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Panel on Financial Affairs

Meeting on 10 July 2012

Background brief on proposal of the Hong Kong Exchanges and Clearing Limited to introduce after-hours futures trading

Purpose

This paper provides background information on the proposal of the Hong Kong Exchanges and Clearing Limited ("HKEx") to introduce after-hours futures trading ("AHFT"), and summarizes the concerns and views expressed by Members at the Council meeting on 23 May 2012.

Background

2. In May 2011, HKEx published a public consultation paper to seek market comments on AHFT. As set out in the consultation paper, the strategic and business reasons for HKEx to provide AHFT are as follows:

- (a) Investors will benefit from having an AHFT platform to hedge or adjust their positions in response to market news and events in the European and US time zones;
- (b) With Hong Kong becoming a Renminbi (RMB) offshore centre, after-hours trading will enable HKEx to serve international trading interest relating to RMB products in the future;
- (c) The capability for after-hours trading is a prerequisite for HKEx to support asset classes traded on a global basis including commodities and foreign exchange;

- (d) Given overseas exchange experience, AHFT should be a source of business growth; and
 - (e) Over time, AHFT can attract European and US investors to participate in HKEx's derivatives market both during and after their working hours.
3. The key features of HKEx's consultation proposal were as follows –
- (a) Products: Initially, Hang Seng Index futures, H-shares Index futures and gold futures would be traded in the after-hours trading session (the T+1 Session);
 - (b) Trading hours of the T+1 Session: The opening of the T+1 Session would be 30 minutes after the close of the regular trading session (the T Session), ie 4:45 pm for Hang Seng Index futures and H-shares Index futures and 5:30 pm for gold futures. The T+1 Session would end at 11:15 pm;
 - (c) Clearing and settlement: All trades in the T+1 Session would be registered as T+1 trades and would be cleared and settled on the following trading day;
 - (d) Risk management: There would be appropriate market monitoring during the T+1 Session and a new mandatory variation adjustment and margin call following the open of the T Session on the following trading day.
4. In December 2011, HKEx published the consultation conclusions on AHFT. According to HKEx, a total of 455 responses were received and more than three-quarters of the respondents (i.e. 353 out of 455, or about 78%) supported the proposal on AHFT, including 67 futures market exchange participants which represented 80% of Hang Seng Index futures and H-shares Index futures market share in the first half of 2011.
5. HKEx indicated that after considering the responses received, it would implement AHFT with refinements to the operational arrangements as summarized below -

No.	Item	Original Proposal	Revised Proposal
1	Opening time of index futures in T + 1 Session	4:45 pm	5:00 pm
2	Closing time of gold futures in T Session and opening time of gold futures in T + 1 Session	5:00 pm and 5:30 pm	4:15 pm and 5:00 pm
3	Closing time of T + 1 Session	11:15 pm	11:00 pm
4	Deadline for collection of mandatory variation adjustment and margin call from clearing participants (CPs)	11:00 am	12:00 noon
5	Threshold that mandatory margin and VA call would not be demanded from CPs	Less than \$1 million	Less than \$2 million
6	Price limit mechanism	Price banding mechanism	To replace the dynamic price banding mechanism by a 5% price limit up/down mechanism

6. Besides, in view of the concerns of some respondents of potential excessive market movements in AHFT, HKEx would implement a 5% price limit up/down mechanism during the T+1 Session. The features of the proposed price limit up/down mechanism in T + 1 Session are as follows-

- (a) The proposed percentage for the price limit up/down is 5%, which would be reviewed and adjusted according to market situation;
- (b) No sell order of price below 95% and no buy order of price above 105% of the last traded price of the spot month contract in the T Session would be allowed. The proposed upper and lower limits would be applied to all contract months;
- (c) Trading would be allowed only within the price limit range during the T+1 Session.

7. The plan of HKEx at that time was to implement AHFT in the second half of 2012, subject to the approval of the necessary rule amendments by the Securities and Futures Commission ("SFC")¹ and market readiness.

Oral question on AHFT raised at Council meeting on 23 May 2012

8. At the Council meeting on 23 May 2012, Hon WONG Kwok-hing raised an oral question regarding the AHFT proposed by HKEx. Mr WONG expressed concern that in conducting the consultation on AHFT, HKEx might not have given a clear account of the positive and negative impacts as well as the risks of the proposed initiative. Mr WONG called on the Administration to request HKEx to temporarily suspend its plan to implement AHFT in the second half of 2012 and conduct consultation afresh on the proposal. Mr WONG also queried why the Administration had not consulted the Legislative Council on the AHFT proposed by HKEx, and the appropriateness of HKEx's treating the submission of the Hong Kong Securities and Futures Professionals Association, which consisted of a few thousand participants in the industry, as merely a single response in the consultation conclusions.

9. The Secretary for Financial Services and the Treasury ("SFST") responded that in accordance with section 21 of the Securities and Futures Ordinance (Cap. 571), HKEx shall manage the risks associated with its business and operations prudently, act in the interest of the public, having particular regard to the interest of the investing public, and ensure that the interest of the public prevails where it conflicts with the interest of the exchange. Apart from consulting the industry, HKEx would also maintain close communication with SFC. In assessing the initiatives proposed by HKEx, SFC would take into account the impact of those initiatives on the Hong Kong financial market, and relevant risk management measures. SFC would handle the AHFT proposal in the same prudent manner. SFST also pointed out that the results of HKEx's consultation showed that the majority of industry and market participants supported the implementation of AHFT. As such, the Administration shared the views of the HKEx and SFC that it was not necessary to consult the public again on the same subject.

¹ According to Schedule 1 and Schedule 10 to the Securities and Futures Ordinance (Cap. 571), the Hong Kong Futures Exchange Limited, of which HKEx is the holding company, is a recognized exchange company under SFO. Section 24 of SFO stipulates that no rule of a recognized exchange company or any amendment thereto shall have effect unless it has the approval in writing of the SFC.

Latest development

10. The Panel on Financial Affairs will discuss the proposal of HKEx to introduce AHFT at its meeting on 10 July 2012.

Relevant papers

11. The relevant papers are available at the following links on the Internet:

Consultation on after-hours futures trading conducted by the Hong Kong Exchanges and Clearing Limited	Consultation paper (May 2011) Consultation conclusions (December 2011) Press release (15 December 2011)
Meeting of the Legislative Council on 23 May 2012	Hansard (floor) (page 33-39) Reply of the Administration to oral question raised by Hon WONG Kwok-hing

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