

An Overview of Hong Kong's Evolving Primary and Secondary Markets

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Section I Global equity market comparisons

According to statistics from the *World Federation of Exchanges*, HKEx ranks as the world's sixth largest market (in terms of market capitalization).

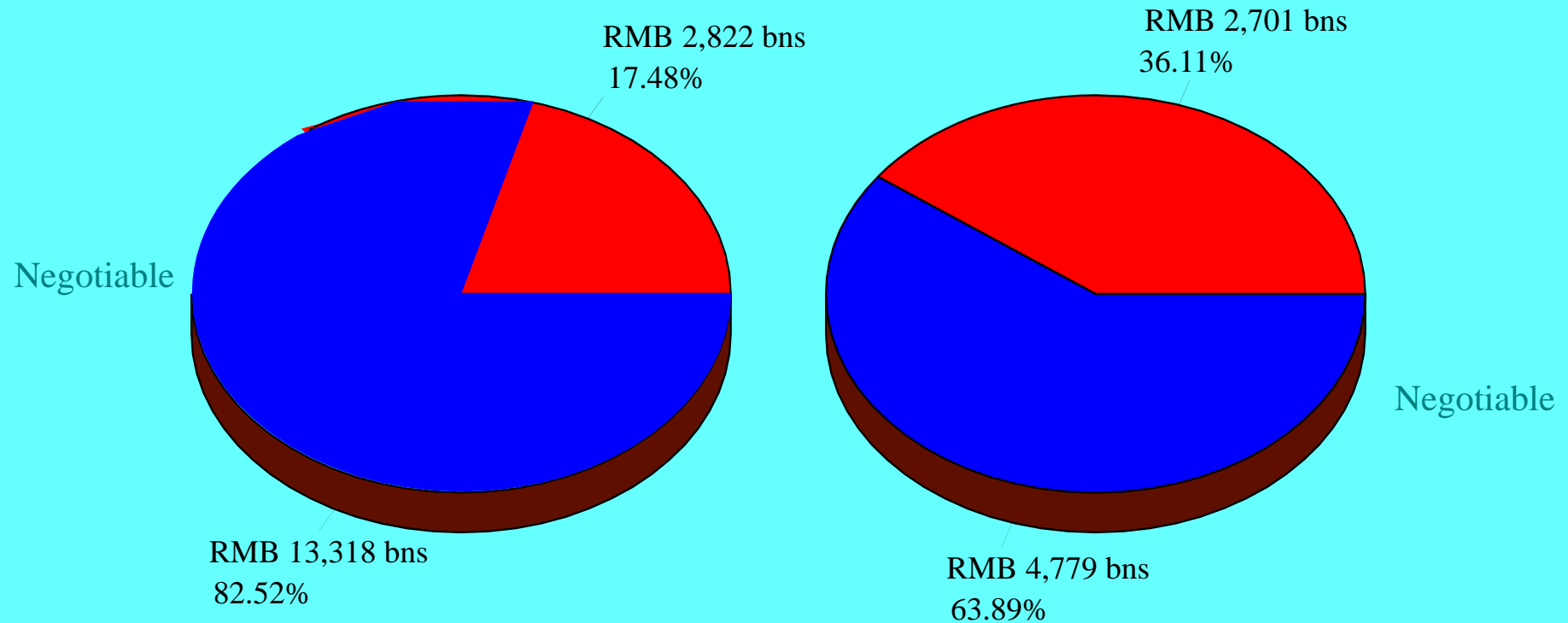
		Market Capitalization Feb 2012 (USD billions)	(Market Capitalization/ 2010 year-end GDP#)*100	Total No. Companies Listed (Feb 2012)
	(i)	(ii)	(iii)	(iv)
1	NYSE Euronext (US)	12,809	91.6%	2,315
2	Nasdaq OMX	4,373	26.6%	2,666
3	Tokyo	3,603	71.0%	2,288
4	London	3,592	84.1%	2,857
5	NYSE Euronext (Europe)	2,722	73.1%	1,109
6	HKEx	2,675	1,197.1%	1,507
7	Shanghai*	2,618	47.3%	934
8	TSX Group	2,112	138.8%	3,964
9	BM&FBOVESPA	1,481	76.4%	372
10	Deutsche Borse	1,393	43.2%	738
11	Australian SE	1,350	119.2%	2,083
12	Bombay SE	1,297	114.1%	5,122
13	SIX Swiss Exchange	1,175	235.3%	278
14	National Stock Exchange India	1,272	111.7%	1,644
15	Shenzhen*	1,177	22.8%	1,430
16	Korea Exchange	1,143	110.7%	1,817
17	Madrid ('BME')	1,110	85.2%	3,251
20	Taiwan SE	753	191.7%	824
22	Singapore	690	297.7%	770

Sources: Data in Columns (ii), (iii) and (iv) are extracted from the World Federation of Exchanges' statistics (at <http://www.world-exchanges.org/>). Figures in Column (ii) reflect 'Domestic Market Capitalization' levels' for February 2010 ["Equity – 1.1 – Domestic Market Capitalization (USD Millions)"] at: <http://www.world-exchanges.org/statistics/monthly-reports> and are rounded to the nearest whole billion dollars. Figures in Column (iii) are extracted from "Indicators – 4.6 Stock markets' significance in the national economy" (at <http://www.world-exchanges.org/statistics/annual/2010/indicators/stock-markets-significance-national-economy>). # In relation to the above, and according to the WFE, "2010 GDP data are IMF estimated data." Figures in Column (iv) are extracted from "Equity – 1.2 – Number of Listed Companies" (at <http://www.world-exchanges.org/statistics/monthly-reports>). 'Total' refers to 'Domestic' plus 'Foreign' (see Notes to Table 1.2 for details). * Refers to negotiable plus non-negotiable market capitalization. Apart from the US, China and India, only one exchange per country is shown.

Comparison of Shanghai and Shenzhen in terms of market capitalization: Negotiable versus non-negotiable market value

Shanghai: Total market cap = RMB 16,140 bns*

Shenzhen: Total market cap = RMB 7,480 bns*



Figures in RMB (billions) reported for 20/03/2012 from HKEx ('China Stock Markets Web', <http://www.hkex.com.hk/eng/csm/highlight.asp?LangCode=en>, 'Market Highlights', 20/3/2012).

* Figures only include capitalization levels for A- shares. B- share capitalization levels from the source above were RMB 77 billions and RMB 90 billions, respectively, for the Shanghai and Shenzhen markets.

Section II Chinese issuers listed on HKEx: (1) mainland PRC-incorporated (H-) issuers; (2) ‘Red-Chips’; (3) privately-controlled mainland Chinese issuers; and (4) ‘China-Concepts’

(1) Mainland PRC domiciled (incorporated) share issuers: Listed on HKEx in H-share form

- Shares in mainland-incorporated entities, when listed on HKEx, are referred to as H- shares (see Chapter 19A of HKEx MB listing Rules).
- Only issuers of mainland PRC incorporation are currently allowed to list in Shanghai and Shenzhen. For such issuers, stock is segmented into tradable (A- and/or B- shares) and non-tradable forms. However, for many A-listed entities, the ‘Split Share Reform’ has resulted in the conversion of non-tradable stock into tradable A- form.
- Tradable A-shares trade in RMB in both locales; tradable B-shares in HK\$ in Shenzhen and US\$ in Shanghai.
- Issuers can have concurrent A- & B- or A- & H- couplings (until recently, B- & H- pairings were proscribed. The 2008 HKEx H-listing of *Shandong Chenming* allowed it to establish a triad of A-, B- & H- listings).
- Apart from trading differences, an entity’s A-, B- and H- shares offer the same par (RMB1), voting and dividend rights. But because A-, B- and H- shares constitute separate blocks of stock, they are not directly exchangeable.
- A- shares are reserved for trades between mainland parties. QFII allows foreign entities limited access.
- B- shares, prior to March 2001, were restricted to trades between ‘foreigners’ (i.e., non-mainland Chinese ‘entities’). The B- market is now open to mainland residents with approved foreign exchange accounts.
- Performance of H- shares tracked by the *Hang Seng China Enterprises Index* (at <http://www.hsi.com.hk/family/family.html>).
- Notable pricing differences exist in entities with cross-listed A- and B- (see Chan et al., 2008) and A- and H- shares (see Wang and Jiang, 2004; Arquette *et alia*, 2008 and Cai *et alia*, 2011).*

* Chan, K., Menkveld, A. J. and Yang, Z., ‘Information Asymmetry and Asset Prices: Evidence from the China Foreign Share Discount’, *The Journal of Finance*, 63(1), 2008, 159-196.

Wang, Steven Shuye and Jiang, Li, ‘Location of trade, ownership restrictions, and Market illiquidity: Examining Chinese A- and H-shares’, *Journal of Banking & Finance*, 28(6), 2004, 1273-97.

Arquette, G. C., Brown, Jr., W. O. and Burdekin, R. C. K., ‘US ADR and Hong Kong H-Share Discounts of Shanghai-Listed Firms’, *Journal of Banking & Finance*, 32, 2008, 1916-1927.

Cai, Charlie X., Paul B. McGuinness and Qi Zhang, ‘The Pricing Dynamics of Cross-Listed Securities: The Case of Chinese A- and H- Shares’, *Journal of Banking and Finance*, 35(8), 2011, 2123-2136.

(2) 'Red-Chip' companies

Incorporated outside the PRC mainland, but state-controlled in terms of ownership.

Performance tracked by *Hang Seng China-Affiliated Corporations Index* (at <http://www.hsi.com.hk/family/family.html>). Service provider adjudges 'Control' (see http://www.hsi.com.hk/HSI-Net/static/revamp/contents/en/dl_centre/brochures/hscii_E.pdf) at threshold set by SFC's *The Codes on Takeovers, Mergers and Share Repurchases* (June 2010).

Importance of H- and 'Red-Chips' on HKEx: Taken together, H- and 'Red-Chips' account for around 45% of the MB's total market cap (see HKEx's 'China Dimension' at http://www.hkex.com.hk/eng/stat/smstat/chidimen/cd_mc.htm).

•As of 28 February 2012, there were 167 H- and 107 'Red-Chip' listings on either the MB or GEM (see 'HKEx Monthly Market Highlights – February 2012' (at <http://www.hkex.com.hk/eng/stat/statrpt/mkthl/mkthl201202.htm>)).

•According to <http://www.hkex.com.hk/eng/stat/statrpt/qtrpt/2011Q4/Documents/02.pdf> (*HKEx's Securities and Derivatives Markets Quarterly Report*, 4th qtr 2011, P. 9), Nine of the top-20 cap stocks were either H- or 'Red-Chips': 1.China Mobile; 2.CCB; 4.CNOOC; 6.ICBC; 7. China Unicom (HK); 13.Bank of China; 15.PetroChina; 16.BOC Hong Kong; and 20.Ping An Insurance).

(3) Privately-controlled mainland Chinese issuers

Referred to by HKEx (see <http://www.hkex.com.hk/eng/stat/statrpt/mkthl/mkthl201202.htm>) in terms of the acronym "NHMPE" ("Non-H Share Mainland Private Enterprises"). According to HKEx, there were 371 such listings as of February 2012. Prominent examples include Country Garden Holdings, Nine Dragons Paper, GOME, Alibaba, and so on.

(4) 'China-Concepts'

Controlled by non-mainland parties (typically HK or other Asian tycoons), with most or all revenue arising from mainland activities (see New World China Land, New World Department St. China, Shui on Land, Want Want China).

For discussion of the four issuer types, see Paul B. McGuinness, 'The Global Pursuit of Chinese Stock Issuers', 110-119 in *The Future of Asian Financial Centres – Challenges and Opportunities for the City of London*, Research Republic, City of London publication, October 2008. (See Pages 110-199 of: http://217.154.230.218/NR/rdonlyres/11CA0BEC-7946-46DB-9552-FB2A0C4EDA91/0/BC_RS_asiaFC.pdf).

Section III

The world's leading IPO markets: Comparison of funds raised (USD billions), 2005-2011

Year	NYSE	Nasdaq	London (AIM & MB)	HKEEx	Shanghai	Shenzhen
2005	23.5	13.9	21.9	24.7	0.3	0.4
2006	32.5*	17.5	54.5	44.1	15.1	2.1
2007	44.7*	20.4	54.2	38.0	60.0	5.4
2008	26.4*	3.0	12.0	8.5	10.8	4.4
2009	17.5	7.7	1.9	32.0	18.3	9.2
2010	30.9	8.1	13.7	57.8	26.9	45.4
2011	31.4^	10.7^	19.2^	36.1^	16.3^	26.2^
2005-11	206.9	81.3	177.4	241.2	147.7	93.1

Data sources:

For 2005-2008: PricewaterhouseCooper's 'Greater China IPO Watch 2007' (p.13&14) and 'Greater China IPO Watch 2008' (p.12 & 13);

* For 2006-8, NYSE and Alternext figures reported separately (but combined for purposes of table above). AMEX figures excluded for 2005.

For 2008-2010: PricewaterhouseCooper's 'Greater China IPO Watch 2010' (p.12 & 13);

For 2011, details obtained from ^ Exchange, January 2012, p. 1 (HKEEx: <http://www.hkex.com.hk/eng/newsconsul/newsltr/2012/Documents/2012-01-02-E.pdf>).

Notes:

Figures for London exclude proceeds generated from the IPOs of 'investment companies' in 2005 but include them for 2006 and 2007 [see PricewaterhouseCooper's 'Greater China IPO Watch 2006' (March 2007, p.14) and PricewaterhouseCooper's 'Greater China IPO Watch 2007' (p.14)]. For 2011, WFE report figures for 'London SE'.

Table adapted, for years 2005-2009, from McGuinness, Paul B. ('The Role of 'Cornerstone' Investors and the Chinese State in the Relative Underpricing of State- and Privately-Controlled IPO Firms', Forthcoming in *Applied Financial Economics*).

In terms of IPO proceeds raised, HKEx ranked number 1 globally in each of 2009, 2010 and 2011 (see *Exchange*, January 2012, at: <http://www.hkex.com.hk/eng/newsconsul/newsltr/2012/Documents/2012-01-02-E.pdf>).

HKEx has been host to some of the largest IPOs in history.

- According to Renaissance Capital, HKEx has hosted five of the globe's 25 largest offerings: <http://www.renaissancecapital.com/IPOHome/Rankings/biggest.aspx>.

Though the number of 'Foreign' listings is still small (24), a number of large international outfits have listed in the last couple of years (see HKEx Fact Book 2011, p. 65:

<http://www.hkex.com.hk/eng/stat/statrpt/factbook/factbook2011/Documents/09.pdf> .

- Fifteen of the 24 'foreign' entities identified in the above, established listing on HKEx in the period since December 2009.
- An SFC/HKEx Joint Policy Statement of 7 March 2007 (http://www.hkex.com.hk/eng/newsconsul/hkexnews/2007/documents/044_joint_statement_e.pdf) ushered-in a notable increase in the number of "recognized overseas jurisdictions" for potential issuers (see also *Exchange*, January 2011, pp. 3-5, at: <http://www.hkex.com.hk/eng/newsconsul/newsltr/2011/documents/2011-01-03-e.pdf>).
- Apart from the four longstanding locales, there are currently 19 "Acceptable overseas jurisdictions" relevant to issuer domicile (see http://www.hkex.com.hk/eng/rulesreg/listrules/listsptop/listoc/list_of_aoj.htm).

Efforts by HKEx to diversify its issuer-base have undoubtedly been spurred by plans for the Shanghai Stock Exchange to launch a market section for overseas-incorporated issuers (i.e., for those of non-mainland Chinese domicile).

- However, the SSE's initiative appears beset with hurdles. For recent commentary on the issue, see the China Daily, 9 March 2012: http://europe.chinadaily.com.cn/epaper/2012-03/09/content_14796412.htm).

HKEx has been a pioneer in the development of the offshore-RMB IPO (see the Hui Xian REIT IPO of 2011. Singapore appears to be on the cusp of listing its first RMB-IPO.

Section IV

Secondary ‘cash’ market trends on HKEx

1 Turnover trends

Over the period 2000-2011, daily average trading turnover on HKEx’s Main Board increased by more than 450 per cent.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Average <i>daily</i> turnover value (HK\$ billions)	12.3	8.0	6.5	10.3	15.9	18.2	33.7	87.4	71.8	62.0	68.6	69.5

Source of data: HKEx Fact Books (2003, p. 22; 2007, p. 25; and 2011, p. 30). Details reported under “Main Board Trading Statistics and Analysis”.

- According to HKEx’s Fact Book 2011 (p. 31), 70.2% of total MB turnover for 2011 arose from trading in “equities”, 15.4% from “warrants”, 10.8 % from “CBBC” securities, 3.5% from “unit trusts” and 0.005% from “debt”.

HKEx has a leading-edge in the trading of “structured products”. As reported in HKEx’s “Market Statistics 2011” (<http://www.hkex.com.hk/eng/newsconsul/hkexnews/2011/Documents/20111220news.pdf>), HKEx ranks first globally in terms of “Total turnover of securitized derivatives, including warrants and CBBCs”

- The above ranking is based on WFE data and, as described by HKEx, amounts relate to: “structured products such as derivative warrants, equity warrants, callable bull/bear contracts and equity linked instruments.” (HKEx Market Statistics 2011, Page 9).

HKEx Listing Statistics for its Main Board (excluding GEM)

	1996	1998	2000	2002	2004	2006	2008	2010	2011
Number of <i>Derivative Warrants (DWs)</i>	219	142	202	347	863	1,959	3,011	5,148	4,027
<i>DW’s contribution to total MB turnover (%)</i>	6.4%	6.0%	5.2%	7.1%	13.3%	21.5%	19.5%	15.8%	15.4%
Number of <i>Equity Warrants</i>	156	129	89	67	32	27	34	22	13
Number of <i>CBBCs</i>	-	-	-	-	-	24	1,314	1,064	901
<i>CBBC’s contribution to total MB turnover (%)</i>	-	-	-	-	-	0.1%	5.9%	8.5%	10.8%
Number of companies in ordinary stock form	591	688	737	813	892	976	1,088	1,245	1,327

Sources of data: HKEx Fact Book (2000, pp. 22 & 73; 2005, pp.19 & 114; 2010, pp. 22, 329 & 573; and 2011, pp. 26, 335 & 530).

2 The role of retail and institutional investors

As revealed on Page 5 of HKEx's March 2012 'Cash Market Transaction Survey 2010/11' (CMTS, see <http://www.hkex.com.hk/eng/stat/research/Documents/cmts11.pdf>), the share of "cash market trading volume" attributable to "Local retail investors" has fallen consistently over the past 9-10 years

- According to the CTMS, from a level of around 32 per cent in 2001/2 to one of 22 per cent in 2010/11.

Nonetheless, the participation of retail investors remains at a high level, especially when compared to rates typically observed in some of the world's other leading markets.

Retail participation in equity ('cash') market investments is noticeably more pronounced in markets like Shanghai.

- See Lee, B.S., Li, W., Wang, S., 2010. The dynamics of individual and institutional trading on the Shanghai Stock Exchange. *Pacific-Basin Finance Journal* 18, 116-137.

3 Stock return volatility

Hong Kong's general market volatility appears to be at reasonable levels compared to other developed markets.

Zhou *et alia*'s (2012) recent paper provides "annualized daily per cent standard deviation" benchmarks for 11 major stock market indices, covering the period 1 February 1996 to 30 December 2009. Their results suggest the following volatility rankings (from lowest to highest, with their computed means reported in parentheses):

Singapore (17.0%); UK (17.10%); US (17.4%); Japan (18.7%); Taiwan (18.8%); France (19.0%); Hong Kong (19.5%); Germany (21.1%); China (23.2%); India (23.5%); and Korea (24.8%). *

* See Page 254, for means and other descriptive measures for the index return volatilities, in Zhou, X., W. Zhang and J. Zhang, 'Volatility spillovers between the Chinese and world equity markets', *Pacific-Basin Finance Journal*, 20, 2012, 247-270.

3 The arrival of “Automated Trading Systems” (ATSS)

ATSS in Asia currently serve much more limited role than their equivalents in the US and Europe.

- Webb-site.com reports that, as of the end of 2010, more than 97 per cent of turnover still went through HKEx’s AMS/3 system (see <http://webb-site.com/articles/darkspread.asp>, 7 August 2011).

This is in stark contrast to the US picture.

- According to HKEx’s *Research & Corporate Planning Department* (‘Asia Pacific markets attract global trading’, Exchange July 2010: “... the market share of ATVs in the US equity market had grown to over 40 per cent in May 2010 ...” (<http://www.hkex.com.hk/eng/newsconsul/newsltr/2010/Documents/2010-07-15-e.pdf>, p. 29).

To some extent, ATSS, as well as ATVs, serve a role in paring trading costs (especially by promoting tighter spreads).

However, the extent of this benefit has to be weighed against the additional regulatory oversight required to ensure that regulatory standards are at least maintained at current levels. There are clear divisions of opinion on this issue.

The current Australian experience may serve as a useful reference point for discussions at the general level. However, given Hong Kong’s special and unique institutional characteristics, careful consultation will inevitably be required before any possible changes to the current regulation of ATSS can be countenanced.

1 Overall trends

Based on numbers of derivatives contracts traded over the period January-June 2011, HKEx ranked 23rd globally.

- Ranking determined by the *Futures Industry Association* in *Futures Industry*, November 2011, page 2, FAI, at: [http://www.futuresindustry.org/downloads/Complete_Volume\(11-11_FI\).pdf](http://www.futuresindustry.org/downloads/Complete_Volume(11-11_FI).pdf)).
- However, the above ranking includes both commodity and financial futures-based exchanges.

HKEx's "Market Statistics 2011" (<http://www.hkex.com.hk/eng/newsconsul/hkexnews/2011/Documents/20111220news.pdf>) reveal that HKEx ranks seventh globally in respect of "Notional Turnover in the Derivatives Markets (Jan - Nov 2011)"

- This ranking utilizes WFE data for products including: "stock options, single stock futures, stock index options and futures and bond options and futures." (HKEx Market Statistics 2011, Page 16).

2 Retail and institutional participation

Almost reaffirming 'cash' market trends, Page 10 of HKEx's November 2011 "Derivatives Market Transaction Survey 2010/11" (DMTS, see <http://www.hkex.com.hk/eng/stat/research/Documents/DMTS11.pdf>) reports a major albeit declining "Local retail investor" contribution (from around 29 per cent in 2001/2 to 20 per cent in 2010/11).

Notwithstanding the above, Page 2 of the DMTS reveals a more than 50 per cent increase in the total volume of HKEx's traded derivative contracts over the four-year period, 2007 to 2011.

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