

Linklaters

年利達律師事務所

10th Floor, Alexandra House
Chater Road
Hong Kong
香港遮打道歷山大廈10樓
Telephone 電話 (852) 2842 4888
Facsimile 傳真 (852) 2810 8133/2810 1695
Direct Line 直線電話 (852) 2901 5350
Direct Fax 直線傳真 2810 8133
stephen.fletcher@linklaters.com

The Securities and Futures Commission
8th Floor
Chater House
8 Connaught Road Central
Hong Kong
Attn: Leo Lam, Intermediaries Supervision
Department

By Hand

10 November 2004

Our Ref 我所文號 SMXF

Dear Sirs

Consultation Paper on Proposed Measures to Address Risks Arising From Securities Margin Financing

We are writing to provide comments on the proposals contained in the Consultation Paper on Proposed Measures to Address Risks Arising From Securities Margin Financing (the "**Consultation Paper**"). We are grateful to the Commission for this opportunity.

We note that the Consultation Paper contains proposals which, if implemented, would affect all licensed firms generally, not only securities margin financiers. We believe that many market participants have will not have focused on these issues, believing that the Consultation Paper is not relevant to them. Accordingly, we would urge the Commission to consider issuing a separate consultation paper in respect of those changes to the Securities and Futures (Financial Resources) Rules (the "**FRRs**") and other regulations, which if implemented, would impact on all persons licensed with the Commission in Hong Kong. While we appreciate that these proposals stem from amendments to existing rules on securities margin financing, we believe that highlighting these general proposals separately would be well received.

In relation to our more specific comments on the proposals in the Consultation Paper which relate primarily to the issues affecting all firms:

SOLICITORS

Resident Partners

Steven Christopher, Simon James Davies, Stephen Fletcher, Patrick Fontaine, James Gardner, Marc Harvey, Dean Lockhart, K.M. Teresa Ma, Andrew Malcolm, Zili Shao, Melvin Sng, Dominic Tsun, Jeremy Webb, Betty Yap

Non-resident Partners

Celia C.L. Lam, James Douglass

Consultants

Vanessa K.L. Poon, Kelly Quinn, Stephen Smith, Christopher Stonehill, David Yun

REGISTERED FOREIGN LAWYERS

Christopher Kelly (*Partner, Linklaters London, Resident in Hong Kong*)

Sanghoon Lee (*Partner, Linklaters New York, Resident in Hong Kong*)

Patrick J. Sheil (*Partner, Linklaters New York, Resident in Hong Kong*)

Please refer to www.linklaters.com/regulation for important information on the regulatory position of the firm.

1 Repledging Limit

The Commission has recommended that a limit be imposed on the amount of client collateral that a securities margin financing ("SMF") provider can repledge to secure bank loans ("repledging limit") on an aggregate basis.

We welcome the Commission's proposal to impose a repledging limit and believe that doing so would require SMF providers to operate more prudently and responsibly, thereby safe-guarding the interests of investors.

2 Tightening the FRR provision on cash client receivables

The current FRRs allow a licensed firm to include in its liquid assets amounts receivable from cash clients in the firm's liquid assets in full, provided that such amount has not been outstanding for more than 5 business days after the due settlement date. It is proposed that the existing grace period be shortened from 5 to 2 business days after the due settlement date.

We welcome the Commission's proposal for the tightening of this FRR provision and would propose a single stage transition. However, we would suggest a lengthy transitional period to allow firms time to adjust to this change.

3 Other applications of the proposed haircut table

Brokers currently follow the same set of FRR haircut percentage rates for all positions, including house investments. Securities firms will be affected if the haircut percentage rates are increased as proposed in the Consultation Paper (e.g. in terms of additional capital required to meet the minimum FRR requirements, in particular in the event of a licensed firm acting as an underwriter of an initial public offering in Hong Kong).

We believe that different sets of haircut percentage rates should apply to SMF providers and other licensed persons. The changes proposed in the Consultation Paper are made in response to a need to better protect investors in the SMF industry. However, the proposals, if implemented, would also significantly impact on the businesses and operations of licensed firms who may not be SMF providers in Hong Kong.

Also, we understand that Hong Kong's present haircut levels for licensed firms (i.e., non SMF providers) are generally comparable with or higher than those set by other markets. If a universal set of haircut percentage rates is maintained and the rates are increased, this could greatly impede on the competitiveness of the Hong Kong market as a global player in the industry.

As an ancillary point, we suggest that the definition of "illiquid collateral" be updated to reflect changes made to the haircut tables.

4 Notification requirement in relation to available credit lines

It is proposed that all securities firms be required to notify the Commission if, for a continuous period of 2 weeks, the firm has utilised 80% or more of its available credit lines (calculated at the lower of total bank facilities and aggregate amount banks are willing to lend against the security the firm has provided, as well as house investments and any client collateral that has not been re-pledged but may be so re-pledged as permitted by the proposed re-pledging limit).

While we welcome the Commission's proposed notification requirement as a way to safe-guard investors and market interests, we urge the Commission to provide further guidance on how credit

Linklaters

lines that are shared among group companies will be accounted for in determining "available credit lines" for the purposes of the new notification requirement.

5 Increasing capital requirements for firms with illiquid positions

We understand that the Commission is considering enabling the Commission to increase the capital requirements of licensed firms whose assets include illiquid positions. We are generally supportive of the Commission's proposal. However, as this proposal has not been covered by the Consultation Paper, we hope that the Commission's proposals will be open to public consultation prior to implementation.

6 Long term objective on tiering regulatory capital to risks

Finally, we are strongly in favour of the Commission's long term objective in tiering regulatory capital requirements to the risks that are incurred by each licensed entity. As the Commission will be aware, this is the direction in which other financial markets are moving. We look forward to the Commission's future proposals in this area.

We would be happy to meet with the Commission to discuss the views set out in this letter. If you have any questions in relation to the comments set out above, please do not hesitate to contact Stephen Fletcher at 2901 5350.

Yours faithfully

Linklaters

Linklaters