

## Reforming HK Markets – the Political Realities

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## Political background

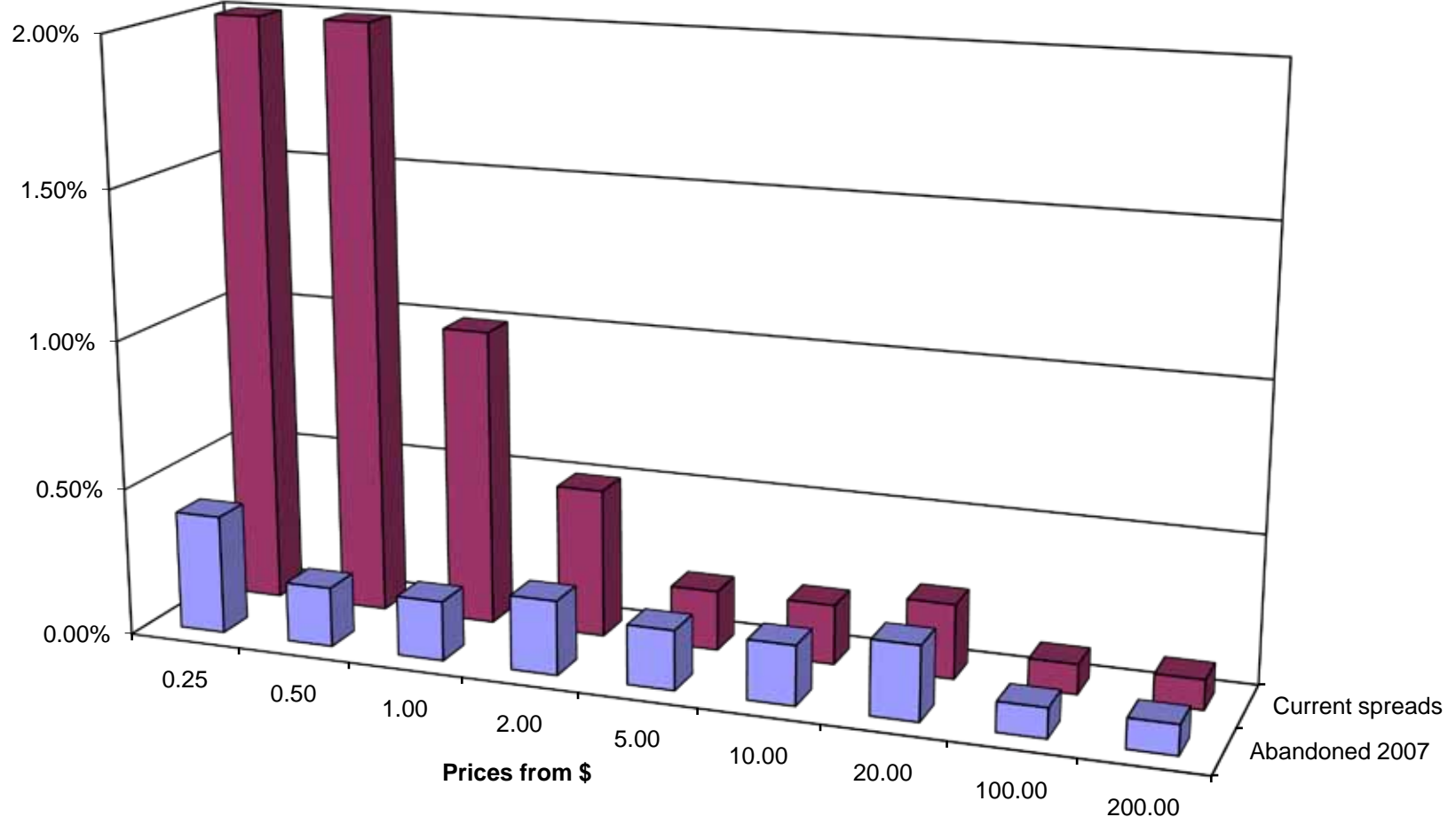
- 800-member Election Committee chose HK chief executive (1200 in 2012)
- 60-seat legislature: 30 elected directly, 30 “functional” (2012: 40 direct, 30 functional)
- Brokerage firms elect 12 (18) EC members plus the “financial services” legislator (who has a criminal record). Small brokers with less than 10% of market volume between them far outnumber the others
- If you are an individual licensed by the SFC, you are trusted with other people’s money but have no vote in the LegCo or EC elections
- Banks elect 12 (18) EC members and the “finance” legislator (currently David Li, former Dow Jones director)
- Insurers elect 12 (18) EC members and the “insurance” legislator
- Govt tends to favour interests of functional constituencies for political reasons, rather than making reforms in the public interest
- Beijing hates to see public protests, for fear of Jasmine effect
- Government appoints a majority of the HKEx board (including several cabinet members) and all the directors of the SFC. It also owns about 6% of HKEx bought by HKMA

## Competition

- HKEx (0388) owns SEHK, HKFE and their clearing houses
- 4 Exchanges in HK until 1986 – running on blackboards
- Since 1986 SEHK has a statutory monopoly, the other businesses of HKEx are *de facto* monopolies
- Government has tabled a proposed competition law
- Chief Executive of HK can exempt any person. HKEx, which had an 84% pre-tax profit margin in 2010, is believed to be lobbying for exemption
- If alternative trading systems (ATS) are to have a level playing field, then HKEx should not be exempt, and the statutory monopoly of SEHK should be removed.
- HK needs competition to reduce transaction costs, increase efficiency
- SFC could establish consolidated quote and reporting system (CQRS) to reduce fragmentation of liquidity and data. Operation could be outsourced
- Clearing houses should interconnect

# Trading spreads – unfinished business

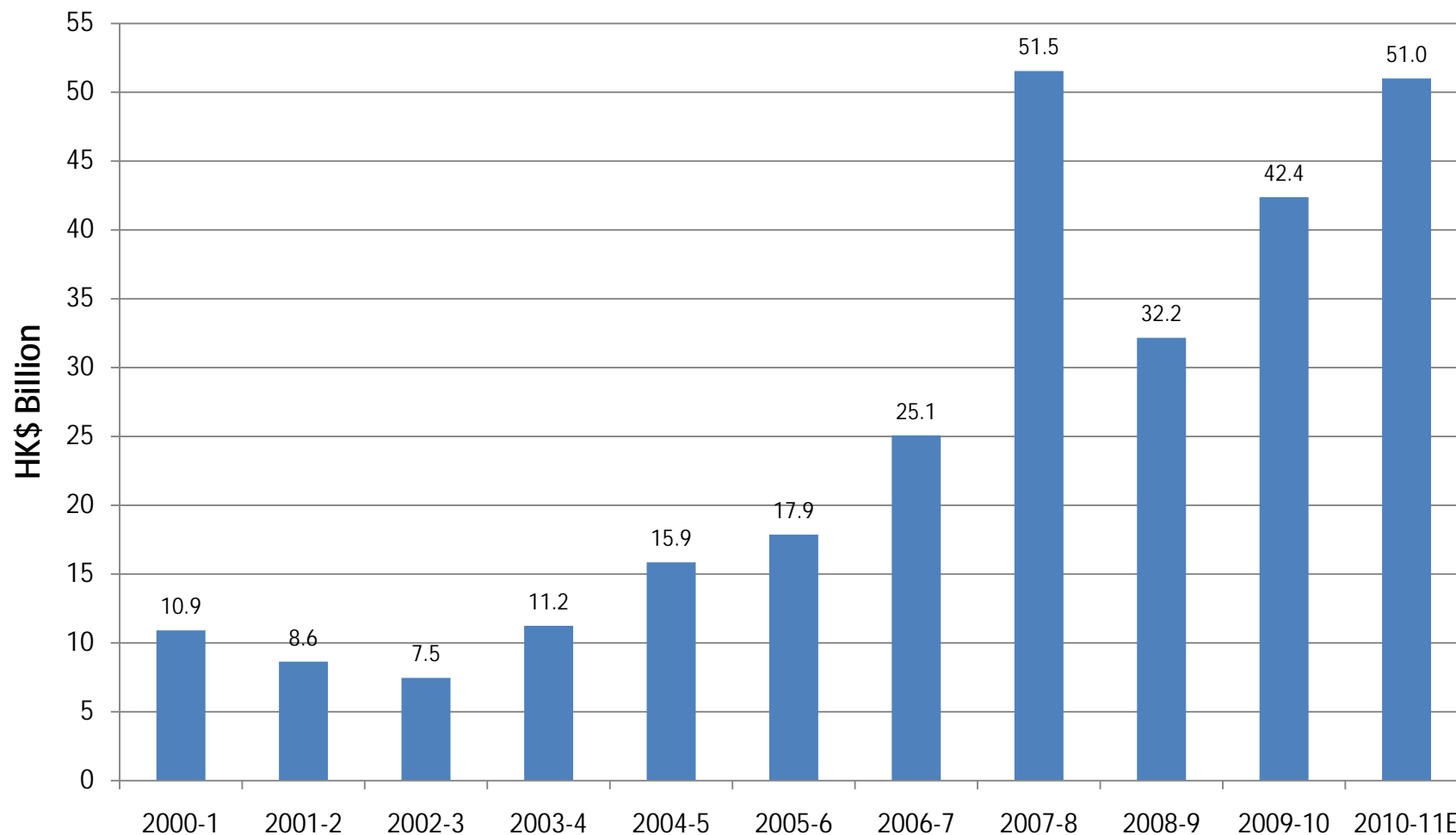
Maximum tick size of current spreads and abandoned 2007 reforms



## Stamp duty

- 0.1% on each side of a trade
- Only applies to equities, not warrants, CBBCs – so this incentivises speculative retail behaviour
- Impediment to higher frequency trading, pair trading, index arbitrage etc.
- Stamp duty is a frictional tax, not based on GDP, and for that reason alone should be abolished, both in stocks and real estate
- Government is going the other way – raised stamp duty on real estate over \$20m to 4.25%
- Pending proposal to charge additional 15%/10%/5% on residential resales within 6/12/24 months on grounds that they are “speculative”
- Indicates government belief that speculation is evil, and a failure to understand that liquidity is the key to successful markets
- “The duty is a good regulatory tool as it adds to the costs for short-term speculators such as high-frequency traders. That is good for Hong Kong as that’s not the kind of trade we want to attract” – K C Chan, Secretary for Financial Services (SCMP, 13-Dec-2010)

## HK's stamp duty addiction



# Broker anonymity

00002 CLP HOLDINGS		QPI Market Watch		Chart	Warrants	Issuer Info.	Actions	News	Up Boll U band
Nominal	64.450	15:59	10.0K	64.500	B	↑	BID BROKER QUEUE		
Day Open	64.400	15:59	2500	64.350	B	↑	6699 Timber Hill		
Day High / Low	64.500 / 64.150	15:59	500	64.300	S	↓	2045 Barclays Capital Asia		
Previous Close	64.450	15:59	4500	64.500	B	↑	2045 Barclays Capital Asia		
Net Change	+0.0 (+0.00%)	15:59	9000	64.300	S		4066 BNP Paribas		
Volume	1.21 M	Bid		Ask		-1			
Turnover	78.20 M	64.300		64.500		7830 Bokhary			
Currency/Lot Size	HKD(0) / 500	40.0K (4)		18.5K (2)		2045 Barclays Capital Asia			
Average Price	64.385	34.5K (5)		65.0K (9)		1197 Credit Suisse			
Fluctuation	0.54%	86.0K (7)		21.5K (12)		1197 Credit Suisse			
P/E Ratio	15.01(X)	125.0K (9)		68.5K (10)		1496 Optiver Trading			
Yield	3.85%	74.0K (8)		85.5K (11)		-2			
EPS	4.2940	359.5K (33)		237.0K (44)		7077 Winfull			
Market Cap	155.08 B	0.050		0.050		ASK BROKER QUEUE			
NAV	33.107	1ST INT DIV \$0.52		Odd Lots		5988 OSK Asia			
52-Week Hi/Lo	65.000 / 54.050	B/C 3/6/11				6699 Timber Hill			
10/50-Day SMA	64.015 / 63.343					+1			
Ex-Date	2011/06/01					8397 HSBC Broking			
Dividend	HKD / 0.520					9063 UBS			
						9422 Hang Seng			
						0316 BOCOM			
						8944 BOCI			
						0319 BOCOM			
						4409 Dah Sing			
						8577 HSBC Securities			
						2045 Barclays Capital Asia			
						Indicative Eq Price			
						Indicative Eq Vol			

## Broker anonymity v disclosure: issues

- If there is any signal value in broker identity, then shouldn't investors be free to exploit it?
- Large brokers benefit from "flow" knowledge; broker identity tends to offset that advantage – if they are anonymised, they may increase market share and inside advantage
- In small/mid caps, identity of broker can be a tell-tale sign of director/controller activity
- But anonymity may allow for more direct market participation – larger asset managers may just become direct exchange participants
- Who needs brokers anyway? Be careful what you wish for!



## Trading hours

- Still out to lunch...
- But trading hours expanded from 4 to 5 hours on 7-Mar-2011 with 90 minute lunch break
- Expected extension to 5.5 hours on 12-Mar-2012 with 60 minute lunch hour (unless small brokers stop it)
- Small brokers opposed because of needing staff to handle customers during lunchtime
- Larger banks and brokers are happy. Retail investors can now trade during their lunch break rather than during their work hours
- Staying open during lunch hour wasn't even an option in the consultation paper
- If we had competing exchanges in HK, this would be a non-issue. We don't have a siesta in other sectors.

## Closing auction

- Suspended on 23-Mar-2009, during height of global financial crisis
- Before suspending it, HKEx had proposed whacky price controls – that the closing auction could not deviate from 4pm price by more than 2% - so of course, if you want to manipulate the closing price, you do it before 4pm
- HKEx refused to consider random closing time on each stock to increase cost of manipulation
- HKEx will likely revisit this issue, so make your views known!

Thank you. Any questions?

