

**For information**

**Legislative Council Panel on Financial Affairs**

**Follow-up to Meeting on 7 January 2008**

**Purpose**

This paper sets out the responses of the Government, the Securities and Futures Commission (SFC), and the Hong Kong Exchanges and Clearing Limited (HKEx) to the follow-up issues raised at the meeting on 7 January 2008.

**Congestion in Securities Trading Network**

*Service Standards and System Requirements for Brokers*

2. In response to Members' suggestion at the last meeting to prescribe objective service standards and system requirements for on-line securities trading, the SFC advised that it has already in place broad requirements and guidance notes on brokers' operational capabilities (including trading system capacity). These requirements are set out in –

- (i) the “Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission”;
- (ii) the “Management, Supervision and Internal Control Guidelines for Persons Registered with or Licensed by the Securities and Futures Commission”; and
- (iii) the “Guidance Note on Internet Regulation”.

3. In general, under the above-mentioned code or guidelines, licensed or registered persons should employ the necessary resources and procedures needed for the proper performance of their business activities. They should handle / transmit orders for prompt execution and that their computer systems should have sufficient operational integrity and be able to address issues of security, reliability, capacity and contingency. The SFC also requests

intermediaries to conduct periodic reviews on their computer systems' security, reliability and capacity.

4. The SFC's existing approach of imposing broad requirements on brokers' operational capabilities focuses on the more important principles and procedures, and provides a flexible framework for brokers to assess and maintain system capacity and reliability. The SFC will keep the existing arrangements under constant review to ensure that the brokers' systems capacities can cope with market activities.

#### *Task Force for Coordination of Emergency Response*

5. In response to Members' suggestion that a task force be formed to coordinate emergency response efforts among various stakeholders when network congestion in securities trading occurs, Members may wish to note that while individual financial regulators<sup>1</sup> are responsible for taking appropriate emergency response measures and formulating their front-line responses when market emergency situations (such as network failure) occur, the Financial Services Branch of the Financial Services and the Treasury Bureau plays a central coordination role in monitoring the operation of different sectors of the financial market and serves as a focal point of communication between the regulators and relevant Government bureaux/departments. The Administration, together with our regulators, will continue to monitor the financial markets closely and take appropriate and prompt actions to ensure that market stability, which is the cornerstone of Hong Kong's success as an international financial centre, is preserved.

#### **Investor Participant Accounts administered by the Hong Kong Securities Clearing Company Limited**

##### *Flow Chart on the trading procedures in an Investor Participant Account (IPA)*

6. At Members' request, the HKEx has prepared a flow chart at **Annex** setting out the procedures required for an IPA holder and his broker to place and execute a buying or selling order.

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<sup>1</sup> Including SFC, HKEx, the Mandatory Provident Fund Schemes Authority, the Hong Kong Monetary Authority and the Office of the Commissioner of Insurance

*Mandatory Use of IPA*

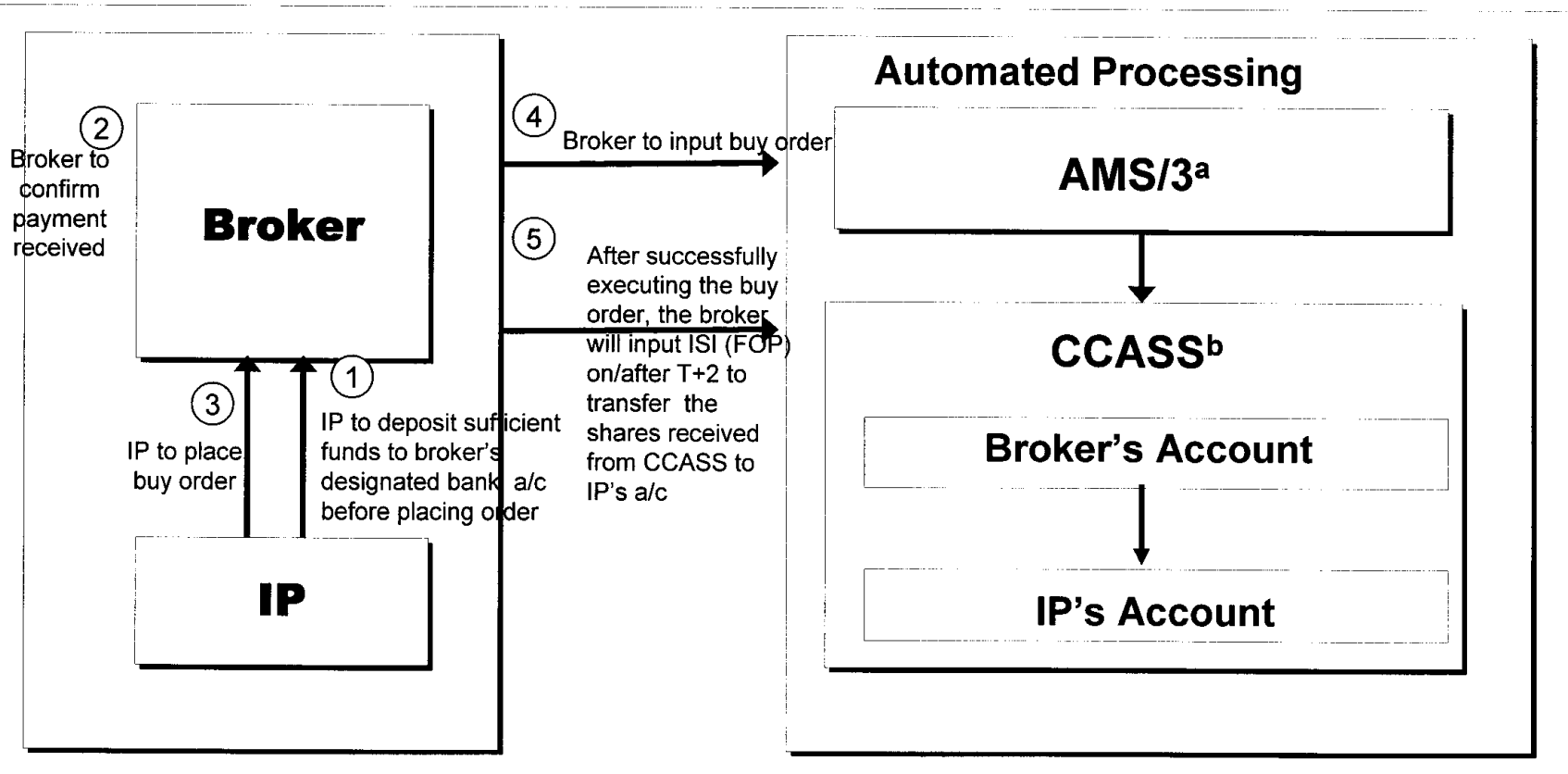
7. Regarding the suggestion to require the mandatory use of IPA as part of the stock transaction regime, the SFC has fully assessed the feasibility of the proposal. It maintains its view that the proposal needed careful consideration as it would not be reasonable to impose the use of IPA as a mandatory requirement across the board on all banks and all brokers' regardless of their size, financial strengths and types of investors they serve (e.g. institutional investors, high net worth individuals or ordinary small retail investors etc). Moreover, it may not be appropriate to deprive investors of their rights to choose how they would like to invest and keep their shares. Notwithstanding the aforesaid, to enhance investor protection, a review will be conducted to identify ways to address the inherent problems with the current asset custodian arrangements with a view to minimizing the risks of possible misappropriation. In the meantime, the SFC will continue to collaborate with HKEx and the industry to educate and promote the wider use of IPA among investors.

**Financial Services and the Treasury Bureau  
Securities and Futures Commission  
Hong Kong Exchanges and Clearing Limited**

**January 2008**



# Investor Participants (IP) Buy Shares – Scenario 1: IP Deposits Sufficient Funds in Broker’s Bank Account before Placing Buy Order

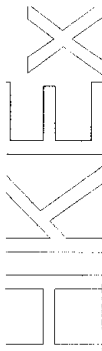


**Settlement arrangement**

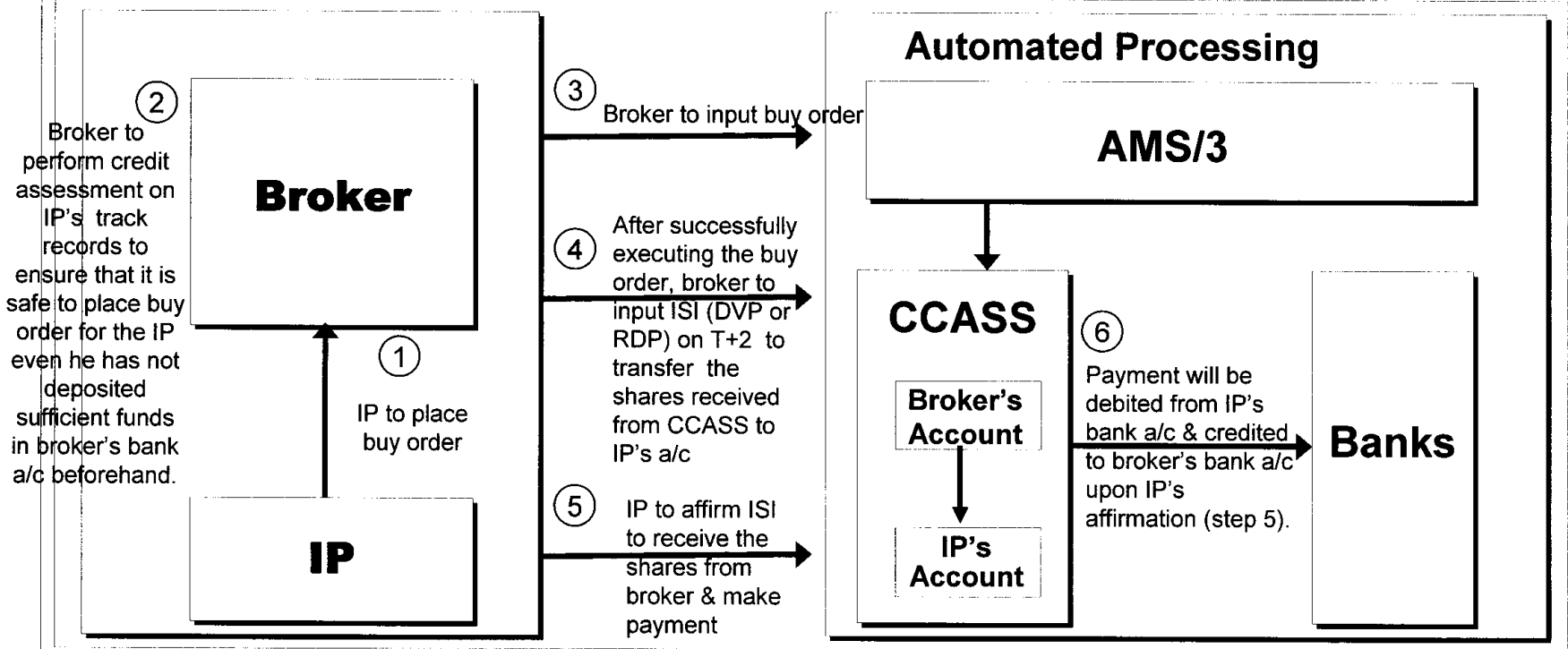
As payment has been collected from IP before placing order, the Investor Settlement Instruction (ISI) effected on settlement day (T+2) is Free of Payment (FOP).

<sup>a</sup> AMS/3: Automatic Order Matching and Execution System / Third Generation

<sup>b</sup> CCASS: Central Clearing and Settlement System

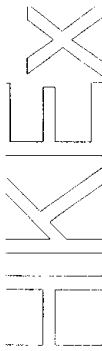


# Investor Participants (IP) Buy Shares – Scenario 2: IP Deposits Funds in Broker’s Bank Account after the Buy Order is Executed

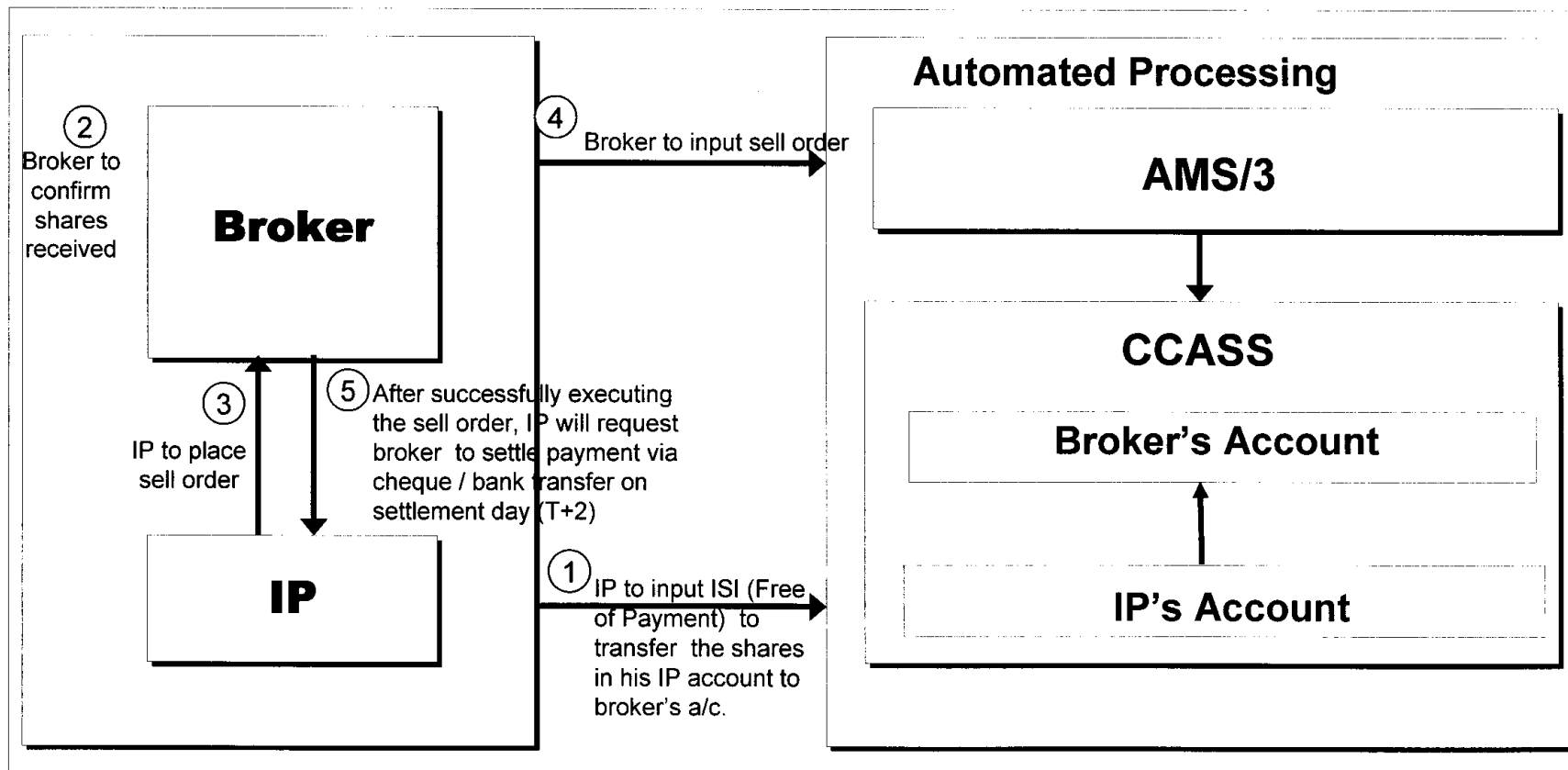


**Settlement arrangement (IP can select Delivery Vs Payment (DVP) or Realtime Delivery Vs Payment(RDP) for shares settlement**

1. Under ISI (DVP) instruction, CCASS will effect shares transfer from broker's a/c to IP's a/c on T+2 while payment will be settled on T+3; or
2. Under ISI (RDP) instruction, shares for settlement will be put "on-hold" in broker's a/c. CCASS will only transfer shares from broker's a/c to IP's a/c when the payment via the Clearing House Automated Transfer System (CHATS) is completed on T+2 (payment debited from IP's bank a/c & credited to Broker's bank a/c).

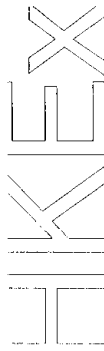


# Investor Participants (IP) Sell Shares – Scenario 1: IP Deposits his Shares in Broker's Account before Placing Sell Order

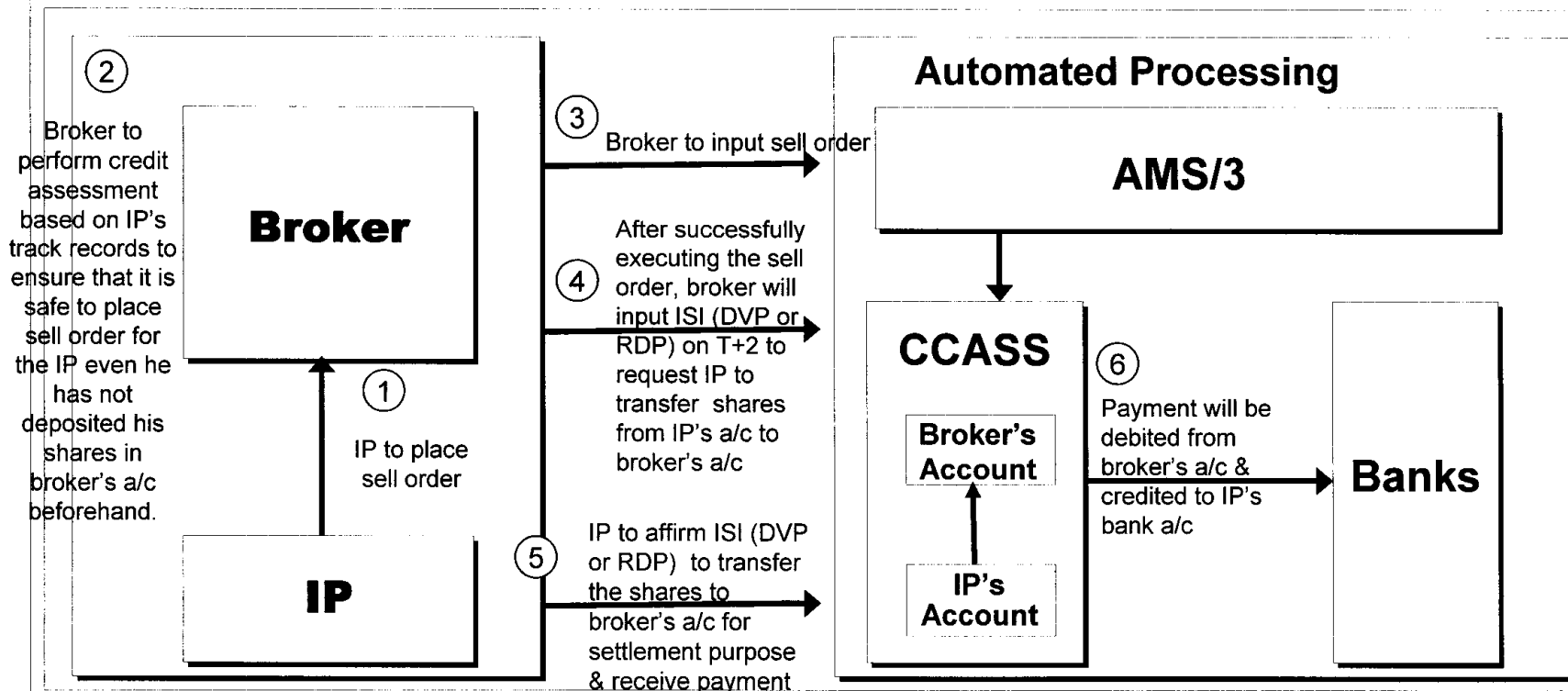


### Settlement arrangement

Depending on IP's preference, broker will either settle payment on T+2 (either by cheque or bank transfer), or settle the payment upon receipt of the relevant settlement amount from CCASS on T+3.



# Investor Participants (IP) Sell Shares – Scenario 2: IP Deposits his Shares in Broker's Account after the Sell Order is Executed



**Settlement arrangement (IP can select Delivery Vs Payment (DVP) or Realtime Delivery Vs Payment(RDP) for shares settlement**

1. Under ISI (DVP) instruction, CCASS will effect shares transfer from IP's a/c to broker's a/c on T+2 while payment settlement will be effected on T+3; or
2. Under ISI (RDP) instruction, shares for settlement will be put "on-hold" in IP's a/c. CCASS will only effect the shares transfer from IP's a/c to Broker's a/c when the payment via CHATS is completed on T+2 (payment will be debited from Broker's bank a/c & credited to IP's bank a/c).