



*Submitted electronically*

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**Re: Consultation Paper on Proposal for Introduction of Volatility Control Mechanism in the Securities and Derivatives Markets and Closing Auction Session in the Securities Market**

Vanguard<sup>1</sup> appreciates the opportunity to comment on the Closing Auction Session (CAS) and Volatility Control Mechanism (VCM) proposal by the Hong Kong Exchange (HKEx). We commend the HKEx for their continued focus on improving the structure of our markets by addressing concerns around intraday price volatility and establishing fair and orderly closing auction processes. **Vanguard strongly supports the CAS and VCM proposals.** While we support the VCM proposal, because we believe the CAS is a higher priority issue, the remainder of this letter will focus on Vanguard's thoughts on the need for a CAS.

As part of a global asset management company, Vanguard is well positioned to opine on the benefits of an orderly closing process. A majority of the products managed by Vanguard and its affiliates are indexed based products, which seek to track indices that are typically benchmarked to the closing prices of securities on the respective primary listing exchange. As such, Vanguard and its global affiliates are active participants in the closing processes across global exchanges and understand the costs and benefits of different types of closing mechanisms.

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<sup>1</sup> Vanguard Investments Hong Kong was established in 2011 to serve as the regional hub for the Asia business of The Vanguard Group Inc. In Hong Kong, Vanguard offers four locally domiciled ETFs for retail and institutional investors, in addition to U.S. and Irish mutual funds and ETFs for institutional investors. The Vanguard Group and its global subsidiaries manage nearly USD \$3.3 trillion in assets for investors worldwide.



Vanguard believes closing mechanisms should: 1) encourage price and size discovery; 2) provide market-wide consistency around closing prices; 3) minimise volatility and operational instability; 4) maximise the matching of orders; and 5) promote fairness among different market participants.

As set forth in more detail below, Vanguard believes a closing auction with an investible closing price and a transparent means of identifying order imbalances such as articulated in the CAS proposal is a more efficient closing process for all investors than a continuous trading process such as that currently administered by the HKEx.

As the HKEx notes in its proposal, the current closing of trading on the HKEx is unique and not consistent with most global markets. In essence, there is no closing mechanism on the HKEx, and continuous trading occurs up until the market closes for the day. Then, the HKEx publishes a "closing price" which is simply a reference price representing a median of five (5) snapshot prices over the final minute of trading. The current process does not provide a mechanism for the markets to consolidate closing trading interest and establish a price which maximises executions at the closing price. Vanguard believes that the current continuous trading process: 1) does not facilitate price and size discovery; 2) increases the likelihood of volatile execution prices; 3) decreases the probability of executions across the market; and 4) distorts the published "closing price" from market reality.

Nearly all other significant global equity markets establish a process for consolidating trading interest at the close because many market participants (not just index funds) have an interest in trading at the end of the trading day. Vanguard supports the HKEx proposal because, like other global markets, the closing auction provides an opportunity for meaningful price discovery and the ability for order imbalances to be resolved. Likewise, by establishing an executable closing price through an auction, all participants are treated fairly and consistently because all executions occur at the same price. In short, the "closing price" is actually the closing price received across the markets. We also believe that a consolidated auction process is less susceptible to manipulation as there is a transparent price discovery process available to all investors.

We support the CAS as proposed. Nevertheless, going forward, we would encourage the exchange to monitor the closing process to determine whether the proposed parameters around price limits and order cancellations should be modified. Also, Vanguard would support a more streamlined roll-out of the CAS. We would prefer to see either the CAS rolled out for all securities at once, or a firm timetable for the implementation of phase 2 (rather than subject to a secondary consultation process).

We hope that over time there will be further opportunity to consult on improvements to the CAS, and Vanguard stands ready to work with the HKEx to adapt the CAS model to suit the needs of all investors in the Hong Kong equity market.



In conclusion, Vanguard fully supports the VCM and CAS proposals. We are comfortable that the proposed CAS model provides improved measures to minimise price volatility, aid price discovery and assist with liquidity formation when compared to the current process.

Signed,