

Securities and Futures Commission  
35/F Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

18 October 2018

Dear Sirs,

Re: Consultation Paper on the Proposed Guidelines for Securities Margin Financing Activities

We refer to the Consultation Paper on the Proposed Guidelines for Securities Margin Financing Activities.

We are pleased to submit this response and welcome the Securities and Futures Commission (“SFC”) making these proposed guidelines to clarify and standardize the risk management practices to all licensed corporations carrying on Securities Margin Financing (“SMF”) activities. Being a member of financial industry, we appreciate the enhancement on the quality and standard in area of SMF. However, such guidelines may discourage the development of our securities market and reduce our competitiveness. Existing regulations and rules, such as the Financial Resources Rules (“FRR”) already address the regulatory concerns. The setup of rigid parameters would limit the business development and reduce the flexibility in brokerage firms. Besides submitting the general view on the Proposed Guidelines for Securities Margin Financing Activities on 16 October 2018, we would also like to highlight our response regarding to your 7 key risk control areas mentioned in the proposed guidelines.

#### **Response on 7 key risk control areas**

##### ***Total margin loan controls***

We do not support the point that SMF brokers should control its total margin loans with reference to the amount of its capital and provide a benchmark for the total margin loan-to-capital multiple because the margin financing business should be carried out mainly based on clients’ financial background and capability, the quality of collateral as well as the overall market sentiment. Moreover, margin financing business is always supported by securities collateral and funding from brokers’ banks through re-pledging at certain amount of margin ratio after comprehensive assessment by banks.

Although we oppose to the idea of setting a quantitative loans-to-capital benchmark, we would like to answer the benchmark for total margin loans-to-capital multiple at the largest level of five times if the suggested range must be implemented after consultation.

##### ***Margin client credit limit controls***

We generally agree that the coverage of related margin clients should be extended. However, it might increase administratively difficulty to monitoring aggregate credit risk exposures which is held by the same beneficial owner.

##### ***Securities collateral concentration controls***

We agree that the exposure of different securities which are highly correlated should be aggregated for the purpose of monitoring. However, the definition of highly correlated securities is not well defined and there is no clear framework. According to the definition provided, we found that the securities issued by the same issuer or by different companies within the same group of companies or securities which exhibit a high

correlation are impractical to be identified. For example, the case of penny stocks crash incident in last June shows that it is impossible to identify the mysterious networks of holding within more than 20 stocks with high correlation. Without having clear guidelines for setting securities collateral concentration limits and list of high correlated securities, we strongly believe that the approach is impractical to manage concentration risk.

For the constituent stocks of any other stock indices, we consider that it should also be treated as index stocks. Like Morgan Stanley Capital International (“MSCI”) Hong Kong & China or Hang Seng Composite Index (“HSCI”) constituents, the index covers most of the companies listed in Hong Kong and global markets. The quality of those securities is high and the risk is comparatively low. According to the suggested ranges of the proposed quantitative benchmarks for implementation, we suggest that X% should be set at the largest of 50% and Y% at the largest of 25%.

#### ***Margin client concentration controls***

Based on the quantitative benchmark, we do not think that the margin client concentration should be measured with reference to the broker’s shareholders’ funds. Due to varying of the capital amount, it makes administratively difficult in monitoring and identifying the concentration. The FRR already covers the margin client concentration risk by making adjustment on margin loan receivables from all clients when significant margin loans exceeds 10% and this arrangement already provides a reference for SMF brokers’ daily monitoring. The more appropriate way to measure the margin client concentration should be measured with reference to the total margin loan. SMF brokers could also set up the margin lending policy and procedures to identify and monitor the major client’s exposures with reference to the total margin loan to ensure the stability of the in-house capital.

#### ***Haircuts for securities collateral***

In order to strike a balance between prudent risk management and our business competitiveness, the haircut ratio or a list of acceptable securities for margin financing shall be decided and maintained by SMF brokers’ own discretion. It is a common practice for SMF brokers to conduct the assessment on the collateral when deciding the acceptable amount on the margin loan to be granted. The existing FRR haircuts requirement already provides us a guideline on the haircut percentage. There will be conflict between the existing FRR haircuts requirement if the proposed quantitative benchmark is implemented. As the final haircut percentage, in any event, not lower than the corresponding haircut percentage prescribed in the FRR, the existing FRR haircuts requirement is already sufficient to act as an indicator. Furthermore, we do not agree on taking the average of the haircut percentage assigned by its top three banks due to the business owner decision is better be made by brokers rather than banks as well as the average will be lowered dramatically in the case if one of the top three banks provide 100% haircuts.

#### ***Margin calls, stopping further advances, forced liquidation***

All brokers normally establish their own policies and procedures of margin control based on risk-based assessment approaches which comply with the regulatory requirement. We disagree on the idea of defining a long-outstanding margin call based on the pre-set time period. The overall risk should be implemented by assessing on various factors, such as clients’ trading and settlement record, financial capability, quality of collateral and market sentiment.

#### ***Stress testing***

We agree that all SMF brokers should conduct stress tests regularly in order to maintain effective risk

management. However, the significant group of highly correlated re-pledged securities collateral is not well defined and it is difficult to follow the mentioned hypothetical stress scenario. Moreover, we agree that constituent stocks of other stock indices should be treated as index stocks.

***Implementation timeline***

In view of the above, the proposed six-month transition period is insufficient for the industry to implement the amended guidelines. We highly recommend that at least a twelve-month transition period should be provided so that we could have sufficient time to negotiate with the vendors or conduct system enhancement.

**Conclusion**

In conclusion, we would urge the SFC to reconsider those quantitative benchmarks mentioned in the proposed guidelines. As stated above, the existing FRR already serve the function on monitoring the capital of SMF brokers. The controls and measures specified in the proposed guidelines would increase the administration costs and reduce the brokers' competitiveness. It is recommended giving a regulatory framework rather than providing a set of quantitative benchmark in relation to SMF activities.

We wish our name to be withheld from publication. Thank you very much for your kind attention.

Yours faithfully,

Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

16 October 2018

Dear Sir,

Re: Consultation Paper on the Proposed Guidelines for Securities Margin Financing  
Activities (the “Consultation Paper”)

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We write in response to the Consultation Paper. We appreciate and welcome a clear guideline for securities margin financing (“SMF”) activities from the Securities and Futures Commission (“SFC”), as it is important to maintain SMF brokers’ financial stability and confidence in the brokerage community as a whole as well as market integrity. Nevertheless, striking a balance in order to enhance the competitiveness of Hong Kong as a world class financial centre is essential. It is with this view in mind that we have the following comments in relation to the Consultation Paper.

We oppose to the idea of a quantitative loans-to-capital benchmark being introduced as the scale of SMF business would be constrained by the size of a broker’s capital if it is to meet such benchmark even with the support of sound securities collateral. Moreover, as a broker’s capital may vary from time to time, it would make it administratively difficult to monitor the total margin loans-to-capital multiple. The SMF market is already of very keen competition, the increased administration cost together with a reduced business would dampen the competitiveness of the brokers, and this may in turn harm the interests of investors.

Many brokers have regularly conducted different stress tests in order to maintain effective risk management for themselves. Brokers should be given flexibility to devise their own policies within the framework and guidelines provided by SFC rather than being provided with a set of a rigid parameters to follow, after all, each broker has its own circumstances and is difficult to have a “one size fit all” parameter.

We are of the view that with existing control measures, namely, the Financial Resource Rules (“FRR”) is a good indicator for the SFC to reflect on the status of the brokers. As SMF brokers are required to submit reports to the SFC periodically, SFC would be able to monitor the margin brokers through these periodic reports, and take action where necessary. In order for more prudent practices of SMF brokers, we suggest to tighten the FRR requirements such as a more stringent haircut percentage instead of introducing new haircut requirements which may duplicate the administrative workload and/or caused conflict and confusion between the two.

In conclusion, many brokers already have long established policies and procedures in order to carry out their risk management. The additional rigid parameters as proposed in the Consultation Paper would reduce the brokers’ competitiveness and yet increase the administration costs for many brokers. In order to strike a balance between risk control and competitiveness, we urge that SFC to (1) revise the requirements of the existing FRR and (2) give a framework rather than a quantitative benchmark in relation to SMF activities in the guidelines and let the brokers to make their own risk management policies which suit their particular business.

We wish our name to be withheld from publication. Thank you very much for your kind attention.

Yours faithfully,