Markets

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

Supervision of HKEX

On-site inspection

As part of our ongoing supervision of the non-listing-related operations of Hong Kong Exchanges and Clearing Limited (HKEX), we completed an on-site inspection of its futures trading and clearing operations for the period from July 2016 to June 2018 and recommended improvements.

New products

We approved 12 derivative contracts proposed by HKEX to meet the trading and hedging needs of market participants.

Volatility controls

To help mitigate risks caused by extreme price volatility, we worked with HKEX to review its volatility control mechanism and consider the introduction of a market-wide circuit breaker. Following an HKEX public consultation concluded in December 2019, initial enhancements to its volatility control mechanism were implemented in May 2020. The introduction of a market-wide circuit breaker is still being studied.

After-hours futures trading session

In April 2019, we approved HKEX's proposal to extend the closing of the After-Hours Trading Session for the futures market from 1:00am to 3:00am effective 17 June 2019. The extension provides investors with more flexibility to capture investment opportunities and conduct timely risk management in response to events during European and US market hours.

New derivative products

	Trading commencement date
USD London Metal Mini Futures	5 August 2019
– USD London Aluminium Mini Futures	
– USD London Zinc Mini Futures	
– USD London Copper Mini Futures	
– USD London Nickel Mini Futures	
– USD London Tin Mini Futures	
– USD London Lead Mini Futures	
Weekly Index Options	16 September 2019
– Weekly Hang Seng Index Options	
– Weekly Hang Seng China Enterprises Index Options	
Indian Rupee Currency Futures	4 November 2019
– Indian Rupee vs Renminbi (Hong Kong) Futures	
– Indian Rupee vs US Dollar Futures	
Silver Futures	8 June 2020
– USD Silver Futures	
– CNH Silver Futures	

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 Kong. Under the regime, reporting of OTC equity derivative transactions to the Hong Kong Trade Repository (HKTR) is mandatory (see sidebar below).

In April 2019, we launched a joint consultation with the Hong Kong Monetary Authority on enhancements to the OTC derivatives regulatory regime. We proposed implementing unique trade identifiers and mandating their use in transactions to be submitted to the HKTR as well as narrowing the masking relief which allows for counterparty information to be redacted under certain conditions. In addition, we proposed updating the list of financial services providers as an annual exercise, and conclusions on this proposal were published in June 2019 with the revised list effective 1 January 2020.

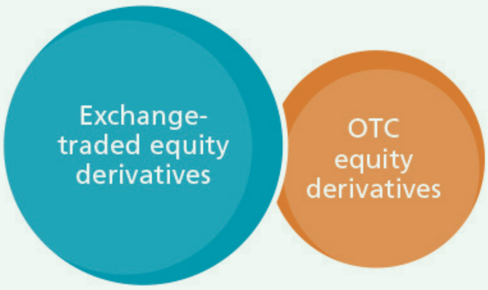
Market risk data

With the implementation of mandatory reporting of OTC equity derivative transactions to the HKTR in July 2017, Hong Kong is one of the first jurisdictions where comprehensive market data is available to regulators to help them assess systemic risks.

We work closely with local and overseas regulators to enhance the quality of this data. We also engage with market participants to understand how OTC activities are reported, the nature of major transactions and the types of investors involved.

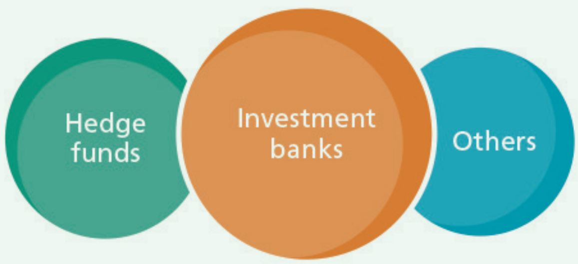
As of 31 March 2020, the market for OTC derivatives on Hong Kong equities was slightly smaller than the exchange-traded equity derivatives market. Investment banks were the major players, accounting for about half of the notional value.

Share of notional value



Source: HKTR

OTC equity derivative investors



Note: Others includes securities firms, insurers, pensions, asset managers, corporates and individuals.

Uncertificated securities market

In April 2020, we concluded a joint consultation with HKEX and the Federation of Share Registrars Limited on a proposed operational model for an uncertificated, or paperless, securities market in Hong Kong. This initiative will make securities-related transactions, including initial public offerings (IPOs) and corporate actions, more efficient and cost-effective by minimising paper and manual processes. Implementation is expected to commence in phases from 2022.

Stock Connect

Since its launch in November 2014, Mainland-Hong Kong Stock Connect has opened up the Mainland equity market to the rest of the world and enabled Mainland investors to diversify portfolios outside their home market.

As of 31 March 2020, Stock Connect covered 1,288 Mainland stocks and 477 Hong Kong stocks, representing about 80% of the combined market capitalisation of the two markets. Since the programme's launch, net inflows reached RMB1,125.7 billion for southbound trading and RMB975.6 billion for northbound trading.

Stock Connect has accounted for an increasing share of Hong Kong's market turnover over time. On average, daily southbound trading reached 9% of total trading in the Hong Kong stock market during January to March 2020, compared to 6% in 2018 and 2019. Northbound trading was 5% of the Mainland market total, in line with the 4% in 2019 and higher than the 3% in 2018.

Mainland-Hong Kong Stock Connect

RMB 1,125.7 billion

net inflow to Hong Kong since launch

Investor identification

We worked with the China Securities Regulatory Commission to implement an investor identification regime for southbound trading under Stock Connect on 13 January 2020. A similar model for northbound trading was put in place in September 2018. The regime enhances market surveillance by enabling both regulators to identify the investor for each order and trade.

Stepping up investor protection

The investor compensation regime provides a degree of compensation to investors who sustain losses in relation to Hong Kong-listed securities or futures contracts and Mainland-listed securities traded under Stock Connect, if those losses are due to the default of an intermediary in Hong Kong. The regime is reviewed regularly and updated as necessary.

To offer better protection to investors and benefit the wider market, changes to the regime took effect on 1 January 2020 following a public consultation.

Higher compensation limit

$500,000

per investor per default

Expanded coverage

includes losses relating to Mainland-listed securities traded under Stock Connect

Investor compensation

In October 2019, we published consultation conclusions on proposals to enhance the investor compensation regime by increasing the compensation limit to $500,000 per investor per default and extending the coverage to include northbound trading under Stock Connect (see sidebar on page 62). The changes took effect on 1 January 2020.

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

Investor compensation claims

	2019/20	2018/19	2017/18
Received	**7**	5	1
Processed	**4**	10	6
– Compensation payments made	**0**	0	3
– Rejected	**0**	7	3
– Withdrawn	**4**	2	0
– Reconsidered	**0**	1	0

Net asset value of compensation funds

	As at 31.3.2020 ($ million)	Change	As at 31.3.2019 ($ million)	Change	As at 31.3.2018 ($ million)
Unified Exchange Compensation Fund[a]	**82**	**3.4%**	79.3	4.6%	75.8
Investor Compensation Fund[b]	**2,428.3**	**1.5%**	2,391.5	1.3%	2,361.2
Total	**2,510.3**	**1.6%**	2,470.8	1.4%	2,437

a See pages 146-159 for the financial statements of the Unified Exchange Compensation Fund (UECF). The Investor Compensation Fund (ICF) was established by the Securities 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 132-145 for the financial statements of the ICF.

Automated trading services

Under the 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.

Over the past year, we approved four Part III applications. Trades conducted on authorised trading venues were mainly in 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 418,000 contracts for the 12 months ended 31 March 2020.

ATS providers

	As at 31.3.2020	As at 31.3.2019	As at 31.3.2018
Under Part III	**54**	50	57
Under Part V	**25**	24	24

Short position reporting

	As at 31.3.2020	As at 31.3.2019	As at 31.3.2018
Market value of short positions as a percentage of total market capitalisation^	**1.24%**	1.42%	1.43%

^ Figures presented in previous reports were calculated based on market capitalisation of reported securities.