



Date: 28 October 2004

Intermediaries Supervision Department
The Securities and Futures Commission
8/F Chater House
8 Connaught Road Central
Hong Kong

Dear Sirs,

Re: Written comments on the consultation paper on proposed measures to address risks arising from securities margin financing

In response to the Commission's recent publication of the above named consultation paper, we would like submit our views on the proposed measures as follows:

● Principal measures:

1. *Limit on the re-pledging of client collateral*

We agree that the limit on the re-pledging of client collateral can provide more effective investor protection but it is also necessary to balance the interest of business doers and the investors. Setting a limit on the re-pledging of client collateral does impose extra costs and administrative works for market practitioners. Our view is that the cap between 130% to 150% is too stringent and we are of the view that a 200% limit would be the most appropriate percentage limit and the transitional period should be allowed to help existing SMF providers to achieve compliance.

2. *Adjustment of Securities and Futures (Financial Resources) Rules ("FRR") haircut percentage rates*

For the haircut percentage rates, we are of the view that it should be only applicable to margin business and not for the house investment. It is because the house investment is already mark-to-market and significant change in the haircut percentage rates will consequently adversely affect the investment decision of the company. This will lead to the situation that regulation dominates the business decision as market practitioners may only invest mostly in blue chip shares instead of other shares. It will damage the liquidity and market efficiency of non-blue chip shares. The trading volume and market turnover for blue chip and non-blue chip shares may go extremes.



Regarding the margin business side, in addition to the above concerns, the proposed haircut percentage rates in this consultation paper are mostly over 100% increase as compared to the existing haircut percentage rates. Such significant change will not only putting extra pressure on existing SMF providers but also driving away their business to bankers. The more the different classes of stocks are created, the more the costs, confusion and administrative works imposed on market practitioners. Our view of the proposed new FRR haircut rates are as follows:

Stock & warrants	Existing FRR Haircut Rates	Proposed New FRR Haircut Rates	Our Proposed FRR Haircut Rates
1. HSI/HSHK LargeCap Index constituents	15%	20%	20%
2. Market cap. > \$10 billion & monthly turnover > \$300 million	N/A	20%	20%
3. HSI/HSHK MidCap Index constituents	20%	40%	40%
4. MSCI HK/MSCI China Index constituents	N/A	40%	40%
5. Market cap. > \$5 billion & monthly turnover > \$300 million	N/A	40%	40%
6. Other Hang Seng Composite Index (HSCI) constituents	30%	60%	40%
7. All other Hong Kong listed stocks	30%	80%	40%
8. Warrants	40%	100%	100%

● Supplementary measures

Tightening the FRR provision on cash client receivables

We noted that it is proposed to shorten the existing grace period allowed for adjusting the regulatory capital of brokers in respect of overdue receivables from cash clients for their stock purchases from 5 to 2 business days after the due settlement date. We are of the view of that this is a matter of credit policy of the market practitioners themselves. The financial situation and position of each firm is different and it is not practicable to



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apply a single set of tighten rule to all firms. Moreover, when considering together with the timing difference between different geographical zones for settlement purposes, we think that reduction from 5 to 4 business days after the due settlement date is more practicable.

Finally, we think that sufficient transitional period should be allowed to help existing market practitioners to achieve compliance for any change in rules. Thank you for your attention to the above matter. In the meantime, please do not hesitate to contact us should you have any queries.

Yours faithfully,
For and on behalf of
SOUTH CHINA SECURITIES LIMITED

Authorized Signature