

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.



Mr Rico Leung, Executive Director of Supervision of Markets, at the ISDA Derivatives Trading Forum

Expanding mutual market access

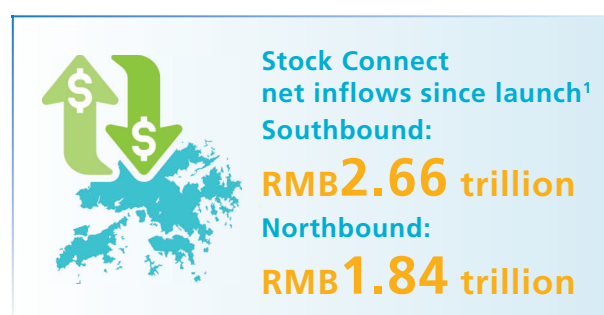
China Treasury bond futures to launch

The amount of China onshore bonds held by offshore investors has increased steadily since the 2017 launch of Bond Connect. With the Mainland authorities' support, the launch of China Treasury Bond Futures in Hong Kong serves as an important risk management tool to facilitate overseas investors' hedging of their China bond holdings and encourage their increased participation in the Mainland bond market. We are making preparations with Hong Kong Exchanges and Clearing Limited (HKEX) for the launch, including reviewing HKEX's proposed rule amendments.

Swap Connect well received

Launched in May 2023, Swap Connect enables offshore investors to access the Mainland CNY interest rate swap (IRS) market more efficiently and better hedge the interest rate risk arising from their investments in the Mainland bond market.

Offshore investors' participation in Swap Connect has recorded steady growth one year into its launch. As of 31 March 2024, there were 50 offshore Swap Connect participants, the majority of which were international banks and asset management firms. For the CNY IRS traded and cleared via Swap Connect, their month-on-month average daily gross notional amount has quadrupled since the programme's launch. We have been working closely with HKEX to introduce further enhancements to the scheme.



Stock Connect enhancements

In August 2023, we announced with the China Securities Regulatory Commission (CSRC) the introduction of block trading (manual trade) under Stock Connect. This new initiative was in response to market demands, paving the way for more trading mechanisms, higher trading efficiency and the mutual development of both securities markets. Once implemented, offshore investors will be able to conduct block trades under Stock Connect on the Shanghai and Shenzhen stock exchanges through the northbound trading link, whilst Mainland investors can report manual trades to the Stock Exchange of Hong Kong Limited through the southbound trading link.

In October 2023, HKEX launched Synapse, a new integrated settlement acceleration platform and the latest enhancement to Stock Connect. This optional service enables northbound Stock Connect participants to streamline their settlement process and reduce operational risks within a tight securities settlement timeframe.

Further enhancements to Stock Connect were announced to raise the scheme's trading efficiency and promote the mutual development of the Mainland and Hong Kong capital markets. These measures include the expansion of the scope of exchange-traded funds (ETFs) and incorporation of real estate investment trusts.

¹ See sidebar on page 67.

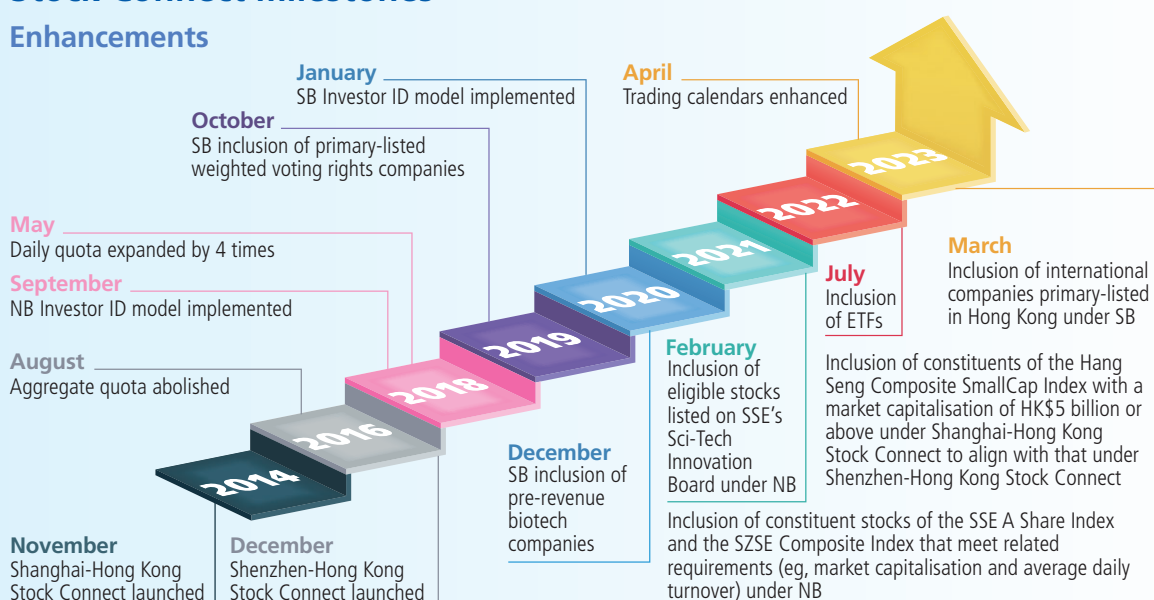
Celebrating a decade of Stock Connect

Year 2024 marks the 10th anniversary of Mainland-Hong Kong Stock Connect. Launched in November 2014, the ground-breaking mutual market access scheme has reshaped the city’s role as the China gateway. With the unique feature of closed-loop securities and fund flows, the scheme has become a preferred channel for investors to trade listed shares in the other market directly through their own local brokers and exchange.

Together with the CSRC, the SFC has introduced a number of important expansions and enhancements through the past decade to promote the steady and healthy development of Stock Connect.

Stock Connect milestones

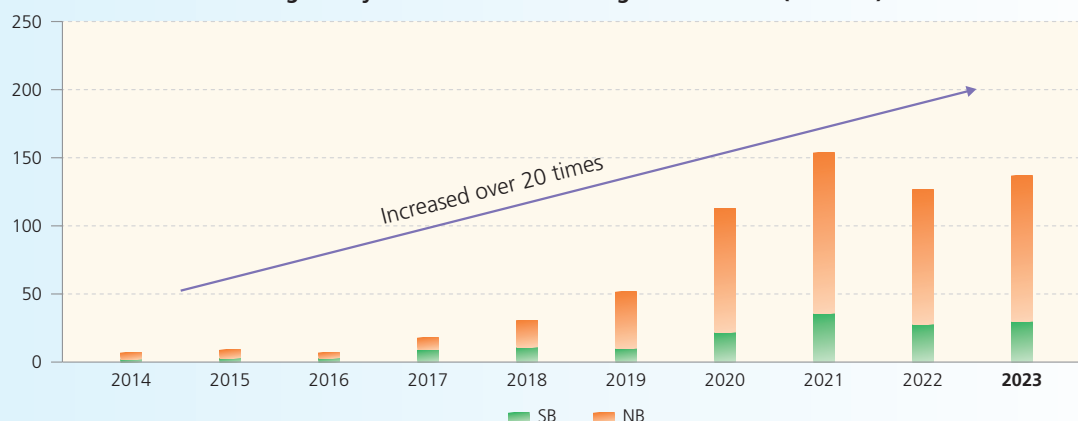
Enhancements



Expansion

Stock Connect has witnessed strong demand, with turnovers and net buys growing rapidly over the past decade. Daily southbound (SB) turnover surged from RMB0.7 billion to RMB28.4 billion from its launch in 2014 to end-2023, whilst daily northbound (NB) turnover jumped from RMB5.6 billion to RMB108.3 billion. During this period, cumulative net buys increased from about RMB0.01 trillion to RMB2.5 trillion for SB trading and from about RMB0.07 trillion to RMB1.8 trillion for NB trading.

Average daily Stock Connect trading since launch (RMB bn)





Officiating guests at the launch ceremony of HKD-RMB Dual Counter Model

HKD-RMB dual counter trading

We promote the issuance and trading of renminbi (RMB)-denominated securities in Hong Kong, working closely with the Hong Kong Monetary Authority (HKMA) and HKEX.

In June 2023, the RMB counters of 24 stocks were launched in Hong Kong, and trading has remained orderly. The average daily turnover of the 24 RMB counters amounted to RMB98.3 million (\$105.1 million) since their launch.

Hong Kong's stock exchange ranked eighth globally²
Market capitalisation³: US\$3.87 trillion

HKD-RMB dual counters allow investors to trade RMB-denominated securities and help strengthen Hong Kong's position as the prime offshore RMB centre. The CSRC announced its support for the inclusion of RMB-denominated stocks into southbound Stock Connect.

Supervising HKEX

Our ongoing supervision of HKEX have focused on a number of initiatives to improve its overall resilience. Last year, we completed an on-site inspection of HKEX's information technology project management and system operations, and made a number of recommendations. We have monitored HKEX's implementation of our recommendations. At our request, HKEX also enhanced the sizing methodology for the default fund in the futures market clearing house to improve its risk management capability.

Short position reporting

	As at 31.3.2024	As at 31.3.2023	As at 31.3.2022
Market value of short positions as a percentage of market capitalisation of reported securities	1.18%	1.23%	1.34%

² In terms of market capitalisation (source: World Federation of Exchanges).

³ As of 31 March 2024.

Enhancing local market infrastructure

Fast Interface for New Issuance (FINI)

The implementation of FINI⁴ in November 2023 was the outcome of our joint effort with HKEX. The implementation was generally smooth, and the settlement process for initial public offerings (IPO) has been shortened from five business days to two, providing investors with quicker access to new listings whilst improving market efficiency. In addition, the new pre-funding arrangements have significantly reduced the “lock-up” period of subscription monies in the banking system. FINI has also prevented multiple subscriptions far more effectively.

Severe weather trading

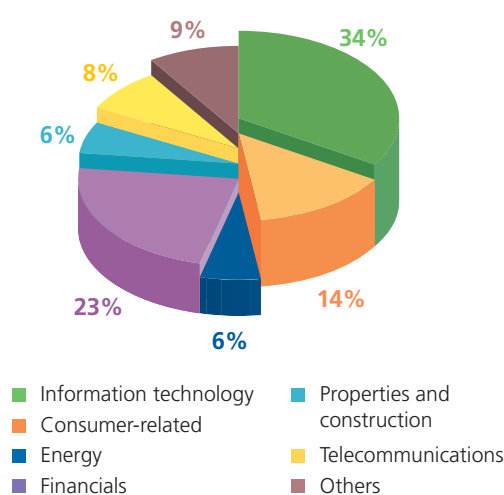
To enhance overall market competitiveness, the SFC, together with the Government, HKMA, HKEX and other industrial associations, established a working group to formulate a proposal to maintain normal operations of Hong Kong’s securities and derivatives markets under severe weather conditions. Based on the working group’s discussions, HKEX launched a two-month consultation to collect market views on the operational model and implementation timeline in November 2023. Taking into account market feedback from the consultation, HKEX is now finalising its proposal and targets to issue consultation conclusions and announce the implementation details around mid-2024.

Uncertificated Securities Market (USM)

We are working towards implementing the USM regime in Hong Kong, which will enable investors to hold securities in their own names without paper documents. Following our March 2023 consultation on subsidiary legislation regarding the technical and operational details of the regime and the regulation

of securities registrars, we launched a further consultation in October on proposed amendments to the code and guidelines for regulating approved securities registrars under the USM environment. We aim to issue a conclusions paper on both consultations later this year.

Market capitalisation of Hang Seng Index constituents by sector[^]



[^] As of end-March 2024.

Position limit

The enhanced position limit regime⁵ became effective in December 2023. The amendments sought to clarify funds-related regulatory requirements, facilitate compliance and provide greater flexibility to the market. Key enhancements included raising the statutory position limits for stock futures, stock options and USD/CNH contracts, expanding the list of “specified contracts” for granting excess position limits, as well as clarifying the application of the laws to the asset managers of funds or sub-funds of umbrella funds. We published an FAQ⁶ and updated the related guidance note to help market participants understand the enhancements.

⁴ FINI is a new digitised platform which allows IPO market participants and regulators to manage the end-to-end settlement process for new listings in Hong Kong.

⁵ Under the Securities and Futures Ordinance, the SFC may prescribe limits on the number of futures and options contracts which a person may, directly or indirectly, hold or control and require a person holding or controlling a reportable position to lodge a notice of that reportable position with a recognised exchange company or the SFC.

⁶ Frequently asked question.

Hong Kong as a risk management centre via mutual market access

Through various Connect schemes, the amount of Mainland investments by international investors has recorded substantial growth, and so has their demand for offshore hedging tools. As the world's leading offshore RMB hub and risk management centre, it is important for Hong Kong to provide the right Mainland-related trading instruments and risk management tools with convenient means of access for international investors.

Swap Connect is a new mutual access programme between the Mainland and Hong Kong interbank IRS markets. Following the launch of Northbound Swap Connect in May 2023, eligible Hong Kong and overseas investors are able to trade CNY IRS on the China Foreign Exchange Trade System (CFETS) with Mainland dealers through a trading link between offshore third-party platforms and CFETS^a. The operation of Swap Connect has been smooth, and the trading and clearing volume has increased steadily. As of 31 March 2024, about 3,200 CNY IRS contracts were traded under Swap Connect.

In the fixed income market, we and HKEX are preparing for the launch of China Treasury bond futures to facilitate international investors' hedging of Mainland interest rate and investment risks, in view of their increased holding of China bonds. Subject to regulatory approval, the Treasury bond futures can add to the suite of Mainland-related risk management tools, encourage further participation by offshore institutional investors in the Mainland bond market and promote its further development.

^a The IRS executed under Swap Connect on CFETS is then submitted to OTC Clear and Interbank Market Clearing House Co., Limited for clearing and settlement. OTC Clear acts as the central counterparty to Hong Kong and overseas investors to clear and settle IRS transactions with Interbank Market Clearing House Co., Limited.

Another key derivatives product to meet investors' demand is the MSCI China A 50 Connect Index futures, launched in October 2021. This has since become an effective tool for international investors to manage the risk of their exposures to Mainland stocks. As at end-March 2024, it recorded an average daily volume of 18,001 contracts and open interest of 12,862 contracts.

As part of our long-term strategy to enhance and expand various Connect schemes, we are working with the CSRC on the launch of MSCI China A 50 Connect Index options to complement the trading of MSCI China A 50 Connect Index futures. We believe the options contract can supplement the existing futures contract and enable market participants to implement more tailored trading and hedging strategies. This will also help drive the launch of more A-share based investment products, thereby boosting the vibrancy of Hong Kong's risk management ecosystem.



OTC derivatives regulation

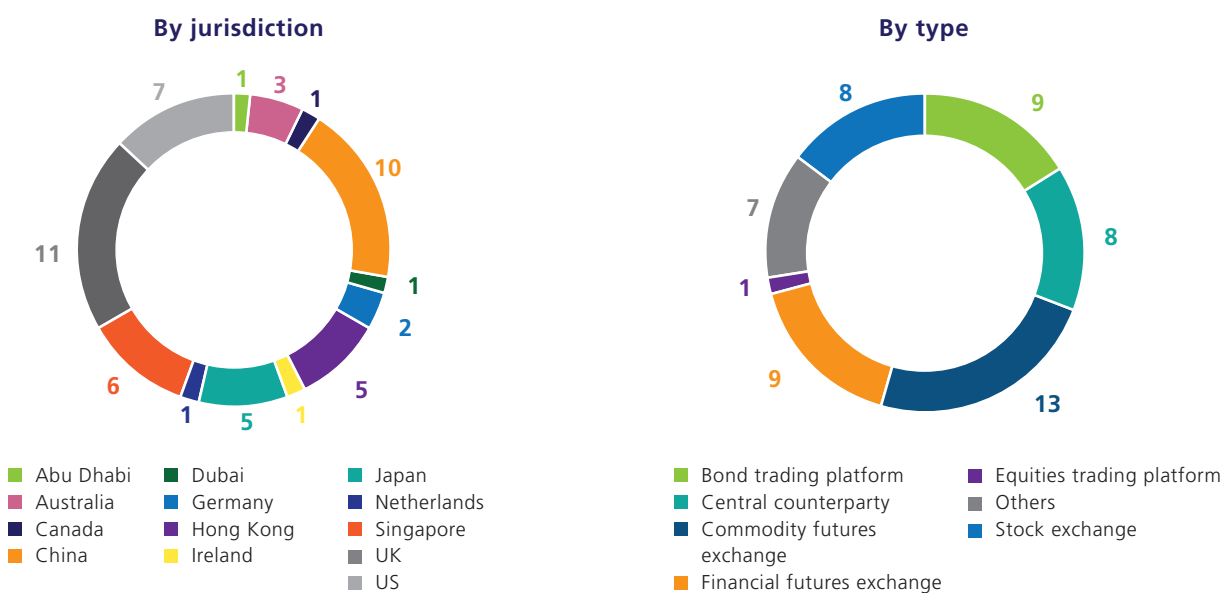
In line with the G20 commitments to reform the over-the-counter (OTC) derivatives market, we have been working with the HKMA and relevant stakeholders on implementing a regulatory regime for the OTC derivatives market in Hong Kong. In April 2023, we launched a joint consultation with the HKMA on the proposed amendments to the Clearing Rules⁷ for OTC derivative transactions. These proposals are in line with the global interest rate benchmark reform, particularly the transition from the use of interbank offered rates to alternative reference rates. We received broad support for our proposals. The legislative process is now complete, with the proposed amendments taking effect in July 2024. We will continue to monitor global developments and fine tune the regime as appropriate.

In March 2024, in a further step to promote global data standardisation and harmonisation, we issued a joint further consultation with the HKMA on enhancing

the OTC derivatives reporting regime. We consulted on mandating the use of Unique Transaction Identifier⁸, Unique Product Identifier⁹ and Critical Data Elements¹⁰, and jointly concluded that the list of designated jurisdictions for the masking relief of the reporting obligation remains unchanged. The consultation period lasted for eight weeks and we are analysing the responses.

ATS

During the year, products traded or cleared through ATS¹¹ providers ranged from benchmark index futures and options, commodity futures, bonds and equities to ETFs and OTC derivatives. The average daily trading volume of futures contracts originating from Hong Kong was about 678,000 contracts for the 12 months ended 31 March 2024. We authorised seven Part III applications during the year.



Operational Review

ATS providers

	As at 31.3.2024	As at 31.3.2023	As at 31.3.2022
Under Part III	54	51	53
Under Part V	29	28	25

⁷ The Securities and Futures (OTC Derivative Transactions — Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules.
⁸ A unique identifier assigned to identify each reported OTC derivatives transaction.
⁹ A unique identifier to denote a specific OTC derivatives product.
¹⁰ These are a standard set of OTC derivatives transaction data elements (other than Unique Transaction Identifier and Unique Product Identifier).
¹¹ Under the Securities and Futures Ordinance (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.

Investor compensation

The current compensation limit is \$500,000 per investor per default. This limit, in place since 1 January 2020, is reviewed regularly. The latest review was completed in the first quarter of 2024, and the results indicated that the current limit remains appropriate.

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

Investor compensation claims

	2023/24	2022/23	2021/22
Balance brought forward	39	37	30
Received	2	9	17
Processed	4	7	10
— Compensation payments made	0	0	0
— Rejected	4	5	10
— Withdrawn	0	2	0
— Reconsidered	0	0	0
Balance carried forward	37	39	37

Net asset value of compensation funds

	As at 31.3.2024 (\$ million)	Change	As at 31.3.2023 (\$ million)	Change	As at 31.3.2022 (\$ million)
Unified Exchange Compensation Fund (UECF) ^a	88.1	2.7%	85.8	0.1%	85.7
Investor Compensation Fund (ICF) ^b	2,636.8	4.8%	2,517.0	2.5%	2,454.9
Total	2,724.9	4.7%	2,602.8	2.4%	2,540.6

^a See pages 193-206 for the financial statements of the 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 180-192 for the financial statements of the ICF.