

LC Paper No. CB(1)104/99-00
(These minutes have been
seen by the Administration)

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**Legislative Council
Bills Committee on
Securities (Margin Financing) (Amendment) Bill 1999**

**Minutes of meeting held on
Thursday, 20 May 1999, at 8:30 am
in Conference Room A of the Legislative Council Building**

Members present : Hon Ronald ARCULLI, JP (Chairman)
Hon Albert HO Chun-yan
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon FUNG Chi-kin

Member absent : Hon Bernard CHAN

**Public officers
Attending** : Mr Bryan CHAN
Principal Assistant Secretary for Financial Services

Miss Hinny LAM
Assistant Secretary for Financial Services

Mr William MADDAFORD
Senior Assistant Law Draftsman,
Department of Justice

Ms Vicki LEE
Government Counsel, Department of Justice

**Attendance by
invitation** : Securities and Futures Commission
Mr Andrew PROCTER
Executive Director of Intermediaries and
Investment Products

Mr Richard YIN
Director of Intermediaries Supervision

Clerk in attendance : Ms Estella CHAN
Chief Assistant Secretary (1)4

Staff in attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Ms Connie SZETO
Senior Assistant Secretary (1)1

I Meeting with the Administration
Submission by the Law Society of Hong Kong
(LC Paper Nos. CB(1)1201/98-99 and 1293/98-99(01))

Members continued to deliberate on the Law Society of Hong Kong (LSHK)'s submission on the Bill.

Miscellaneous

2. On LSHK's concern that the Bill would not regulate the provision of financial accommodation to finance futures trading, the Principal Assistant Secretary for Financial Services (PAS/FS) responded that the Administration did not consider such activities a matter of regulatory concern in the Hong Kong. On the other hand, the need to regulate securities margin financing activities and to require registration of securities margin financiers (SMF) had however become apparent. The sole business requirement on a SMF would serve to restrict its business to finance securities trading and to prevent contagion of risks from other businesses operated by the SMF, therefore offering better protection to investors.

3. With regard to the comments on drafting of the Bill as marked on the extracts of the Bill attached to LSHK's submission, PAS/FS said that the Administration would provide written responses as soon as possible.

Comparative studies on the regulation of securities margin financing in other jurisdictions
(LC Paper No. CB(1)1354/98-99(01))

4. The Executive Director of Intermediaries and Investment Products, SFC (ED/IIP(SFC)) took members through major features of the regulatory regimes on securities margin financing of Singapore, Taiwan, the United States (US)

and the United Kingdom (UK), as compared with the proposed system for Hong Kong.

5. Members noted that the regulatory regimes of the above jurisdictions were different from each other in respect of licensing and capital requirements for SMFs and pooling arrangement of clients' securities collateral etc. From the information given in the comparative table, they observed that the proposed regulatory regime for Hong Kong was the most liberal among all jurisdictions.

6. Mr Albert HO was concerned about the arrangement to pool and repledge clients' securities collateral to banks for credits. ED/IIP(SFC) said that although SMFs in Singapore, US and UK often funded their business out of the firms' own capital, they were subjected to certain conditions when they were allowed to pool clients' securities collateral for securing bank loans. For instance, in the Singapore system, a SMF could only pledge a client's securities for a sum not exceeding the amount owed by the client. Under the US system, margin clients were required to deposit with their SMFs securities collateral with market value equal to 140% of their margin accounts' debit balance. The securities collateral was available to SMFs for purposes of financing the debit balance and might be repledged to banks for loans. In the UK system, SMFs needed to notify banks that the firms did not have ownership of the pooled collateral for acquisition of the banking facilities in order to ensure that clients' securities would not be used for meeting cross liabilities of the firms or other margin clients.

7. As for the Taiwan system, members noted that provision of securities margin financing service were restricted to a few government designated securities dealers. Clients' securities were permitted to be used in securities borrowing and lending or for obtaining refinancing from within the securities industry. The regulations were silent on the point regarding pooling. The use of clients' securities to apply for banking facilities was forbidden.

8. PAS/FS stressed that pooling was a common practice in Hong Kong and crucial for SMFs to remain commercially viable. The Administration recognised the risks and problems involved in pooling, such as mingling of clients assets and the difficulty in identifying proprietary interest of pledged securities in case of default of the SMFs. Safeguards in the proposed regulatory regime including segregation of clients' cash and margin accounts, proper record keeping, standard margin agreement with clear disclosure on the risk of pooling and proposed Code of Conduct for SMFs would help to a large extent address these problems.

9. Upon members' request, PAS/FS undertook to provide more information on the following -

- (a) the pooling situation in Taiwan;
- (b) whether credit balance of clients' cash accounts could be used for margin financing in US; and
- (c) UK's rules on pooling.

10. Mr FUNG Chi-kin shared that the Hong Kong situation was unique. The securities margin financing market was characterised by a large number of small sized firms with limited capital and active participation of retail investors. Complete banning of pooling would force existing securities margin financing operators out of business.

11. Due to the unique practice of pooling in the local market where banking institutions and money lenders were closely involved in securities margin financing business as they were the major source of funding for SMFs, Mr Albert HO was of the view that the proposed regulatory regime which would only govern SMFs and exempt authorized institutions (AI) might be insufficient.

12. In response, ED/IIP(SFC) said that the proposed regulatory regime would have little resource implication on SFC's licensing duty as it was envisaged that only a small number of firms would apply for registration to conduct securities margin financing as a stand alone business. In respect of policing and monitoring of securities margin financing activities, SFC had been stepping up with enforcement actions against unregistered persons and non-compliance of registrants since last quarter of 1997, and actions had been taken against mal-practices of money lenders and stockbrokers over the past year as far as possible. In addition, there would be proposals under the composite Securities and Futures Bill to widen SFC's supervisory power over firms or persons associated with registrants in relation to the registrable business of the latter. In the course of investigation into suspected breaches of the law by registrants, SFC could require such associated firms or persons to produce relevant books and records. As regards supervision of AIs, notwithstanding that they were under the ambit of Hong Kong Monetary Authority (HKMA), there had always been close liaison and joint effort between SFC and HKMA on regulatory issues of their mutual concern.

II Any other business

Press release on the Bill

13. Members agreed to issue a press release to draw public attention to the Bill and invite interested parties to give views on it.

(*Post-meeting note* : The press release was issued on 20 May 1999 and was covered by Hong Kong Economic Times and Sing Tao Daily on 21 May 1999. The press cuttings had been circulated to members vide LC Paper No. CB(1)1372/98-99.)

Dates of future meetings

14. The Chairman reminded members that the next meeting had been scheduled for 1 June 1999, at 8:30 am, to meet representatives of Hong Kong Securities Professionals Association, the Institute of Securities Dealers Limited, Hong Kong Stock Brokers Association and LSHK to discuss their views on the Bill. As regards views from non-AI finance companies engaged in securities margin financing business, members noted that the Administration was not aware of any trade organization of non-AI finance companies as such.

15. Members agreed to schedule two further meetings for 2 and 14 June 1999, both at 8:30 am, to continue deliberation on the Bill.

16. The meeting ended at 10:00 am.

Legislative Council Secretariat

12 October 1999