Hong Kong Investment Funds Association
(company incorporated with limited liability 有限責任公司)

April 10, 2015

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

Dear Sir/madam

Re: Consultation Paper for Introduction of Volatility Control Mechanism ("VCM") in the Securities and Derivatives Markets and Closing Auction Session in the Securities Market

On behalf of the Hong Kong Investment Funds Association ("HKIFA"), I wish to express support to the proposed mechanisms as outlined in the captioned consultation paper.

Our member firms are traditional long-only fund managers, which manage public funds (unit trusts/mutual funds), pension schemes and segregated mandates on behalf of both Hong Kong and overseas retail and institutional clients. Fund managers have the fiduciary duty to the clients and they should always act in their best interests.

Our members believe that the implementation of Closing Auction Session ("CAS") will serve the interest of the clients as it could potentially lower the transaction costs for execution and be conducive to price discovery.

CAS is virtually a global norm – all developed markets and most emerging markets have this in place already as this is proven to be an efficient mechanism to meet investors' trading needs. Significant equity flows require execution at the closing price as a lot of funds (both passive and actively-managed ones) are required to do so. Closing price is also typically used for portfolio valuations and benchmarking purposes. It is estimated that in Hong Kong, around 10% of equity flow on a normal day and 30%+ on index rebalancing days are required to trade at the close. This percentage is expected to rise as Hong Kong's position as a regional fund management centre continues to expand. At present, without CAS, there are tracking errors for index funds, resulting in higher transaction costs, hampering investment returns. The benefit that CAS can bring to the ultimate investors has taken on added significance in the MPF context because more and more passive funds have been used for MPF purposes to drive down costs, and this trend is only going to pick up with the introduction of default funds.

CAS will not only benefit fund investors, but can also open up another avenue for direct retail clients which have hitherto not been able to avail of this channel: outstanding orders entered in the CTS would be carried over to CAS and enjoy higher time priority. CAS provides an additional trading session to investors and can potentially give them price improvement opportunities. Investors can input new orders using at-auction limit orders throughout the CAS which would give them the opportunity to trade at a price at or better than their input price (i.e. the opportunity to buy low, sell high), rather than waiting to be matched at their specified price as in the continuous session.

As retail investors will be able to trade with the funds as their counterparts, this would mean that retail brokers can also participate in market on close ("MOC") orders and rebalancing. Currently, when the larger brokers are not able to execute MOC orders on the exchange, they may trade off the exchange (i.e. match their orders by their own book) and this would reduce market transparency and liquidity.

As for the price limit, we believe that 5% is the optimal level. Based on the most recent historical data in Hong Kong, a percentage lower than that would be overly restrictive to trading. For instance, if it were set at 2%, about 10% of stocks cannot complete trading on all trading days and some fund managers have even indicated that a restrictive price range would mean that effectively, they will not be able to use this mechanism at all – and our concern is that the potential low level of usage would defeat the whole purpose of introducing this mechanism in the first place. Furthermore, a restrictive price range may cause market participants to input overly aggressive price or to trade ahead of the market close, causing unwarranted volatility and poor liquidity in the CAS. Orders not completed may also lead to potential loss for investors.

Thus, all in all, we believe that to make this mechanism works, it is imperative that the price limit be struck at the optimal level on day one. If we look at overseas models, especially the developed markets whose models are well-tested, they are typically pitched at a much higher level – ranging from 7% to 10%. In fact, we believe that the HKEx can consider going for a higher threshold.

We understand that certain quarters have concerns about the potential price manipulation that CAS can give rise to. We believe that the measures to be implemented by the HKEx will go a long way in addressing these concerns. The proposed CAS model has a number of new features such as price limit, random closing, and better auction transparency to prevent large price movement and to ensure the auction process is orderly and fair. It would be very difficult to manipulate or move price in the proposed CAS. Furthermore, the HKEx will work closely with the SFC to detect and deter any manipulative activities for all sessions not just in CAS. Both HKEx and SFC will enhance their surveillance systems.

Thus, in a nutshell, we believe that the CAS proposal, as it currently stands, has struck the appropriate balance and should be implemented as soon as possible so as to ensure that investors – be they direct or indirect investors, can benefit from it. As for the other two other proposals, i.e. VCM and trading halts, we are in support as well. However, as it may require more time to implement these two mechanisms and we don't think there is a need to have all three mechanisms to be introduced at the same time; we would suggest that the HKEx can stagger the implementation timeline by introducing CAS first, followed by the other two mechanisms when the respective systems are ready.

If you have any queries or need further information, please do not hesitate to contact me on .