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19 May 1999

Ms. Estella Chan
Clerk to Bills Committee
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Estella

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

Thank you for your letter of 12 May 1999.

On the outstanding items, please find at Enclosure A a short note summarising the judgement given by the Court of First Instance in relation to the issue of proprietary rights in the C. A. Pacific case. A copy of the original judgement is at the annex attached thereto. Separately, in response to Members' request, the Securities and Futures Commission ("SFC") has now prepared a summary table of the regulation over securities margin financing in other jurisdictions including the United States, the United Kingdom, Singapore and Taiwan (Enclosure B).

In respect of the question of whether warrants should be included as collateral, the SFC has done a statistical review on the movement of selected warrants over the period of the last six months. At

a haircut of 40%, most of the volatility of the price movement of the warrants observed during this period would have been covered. In addition, as pointed out by Mr. Andrew Procter at the last meeting, the collateral value of the warrants are calculated on a mark-to-market basis and thus any short term volatility can be effectively tackled. We therefore believe that the present haircut system is appropriate.

The attendance list for forthcoming meetings is at Enclosure C.

Yours sincerely,

(Mr. Bryan Chan)
for Secretary for Financial Services

Att.

c. c. Mr. Andrew Procter
Mr. William Maddaford
Ms. Vicki Lee

Enclosure A

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

INTRODUCTION

This short note responds to the request made by Members at the meeting of the Bills Committee on the Securities (Margin Financing)(Amendment) Bill on 11 May 1999 for the Administration to provide further information about the judgement handed down by the Court of First Instance of the High Court in relation to the proprietary interest in stocks held in the Central Clearing and Settlement System ("CCASS") by brokers on behalf of their clients in the C. A. Pacific case. The views set out below on the judgement are those of the Administration's and Members may wish to separately consult the Legal Adviser of the Council for advice.

DETAILS

Background

2. On 20 January 1998, the C. A. Pacific Securities Company ("CAPS"), a member of the C. A. Pacific Group, was declared in default after its failure to satisfy a call for $38.5 million to settle its position in CCASS. On the same day, the Securities and Futures Commission ("SFC") presented a petition to wind up CAPS on the grounds that it was insolvent and that it was just and equitable and in the public interest for it to be wound up. Liquidators were eventually appointed by the Court of First Instance to carry out and report to it the progress of the liquidation.

3. In the course of the liquidation process, the liquidators applied to the Court of First Instance for directions concerning the question whether the clients of CAPS had any proprietary interest in the securities they instructed CAPS to acquire and which were held by or to the order of CAPS. Such securities were paid for by the clients from their own resources and were deposited in CCASS under CAPS' account.

CCASS is a computerised book-entry system where scrips are kept in depositaries of Hong Kong Securities Clearing Limited ("HKSCC", owner of the CCASS) and have not been earmarked.

The Judgement

4. The Honourable Justice Yuen handed down her ruling on the case on 17 December 1998. A copy of her judgement is at Annex I for Members' reference.

5. Justice Yuen ruled that the relation between CAPS and its clients is that of "principal and agent". The broker "owes fiduciary duties to client/principal" (p.6, Line E) and "one such fiduciary duty is to account for the principal's property, whether it be money or securities, if it comes to the agent's hands, so that the agent holds the money or securities in trust for the principal" (p.6, Lines E-G) and therefore the proprietary interest in the money or securities held in trust still belong to the client.

6. The Judge also held that "neither the Client Agreement nor the non-segregation of securities in CCASS effects any change [to the "principal-agent" relationship]. The fungibility of the securities in CCASS also does not pose any challenge to the position that the proprietary interest in the securities belongs to the client; on the contrary, the fungible nature of such securities permits the client to retain a proprietary interest in them without the need for appropriation". (p.25, Lines R-S and p.26, Lines A-C)

7. The Judge appreciated that a "finding of individual proprietary interests may pose extremely difficult (or at least cumbersome) administrative problems which will take substantial time and money to unravel". (p.27, Lines E-G)

Administration's Observation

8. The Court ruling is indeed in line with the long-held understanding of the Administration, the SFC and the Stock Exchange that as a general rule, proprietary interests of stocks held in safe custody by brokers on behalf of their clients belong to the clients. As we understand it,

the main thrust of the judgement concerns proprietary interest in securities **acquired** by a broker from clients' **own resources** and which are then held by or to the order of the broker. This is however not identical to the scenario whereby the dealer holds securities of a client as **collateral** for the provision of financial accommodation (i.e. margin clients). In connection with the latter aspect, there are indeed a few legal issues that the joint liquidators of the CAPS and the C. A. Pacific Finance Ltd. ("CAPF") will need to resolve in due course, as pointed out in a press release issued by the liquidators on 18 January 1999 (copy attached at Annex II). These legal issues include, among other things, the validity of the security taken by CAPF's bankers over shares of clients and the precise legal effect of the documents signed between CAP Finance and clients.

9. The Securities (Margin Financing) (Amendment) Bill 1999 does not intend to change the principle that clients should have proprietary rights over the securities held in custody by brokers on their behalf. On the issue of the proprietary rights over securities collateral deposited by the clients, we are of the view that such aspects should have been governed by the terms of the agreements between the parties concerned and are rules of common law and equity. Thus, we have not attempted to establish a statutory position in the Bill on the relationships among different parties. In this connection, it is worth noting that as mentioned in the above paragraph, the matter is presently under consideration and study by the liquidators and Court's direction may be sought as necessary.

Financial Services Bureau
19 May 1999

Annex I

附件 I

HCCW 36/98
HCCW 37/98

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
COMPANIES (WINDING-UP) ACTIONS NO. 36 AND 37 OF 1998

IN THE MATTER of the Companies Ordinance Cap. 32

and

IN THE MATTER of C.A. PACIFIC FINANCE LIMITED (in Liquidation)

and

IN THE MATTER of C.A. PACIFIC SECURITIES LIMITED (in Liquidation)

BETWEEN:

DENIS M.P.C. HO and JAN G. W. BLAAUW
JOINT LIQUIDATOR Applicants

and CHAN KAM TIM

1st Representative Respondent

and

TSUI YUET LING 2nd Representative Respondent

Coram: The Hon Madam Justice Yuen in Court
Dates of Hearing: 12-13, 16, 18-20 November 1998
Date of Delivery of Decision: 17 December 1998

DECISION

This is an application by the Joint Liquidators of C.A. Pacific Finance Ltd (in liquidation) and C.A. Pacific Securities Ltd (in liquidation) for the determination of certain questions which have arisen in the course of the liquidations. The facts which have led to the present application are as follows.

Business of the companies

Both CA Pacific Securities Ltd and CA Pacific Finance Ltd were members of the C.A. Pacific Group.

C.A. Pacific Securities Ltd ("CAPS") carried on business in Hong Kong as a broker or dealer in securities. It was registered as a securities dealer under the Securities Ordinance, cap.333 and as such, was regulated by the Securities and Futures Commission ("SFC"). It was a member of the Hong Kong Stock Exchange and was a Broker Participant in the Central Clearing and Settlement System ("CCASS") operated by the Hong Kong Securities Clearing Co. Ltd ("HKSCC").

C.A. Pacific Finance Ltd. ("CAPF") carried on business in Hong Kong as a finance company. It was registered as a money lender under the Money Lenders Ordinance, cap.163. As it was not a registered securities dealer, it was not regulated by the SFC. As part of its operations, CAPF provided margin facilities to clients of CAPS.

As at January 1998, CAPS had some 11,000 clients, of which some 8,000 were also clients of CAPF, although not all CAPF clients traded on margin facilities. Indeed, a number of CAPF clients claim to be unaware that they had entered into contractual relations with that company at all.

Petitions for winding-up

In the late afternoon of 19 January 1998, a company within the C.A. Pacific Group presented a petition to wind-up CAPF on the basis of its inability to pay an inter-company loan. On 20 January 1998, the SFC presented a petition to wind-up CAPS on the grounds that it was insolvent and that it was just and equitable and in the public interest for it to be wound-up.

On the same day, Mr. Jan G.W. Blaauw and Mr. Denis M.P.C. Ho were appointed provisional liquidators of CAPS. On 21 January 1998, the same two persons were appointed provisional liquidators of CAPF as well.

It is not necessary for present purposes to recount the history of the petitions. Both companies were eventually wound-up unopposed on 4 June 1998. The Official Receiver applied for a regulating order, and the provisional liquidators were appointed liquidators for both companies.

The Title Question

On 18 June 1998, the Liquidators applied for directions concerning the question whether the clients of CAPS had any interest in the securities they had instructed CAPS to acquire and which were held by or to the order of CAPS.

That question had arisen because CAPS had purchased securities on the Stock Exchange through CCASS, a computerised book-entry settlement system where unnumbered share certificates are “immobilised” and deposited with a central securities depositary.

Put simply, the question is whether CAPS’ clients have any proprietary interest in the securities they have instructed CAPS to acquire, when the share certificates are in a central pool and have not been earmarked.

The question of title has now been confined and refined as a preliminary

issue by agreement of the parties, and can be summarised as follows:-

"whether, on the basis of the contractual arrangements, the regulatory framework and the arrangements for the custody of securities set out in the evidence,

(i) clients who have paid for securities from their own resources and upon whose instructions CAPS purchased securities on the Hong Kong Stock Exchange settled through CCASS may have

(a) acquired;

(b) thereafter retained whilst subject to the arrangements for the custody of securities in CCASS;

(c) subsequently upon removal from CCASS acquired or reacquired;

a proprietary interest in securities so purchased;

(ii) if so, what is the nature and basis of such proprietary interest."

Representative Respondents

Due to the large number of clients involved, directions were given for the appointment of two representatives.

The 1st representative respondent Mr. Chan represents those clients whose recovery in the winding-up would be maximised if it was determined that clients of CAPS had, in principle, *proprietary* claims to securities acquired and held by the company, and to cash held by the company. In Mr Chan's case, this is because there was no shortfall in scrip of Techtronic Industries Ltd, the shares he acquired through CAPS. So as far as securities were concerned, he would be able to achieve 100% recovery.

The 2nd representative respondent Miss Tsui represents those clients

whose recovery in the winding-up would be maximised if it was found that clients of CAPS did *not* have any proprietary interest in the securities, even though they had paid for them in full out of their own resources. The Liquidators have informed the Court that Miss Tsui would only be able to achieve 2% recovery on a proprietary basis, as opposed to 60% recovery on the basis that all the securities held by CAPS or to its order were held as part of CAPS' general assets.

In any event, for the purposes of these proceedings, Mr Chan's and Miss Tsui's particular circumstances do not matter. The issues of principle to be decided are of general application.

I should add that although both Mr Chan and Miss Tsui were clients of CAPF, the Court has been asked to determine the issues at this hearing on the basis that they had both paid for securities in full out of their own resources. In this Decision, I have used the term "clients" to describe all such persons who had instructed CAPS to purchase securities and who had paid for them in full out of their own resources.

Issues

It may be helpful to consider the issues in this way:-

(I) Prior to the introduction of CCASS, did a client acquire a proprietary interest in securities he had instructed his broker to purchase for him?

(II) If the client did have a proprietary interest, what is the effect of the introduction of CCASS and the broker's acquisition of the securities under this system?

(I) Prior to the introduction of CCASS

Relationship between Broker and Client

It is clear that at common law, as recognized by the courts of Hong Kong, a broker is his client's agent. Although the broker/agent is not a trustee in the strict sense of the word (*Re Strachan ex p Cooke (1876) 4 Ch D 123, 128*), he owes fiduciary duties to his client/principal.

One such fiduciary duty is to account for the principal's property, whether it be money or securities, if it comes to the agent's hands, so that the agent holds the money or securities in trust for the principal.

Intention of parties

Of course it is not invariably the case that whenever a principal pays money to his agent, that money is held by the agent in trust for the principal (see e.g. *Neste Oy v Lloyds Bank Plc [1983] 2 LL Rep 658). Whether the money is held on trust will depend on the intention of the parties (Re Multi-Guarantee Co. Ltd. (No.2) Fin, Times 15 August 1984 at p.5*).

Where the intention of a client and his broker is that the client's property is entrusted to the broker for any special purpose, such as the acquisition of certain securities (as is the usual case), that property belongs to the client, and is regarded as covered by a trust. This enables the property (even money) to be traced, even at common law so long as it is capable of being identified and distinguished, albeit in changed form (*Taylor v Plumer (1815) 3 M&S 562, Re Strachan ex p Cooke at p. 128*).

Client's proprietary interest

So in the traditional way, where a client puts his broker in funds for the

purpose of acquiring certain securities, and those securities are acquired, the proprietary interest in the money and the scrip belong to the client. This is so even if the client has arranged with the broker that the securities would be deposited with the broker, to be delivered to the client if and when called for.

This is to be contrasted with the less conventional situation of a running account between the broker and the client, where the parties' intention was that the client would only be claiming money standing to his credit in the account he holds with the broker (e.g. in *King v Hutton [1899] 2 QB 555, [1900] 2 QB 504, 507*, *Re Goode ex p Mount [1974] 4 ALR 579, 586*).

In the traditional conventional transaction, the broker has no general property in the securities he has acquired on behalf of his client. His only interest in the securities may be by way of a lien if the client owes him any money (*Re London and Globe Finance Corp. [1902] 2 Ch 416, 420-1*).

The existence of a broker's lien is a recognition that the general property in the securities belongs to the client, because it is the characteristic of a lien that it is a special claim over property belonging to someone else, viz. the client.

Broker's obligations regarding securities acquired

So, it is clear that when a broker, acting on his client's instructions, acquires certain securities on the market, he has to hold them on trust for the client.

It has been recognised by the Privy Council in *Solloway v McLaughlin [1938] AC 247* that a broker need not retain the *very* shares that the selling broker had handed to him in that specific transaction, but he must get into his possession and retain an *equivalent* quantity of those securities to satisfy his

client's proprietary interest. If he deals in the securities and fails to retain at all times an adequate quantity of those securities to meet his client's proprietary interest, he would be guilty of conversion, even though he may be able to purchase the necessary quantity of securities from the market and supply them when the client calls for delivery.

So that is the traditional position of the client regarding the securities he has instructed his broker to acquire on the market with funds provided by him.

The issue in these proceedings is whether there has been any change of that position.

Section 84 Securities Ordinance

Before I consider CCASS, it is first necessary to see whether s.84 Securities Ordinance has any effect on the traditional obligations of the broker to its client as discussed above.

This is because one of the submissions of Mr Robert Hildyard QC, counsel for the 2nd Representative Respondent, is that on his construction of s.84, money received by a broker is not held on trust for the client until the expiry of 4 bank trading days after its receipt by the broker. If this money is not held on trust, so the argument goes, then it is at least possible that securities purchased by the broker were not held on trust.

Section 84 provides:-

> "(1) A dealer shall establish and keep at a licensed bank one or more trust accounts designated or evidenced as such into which he shall pay -
>
> (a) all amounts (less brokerage and other proper charges) which are received for or on account of any person (other than a stockbroker) from the sale of securities, except those amounts paid to that person or in accordance with his

directions within 4 bank trading days after their receipt;

(b) all amounts (less brokerage and other proper charges) which are received from or on account of any person (other than a stockbroker) for the purchase of securities, except those amounts attributable to the purchase of securities which are delivered to the dealer within 4 bank trading days after receipt of the amounts;

(c) subject to any agreement to the contrary, all amounts derived by way of interest from the retention in a trust account of any amount mentioned in paragraph (a) or (b).

(2) All amounts required to be paid into a trust account shall be kept there by the dealer until they are paid to the person on whose behalf they are being held or in accordance with his directions or, as the case may be, until they are required to complete payment in respect of the purchase of securities on behalf of any such person.

(3) Money required by this section to be paid into a trust account shall be so paid within 4 bank trading days after it is received by the dealer.

(4) All sums derived by way of interest from the payment of money by a dealer into a trust account under this section shall, subject to any agreement to the contrary, belong to the person to whom the dealer is accountable.

(5) No amount other than an amount referred to in subsection (1)(a) or (b) shall be paid into a trust account.

(6) Every dealer shall keep records [etc]

(7) A person who -

(a) without reasonable excuse contravenes any provisions of this section shall be guilty of an offence [etc.]”

Section 84 is followed by s.85 which stipulates that money held in a trust

account shall not be available for payment of the debts of a dealer or be liable to be paid or taken in execution, nor shall any person to whom the money is paid obtain title to it.

As I read it, s.84 is completely consistent with a trust of the client's money at all times. The section provides that all amounts for or from the client must be deposited into the trust account. The amounts exempted in s.84(1)(a) and (b) are consistent with that intent, because the amounts exempted there are used in the actual execution of the trust - in the case of s.84(1)(a), in payment of money to the client; and in the case of s.84(1)(b), in the purchase of securities for the client.

Section 84(3) does not mean that during the period of 4 bank trading days referred to, the broker can for its own purposes freely make use of its client's money which had been paid to it for the specific purpose of acquisition of securities. It should be read consistently with the purpose set out in s.84(1), not as an exception to it. The period referred to in s.84(3) is merely a grace period within which the broker would not be at risk of criminal sanction if it fails to deposit the money into the trust account.

Accordingly, s.84 does not change in any way the traditional obligations of the broker to its client as discussed above. The next consideration is whether any change has been effected by trading through CCASS.

"CCASS"

It is first necessary to describe briefly what CCASS is. It is a computerised settlement system run by HKSCC, which was introduced to the Hong Kong Stock Exchange in 1992.

It operates for those securities which have been selected by HKSCC as

"Eligible Securities", which are presumably the more popular securities which account for the greatest volumes of trade on the exchange. There are far less non-Eligible Securities than Eligible Securities, and trading in non-Eligible Securities is effected in the traditional way. I have been told that some 99% of the trades on the Hong Kong Stock Exchange is in Eligible Securities, which have to be traded through CCASS.

All brokers on the Hong Kong Stock Exchange are required to be participants in CCASS (Stock Exchange Rule 358). The relationship between the brokers and HKSCC concerning the operation of CCASS is governed by a Broker Participation Agreement in prescribed standard form and by a set of rules called the CCASS Rules.

Aspects of trading through CCASS

There are two main aspects of the trade in securities through CCASS. The first concerns the *buying and selling* of securities on the exchange. In the traditional way, a broker who has instructions to buy certain shares at a certain price, contracts on the floor of the exchange with another broker, who has instructions to sell those shares at the same price.

Under CCASS however, a computerised system matches the buying and selling orders when the prices meet. HKSCC is then interposed between the buying broker and the selling broker, so that the shares are deemed to be sold to HKSCC, and HKSCC is deemed to on-sell those shares to the buying party, at the price agreed between the brokers. In law, a novation is effected, so that the original contract is superceded by two new contracts, with HKSCC being the buyer in one, and the seller in the other (CCASS Rule 3301).

Under the CCASS Rules, the brokers are treated as principals in these

two new contracts (CCASS Rule 402).

The second aspect of CCASS concerns the *holding* of the securities bought through this system. HKSCC also acts as the custodian of the securities, which are registered in the name of HKSCC or its nominees, and the scrip (with transfer forms) are kept by depositaries of HKSCC. A client wishing to hold actual scrip may, however, through the broker require delivery to him of certificates for the appropriate quantity of securities.

No beneficial interest of HKSCC in securities

Since all scrip in CCASS are registered in the name of HKSCC or its nominees, HKSCC is the legal owner of the securities. However it has asserted quite clearly that it has no beneficial interest in the securities deposited into CCASS.

Mr. Hildyard has (in addition to his original submission that HKSCC has no beneficial interest in the securities) submitted as an alternative contention that HKSCC could well be the beneficial owner of the securities in CCASS. Although this alternative contention was not fully developed, it is necessary to consider the materials to see if it can be established.

CCASS Rule 802 provides:

> "Eligible Securities deposited into CCASS by Participants will be held in safe-custody upon the terms and subject to the provisions of the Rules. For the avoidance of doubt, HKSCC acknowledges and confirms that, save as otherwise provided in the Ruies, HKSCC has no proprietary interest in the Eligible Securities deposited into CCASS, in particular, Eligible Securities in the Stock Segregated Accounts of Participants."

CCASS Rule 817 provides:

> "HKSCC may from time to time appoint one or more banks, custodians, trust companies or other entities as its Appointed Depositary to perform or to assist in the performance of the depositary, nominee and custodian services contemplated herein in respect of all or part of the Eligible Securities held in CCASS
> . . .
> HKSCC shall procure that each Appointed Depositary acknowledges and confirms to the effect that it shall have no proprietary interests in the Eligible Securities so held by it in its capacity as Appointed Depositary."

CCASS Rule 1102 provides:

> "HKSCC shall not be authorised or entitled to exercise rights or entitlements accruing to Eligible Securities in CCASS belonging to Participants for its own benefit or purpose and except as expressly provided in the Rules, shall not exercise such rights or entitlements without instructions of Participants save in the case where HKSCC considers it will be in the interest of Participants to do so."

HKSCC's assertion is that it has no beneficial interest in the securities *deposited* into CCASS. This *may* be distinguished from the situation when it is actually *trading* in the securities under the novated contracts.

As Trader

Under the novated contracts, HKSCC stands in the shoes of the original counterparties (although in practice, the original counterparties are still identified in the statements). As such, HKSCC, as the seller of the securities being traded, has to pass the property in the securities.

It may be that in the sale of securities to HKSCC and the on-sale by it,

there is a *scintilla temporis* whereby the beneficial interest in the securities is passed to HKSCC, which directly passes it on to the purchaser of the securities. There would then be a constructive delivery and re-delivery of the securities by CCASS as vendor to CCASS as custodian without the securities actually changing hands (cf. *Dublin City Distillery Ltd v Doherty [1914] AC 823* referred to in *Re Goldcorp Exchange Ltd (in receivership) [1995] 1 AC 74, 92*).

As Custodian

In any event, the question of title before the Court now relates to the proprietary interest in securities which have already been acquired by CAPS through CCASS. The assertion by HKSCC that it has no beneficial interest in the securities it holds as *custodian* is clear and easier to rationalize.

Those securities have been paid for by the client, not by the broker nor by HKSCC. Although there is a continuous netting system in operation, title to the securities purchased would not pass until settlement day (Transaction +2 days), when the purchasing broker's Money Ledger Account with CCASS would be debited with the purchase price (see Clause 6 of the Broker Participation Agreement). These funds would have come from the client, because CAPS required its clients to put it in funds before the transaction is put through, or at the latest, by T+2. If the client fails to put it in funds, CAPS is entitled to sell the securities contracted to be bought. This is not a "contango" situation: the broker does not provide the funds first to finance the client in his purchase.

Since it is the client who had paid for the acquisition of the securities, there is a natural presumption that he, not his broker nor HKSCC, is the beneficial owner of the securities. So it would appear that HKSCC is correct in

its acknowledgment that it has no beneficial interest in the securities deposited into CCASS.

Consistency with purpose and practice

This is consistent with the purpose and the practice of CCASS. The stated purpose of its establishment was to provide more efficient and more secure trades which would be of benefit to investors. There would be less, not more, security for investors if securities acquired on their instructions and with their funds have become, by a side-wind, the property of their brokers or HKSCC, neither of whom have paid the money in exchange for those securities.

Further, HKSCC does not take any part in corporate activities such as voting or rights issues without specific instructions from the brokers who had acquired the relevant securities. Dividends are not kept by HKSCC, but are passed on to the relevant brokers. Bonus issues and similar entitlements accruing to Eligible Securities are deposited into Stock Segregated Accounts, not the Stock Clearing Accounts, which (except in exceptional limited circumstances) are not accessed by HKSCC.

Moreover, there is no evidence that HKSCC has ever complied with any reporting requirements which would have been necessary had it been the beneficial owner of substantial quantities of securities held through CCASS.

These factors are all consistent with my finding that HKSCC has no beneficial interest in those securities deposited into CCASS which had been purchased by CAPS on the instructions of and with funds provided by its clients.

The next and most important question for present purposes is whether the

beneficial interest is held by the broker (CAPS) or by its clients. I have set out above how traditionally, where a client puts his broker in funds for the purpose of acquiring certain securities, and those securities are acquired, the proprietary interest in the money and the scrip belong to the client. Has any change been effected by the introduction of CCASS?

(II) No change in Client's proprietary interest

The Client Agreement

To see if there has been any change, one must logically start with the Client Agreement which governed the relationship between CAPS and its clients. The Client Agreement used by CAPS was in the standard form prescribed by Stock Exchange Rule 532.

The language of the Client Agreement shows clearly, in my view, that the intention of the parties was that the broker is the client's agent, and that securities acquired by the broker on the instructions of the client and with the client's funds are the beneficial property of the client. No distinction is made between trades effected through CCASS and non-CCASS trades (i.e. trades in non-Eligible Securities).

The intention that the client is the principal and has the proprietary interest in the securities is manifested throughout the Client Agreement.

Clauses 1 and 4 refer to transactions in securities "for or on my behalf". As noted in *Castlespring Enterprises Ltd v Core Resource (HK) Ltd [1989] 1 HKC 283*, the words "for and on behalf of" are a well-known formula for indicating agency.

Clause 6 contains an agreement that all securities acquired by the broker for or on behalf of the client shall be subject to a general lien for the discharge

of the client's obligations to the broker arising from the business of dealing in securities. As noted previously, the existence of a lien is a recognition that the beneficial property belongs to the client, because a broker's lien would simply be nonsensical if the securities already belonged beneficially to it.

Clause 9 contains provisions for securities purchased by the broker and deposited with it "for safe-keeping".

Clause 10 provides for the crediting of the client's account with dividends in respect of securities held on the client's behalf.

Clause 11, which is significant (and which Mr Hildyard accepts applied to CCASS trades), provides that the broker shall not, without the client's prior written consent, deposit any of the client's securities as security for loans or advances or lend or otherwise part with the possession of any such securities for any purpose. It can be seen that the restrictions imposed by this clause are inconsistent with the securities being the beneficial property of the broker, and are consistent with the securities being the beneficial property of the client. The Client Agreement goes on at Clause 16 to warn the client against the risks of authorising the broker to deposit securities as collateral for loans or advances made to the broker.

So it will be seen that the Client Agreement does not effect any change in the traditional relationship between broker and client as agent and principal, nor in the legal position that securities acquired on the instructions of and with the funds of the client belong beneficially to the client.

Broker an agent vis-a-vis the client, although a principal vis-a-vis HKSCC

Mr Hildyard sought to overturn this analysis at its foundation, by relying on the fact that under the CCASS Rules, the broker is not regarded as an agent,

but is treated as the principal in its trades through CCASS. He relied on the following rules.

CCASS Rule 402 provides:

> "So far as the rights and liabilities between HKSCC and each Participant are concerned, a Participant using any of the services of CCASS shall be treated as acting as principal and not as agent, and shall be liable to HKSCC as such.
>
> In rendering its services, HKSCC shall be under no obligation to recognize any right or interest which any person other than a Participant may have or claim to have in relation to all matters concerning CCASS (including, without limitation, Eligible Securities deposited into CCASS and transactions to be settled thereunder) and the operation thereof by HKSCC".

CCASS Rule 805 also provides:-

> ". . .
>
> Except as otherwise provided in the Rules, HKSCC may regard each Participant as having full authority and control in respect of the Eligible Securities in its Stock Accounts and HKSCC shall be under no obligation to recognize any right or interest which any person other than the Participant may have in such Eligible Securities".

CCASS Rule 3302 also provides:-

> ". . .
>
> The benefit of the performance by HKSCC of such obligations [obligations whether as seller or buyer under Market Contracts under the terms of the Novation] is conferred upon Broker Participants as principals and not upon any other person whatsoever".

However, a person does not lose his capacity as an agent vis-a-vis his principal just because he has to contract with a third party as principal. An agent can conclude a contract on behalf of his principal in a number of ways, and one of those ways is by creating privity of contract between himself and the third party, but no such privity between the third party and his principal. When he does that, he is a principal in relation to the third party, but he remains an agent in relation to his principal (*Teheran-Europe Co Ltd v S.T. Belton (Tractors) Ltd [1967] 2 QB 53, 60*).

Thus, CAPS was capable of dealing with HKSCC as principal, whilst acting as agent for its clients in the purchase of securities through CCASS. There is nothing in the Client Agreement which prohibits that. On the contrary, as discussed above, the Client Agreement shows clearly that the broker was intended to act as agent only.

Further the standard form Broker Participation Agreement entered into between brokers and HKSCC recognises that the broker may be acting as agent for its clients.

Clause 4 of the Broker Participation Agreement provides:-

> "The Participant shall, in relation to all its matters dealings and transactions in CCASS or with HKSCC or in relation to all Eligible Securities standing to its credit in CCASS be liable to HKSCC as a principal *notwithstanding that it may be acting as the agent or the trustee of another person or otherwise in a fiduciary capacity*." [my emphasis]

Further, in all the Contract Notes which have been prepared pursuant to the requirements of s.75 Securities Ordinance, CAPS has stated that it has contracted as agent in the transactions and not as principal.

Accordingly, I conclude that when CAPS contracted with its clients to

execute orders through CCASS for the purchase of securities on the instructions of and with the funds of the clients, CAPS was acting as an agent. It follows that when such securities were acquired, the law would regard the client as having the beneficial interest in them, unless there is anything which refutes that position.

Declaration of trust not necessary

Mr Hildyard submitted that a trust of the securities in favour of the client is not capable of being created or taking effect. His first submission was that there was no certainty of words, because the Client Agreement did not amount to a proper declaration of trust. He submitted that this was no more than a commercial transaction from which a trust should not be created, and in any event, even if the Client Agreement were a declaration of trust, a trust could not have been validly created then, because no trust property would have existed yet at the time the Agreement was signed.

In my view, the Client Agreement does not need to be read as a declaration of trust for the purposes of the 1st Representative Respondent's case. The client's proprietary interest in the securities arises simply from the fact that those securities had been acquired with his funds and on his instructions by his agent the broker. The Client Agreement was simply the document which articulated the relationship of principal and agent between client and broker.

Certainty of subject-matter

Mr Hildyard's further submission was that there could be no trust because immobilized shares with unnumbered share certificates in CCASS

cannot be the subject-matter of a trust for want of certainty.

It is the case that after a purchase of securities through CCASS, scrip deposited with HKSCC do not physically change hands unless and until a purchasing client requires delivery of the scrip. There is no ear-marking of the scrip, by number or otherwise. Section 65A of the Companies Ordinance cap. 32 provides that where shares are fully paid up and rank *pari passu* for all purposes, none of those shares need have a distinguishing number.

Indeed, the securities are expressly treated under the CCASS Rules as fungibles, in other words, as interchangeable units for the purposes of transfer or delivery (see CCASS Rule 809).

However, it does not follow that there is no certainty of subject-matter. There are strict recording requirements at each level to show what securities are held for whom. All transactions for sale and purchase through CCASS are recorded in detail. The quantities of each type of securities held for the account of each broker is recorded by HKSCC. And the quantities of each type of securities held for the account of each client is recorded by the broker.

Even though the *net* quantity of securities of a particular type standing in a broker's Stock Clearing Account with CCASS may not change at the end of the day because the broker had effected purchases and sales of the same quantity of shares, each such transaction is recorded by CCASS and entered into its books. Similarly, the brokers are required under s.83 Securities Ordinance and Stock Exchange Rule 424 to record each transaction for each of its clients in its own books.

Short sales are in general not permitted (see s.80 Securities Ordinance), so in effecting each sale order, the broker would have to have ready the securities available to fulfil that order. A situation would not arise where

securities purchased by one client and held in CCASS would be depleted by a sale order of another client.

Thus in this system, each purchaser of securities would have his quantity of scrip available with HKSCC's depositary, even though he would not be able to point to any particular tranche of shares as his own. I would add that it is not suggested that there has been any shortfall of scrip in CCASS.

Consideration of the nature of the subject-matter

Mr Hildyard submitted that there was no certainty of subject-matter of the trust, because there has been no appropriation of securities to each client. He relied heavily on the decisions in *In re Wait [1927] I Ch 606*, *In re London Wine Company (Shippers) Ltd [1986] PCC 121* and *Goldcorp*, *supra.*

It is correct of course that certainty of subject-matter is essential to the creation of a trust. But in considering whether there is sufficient certainty of subject-matter, one must have regard to what the subject-matter is.

For certain types of goods, such as wheat in *Re Wait*, wine in *London Wine* and bullion in *Goldcorp*, segregation or appropriation is the means of identifying the goods which have been made the subject-matter of the trust. But in my view, it does not follow that segregation or appropriation is necessary for *all* things.

What is required is not segregation for the sake of segregation. What is required is certainty of the property over which it is intended there should be a disposal of the beneficial interest. What is necessary is the means of identifying or distinguishing the subject-matter of the trust.

How one identifies or distinguishes things must depend on the nature of the thing. For tangible goods, that is done by segregating one parcel from the

rest of a bulk. Each parcel has its own characteristics and would be subject to its own risks (e.g. corking of the wine in *London Wine*). But for intangible things such as fungible shares ranking *Pari passu* - which enjoy exactly the same rights, which have no separate characteristics and no inherent risks (as HKSCC takes responsibility for replacing any defective securities in CCASS: CCASS Rule 815) - it is difficult to see why segregation is necessary, so long as one knows the quantity of the shares which are to form the subject-matter of the trust.

Nature of tangible goods

In Re Wait London Wine and *Goldcorp*, the persons who were asserting a trust were purchasers who had failed to obtain the passing of legal title to goods, due to a failure to appropriate goods to the contracts of sale. In *Re Wait*, there was a sale of goods ex-bulk, but even that feature was not present in *Goldcorp*, where it was held that there was only a sale of unascertained generic goods.

Even if there had been actual goods which could have been appropriated, however, a trust could not be validly created unless the beneficial interest has been properly "hived off" from the legal and beneficial interests owned by the vendors before the transaction. It was in this "hiving off" process that difficulties were faced by the purchasers in those cases.

I should add that I note that in *London Wine*, Oliver J dealt with an argument that the trust was of a proportion of a homogeneous mass and rejected it due to the absence of clear words, especially when the numerical whole was not known. I would however agree with respect with Rimer J's view in *Hunter v Moss* that it is not really possible to have a homogeneous mass of tangible

assets, because tangible assets are inherently physically separate, and so distinguishable one from the other.

Nature of shares

In our case, however, the subject-matter is shares. It is well-established that shares are simply bundles of intangible rights against the company which had issued them. Share certificates are not valuable property in themselves - they are just *evidence* of the true property, which are the proportionate interests of the shareholders in the ownership of the company.

One *pari passu* share is exactly the same as another. This was recognized in *Solloway v McLaughlin* where the Privy Council held that the broker need only have retained an *equivalent quantity* of stock in its possession, and in the more recent cases of *Hunter v Moss [1993] 1 WLR 934, [1994] 1 WLR 452* and *Re Harvard Securities Ltd [1997] 2 BCLC 369.* Therefore, each share certificate with HKSCC's depositary evidences the same bundle of rights, and each bundle of rights can satisfy the client's proprietary interest as any other.

Client's beneficial interest at inception of trade through CCASS

Mr Hildyard further submitted that in an insolvency situation, a court would not assist a party who had a contractual right to have a trust fund set up, but who had failed to enforce that right prior to insolvency (*Mac-Jordan Construction Ltd v Brookmount Erostin Ltd. [1992] BCLC 350*). So if CAPS' clients are to enjoy a proprietary interest in the securities, they would have had to acquire it before CAPS collapsed.

There is no difficulty here, because the broker (CAPS) never had the

beneficial interest in the securities. The beneficial interest starts and remains with the client, because the securities had been acquired by the broker as his agent with money provided by him. There is no need to set up a trust fund with money belonging originally to another (as in *Mac-Jordan*), or to "hive off" the beneficial interest from legal and beneficial interests originally vested in the same person (as in the failed sale of goods cases).

In *Goldcorp*, Lord Mustill remarked at pp100H-101A:-

> "The facts of the present case are however inconsistent with any such trust. This is *not* a situation where the customer engaged the company as agent to purchase bullion on his or her behalf, with immediate payment to put the agent in funds, delivery being postponed to suit the customer's convenience. The agreement was for a sale by the company to, and not the purchase by the company for, the customer."

What Lord Mustill said was *not* the situation in *Goldcorp*, is exactly the situation in our case.

Since *Goldcorp* dealt with unascertained generic tangibles, and *Hunter v Moss* dealt with intangible shares, it is clear that different considerations applied to the question of certainty of subject-matter. It is therefore not surprising that leave to appeal to the House of Lords was refused in *Hunter v Moss* after the report of the Privy Council decision in *Goldcorp* (see *Haryard Securities p.381a*).

Conclusion

In conclusion, therefore, I find that neither the Client Agreement nor the non-segregation of securities in CCASS effects any change. The fungibility of the securities in CCASS does not pose any challenge to the position that the

proprietary interest in the securities belongs to the client; on the contrary, the fungible nature of such securities permits the client to retain a proprietary interest in them without the need for appropriation. Such a finding is also consistent with the trust of money referred to in s.84 Securities Ordinance.

Nature and basis of proprietary interest

Having found that the client had acquired and retained the proprietary interest in the securities in CCASS, the issue is what is the nature and basis of that proprietary interest. Does *each* client have a beneficial interest in a quantity of securities held in CCASS, or do *all* clients with interests in a particular type of securities have a beneficial tenancy-in-common of the entire pool of those securities?

A tenancy-in-common has been postulated in a number of academic publications as the best solution. That solution has been employed for cases where there has been an accidental mixing of goods (e.g. in *Spence v Union Marine Insurance Co. (1868) LR 3 CP 427*, *Indian Oil Corp v Greenstone Shipping [1987] 3 All ER 893*, *Re Stapylton Fletcher Ltd. [1994] 1 WLR 1181*). It has apparently also been used in cases where the mixture was intentional (*The South Australian Insurance Co v Randell (1869) LR 3 PC 101*).

However I find it difficult to infer a tenancy-in-common of a pool of securities (which may change in quantity from day to day) when the language of the Client Agreement is in terms of an individual proprietary interest. And as recognised by Oliver J in *London Wine,* where the numerical whole is unknown because of its ever-changing nature, it would be even more difficult to infer an intention of the client that his interest would be that of a tenant-in- common of an ever-changing proportion of an unknown quantity.

I conclude therefore that the Specified Clients as defined in paragraph 7C of the 9th Affidavit of Mr Blaauw have acquired and retained proprietary interests in the securities so purchased, and that they hold their proprietary interests as individual beneficiaries.

I appreciate that a finding of individual proprietary interests may pose extremely difficult (or at least cumbersome) administrative problems which will take substantial time and money to unravel, and indeed may lead to an unjust result. The rule in *Clayton's* case is however only one of convenience, and it may be that this is a suitable case where some other form of arrangement may be fairer and less expensive. However I should not at this stage attempt any formulation of a proposal before hearing from the liquidators and possibly opposing camps of individual beneficiaries.

Finally as a matter of completeness, I record that as requested by the parties, I have adjourned the hearing of paragraph 2 of the Summons.

I shall hear the parties further as to costs.

It only remains for me to thank counsel for their assistance.

(MARIA YUEN)
Judge of the Court of First Instance
High Court

Mr Godfrey Lam instructed by Herbert Smith for the Applicants (Liquidators) Mr Leslie Kosmin QC and Mr Sanjay Sakhrani instructed by Lovell White & Durrant for the 1st Representative Respondent
Mr Robert Hildyard QC and Miss Jennifer Tsang instructed by Allen & Overy for the 2nd Representative Respondent

PRICEWATERHOUSECOOPERS

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附件 II

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MEDIA RELEASE

PricewaterhouseCoopers Says 1999 Will See Good Progress On CA Pacific Liquidations

[Hong Kong 18 January 1999] "The liquidators of CA Pacific Securities Limited and CA Pacific Finance Limited expect to make substantial progress during the course of the year, despite the complexities of the issues remaining," Mr. Jan Blaauw, one of the two Court appointed joint liquidators from PricewaterhouseCoopers, said today.

"Obviously we are keen to commence making a return to former clients and creditors as soon as possible, but we can only do so within the constraints imposed by the law. We need to consider a method for determining each of the clients' and creditors' claims, which then needs to be approved by the Court," said Mr. Blaauw.

The joint liquidators have written to all former clients and creditors advising them of recent progress in the liquidations and outlining key issues that continue to require resolution. A copy of the letter is attached.

"We have written again to every former client and creditor as we are determined that our actions be completely transparent," Mr. Blaauw said.

"We have met with each of the two committees of inspection on four occasions to date and we have already set meeting dates with the two committees in February immediately after the Chinese New Year holidays where we intend to present our proposals as to how the outstanding issues should be addressed. Thereafter, we hope to be able to present our proposals to the Court and seek its directions where necessary in the weeks following the meetings," Mr. Blaauw said.

"The liquidations have been extremely complex and have required the High Court to determine some fundamental legal issues," Mr. Blaauw said.

Mr. Blaauw said that the High Court's decision of 17 December 1998 had been a crucial step required to progress the liquidations. However, it may be necessary to seek further directions from the Court before finalising the liquidations.

"Following the High Court's decision of 17 December 1998, the joint liquidators are now considering a method for determining each one of more than 10,000 claims by former clients and creditors. This is a huge task, involving tracing many tens of thousands of individual transactions, and one that even the Court has recognised 'may well pose extremely difficult administrative problems which will take substantial time and money to unravel, and indeed may lead to an unjust result'. However, we will do everything we can to ensure that the result is a just one," Mr. Blaauw added.

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PRICEWATERHOUSECOOPERS

"Our remuneration as provisional liquidators is determined by the Court and as liquidators by the Committees of Inspection. As such, our remuneration is subject to a rigorous approval process," Mr. Blaauw said.

"The remuneration being requested is only a very small percentage of the total claims lodged. To put this in context, the costs of the liquidations for one year are significantly less than the operating costs for CA Pacific Securities and CA Pacific Finance that were being incurred prior to our appointment," Mr. Blaauw said.

Mr. Blaauw said that the liquidators were faced with total claims from about 10,000 former CA Pacific clients amounting to approximately HK$1.4 billion but the shares held by CA Pacific were valued at only approximately HK$900 million when it collapsed in January 1998.

"With regard to the collection of assets of the two companies, we are continuing our efforts in actively pursuing the recovery of debts owed to the companies, and resorting to formal legal proceedings where necessary. We are also negotiating the sale of CA Pacific Securities' Stock Exchange seats and are making progress," Mr. Blaauw added.

"The joint liquidators have made substantial progress on the liquidations during the course of 1998 and are confident that we can make further progress during the course of this year. We are committed to making initial returns to former clients and creditors as soon as this becomes possible," Mr. Blaauw concluded.

Ends.....18 January 1999

For further information, please contact:

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LETTER TO ALL CLIENTS AND CREDITORS

CAP Securities Ltd. & CAP Finance Ltd.
(both in compulsory liquidation)

Dear Sir/Madam,

We are writing to you in our capacity as joint liquidators of C.A. Pacific Securities Limited ("CAP Securities") and C.A. Pacific Finance Limited ("CAP Finance"). The purpose of this letter is to report to all clients and creditors of the two companies in respect of the progress of the liquidations in the light of the judgment given by the Honourable Madam Justice Yuen of the High Court on 17th December 1998. We are fully aware of the considerable concerns on the part of clients and creditors, and of the public interest in this matter. For these reasons our intention is to continue to disclose wherever practicable as much useful information as we can in respect of the liquidations.

As advised in our letter of 14th August 1998, following previous court directions, an application was made to the court by way of a representative action to determine the most fundamental and basic question - whether clients of CAP Securities in principle have a proprietary interest in shares held by the companies or only a contractual claim against CAP Securities. The representative application was heard in mid-November 1998 for six days and the judgment was delivered on 17th December 1998.

The judgment is a crucial, first step in progressing the liquidations. The court determined that, in principle, clients of CAP Securities have a proprietary interest in shares held at CCASS acquired by CAP Securities on the clients' instructions and paid for with their own funds. The effect of the judgment is that the joint liquidators will be required to trace the individual claims of each and every one of the 10,000 or so clients against the securities held by CAP Securities, CAP Finance and CAP Finance's bankers. As we foresaw from early in the liquidations, this is not going to be straightforward. As we have previously explained, it is unlikely that clients and creditors of the two companies will receive any returns in the liquidations until the second half of 1999, if not beyond. The judge herself said in her judgment:

> *"I appreciate this task may well pose extremely difficult administrative problems which will take substantial time and money to unravel, and indeed may lead to an unjust result."*

We wish to assure all involved that we will do everything we can, within the constraints of Hong Kong insolvency law, to ensure that the result is a just one, and that the liquidations are conducted in a manner which is as speedy and cost-effective as is possible.

Our legal advisers have already provided preliminary advice on the issues which now confront us. Clients and creditors may recall that in our letter dated 14th August 1998, we summarised these issues as:

- the validity of the security taken by CAP Finance's bankers over shares of clients;
- the precise legal effect of the documents signed between CAP Finance and clients;
- recovering the substantial amount of monies due from debtors to the two companies;
- determining (in the light of the judgment) to what extent different categories of clients have different claims to the return of shares;
- determining the impact of action taken by CCASS at the commencement of the liquidation of the two companies;

- carrying out the complex task (in the light of the judgment) of tracing individual clients' claims to those shares that remain.

Insofar as the tracing task is concerned, the court suggested that this may be a suitable case where a fairer and less expensive arrangement might be sought to simplify the issues to be addressed. This is certainly something that we are now looking at. We have instructed our legal advisers to finalise their advice by the end of January 1999. As soon as is possible thereafter, we will consider how we will tackle the issues in practice, in the light of the legal advice, and in accordance with any directions from the judge.

We have already set dates for meetings of the two companies' committees of inspection for the end of February 1999 (immediately after the Chinese New Year holidays). We intend to present to the committees at those meetings our proposals as to how the outstanding issues should be addressed. Thereafter, we would hope to be able to present our proposals to the court and seek its directions where necessary in the weeks following those meetings.

We are also considering [illegible]thod for agreeing each of the client's and creditor's claims (totalling over 10,000 in number), and subject to this procedure being approved by the court, we will be writing to each client and creditor in due course.

With regard to the collection of assets of the two companies, we are continuing our efforts in actively pursuing the recovery of debts owed to the companies, and resorting to formal legal proceedings where necessary. We are also negotiating the sale of Stock Exchange seats and are making progress.

The costs of the provisional liquidations have been submitted to the court and we are still awaiting the court's approval. The costs of the liquidations will be submitted to the committees of inspection for them to review and approve as soon as possible thereafter.

Some clients will have already received compensation from the Stock Exchange compensation fund up to the statutory limit of $150,000. Claims against the compensation fund are administered by the Securities & Futures Commission ("SFC"), not by us as joint liquidators and any questions clients have on the compensation fund arrangements should be directed to the SFC.

As court-appointed joint liquidators, we are very conscious of our responsibilities and obligations to the court, the Official Receiver, the committees of inspection, clients and creditors. Since the two committees of inspection were appointed on 10th June 1998, we have had four meetings with each of them, and we will continue to report to and keep the committees apprised of the progress in the liquidations. We will also continue to liaise closely with the court, the Official Receiver, the Government, the SFC and the Stock Exchange of Hong Kong.

Jan G.W. Blaauw and Denis M.P.C. Ho
Joint Liquidators
C.A. Pacific Securities Limited
C.A. Pacific Finance Limited
16th January 1999

Comparative Study of Regulation over
Securities Margin Financing in Overseas Jurisdictions

1.	Do finance providers need to be licensed?	There are several categories of finance providers in Singapore. These include banks, merchant banks, finance companies, companies licensed under the MoneyLenders Act, as well as securities companies (licensed by MAS).	Securities dealers approved by the Taiwan SFC ("TSFC") and margin financing companies approved by the Ministry of Finance and TSFC may provide margin financing.	Broker-dealers as well as non-broker-dealers may provide margin financing. They are governed by different Regulations issued by the Federal Reserve.	Firms do not need a special licence but have to be authorised by the SFA to carry on investment business under the terms of the Financial Services Act 1986.	Under the proposed regime, only securities dealers and securities margin financiers registered with the SFC may provide margin financing, unless they are banks and other companies specifically exempted from registration.
2.	Must they hold capital against the loans, which they provide?	For securities companies licensed under the Securities Industry Act, they are required to hold capital against the loans that they provide.	There are minimum net worth requirements and exposure limits for dealers carrying on margin financing business; there are no specific requirements on margin financing companies but there are restrictions on their source of funding.	All registered broker-dealers are subject to net capital requirements. At a minimum, broker-dealers must maintain capital equal to or greater than 2% of customer financing. In addition, broker-dealers that maintain net capital below 5% of aggregate debit items are subject to additional regulatory requirements and are limited in their broker-dealer activities.	Yes, the liquidity adjustment for a loan granted by a firm which is not due to be repaid within 90 days is either 8%* Counterparty weight or 100% of the balance sheet value, except there is no liquidity adjustment for amounts due which are secured by acceptable collateral, as defined in the SFA rulebook.	Securities dealers and securities margin financiers are subject to issued share capital requirements as well as liquid capital requirements. At a minimum their liquid capital must be equal or greater than 5% of their total liabilities.
3.	Are they permitted to pool and pledge clients' securities collateral with their bankers for funding?	Please refer to Question 7.	The regulations only permit clients' securities to be used in securities borrowing and lending or for obtaining refinancing from within the securities industry. The regulations are silent on the point regarding pooling. Both margin financing company and securities dealers are forbidden to use clients' securities for applying banking facilities.	Please refer to Question 4.	Yes, but subject to conditions. The bank would have to be notified that the collateral does not belong to the firm. It is standard market practice in the derivatives markets for firms to pool client accounts although there is the option to hold client money in designated client bank accounts.	Yes.

4.	**Must they obtain specific client authority for this purpose?**	Not applicable	The regulations require a Margin Client Agreement to be entered into with client specifying that clients'collateral cannot be dealt with other than as stipulated in the regulations.	Broker-dealers are required to segregate excess margin securities in a line-free environment. Margin securities are those securities carried for a customer in a margin account, with market value equal to (or less than) 140% of the account's debit balance. Such securities are left available to the broker-dealer for purposes of financing the debit balance and may be used as collateral for bank loans or stock loans. Excess margin securities are those securities that have a market value in excess of 140% of the aggregate debit balance in that customer's account. Broker-dealers are required to obtain a customer's written consent in order to hypothecate securities under circumstances that would permit the commingling of customers' securities and to give written notice to a pledgee that, among other things, a security pledged is carried for the account of a customer.	Yes, firms must notify their clients that the collateral will not be registered in the clients individual name and obtain written consent or satisfy themselves that such prior consent has been given.	Yes. Securities dealers must obtain specific authority from clients. Client authorisations cannot extend beyond the usage allowed in the law.
5.	**Must such client authority be renewed regularly? If yes, please specify renewal period.**	Not applicable	No specific regulation in this regard.	No. Broker-dealers are not required to renew client authority after receiving a signed margin agreement containing authorization to hypothecate securities under certain circumstances. However, broker-dealers are required to furnish periodic disclosures to customers relating to customer financing. This periodic disclosure informs the customer of the actual cost of credit, and,	It depends on the individual agreement between the firm and the client.	Yes, every 12 months.

				with the aid of the initial disclosure, enables him to accurately assess that cost.		
6.	Besides pledging with banks, can clients' securities collateral be used for any other purpose? If yes, please specify.	No	Clients' securities can only be applied within the securities industry for the purposes set out in Question 3.	Yes. These can be used to finance customer debit balances and may, in addition to being used for bank loans, be used as collateral for stock loans or repurchase agreements.	The bank (or third party) cannot claim any lien or right of retention or sale over the collateral except to cover the obligations to the bank which gave rise to that deposit, pledge, charge or securities arrangement or any charges relating to the administration or safekeeping of the collateral.	Securities dealers can pledge clients' securities with banks use them in stock borrowing/lending or deposit them as collateral with HKSCC and SEOCH whereas securities margin financiers can only pledge clients' securities with banks or securities dealers.
7.	Must they operate each client account on a fully segregated system so that a client's collateral can only be applied to obtain funding for that client's borrowing needs?	A dealer may pledge a client's securities for a sum not exceeding the amount owed by the client.	No. The regulations merely require securities firms to maintain accounting records to account for clients' positions on an account-by-account basis.	No. Broker-dealers are not required to operate each client account on a fully segregated system so that a client's collateral can only be applied to obtain funding for that client's borrowing needs.	Yes, the collateral must be identifiable from assets of the firm plus the customer providing the collateral must be identifiable by the firm at all times.	No.