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.

strongly support the introduction of an instrument-level VCM based on a dynamic price limit model in Hong Kong. Such a mechanism would safeguard market integrity and contain systemic risk during periods of extreme price volatility (whether caused by errors or otherwise). Introducing this new feature would ensure that Hong Kong is aligned with global industry best practice (many other international exchanges have already established similar controls) and international regulatory guidance.

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.

Introducing the VCM model for only HSI and HSCEI stocks would be strongly supported over no VCM model at all. Though believe that the benefits of a VCM model would be equally applicable to all stocks listed on the exchange rather than just the HSI and HSCEI names.

We note from point (3) of the Executive Summary that IOSCO is encouraging the reduction of systemic risk. We have some concern that complexity tends to increase risk; static data errors are often the root cause of systematic trading errors. Accordingly we would recommend having one mechanism apply to all stocks. We further note that the indices are changed every 6 months and although controls can be put in place to check accuracy, it would be preferable to apply the new rules equally to all stocks so there is no risk of static data errors resulting from incorrect inclusion or exclusion of a given name. We see that the consultation considers widening the stock universe for Phase 2 and suggest it could be moved forward to Phase 1.

acknowledge that if a VCM model was to be applied to all listed stocks then consideration would need to be given to particularly illiquid stocks and low priced stocks which may trade with relatively large spreads that could exceed the proposed +/-10% threshold.

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 derivatives market?

☐ Yes

☒ No

Please give reasons for your view.

Introducing the VCM model for only HSI, HHI, MHI & MCH (spot month and the next calendar month) index futures would be strongly supported over no VCM model at all. Though, similar to the securities market, believe the benefits of a VCM model would be equally applicable to all index futures.

The same static data risk comments above in the response to Question 2 are also applicable here.

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.

agree that the proposed 15 minute uninterrupted trading period before the end of the last continuous trading session would be appropriate in order to allow an efficient price discovery process to unfold prior to the close.

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.

agree that the price of the last trade 5 minutes ago is an appropriate reference price for the VCM model in the securities market (and 5 minutes is also consistent with several similar controls across other international exchanges).

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.

agree that the price of the last trade 5 minutes ago is an appropriate reference price for the VCM model in the derivatives market (and 5 minutes is also consistent with several similar controls across other international exchanges).

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.

agree that the 10% threshold in the securities market would be appropriate for most liquid stocks as it is low enough to provide a meaningful volatility control without being too low so as to unnecessarily restrict an efficient price discovery process. However, as noted in our response to Question 2, support expanding the VCM scope to cover all stocks. This would necessitate a liquidity sensitive tiered trigger as certain illiquid stocks would be much more likely to be triggered at the 10% level. Indeed particularly illiquid stocks and low priced stocks may trade with relatively large spreads that could exceed the proposed +/-10% threshold.

We propose that although this does introduce some complexity, it is balanced by the benefit of having an orderly market for both liquid and illiquid names. We suggest the exchange could take their analysis of historical market data to the next level by creating buckets of stocks based on their liquidity and consider where the best balance lies between multiple bands and unnecessary granularity.

8. Do you agree with the proposed triggering level for the derivatives market, namely 5% 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.

support the 5% threshold in the derivatives market and agree that the lower level compared to the securities market is appropriate given the basket nature of the index products that are proposed to be covered by the VCM.

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

Please give reasons for your view.

would support the introduction of the VCM with the proposed two trigger limit per trading session over no VCM at all. However consider the VCM to be an important control and see no need to arbitrarily limit it to only 2 triggers per trading session. would support unlimited triggers (with the exception of the 15 minutes prior to the end of the last continuous trading session as already stated in the response to Question 4).

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.

support trading within a price limit during the cooling-off period. also acknowledge that an auction process could provide an efficient alternative and suggest that this is considered for a later date. Similarly to the CAS, an intra day auction for VCM (where trading is paused for 5 minutes while market participants enter bids and offers, an indicative price is given and the exact uncrossing time is randomised) could also be used. While we highly commend the free market philosophy of Hong Kong, an auction would further promote a fair and orderly market by allowing equal pricing for all participants in line with HKEx's and academic research.

As noted by the HKEx in (85), auctions maximise matching and having an intra day uncrossing would allow for maximum volume to be traded at a single price that could then be used as the new reference price. It would also increase the likelihood of trading compared to continuing normal trading within a price band as it would not require one party to cross the spread but allow for the orders to be matched at the price that is best for all. The trade will still execute, it would just happen 5 minutes later.

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.

support the proposal to resume the VCM after a cooling-off period with the same dynamic price limit mechanism. To vary the monitoring mechanism following a cooling off period would introduce unnecessary complexity.

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

If there are no trades during the cooling-off period then the proposal currently states that the first trade after the cooling-off period can be executed without any price limit applied.

are concerned that this could allow extreme price movements to occur which may potentially result in the same price volatility that the original trigger was designed to prevent. For example if the VCM was triggered due to an error that would have caused extreme price volatility, and there were no trades during the cooling-off period, and the error was not addressed during the cooling-off period, then the same extreme price volatility could still occur upon resumption of trading (albeit 5 minutes later than would have been the case with no VCM).

In order to resume trading in a controlled manner (following a cooling-off period in which there were no trades) would support either:
(i) an auction process to establish the new clearing price (as also referenced in the response to Question 10); or
(ii) set the reference price as the highest bid (or lowest offer) depending on the price movement direction until an actual trade is executed (i.e. the reference price would gradually step downwards or upwards to find the appropriate market level).

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.

support the proposed cooling-off period duration of 5 minutes. This is long enough for market participants to consider the trigger implications without being too long so as to unnecessarily disrupt the trading session.

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.

support the proposal for market data dissemination. Indeed this would be crucial as individual market participants would not have the technology to monitor the reference prices and limits themselves.

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.

In the event of a VCM being triggered for a given instrument, trading of related instruments on the same underlying would not continue trading as normal. For example, as noted in the consultation paper, it would not be possible for market makers to meet their market making obligations in such related instruments.

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 response to Question 15.

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

As previously mentioned, strongly support the introduction of a VCM model. Although a number of changes are suggested in the comments above, would certainly support the introduction of the VCM model as proposed above no VCM at all. Further enhancements could be planned for a later date once all market participants were comfortable with the new mechanism.

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.

strongly support the introduction of a CAS in the Hong Kong securities market. Such a change would bring HKEx into line with universally accepted best practice and align the Hong Kong closing process with similar auctions already established at almost all international exchanges in both developed and emerging markets. Furthermore the introduction of a CAS would result in an efficiently discovered official closing price that would allow for more precise fund valuations and facilitate more accurate index tracking opportunities via market-on-close orders. These would yield great benefits to all market participants and investors either directly or indirectly.

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.

would support the introduction of a CAS for only the major index constituent stocks over having no CAS at all. However do not see why the compelling benefits of a CAS should be arbitrarily restricted to only a sub-set of securities. would therefore support the introduction of a CAS that was applied consistently for all listed securities.

In particular, some of the largest pre-close price volatility and dislocation could potentially be observed in stocks immediately prior to their inclusion in the major indexes. Such stocks would not be covered in the scope of the current proposal yet would greatly benefit from a CAS.

Similar to the comments in the response to Question 2, restricting the scope of CAS stocks introduces static data risks associated with the inclusion and exclusion of stocks (especially over time as the indices are updated).

Furthermore, having different closing times for CAS stocks and non-CAS stocks may result in market participants thinking they still have time to trade when in fact they do not.

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.

see no reason why ETFs should be excluded from the proposed CAS.

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 practicable

☐ No

Please give reasons for your view.

As noted in the response to Question 18, the benefits of a CAS are widely acknowledged therefore see no reason to restrict the equity security scope or delay the introduction timing.

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.

support the proposal to exclude structured products, equity warrants and debt securities. Such instruments are generally excluded in other markets due to differences in trading characteristics and market-on-close order demand.

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

☒ Yes

☐ No

Please give reasons for your view.

support the proposal of a price limit during the CAS as an important volatility control however please note the further comments below in the response to Question 24.

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.

would support a CAS with a 5% price limit over no CAS at all. However having a price limit that is unduely restrictive could actually be detrimental to the price discovery process as market participants react to the possibility of limits being hit thus increasing volatility. As such would support a higher price limit of 8% or 10%.

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.

would consider this additional limit to be unnecessarily restrictive for potential liquidity. In the interest of reducing complexity the same price limits should be applied consistently throughout.

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

☒ Yes

☐ No

Please give reasons for your view.

support the proposal to allow at-auction limit orders throughout the CAS as this would facilitate price discovery throughout the CAS period rather than having only at-auction orders which may be largely entered at the very end of the CAS.

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.

support the proposal to allow short selling with a tick rule during the CAS. Short selling would contribute to the efficiency of the CAS by adding liquidity whilst also providing market participants with an important hedging and risk management tool.

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.

would support short selling during the CAS but would suggest that the continuous trading session tick rule conditions are applied consistently in the CAS. There is no need to further restrict the short selling conditions during the CAS.

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.

support the proposal that order amendment and cancellation be disallowed during the No Cancellation Period and Random Closing Period. However consideration should be given to provisions that could cover instances of genuine errors being made during those periods.

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

☒ Yes

☐ No

Please give reasons for your view.

strongly support the random closing time proposal as this provides an important anti-gaming control that is widely implemented across other international exchanges. Indeed this feature is essential to the effective and orderly operation of the CAS (and was notably missing from the ultimately unsuccessful previous Hong Kong CAS).

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: 1 minute

Please give reasons for your view.

consider two minutes to be unnecessarily long for the Random Closing Period. One minute would be a sufficient duration to provide an effective anti-gaming control.

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.

agree that using the reference price as the closing price and for trade matching is a reasonable approach in situations where no final IEP is established.

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.

support the proposed 7 minute Order Input Period as that provides sufficient time for order entry and subsequent amendments or cancellations. Though please note the comments in the response to Question 31 with respect to the proposed duration of the Random Closing Period.

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): Auction

☐ No

Please give reasons for your view.

would support the introduction of an auction process in the opening session and during trading halts (as already noted in the response to Question 10) as many of the auction benefits outlined above would be equally applicable in those circumstances.

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.

stongly support the introduction of a CAS as soon as practicable and agree that additional enhancements to the POS and/or Trading Halts could potentially be implemented at a later date once all market participants are comfortable with the auction process.

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.

do not anticipate any operational issues with our end of day processing as a result of extending the trading time.

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.

supports the proposal to change the start time of the AHFT to 17:15 as this would maintain a sufficient window of time in which to perform various operational processes.

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.

considers both the VCM and CAS to be important developments worthy of high prioritisation. They should both be implemented as soon as practicable. Further enhancements can be considered for later implementation once the core functionality is established.

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.

As mentioned above in the response to Question 38, considers both the VCM and CAS to be of high importance. Some of the risks targeted by the VCM are partially mitigated through most market participants having their own risk controls and through the recent introduction of additional regulatory rules and guidance (including the SFC Electronic Trading rules). However the CAS would be a transformational development with significant benefits for all market participants and investors (whilst also closing an important gap between Hong Kong and their global exchange peers). So if it was not possible to action both simulataneously then would support introducing the CAS first.

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.

would support a 4-6 month rollout for the VCM as this would provide sufficient time for market participants to prepare for the changes.

(ii) CAS:

☐ a). under 3 months;

☒ b). 4-6 months;

☐ c). 7-12 months

☐ d). >12 months

Please give reasons for your view.

Similar to the VCM, would support a 4-6 month rollout for the CAS.

- End -