

Markets

We supervise and monitor exchanges, clearing houses, share registrars and automated trading services (ATS) in Hong Kong to ensure orderly markets. We introduce measures to improve market infrastructure and support Hong Kong's development as a premier risk management centre.

Supervision of HKEX

Volatility control mechanism

Following our approval, the Stock Exchange of Hong Kong Limited (SEHK) introduced initial enhancements to its volatility control mechanism to cover more securities in May 2020. Further enhancements, implemented in March 2021 after our approval, allow multiple triggers of the volatility control mechanism during a trading session. Separately, the introduction of a market-wide circuit breaker is still being studied.

Derivatives market suspension

We reviewed Hong Kong Exchanges and Clearing Limited's (HKEX) suspension of the derivatives market in September 2019 and requested that it take necessary measures to enhance system resilience and adopt our recommendations in areas such as prevention, system monitoring, mitigation and communication. We closely monitored how HKEX implemented the remedial measures and ensured that our recommendations were fully adopted. In December 2020, HKEX issued a report on the incident which included its response to our recommendations.

OTC derivatives

In line with the G20 commitments to reform the over-the-counter (OTC) derivatives market, an OTC derivatives regulatory regime is being implemented in phases in Hong Kong¹. We continue to work on improvements to the regime, such as enhancing data quality and promoting data harmonisation in trade reporting.

Investor identification

In December 2020, we launched a consultation on the introduction of a trading-level investor identification regime for the Hong Kong securities market and an OTC securities transactions reporting regime for shares listed on SEHK². The proposals aim to enhance our market surveillance function by facilitating the identification of investors placing securities orders and by collecting data on off-exchange securities transactions. This would help ensure market integrity and put us on par with developments in major overseas jurisdictions.



Uncertificated securities market

Following the conclusion in April 2020 of a joint consultation with HKEX and the Federation of Share Registrars Limited on a proposed operational model for an uncertificated, or paperless, securities market, we worked with the Government to prepare the necessary legislative changes. This initiative will make securities-related transactions, including initial public offerings and corporate actions, more efficient and cost-effective.

¹ See more on the OTC derivatives licensing regime on page 48.

² The consultation closed in March 2021.

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Stock Connect

Mainland-Hong Kong Stock Connect enables mutual market access and provides a unique opportunity for Hong Kong and Mainland investors to trade eligible stocks in each other's markets.

As of 31 March 2021, Stock Connect covered 1,472 Mainland stocks and 519 Hong Kong stocks, representing about 80% of the combined market capitalisation of the two markets. Net inflows since the programme's launch amounted to RMB1,835.4 billion for southbound trading and RMB1,302.2 billion for northbound trading.

The share of Hong Kong market turnover attributable to Stock Connect is significant and growing. On

Mainland-Hong Kong Stock Connect

RMB 1,835.4 billion

Southbound net inflows since launch

average, daily southbound trading was 14% of total trading in the Hong Kong stock market during January to March 2021, compared to 9% in 2020 and 6% in 2019.

Northbound trading was 7% of the Mainland market total in the first three months of 2021, 5% in 2020 and 4% in 2019.

Trends in Stock Connect

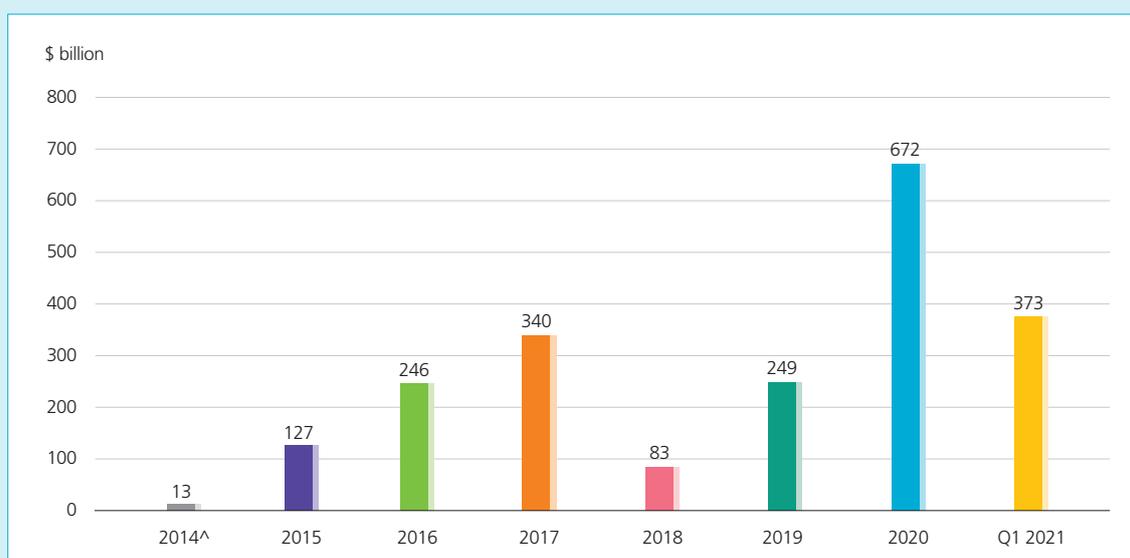
Since the launch of Stock Connect in November 2014, southbound trading has accounted for an increasing share of the Hong Kong market.

Southbound net inflows reached a total of \$672.1 billion for 2020. This was an annual record high and almost double the previous record in 2017.

Since March 2019, southbound net inflows were recorded for 24 consecutive months and southbound net buy remained positive.

For Mainland investors, Stock Connect provides a channel to broaden the scope of their investments and reduce risk through portfolio diversification. They have shown strong interest in buying large-cap stocks listed in Hong Kong and southbound inflows to leading technology stocks have been particularly significant.

Annual southbound net buy since the launch of Stock Connect



[^] Shanghai-Hong Kong Stock Connect launched on 17 November 2014.

Investor compensation

During the year, the Investor Compensation Company Limited, a wholly-owned SFC subsidiary, received 39 claims against the Investor Compensation Fund and processed 24 claims.

New derivatives products approved

Following our approval, HKEX launched 40 MSCI index futures and options contracts in July, August and September 2020 and March 2021. Referencing the performance of Asia and other emerging market indices, these contracts expand HKEX's derivatives product range and provide more trading and hedging tools for market participants.

We also approved HKEX's proposals for Hang Seng TECH Index futures and options contracts to meet the market's need for an exposure management tool covering the technology sector and the Mini USD/CNH

futures contract to enhance their currency product suite. The Hang Seng TECH Index futures and options contracts were launched in November 2020 and January 2021 respectively, while the Mini USD/CNH futures contract was launched in April 2021.

Bond Connect

Bond Connect, which facilitates northbound trading into the China Interbank Bond Market, recorded persistently strong growth in 2020. Total trading volume reached RMB4,810 billion, representing an 82.8% increase from 2019. The number of eligible foreign investors admitted for trading was up 46.9% to 2,352 from 1,601 as at end-2019. The Bond Connect Company Limited launched a new ePrime system to facilitate the primary market offering of offshore bonds (including Kungfu bonds and Dimsum bonds) in October 2020 after consulting us.

Investor compensation claims

	2020/21	2019/20	2018/19
Received	39	7	5
Processed	24	4	10
– Compensation payments made	0	0	0
– Rejected	21	0	7
– Withdrawn	3	4	2
– Reconsidered	0	0	1

Net asset value of compensation funds

	As at 31.3.2021 (\$ million)	Change	As at 31.3.2020 (\$ million)	Change	As at 31.3.2019 (\$ million)
Unified Exchange Compensation Fund ^a	86.1	5%	82	3.4%	79.3
Investor Compensation Fund ^b	2,444.1	0.65%	2,428.3	1.5%	2,391.5
Total	2,530.2	0.79%	2,510.3	1.6%	2,470.8

a See pages 145-158 for the financial statements of the Unified Exchange Compensation Fund (UECF). The Investor Compensation Fund (ICF) was established by the Securities and Futures Ordinance on 1 April 2003 to replace the UECF. After settlement of all claims against the UECF and its other liabilities, any remaining balance will be transferred to the ICF.

b See pages 132-144 for the financial statements of the ICF.

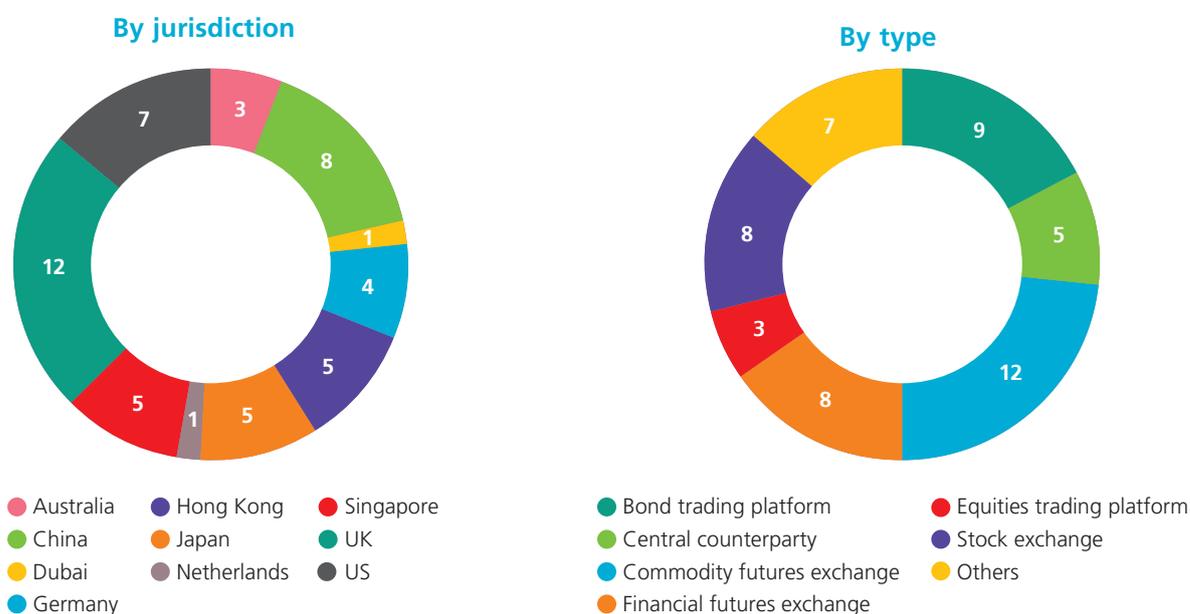
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Automated trading services

Under the Securities and Futures Ordinance (SFO), two regimes regulate ATS providers. Generally, those that offer facilities similar to those of a traditional exchange or a clearing house are authorised under Part III of the SFO. Intermediaries which provide traditional dealer functions along with ATS as an added facility (eg, operating a dark pool or a pre-IPO trading platform) are expected to be licensed under Part V of the SFO.

Trades conducted on authorised trading venues were in products ranging from benchmark index futures and options, commodity futures, bonds, equities and exchange-traded funds offered by overseas exchanges. The average daily trading volume of futures contracts originating from Hong Kong was about 433,000 contracts for the 12 months ended 31 March 2021.

ATS providers under Part III



ATS providers

	As at 31.3.2021	As at 31.3.2020	As at 31.3.2019
Under Part III	51	54	50
Under Part V	24	25	24

Short position reporting

	As at 31.3.2021	As at 31.3.2020	As at 31.3.2019
Market value of short positions as a percentage of total market capitalisation	1.16%	1.24%	1.42%