

立法會
Legislative Council

LC Paper No. CB(1) 1669/99-00

Ref : CB1/SS/4/99

**Paper for the House Committee meeting
on 26 May 2000**

**Report of the Subcommittee on
Financial Resources Rules,
Commodities Trading (Accounts and Audit) (Amendment) Rules 2000 and
Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000)
(Commencement) Notice 2000**

Purpose

This paper reports on the deliberations of the Subcommittee on Financial Resources Rules, Commodities Trading (Accounts and Audit) (Amendment) Rules 2000 and Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000) (Commencement) Notice 2000.

Background

2. The Financial Resources Rules (“FRR”) are subsidiary legislation under the Securities and Futures Commission Ordinance (Cap. 24). The aim of the FRR is to provide appropriate prudential standards on the financial resources of market intermediaries. The current FRR, which stipulate the financial resources requirements of securities and futures intermediaries, have been in operation since 1 December 1993. In March 1997, the Securities and Futures Commission (“SFC”) completed a review of the FRR and recommended amendments to FRR in order to keep up with changes in market practices and strategies. On 15 March 2000, the Securities (Margin Financing) (Amendment) Ordinance 2000 was enacted and a new class of registrant called “securities margin financier” has been created. The regulatory regime has brought securities margin financing activities into the purview of the Securities Ordinance and subjected them to the supervision of the SFC. One of the key objectives of the new FRR is to extend appropriate financial regulation to securities margin financiers.

3. As the new FRR introduce, inter alia, a set of liquid capital requirements to replace the “adjusted net admissible assets” requirements for commodities dealers, the Commodities Trading (Accounts and Audit) (Amendment) Rules 2000 (“CTR”) were also made by SFC pursuant to section 109 of the Commodities Trading Ordinance (Cap. 250) to reflect the relevant changes.

4. The FRR, the CTR and the Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000) (Commencement) Notice 2000 (“the Commencement Notice”) were gazetted on 20 April 2000 and tabled before the Legislative Council on 3 May 2000. The commencement date for these three pieces of subsidiary legislation is 12 June 2000.

The Subcommittee

5. The House Committee agreed at its meeting on 28 April 2000 to form a Subcommittee to study the FRR, CTR as well as the Commencement Notice. Hon Ronald ARCULLI was elected Chairman of the Subcommittee. The Subcommittee has held two meetings with the Administration. The membership list of the Subcommittee is at **Appendix I**.

Deliberations of the Subcommittee

6. The Subcommittee has no objection to the Commencement Notice, which appoints 12 June 2000 as the commencement date of the Securities (Margin Financing) (Amendment) Ordinance 2000. Members also support the introduction of the CTR to make the consequential amendments to the Commodities Trading (Accounts and Audit) Rules to reflect changes made in the new FRR.

7. As regards the new FRR, the Subcommittee has noted that they are basically the same FRR examined by the Bills Committee on Securities (Margin Financing) (Amendment) Bill 1999 at the time when the Bill was scrutinized. The new FRR have addressed the then Bills Committee’s concern and incorporated its suggestion of excluding constituent stocks of the Hang Seng Index from the concept of “related collateral” in the calculation of the concentration risk adjustments on securities collateral. However, the Subcommittee has noted some possible problems associated with the operation of the new FRR as detailed in the following paragraphs.

Returns and notifications to SFC

8. Under the new FRR, a dealer, a securities margin financier or an investment adviser is required to report regularly to SFC regarding its assets and liabilities, including the liquid capital, loans, collateral received from clients, proprietary derivative positions, etc. based on the revised haircut percentages and new adjustment rates applicable. In view of the complex calculation and computation necessitated to produce the required information, members consider it necessary to assist market participants in familiarizing with the new requirements. In this respect, members are advised that SFC has taken a series of measures including:

- a) organizing meetings and workshops to brief market and professional bodies on the new FRR;
- b) producing operation guidelines to the industry; and
- c) briefing 10 software vendors on the requirements under the FRR, making sure that the software they produce will facilitate the market professionals to complete the prescribed forms for monthly returns to SFC.

9. Members are satisfied with the familiarization work undertaken by SFC for the industry. As regards the production of computer software, members accept that it may not be appropriate for SFC to give accreditation to individual software as a means of quality control. SFC has nevertheless assured members that it will continue to monitor closely the development of the software. In the long run, SFC has undertaken to consider members' suggestion of following the example of the Inland Revenue Department in producing its own electronic reporting device for use by the industry.

Calculation of liquid assets

10. Securities and futures intermediaries are subject to the financial resources requirements set under the FRR, such as the requirements for minimum paid-up capital, minimum liquid capital etc. In calculating the liquid assets, members have noted that there is a disparity in treatment between a dealing company or a securities margin financier registered in Hong Kong operating an overseas branch and an overseas company operating a Hong Kong branch. Under section 11(2) of the FRR, assets used to satisfy the financial resources requirements of the overseas regulatory authority in relation to an overseas branch of an intermediary registered in Hong Kong shall not be included in the calculation of the liquid assets of the parent company in Hong Kong for the purpose of complying with the liquid capital requirement under the FRR. However, in the case of an overseas company setting up a branch in Hong Kong, the assets of the entire company would be applicable in the

calculation of liquid assets for compliance with the FRR by the Hong Kong branch. In other words, assets of a Hong Kong intermediary are prohibited by the FRR to be double counted vis-à-vis its overseas branch's liabilities while no similar restriction is applicable to a Hong Kong branch of an overseas company. Such disparity in treatment is not only unfair to companies registered in Hong Kong, but will also encourage local companies to relocate overseas and to operate through a branch in Hong Kong to take advantage of the more favourable treatment. The Subcommittee considers that a branch of an overseas company in Hong Kong should be regarded as a separate entity having adequate assets to comply with the same liquid capital requirement applicable to a Hong Kong company.

11. Members are nevertheless advised that a company operating a branch in Hong Kong has to fulfil other requirements such as placing deposits in prescribed banks in Hong Kong and complying with the auditing standards of Hong Kong. Because of the higher cost of compliance, most overseas companies would prefer to establish a subsidiary company instead of a branch in Hong Kong. SFC also confirms that currently there are only three overseas securities companies operating through a branch office in Hong Kong. To address members' concern, the Administration has undertaken to review in a separate exercise the disparity in treatment described above and its implication on encouraging companies to relocate from Hong Kong.

New minimum capital and liquid capital requirements for sole proprietors

12. Currently, there is no minimum capital requirement for securities dealers. However, they are required to fulfil liquid capital requirements which are \$500,000 for sole proprietors and \$3 million for corporate dealers. Under the new FRR, sole proprietors will be required to maintain a liquid capital of \$3 million to be on par with the requirement for corporate dealers and a minimum capital of \$5 million (\$10 million if also providing securities margin financing). There is no transitional period for the application of this new requirement. Some members are concerned about the possible difficulties encountered by individual sole proprietors in complying with the new capital requirement. The Administration has therefore been requested to examine whether the six-month grace period, which is to be applied to securities dealers providing securities margin financing for compliance with the minimum capital requirement and the concentration risk adjustments, may also apply to sole proprietors. However, in view that the objective of revising the FRR is to ensure that licensed entities engaged in securities businesses are financially sound to stand the risks undertaken, and that SFC has not received any objection from sole proprietors during the consultation period, the Subcommittee agrees that the FRR will commence as scheduled but SFC should continue to approach individual sole proprietors and offer assistance as necessary on a case by case basis.

Amendments to be moved by the Administration

13. The Subcommittee has not proposed any amendments. However, in the light of members' views, the Administration will move amendments to improve the drafting of the FRR. The draft amendments are attached at **Appendix II**.

Recommendation

14. The Subcommittee recommends that the FRR, CTR and the Commencement Notice be supported.

Advice sought

15. Members are invited to note the deliberations of the Subcommittee and support the recommendation at paragraph 14 above.

Prepared by
Council Business Division 1
Legislative Council Secretariat
24 May 2000

**Subcommittee on
Financial Resources Rules,
Commodities Trading (Accounts and Audit) (Amendment) Rules 2000 and
Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000)
(Commencement) Notice 2000**

Membership list
(as at 9 May 2000)

Hon Ronald ARCULLI, JP (Chairman)
Hon Albert HO Chun-yan
Hon Eric LI Ka-cheung, JP
Hon HUI Cheung-ching
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon Ambrose LAU Hon-chuen, JP
Hon FUNG Chi-kin

Total : 8 Members