

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

**Response to the Limited Market Consultation
on Pooling of Clients' Assets**

BACKGROUND

At the meeting of the Bills Committee on the Securities (Margin Financing)(Amendment) Bill 1999 held on 27 September 1999, the Administration submitted a short paper setting out its intention to imposing certain conditions on the amount of credit facilities that can be obtained by pledging margin clients' securities collateral by a securities dealer or a securities margin financier. The Bills Committee has subsequently consulted the industry on the proposal on a limited basis. Submissions were received from the Hong Kong Association of Banks (HKAB), the Law Society of Hong Kong (LSHK), the Hong Kong Stockbrokers Association (HKSbA) and the Institute of Securities Dealers (ISD). This note summarizes the Administration's response to these submissions.

DETAILS

Submissions from HKAB and LSHK

2. In response of the queries raised by HKAB and LSHK, we would like to clarify that the intention of the proposal is to impose certain limit on the amount of credit facilities that are obtained by a securities dealer or a securities margin financier by pledging margin clients' securities collateral on an aggregate basis, rather than the purpose of the application of the credits so obtained by the dealer or the financier. We would ensure that the policy intent is clearly reflected in the relevant provisions of the Bill.

3. Separately, the HKAB and LSHK have proposed to clarify in the Bill that the position of the lender taking security over a client's securities should not be affected by any breach of the proposed restriction under question. As explained in our previous submission to the Bills Committee (our letter dated 19 May 1999 issued to the Clerk to

the Bills Committee refers), we are of the view that the proprietary rights over securities collateral deposited by the clients should be governed by the terms of the agreements between the parties concerned and the rules of common law and equity. We have not attempted to establish a statutory position on the relationships among different parties in the present Bill.

Submission from HKSbA

4. It is noted that the HKSbA does not object in principle to our proposal to impose a cap on the amount of credit facilities obtained by pooling and pledging of clients securities collateral by securities dealers and margin financiers. The Association has, however, counter-proposed that a buffer limit of 20% and a grace period of seven business days should be permitted to meet the practical needs of the dealers and financiers to comply with the requirement. It has further suggested that the relevant rule should be implemented by way of non-statutory guideline or code of conduct, as opposed to the legislation.

5. We have in consultation with the Securities and Futures Commission examined carefully these proposals and whether the proposed requirement should be incorporated in the code of conduct. To ensure effective enforcement, we consider it necessary to provide legislative backing to the proposed requirement. Nonetheless, we accept that certain flexibility should be permitted to accommodate the practical needs of the industry. It is therefore proposed to enable SFC to make rules to prescribe the maximum amount of credit facilities that can be obtained (subject to the negative vetting of the Legislative Council). On balance of the level of protection provided to investors and the burden that would be imposed on the dealers and financiers, our present view is that a buffer limit of 5% and a grace period of 3 business days would be appropriate. In other words, dealers and financiers will be permitted to obtain credit facilities from third-party banks at an amount up to 105% of the aggregate value of clients' securities collateral and have 3 days to adjust their portfolios after the margin clients have return their margin loans.

Submission from ISD

7. The Institute indicates that it supports our proposal.

Financial Services Bureau
10 December 1999