

## **LEGISLATIVE COUNCIL BRIEF**

### **Securities and Futures Ordinance (Cap. 571)**

### **SECURITIES AND FUTURES (CLIENT SECURITIES) (AMENDMENT) RULES 2006**

#### **INTRODUCTION**

The Securities and Futures Commission (the SFC) has made the Securities and Futures (Client Securities) (Amendment) Rules 2006 (the Amendment Rules) attached as the **Annex**, pursuant to section 148 of the Securities and Futures Ordinance (Cap. 571).

#### **BACKGROUND**

2. The SFC released the Consultation Paper on Proposed Measures to Address Risks Arising from Securities Margin Financing (the Consultation) together with relevant draft rule amendments on 28 September 2004 for public comment. The Consultation proposal set out a repledging limit that prescribes the maximum amount of clients' securities collateral that the intermediary or an associated entity of the intermediary is permitted to deposit as collateral for financial accommodation provided to the intermediary, based on the amount of total margin loans outstanding at the time. This repledging limit would make such repledging practices fairer to investors as well as help reduce pooling risk.

3. The Amendment Rules aim to amend the Securities and Futures (Client Securities) Rules (the principal Rules) to provide for the repledging limit.

#### **PUBLIC CONSULTATION**

4. A total of twenty-four submissions were received and numerous discussions over the repledging limit proposal have been held with industry participants and other interested parties. Non-industry respondents were supportive of the proposal. Industry respondents were more concerned about the costs and inconvenience to their businesses.

5. The SFC has reported twice, in December 2004 and February 2006, to the Panel on Financial Affairs (Panel) regarding the consultation feedback and subsequent discussions. The SFC received the support of most of the Panel members for the repledging limit proposal.

## **MAJOR POLICY CONSIDERATIONS**

6. The SFC has considered all the comments received and revised the Rules as appropriate. We strongly believe that a high repledging limit provides little protection to margin clients and maintain the view that the ultimate repledging limit should be set between 130%-150% as recommended by the SFC's Working Group on Review of the Financial Regulatory Framework for Licensed Corporations<sup>1</sup>.

7. To accommodate requests from the industry for a gradual phased-in approach so that they are better able to comply, we will adopt a two-stage approach by:

- (a) implementing a repledging limit of 180% that will come into effect on 1 October 2006; and
- (b) after a further period of 12 months, i.e. on 1 October 2007, the repledging limit will be fixed at 140%.

## **THE AMENDMENT RULES**

8. The Amendment Rules amend the principal Rules for the purpose of imposing a repledging limit on intermediaries licensed for dealing in securities or securities margin financing. The repledging limit applies when an intermediary or an associated entity of such intermediary repledges securities collateral of the intermediary.

9. Sections 2 to 4 provide for a limit on the amount of securities collateral which an intermediary or an associated entity of such intermediary is

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<sup>1</sup> The Working Group consisted of senior financial and industry people, members from academia and the Consumer Council.

permitted to deposit as collateral for financial accommodation provided to the intermediary.

10. Section 5 adds a new section 14 to the principal Rules to provide for a 12-month transitional period for phasing in the 140% repledging limit.

#### **FINANCIAL AND STAFFING IMPLICATIONS**

11. There are no financial or staffing implications for the Government.

#### **COMMENCEMENT DATE**

12. The Amendment Rules will come into operation on 1 October 2006.

#### **PUBLICITY**

13. The Rules will be published in the Gazette on 19 May 2006. The SFC will issue a press release on the same day.

#### **ENQUIRIES**

14. For any enquiries on this brief, please contact Mrs. Yvonne Mok of the Intermediaries Supervision Department of the Commission at 2842 7638.

The Securities and Futures Commission  
17 May 2006

**SECURITIES AND FUTURES (CLIENT SECURITIES)  
(AMENDMENT) RULES 2006**

(Made by the Securities and Futures Commission under section 148 of the Securities and Futures Ordinance (Cap. 571) )

**1. Commencement**

These Rules shall come into operation on 1 October 2006.

**2. Treatment of client securities and securities collateral by intermediaries licensed or registered for dealing in securities and their associated entities**

Section 7(2)(b) of the Securities and Futures (Client Securities) Rules (Cap. 571 sub. leg. H) is amended by adding “subject to section 8A,” before “deposit”.

**3. Treatment of securities collateral by intermediaries licensed for securities margin financing and their associated entities**

Section 8(2) is amended by adding “, subject to section 8A,” before “deposit”.

**4. Section added**

The following is added –

**“8A. Repledging Limit**

(1) This section applies to –

- (a) an intermediary licensed for dealing in securities;  
and
- (b) an intermediary licensed for securities margin financing,

where the intermediary or an associated entity of such intermediary repledges securities collateral of the intermediary.

(2) On each business day, the intermediary to which this section applies shall ascertain the aggregate market value of the repledged

securities collateral, which shall be calculated by reference to the respective closing prices of the collateral on that business day.

(3) If the aggregate market value of the repledged securities collateral calculated pursuant to subsection (2) exceeds 140% of the intermediary's aggregate margin loans on the same business day ("relevant day"), the intermediary shall by the close of business on the next business day following the relevant day ("specified time") withdraw, or cause to be withdrawn, from deposit an amount of repledged securities collateral such that the aggregate market value of the repledged securities collateral at the specified time, which is calculated by reference to the respective closing prices on the relevant day, does not exceed 140% of the intermediary's aggregate margin loans as at the close of business on the relevant day.

(4) In this section –

"aggregate margin loans" (保證金貸款總額), in relation to an intermediary, means the sum of margin loans owed to the intermediary by its margin clients as at the close of business on the relevant business day;

"business day" (營業日) means a day other than –

- (a) a Saturday;
- (b) a public holiday; and
- (c) a gale warning day or black rainstorm warning day as defined in section 71(2) of the Interpretation and General Clauses Ordinance (Cap. 1);

"margin client" (保證金客戶) has the meaning assigned to it by section 2(1) of the Securities and Futures (Financial Resources) Rules (Cap. 571 sub. leg. N);

"margin loan" (保證金貸款), in relation to a margin client of an intermediary, means the net amount owed to the intermediary by

the margin client arising from the provision of securities margin financing by the intermediary to the margin client, excluding any amount added to or deducted from such net amount in respect of dealing in securities by or for the margin client which are not yet due for settlement according to the settlement date;

“repledge” (再質押), in relation to an intermediary or an associated entity of an intermediary, means an act by which the intermediary or the associated entity deposits securities collateral of the intermediary as collateral for financial accommodation provided to the intermediary;

“repledged securities collateral” (被再質押的證券抵押品) means any securities collateral which is on deposit as collateral for financial accommodation provided to an intermediary, whether repledged by the intermediary or an associated entity of such intermediary;

“settlement date” (交收日期) means the date on which payment for any dealing in securities is first due as agreed between the parties to the transaction.

(5) In subsection (4), “securities margin financing” (證券保證金融資) has the meaning assigned to it by section 2(1) of the Securities and Futures (Financial Resources) Rules (Cap. 571 sub. leg. N).”.

## 5. Section added

The following is added –

### “14. Transitional

In relation to –

- (a) an intermediary which is licensed immediately prior to 1 October 2006 for dealing in securities;
- or

(b) an intermediary which is licensed immediately prior to 1 October 2006 for securities margin financing,

for the period from 1 October 2006 to 30 September 2007, any reference in section 8A(3) to 140% shall be construed as a reference to 180%.”.

Martin Wheatley  
Chairman,  
Securities and Futures Commission

15 May 2006

### **Explanatory Note**

These Rules amend the Securities and Futures (Client Securities) Rules (Cap. 571 sub. leg. H) (“the principal Rules”) for the purpose of imposing a repledging limit on intermediaries licensed for dealing in securities or securities margin financing.

2. Section 4 adds a new section 8A to the principal Rules. It provides for a limit on the amount of securities collateral which an intermediary licensed for dealing in securities or securities margin financing or an associated entity of such intermediary is permitted to deposit as collateral for financial accommodation provided to the intermediary. Sections 2 and 3 amend sections 7(2)(b) and 8(2) of the principal Rules in order to make the provisions subject to the new section 8A.

3. Section 5 adds a new section 14 to the principal Rules setting out the transitional arrangement in respect of the new section 8A.