March 2020

RESEARCH REPORT

THE CONNECTIVITY PLATFORM OFFERED BY THE HKEX COMMODITIES MARKET FOR THE MAINLAND AND THE WORLD

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24 March 2020

SUMMARY

This chapter describes how the Hong Kong Exchanges and Clearing Limited (HKEX) aims to position itself as a major commodities market trading platform in the world. In its endeavour to do so, it has acquired the London Metal Exchange (LME), established the Qianhai Mercantile Exchange (QME) and is currently focusing on developing new products as well as its infrastructure connectivity.

In recent years, HKEX successfully launched gold futures, base metals futures and ferrous metal futures. It also aims to replicate the Stock Connect model for commodities trading and clearing, connecting the prices formed in the Mainland and international commodities markets by linking LME and QME. Reciprocal Membership Arrangement has been introduced in order to encourage LME members to join the Hong Kong Futures Exchange (HKFE, the derivatives exchange subsidiary of HKEX) in support of the launch of commodity products on the HKEX derivatives market. The launch of LME Metal Mini Futures in 2019 symbolised the first step of “Hong Kong – London Connect”. In addition, various Memoranda of Understanding have been signed, in particular with Mainland organisations, in order to seamlessly connect the Mainland commodities market with the international commodities market.

1. THE UNIQUE POSITIONING OF THE HKEX COMMODITIES MARKET

1.1 How HKEX position itself as a platform for the Mainland and the world

HKEX's commodity strategy is set to focus on two aspects: buy and build. Externally, in 2012, HKEX successfully acquired the 140-year-old London Metal Exchange (LME), which was its first step in the acquisition of international financial infrastructure. Internally, HKEX deploys a China-centric strategy, cooperates closely with Mainland regulatory authorities and institutions, and leverages Hong Kong's unique position. These efforts are focussed on building a new commodity spot market in the Mainland, serving industry entities as well as complying with laws and regulations, and serves to open up channels for linking finance with the physical economy. Qianhai Mercantile Exchange (QME) was then established as a leap towards HKEX's commodities vision.

Hong Kong is one of the most densely populated cities in the world which lacks a development environment and traditional background conducive for trading commodities. A unique approach is required to develop the commodities market that addresses Hong Kong's current situation, leverages its advantages and fulfils domestic demand. As a result, HKEX began to explore a "Win-Win" commodities strategy: a "futures" strategy — achieving mutual benefits via mutual connection with the Mainland exchanges; and a "spot" strategy — by buying existing platforms with desired expertise and build in-house physical delivery facilities.

The ultimate goal of the buy-and-build strategy is to effectively connect the externally acquired platform with the internally built platform by utilising Hong Kong's unique position in Asia-Pacific, and to accelerate the internationalisation of the Mainland commodities market by taking advantage of Hong Kong's international financial infrastructure, achieving the eastward shift in the pricing of international commodities. This is also essential to the "Belt and Road" initiative (BRI) of China. The BRI involves more than 60 countries and it is estimated that within a decade, the trade volume between China and the involved countries will reach US$2.5 trillion[1], a remarkable proportion of which would be commodity resources that embody huge development potential. For the Mainland, how to effectively manage the risks caused by commodity price fluctuations will also directly affect the progress of many projects under the BRI. Hong Kong and London are two international financial centres along the Belt and Road. If the "Win-Win" strategy is successfully implemented, HKEX will be able to link the international experience of London and Hong Kong to the needs of China's physical economy.

1.2 What has HKEX done to develop itself into a successful connectivity platform for the commodities market

The most important development of HKEX's commodity business in recent years has been: (1) the acquisition of LME in 2012; and (2) the establishment of QME in 2018. These two major moves correspond to the Mutual Market Access (MMA) programme and the buy-and-build strategy.

1.2.1 LME acquisition

LME is the major pricing centre of global industrial metals, with over 80% of global non-ferrous metals futures contracts traded on its platform[2]. Pricing metals has always been one of the core functions of LME. The main benchmark prices, including the LME Official Price and the LME Closing Price for each commodity product, are "discovered" by trading through the open outcry trading hall, the Ring in London, during fixed time slots on LME

[1] Source: "China's Xi: Trade between China and Silk Road nations to exceed $2.5 trillion", *Reuters*, 29 March 2015.

[2] Source: LME.

trading days. The open outcry in the Ring has a long history, which can be traced back to 1877 and still has a very high circulation volume today.

HKEX successfully acquired LME in 2012 after prudent evaluation and extensive consultation. There are two main reasons for acquiring LME. Firstly, LME is in the European and US market trading time zone and is an offshore US dollar (USD) financial centre as well as a leading currency market. Secondly, HKEX is a leading offshore Renminbi (RMB) trading hub and a derivatives exchange located in the Asian market trading time zone.

This acquisition is an important step in building HKEX's commodities platform. Although it can't solve all challenges in developing its own commodity trading and settlement platform, it is the first attempt which announces to the world that Hong Kong can become a world-class commodity centre and provide a means towards internationalisation for Mainland China's commodity market participants. Although LME is located in London and has a big time difference with Asia, through the 18-hour LME electronic trading system, the morning trading session of LME overlaps with the afternoon trading session of Asia, and the Asia-focused trading activities at LME are increasing year by year. The higher the trading volume originated from Asia, the greater the need for the price to be discovered in the Asian trading zone to reflect Asia's supply and demand.

The first phase after the acquisition of LME focused on improving LME's existing Asian business. In this phase, there was not much financial investment or infrastructure restructuring, but most efforts were devoted to make LME's trading platform simpler, easier to access, and better to meet the demand of Asian clients. Consequently in 2013, Kaohsiung port in Taiwan, became the 9th LME-recognised delivery location in Asia, with the others in Singapore, Malaysia, South Korea and Japan. In 2014, HKEX launched a reciprocal membership arrangement (RMA) in conjunction with LME for the first time. Under this arrangement, a number of LME members also became qualified for membership of the Hong Kong Futures Exchange (HKFE), the derivative arm of HKEX, making bilateral transactions easier. This plan continues to go forward and the details of RMA are discussed in sections below.

The second phase of the strategy is to build the infrastructure of HKEX's new chapter. This phase takes longer and costs more, yet the returns are not only financial, but also strategic. One major investment is the establishment of LME Clear. Prior to this, LME had to settle through an external clearing house. As a result, LME could not take full control of its own development pace, especially the speed and flexibility of new product launches. After the establishment of LME Clear, LME has thereby gained autonomy in settlement, thus can accelerate the launch of new products to the market and generate its own revenue therefrom. In addition, LME's information technology development has been shifted from the then outsourcing mode to in-house development. While improving efficiency, this shift has also turned the information technology of LME into a strategic asset.

The third phase is to capture more clients. The strategy of this phase includes accomplishing cross listings and licensing arrangements of cross-regional products, and establishing strategic partnerships with key players as well as institutions from other commodity markets. In particular, principal institutions in the Mainland commodity market will be among our main partners given the scale of the Mainland market and its need to go international. Driven by these partnerships, our development began with base metals and further expanded into other commodities. Since the acquisition of LME, HKEX has successively listed LME metal mini contracts denominated in offshore RMB (CNH), dual-currency-denominated gold contracts (in USD and CNH) and iron ore contracts listed concurrently with LME, and the most recent USD-denominated LME metal mini contracts listed in 2019.

1.2.2 QME establishment

Shenzhen and Hong Kong are adjacent to each other, and each bear special missions and unique advantages in China's reform and opening-up process. The central Chinese government set up the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone in Shenzhen, providing a platform that closely integrates Shenzhen and Hong Kong. Qianhai was also the first stop of the Chinese President, Xi Jinping, in his visit to Guangdong in 2012 after the 18th National Congress of the Communist Party of China. He specifically gave policy-directions that Qianhai should "rely on Hong Kong, serve the Mainland and face the world"[3]. At the time of the National People's Congress and the Chinese People's Political Consultation Conference in 2019, Premier Li Keqiang put forward the need to study and formulate a development plan of the Guangdong-Hong Kong-Macao Greater Bay Area urban agglomeration to further promote and deepen Guangdong-Hong Kong-Macao cooperation.

However, as one of the key geographical regions in the national economic development plan, southern China still lacks a national commodities trading market. After years of preparation, under the support of the Shenzhen Municipal Government, HKEX teamed up with Qianhai Financial Holdings Co., Limited to fully exploit Qianhai's special policy advantages and jointly founded QME.

Since its inception, QME has been actively exploring policy implementation and in-depth cooperation programs with regulatory bodies and industry clients, in the hope of establishing a China-anchored, globally connected commodities spot platform by leveraging HKEX's unique advantages. This is also the first time that a major Hong Kong financial infrastructural entity set up a financial platform in the Mainland.

QME officially made debut on 19 October 2018 with trading in alumina. The first spot transaction saw 3,000 tonnes of alumina changed hands between Chalco Trade and Xiamen Xiangyu at a price of 3,030 yuan a tonne, recording the first benchmark pricing of spot alumina based on actual transactions in the Mainland market.

In the past few years of exploration and evolution, QME has been geared towards spot commodities and the physical economy. In the future, by means of technology, cross-border arrangements and finance, QME will build standardised asset classes that connect entities with finance to resolve the fund-raising difficulties of business enterprises, and leverage the East-West coordination effect derived from LME, now a subsidiary of HKEX, to gradually achieve the strategic goal of building QME into a global commodity RMB pricing centre.

While absorbing LME's prior experience in serving the physical economy and industrial clients, QME cannot completely replicate the LME model and must fit China's national conditions. LME's experience of serving the physical economy should be creatively used for QME's reference to serve the Mainland and cultivate a spot market focused on institutional clients, in particular small and medium-sized industrial enterprises (SMEs). Specifically, QME will begin with building reliable warehouses and convenient logistics to establish LME-style delivery warehouse network and industry credibility. To follow up, it will focus on serving the needs of enterprises and provide commodity users, traders, logistics service providers, financial intermediaries, etc. with a series of comprehensive services such as secure and efficient commodity spot trading, financing, warehousing and logistics as well as supply chain management. Thirdly, QME will innovate its service model to

[3] Source: The website of the Authority of Qianhai Shenzhen-Hongkong Modern Service Industry Cooperation Zone (http://qh.sz.gov.cn).

minimize the capital and trading costs of enterprises, especially to reduce the cost of hedging for SMEs, and to provide them with more customised services.

2. PROSPECTIVE PLATFORM DEVELOPMENTS

2.1 Strategic product developments

Apart from the recent launch of futures contracts on gold, base metals and ferrous metals, HKEX will continue to introduce contracts on other assets in order to capture the full spectrum of actively traded underlying assets pertinent to Asian commodities experience.

Apart from commodity futures, other tradable commodity derivatives as well as various forms of delta-1 products [4]are also under consideration or in active development, in order to serve various types of commodity industry participants, including producers and consumers, to efficiently hedge their commodities exposure.

2.1.1 Gold

On 10 July 2017, HKEX launched USD and CNH gold futures contracts with physical settlement ("the Gold Contracts").

The Gold Contracts are the world's first pair of dual-currency futures that are settled with physical delivery in Hong Kong, with global delivery mechanism and kilo-bar standards recognised both by Mainland China as well as global investors. They are designed primarily to serve (1) physical market participants such as gold refiners, fabricators and jewellers who need to hedge gold price risks; (2) financial participants such as banks and funds which utilise the derivatives market to link their gold-related investment products; (3) arbitrageurs who trade on price disparity between onshore and offshore markets and adopt other trading strategies involving foreign exchange and interest rate differentials; and (4) other investors and traders who may have potential appetite to gain exposure in gold.

Attributed to the free market and tradition of being an entrepot trading hub, Hong Kong serves as the main physical gateway of gold channelled to Mainland China.

The Mainland has an extremely active physical gold trading market and enjoys the status as one of the major bullion markets in the world — it has been the world's largest consumer of gold[5] as well as the largest gold importer, with around 1,500 tonnes of metal (equivalent to one-third of world's supply) imported in 2018[6]. Although Hong Kong's share of China's gold imports has recently dropped to around 40% by September 2019 (primarily because of political unrest in Hong Kong), it was consistently at an average of 60% during 2012 to 2016[7]. The primary demand for physical gold comes from Hong Kong's adjacent city, Shenzhen, which accounts for almost 70% of the total Chinese jewellery sales[8]. Hong Kong's geographical proximity with Mainland China, and in particular Shenzhen, thereby puts it at an unparalleled advantage to serve the Mainland bullion market.

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4 "Delta" is the measurement of the sensitivity of a financial derivative to movements in the price of the underlying asset class. "Delta-1 product" is a financial derivative with delta equals to 1, which means that it directly tracks the price of its corresponding underlying asset, in terms of its percentage change.

5 Source: "China tops world's gold consumers for 6th year", *XINHUANET* (http://www.xinhuanet.com), 31 January 2019.

6 Source: "China eases restrictions on gold imports: sources", *Reuters*, 22 August 2019.

7 Source: "Hong Kong gold market losing shine amid political unrest", *Reuters*, 13 September 2019.

8 Source: HKTDC Research (http://china-trade-research.hktdc.com/business-news/article/China-Consumer-Market/China-s-Jewellery-Market/ccm/en/1/1X000000/1X002MMK.htm]

In addition, as the largest offshore RMB centre, Hong Kong has a unique position in facilitating RMB internationalisation. The launch of the dual-currency Gold Contracts in Hong Kong is a stepping stone to achieve this objective.

The strategic values of introducing the Gold Contracts on HKEX are seen as follows:

- To enhance Hong Kong's status as a key gold trading centre with both active physical market as well as derivatives market by introducing the first dual-currency gold futures in the world;
- To attract the participation of investors from Hong Kong, the Mainland, the rest of Asia as well as the western time zones, with the aim to build an Asian benchmark price for gold kilo bar in Hong Kong and to enhance the pricing power of commodities in Asia;
- To help HKEX obtain physical delivery capability by introducing the very first physical-delivered commodity futures in the history of Hong Kong

As the first key step to prepare for introducing more precious metal derivative products, six gold futures indices, namely Excess Return Index, Total Return Index and Spot Index (the "Gold Indices") in both USD and CNH were launched on 24 June 2019. The Gold Indices offer independent, transparent and timely benchmarks for tracking gold price changes in the Hong Kong market. The indices are based on prices of the USD and CNH Gold Futures contracts with 10 July 2017 as the base date. They are calculated and administered in accordance with the Principles for Financial Benchmarks as published by the International Organisation of Securities Commissions (IOSCO). These indices provide the basis as underlying indices for future development of relevant exchange-traded funds (ETFs) and/or ETF option products.

After considerable market research, HKEX is prepared to launch more new products such as silver futures and various forms of gold derivatives to contribute to an expanded landscape of the precious metal product suite.

2.1.2 Base metals

On 5 August 2019, HKEX launched the USD-denominated London Aluminium, Zinc, Copper, Nickel, Tin and Lead Mini Futures Contracts (collectively called the "USD London Metal Mini Futures"). These contracts were designed to complement the existing set of London Metal Mini Futures on the same commodities that are denominated in CNH (launched in two batches in December 2014 and December 2015).

The global demand for base metal consumption has been growing rapidly. It is primarily led by China's multi-decade long economic expansion. During 1983 to 2018, China enjoyed an unprecedented average annual growth rate of 9.7% in its gross domestic products (GDP)[9] and it is believed that it has become the biggest consumer in the world for a majority of the base metals. This growing demand has structurally driven up the prices of physical metals and related futures contracts in recent years. Trading volumes of base metal contracts on both the Chicago Mercantile Exchange (CME) and LME have also increased steadily[10]. The trading landscape in base metals, which used to be dominated by traditional physical market participants, has also changed dramatically. A larger number of financial investors, professional traders and money managers are now actively engaged in this asset class, as indicated from the Commitments of Traders Reports of the US Commodity Futures Trading Commission (CFTC) published at the CFTC official website.

[9] World Bank Data (https://data.worldbank.org)

[10] Reference can be made to the statistics of the Futures Industry Association (FIA).

Base metal futures are actively traded in over-the-counter ("OTC") markets globally and are also listed on a number of exchanges such as LME, CME, the Shanghai Futures Exchange ("SHFE") and the Multi Commodity Exchange of India ("MCX"). After HKEX's acquisition of LME in 2012, these base model products on HKEX were primarily launched in order to leverage on the branding and membership network of LME, as well as on LME's reference pricing in base metals which is widely adopted by physical markets worldwide. The USD London Metal Mini Futures aim to provide trading opportunities for investors that have exposure in USD denominated base metals in the Asian time zone.

The metal mini futures contracts are designed with much smaller lot-size (as compared to LME's standard base metal contracts) and are cash settled. Smaller lot-size is primarily aimed to encourage retail participation in a market which has been traditionally dominated by large physical market participants or institutional traders. In order to encourage the participation from LME members and their clients, HKFE has set up RMA with LME, which allows significant fee waivers for new applicants who already hold a membership or participantship at either one of the exchanges.

2.1.3 Ferrous metals

Ferrous metals are fundamental products in the commodities market and cover a broad range of products. They can be classified into product classes like iron ore, steel, coking coal and scrap, all of them are non-standardised products. Each product class is very diverse in product types. Currently, global derivatives markets only offer a few main-stream products in each product class. Market participants has increasing demand for the non-mainstream products to be launched in the futures market. China is the biggest importer of iron ore and producer of steel[11]. A significant volume of Chinese imports and exports in ferrous metals every year has triggered a strong demand from both physical and financial market participants for hedging, arbitrage or speculation using derivative products.

Launching the Iron Ore Futures (the TSI Iron Ore Furies 62 per cent Fe CFR China Futures) in 2017 as the first product in the ferrous sector is HKEX's strategy to set a foothold into the ferrous market. With a suitably designed incentive programme and marketing efforts, there has been increasing participation from global professional investors in this market segment to help build up the liquidity pool. Meanwhile, with the effort and cooperation with our partners on marketing and business development in Mainland China and south Asia, we saw an increase in the number of Exchange Participants and physical market traders engaged in the market in 2019. In 2019, HKEX signed several Memoranda of Understanding (MoUs) with Chinese Price Release Agencies (PRAs) including Mysteel to further extend its reach into the commodity market and exploit potential opportunities in other ferrous products. More details will be elaborated in Section 2.2 below.

2.2 Infrastructure connectivity

2.2.1 Platform linkage with LME and QME

In line with HKEX's group strategy, the focal work has been to lay the foundation for our global commodities strategy with the acquisition of LME and the establishment of QME. The next ten years will see our efforts to accelerate the connection between the Chinese and international commodities markets. We will work to replicate the Stock Connect model for commodities trading and clearing, connect the prices of the Chinese and international commodities markets through product cross-listings and developing price benchmarks, and to accelerate the internationalisation of onshore physical deliveries in China. We will also

[11] In 2018, China's total import of iron ore was 1,064.4 million tonnes, crude steel production was 928.3 million tonnes (more than half of the world's total crude steel production of 1,808.4 million tonnes). Source; World Steel Association, as of March 2019.

attempt to use technology to help reshape the trading and financing ecosystem of China's commodities market.

2.2.2 RMA (Reciprocal Membership Arrangement)

The RMA was first introduced in November 2014 to encourage LME Members to join HKFE in support of the launch of commodity products on HKEX in December 2014, namely the CNH London Aluminium, Copper and Zinc Mini Futures contracts. The RMA had an initial duration of one year and an extension was granted in 2015 for a further year. A few LME membership and HKFE participantship applications under the scheme were received during the two years.

Under the original terms of the RMA, LME and HKFE waived their respective first year's annual subscription and application processing fees for new applicants who already held a membership at either HKFE or LME. The RMA was re-introduced in 2019 on broadly the same basis as previously (see Table 1). The re-introduction of the RMA is considered in alignment with HKEX's strategy for developing its commodities business, including the launch of new products such as the USD-denominated London Metal (Aluminium, Zinc, Copper, Nickel, Tin and Lead) Mini Futures contracts (launched on 5 August 2019) and other commodity products that may have synergies with LME products.

In order to encourage participation from LME members and their clients with the launch of the new USD London Metal Mini Futures, thus broadening access, providing liquidity, and growing international participation, HKFE will waive its membership fees for LME members or affiliates of LME members wishing to join HKFE under RMA. In conjunction with this initiative, LME has also introduced a RMA during the same period as HKFE's RMA and will waive the membership fees for HKFE or affiliates of HKFE Participants wishing to join LME.

It is believed that additional commodities traders from LME who become HKFE Participants will help connect the London and Hong Kong markets. The cross-exchange membership should allow brokers and clients to more easily arbitrage between products and to better manage their risks. LME Members who have access to HKFE will also be able to provide reasonable base metal prices by acting as market makers or liquidity providers for the USD-denominated London Metal Mini Futures contracts.

The RMA will cover HKFE and LME Exchange Participant fees only, not HKFE and LME Clearing Participant fees. With respect to HKFE membership applications, the fee waiver will be applied to applications received that are deemed complete by the HKFE (i.e. submitted with all relevant supporting documentation) and accompanied by evidence, where applicable, that an application for HKFE membership and the approval of the Hong Kong Securities and Futures Commission (SFC) for Type 2 licence are in progress. All other current membership criteria and costs remain unchanged.

Table 1. Summary of RMA

Exchange	Effective period	Membership fee waiver	Eligible applicants
HKFE	29 July 2019 – 29 July 2022 (both dates inclusive)	• Futures Exchange Trading Right fee (one-off): HK$ 500,000[12], and • 1st year's Exchange Participantship subscription fee (annual): HK$6,000	Any LME Member or affiliate of an LME Member
LME		• 1st year's (annual) service subscription fee (inclusive of the application processing fee, as applicable for each service) for LME membership applicants[13] for the following services: (i) LME Categories 1 – 5, (ii) LMEprecious General Clearing Members, Individual Clearing Members and Non-Clearing Members, and (iii) Registered Intermediating Brokers	Any HKFE Participant or affiliate of an HKFE Participant

2.2.3 Hong Kong-London Connect

The launch of London Metal Mini Futures symbolised the first step of "Hong Kong-London Connect". The mini futures were derived from LME products, based on LME base metals' contract specifications, and first offered in the Asian time zone. It will supplement and cover both Asian hour and London hour time zone for base metals trading. As a second step, LME is considering implementing a "pass the book" model that allows market participants of each of HKFE and LME to trade and hedge positions in both time zones by means of certain agreed arrangements. The final step would include the development of a true "Connect" scheme where both HKFE and LME's order books are literally "connected".

2.2.4 MoU signed to explore more opportunities

Continuing with the "Connect" scheme under HKEX's three-year strategy to further extend the commodities business strategy, HKEX signed four MoUs with Chinese PRAs and industrial organisations respectively, namely SMM information & Technology Co.,Ltd (SMM), Beijing Antaike Information Co Ltd (Antaike), Shanghai Ganglian E-Commerce Holdings Co., Ltd. (Mysteel) and Wuxi Stainless Steel Exchange. Each of them is an information and index service provider in base metals or ferrous metals industry (see Table 2).

Table 2. MoUs signed by HKEX with professional commodity service providers in 2019

External party in MoU	Date	Location	Business scope
Mysteel	7 May 2019	Hong Kong	Iron ore and other ferrous metals
Antaike	24 May 2019	Beijing	Aluminium and base metals
SMM	30 October 2019	London	Base metals
Wuxi Stainless Steel	7 May 2019	Hong Kong	Stainless steel and other steel products

The MoU with SMM was signed to establish strategic partnership in commodities business and promote mutual business development in the financial and commodities markets, with the ultimate aim of raising the international influence of Mainland China's commodity prices. In the light of the market recognition of the SMM Indices in the Mainland as reflected by market users, suitable corresponding derivative products based on the SMM indices, if

12 For the HKFE one-off trading rights fee, eligible applicants will pay a nominal fee of HK$1 instead of HK$500,000.

13 LME membership information is available on the LME website (http://www.lme.com/en-gb/trading/membership/).

launched in Hong Kong, would be able to provide global clients with exposure to Chinese underlying assets.

The MOU signed with Antaike aims at further expanding cooperation in the spot market of non-ferrous metals, and jointly promoting the internationalisation of spot prices of Mainland China's non-ferrous metals.

The MoU signed with the Wuxi Stainless Steel Exchange works towards strengthening communications and cooperation, as well as stimulating mutual business development in financial and commodities markets.

The MoU signed with Mysteel seeks to raise the international influence of Mainland China's commodity prices. HKEX has been continuously working on the potential product design with Chinese underlyings to enrich its commodity product suit, in the hope of effectively helping physical market participants discover the true market price and offering financial participants with the most efficient platform to execute their investment strategies.

By aligning Chinese partners in the industry like the above MoU partners, HKEX is further building up its network and resources in Mainland China.

HKEX is also in active discussions with domestic Chinese exchanges to exploit potential business opportunities and extend the connectivity strategy into the commodities sector.

3. CONCLUSION

Before the HKEX Group initiated its strategic focus on commodity asset classes, consumers and producers of commodities in Asia would primarily hedge their risk in the physical market through corresponding benchmark contracts in London, New York and Chicago, thereby exposing themselves to significant basis risk and liquidity risk during Asian trading hours. China's decades-long expansion which has eventuated in it becoming the biggest consumer of global commodities has necessitated the Hong Kong bourse to close this gap between the physical and derivatives markets in Asia.

HKEX's dual strategy of "buy and build" i.e. overseas mergers/acquisition and the establishment of a direct Commodities Connect with the Mainland is expected to be a significant impetus to accelerate the internationalisation of China's commodities market by taking advantage of Hong Kong's own international financial infrastructure, thereby helping achieve the eastward shift in the pricing of international commodities.

The acquisition of LME in 2012 gave HKEX the direct access to a globally recognised pricing centre of industrial metals. The subsequent rationalisation of LME's trading platform, the set up of a delivery port in Taiwan and the RMA between HKFE and LME has improved access to LME by Asian clients.

The establishment of QME in 2018 is a key step towards establishing a China-anchored, globally-connected commodity physical trading platform.

A series of commodity product developments on the HKEX platform further progress the connectivity strategy for users in China and other Asian regions. The LME metal mini futures contracts denominated in both USD and CNH support Asian traders for hedging and provide Asian investors with trading opportunities. The physically delivered Gold Contracts, also in dual currency, serve Mainland China's gold market, the biggest bullion market in the world, and to facilitate RMB internationalisation. The Iron Ore Futures provide efficient hedge to the underlying physical market in Mainland China, the biggest importer of iron ore and producer of steel.

Furthermore, enhanced cooperation between between HKEX and Chinese PRAs and industrial organisations through signing MoUs seek to promote mutual business development in the financial and commodities markets. The ultimate aim is to strengthen the international influence of Mainland China's commodity prices.

All these initiatives (and more to come) are undertaken to build up and solidify the HKEX connectivity platform for effective connection between the Mainland and the world's commodity markets.