

19 January 2017

## **HKEX Chief Executive Charles Li's Elaboration on HKEX's Key Initiatives in 2017 Presented at the Annual Media Luncheon**

### **1. Why should Hong Kong consider a New Board? How will the New Board differ from the Main Board and Growth Enterprise Market (GEM)?**

HKEX continuously seeks ways to strengthen the competitiveness of the Hong Kong financial market.

In recent years, we have noticed demand for greater market segmentation to meet the needs of established international companies as well as emerging, new-economy companies. There is also demand among investors for a greater selection of listed companies in Hong Kong while also maintaining our high standards of investor protection.

At the moment, our market is skewed towards Mainland issuers and companies from the financial sector. With the continuous opening of China's economy and liberation of the Mainland's financial market, it is imperative that Hong Kong expand its financing capacity to companies at different development stages and provide investors with a wide range of investment opportunities across a broad spectrum of sectors, from both the Mainland and abroad, so that Hong Kong can further secure its position as an equities leader and a market of choice for both Mainland and international investors and issuers.

We are in the process of formulating proposals, including what can be done to attract our target issuers, investor eligibility requirements, initial and ongoing listing requirements, investor protection measures, and more. We are also in discussion with our regulators and plan to consult the market in due course. We believe the final proposals will be in the best interest of Hong Kong and further enhance our market. No timetable for the consultation paper has been confirmed.

### **2. What would come next under the Connect programme after Shenzhen-Hong Kong Stock Connect? What would be the scope and timetable?**

#### Stock Connect Extension

##### - ETF Connect

We are working with our Mainland counterparts to include ETFs in the Connect programme. Given Mainland investors' growing demand for asset diversification, including ETFs in the scheme will provide additional investment opportunities for Southbound investors. Therefore, it is strategically important for Hong Kong as a wealth management centre.

Due to the differences in settlement arrangements between stocks and listed funds on the Mainland, including ETF in the scheme will involve system development and operational issues. We are working with our Connect counterparts on a model.

The launch of ETF Connect is subject to the regulators' approval of the specific scope of the project, the resolution of related technical issues, and the technical readiness of market participants.

- Holiday Trading

Under a quick win model we are studying, investors would be allowed to sell stocks under Stock Connect's Northbound channels on Hong Kong holidays that are trading days on the Mainland if the Mainland regulator allows. Hong Kong brokers could participate in holiday trading on a voluntary basis. Northbound trading investors would benefit through reduced holding risk.

Our long-term aim is to make both buying and selling of Connect stocks possible on Hong Kong's holidays that are trading days on the Mainland but requires the support of clearing banks, which are not ready to provide such support at this time.

Primary Connect

Primary Connect would bring several benefits. It would be the fastest way for the Mainland to leverage Hong Kong's unique advantages to quickly meet the needs of Mainland investors who have been seeking to internationalise their asset allocation. It would also give overseas investors access to new A-share listings, leading to a more diverse group of investors in the Mainland market.

Primary Connect could fundamentally change Hong Kong's proposition as a listing centre for international issuers while enhancing the appeal of the Southbound channels of Shanghai and Shenzhen Connect.

Bond Connect

Bond Connect would give us a much bigger role in a significant asset class and strengthen Hong Kong's position as an international financial centre. We are considering a Bond Connect model that is built around off-exchange trading with a focus on the institutional bond market. The aim is to provide cross-border cash bond trading and settlement connectivity with the Mainland's major onshore bond market infrastructures. We are confident that we can deliver a unique value proposition to make existing markets connect better, without trying to reinvent the way that investors currently trade bonds. We hope to provide further details about Bond Connect this year, potentially together with our initiative on Mainland Ministry of Finance T-bond futures.

Commodities Connect

There are a few possible ways to extend the Connect concept to commodities, including mutual market access (like Stock Connect) and cross-listing. We are leveraging on our experience with the London Metal Exchange to build a spot commodities trading platform in Shenzhen's Qianhai Economic Zone. Once the Qianhai platform is up and running, we will look at ways to connect it with the LME to provide new opportunities to players that are active in both the Mainland's domestic markets and international markets.

### **3. What are your plans on new products this year?**

We are planning to introduce a number of products this year.

#### Equity and Equity Derivatives

We will expand the scope of the underlying assets of Leveraged and Inverse Products and plan to conduct a thorough review of the market making programme with the aim of boosting liquidity across the ETF platform.

We continue to look at opportunities to develop Mainland-related equity derivatives as international appetite continues to increase. Investors' demand for such risk management tools has grown, particularly since the launch of Stock Connect.

We also plan to develop weekly index options tied to the Hang Seng Index (HSI) and H-shares index (HHI). They will be complementary to the current monthly HSI and HHI options. Weekly index options have low premiums and are used to manage event risk.

#### Commodities

On commodities front, we are planning to launch gold products in both Hong Kong and London this year.

In Hong Kong, we are preparing physically settled gold futures contracts denominated in USD and CNH, a first of their kind in Hong Kong. The product is currently under the SFC's review and we are in talks with market participants to prepare for the rollout.

Our gold futures is developed with an aim to establish a local gold future benchmark in Hong Kong. It will represent a convergence of futures prices with spot market prices, thus rendering the contracts relevant to the hedging needs of end users and investors. Dual-currency contracts will generate an implied USD/CNH FX rate as the contracts have the same underlying asset. Thus it's not only a commodities contract, but a commodities contract wrapped in interest rate and exchange rate futures. The new futures will have strong synergy with our existing RMB products like USD/CNH futures and offer various arbitrage opportunities for market players.

The LME announced on 9 August 2016 that the World Gold Council and key market participants had expressed their intention to join the LME in introducing a suite of exchange-traded and centrally-cleared precious metals products called LMEprecious. The launch is expected in the first half of 2017, pending regulatory approval. The initiative has been driven by the need for greater market transparency, to support and aid ongoing regulatory change, provide additional robustness to the precious metals market, broaden market access, make trading more capital efficient and trade lifecycle management easier. LMEprecious will be developed to accommodate the interests of the full range of market stakeholders and to reinforce the strengths of the London market.

We are pleased to see LME steel scrap and rebar volumes begin to thrive, which we view as representative of the growing support from the industry since the ferrous products' launch in November 2015. We are keen to build on this success and are considering the

expansion of our ferrous suite to include other cash-settled contracts such as hot-rolled coil in London.

We are also targeting to launch index-linked and cash-settled iron ore futures in Hong Kong this year, subject to regulatory approval. It is part of our commodities strategy to enrich our product offerings and provide a risk management and trading platform to both Mainland and international investors. The product will be USD-denominated.

There is a highly liquid exchange-traded iron ore futures market in the Mainland. In the offshore market, however, most of the liquidity is in the OTC market and transactions are done via voice broking. The aim behind our exchange-traded product is to help improve the price transparency and price discovery process in offshore iron ore trading. With the transparency and efficiency of exchange trading, the market can expect a more timely and effective interaction between the onshore and offshore markets.

Currently, the Mainland produces half of the world's crude steel and is the world's single largest iron ore importer and consumer, and it is highly reliant on imported iron ore (more than 80 per cent reliant on imports). Given the high price volatility of iron ore, price risk management is vital for market participants. Our iron ore futures will serve as an effective risk management tool.

#### Fixed Income and Currency Products

We plan to offer RMB Currency Options and are aiming to roll out a USD/CNH contract in late March this year, subject to market readiness. The new options will complement our USD/CNH Futures and other RMB Currency Futures, which lead the world with the best liquidity and distribution among exchanges.

Our USD/CNH Futures volume is often close to 4,000 to 5,000 contracts a day now and we had a peak of over 20,000 contracts in the first week of January.

Usually options are very complementary to futures. The product has already obtained regulatory approval and we will organise training sessions for our Exchange Participants this month.

We are also planning to launch Mainland Ministry of Finance T-bond futures before the end of the first half of 2017, subject to SFC approval. This product is critical for HKEX to build some new fixed income capability and will be a fantastic proxy for hedging onshore CNY bond risk. Once regulatory approval is obtained we will communicate with the market on the product's launch date. We expect the product to attract investors from the global fixed income market to our market.

In the summer or the third quarter of 2017, we plan to introduce futures on our co-branded RMB index, which tracks the performance of CNH against a basket of currencies.

#### OTC Clearing

We plan to expand OTC Clearing's services in 2017. In the pipeline are the acceptance of non-cash collateral (eg, government bonds such as Exchange Fund Notes and T-

bonds), the introduction of client clearing and additional clearing services (eg, clearing of non-deliverable interest rate swaps denominated in Asian currencies).

#### **4. What are your market structure plans for 2017?**

We introduced our Closing Auction Session (CAS) for securities on 25 July last year, when we said the second phase of the CAS would be rolled out after a review, tentatively planned for six months after Phase 1. Phase 1 has been smooth and meet institutional needs for execution at close. We now considering to allowing regulated short selling orders during the CAS; and inclusion of more stocks in the CAS.

To safeguard market integrity, our Volatility Control Mechanism (VCM) for securities was introduced on 22 August 2016 and we rolled out our VCM for derivatives on Monday of this week. The VCM only applies to the 81 constituent stocks of the Hang Seng Index (HSI) and the Hang Seng China Enterprise Index (HSCEI, or H-shares index); the spot month and next calendar month of HSI and H-shares index futures contracts, and the futures contracts' respective mini contracts. HKEX has no plans at this time to include more securities or derivatives market products to the list of products subject to the VCM.

We are looking at extending the trading hours and expanding the products in the After Hours Futures Trading (AHFT) session as volume of AHFT continues to grow. Our statistics show AHFT trading volume equaled 7.82 per cent of the derivatives markets' morning and afternoon volume in 2015 and the percentage rose to 12.42 per cent in 2016. We plan to consult the market in the middle of the year on extending AHFT by phases and including HSI Options.

We believe enhanced AHFT will bring new business to the brokerage industry in Hong Kong; it will help investors by enabling them to hedge or adjust their positions in response to financial news or events during the business day in Europe and much of the business day in the US; and it will bolster the overall competitiveness of the Hong Kong market by providing more time to trade global asset classes such as currencies, interest rate and commodities.

In the third quarter of this year, we plan to consult the market on aligning the securities market's Pre-opening Session and the CAS. The consultation will also cover the arrangements for mid-session auction upon the lifting of a trading halt following a listed issuer's release of inside information during securities market trading hours.

In a consultation concluded in 2013, a majority of respondents supported the proposal to allow listed issuers to release inside information during trading hours subject to a short trading halt. We concluded then that a single price auction should take place in the securities market for the relevant stocks and any related structured products upon the lifting of the trading halt to facilitate price discovery. The changes we envision would align us the practices of some of the major overseas markets.

## 5. Do you plan to upgrade your market infrastructure in 2017?

We are upgrading our market engines in both Hong Kong and London.

### Orion Trading Platform for the securities market

We plan to implement the Orion Trading Platform (OTP) for our securities market, which is scheduled for launch in the fourth quarter of this year. The new platform has been developed based on open systems technology to give it the flexibility to support new functionalities and increased capacity requirements in the next decade. The current trading platform was introduced in 2000 and has had some major upgrades over the years. Rollout of OTP mainly involves changes of HKEX's host system. As all Exchange Participants (EPs) are connecting with the HKEX trading engine via the Orion Central Gateway, they are not expected to have to make major changes to their systems. EPs will be required to participate in the market rehearsals before the system rollout. OTP's new functionalities will be introduced in phases after it replaces the current system.

### Genium upgrade for the derivatives markets

Genium is technology provided by Nasdaq that is used for the HKATS and DCASS systems we use for our derivatives trading and clearing. An upgrade to this technology is planned for this year and we are tentatively scheduled to implement it in the third quarter of 2018. The new version of Genium will ensure our derivatives market operates with the latest technology and has an up-to-date set of business functionalities. The existing version was introduced in 2013 and has had a few minor enhancements in the past few years. The underlying OAPI protocol will be preserved and the new version is not expected to require major changes to Exchange Participant systems although a web based frontend will replace the existing workstation software. After the upgrade, Exchange Participants will no longer be required to install Network Gateways in their premises. Under the new arrangements, they will connect to Central Gateways located at the HKEX data centres. Participants should be prepared to have their systems ready for market rehearsals around mid-2018. Details of the OAPI changes and web based frontend as well as other technical details for the implementation of the upgraded Genium will be made available in due course.

### Next Generation Clearing

Over the course of the next three to four years we will be significantly upgrading most areas of our post trade infrastructure. Our drivers are simple – *reduce cost* for the market as a whole, *reduce risk* for the market as a whole, *improve service* by the exchange, and provide *tools for our participants and customers to better manage and control their business*.

Our Next Generation Clearing initiative is more than a refresh of existing technology. We aim to make significant enhancement in technology, risk models and business processes in this upgrade.

In 2016 we started to look at the role new technologies (such as cloud computing and distributed ledger) can play in our future development and this will continue in 2017 when we will determine our NextGen roadmap.

#### System upgrades in London

The LME and LME Clear will be upgrading their electronic trading system (LMEselect 9), matching system (LMEsmart) and clearing system (LMEmercury) this year. Some of the new features of these upgrades will include dynamic price limits, lower latency, new and improved market data distribution, and the introduction of 'Flex' – a tailored solution for trading monthly averages.

#### **6. What is the latest on the development of HKEX's commodities venture in Qianhai?**

We are currently preparing to establish a spot commodities trading platform in Qianhai, Shenzhen, a newly developed Mainland Free Trade Zone near Hong Kong.

Leveraging on the LME's successful model and our experience in Mainland China, we aim to "physicalise" the Mainland's commodities market and create an effective platform which has close ties to the Mainland's physical markets just like the LME's close ties to its corresponding physical markets.

In time, the platform could generate a series of truly representative and globally influential "China price" benchmarks and provide a solid foundation for commodity futures trading either on the Mainland or in global markets including Hong Kong.

HKEX is continuing to seek all necessary approvals to operate a spot commodities trading platform in Qianhai.

We aim to provide a sophisticated trading venue with related infrastructure and offer various trading models along with settlement, physical delivery, financing, logistics, information services, etc. The market will include commodities users as well as intermediaries that provide trading, logistics and financing services.

We have largely completed the development of the IT systems and have started internal testing. We are also in talks with leading warehouse companies on the Mainland about potential partnerships. We expect to launch the platform this year.