立法會
Legislative Council

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(These minutes have been seen by the Administration and cleared by the Chairman)

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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

Minutes of meeting
held on Tuesday, 9 May 2000, at 10:45 am
in Conference Room B of the Legislative Council Building

Members present : Hon Ronald ARCULLI, JP (Chairman)
Hon Eric LI Ka-cheung, JP
Hon HUI Cheung-ching
Hon SIN Chung-kai
Hon Ambrose LAU Hon-chuen, JP
Hon FUNG Chi-kin

Members absent : Hon Albert HO Chun-yan
Hon Jasper TSANG Yok-sing, JP

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

Mr Howard YAM
Assistant Secretary for Financial Services

Attendance by invitation : Securities and Futures Commission

Mr Andrew PROCTER
Executive Director of Intermediaries and Investment Products

Mr Leo LEE
Director of Licensing

Mrs Yvonne MOK
Associate Director of Intermediaries Supervision

Clerk in attendance : Ms LEUNG Siu-kum
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 Election of Chairman

Proposed by Mr FUNG Chi-kin and seconded by Mr Eric LI Ka-cheung, Mr Ronald ARCULLI was elected the Chairman of the Subcommittee.

II Meeting with the Administration
(LC Paper Nos. CB(1) 1535/99-00(02) and (03), LS 119/99-00
LegCo Brief Ref: 121/LG/1001/0200))

Briefing on the subsidiary legislation

2. The Principal Assistant Secretary for Financial Services ("PAS/FS") explained that the Financial Resources Rules ("FRR"), being subsidiary legislation under the Securities and Futures Commission Ordinance (Cap. 24), provided appropriate prudential standards on the financial resources of market intermediaries. The current FRR had been in operation since December 1993. The Securities and Futures Commission ("SFC") completed a review of the FRR in March 1997 and recommended amendments to the rules in order to keep up with changes in market practices and strategies, to respond to development of new products, as well as to rectify anomalies and deficiencies identified in operating the rules. On 15 March 2000, the Securities (Margin Financing) (Amendment) Ordinance 2000 was enacted and a new class of registrant called "securities margin financiers" ("SMF") had been created. The regulatory regime had brought securities margin financing activities into the purview of the Securities Ordinance (Cap. 333) and subjected them to the supervision of SFC. The new FRR would replace the existing rules. Essentially, they were to standardize the financial resources requirements of securities and futures dealers, as well as to extend appropriate financial regulation to SMF.

3. PAS/FS added that the industry was consulted on the initial review of FRR in March 1997 and on the proposed regulation of securities margin financing in May 1998. Moreover, the FRR in draft form had been submitted to the Bills Committee on the Securities (Margin Financing) (Amendment) Bill 1999 for reference. The Bills Committee's suggestion of excluding constituent stocks of the Hang Seng Index ("HSI") from the concept of "related collateral" in the calculation of the concentration risk adjustments on securities collateral had been incorporated in the new FRR. The new FRR were basically the same as the FRR in draft form as previously examined by the Bills Committee.

4. As regards the Commodities Trading (Accounts and Audit) (Amendment) Rules 2000, PAS/FS said that they were made by SFC pursuant to section 109 of the Commodities Trading Ordinance (Cap. 250) to reflect the relevant changes made in the new FRR. A new set of liquid capital requirements would be introduced in the new FRR to replace the "adjusted net admissible assets" requirements for commodities dealers.

5. On the Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000) (Commencement) Notice 2000 ("the Commencement Notice"), PAS/FS said that the Commencement Notice appointed 12 June 2000 as the day on which the Securities (Margin Financing) (Amendment) Ordinance 2000 (other than item 4 of Schedule 3) was to come into operation.

The FRR

6. Mr Andrew PROCTER, Executive Director of Intermediaries and Investment Products, SFC briefed members on the major features of the new FRR. He highlighted the following points :

(a) In respect of regulatory capital requirements for market intermediaries, the new FRR would standardize the financial requirements for securities and futures dealers and SMF. New minimum paid-up share capital requirement (or equivalent in the case of sole proprietors) of $10 million would be introduced for SMF and securities dealers providing securities margin financing. The corresponding requirement for other dealers was $5 million. Whilst under the existing FRR, dealers who were sole proprietors enjoyed a lower liquid capital requirement of $500,000, the new FRR would require them to maintain a minimum liquid capital of $3 million to be on a par with the current requirement for corporate dealers.

(b) The FRR laid down rules for the calculations of risks associated with the business of market intermediaries and the required liquid assets to guard against these risks. In the calculation of liquid assets, the values of securities collateral were discounted to take into account price fluctuations due to market volatility and to reflect the concentration of risks. On position risk adjustments, there would be amendments in the haircuts applicable to different categories of securities collateral and changes in the qualifying criteria for debt securities. Categories of securities collateral included stocks and warrants listed on the Stock Exchange of Hong Kong ("SEHK"), and shares listed overseas. Different haircuts would be applied to HSI constituent stocks, HS 100 constituent stocks and all other stocks listed on SEHK as well as to different categories of stock collateral traded overseas. As regards concentration risk adjustments, concentration discounting factor would be applied to individual or related collateral received from margin clients to address the problem of over-exposure to individual stock collateral. Loan receivable from any single individual or related margin clients in excess of 10% of the total loan portfolio of a dealer or SMF would be subject to additional haircuts.

(c) There would be new reporting requirements for dealers and SMF. They would be required to include in the monthly returns the summary on banking facilities, information on selected margin clients, securities collateral, proprietary derivative positions, profit and loss account and analysis of client assets. They would also need to notify the SFC immediately of changes in accounting policies and circumstances specified in sections 32 to 34.

(d) A six-month grace period would be given to existing securities dealers providing securities margin financing in complying with the minimum capital requirement of $10 million, as well as the requirement for applying concentration discounting factor to individual or related collateral received from margin clients, and concentration risk adjustments arising from individual or related margin accounts.

Assistance to the securities industry and professionals in complying with the new FRR

7. Mr Eric LI Ka-cheung expressed concern about the difficulties market intermediaries and accounting profession would have in comprehending details of the new requirements and in familiarizing with the complex rules before they were put into operation on 12 June 2000. As the new FRR would expand the scope of an auditor's work, Mr LI remarked that it would be necessary for SFC to develop operational guidelines on the rules for the accounting profession and the industry. In view of the complex calculation and computation necessitated to produce the required information in FRR returns,

Mr LI was also concerned that the new FRR would increase the compliance cost for the securities industry, in particular the small dealers. He considered it desirable for SFC to develop appropriate computer software for use by the industry. He said that the Inland Revenue Department had already produced its own electronic reporting device to facilitate companies to complete the required returns.

8. In response, Mr PROCTER advised that SFC had scheduled ten meetings and workshops, of which seven had already been held, to brief the market and professional bodies on the new FRR. It had also written to all registered intermediaries informing them of the major changes in the rules. Moreover, SFC, by making reference to the current financial circumstances of registrants, had screened out some 50 firms which it considered might have difficulty in complying with the new FRR and held discussions with them to ensure that they had put in place proper measures to prepare themselves for the implementation of the new FRR. He added that apart from enquiries about the implementation details of the new FRR, the industry had not raised particular problems so far. In order to facilitate market participants to identify related securities for the application of concentration risk adjustments, SFC had undertaken to up-date such a list to be published on its web site on a weekly basis.

9. As regards the impact of the new FRR on the accounting profession, Mr PROCTER said that there would be no material difference in auditing requirements. Therefore, the new FRR would not increase the scope of work of auditors. The only additional requirement in relation to accounting would be the inclusion of a profit and loss account in the FRR return. He added that SFC had produced operating guidelines for the industry in this respect. SFC was prepared to assist the Hong Kong Society of Accountants ("HKSA") in working out relevant guidelines for the accounting profession if necessary. Mr Leo LEE, Director of Licensing, SFC supplemented that a seminar on the new FRR had been arranged for HKSA and another seminar would be held for the Financial Services Interest Group of HKSA later this month.

10. On the suggestion of developing appropriate software to facilitate market participants and professionals in completing the FRR returns, Mr PROCTER said that SFC, in collaboration with consultants, had been working on an electronic filing system for the industry to submit returns through computer networks. A group of market participants including some small firms had participated in the pilot programme. The project was in good progress and was expected to be ready before the grace period expired by the end of 2000.

New minimum capital and liquid capital requirements for sole proprietors

11. Mr FUNG Chi-kin conveyed the concern of some sole proprietors about their difficulty in complying with the new paid-up capital requirement of $5 million. Pointing out that a six-month grace period would be allowed for securities dealers providing securities margin financing to comply with the minimum capital requirement, Mr FUNG urged SFC to consider extending the grace period to sole proprietors.

12. In response, Mr PROCTER said that SFC recognized the concern of sole proprietors. However, he stressed that the objective of revising the FRR was to ensure that licensed entities engaged in securities businesses were financially sound to stand the risks undertaken. SFC considered that no transitional arrangement was necessary for sole proprietors. It also envisaged that no sole proprietors would have to cease operation due to the imposition of the new capital requirement. SFC would endeavour to contact individual sole proprietors and offer them assistance where necessary in complying with the new requirement.

Concentration risk adjustments

13. The Chairman pointed out that it might be difficult for securities dealers or SMF to adjust on time their loan portfolios as a result of changes in the composition of constituent stocks of HSI or HS 100. He was concerned that dealers or SMF would breach the FRR under such circumstances.

14. In response, Mr PROCTER said that dealers or SMF had to adjust their loan portfolios by taking other securities or making margin calls to clients to meet the shortfall in liquid assets. Under extreme market conditions where dealers and SMF had a genuine difficulty in complying with the concentration risk adjustment rules, SFC would consider granting exemptions to some securities collateral from the application of concentration discounting factor, or waivers to some dealers and SMF from strict compliance with the rules, if it was satisfied that it would be in the interest of the investing public or in public interest to do so.

Examination on the new FRR

Section 2 -- Interpretation

15. The Assistant Legal Adviser 6 (ALA6) enquired about the inconsistency where the reference to "for the purposes of these rules", which appeared in some of the definitions in section 2, had been omitted in some instances in the Chinese version of the FRR. Mr PROCTER responded that SFC had raised the same query. The Law Draftsman confirmed that it was consciously left

ALA6 out in the Chinese version. The Chairman invited ALA6 to follow up the matter with the Law Draftsman.

SFC 16. In the definition of "introducing broker", ALA6 opined that the meaning of the term "exchange participant" was unclear. Mr PROCTER undertook to refer the matter to the Law Draftsman for consideration of improving the drafting of the provision.

Admin 17. In the definitions of "qualifying debt securities" and "special debt securities", the Chairman requested the Administration to consider replacing the reference of "the central government or central bank of the People's Republic of China" by their official terms.

Section 7 -- Compliance with liquid capital requirement

Admin 18. Members noted that under section 7(b) liquid capital deficiency should not occur on more than a total of four business days during any two-month period. ALA6 pointed out that the present drafting of the section did not achieve the intention. The Administration undertook to review the drafting of the provision.

Section 11 -- Calculation of liquid assets

Admin 19. ALA6 pointed out that under section 11(2), a dealer or SMF registered in Hong Kong operating an overseas branch could not include his overseas assets, which were used to satisfy the financial resources requirements of an overseas regulatory authority, in the calculation of the liquid assets for the purpose of complying with the liquid capital requirement under the FRR. He enquired about the treatment in respect of an overseas company operating a branch in Hong Kong. The Administration undertook to respond to the enquiry at the next meeting.

Commencement date of the subsidiary legislation

20. Members noted that the three pieces of subsidiary legislation under scrutiny by the Subcommittee were gazetted on 20 April 2000 and tabled before the Legislative Council on 3 May 2000. The commencement date of the subsidiary legislation was 12 June 2000. Members also noted that the scrutiny period for the subsidiary legislation could be extended to 7 June 2000. The Subcommittee should report to the House Committee at its meeting on 26 May 2000 at the latest.

III Any other business

21. Members agreed to hold the next meeting on 16 May 2000, at 10:45 am.

22. The meeting ended at 12:50 pm.

Legislative Council Secretariat
25 August 2000