FREQUENTLY ASKED QUESTIONS

Updated: 4 July 2019

The FAQ will be updated from time to time and is subject to change.

VCM

1. What are the design principles behind the VCM model for Hong Kong?

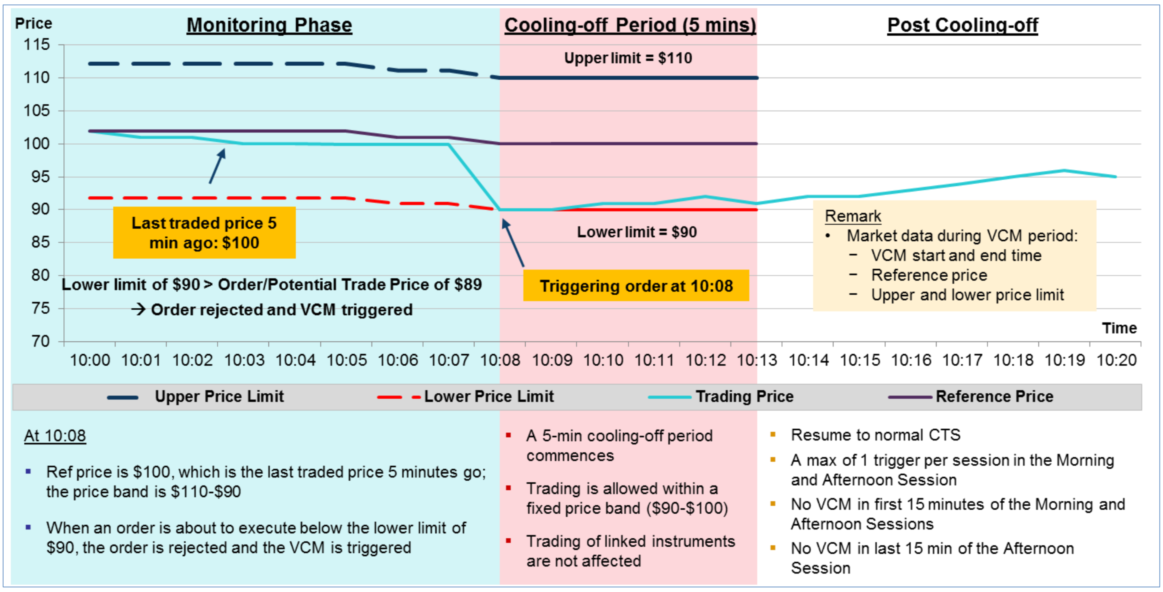
Historically different events have driven different VCM model to be chosen in different markets. Hong Kong has been able to learn from the VCM experience of other markets, and HKEX decided that a light-touch and simple model would be most suitable for Hong Kong's markets since they've never had a VCM and may not be familiar with such mechanisms.

HKEX's proposed VCM is specifically designed to safeguard market integrity from extreme price volatility arising from automated trading ("Flash Crash", bad algorithms, etc.). It also serves to alert the market with a temporary cooling-off period for the participants to reassess their strategies and positions and make investment decisions. It is not a trading halt, does not intend to limit the ups and downs of stock prices due to fundamental events, and it also does not work the same way as the daily price limit model which sets a specific daily price range for securities trading as seen in some markets.

Special care has been taken in the VCM design to minimise market interruption. For example, it applies to individual instrument rather than the entire market, it is based on a dynamic rather than a static reference price, the triggering level (±10% for securities market and ±5% for derivatives market) is set up such that it would not trigger the VCM too often, the VCM is not applicable in certain periods (the first 15 minutes of the morning and afternoon CTS and the last 15 minutes of the afternoon CTS) and to certain instruments, and the fact that a maximum number of triggers per instrument in each trading session (maximum 1 trigger per instrument per CTS) is imposed to prevent excessive trading interruption.

2. How does the VCM model work?

HKEX has adopted a dynamic price limit VCM model for the securities and derivatives markets, which would trigger a cooling-off period in case of abrupt price volatility detected at the instrument level.



- The VCM is only applicable for board lot order input during the Continuous Trading Session (CTS), but not for any orders input during the Pre-opening Session (POS) and CAS.

- During the CTS, the potential trade price of a VCM security will be continuously checked against a dynamic price limit of ±10% based upon the reference price (±5%, for the derivatives market) which is the last traded price 5 minutes ago.

- The VCM is triggered if a stock is ±10% away (or if a futures contract is ±5% away) from the last traded price 5-min ago; A 5-min cooling-off period will start.

- For each VCM instrument, there will be a maximum of one VCM trigger in each trading session (Morning Session and Afternoon Session are counted as two separate trading sessions).

- Normal trading without restriction will resume on the VCM-triggered instrument after the cooling-off period. There will not be any VCM monitoring on the VCM-triggered instrument within the same trading session.

3. What instruments are covered under the VCM? Would it be extended to cover all securities in the future?

For the securities market, the VCM would cover Hang Seng Index (HSI) and Hang Seng China Enterprise Index (HSCEI) constituent stocks (as of 31 July 2016 there are 81 such stocks listed on the Stock Exchange of Hong Kong).

The finalized list of the VCM securities would be published on the HKEX website before the launch of the VCM. Any addition of constituent stocks to the HSI or HSCEI subsequently will also be added to the list of VCM securities on the effective date of the addition. Similarly, any deletion of constituent stocks from the HSI or HSCEI will also be removed from the list VCM securities on the effective date of the deletion.

For the derivatives market, the VCM would cover spot and next calendar month index futures contracts with HSI or HSCEI as their underlying index (currently 8 futures contracts).

HKEX currently has no plan to include more instruments in the securities or derivatives markets which would be subject to the VCM.

4. What is the applicable period for VCM monitoring?

VCM monitoring is applicable to continuous trading session (CTS), excluding:

- the first 15 minutes of the morning and afternoon trading session
- the last 20 minutes[1] of the afternoon trading session
- the After-Hours Futures Trading session in the derivatives market

5. Why would trading of the related or linked instruments of a particular security / futures contract be allowed to continue if the security / futures contract has had a VCM trigger and is in a "cooling-off" period? What is the rationale behind that?

As the security / futures contract is still allowed to trade within a band during the cooling-off period, its linked or related instruments should be allowed to trade as well. Consideration was given to whether the linked or related instruments should also trade within a band, but defining a band is not practical since the linked or related instruments are typically leveraged or may have inherently different product characteristics. Halting trading of these linked or related instruments would not be preferred too as it may have a significant impact and amount to excessive market intervention. Based on the market feedback received, many respondents agreed the approach taken is the preferred approach for the launch of VCM in the Hong Kong market, as it is new to the market. HKEX would obtain feedback from the market on this arrangement after its implementation and may review it again when the market is more familiar with it.

6. What is the VCM arrangement with respect to adverse weather?

In the case that market open is delayed due to bad weather (e.g. hoisting of typhoon signal no.8 or above or issuance of black rainstorm warning), similar to the normal market open, the first 15 minutes after market open will not be subject to the VCM monitoring.

In the case of an early close of the market due to bad weather (e.g. hoisting of typhoon signal no.8 or above during trading hours), cooling-off period can still be triggered in the last 15 minutes before market close and can continue until market close.

7. Can VCM be triggered on an applicable instrument multiple times in a trading day?

For each VCM instrument, there will be a maximum of one VCM trigger in each trading session (Morning Session and Afternoon Session are counted as two separate trading sessions). When normal trading has been resumed after the VCM, there will not be any VCM monitoring within the same CTS.

8. Does the normal price checking during the CTS apply during after a VCM is triggered?

The 24 spreads rule, the 9 times rules, as well as the existing price warning mechanism would continue to be applicable during the cooling-off period.

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[1] Since a cooling-off period will last for 5 minutes, the monitoring will stop 20 minutes before end of the Afternoon Session

Trading of Structured Products

9. Can derivative warrants or CBBCs be traded during the 5-minute cooling-off period after the triggering of the VCM?

Since the affected underlying security or index is not suspended and continues to trade within a specified price limit during the 5-minute cooling off period after the triggering of the VCM, the derivative warrants and CBBCs can still be traded without any price limit.

However, investors should note that where events surrounding VCM causes abnormal trading behavior of the underlying leading to hedging difficulties, the liquidity provision obligations of issuers could be exempted. In this case, there may be a temporary absence of price quotes, a reduction in quote size, or a wider bid-ask spread during the 5-minute cooling-off period.

10. What will happen to Quote Requests for the warrant and CBBC, on a day when the underlying was subject to a VCM?

The issuer will commit to Quote Request obligations during the day, including during the cooling off period, unless an exemption is obtained for Quote Request.

11. How will the provision of Active Quotes be affected for a warrant/CBBC when the underlying security is subject to VCM?

Investors should be aware that standards for Active Quotes described in the Industry Principles[2] are intended to apply to normal market conditions. Provision of Active Quotes may be affected where there are abnormal or exceptional market conditions.

Quotes provided by liquidity providers necessarily reflect the liquidity of the underlying securities or indices at any given time. If the liquidity of the underlying is impaired by conditions surrounding a VCM event, or by the VCM itself, the liquidity of the warrant or CBBC may be adversely affected in terms of quote size and spread relative to more normal market conditions.

During the 5-minute cooling off period after triggering of the VCM, where issuers' hedging ability is materially affected due to the uncertainty in the underlying securities or index, it is possible that the minimum service level for Active Quotes will not be fulfilled, such as no bid-ask quotations, widening of bid-ask spread and reduction in quote size.

Similarly, after the 5-minute cooling off period, liquidity provision may still be affected if issuers continue to experience hedging difficulties. Under such circumstances, Liquidity Providers may not fulfil the minimum service level for Active Quotes as described in the Industry Principles.

However, issuers will use best efforts to meet quote request requirements.

Market Data Related

[2] Industry Principles on Liquidity Provision for Listed Structured Products (July 2012) published by the Exchange, available at (http://www.hkex.com.hk/eng/prod/secprod/dwrc/Documents/principle.pdf).

12. **When the cooling-off period is started or ended for a securities or futures contract, will there be relevant message broadcasted in the trading system?**

A message will be broadcasted in AMS/3.8 or HKATS when the cooling-off period is triggered for the specific securities or futures contract. Information includes: the start time and end time of cooling-off period, reference price and price limits of the securities or futures contract during the cooling-off period.

Since the information of cooling-off period's end time has already been included in the message when cooling-off period is triggered, there will be no additional message broadcasted at the end of cooling-off period.

Securities Market (The number in the bracket represents the corresponding OMD-C message ID)

13. **Would VCM Trigger (23) message be disseminated to indicate the end of the cooling-off period?**

For each cooling-off triggered by the VCM, a VCM Trigger (23) message would be disseminated in AMS/3.8 when the cooling-off period begins for specific securities or futures contract. The message provides, among other related information, both the start time and end time of the cooling-off period. There would be no other messages to indicate the end of the cooling-off period.

14. **Would I be able to retrieve the VCM Trigger (23) message by any means after the cooling-off end time has passed?**

In general, the VCM Trigger (23) message is available in Refresh Channel for each cooling off period triggered in a day except when the same security has more than one cooling off period triggered for the day. In this exceptional case, only the VCM Trigger (23) message for the latest cooling-off period would be found in Refresh Channel for that security.

Derivatives Market

15. **I noticed that there would be newly added Market States for the implementation of the VCM in Derivatives Market. Can I have more details about each new state?**

Four new Market States, namely "OPEN_DPL_VCM", ""OPEN_VCM", "VCM_COOL_OFF_DPL" and "VCM_COOL_OFF", are introduced for the implementation of VCM in Derivatives Market. The first two states are applicable to market, instrument type and class levels whereas the remaining two states down to series level to indicate a cooling off period is triggered by VCM for the series concerned. Please refer to OMD-D Interface Specification and OMD-D Developers Guide for more details.

16. **When I receive Market State "OPEN_DPL_VCM" or "OPEN_VCM" for a market, does it mean that all the series under this market are eligible for the VCM?**

Only 8 contracts, namely HSI Futures (HSI), Mini-HSI Futures (MHI), H-shares Index Futures (HHI) and Mini H-shares Index Futures (MCH) spot month and the next calendar month contracts are covered in the VCM for the derivatives market. Therefore if the Market State "OPEN_DPL_VCM" or "OPEN_VCM" is received for a market, an instrument type or a class, it does not necessarily mean that all series within that market/instrument type/class are eligible for VCM.

17. In which message I can find the VCM related information (e.g. cooling off start and end time, upper and lower price limit and reference price)?

The information of a VCM cooling off period is provided in two Market Alert (323) messages in a structured manner so as to facilitate retrieval of the information including the start time, end time, reference price, upper and lower price limits. For details, please refer to OMD-D Developers Guide.