost and effort of multiple concurrent changes

- End -