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.

> We welcome volatility controls in accordance with international best practices. However, the introduction of VCM in Hong Kong as proposed will result in further differentiation of marketstructure and a more restrictive trading environment when compared to Mainland China. Specifically, dual-listed A/H shares will be out of sync when VCM is in effect. Unlike China's +/-10% limit from previous close and other global markets' circuit breakers, the proposed HKEx mechanism differs from standard practice. Hong Kong's uniqueness will likely be difficult for investors to understand and may reduce the attractiveness of the marketplace. Simplicity in managing market volatility via pre-trade checking mechanisms and simple circuit breakers would be preferred.

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

☐   Yes

☒   No

Please give reasons for your view.

> Systems complexity will be increased by limiting the model to "key index stocks and key index contracts". Names with large spreads are more likely to breach the +/-10% price change level regardless of whether they are "key index stocks" and controls should therefore be uniformly applied.

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.

> see above.

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 formation process leading into the close would be materially affected if the VCM were triggered, impacting the auction's opening reference price and resulting permissible price movement band.

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: Previous close price as per China

Please give reasons for your view.

> A rolling reference price will be confusing, by setting the price to the previous close the market will have a clear understanding of trigger points. Furthermore, the fixed reference price level should be applied throughout continuous trading and both auctions for simplicity and consistency.

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 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: <u>20%</u>

Please give reasons for your view.

> To be consistent with China's market the band should be set at 10% if using a fixed reference price. 20% may be more appropriate if using a rolling reference price.

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: <u>10%</u>

Please give reasons for your view.

>

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: _____

Please give reasons for your view.

> A maximum of two volatility triggers is in-line with other global markets' practices.

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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.

Less complexity is better.

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.

Less complexity is better.

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

Less complexity is better.

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.

Less complexity is better.

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.

Additional datapoints will be important for the market to monitor the status of VCM eligible instruments. One additional helpful per-instrument indicator would be a "VCM trigger count" that displays the # of VCMs that have been entered into per session. This is especially important if there is a limit of two VCM per session.

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.

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.

Without harmonization of structured products there will be instances where the underlying enters a "cooling-off" state while the inverse and leveraged products are unrestricted. It is suggested that a linkage be formed that harmonizes structured products before any rollout of dynamic price limits.

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

Implementation of VCM should be lower priority than CAS. The VCM in it's
currently planned design is too complex and will likely lead to unintended
consequences affecting the fairnes and transparency of the market. Clarity on the
planned treatment of ETFs under VCM is welcomed.

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.

> The daily close price is an important metric for fund managers' portfolio valuation and price tracking trading strategies / algorithms. It is extremely important that HKEx reintroduce a closing auction mechanism. As noted in HKEx's preliminary discussion paper, significant daily volume requires execution at the closing price, especially on index rebalance days. Since the suspension of the CAS in March 2009 the SEHK has utilized a median snapshot mechanism that differs from Global Stock Exchange practices. The current mechanism does not allow investors to secure the close price natively on the Exchange, which requires alternative methods to approximate the price. An immediate re-launch of the CAS using a model in-line with Global practice would be a welcome improvement to Hong Kong's Capital market infrastructure.

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.

> Limiting the applicable universe provides unneccessary complexity and does not take into account the number of other important index benchmarks that investors follow. For example, the MSCI Investable Market Indexes (IMI--Large, Mid & Small) and FTSE Global All Cap Index (Large, Mid and Small) would have some constituents subject to CAS while others use the closing reference price. It will be needlessly expensive and complicated for brokers and investors to support both formats. The closing auction function can be useful for all single stocks / ETFs and the price control band can limit adverse effects on small cap names.

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 closing auction function can be useful for all ETFs and the price control band for movement during the auction can limit adverse effects on ETFs.

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 practical

☐ No

Please give reasons for your view.

> See above.

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.

> Inclusion of structured products including warrants, CBBCs and debt instruments is not common practice in other markets offering a closing auction. These products are designed to reflect the value of the underlying and auction IEP will not necessarily reflect that.

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

☐ Yes

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☒ No

Please give reasons for your view.

> see below.

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.

> While we understand concerns about volatility in the closing auction, especially in light of historical context, it should be noted that price bands are typically wider than 5% in markets that employ them. For reference, the NYSE Arca closing auction has the following price collar policy1: "The Closing Auction will not execute at a price that is greater than 10% away from the consolidated last sale for stocks priced $10 and above or 25% away from the consolidated last sale for stocks priced under $10." (source: http://www1.nyse.com/equities/nysearcaequities/1157623605155.html). Our recommendation would be to eliminate the band completely or to increase the level to at least +/- 10% of the previous day's closing price to be in-line with Shanghai.

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 is an unneccesarily complex application that will confuse the market.

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

☒ Yes

▣ No

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Please give reasons for your view.

> Limit orders reduce pricing uncertainty, at auction limit orders help to maximize liquidity and facilitate price discovery.

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 selling improves liquidity and reduces volatility by allowing short sales to offset an imbalance on the long side. Note that Korea's closing auction has much lower volatility compared to Taiwan, which has a short sell quota restriction. Short selling should be supported in the CAS with the last tick of the continuous session used to set acceptable shorting price points.

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.

> see above.

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.

> Mirror the practice of the opening auction for simplicity's sake (also in-line with NYSE).

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

▩ Yes

☒ No

Please give reasons for your view.

> Knowable market close times and trading duration increments are preferred to a
> random mechanism. Underlying systems that trigger post-trading processing after the
> close will become more complex when compared to an auction extension feature that
> can equally address large price movements.

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: _____

Please give reasons for your view.

> see above.

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.

> Please use the last tick of the continuous session for simplicity's sake.

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.

> Duration is less important than having a knowable closing time (remove random close).

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): _____

☒   No

Please give reasons for your view.

> Use the existing POS model instead of forcing a new model onto a well-established market practice.

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.

> The reintroduction of a Closing Auction Session should be top 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.

[blank box]

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.

Timing is largely irrelevant as futures traders covering regional markets stay past 6pm.

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: CAS ASAP without VCM / Trading Halts

Please give reasons for your view.

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.

CAS is high priority, the other two options are not a 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;

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☒ c). 7-12 months

☒ d). >12 months

Please give reasons for your view.

> Changing intraday market price movement behavior will force a significant change of trading systems to take the new VCM into account. The amount of work required by the industry to implement VCM as proposed should be carefully considered on a cost/benefit basis. There are proven mechanisms that are much simpler to implement that could achieve the same desired market protection effects while converging Greater China market behavior.

(ii)   CAS:

☒ a). under 3 months;

☒ b). 4-6 months;

☒ c). 7-12 months

☒ d). >12 months

Please give reasons for your view.

> A reasonable timeline for launch would be end of 2015. This is predicated on early and clear publishing of the mechanism's features by HKEx well in advance of go-live.

- End -