



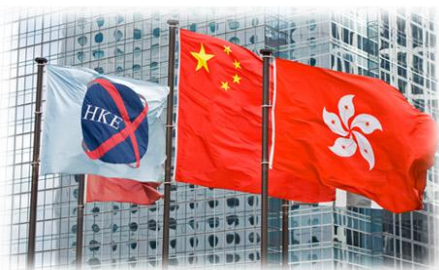
HKEx Hosting Services Ecosystem Forum

Update on VCM and CAS Consultation

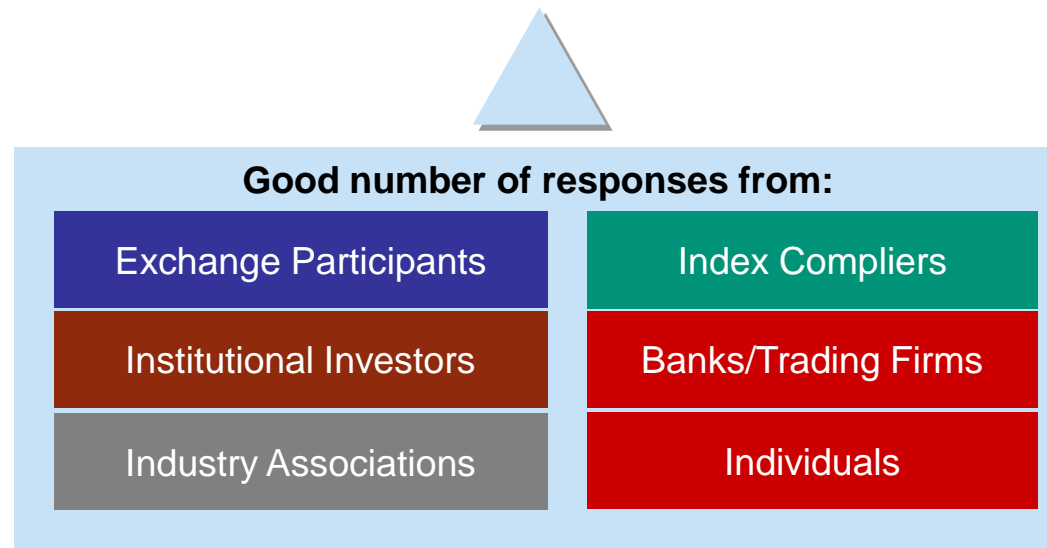
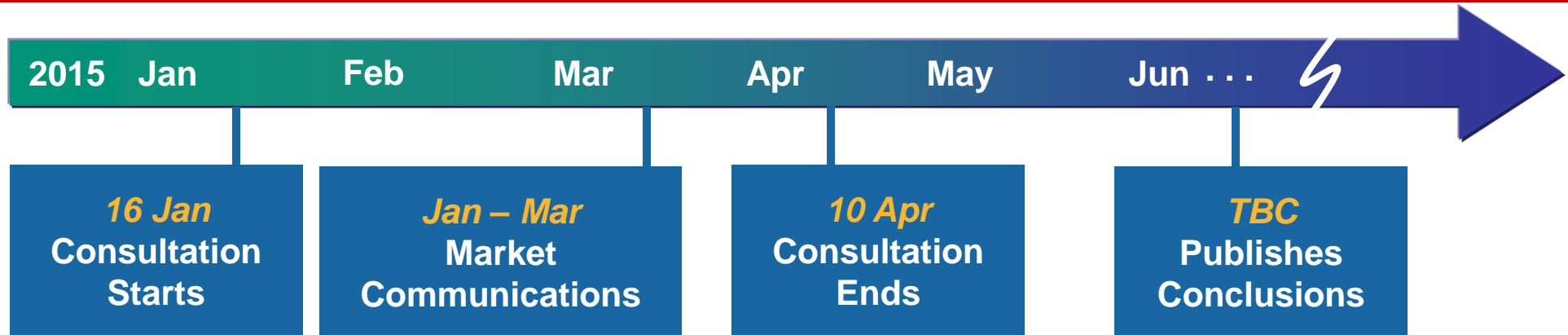
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Cash Trading, Global Markets

22 April 2015



Where are we now with the VCM/CAS project?



Comprehensive feedback received from a good representation of market participants

Recapping reasons for reviewing VCM & CAS

Volatility Control Mechanism (VCM)

Safeguarding market integrity

- Protection of the market from disorderly volatility while not preventing normal price discovery
- Containing systemic risk caused by benchmarking index products
- For both cash and derivatives markets

Closing Auction Session (CAS)

Meeting diverse trading needs from the investors in our market

- High institutional demand – allowing execution at the closing price
- Adopted by all developed and most developing securities markets
- For cash market only

The two market structure reviews are aimed at increasing the global competitiveness of the Hong Kong Market

Why VCM?

G20 & IOSCO*

- Trading venues should have suitable VCM to deal with systemic risks arising from volatile market situations, particularly with respect to benchmark index products
- The VCM mechanism should provide a temporary cooling-off period to allow market participants to reassess their strategies, reset their algorithm parameters, and re-establish an orderly market

SFC

- Support HKEx's review of VCM for safeguarding market integrity
- Discussed with HKEx on suitable VCM models for market consultation

International Practice

- Major US, European and Asian markets have developed VCMs to safeguard market integrity under extreme volatility
- Hong Kong is the only major international market without a VCM

It is HKEx's statutory duty to review VCM for safeguarding market integrity

* Based on: 1). the review called by the G20 in Nov 2010; 2). IOSCO's report on "Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency" published in Oct 2011; and 3). the Joint Report from SEC and CFTC on Flash Crash.

High level model design

- A dynamic price limit model applied at the individual instrument level to capture rapid price changes ($\pm 10\%$ or $\pm 5\%$) from trade prices 5-minute ago
- Trading within band when triggered during the 5-minute cooling-off period

Applicable products

- Securities Market: HSI & HSCEI constituent stocks (currently with 81 stocks)
- Derivatives Market: spot and spot next month Index futures contracts with HSI or HSCEI as their underlying index (currently with 8 future contracts)

Applicable trading session

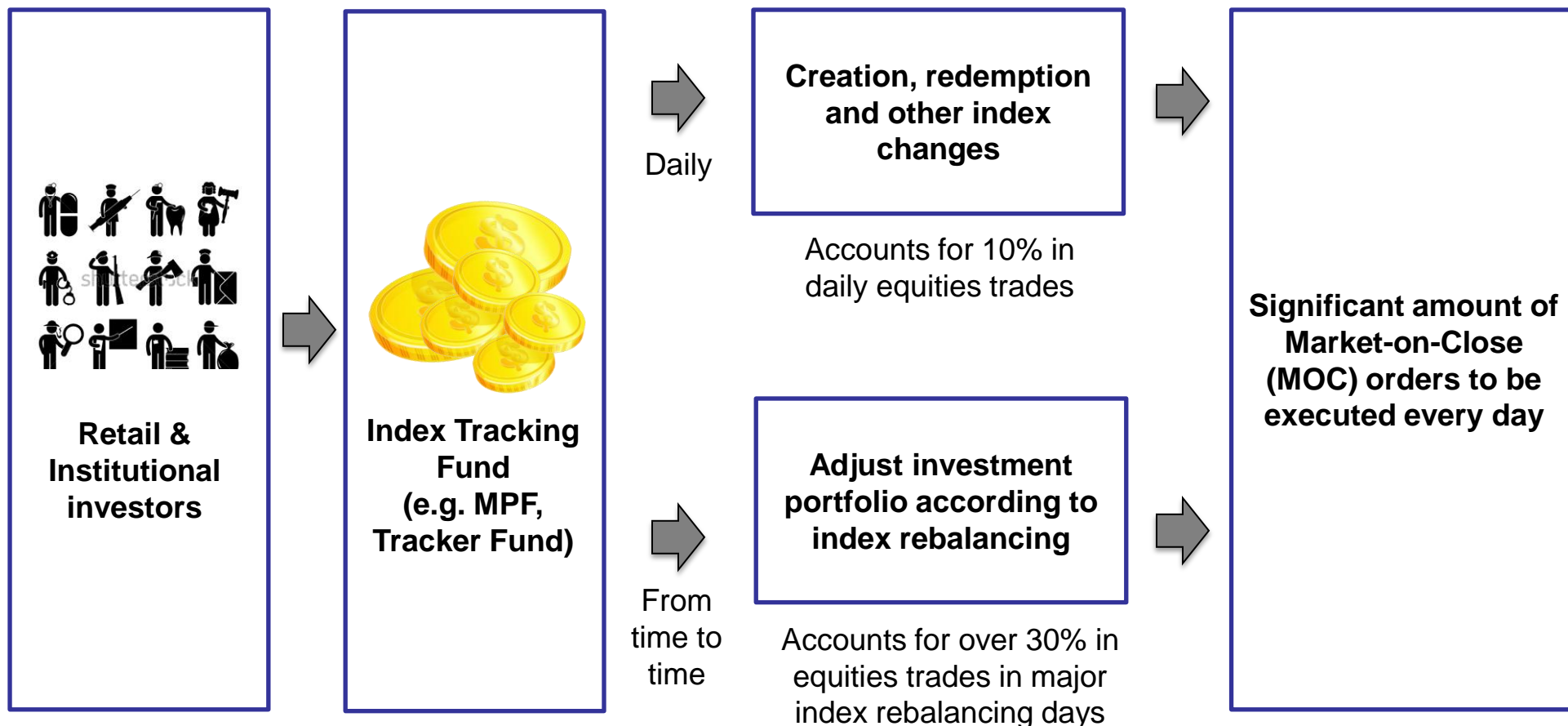
- Only applied in Continuous Trading Session (CTS) but not auction sessions
- Exclude last 15 minutes of the CTS to allow free price discovery at market close

Key points for consideration

- What products should the VCM be applied to?
- When should the VCM be applicable?
- What reference price for VCM monitoring would be appropriate?
- What should be the triggering level for the CB?
- Any maximum number of triggers per day or per session?
- How should the VCM work? Trading within band or auction?
- What should happen to the linked instruments when CB is triggered?

A delicate art to balance different voices in the market

Why CAS?



These funds are mandated to execute trades at the closing price (i.e. MOC order)

All developed markets except Hong Kong and most emerging markets have CAS



All Developed Markets* except Hong Kong have CAS

With CAS (22):

- | | |
|-------------|---------------|
| ✓ Australia | ✓ Japan |
| ✓ Austria | ✓ Netherlands |
| ✓ Belgium | ✓ New Zealand |
| ✓ Canada | ✓ Norway |
| ✓ Denmark | ✓ Portugal |
| ✓ Finland | ✓ Singapore |
| ✓ France | ✓ Spain |
| ✓ Germany | ✓ Sweden |
| ✓ Ireland | ✓ Switzerland |
| ✓ Israel | ✓ UK |
| ✓ Italy | ✓ US |

Without CAS (1):

- × Hong Kong

Most Emerging Markets* have CAS

With CAS (20):

- | | |
|-------------------|----------------|
| ✓ Brazil | ✓ Peru |
| ✓ Colombia | ✓ Philippines |
| ✓ Czech Republic | ✓ Poland |
| ✓ Greece | ✓ Qatar |
| ✓ Hungary | ✓ Russia |
| ✓ Indonesia | ✓ South Africa |
| ✓ Korea | ✓ Taiwan |
| ✓ Mainland (SZSE) | ✓ Thailand |
| ✓ Malaysia | ✓ Turkey |
| ✓ Mexico | ✓ UAE |

Without CAS (4):

- | | |
|------------------|---------|
| × Chile | × Egypt |
| × Mainland (SSE) | × India |

Without CAS, Hong Kong's competitiveness as an international finance centre is hampered

* Based on MSCI classification.

High level model design

- A 12-minute auction session after CTS to form a closing price for trade execution at that price
- New enhanced features (e.g. 2-staged price limit, random closing, better auction transparency) to address price volatility issue

Phased implementation approach

- Phase 1: major index constituents and ETFs with HK underlying (~320 stocks)
- Phase 2: all equities and funds excluding structured products (~1,800 in total)

Other measures to address possible market concerns

- Strengthen market education
- Enhance market surveillance system to monitor and detect any irregular market activity
- Allow adequate time for rollout preparation

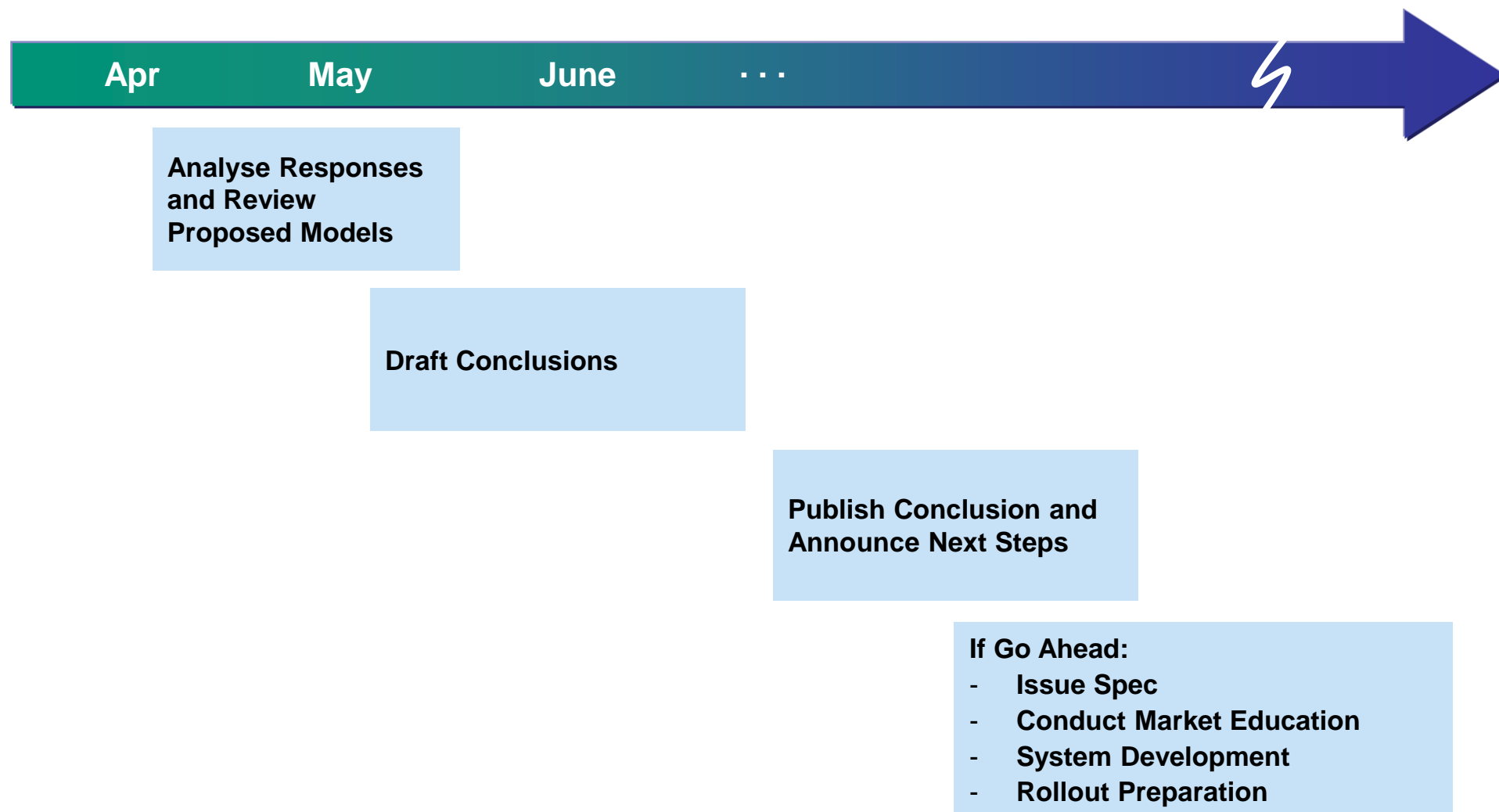
Key points for consideration



- What securities should CAS be applied to?
- The price limit – should it be greater than, same as, or smaller than the 5% proposed?
- Duration of CAS: 12 minutes as proposed or shorter?
- Should the rollout be in phases?
- When should be phase 2 and if it should be subject to a separate consultation?
- Should we implement CAS/VCM first, or together with Trading Halts?

Doing the right implementation at the right time to benefit the whole market

Next steps – tentative timeline



We will work closely with the market participants to ensure a successful implementation

Any Questions?