

LEGISLATIVE COUNCIL BRIEF

SECURITIES ORDINANCE

SECURITIES (DEALERS, INVESTMENT ADVISERS, PARTNERSHIPS AND REPRESENTATIVES) (AMENDMENT) RULES

INTRODUCTION

1. At its meeting on 12th February 1999 the Commission made the Securities (Dealers, Investment Advisers, Partnerships and Representatives) (Amendment) Rules 1999 (“The Amendment Rules”). (Annex 1).

BACKGROUND AND ARGUMENT

2. The Commission has made rules under the Securities Ordinance (Cap. 333) known as the Securities (Dealers, Investment Advisers, Partnerships and Representatives) Rules (the “Rules) which include provisions, in rule 15 of the Rules, prohibiting a dealer from being a party to a securities borrowing unless he first enters into a written agreement with the other party to the securities borrowing. The written agreement must (i) require the borrower to deposit with the lender collateral for the borrowed securities exceeding the market value of those securities; (ii) require daily valuation by both parties of the borrowed securities and collateral deposited; (iii) specify the circumstances in which each party is entitled to terminate the securities borrowing; and (iv) specify the rights and liabilities of a party in the event of a default by either party.

3. In response to the market turmoil that took place in August 1998, the Administration announced a 30-point programme to strengthen the order and transparency of the securities and futures market, among which was the strict enforcement of compulsory buy-in for outstanding positions which failed to settle by T+2. To implement these measures the Hong Kong Securities Clearing Company Limited (“Hongkong Clearing”) which operates the Central Clearing and Settlement System (“CCASS”) proposes to launch a compulsory securities borrowing mechanism (“CSB”). Under this mechanism, Hongkong Clearing will borrow, as a principal, securities to deliver to buyers in cases where sellers default on their delivery obligations on T+2 (i.e., 2 days after the date of the transaction). Without this CSB mechanism buyers would have to wait until T+3 to T+5 for delivery of the securities following a default.

4. It is intended that Hongkong Clearing as the borrower in CSB transactions will not deposit collateral with lenders of securities because of the risk that lenders may not be able to return collateral to Hongkong Clearing upon the closing of CSB transactions. Lenders will rely on Hongkong Clearing’s creditworthiness, and the risk management mechanisms that it applies to control its exposure to participants’ defaults, to guarantee the return of securities equivalent to the borrowed securities (or payment of fair compensation by Hongkong Clearing if it is unable to deliver equivalent securities). Securities lenders may apply to Hongkong Clearing to join the CSB scheme on a voluntary basis.

5. It is also intended that Hongkong Clearing and the broker lending the securities will not be required to enter into a written agreement, as is presently required by rule 15 of the Rules, as their relationship (including the aspects stated in rule 15(c) and (d)) will be governed by the CCASS Rules, Operational Procedures and new Compulsory Stock Borrowing and Lending Regulations to be added to the CCASS Operational Procedures. Consequential amendments will also be made to the Rules of the Stock Exchange.

THE AMENDMENT RULES

6. The Amendment Rules amend the Rules to provide that rule 15 shall not apply to securities borrowing of Hong Kong stock by a recognized clearing house acting as principal in accordance with the rules of the recognized clearing house.

PUBLIC CONSULTATION

7. Both the Commission, Hongkong Clearing and the Stock Exchange of Hong Kong support the introduction of CSB and the amendment of Rule 15 of the Rules. Given the technical nature of the amendment, the public interest in this matter is expected to be limited. It is therefore considered that public consultation will not be necessary.

FINANCIAL AND STAFFING IMPLICATIONS

8. There are no financial and staffing implications for Government.

COMMENCEMENT DATE

9. The commencement date for the Amendment Rules will be 28 days following the Gazettal date.

PUBLICITY

10. The Amendment Rules will be published in the Gazette on 26th March 1999. Hong Kong Clearing will make an announcement when the CSB mechanism will be launched.

ENQUIRIES

11. For any enquiries on this brief, please contact Mr. Anthony Wood, Senior Counsel of the Legal Services Division at 2840 9276 or Ms. Lynn Bai Senior Manager of the Supervision of Markets Division, at 2842 7778.

The Securities & Futures Commission
22nd March 1999.

SECURITIES (DEALERS, INVESTMENT ADVISERS, PARTNERSHIPS AND REPRESENTATIVES) (AMENDMENT) RULES 1999

(Made by the Securities and Futures Commission under section 146A of the Securities Ordinance (Cap. 333))

1. Commencement

These Rules shall come into operation on 23 April 1999.

2. Written agreements for securities borrowing by dealers

Rule 15 of the Securities (Dealers, Investment Advisers, Partnerships and Representatives) Rules (Cap.333 sub. leg.) is amended -

- (a) by renumbering it as rule 15(1);
- (b) by adding -

“(2) Subrule (1) shall not apply to securities borrowing of Hong Kong stock by a recognized clearing house acting as principal in accordance with the rules of the recognized clearing house.

(3) For the purposes of subrule (2), “Hong Kong stock” (香港證券) shall have the same meaning as is assigned to it in the Stamp Duty Ordinance (Cap.117.)”.

Acting Chairman
Securities and Futures Commission

23 March 1999

Explanatory Note

Under section 146 A of the Securities Ordinance (Cap. 333) the Securities and Futures Commission may make rules concerning the conduct of business by registered dealers.

2. The Commission has made rules under the Securities Ordinance (Cap. 333) known as the Securities (Dealers, Investment Advisers, Partnerships and Representatives) Rules (Cap. 333 sub. leg.) including rule 15 which prohibits a dealer from being a party to a securities borrowing unless he first enters into a written agreement with the other party to the securities borrowing. Rule 15 is now amended so that it does not apply to securities borrowing of Hong Kong stock by a recognized clearing house.