



Hong Kong

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HKEX PROPOSES “LONDON-HONG KONG CONNECT” TO LINK COMMODITIES MARKETS

Introduction

The Hong Kong Exchanges and Clearing Limited (**HKEx**) Group has recently made an announcement (with supplementary information) in relation to a proposal to build “London-Hong Kong Connect” linking the commodities markets in London and Hong Kong, following the successful launch of Shanghai-Hong Kong Stock Connect in November last year. The proposed “London-Hong Kong Connect” would separately establish a trading link between Hong Kong Futures Exchange Limited (**HKFE**) and the London Metal Exchange (**LME**) and a clearing link between HKFE Clearing Corporation Limited (**HKCC**) and LME Clear Limited (**LME Clear**).

The announcement was made following the signing of a non-binding memorandum of understanding (**MOU**) on 21 October 2015 between HKFE, HKCC, the LME, LME Clear, subsidiaries of HKEx and members of the HKEx Group for the proposed development of “London-Hong Kong Connect”, which was signed as part of the cooperation initiatives announced in a ceremony led by Chinese President Xi Jinping and British Prime Minister David Cameron.

If implemented, “London-Hong Kong Connect” will enable HKFE’s eligible Exchange Participants to trade LME products, and HKCC’s eligible Clearing Participants to clear those trades. This is however subject to having all necessary regulatory approvals and rules in place, further development of the model, and determination of the appropriate trading and clearing arrangements.

Background

The proposed “London-Hong Kong Connect” is a logical development. The LME is the world centre for industrial metals trading¹ and risk management in the global metals industry² whilst China is the world’s biggest importer of commodities and a growing number of Mainland companies need to hedge their risks through the financial futures market. Following the successful acquisition of the LME in December 2012, HKEx has carried out business consolidation, built LME Clear and reformed the warehouse system, with the aim of linking China with the world through the LME platform.

Further, the LME network has more than 700 warehouses across 38 locations in 14 countries and regions, with over 500 of them across 26 locations along China’s “Belt and Road”³ countries and regions. However, due to trading costs and other barriers, China remains under-represented and under-hedged on the LME relative to its size in global production and consumption.

- ¹ The world’s metal community uses the LME to trade futures and options contracts of 11 base metals including copper, aluminium, tin, nickel, zinc and lead.
- ² More than 80% of global non-ferrous metals business is conducted on its trading platforms.
- ³ The Belt and Road Initiative covers more than 60 countries. Some expect it could bring over US\$2.5 trillion in trading with China in the next ten years and the majority of the trading volumes would be related to commodities.

All-round benefits

For Mainland Chinese investors and companies, the proposed “London-Hong Kong Connect” will lower the trading costs and barriers, allowing them to better manage their hedging risks through LME products. They will also benefit from a broad variety of investment opportunities, enabling them to internationalise their asset allocation and participate in the international price-setting ecosystem. They are also more familiar with Hong Kong’s trading platforms.

Hong Kong brokers will also be able to directly access LME products for their clients in a low cost way, clearing in Hong Kong will enhance capital efficiency, and increased liquidity in the Asian time zone will help develop Hong Kong into a commodities trading hub.

Overall, the proposed link will enhance Hong Kong’s strategic role as the primary risk management and wealth management centre for Chinese and other Asian investors.

Implementation of “London-Hong Kong Connect”

Implementation of the trading and clearing links is subject to regulatory approval in Hong Kong, the United Kingdom and the European Union. As of now, no formal agreement has been entered into. HKFE, HKCC, LME and LME Clear will discuss the types of products to be included, the operational model, the system requirements and other related issues with the relevant regulators, and will provide an update in due course.

Once implemented, HKEx intends to roll out more RMB-denominated futures and commodities products to promote RMB internationalisation and further enrich investment products in the offshore RMB market.

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