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.

   Despite regulatory controls and best practice disciplines, the combination of sophisticated electronic trading systems and the people using them will never completely eliminate human error or isolated rogue behaviour. Moreover, extreme market conditions can trigger extreme market responses that can exacerbate markets creating exaggerated levels of volatility. VCM's have become globally accepted as the best means to safeguard markets and avoid market distortions through contagion. Adopting the best VCM practice would put HKEx in line with exchanges in most other global markets , making it safer for current market participants and more appealing to new ones.

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.

   Whilst the above reasons for adopting a VCM apply to all stocks, initially at the very least, VCM should be applied to the HSI and HSCEI stocks. We do believe that over time VCM practice should be widened with adjustments for less liquid stocks such as widening bands.

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.

As per the response above we think it may be more realistic to initial apply the VCM to the HIS, HHIMHI &MCH index futures in derivatives. However as the principle of VCM applies to stocks in or out of these indexes and over time, we advocate axpanding to all stocks with adjustments for liquidity.

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.

This would only be necessary under the present proposal, where the number of triggers is limited to two. It would be better for price discovery to have a system of unlimited triggers with no suspension of VCMs in the last 15 minutes of trading. This way the market would naturally reflect true market conditions, whilst restraining excessive price volatility.

5. 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?

☒ Yes

☐ No, I would prefer: ______________________

Please give reasons for your view.

Yes- this is important to ensure that true market conditions are taken into account while still allowing the VCM bands to protect against excessive price movement.

6. 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?

☒ Yes

☐ No, I would prefer: ______________________

Please give reasons for your view.

PLease see 5 above.

7. 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?

☒ Yes

☐ No, level that I would prefer: ____________________

Please give reasons for your view.

This seems to be an aceptable balance between providing for halts in a non-disruptive way (allowing the market to function and enabling price discovery), whilst providing safeguards by capturing anomolies from errors or potentially malicious behaviour.

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.

However only where such instruments have significantly reduced liquidity.

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.

As per previous answers we believe that the naturally price discovery process would be best served through unlimited triggers.

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: Auction

Please give reasons for your view.

Auctions have been proven to work best during the cooling off period, allowing the market to pause, digest sentiment and find its natural level before resuming within the VCM bands.

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.

Once the market has digested sentiment it should be allowed to resume within the previous VCM bands.

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

We advocate the well established use of auctions as previously stated.

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.

5 minutes has been well established as a suitable yet not overly disruptive period to digest conditions.

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.

In order to correctly evaluate the situation it is important to have as much information available as possible.

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.

We do not believe it would be necessary to extend a VCM halt to instruments related to the underlying, though our members would want market making obligations to be waived.

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.

With the same proviso given in Q15

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

Our members have long advocated that HKEx adopts a VCM model to bring it in line with best practice in other markets. Contagion is a global phenomenon and with increasingly interconnected markets it is important that Hong Kong has the necessary measures to protect against erroneous or malicious trades.

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.

Our members have long argued that a closing auction session (CAS) in Hong Kong will bring a fairer, harder to manipulate market, bringing the Exchange in line with other global and regional markets. All participants, whether institutional or retail clients have benefited in every market that his introduced a well designed CAS.

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.

Although CAS in principle works for all stocks, it is important that HKEx introduces a simple, robust mechanism that will work first time for the majority. Accommodating less liquid stocks would add complexity and require refinement. Therefore we agree that in the foreseeable future the CAS should apply to the major index constituent stocks.

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.

CAS has been proven to work so we see no case for unnecessary limitation

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: Once the initial phase has been successfully introduced

☐ No

Please give reasons for your view.

As stated above, it is vital that Hong Kong's CAS is quickly and successfully introduced and shown to work with the major constituent stocks. Once proven, stocks with added complexity such as less liquidity should be considered as a well designed CAS has been proven to be superior in major financial centres around the world

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.

We believe the different characteristics of these securities such as an imperitave to close at the end of day, mean there is less of a case for CAS, as evidenced by market practice for CAS's elesewhere.

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

☒ Yes

☐ No

Please give reasons for your view.

For the purpose of containing extreme violatility - with the caveat that the price limit should not be too narrow.

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.

A price band is introduced in this mechanism to contain volatility. The setting of the price band requires that it is wide enough to be relatively un-restrictive, while fulfilling the purpose of a safety valve to filter extreme volatility. A tight price band discourages trading in auction as it increases order incompletion risk, and introduces more volatility around the limit of the band, which becomes self-fulfilling. In the US, NASDAQ sets this price band as 10% As noted in this CP, with the exception of Taiwan (which we believe is currently seeking a wider price band) there is either a limit of 10% or no limit whatsoever. Therefore our recommendation would be for a limit no less than 7.5% and nio more than 10%.

(Please refer to Quorum 15's proposal to "A Revised Closing Mechanism Proposal for Hong Kong" dated 25th Oct 2012 for a comprehensive statistical analysis.)

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.

We believe this would be an unnecessary intervention that would impair liquidity and the overall price discovery process.

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

☒ Yes

☐ No

Please give reasons for your view.

At auction limit orders contribute liquidity and price discovery, reducing uncertainty and therefore volatility in the closing auction.

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 orders are necessary to redress the balance on the long side. They are an important mechanism for hedging and will improve liquidity and efficiency during the closing period.

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.

We believe this would be an unnecessary constraint that would impair short selling contributions to liquidity as highlighted above. The uptick rule should be sufficient so this additional constraint would be unnecessary and counter productive.

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.

We believe a well designed CAS with random close would mean that this would be unnecessary.

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

☒ Yes

☐ No

Please give reasons for your view.

Random Close has now been proven to be a proficient anti-gaming tool in exchanges around the world. It is relatively easy to implement and removes a number of setbacks associated with fixed closing time such delays to posting buying or selling intent which in turn create the need for last second adjustments.

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: 90 seconds

Please give reasons for your view.

Our members believe 2 minutes is longer than necessary and less than 1 minute is insufficient.

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.

To reduce cost and complexity. Even though a VWAP reference price would be harder to game, we suggest having the timely implementation of a CAS in HK is important and this could be a future consideration once the CAS 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.

The 7-minute period provides sufficient time for oders to be entered, amended and cancelled.

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): The CAS - the auction mechanism

☐ No

Please give reasons for your view.

As evidenced in other global markets the actual auction mechanism would equally benefit the Pre- Opening Session.

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.

As stated Hong Kong needs a CAS sooner rather than later. Therefore we prefer a phased approach where the CAS could be quickly implemented, understood and with familiarisation, accepted by financial market participants. It could then potentially be enhanced, would provide a more timely CAS and de-risk both the CAS and rollout to the POS.

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.

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.

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.

CAS and VCM are top priorities in that order and this approch would optimise a timely rollout and reduce project risk

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 a top priority. Hong Kong is unique in not possessing a CAS in major global markets so implementing an efficient and fair CAS would send the correct signal and boost confidence by reducing risk. VCM is another important missing component that should be implemented ASAP to contain risk and contagion of increasingly connected and highly automated global markets. However as stated im Q38 our top priority is CAS and if the dual development, testing and rollout of VCM were to delay or endanger CAS, we would advocate deferring VCM and then trading halts.

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.

Minimum time for systems design, internal and client training etc. especially given other anticipated Stock Connect changes.

(ii) CAS:

☐ a). under 3 months;

☒ b). 4-6 months;

☐ c). 7-12 months

☐ d). >12 months

Please give reasons for your view.

As per (i) but please note we see CAS as a top priority.

- End -