1. **Do you agree that an SMF broker should control its total margin loans with reference to the amount of its capital?**

   Agreed.

2. **Do you agree that the proposed guidelines should provide a benchmark for the total margin loans-to-capital multiple?**

   Agreed.

3. **During the soft consultations, some respondents recommended setting the benchmark for total margin loans-to-capital multiple at two to five times. Within the suggested range of two to five times, what do you think is the appropriate quantitative benchmark for total margin loans-to-capital multiple? Please provide the rationale for your comment or suggestion.**

   Suggested the benchmark should be 4-5 times, some small to mid-sized LCs have utilized lots of cash flow on daily dealing settlement and leaving margin financing to banks to refinance the clients. As most of the banks only allow high quality collaterals which provides adequate protection on market risk and liquidity risk, further tighten the control with a very low margin loans-to-capital multiple could be overwhelming.

   In addition, margin financing become a major income source for lots of LCs after the removal of Minimum Commission Rate, it may have severe impact on operating profits on the LCs. As a result, anything less than 4-5 times would make Hong Kong less competitive than other markets. It may also negatively impact market sentiment since there would be less money available to invest in the Hong Kong stock market.

4. **Do you agree that a higher benchmark for total margin loans-to-capital multiple should apply to a broker that does not use approved subordinated loans as regulatory capital than to a broker that does?**

   Disagreed, the same benchmark should be imposed regardless if using approved subordinated loans as regulatory capital or not. Sub-loan is one of internal financing from its shareholders with actual cash flow. As it is not easier to apply for capital reduction under current legislation, [What does this mean? Amended] The subordinated loans serve as effective flexible tools to finance LCs capital requirements. In addition, sub-loan is capital in nature and it is opened for all LCs to utilise and therefore, rules and regulations should not discriminate the LCs with sub-loan arrangement as long as it is approved by SFC. Accordingly, we suggest same benchmark should be imposed.

5. **While "group of related margin clients" is defined in section 42(3) of the FRR, do you agree that the coverage of related margin clients should be extended, eg, to include margin accounts which are held by the same beneficial owner for the purposes of monitoring aggregate credit risk exposures?**

   Agreed. It is a common practice for investors to operate different accounts with SPVs, LCs should already have considered those SPVs as one single investor for the risk management.

   However, in case the margin account that is jointly owned or any companies shareholding with more than one shareholder, please consider to have clearer definition of ownership to constitute group related clients, i.e. any thresholds to be calculated with the same beneficial owners among two accounts.

6. **Do you agree that exposures to different securities held as collateral which are highly correlated should be aggregated for the purposes of monitoring concentration risk?**

   Disagreed, as mentioned in the consultation paper, the FRR already requires a deep haircut for illiquid collateral. By introducing this aggregation for highly correlated securities, it will just lead to confusion among brokers as to what is "highly correlated securities" and it would require an advanced computer system to identify the stocks with correlation from over 2000 stocks. For example, it would be extremely challenging to identify those who have significant business affiliations. There will have to be very clear guidelines on the definition of "highly correlated", such as what would be deemed "significant" business affiliations. In addition, it is reasonably believe that most of the constituent stocks of HSI/certain indexes or stocks in the same business sector could be easily become highly correlated.

7. **Do you agree with the definition of "highly correlated securities" set out in paragraph 38 above?**

   Disagreed. This would impose an unnecessary burden to the SMF brokers and therefore, would hinder the Hong Kong market. As mentioned above, it is not feasible to let LCs to decide whether those stocks are highly correlated by the LC itself. There will be confusion in the market because not only should the SMF brokers take into the non-exhaustive list of factors, but also set its own collateral concentration limits. This could lead to arbitrage by clients among the brokers. These requirements, such as looking at whether two or more securities exhibit high correlation in historical price movements, would require huge amount of infrastructure expense and resources to trace the correlation in historical price movements amongst all securities and to collect information regarding securities issuers with group affiliations, material cross-shareholding ("material" has to be defined) and significant business affiliation ("significant" has to be defined). In addition, it is reasonably believe that most of the constituent stocks of HSI/certain indexes or stocks in the same business sector could be easily become highly correlated.

   Moreover, according to the statistic from Census and Statistics Dept (please refer to the table 037: "Chain volume measures of GDP by economic activity" https://www.censtatd.gov.hk/hkstat/sub/sp250.jsp?subjectID=250&tableID=037&ID=0&productType=8), HK GDP heavily relies on Financial Services, Real Estate and Import/Export. Lots of stocks listed in HKEx are coming from those industries, and they are all price sensitive and have similar behavior to any related local & overseas policy and regulations. They could all become highly correlated as mentioned in the Consultation Paper.

   However, these businesses represent the majority of the HK economy and they are well developed, so it is not necessary to consider the exposure on these industries as overly risky. In addition, the Consultation Paper also suggests that two or more securities (including Bonds) which are issued by the same issuer or different companies within the same group would be considered as "Highly Correlated", this could hurt the bond market or stock market as investors will tend to stop buying any related securities to avoid a lower margin limit. We consider there is no further additional control on the so-called "Highly Correlated Securities".

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8. **Do you consider that constituent stocks of any other stock indices should also be treated as index stocks for the purposes of paragraph 43 above? Please provide the rationale for your suggestion.**

   Apart from the "index stocks" which are proposed to cover the constituent stocks of the Hang Seng Index or Hang Seng China Enterprises Index, it is also suggested to include the constituent stocks of Hang Seng Composite LargeCap Index as the event risk of large cap stocks should be lower than that of mid or small cap stocks.

9. **During the soft consultations, some respondents suggested setting X% at between 30% and 50%, and Y% at between 20% and 25%. Within these suggested ranges, what percentages do you consider as appropriate benchmarks? Please provide the rationale for your suggestion.**

   Disagreed, X% should be extended to 100% and Y% should be extended to 50%.

   The constituents of the Hang Seng Index or Hang Seng China Enterprises Index are the backbone of the HK financial sectors, they have been reviewed and evaluated by HKEx, they are supposed to be the stocks with highest quality in HK.

   In fact, the ratio should be compared to the Shareholders' equity instead of ELC which fluctuates every day and it is heavily affected by short term activities such as IPO, placement, underwriting and the sudden increase of trading volume on the indices rebalancing. Thus, the ratio shouldn't take reference to the ELC but Shareholders equity.

   Furthermore, according to the existing FRR framework, 3 tiers haircut ratios are applied to different stock indices/stocks categories to have a better classification. We suggest to take similar approach to set 3 benchmarks where X% are 100%, Y% are 75 and Z% are 50% respectively in order to have a better picture on the hypothetical stress test.

10. **Do you think that as a quantitative benchmark, margin client concentration should be measured with reference to the broker's shareholders' funds? If not, what is your alternative suggestion? Please provide the rationale for your suggestion.**

    The margin client concentration should be measured with reference to LCs' Total Liquid Assets minus Client Concentration Adjustment in Ranking Liabilities instead of Shareholders' Fund. As margin facility is not a naked loan to clients, all margin clients have pledged collaterals to support the loan amount and LCs would assess the marginable value (Haircut has been reviewed and proposed in Q14) and liquidity in the market. This is to ensure the quality of the collaterals has been accounted for in the assessment. Additional adjustment from the Client Concentration Adjustment in Ranking Liabilities should set off to the Total Liquid Assets to ensure the LC is financially stable to expend the margin business.

    Under the existing framework, the fluctuation of Liquid Assets has a notification requirement to alert SFC if it is deteriorated. We believe that this process provides a better skeleton to the market to control the "excessive exposure" and leaving enough room to allow LCs with a sound financial and risk control to grow the margin business to facilitate the market needs.

11. **During the soft consultations, some respondents recommended setting the quantitative benchmark for margin client concentration at between 20% and 40% of a broker's shareholders' funds. Within this suggested range, what percentage do you think is appropriate for benchmarking purpose? Please provide the rationale for your suggestion.**

    Referring to Q10, the Shareholders' Fund is not a completed indicator for margin business. It is suggested to set 40% as the limit to the net amount of LCs' Total Liquid Assets minus Client Concentration Adjustment in Ranking Liabilities. Again, the quality of the collaterals should be reflected in the assessment to limit the excessive exposure and leave room to grow the business at the same time. Otherwise, the SME LCs will not have chance to accept relatively sizeable clients to them and putting too much constraints to grow/ survive their business.

12. **Do you have any comment on the basis for determining whether a margin loan is a significant margin loan?**

    The basis should be related to Total Liquid Assets minus Client Concentration Adjustment.

13. What should be the appropriate percentage with reference to the broker's shareholders' funds for determining whether a margin loan is significant? Please provide the rationale for your suggestion.

As this mechanism didn't account for the quality of collaterals, the percentage should be higher. Referring to Q3, margin loans-to-capital multiple should be set at 4-5 times, applying the same 10% threshold from FRR capital charge for concentration risk, the calculation would be illustrated as, (Shareholders Fund + Sub-loan) times 5 times 10%, which is equal to 50% of the sum of Shareholders Fund + Sub-loan.

14. During the soft consultations, some respondents commented that X% in paragraph 64(b) above should be set at 15% to 20%. What percentage point within this range do you think is appropriate? Please provide the rationale for your suggestion.

Not sure if SFC has any statistics to prove that the 228 SMF brokers reported FRR margin shortfalls as at 31 December 2017 and total FRR margin shortfalls increased by 14 times from $2.3 billion to $33.7 billion were caused by the aggressive margin ratio (Paragraph 59) instead of market fluctuation magnitude has been increased because of A-share effect & China-HK political and economic policy?

Disagreed with this measure, some LCs are the subsidiaries or affiliates of banks which may offer advantaged margin ratio to their subsidiaries/ affiliates which create inequitable competition among LCs. In addition, banks in HK only allow quality collaterals in the market, and those stocks are not likely to have margin shortfall under normal circumstance. The SFC should impose a tighter control on the margin ratio for those penny stocks and anything with thin trading volume instead of cutting down the margin ratio of those quality stocks.

Besides, banks normally do not offer margin financing to new issues even for some listing companies have significant market capitalization and financially strong, if LCs have to determine haircut percentage by referring to their lending banks' haircut percentages, LCs will lose the competitiveness and there will be negative impact to investors and market liquidity.

By simply averaging the haircut percentage of lending banks may not be a meaningful reference since banks usually provides different haircut percentage to different LCs and they also set limit on the quantity of pledging shares.

Bank also exercised its caution in conducting margin financing business to discount the collateral stock values. We considered that there is no further additional measures to control the margin ratio setting by LC.

15. Do you agree that total unsettled margin calls should not exceed the shareholders' funds of an SMF broker? Please provide the reason for your comment.

Agreed.

16. During the soft consultations, some respondents indicated that a margin call which has remained outstanding for more than 30 days to 90 days should be treated as a long-outstanding margin call. Within this suggested range, at which point do you think a margin call should be treated as a long-outstanding margin call?

Agreed.

17. During the soft consultations, some respondents recommended limiting total long-outstanding margin calls to between 20% and 25% of an SMF broker's shareholders' funds.

Within this suggested range, what percentage do you think is appropriate? Please provide the rationale for your suggestion.

The range is too small, it doesn't make a difference. LCs already implemented effective risk control measures to avoid long outstanding margin calls. The margin call shortfall will be haircut under FRR, we consider that it is not necessary to impose such limit.

18. During the soft consultations, some respondents suggested applying a 15% to 30% hypothetical price drop where the collateral pool mainly comprised index stocks, whereas for a collateral pool comprised few index stocks, the hypothetical price drop should be between 30% and 50%. Do you have any suggestions on the hypothetical price drop percentage to be applied in each of the scenarios (ie, X%, Y% and Z%) suggested in paragraph 85 above? Please provide the reason for your suggestion.

X% - 15%, assuming index stocks drop 10% and others drop 30% which are very remote unless financial crisis appear.

	Component Ratio	Drop	Weighted Ratio
Others	0.25	0.3	0.075
Index stocks	0.75	0.1	0.075
	1		0.15

Y% - 20%, which gives enough stress as the collateral pooled with 25%-75% Index Stocks.

	Component Ratio	Drop	Weighted Ratio
Others	0.5	0.3	0.15
Index stocks	0.5	0.1	0.05
	1		0.20

Z% - 25%, as the majority is non-index stocks which could fluctuate a lot

	Component Ratio	Drop	Weighted Ratio
Others	0.75	0.3	0.225
Index stocks	0.25	0.1	0.025
	1		0.25

19. As regards the weighting of index stocks in the collateral pool in each of the hypothetical scenarios suggested in paragraph 85 above (ie, 75% and 25%), do you agree with the suggested thresholds as the dividing line for distinguishing a high-quality collateral pool from a low-quality collateral pool? Please provide the reason for your suggestion.

Agreed.

20. Do you consider that constituent stocks of any other stock indices should be treated as index stocks for the purposes of paragraph 85 above? Please provide the reason for your suggestion.

Agreed, propose to include the constituent stocks of Hang Seng Composite LargeCap Index as the volatility of large cap stock should be lower than that of small or mid cap stocks.

21. Do you agree that 10% is an appropriate threshold for the definition of "significant group of highly correlated securities"? Please provide the reason for your

suggestion.

Disagreed, should be at least 20% as it is more than one single stock.

22. Do you agree that 10% is an appropriate threshold for the definition of "significant re-pledged securities collateral" and "significant group of highly correlated re-pledged securities collateral"? Please provide the reason for your suggestion.

10% should be applied to single repledged securities collateral, 20% should be applied to group of highly correlated re-pledged securities collateral.

23. Do you think that a six-month transition period is appropriate? Please provide the reason for your suggestion.

If the SFC insisted to apply the above mentioned guidelines, especially the aggregation of highly correlated securities for risk monitoring, 6 months transition period would not be enough for LCs to understand the requirements, to discuss internally and to choose system vendors to setup the methodology and for implementation. A 12–month transition period would be more reasonable.

We suggest to implement those measures by phases, like phase 1 may be cover points 1 to 4. It can be implemented within 6 months.