

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.

Having a VCM is in line with other international markets and is prudent to avoid volatile market conditions and errors, which can disrupt orderly markets. Most international markets globally have introduced VCM's (circuit breakers) in order to smooth out the effect of orders that are either not worked carefully or in cases where there's short-term mismatches between supply and demand. Regardless of the fact that each market participant should have their own controls and risk measures in place to avoid and minimize errors and fat-finger trades, it should also be the responsibility of the exchanges providing trading services to have their own safeguards in place. Good VCM can save much hassle of trying to assign responsibilities post-trade for mistakes and compensation.

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.

No, it should be applied to all stocks listed on the Exchange since we see it more as a safeguard measure, and not just something relevant to the larger stocks, or to those that form an index.

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.

No, it should be applied not just to stocks listed on the Exchange but to multiple products. Its purpose is to safeguard integrity of the market and reduce potential mistakes and excessive volatility without reason.

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.

Thought it's desirable to have an official closing price, it should not be allowed 'at any price' or it negates the need for a closing mechanism. We need to promote a system which would allow a balance between true supply and demand, and at reasonable prices, not those which could occur at 'any price'. Therefore I think it's still prudent to have VCM in place throughout the markets trading hours. To avoid any misunderstanding, I do think stocks generally need the ability to trade and have an official closing price. Ideally that would occur within the normal trading hours though the HKEx may find a solution in extending trading beyond 4pm only for those stocks which had experienced a VCM halt in the final minutes of the markets.

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.

Using a 5-minute historical reference price is a similar practice to other markets and is usually a fair way to gauge a securities value unless some significant news happens to be released during the market. This look-back allows sufficient flexibility for the stock's price to flexibly move according to market sentiment while still allowing for rational price movements. Although more complex to implement, mixed use of dynamic and static limits should be used.

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.

See our response & justification to the above question #5 referring to general securities. Both dynamic and static limits should be used.

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: 5%

Please give reasons for your view.

There is no perfect level at which to have stocks go into temporary suspension, but a good level would probably be closer to 5% than 10% (in many cases 10% may be too volatile, and if you recall back to the trade in HSBC (5 HK) that moved 11% on the close – along with other stocks – most were smaller moves so 10% seems excessive). I'd prefer more frequent and shorter periods of even less than 5% to avoid excessively disruptive events, but still allow stocks to reach their clearing prices.

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.

As above, there is no perfect level but selecting 5% for derivatives, some of which are essentially covering multiple securities should be wide enough.

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: No limit.

Please give reasons for your view.

There doesn't need to be a limit to the number of VCM triggers in one session, though in practice the chance of more than 2 in one session should be very rare.

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: trading halt, then auction open

Please give reasons for your view.

The above approach may work, but the exchange should also consider the mini-auction model after a trading halt which is used by some exchanges (ASX) for their VCM process. This should be explored to see if it could be implemented instead.

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.

This appears to be a fair solution though consistent 5% bands for all securities, both cash and derivatives, may be even better. I think a combination of an auction price with reference to a dynamic price limit monitoring mechanism may be a better solution.

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

The exchange should consider auctions for opening up stocks triggered in the VCM halts like the POS, by:

- After using trading halts, use auctions to resume stock trading and encourage efficient price discovery.
- Use static and dynamic reference prices in circuit breakers.

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.

As mentioned earlier in this questionnaire, we prefer more frequent, but also more restrictive VCM stops as opposed to limited, but wider bands. Though investors and traders may not quickly know the full reason for why a stock suddenly moved 5 – 10% so quickly, at least they may have enough time to amend their orders. The VCM suspension period allows for an orderly withdrawal of order balances or for the generation of new orders which would help establish the market clearing price for a stock.

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.

Yes, offering transparency of information of halted stocks about the prices & limits, and trading situation of the VCM expiry/resumption will help investors make informed decisions about their trading actions.

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.

While the underlying usually drives the pricing of other listed instruments (SS options or warrants), what really drives securities price movements are the supply and demand of each which are unique. So even though there may be an imbalance or error on one, it doesn't mean trading on the others should automatically be suspended.

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.

As stated in question 15 above, even if the underlying stocks movements drive the pricing of other listed instruments (SS options or warrants), what really drives securities price movements are the supply and demand of each which are unique. So even though there may be an imbalance or error on one, it doesn't mean trading on the others should automatically be suspended. They should be allowed to trade separately.

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

The HKEx is to be commended for recognizing the danger to the market by not having VCM and we fully support their implementation.

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.

We do support a CAS and without one it just means that investors benchmarked to the close are always guessing and scrambling to finish their orders at the close even if the prices may not be optimal. And because it all happens so quickly in that last minute there's little ability for them to really monitor the dozens or hundreds of index stocks in their baskets so it's not unusual for some to move considerably.

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.

CAS should be applied to all securities instead of only a subset since abnormal price movements occur outside index stocks too.

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.

As above, CAS should be applied to all securities, including all ETF's.

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: CAS implementation should be quick.

No

Please give reasons for your view.

CAS should be applied to all securities but if doing so would require significant delays in HKEx introducing them, then as an interim measure only, a subset of securities could be chosen.

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.

CAS should be applied to all listed securities so if there's supply and demand posted on the bid/offer then it should be applicable though in rare cases warrants may move significantly based on only a couple spreads of the underlying. In such cases an alternative solution should exist. For non-listed structured products the CAS is probably less meaningful.

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

Yes

No

Please give reasons for your view.

CAS price limits are advisable to avoid too much sudden volatility. But at the same time, a closing price is important for the index and passive traders so it must ensure that in most cases stocks can't close in an imbalance without volume going through. An extension to normal trading hours may be the answer, or a closing system like the Indian markets (VWAP of last 30 minutes), though would not suggest such a long period, thinking 5 – 10 minutes may be adequate to reduce extreme volatility at the very close caused by imbalances.

This one of the most important questions in the survey because we can already foresee using a 5% limit in a sudden CAS may result in incomplete executions on a number of names. Since this is undesirable, the above Indian solution or alternative (LSE often quoted) should be considered so a real closing price is reached, and the volume required by all sellers and buyers is met.

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.

Though some would argue to increase the band from 5%, and understandably the wider the band, the more chances the stock trades all the volume it would within that band, and will close, but it defeats the purpose of trying to reduce volatility.

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 may not be necessary within the 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.

I do agree that at-auction limit orders should be accepted and encouraged as the 'at market' orders have no price discretion whatsoever and just encourage increased volatility.

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.

Discovery Short-selling orders should be allowed and will increase liquidity, and likely reduces volatility as has been mentioned as a result of the same practise in markets like Korea.

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.

Discovery As long as the uptick rule is kept consistent with normal continuous trading this should be enough.

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.

I think this may be an important feature to avoid gaming which would otherwise likely occur, so that the orders in the system set for the close and contributing to the Indicative Equilibrium Price (IEP) will be more genuine.

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

Yes

No

Please give reasons for your view.

Using a random close is an important anti-gaming mechanism and easy to implement. Random closes also preclude spurious last-second additions and withdrawals of liquidity commonly seen with fixed closing times, changes which defeat the purpose of the Indicative Equilibrium Price (IEP) in the first place. Random closes by their nature encourage traders to get their orders into the system earlier rather than later so they don't miss the actual close.

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: _____

Please give reasons for your view.

A two-minute window for the random close seems appropriate.

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.

This should be fine as the reference price mechanism is a median price.

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 seven-minute input period provides adequate time in which orders can be entered, amended, and cancelled, but prefer if all this started well before 4 o'clock so that the actual final price is determined at 4pm sharp.

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): Explore using the CAS mechanism

No

Please give reasons for your view.

The CAS mechanism may be optimal for the opening as well but this would have to be tested and considered carefully. For stocks which have considerable overnight news and are expected to move sharply I am in favour of a slower graduated opening on balance of shares as seen in the Japanese market.

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.

While I do think work should be done on POS & Trading halts, the HKEx top priority should be introducing the Closing Auction Session (CAS). Both the POS & Trading halts can be thought of and introduced at different times without delaying further the CAS.

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.

No particular deadline which those 12 additional minutes would impact.

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.

No particular concern for the AHFT which we don't use, so suggest AHFT period after normal trading be as long as practical.

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.

Implementation of VCM and CAS should be the top priorities, so if adding the trading halts to the requirement would delay the former two items, then better to roll them out in stages with VCM & CAS first.

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.

Introducing the CAS should probably be the first priority, followed by the VCM. The trading halts can come shortly later in a different rollout.

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.

Both the VCM and CAS, should be introduced as soon as practicable, but brokers will need some testing time so most should be able to do this in under 6 months.

(ii) CAS:

a). under 3 months;

b). 4-6 months;

c). 7-12 months

d). >12 months

Please give reasons for your view.

As stated above, both the VCM and CAS, should be introduced as soon as practicable, but brokers will need some testing time so most should be able to do this in under 6 months.

- End -