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The Supervision of Markets Division
The Securities and Futures Commission
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Supervision of Markets Division
Securities & Futures Commission

By Hand

4 February 2005

Our Ref 我所文號 L-063699

Dear Sirs

Consultation Paper on the Review of the Level and Funding of the Investor Compensation Fund, Broker Defaults since 1998 and the Operation of the Investor Compensation Arrangements (the "Consultation Paper")

We are writing to provide comments on the proposals set out in the Consultation Paper on behalf of the 4 financial institutions listed below (the "**Group**"). We are grateful to the Commission for this opportunity.

We set out below our comments in relation to the heads of proposals in the Consultation Paper.

1 Automatic levy triggering mechanism

*The Commission proposes to introduce an automatic levy triggering mechanism in relation to the Investor Compensation Fund ("**ICF**") with the following key features:*

- *the current investor compensation levies will be imposed if the net asset value of the ICF falls below HK$1 billion;*
- *the current investor compensation levies be suspended if the net asset value of the ICF exceeds HK$1.4 billion;*
- *a month-end net asset value of the ICF which is certified through an audit by the auditors of the ICF will be used for the purposes of applying the levy triggering mechanism;*

- *the Commission is responsible for implementing and monitoring the operations of the levy triggering mechanism as well as informing the public and the market by way of a notice of any changes to the prevailing levy arrangements including the date of implementation of such changes; and*
- *for the imposition of levies, the implementation date is set at at least two months after the date of issue of the Commission's notice; and for the suspension of levies, the implementation date is set at one month after the date of issue of the Commission's notice.*

The Group welcomes the introduction of the automatic levy triggering mechanism which would impose compensation levies if the net asset value of the ICF fell below HK$1 billion and would suspend compensation levies if the net asset value of the ICF exceeded HK$1.4 billion.

The Group generally supports the Commission's proposal to give market participants a 'grace period' before implementation of the imposition/suspension of levies. However, the Group suggests that it would be more convenient to set the same 'grace period' for the implementation of both imposition and suspension of levies. In particular, the Group suggests that the implementation date for both the imposition and suspension of levies should be at least one month after the date of issue of the Commission's notice.

Having said that, the Group recognises that there may be fluctuations in the net asset value of the ICF. Where the fluctuations are frequent and involve significant changes in the value of the ICF, the Group would urge the Commission to consider shortening the 'grace period' so as to avoid having to retrace any trigger on imposition/suspension of levies during the 'grace period'.

2 Level of compensation coverage

The Commission suggests that the per investor compensation limit be retained at HK$150,000 per investor but will be reviewed if experience shows that the average level of coverage has fallen significantly.

The Group agrees that the HK$150,000 per claimant level under the existing policy should remain unchanged. However, the Group suggests that the Commission should maintain a monitoring system such that due consideration can be given to the per claimant level if and when necessary.

3 Power for the ICF to advance funds to redeem pledged shares

The Commission turns down the recommendation by liquidators involved in recent broker default cases that the ICF should be able to advance funds for the purpose of facilitating the return of client's shares pledged by a broker as security for a loan.

The Group supports the arguments against the proposal to empower the ICF to advance funds to redeem pledged shares because granting such power to the ICF would involve numerous legal and economic hurdles, including imposing additional expense to the ICF.

4 Power for liquidators to sell securities and distribute money

The Commission refutes the recommendation that power be granted to liquidators to sell clients' securities as soon as possible on receipt and to distribute money rather than shares to the clients after the ownership of the securities has been ascertained. The Commission finds that this suggestion is inconsistent with established case law in Hong Kong and concludes that this area *should be left to common law. However, the Commission will continue to monitor the development of the law in other major jurisdictions in this regard.*

The Group agrees with the Commission that the suggestion for liquidators to sell clients' securities as soon as possible on receipt and to distribute the money rather than shares should not be pursued further.

5 Use of ICF funds to pay for an administrator

The suggestion that ICF funds should be made available to pay for an administrator who is charged with protecting and returning client assets will not be further pursued by the Commission as this suggestion would, among other things, increase exposure to the ICF.

The Group strongly agrees that administrators should be paid out from the trust property and the realised assets of the broker as discussed in the Consultation Paper. The ICF funds are available for, first and foremost, the benefit of clients. The Group also believes that to allow ICF funds to be used to pay for an administrator's fees may in the long run have an adverse effect on the funds available to clients. The Group therefore agrees that the Commission should not pursue this suggestion further. The Group, however, supports the Commission's recommendation to appoint an administrator at an early stage to protect client assets and return shares to clients and where possible, establish practices which would minimise administration costs provided these practices would not be detrimental to the interests of the clients.

6 Other matters

The Commission will continue to concentrate on measures (such as recent proposals for limits on pledging client securities) to reduce the risks of pooling of margin client securities. The Commission will also continue in its investor education programme to emphasise increasing investor understanding of market risks.

We strongly support the Commission in its emphasis on the importance of investor education and look forward to seeing further developments of educational programmes to enhance investor awareness of market risks, etc.

The Group would welcome the chance to comment on the required legislative amendments in support of the Commission's proposals at the earliest opportunity.

The Group would be happy to meet with the Commission to discuss the views set out in this letter. If you have any questions in relation to the comments set out above, please contact Stephen Fletcher at 2901 5350.

Yours faithfully

Linklaters

Linklaters

on behalf of

Credit Suisse First Boston (Hong Kong) Limited
Merrill Lynch (Asia Pacific) Limited
Morgan Stanley Dean Witter Asia Limited
UBS AG