

Press release

LCQ4: After-hours futures trading

Wednesday, May 23, 2012

Following is a question by the Hon Wong Kwok-hing and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (May 23):

Question:

It has been reported that the Hong Kong Exchanges and Clearing Limited (HKEx) will introduce after-hours futures trading (AHFT) in the second half of this year. I have received complaints from the Hong Kong Securities and Futures Professionals Association, pointing out that such an arrangement may pose substantial risks to investors and securities dealers, and may also easily cause drastic fluctuations in the market. In this connection, will the Government inform this Council:

(a) whether it knows if HKEx, in conducting the consultation on the aforesaid arrangement last year, had given a clear account on the positive and negative impacts of such arrangement on various aspects (including the impact on the fluctuations of the local financial market and that on additional liabilities of securities dealers and additional risks for investors, as well as the impact of dealers not participating in AHFT, etc.) and the relevant measures (including margin calls, management of the risk of breach of contract, delisting procedures and the price limit range during AHFT) required to be introduced in respect of such impacts; if it had, the views collected and the conclusions drawn; if not, whether HKEx has assessed if the consultation was comprehensive, and whether HKEx might have misled the public;

(b) whether it knows if HKEx, in introducing various new measures in recent years, has assessed the risks and impacts that such measures bring, and accorded priority to considering the impacts on the overall interests of the local financial market as well as the risks that it can bear; whether the authorities have assessed if HKEx, in introducing the aforesaid arrangement, has put commercial interest before the security and stability of the financial market of Hong Kong; how HKEx and the regulatory authority ensure that the local market will not be under attack or will also not be manipulated because there are loopholes in such an arrangement, and subject to drastic fluctuations; regarding the confidence crisis in the market and financial turmoil that may be triggered by such an arrangement, who will be and how they can be held accountable by members of the public for that; and

(c) given the concerns of the industry, and that members of the public and investors have indicated that they do not understand the impacts that may be brought about by the aforesaid arrangement on their investments, whether the authorities will request HKEx to temporarily suspend its plan to implement such an arrangement in the second half of this year, conduct consultation afresh, and set out the impacts and the measures required to be introduced as listed in (a), with a view to facilitating in-depth discussion by various parties, and decide whether to implement the arrangement only after announcing the detailed outcome; if not, of the reasons for that, and what risk management mechanism will be put in place upon the implementation of such arrangement?

Reply:

President,

The Hong Kong Exchanges and Clearing Limited (HKEx) proposes to introduce after-hours futures trading (AHFT) to provide the opportunity for investors to conduct futures trading in the night time in order to hedge or adjust their positions to manage their risks during the European and the US time zones. This would help reduce the volatility in the next day's opening and provide new business opportunity to the futures industry. My replies to the three sub-questions are as follows -

(a) In May 2011, HKEx published a public consultation paper to seek market comments on AHFT. The consultation paper introduced in detail the features of the proposal and the rationale behind, including the types of products to be covered, the benefits to the market, the possible implications to different market participants and the trading, clearing and risk management arrangements. HKEx published the consultation conclusions in December 2011 and reported that the proposal received general support from market participants. HKEx has made a number of refinements to the operational arrangement of the proposal in response to the comments received.

Under the revised proposal, the AHFT session will open 45 minutes after the close of the regular futures trading session (i.e. 5pm) and end at 11pm. Products covered include Hang Seng Index (HSI) futures, H-Shares Index (HHI) futures and gold futures. On risk management, brokerage firms participating in AHFT have to follow capital-based position limit. HKEx also proposes to make reference to the practice of other major markets to impose a 5% price limit, i.e. 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 regular trading session are allowed to be placed.

On margin arrangement, the prevailing minimum margin requirement for brokerage firms is set at 5% of the value of the futures contracts, the minimum client margin is at 6% in general. Under HKEx's proposal, there will be no margin call against brokerage firms during the AHFT session. HKEx will notify the brokerage firms about their variation adjustments and margin calls during the next regular trading session at 10am. HKEx will conduct an assessment for every brokerage firm to see whether it has mark-to-market loss for its positions and whether it fulfills the minimum margin requirement, based on the Opening Price, which is the equilibrium market price derived from the price discovery period of thirty minutes before the opening of the morning trading session. If the fund of a brokerage firm at the clearing house does not meet the minimum margin requirement, it has to settle the margin due by noon on the same day.

HKEx has pointed out in its consultation paper and consultation conclusions the fact that in case there are major financial news or events during the European and US time zones, Hong Kong investors are unable to effectively hedge or adjust their positions with no night time trading for Hong Kong's cash and futures markets. We note that some investors may use other derivatives products in overseas markets during the night time to hedge their exposure. Out of the 183 Futures Exchange participants, more than half of them are providing after-hours overseas derivatives trading services for their clients, including small and medium size brokerage firms. Offering AHFT could provide investors with the opportunities to hedge or adjust their positions in the AHFT session in response to news and events in the European and US time zones and thus helps reduce the volatility and investors' risk when the market opens the next day.

(b) According to section 21 of the Securities and Futures Ordinance, 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.

Hence, in planning to introduce new initiatives, HKEx is required to assess the risks of those measures to and their impact on the market. Apart from consulting the industry, HKEx will also maintain close communication with the Securities and Futures Commission (SFC). In assessing the initiatives proposed by HKEx, the SFC will assess the impact of those initiatives on the Hong Kong financial market, including the competitiveness of our market and risk management. The SFC will handle the AFHT proposal in the same prudent manner.

Regarding AHFT, major futures exchanges around the world such as CME Group of the United States, Eurex and NYSE Liffe of Europe, Australian Stock Exchange, Singapore Exchange, Osaka Securities Exchange of Japan, etc., all have started AHFT successively since many years ago.

To facilitate better preparation by the market, HKEx has explained to industry associations in detail operational arrangements on trading, clearing and risk management under the AFHT proposal, through regular contacts and a series of briefing sessions. HKEx will continue such contacts with the industry. HKEx will facilitate the futures industry in the preparation work, such as enhancements to trading and back office systems and staff training, before the formal implementation of AHFT.

(c) As shown in the results of HKEx's consultation, the majority of industry and market participants support the implementation of AHFT.

Among 455 responses received, 353 responses (or about 78%) supported AHFT. 287 submissions were received from employees of brokerage firms and 243 responses (or about 85%) supported AHFT. 103 submissions were received from corporate respondents, 89 responses (or about 90%) supported AHFT, including 67 Futures Exchange Participants, one-third of them are major international securities and futures institutions and two-third are small/medium-size securities and futures trading firms.

HKEx is refining the details of its proposal for submission to the SFC for approval. After receiving HKEx's proposal, the SFC will consider the views of all market participants and the development need of the Hong Kong financial market. We share the views of the HKEx and SFC that it is not necessary to consult the public again on the same topic.

Ends