

Section 2: Response to the Consultation Paper on After-Hours Futures Trading

In principle, Guotai Junan Futures (Hong Kong) Limited supports the HKEx's proposal on after-hours trading for the futures market. We do agree and share the same view of the Exchange in its proposal regarding on the strategic and business rationales. However, we do have some concerns regarding to the arrangement on the operation, clearing and risk management on the after-hours trading in the proposal.

In order to attract investors to participate in the after-hours trading as well as to increase the futures trading turnover, the Exchange need to propose and make some changes to the rules and regulations of the Hong Kong futures market which are as follow:

1. Abandon on EP to segregate its client fund under HKFE-Market and Non HKFE-Market under the Securities and Futures Client Money Rule. **This will allow and encourage EP's client with fund in Non HKFE-Market (Overseas Market) to trade HKFE futures contracts during after-hours session.** Overseas futures markets do not require EP to segregate clients fund into two different bank trust accounts in different future markets. With this rule intact, HKFE will be difficult to expand into other futures contracts in different currencies (e.g. HKFE Gold futures contract) as each currency balance has to be segregated into a separate HKFE-Market bank account apart from the Non HKFE-Market account.
2. Abandon on EP to require its client to meet the minimum margin requirement stipulated by the Exchange for any position ever established even if such position is subsequently closed out on the same trading day on "Exclusive Day Trade Client" under Exchange Rule 617 and guidelines. **This will also allow and encourage EP's client with fund in the other currencies (e.g. USD) to trade HKFE futures contracts during after-hours session and do not have to convert them into HKD if the position is eventually closed out on the same day.** Most overseas exchanges do not have a full margin requirement on day trader as they are considered with lower risk.
3. Increase the open position limit of 10,000 lots (on delta) as to attract more investment funds to participate in Hong Kong market. Together with the relaxation on day trading margin requirement above, the liquidity of the Hong Kong futures market should be improved.

As the Exchange is proposing to collect margin variation and position margin on all T and T+1 trades in the morning session of T+1, we suggest the Exchange to treat all T+1 trades as for the previous day (T) trades, otherwise EP will have problems in

1. Registering the T+1 trades into the back office system as the T+1 trades are suppose to be entered into the back office system after day-end of T

day, and most EP who operate overseas markets will perform day-end of T day in the next morning (T+1), as a result EP will not be able to run an offset reports on both T and T+1 trades together that the Exchange is proposing to margin on. In another word, the Exchange should either collect the margin requirement of the T+1 trade on the next business day as usual and not on the same business day, otherwise it should not call it as T+1 as we have suggested it should be T (Extended Trade-ET or After-hours Trade-AT).

2. The Exchange should allow at least an hour for EP to close out client's position, margin call, and transfer of position (give out) on client trade after the market opened. We suggest the T Clearing Session Time to extend from 7:45 a.m. to 10:30 a.m. so that EP can handle post-trade activities (includes position management function) for T+1 trades if the clients fail to meet margin call and EP can close-out their positions. **This is important if the Exchange decided to use the Calculated Opening Price of the T+1 session for Mandatory Market VA and position margining.** Under the exchange proposal, **EP may easily default if the market is largely opened gap up or down** (uncontrollable by the EP and Exchange) from the previous day close. As one can see that EP will not be able to do anything once the market is opened with the T and T+1 trade on hand. The Trigger Mandatory Call on positions should also be moved forward to 10:45 a.m., Notify CP on 11:30 and Settlement Due on 12:30 p.m. accordingly.
3. The exchange should consider providing a SPAN file that based on Calculated Opening Price shortly after market opened for EP as this is the basis for EP to make margin call on client with options and T+1 trade.
4. We do have concern using the Calculated Opening Price for Mandatory Market VA and position margining that can be easily manipulated even though the average daily number of HSI futures contracts traded during the pre-market opening session is about 1,000 contracts. This methodology will face a huge challenge if the futures contract is with less liquidity. Unfortunately, at this point, we are unable to come out with a better suggestion for it. It may make sense to use the previous day closing price (the existing methods) as the benchmark on VA and margining and the T+1 trade will be margin on the next business day.

Guotai Junan Futures is fully in support of the after-hours trading on the futures market and we believe the Exchange, EP and our regulator can come out with a solution for the futures market to move forward. We do have confidence that the after-hours trading will be welcomed by international as well as local investors as Hong Kong is a key proxy to China growing market which is also gaining influential over global economic.