CFA Society Singapore Response to Singapore Exchange Limited Consultation paper on Propose Enhancements to Auction Routines for the SGX-ST market

Name of Organisation	CFA Society Singapore • Alan Lok, CFA • Joshua Wu
Contact number for any clarifications	(65) 6323 6679
Email address for any clarifications	advocacy@cfasingapore.org

Summary

We welcome Singapore Exchange Limited's (SGX) move to introduce volatility control mechanisms during auction routines. The move is a step in the right direction to address concerns from traders after a flash crash in January 2019 briefly wiped out $56.6 billion off Singapore-listed Jardine Matheson's market cap in pre-market trading.

After studying the consultation paper and the proposed solutions, we are inclined towards the hybrid model.

The model takes into consideration the different circumstances affecting opening, mid-day and closing prices. The emphasis on market led price discovery is most relevant for opening sessions as the last trade could have happened over 16 hours ago, or longer if it takes place after the weekend. This is also applicable to the mid-day session albeit to a smaller extent due to the significantly shorter one hour break in between.

The length of the non-trading period is positively correlated with the increased likelihood of significant events (E.g. M&A announcement, positive/ negative profit warning) affecting the market price of the security.

Furthermore, for time extensions, there isn't a need to cancel resting orders from the preceding trading phase or block new orders beyond the given price range. The five minutes time extension proposed by SGX would also be communicated to market participants who can then enter new orders or modify existing ones for the affected security.

Hence, we conclude that for the Opening Routine and Mid-Day Break, time extensions are appropriate.

We are also of the opinion that a price collar could work better for Closing Routines as it provides end-time certainty across the board. SGX stated that: "[price collar] is important and especially relevant to downstream, systems and processes of market participants as well as index providers and fund managers who use the closing price to price the derivative instruments or funds". We concur with this observation as internal systems used by market participants require the timing of the closing price to be consistent across all counters (ie for a STI derivative or ETF, a price triggered time extension for a single counter within the index might result in an inaccurate capture of the entire index's closing price).

Benefits to stakeholders to proposed regulations

Investors – Investors particularly the mom and pop retail investors will have more confidence in the integrity of the system as they are protected from extreme price movements and potential manipulation is discouraged. For example, if an investor who requires execution certainty puts in a Sell on Open/Close Market order, the investor knows that there would be adequate safeguards in place that would put a percentage floor on the executed price or alert him or her if it were to be otherwise.

SGX – The exchange would benefit from greater investor confidence which could result in greater market participation which is positive for SGX from both a business and reputation point of view. It also saves the exchange the time and effort to review appeals as the proposed safeguards would limit related appeals from brokers' and financial institutions' to a minimum. The proposed measures also reduce the risk of undue market alarm and systematic risks across the exchange.

Recommendation upon implementation of proposed regulation

SGX should work with brokers to communicate and educate their clients on the new safeguards in place. A well-illustrated email or infographics, or a short video, for retail investors are feasible options.

Trading representatives can also undergo an online quiz on the new features to ensure that they are well equipped with the knowledge to further elaborate on the above to retail investors should there be any enquiries.

SGX should also communicate the summary of responses received from the public consultancy exercise.

Question 1:

a) We are in favour of employing time extensions. Important announcements that have the potential to impact a company's share price such as earnings results, profit guidance and dividend announcements typically take place after market hours.

Although there are suggestions on increasing the range of the price collar, having the collar too wide apart defeats the intent of the price collar.

b) Significantly illiquid counters as per the example given are not likely to post strong systemic risks hence could be temporarily left alone until more customized solutions for these are found.

c)Five minutes is sufficient. It does give adequate time for market participants to amend or put in orders according to the current situation.

Question 2:

a) We are in favour of employing time extensions. The time extension would not interfere with market led price discovery, especially on the back of important pre-mid day announcements. We also expect less of an impact since most companies do not make mid–day announcements due to the short time period in a mid-day break.

b) Significantly illiquid counters as per the example given are not likely to post strong systemic risks hence could be temporarily left alone until more customized solutions for these are found.

c) Five minutes is sufficient. It does give adequate time for market participants to amend or put in orders according to the current situation. If the time extension is too long it could interfere with usual market functions.

Question 3:

a) We prefer price collars. Price stability is important for the Closing Routine. There would have been a full day of trading prior to the Closing Routine which means the market has already priced in market moving news throughout the trading day, and hence reducing the possibility of sharp price movements during the closing.

It also ensures certainty with regards to the closing auction end time. Considerations also include having a system robust enough to block new limit orders beyond a certain range and also de-activating long dated orders and cancelling resting day orders from continuous trading sessions in the afternoon.

b) We seek SGX clarification for the need to lift a price collar if the counter has not had a single trade in that trading day.

c) *Not applicable*

Question 4:
a) We are inclined towards the hybrid model.

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Furthermore, for time extensions, there isn't a need to cancel resting orders from the preceding trading phase or block new orders beyond the given price range. The five minutes time extension proposed by SGX would also be communicated to market participants who can then enter new orders or modify existing ones for the affected security.

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Question 5:
a) We agree with the scope of instruments covered. STI Index and MSCI Singapore component stocks have sufficient liquidity and are a good representation of the Singapore market.

b) We agree with how the reference price is determined. Stock splits and share consolidations might not affect the total value of the shares but the price would change drastically hence the need to use the adjusted price based on the pricing model from SGX.

c) A range of ± 30% should be adequate to address concerns about price discovery as most stocks trade well within that range. The opening price should be wider than the mid-day break and closing routine because there is a longer period of inactivity for Opening Routines which increases the likelihood of significant price sensitive announcements.

The ± 30% band is in line with other markets such as Korea and Thailand.

Question 6:
We agree with the proposed treatment of the various types of linked instruments when a Volatility Control has been activated on the underlying. This is to align the relevant price discovery phase for both the underlying security and the single counter derivative instrument from which it draws its reference from.

Question 7:
We agree with the proposed market coverage of the Volatility Control in the ready market as an overwhelming majority of trades are executed there.

Existing Exchange restrictions in the unit share market that prevent orders of quantity greater than 99 (which is the lot size in the ready market) from being placed is sufficient to reduce the chances of disorderliness.

Question 8:
It may take between six months to a year for implementation.