

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.

It is important to have any form of circuit breakers which currently do not exist. In addition to dynamic controls, limits based on static reference prices like those on the LSE would be prudent. In the HKEx presentation, US and European models are cited as too complex. Complexity should not play a part in determining appropriate safety measures.

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.

Safety measures should apply to all stocks equally. There is no reason to have these protections only on certain index constituents; however, for this to happen, we need a max(10%, 10 ticks) type volatility control mechanism in place to ensure that penny stocks are still tradable.

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.

Again, safety measures should be applied to all securities though we do recognize the need to have different controls in place for the far more volatile longer dated instruments.

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.

Safety measures should be implemented at all times to be effective else they will simply dislocate periods of 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.

Long term: Price from 5 minutes ago (a dynamic reference price) will move along with price impact. As such, we favor the LSE safety measures as they complement the price from 5 minutes ago with static reference price (auction or last traded price) single stock circuit breakers.

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 our answer to Question 5.

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.

Long Term: Using dynamic as well as static reference prices with a lower threshold like max(5%, 5 ticks) should provide a higher level of safety for the entire market, covering every security.

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.

Please see our response to Question 7.

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.

No arbitrary limit should be imposed to minimize inconvenience. After two triggers the market would become vulnerable and unprotected at already dislocated levels.

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: _____

Please give reasons for your view.

Long Term: Trading Halts unwound by auction mechanisms work better. The auction prices could then be used as a reference price.

11. 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?

Yes

No, I would prefer: _____

Please give reasons for your view.

Auctions with extensions similar to the LSE methodology are very efficient mechanisms for price discovery. Unlike trading limits (like those imposed by Taiwan) LSE safety measures do not stop trading. They offer safety without trading disruptions. As such, having static reference price circuit breakers that re-snap the reference price on each intraday auction would be ideal.

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

Long Term: We would like to see both static and dynamic reference price based circuit breakers. Using ticks as well as percentages would allow us to cover all securities in the market and use tighter limits without hindering legitimate trading activity.

We prefer max(5% and 5 ticks) to be used for each security as well as the overall market as a VCM threshold. We also would like trading halts followed by auction mechanism (we definitely prefer the proposed CAS mechanism to the current POS mechanism as the latter can fail to offer price stability).

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 should be sufficient although we do favor extensions in case of large price movements from the reference price.

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.

The proposed additional data should be sufficient.

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.

Errors in one instrument don't necessarily mean errors in related instruments and may be unnecessary interruption.

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.

Same as above.

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

It is very important to have exchange level controls in place to limit volatility. The above long term suggestions should in no way jeopardize the VCM. In any form it will provide additional protection that does not currently exist.

In summary, we would like the use of dynamic as well as static reference price limits that utilize both percent moves and tick moves; i.e. max(5%, 5ticks).

When VCM is breached, we would like to utilize trading halts which are unwound by auctions that are similar to proposed CAS (in line with the LSE, using extensions instead of price limits for these auctions would be ideal)

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.

There are US\$150bn in estimated assets tracking various Hong Kong indices that are priced based on the closing price. They need a reliable closing mechanism in order to achieve their objectives. As stated in the consultation, Hong Kong is the only developed market that does not have a closing auction.

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.

Long Term: There is no reason to limit the universe to index constituents. All stocks should benefit from an efficient closing auction mechanism. If the CAS model is applied to only index constituents, then there need to be provisions for index change events where index additions would not have a CAS while index deletions would.

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.

There is no reason why ETFs should be excluded.

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: As early as practical.

No

Please give reasons for your view.

An efficient closing mechanism should be applied to all securities at the same time. However, it is important that this does not delay the rollout of the CAS.

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.

Long Term: An efficient closing auction mechanism should be applied to warrants. As is, the mechanism may limit trading at the close for penny stocks and derivatives instruments , which have tick sizes that are too large.

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

Yes

No

Please give reasons for your view.

Price limits will result in a shift of liquidity from the CAS to the CTS. It is very important that at the least any potential price limits are not at too restrictive. We would prefer price limits, if it has to be implemented, to be not less than 10%.

We find that at a 2% price limit, 18.3% of rebalance names would not be able to complete based on their price range in the last 10 minutes (looking at the last minute gives similar results). Even at a 5% limit, we would have nearly 6,000 cases where a stock moves above the threshold (approx. 4% of the time) based on our analysis of the past 2 quarters on all stocks using a last 10-minute trading range.

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.

We do not support adding price limits as these would render the CAS less effective and result in shifting liquidity to the CTS. LSE has a solid mechanism that results in minimum price volatility and maximum auction volume without the use of price limits (they utilize extension periods).

Our internal study shows that if a 5% limit is introduced, 2/3 of index rebalance add/deletes would not be able to complete forcing traders to start trading early, rendering the auction ineffective. as such, a more restrictive threshold would cripple the CAS and the market trading activity.

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.

This is an unnecessary constraint on price discovery.

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

Yes

No

Please give reasons for your view.

This order type is the foundation of efficient price discovery in auctions.

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.

No additional liquidity should be unnecessarily excluded.

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.

No reason to have a price restriction especially given the tick rule is going to be in place.

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.

This is an excellent anti-gaming feature, the lack of which resulted in substantial price movements in other auctions in our region. We would like the HKEx to come up with a policy to allow erroneously entered orders to be canceled.

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

Yes

No

Please give reasons for your view.

Not only is this an excellent anti-gaming feature, it also aids price discovery.

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: 1 minute

Please give reasons for your view.

If changing this is difficult, 2 minutes should work.

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.

Given that the reference price is determined as the median of 5 snapshots, it is better than simply using the last price. A 10-minute VWAP price may serve as a better reference price. It is important that if the reference price mechanism changes and becomes unreliable (i.e. moving to last print) then matching market orders there would no longer be ideal.

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.

Long Term: We would prefer abolishing the use of price limits and moving into a similar mechanism utilized by the LSE. Price bands should for extension periods should utilize max(5%, 5 ticks) to account for all securities in the market.

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): All of its features should benefit the current POS

No

Please give reasons for your view.

The pre-open session has considerable price stability issues. As such, utilizing the CAS would be extremely beneficial for market integrity. However, one cannot implement price limits at the POS as it would stop overnight newsflow from being implemented at the open. As such, at the worst case scenario, we would prefer wider price limits for the POS (at least 10%) - it should also not apply to stocks that are coming out of suspension and to IPOs.

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.

Any measure that supports efficient price discovery and helps market safety should be implemented as soon as possible. The case of fixing the POS is particularly urgent in our opinion.

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.

Not aware of any issues.

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.

Not aware of any issues.

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.

The fastest implementation time is preferred.

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.

The CAS is by far the highest priority item. VCM is also something that the HKEx should have in place soonest but not at a cost of delaying the CAS implementation. Trading Halts are lower in priority than the others.

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.

Three months should be sufficient.

(ii) CAS:

a). under 3 months;

b). 4-6 months;

c). 7-12 months

d). >12 months

Please give reasons for your view.

Three months should be sufficient.

- End -