

# Market infrastructure and trading

To ensure orderly markets, we supervise and monitor exchanges and clearing houses in Hong Kong. During the year, we made progress on a number of initiatives to enhance the securities and futures markets.

## Supervision of HKEX

### On-site inspection

We conduct regular on-site inspections of the non-listing-related operations of Hong Kong Exchanges and Clearing Limited (HKEX). In August 2017, we conducted an inspection of its cash market clearing and settlement operations, focusing on the admission and monitoring of clearing participants as well as depository, custodian and nominee services.

### Recognised clearing houses

During the year, we worked on risk management initiatives to improve the resilience of recognised clearing houses in Hong Kong and better comply with international standards published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions. We worked with HKEX to enhance the clearing houses' recovery plans for managing extreme market situations and also approved measures to strengthen clearing guarantee funds, including risk-based contributions from the clearing houses and more timely collection of collateral from clearing members. In addition, we began to develop resolution plans for the clearing houses under the Financial Institutions (Resolution) Ordinance which came into effect on 7 July 2017.

## Closing Auction Session

In July 2017, we approved HKEX's launch of Closing Auction Session (CAS) Phase 2<sup>1</sup> which expanded the list of securities to constituents of the Hang Seng Composite SmallCap Index and allowed regulated short-selling orders to be placed during CAS.

## New products

We approved a number of derivative products proposed by HKEX to meet the trading and hedging needs of market participants (see table below).

## Hong Kong as a risk management centre

As mainland China continues to open up and integrate with global capital markets, it is vital to enhance Hong Kong's role as the premier risk management centre for Mainland risk and a booking hub for Asian derivatives.

## A-share futures

To enable Hong Kong to develop A-share index futures in due course, we entered into a memorandum of understanding (MoU) with the China Securities Regulatory Commission (CSRC) on 28 December 2017 which facilitates supervisory and enforcement cooperation in the Mainland and Hong Kong futures markets and enhances supervisory assistance and information exchange on cross-boundary derivatives, futures exchanges and futures brokers.

## Derivative products approved

	Trading commencement date
Physically-settled gold futures contracts	10 July 2017
Cash-settled iron ore futures contract	13 November 2017

<sup>1</sup> CAS Phase 1 was launched in July 2016 to facilitate trade execution of major index constituents and all exchange-traded funds at closing prices.

### OTC derivatives

In line with the Group of Twenty's commitment to reform the over-the-counter (OTC) derivatives market, we have been working with the Hong Kong Monetary Authority (HKMA) to implement an OTC derivatives regulatory regime in Hong Kong in phases<sup>2</sup>.

Phase 2 mandatory reporting of OTC derivatives transactions, covering all five major asset classes<sup>3</sup>, came into effect on 1 July 2017.

In response to market requests, we launched a joint HKMA-SFC consultation in April 2017 and implemented subsidiary legislation to adjust the scope of the term "OTC derivative product" under the Securities and Futures Ordinance (SFO). Engaging with market participants, we identified issues relating to the scope of regulated activities, on which we consulted the market in December 2017<sup>4</sup>, and are proposing refinements to address them.

In March 2018, we issued another joint HKMA-SFC consultation on enhancements to the OTC derivatives regulatory regime to mandate the use of Legal Entity Identifiers<sup>5</sup> for the reporting obligation, expand the clearing obligation and adopt a trading determination process for introducing a platform trading obligation.

### OTC Clear

For mandatory clearing purposes, we designated OTC Clearing Hong Kong Limited (OTC Clear) as a central counterparty for Hong Kong dollar basis swaps in June 2017. We also approved OTC Clear's new products, including non-deliverable interest rate swaps in Asian currencies, cross-currency swaps for Hong Kong dollar vs US dollar and deliverable FX forwards and swaps.

## Mutual market access

### Stock Connect

We are in discussions with the Mainland authorities to further expand the scope of eligible securities under Stock Connect, which allows Hong Kong and Mainland investors to trade eligible stocks in each other's markets.



Mr Keith Lui, Executive Director of Supervision of Markets, at the WFC Global Conference of Central Securities Depositories 2017

Stock Connect now covers some 1,500 Mainland stocks and 460 Hong Kong stocks, representing more than 80% of the two markets' combined market capitalisation.

As of 31 March 2018, southbound trading from Shanghai and Shenzhen into Hong Kong reached a net inflow of RMB723.8 billion since the programme's launch. Through northbound trading, international investors bought in RMB389.7 billion worth of A-shares as of that date.

The daily quotas were increased to RMB52 billion for each of the northbound trading links and RMB42 billion for each of the southbound trading links effective 1 May 2018.

Since inception, Stock Connect accounted for an increasing share of Hong Kong's market turnover. On average, daily southbound trading reached 7% of total trading in Hong Kong from January to March 2018, compared to 6% in 2017 and 3% in 2016. Northbound trading also increased to 2% of the Mainland's total market turnover, compared to 1% in 2017 and 0.3% in 2016.

<sup>2</sup> We implemented two phases of mandatory reporting—Phase 1 reporting came into effect on 10 July 2015 and Phase 2 on 1 July 2017. The first phase of mandatory clearing became effective on 1 September 2016.

<sup>3</sup> Including interest rates, foreign exchange, credit, commodities and equities.

<sup>4</sup> See Intermediaries on pages 39-46.

<sup>5</sup> A unique 20-digit, alpha-numeric code which identifies entities in a financial transaction.

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### Bond Connect

On 29 June 2017, we approved the automated trading services (ATS) application of Bond Connect Company Limited, a Hong Kong-based joint venture established by HKEX and the China Foreign Exchange Trade System & National Interbank Funding Center, to facilitate the operation of Bond Connect. Northbound trading under the scheme, launched on 3 July 2017, allows Hong Kong and overseas investors to invest in the China Interbank Bond Market. We are collaborating with other regulatory authorities to closely monitor the scheme's operations.

### Market enhancements

#### Investor identification

We worked with HKEX and the Mainland exchanges and clearing house to develop an investor identification model for northbound trading under Stock Connect to facilitate market surveillance. To this end, we reached an agreement with the CSRC in November 2017 and announced the expected launch of the model in the third quarter of 2018<sup>6</sup>. We also agreed to develop a similar model for southbound trading after the northbound trading model is implemented.

#### Position limit regime

Following the conclusion of a public consultation in March 2017, the enhanced position limit regime for the futures market took effect on 1 June 2017. The regime expanded the scope of excess position limits which can be granted to qualified market participants. Amendments were made to the Securities and Futures (Contracts Limits and Reportable Positions) Rules as

well as the SFC's Guidance Note on Position Limits and Large Open Position Reporting Requirements. Since implementation, we have received more enquiries about and applications for excess position limits.

#### Automated trading services

Under the SFO, two regimes regulate ATS providers. Part III of the SFO authorises those offering facilities similar to those of a traditional exchange or clearing house and Part V licenses intermediaries providing dealing services with ATS as an added facility. During the year, trades conducted on authorised trading venues were mainly in commodity futures, benchmark index futures and options, bonds, equities and exchange-traded funds.

Over the past year, we approved 12 applications from overseas regulated exchanges and electronic trading facilities. The average daily trading volume of futures contracts originating from Hong Kong to authorised overseas exchanges was about 326,000 contracts for the 12 months ended 31 March 2018.

#### Short position reporting

In November 2017, we published a Short Position Reporting Service User Guide and frequently asked questions on our website. This followed the March 2017 expansion of short position reporting requirements to all securities which are permitted for short-selling under the rules of The Stock Exchange of Hong Kong Limited.

During the year, aggregated short positions for these securities accounted for 1.3% to 1.6% of the total market capitalisation of these securities.

### ATS providers

	As at 31.3.2018	As at 31.3.2017	As at 31.3.2016
Under Part III	57	49	38
Under Part V	24	24	24

<sup>6</sup> On 30 November 2017, HKEX issued an information paper, *Investor ID Model for Northbound Trading Under Stock Connect*, which sets out operational details of the regime.