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Legislative Council Panel on Financial Affairs

Follow-up to the meeting on 6 February 2006 on the progress report on proposed measures to address risks arising from securities margin financing

Purpose

This note sets out our response to the questions raised by Members at the meeting of this Panel on 6 February 2006.

Background

2. On 6 February 2006, the Securities and Futures Commission (SFC) briefed Members on its proposal to implement a re-pledging limit on securities margin finance ("SMF") providers in two stages, i.e. to set a 180% re-pledging limit initially and by the end of 12 months after implementation, reduce the limit to between 130% and 150%. We also suggested to further assess the possible consequences of the proposition of complete segregation of collateral of borrowing and non-borrowing margin clients and how it could be implemented cost-effectively.

3. At the meeting, Members requested the SFC to provide the following information:

(a) the number of SMF providers that are likely to be affected by a re-pledging limit of 180%;

(b) the impact of the long-term measure of complete segregation of collateral of borrowing and non-borrowing margin clients:
   (i) on the operating cost of SMF providers, including the respective impact on small, medium and large-sized SMF providers; and
   (ii) on borrowing and non-borrowing margin clients, including the likely increase in service fees paid by them.

Number of SMF providers likely affected by 180% re-pledging limit

4. Based on financial data as of September 2005 submitted by SMF providers, we estimated that only 4 out of 84 SMF providers that re-pledge client collateral may be required to obtain alternative funding in order to comply with a re-pledging limit of 180%. The number of firms that may be affected in a similar manner is 7 if the re-pledging limit is set at 130%.

Cost implications of complete segregation

5. The SFC agrees to further study the cost effectiveness and cost implications of complete segregation of collateral of borrowing and non-borrowing margin clients in order to better understand its impact on the industry and investors' interests.

6. Given that there is no current requirement on SMF providers to segregate collateral of borrowing and non-borrowing margin clients, most SMF providers do not have readily available data and tools to enable them to assess the cost of operating such segregation and the costs to borrowing and non-borrowing margin clients. The SFC will further discuss with the industry on how best to take forward the study. We will report to this Panel when the study results are available.

Securities and Futures Commission
March 2006