Markets

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

Supervising HKEX

Infrastructure

We closely monitor and supervise the system operations and infrastructure-related initiatives of Hong Kong Exchanges and Clearing Limited (HKEX). During the year, HKEX relocated its cash market's clearing system to a new secondary data centre to enhance system integrity. It also expanded the coverage of the Volatility Control Mechanism to Hang Seng TECH Index futures contracts.

On-site inspection

As part of our ongoing supervision of the non-listing-related operations of HKEX, we completed an on-site inspection of its information technology project management and system operations during the period from 1 January 2020 to 31 December 2021 and recommended improvements during the year.

New trading fee structure and risk models for cash market

In October 2022, we approved HKEX's proposal to enhance its trading fee structure for the cash market. Effective January 2023, the previous trading tariff of $0.50 payable on each trade was removed and the trading fee per side of a trade was adjusted to 0.00565% from the previous 0.005%.

Hong Kong's stock exchange ranked seventh globally[1]

Market capitalisation[2]: US$4,700.9 billion

Mr Rico Leung, Executive Director of Supervision of Markets, speaks in the video "Unlocking Investor ID" for the public

After our approval, HKEX implemented new risk models in June 2022 which strengthen the resilience of the cash market clearing house. The initial margin and default fund requirements for its clearing participants were more precisely sized based on a wide range of stress scenarios and to better align with international standards.

Risk management of the futures market

To address a recommendation from the Financial Sector Assessment Program's[3] report and better align with international standards, we requested HKEX to revise its sizing methodology for the default fund of the futures market from covering risk exposures of "the first plus fifth largest clearing participants (CPs)" to "the first plus second largest CP Groups" (ie, Cover 2), which can provide more financial resources to support the clearing house and strengthen its resilience. The enhancement was implemented in April 2023.

Holiday trading on derivatives market

Following our approval of exchange and clearing house rule amendments, holiday trading on the derivatives market commenced in May 2022. The market has been operating smoothly on holiday trading days[4].

New quotation rules for exchange-traded products

Under the new dual-limit quotation rules for trading exchange-traded products (ETPs)[5] which came into effect in March 2023, ETP orders inputted to the trading system of the Stock Exchange of Hong Kong

1 In terms of market capitalisation (source: World Federation of Exchanges).
2 As of 31 March 2023.
3 Conducted by the International Monetary Fund, the Financial Sector Assessment Program provides an analysis of the resilience of a country's financial sector.
4 There were 10 holiday trading days from 1 April 2022 to 31 March 2023.
5 ETPs include exchange-traded funds and leveraged and inverse products.

Limited (SEHK) during the continuous trading session will be validated against the greater of the old 24-spread limit or a new spread which is 3.5% from the reference price. The new rules strengthen the pre-trade price controls for ETP market making orders while providing sufficient flexibility for ETP market makers to quote prices.

New derivatives products

In November 2022, we approved the Hang Seng TECH Index Futures Options contract proposed by HKEX and it commenced trading in the same month. The contract expanded HKEX's Hang Seng TECH product suite and will help better meet the trading and hedging needs of market participants.

Expanding mutual market access

Stock Connect

Introduced in November 2014, 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 2023, Stock Connect covered 2,526 Mainland stocks and 561 Hong Kong stocks, representing about 86% of the two markets' combined market capitalisation. Since the launch of the programme, net inflows reached RMB2,310 billion for southbound trading and RMB1,910.5 billion for northbound trading.

The share of Hong Kong market turnover attributable to Stock Connect remained large. On average, daily southbound trading accounted for nearly 15% of total trading in the Hong Kong stock market during January to March 2023, compared to some 13% in both 2022 and 2021. Northbound trading was 6% of the Mainland market total during January to March 2023, compared to the 5% in 2022 and 6% in 2021.

In August 2022, we jointly announced with the China Securities Regulatory Commission (CSRC) the in-principle approval of enhancements to the trading calendars for both northbound and southbound trading. Coming into effect on 24 April 2023, the adjustments enable Stock Connect trading on all days when both the Mainland and Hong Kong markets are open.

Stock Connect net inflows since launch[6]

Southbound: RMB**2,310** billion

Northbound: RMB**1,910.5** billion

To further strengthen mutual market access and provide additional market liquidity, we and the CSRC announced in December 2022 our in-principle approval for the expansion of eligible stocks for northbound and southbound trading such as including foreign companies primary-listed in Hong Kong that meet relevant criteria for southbound trading. The expansion was implemented on 13 March 2023 and since then stocks eligible for Stock Connect have accounted for more than 80% of the equity trading in each market.

Bond Connect

Bond Connect, a mutual bond market access programme, marked its fifth anniversary in July 2022. During the year, northbound Bond Connect maintained steady growth with total trading volume increasing to RMB8 trillion, an increase of about 19% compared to the year before. There were 784 approved foreign institutional investors admitted for trading as at end-2022.

In July 2022, northbound primary service was introduced to facilitate global investors to participate in the cross-border subscription of new bond issuances in the China Interbank Bond Market.

Swap Connect

The SFC, the People's Bank of China and the Hong Kong Monetary Authority (HKMA) jointly announced in July 2022 the development of Swap Connect, which was launched on 15 May 2023 with the commencement of northbound access at the initial stage. Through connections between the financial infrastructures in both places, northbound access enables offshore investors to execute interest rate derivatives transactions with onshore investors in Mainland China as a means to manage interest rate risks arising from investments in the Mainland bond market.

6 As of 31 March 2023.

Enhancing local market infrastructure

Investor identification

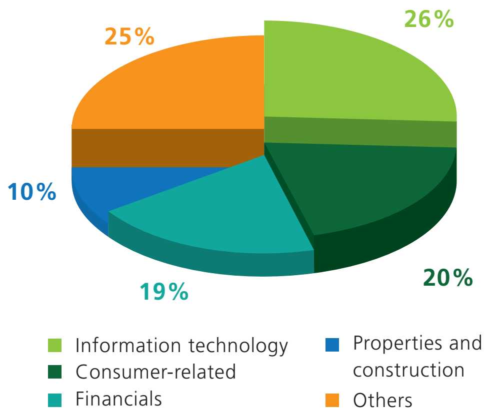
On 20 March 2023, we launched the investor identification regime for the Hong Kong securities market[7]. The over-the-counter (OTC) securities transactions reporting regime for shares listed on SEHK will be launched in September 2023. By enabling us to identify investors in a timely manner, the new regimes help facilitate more effective market surveillance. To support intermediaries in preparing for the new regimes, we closely monitored market readiness and arranged an end-to-end test and market rehearsals for intermediaries to test their system connectivity and readiness.

We commenced a multi-media publicity campaign[8] in August 2022 to raise the public's and the industry's awareness of the new regimes.

Uncertificated securities market

We have been working with HKEX and the Federation of Share Registrars Limited (FSR) on developing the technical details and specifications of the operational model for implementing an uncertificated, or paperless, securities market in Hong Kong. In March 2023, we issued a consultation paper on the subsidiary legislation to support that model. (See sidebar on page 54.)

Distribution of Hong Kong stocks by sector in terms of market capitalisation as of end-2022



Position limits

To help maintain market stability in light of recent developments in Hong Kong's derivatives market, we issued a consultation paper in April 2022 on proposed changes to the position limits regime for listed futures and options contracts. A key proposal is to set out how the statutory prescribed limits and reporting requirements should be applied to unit trusts and sub-funds under an umbrella fund.

After considering the market feedback, we concluded in November 2022 to proceed with some of the proposals, including expanding the list of specified contracts for excess position limits and introducing an excess position limit regime for clearing participants.


SECURITIES AND FUTURES COMMISSION
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Tips on the Investor Identification Regime

You may have received a notification from your broker and bank asking you to sign a consent form and update your personal information. If you are unsure what to do, here is some practical information which may help.

What is the Investor Identification Regime?

The Hong Kong Investor Identification Regime and the Over-the-counter Securities Transactions Reporting Regime, collectively known as the Investor Identification Regime, will enhance the market surveillance function of the Securities and Futures Commission (SFC) by identifying the underlying investors of orders.

Under the regime, brokers and banks will need to submit their clients' identity document information to Hong Kong Exchanges and Clearing Limited (HKEX) and the SFC. If you are an individual client, your information to be submitted will include your full name as shown on your identity document and the place of issue, type and number of the identity document.

1

If you are a holder of Hong Kong Identity Card, but used a different identity document when you opened your account, your broker or bank will contact you to update your identity document information.

To comply with the Personal Data (Privacy) Ordinance and the SFC's requirements, brokers and banks will need your signed consent before submitting your identity document information to HKEX and the SFC.

The new regime will take effect by the end of 2022 at the earliest. Preparations are well underway, and that is why you may have received a notification from your broker and bank.

2

Should I sign the client consent? What would happen if I do not sign it?

The client consent authorises your broker and bank to submit your identity document information to HKEX and the SFC as required under the Investor Identification Regime.

Without your signed consent, your broker and bank would not be able to submit your identity document information to HKEX and the SFC. Following the implementation of the regime, they would also not be able to buy or deposit stocks for you. You would only be able to sell or withdraw the stocks you hold.

3

Will my identity document information be kept confidential?

All of your identity document information will be encrypted and kept in the secured data repositories of HKEX and the SFC. Moreover, it will only be accessible by authorised HKEX and the SFC personnel on need-to-know basis.

If the elderly in your family have a stock account, you should share this information to help them understand the importance of the new requirements and what they need to do.

Investor Identification Regime dedicated webpage

"Unlocking Investor ID" short video

4

SFC pamphlet introduces the investor identification regime

7 Under the investor identification regime, relevant intermediaries are required to assign a unique identification code–"Broker-to-Client Assigned Number" (BCAN)–to their direct clients and tag the BCAN to an on-exchange order or off-exchange trade reportable to SEHK. Each BCAN must be mapped to the client's identification information data (CID), and relevant intermediaries need to provide the BCAN-CID mapping files to SEHK.

8 See Communications and Education on pages 70-75.

A paperless securities market for the benefit of all

With a settlement efficiency rate of over 99.9%, the Hong Kong securities market is one of the world's most efficient. However, the law remains rooted in paper requirements and manual processes. The introduction of an uncertificated securities market seeks to remove these where possible and enable electronic alternatives, making the process of holding and transferring legal title to shares and certain other securities in investors' own names more convenient, efficient and environmentally friendly.

How will the new initiative benefit investors and the market as a whole?

Investors

Currently, investors face a dilemma. They can hold and transfer shares in their own names, but in paper form. This provides better protection but is less efficient[a]. Alternatively, they can hold and transfer shares electronically within the Central Clearing and Settlement System (CCASS), but in the name of the central nominee, HKSCC Nominees Limited. This is much more efficient[b]. The introduction of an uncertificated securities market will help address this dilemma by giving investors the option to hold and transfer shares electronically *and* in their own names. They will thus be able to enjoy both better protection and greater efficiency.

Intermediaries

The operational model for the uncertificated securities market retains the existing CCASS nominee structure, thus preserving existing settlement practices and leaving many of the current CCASS processes largely unchanged. As a result, the need for system enhancements will be limited, which also means the cost impact on intermediaries should not be substantial. Intermediaries may also benefit from cost savings as they will no longer need to physically deliver certificates and instruments of transfer to share registrars.

Issuers

As more investors opt to hold shares in their own names, issuers will benefit from greater shareholder transparency as well as improved communications and better relations with their investor base. The removal of paper documents and processes will also have cost benefits for issuers over the long term.

The wider market and society

On a broader scale, the move to a paperless market will enhance Hong Kong's financial market infrastructure and pave the way for greater integration with other markets. Using less paper and eliminating manual processes will also promote greener practices and reduce carbon footprints.

The move to an uncertificated securities market is planned for around mid-2025. Together with HKEX and the FSR, we will engage the industry and market participants to help them prepare for the new regime.

a This allows them to enjoy better shareholder rights and protection, but also requires them to deal with manual and paper processes, which can be cumbersome and inefficient.

b This means investors hold only a beneficial interest in their shares, and hence need to rely on intermediaries to enjoy shareholder rights and protection. However, they do not need to deal with manual or paper processes as the process of holding and transferring shares through CCASS is electronic.

At the same time, we further consulted the public on additional amendments related to the application of position limits and reporting requirements for funds and changes to the position limits for some contracts, including stock futures and options. The further consultation ended in December 2022 and a conclusions paper will be published in due course.

OTC derivatives

An OTC derivatives regulatory regime is being implemented in phases in Hong Kong to align with the G20 commitments to reform the OTC derivatives market. In March 2023, we launched a joint consultation with the HKMA on proposed changes to the types of transactions subject to clearing obligations under the Clearing Rules[9] for OTC derivatives. These changes would be in line with global interest rate benchmark reform, particularly the transition from the use of interbank offered rates to alternative reference rates.

In December 2022, enhancements to the reporting templates for OTC derivatives were implemented to keep the OTC derivatives reporting regime relevant and appropriate. Additional calculation periods were added to the clearing rules in March 2023 to extend calculation periods which expired in 2022.

Investor compensation

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

Investor compensation claims

	2022/23	2021/22	2020/21
Balance brought forward	**37**	30	15
Received	**9**	17	39
Processed	**7**	10	24
– Compensation payments made	**0**	0	0
– Rejected	**5**	10	21
– Withdrawn	**2**	0	3
– Reconsidered	**0**	0	0
Balance carried forward	**39**	37	30

Net asset value of compensation funds

	As at 31.3.2023 ($ million)	**Change**	As at 31.3.2022 ($ million)	Change	As at 31.3.2021 ($ million)
Unified Exchange Compensation Fund[a]	**85.8**	**0.1%**	85.7	-0.5%	86.1
Investor Compensation Fund[b]	**2,517**	**2.5%**	2,454.9	0.4%	2,444.1
Total	**2,602.8**	**2.4%**	2,540.6	0.4%	2,530.2

a See pages 162-175 for the financial statements of the Unified Exchange Compensation Fund (UECF). The Investor Compensation Fund (ICF) was established by the Securities and Futures Ordinance (SFO) 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 149-161 for the financial statements of the ICF.

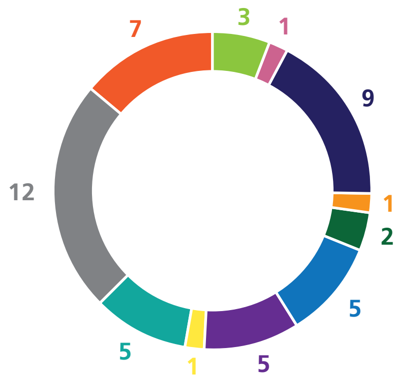
9 The Securities and Futures (OTC Derivative Transactions–Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules.

Automated trading services

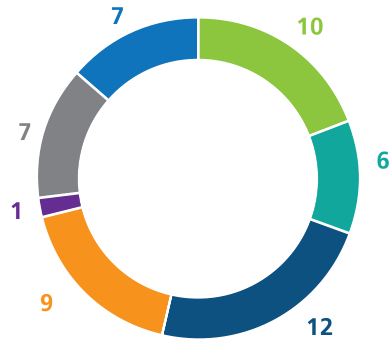
During the year, products traded or cleared through ATS[10] providers ranged from benchmark index futures and options, commodity futures, bonds and equities to exchange-traded funds and OTC derivatives. The average daily trading volume of futures contracts originating from Hong Kong was about 586,000 contracts for the 12 months ended 31 March 2023. We authorised two Part III applications during the year.

ATS providers

By jurisdiction



By type



ATS providers

	As at 31.3.2023	As at 31.3.2022	As at 31.3.2021
Under Part III	**51**	53	51
Under Part V	**28**	25	24

Short position reporting

	As at 31.3.2023	As at 31.3.2022	As at 31.3.2021
Market value of short positions as a percentage of market capitalisation	**1.23%**	1.34%	1.16%

10 Under the SFO, two regimes regulate ATS providers. Typically, 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 dealing services with ATS as an added facility are licensed under Part V of the SFO.