



Alternative Investment Management Association

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

By email: response@hkex.com.hk

9th April 2015

Dear Sirs

Consultation Paper on Proposal For Introduction of Volatility Control Mechanism (“VCM”) in The Securities and Derivatives Markets and Closing Auction Session (“CAS”) in The Securities Market

The Alternative Investment Management Association (**AIMA**)¹ welcomes the opportunity to provide comments on the Consultation Paper and its proposals. We understand that the two proposals are aimed at improving the global competitiveness of the Hong Kong market, in the case of the VCM by containing systemic risk cause by extreme price volatility in both the securities and derivatives markets, and in the case of the CAS by providing an auction mechanism to meet the diverse needs of investors for the securities market by allowing execution at the closing price.

We are supportive of each of HKEx’s proposals to introduce a new VCM and a CAS and provide more detailed comments below with regard to each proposal. We recognize that the introduction of these new features to the Hong Kong market involves an assessment of their suitability to Hong Kong and that models from other jurisdictions may not be able to be replicated without appropriate adjustments and changes. However, we also believe that harmonization of market mechanisms in Hong Kong with international markets, where possible, is beneficial for Hong Kong; and we encourage HKEx to consider this as an objective as it undertakes this consultation process.

I Proposed VCM Model

Question 1: Do you support the introduction of an instrument-level VCM based on a dynamic price limit model in Hong Kong? Please give reasons for your view.

Yes. Please refer to our comments elsewhere in this response.

Question 2: Do you agree that the proposed VCM model should only be applied to the HSI and HSCEI constituent stocks in the securities market? Please give reasons for your view.

¹ The Alternate Investment Management Association (**AIMA**) is a global hedge fund association with over 1,500 corporate members (with over 8,000 individual contacts) worldwide, based in over 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA’s members manage a combined US\$1.5 trillion in global assets (as of March 2014).



Alternative Investment Management Association

We agree that the VCM model should only be applied to HSI and HSCEI constituent stocks in this implementation stage of the VCM. We request the Exchange to provide details in due course of a suitable arrangement for flagging the stocks to which the VCM applies and suggest that a method similar to flagging short selling stocks should be considered.

Question 3: Do you agree that the proposed VCM model should only be applied to the HSI, HHI, MHI and MCH (spot month and the next calendar month) index futures in the derivatives market? Please give reasons for your view.

We agree that the proposed VCM model should only be applied to the HSI, HHI, MHI and MCH index futures.

Question 4: Do you agree that the market should have a 15 minute uninterrupted trading period before the end of the last continuous trading? Please give reasons for your view.

Yes. This is in line with international practice.

Q5: Do you agree with the proposed reference price for the securities market, namely the price of last trade 5 minutes ago? If not, what would you prefer? Please give reasons for your view.

Yes. This is in line with international practice.

Q6: Do you agree with our proposed reference price for the derivatives market, namely the price of last trade 5 minutes ago? If not, what would you prefer? Please give reasons for your view.

Yes. Given the relatively few number of instruments affected, we agree that standardizing the reference price for both markets is sensible.

Q7: Do you agree with the proposed triggering level for the securities market, namely 10% from the reference price across the proposed instruments covered by the VCM? If not, what level would you prefer? Please give reasons for your view.

Yes based on the figures provided by the HKEx in the Consultation Paper, we consider that this is an acceptable reference price.

Q8: 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? Please give reasons for your view.

Yes this is an acceptable reference price.

Q9: Do you agree that a maximum of two VCM triggers per trading session per instrument should be imposed to minimise market interruption? Please give reasons for your view.

We agree that during the initial stage of implementation of the VCM in Hong Kong, a maximum of 2 VCM triggers per trading session per instrument is acceptable but request that the HKEx keeps this limit



Alternative Investment Management Association

under review and consider in due course if multiple triggers should be introduced in line with international practice.

Q10: Do you support trading within a price limit during the cooling-off period? If not, do you prefer another approach? Please give reasons for your view.

Yes, but as stated in paragraph 67 of the Consultation Paper the price limit should apply only to new orders; and not those orders already inputted into the HKEx and which require amendment or cancellation.

Q11: After the cooling-off period, do you support resuming the same dynamic price limit monitoring mechanism (i.e. $\pm 10\%$ ($\pm 5\%$) from the last trade 5 minutes ago in the securities (derivatives) market)? If not, do you prefer another approach? Please give reasons for your view.

AIMA supports resuming trading at the same dynamic price limit monitoring mechanism.

Q12: Do you have any other suggestions on enhancing the resumption procedures?

No.

Q13: 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? Please give reasons for your view.

Given the more dynamic nature of the derivatives market, we are of the view that consideration should be given to a shorter cooling off period for the derivatives market. International practice varies considerably in this respect, but in most developed markets the cooling off period for a dynamic reference price is usually less than 30 seconds. The HKEx may wish to provide further information to market participants on the operational rationale for using the same cooling off periods in both markets.

Q14: Do you agree with the additional market data dissemination for the proposed VCM model? If not, what would you propose and why? Please give reasons for your view.

Yes. AIMA is satisfied with the process for market data dissemination.

Q15: If a VCM is triggered for a given instrument, should trading of related instrument (e.g. futures contract of different contract months) on the same underlying continue as normal? Please give reasons for your view.

Pricing relationships would usually exist where related instruments are based on a common underlying; and a cooling-off of one instrument without also halting its related instruments may skew these pricing relationships. Further review of this aspect of implementation may be advisable.



Alternative Investment Management Association

Q16: 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? Please give reasons for your view.

See response to Q15 above.

Q17: Do you have any other comments on the VCM proposal?

No.

II Closing Action Session (CAS)

Question 18: Do you support the introduction of the new CAS session model in the Hong Kong securities market? Please give your reasons for your view.

AIMA supports the introduction of the new CAS. Alternative asset managers generally have an obligation to achieve best execution for their clients, and the availability of a CAS that allows them to execute trades at a market closing price will enhance their ability to do so. Tracking error can also affect alternative investment managers and where this can be mitigated by a CAS then this will benefit them and their clients. Many alternative managers have experience in operating in other closing auction sessions in other markets and are accustomed to being able to achieve execution at closing prices in those other markets, so the introduction of a CAS in Hong Kong with appropriate controls and safeguards is a welcome development.

We believe that a CAS will be for the benefit of institutional and retail investors alike; as the CAS will be open to all investors, who will have additional opportunity to complete execution of orders. While it is possible that relative participation in CAS may be lower for retail investors who have a tendency to trade more actively during the continuous auction session, the needs and interests of the ever increasing numbers of retail investors who participate indirectly in the markets through index tracking funds and other retail indexed products should be also taken into account.

Question 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)? Please give your reasons for your view.

In the longer term, we believe that the introduction of a CAS that applies to a broader scope of stocks would be beneficial to the development of the Hong Kong market. However, we agree that a phased approach over time which starts with application to only the major index constituent stocks may be prudent as the various controls and safeguards that are proposed to be adopted (e.g., 5% price limit, random closing period) are more appropriate in the context of those major stocks.

Question 20: Do you agree that the new CAS model should only be applied to the major index constituent stocks?

See response to Question 19 above.



Alternative Investment Management Association

Questions 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?

See response to Question 19 above.

Question 23: Do you support introducing a price limit during the CAS? Please give reasons for your view.

AIMA supports the introduction of a price limit during the CAS. However, we note that the closing auction sessions of other markets that do provide for a price limit allow for significantly larger price limits than the 5% price limit proposed by HKEx. In the event that the 5% price limit does not allow for adequate price discovery during the CAS, there is a risk that trading volumes for certain securities may migrate back to the end of the continuous trading session and impair the success of the CAS. For this reason we believe that a wider trading band should be considered, which will have the effect of promoting the ability of the participants in the CAS to achieve completion while protecting against undue volatility. We believe that a price limit of no less than 7.5% would be more appropriate.

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

See response to Question 23.

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

We agree that at-auction limit orders should be allowed throughout the CAS in combination with other safeguards and controls proposed by HXEx. At-auction limit orders play a role in price formation and in providing liquidity.

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

We believe that short selling orders should be allowed during the CAS as this will be beneficial to liquidity, and we are not aware of any compelling reasons for the exclusion of short sale orders from the CAS. As discussed below in response to Question 28, we would not be opposed to the application of a modified tick rule that is suited to the particular auction model used during the CAS.

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

We are of the view that applying a traditional tick rule to any short selling during the CAS should be sufficient to control undue volatility and that a further restriction that requires that the short sale be at or higher than the reference price is unnecessary. A requirement that any short sale be at or higher than the reference price is not an intuitive rule and does not appear to feature as a requirement in any the CAS for any other development market. Hong Kong laws and regulations already provide for a well regulated and functioning system in which short selling of equity securities may occur, and the benefits of additional restrictions or limitations with respect to short selling beyond those that are already a feature of the market are not apparent to us.



Alternative Investment Management Association

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

We believe that development and testing of the VCM, CAS and Trading Halts should be developed and tested together, but that the new features should be implemented one by one and at separate times, so that market participants can have sufficient time to conduct their own implementation and systems changes with respect to each new feature separately.

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

While all three proposals are important for the development of the Hong Kong capital markets, we believe that the implementation of a CAS should be given priority due to the immediate need for a mechanism of this type.

AIMA is grateful for the opportunity to provide our thoughts on the initial proposals contained in the Consultation Paper and would be pleased to discuss these comments in further detail. We look forward to providing our views on the proposed legislative draft when available.

Yours faithfully,