FAQs on Guidelines for Securities Margin Financing Activities

Overall

1. Are securities margin financing (SMF) brokers required to fully comply with all the benchmarks set out in the Guidelines as of the implementation date?

The Guidelines provide guidance to brokers on their margin lending policies and risk controls for SMF activities, setting out both qualitative guidance and quantitative benchmarks. The objective is to help SMF brokers identify and manage financial risks and in particular to help them properly manage the risks to their excess liquid capital buffers. With robust risk management, brokers can minimise the risk of a breach of the minimum liquid capital requirement under the Securities and Futures (Financial Resources) Rules (FRR), which would result in the cessation of their business under the Securities and Futures Ordinance and adversely affect the interests of their clients.

SMF brokers are expected to assess their risk controls in relation to their SMF business with reference to the guidance and benchmarks set out in the Guidelines when they come into effect.

As stated in paragraph 6 of the Introduction to the Guidelines, the benchmarks supplement the qualitative guidance set out in the Guidelines. A deviation from a benchmark does not automatically translate into failure of compliance or result in disciplinary action. A deviation from the benchmarks may be acceptable if it can be properly justified by equivalent or compensating controls which are as prudent and effective as those set out in the Guidelines.

The SFC will adopt a pragmatic and holistic approach in assessing whether a deviation from the Guidelines is acceptable. If a deviation is assessed not to be acceptable, the SFC will engage constructively with individual brokers and a reasonable period of time will be given to make adjustments in their transition to operate in alignment with these expectations.

2. What is the supervisory process under which the SFC deals with a deviation from a benchmark?

When a deviation from a benchmark is reported, the SFC will consider, in addition to the deviation itself, other relevant factors1, and engage constructively with the reporting broker to assess the effectiveness of its risk controls and its overall financial risk.

Where necessary, the SFC may discuss with the reporting broker a suitable risk mitigation plan, such as the adoption of temporary or interim risk control measures or the injection of capital. Sufficient time will be given to the broker to implement the agreed risk mitigation plan.

In the extreme case where an SMF broker fails to address its financial risk responsibly after interacting with the SFC on the risk mitigation plan, or faces an imminent risk of insolvency or breaching the minimum liquid capital requirement under the FRR, the SFC will consider taking appropriate regulatory action, for example, imposing licensing conditions, to protect investor interests.

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1 Including but not limited to the firm’s financial strength, the quality of its margin loan portfolio, the potential financial impact on the firm and its clients, the extent of the deviation, the level of risks, the size and resources of the firm, equivalent or compensating controls and any other risk mitigating factors.
3. A number of small and medium-sized brokers rely on external vendors to adjust their IT systems to capture the benchmarks or conduct the stress tests. What will be the implications for an SMF broker if its IT system is not ready during the initial period of implementation of the Guidelines?

Brokers are required to notify the SFC of any delay and how much time it is expected to take for the system to be ready. Sufficient time will be allowed for brokers to adjust their IT systems and controls to align with the expected standards set out in the Guidelines.

Total margin loans-to-capital multiple

4. In calculating the total margin loans-to-capital multiple, can an SMF broker exclude the amount of impairment losses recognised in respect of margin loans from total margin loans?

Yes.

Securities collateral concentration

5. What action is an SMF broker required to take if the result of the excess liquid capital (ELC) impact analysis conducted on a security held as collateral in accordance with paragraph 3.10 of the Guidelines exceeds the specified ELC impact benchmark?

The SMF broker should tighten its internal concentration limit of that securities collateral in accordance with paragraph 3.11 of the Guidelines and notify the SFC in accordance with paragraph 8 of the Guidelines.

6. For the purposes of identifying groups of connected major securities collateral, if an SMF broker finds that two of the ten largest securities held by it as collateral are constituents of the Hang Seng Index, can the SMF broker only conduct assessment of the remaining eight securities collateral?

Yes.

Haircuts for securities collateral

7. Can a re-pledging broker provide financing for securities not acceptable as collateral by all of its top three lending banks?

For securities not acceptable as collateral by all top three lending banks of a re-pledging broker, the re-pledging broker may apply a haircut percentage of not less than 80% on such securities in accordance with paragraph 5.5 of the Guidelines. Paragraph 5.6 of the Guidelines allows a re-pledging broker to assign a lower haircut percentage provided that it has clearly documented its justification, its assessment of the impact on its financial position and its measures to mitigate the additional risks arising from applying a lower haircut percentage.
Margin calls

8. Paragraph 6.4 of the Guidelines requires an SMF broker to take reasonable steps to avoid excessive exposure to outstanding margin calls, for example, where the total amount of outstanding margin calls has exceeded its shareholders’ funds or total amount of long-outstanding margin calls has exceeded 25% of its shareholders’ funds. What could be regarded as reasonable steps?

Whether the steps taken by an SMF broker are reasonable depends on the specific circumstances of each case, for example, the firm’s financial position, the quality and composition of the securities collateral, the client’s financial position, trading pattern and settlement history and the measures taken by the SMF broker to mitigate the financial risks arising from the accumulation of outstanding margin calls. Possible steps that an SMF broker may take to avoid excessive exposure to outstanding margin calls include making margin calls or not permitting further advances that may worsen the situation.

9. For the calculation of "total amount of outstanding margin call" and "total amount of long-outstanding margin call" stipulated in paragraph 6.4 of the Guidelines, (a) can an SMF broker deduct from the margin call amount in respect of a margin loan any amount of impairment losses recognised in respect of the loan; and (b) can an SMF broker exclude any margin call amount that has been waived?

(a) Yes.

(b) No. In note 1 of paragraph 6.4 of the Guidelines, the amount of outstanding margin call is defined as the unsettled margin shortfall in the margin client’s account in respect of which a margin call has been made or should have been made by an SMF broker in accordance with paragraph 6.3 of the Guidelines.

10. Paragraph 6.5 of the Guidelines provides an example of a margin client who has failed to settle margin calls in a total of 15 days or more in the preceding 30 calendar days and thus could be treated as having a poor history of settling margin calls. How should an SMF broker count the number of days a margin client has failed to settle a margin call?

For the purposes of calculating the number of days a margin client has failed to settle a margin call, an SMF broker can count the number of days between the date the margin call is due for settlement and the date it is settled. In this regard, an SMF broker may exclude the grace period for the client to settle the margin call after the margin call is made, as set out in its margin call policy. Such grace periods should be reasonable and prudent in light of the circumstances of both the margin client and the SMF broker.
Stress testing

11. If the result of the stress tests conducted by an SMF broker in accordance with paragraph 7 of the Guidelines suggests a significant deterioration of its ELC or liquidity in times of stress, what action is the SMF broker required to take and what will be the consequence?

The Guidelines provide hypothetical stress scenarios to be applied by an SMF broker in conducting stress tests on ELC and liquidity. If the stress tests suggest that the SMF broker’s ELC and liquidity would significantly deteriorate under the specified stress scenarios, the broker should notify the SFC in accordance with paragraph 8 of the Guidelines and take measures to prevent a liquidity crunch, insolvency or non-compliance with the minimum liquid capital requirement.

The SFC will contact the reporting broker to obtain details of the stress test results and the broker’s financial position, and work out with it to formulate a risk management plan taking into account its circumstances.

12. Can the stress testing required under paragraph 7 of the Guidelines replace all other requirements set out in the Guidelines?

Paragraph 7 and the other parts of the Guidelines serve different objectives, and are different in their nature and coverage. The guidance and benchmarks set out in Paragraphs 1 to 6 of the Guidelines provide a foundation for SMF brokers to build up a robust risk management system for SMF business. The qualitative and stress test requirements for individual securities collateral concentration under paragraph 3 of the Guidelines ensure that SMF brokers assess the event risk of individual securities collateral, whereas the stress testing requirements under paragraph 7 of the Guidelines ensure that SMF brokers evaluate the overall effectiveness of their risk controls in times of volatile market. Accordingly, the requirements in the Guidelines do not overlap but rather complement one another.

Others

13. Will the SFC provide further guidance to the industry to facilitate their compliance with the Guidelines and conduct a review of the practical issues encountered by the industry?

The SFC will continue to constructively engage individual brokers and brokers associations in discussions on practical compliance issues. Further training, especially during the first six months after implementation, will be provided.

The SFC will hold further meeting with the industry associations to collect feedback on the benchmarks as part of an ongoing review.