16 October 2018

By online and e-mail

Email: 2018_SMFconsultation@sfc.hk

Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs and Madams,

Re: Consultation Paper on the Proposed Guidelines for Securities Margin Financing ("SMF") Activities ("Consultation Paper")

We refer to the subject Consultation Paper issued by Securities and Futures Commission ("SFC") on 17 August 2018 and set out our comments below.

i) Total margin loans controls

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

Answer: Agree. Controlling total margin loans with reference to the amount of capital ensures the financial stability of an SMF broker.

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

Answer: Agree. Regulators should develop uniform standards for SMF brokers information and reference.

Question 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.

Answer: regards setting the benchmark for total margin loans-to-capital multiple at three times as an appropriate standard.

Question 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?
Answer: Disagree. The standards set by regulators should be fair and uniform.

ii) Margin client credit limit controls

Question 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?
Answer: Agree.

iii) Securities collateral concentration controls

Question 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?
Answer: Agree.

Question 7. Do you agree with the definition of "highly correlated securities" set out in paragraph 38 above?
Answer: Due to the broad definition in paragraph 38 of the Consultation Paper, it is difficult to identify and verify accurately in practical. Once the proposal is implemented, we suggest that the list of highly correlated securities should be updated and released regularly by the regulator.

Question 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.
Answer: No. Compared to HSI and HSCEI constituents, other index constituents are not authoritative, variant, and with huge difference in quality, which should not be treated equally.

Question 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.
Answer: Suggest setting at 30% as a uniform benchmark. To minimize the operational error, a uniform benchmark shall be introduced.

iv) Margin client concentration controls

Question 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.

Answer: Agree.

Question 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.

Answer: 30% is appropriate, but should have waiver for IPO, right issues, and M&A businesses.

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

Answer: Agree with the basis that classifies a margin loan higher than 10% of the broker's shareholder funds as significant.

Question 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.

Answer: 10% is appropriate as it's currently applicable.

v) Haircuts for securities collateral

Question 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.

Answer: have concerns with the proposal of setting the haircut percentage based on those assigned by the top three lending banks for the whole brokerage industry. The top three lending banks use their internal models to set the haircut percentage based on their risk appetite. The variance of the models' factors can lead to significant difference of view on the quality of the same stock. Thus setting the haircut percentage for the brokerage industry based on those assigned by the top three lending banks is not appropriate.

Referring to the banking regulation practices, it would make more sense to apply a two-method approach for the haircuts definition for the brokerage industry.

1) **Advanced Approach:** Under this approach, the qualified or leading brokerage firms are allowed to develop their own models to determine haircuts. Taking as an example, it adopts data mining, statistical modeling and machine learning to systematically classify the stocks into certain categories, hence determine haircuts.
2) **Standardized Approach:** For those small or medium brokerage firms, there will be no such resource internally, hence it might be reasonable for the regulator to introduce a standardized approach as guidance to determine the haircuts.

vi) Margin calls, stopping further advances and forced liquidation

Question 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.

Answer: Agree. Total unsettled margin calls will have implication to the shareholders' fund of an SMF broker once it treats as bad debt.

Question 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?

Answer: Over 90 days should be treated as long-outstanding.

Question 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.

Answer: 25% is more appropriate, as the long-term suspended stocks would influence this part of margin calls.

vii) Stress testing

Question 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.

Answer: A same percentage of 30% should be applied to all hypothetical scenarios, considering the feasibility and implementation effectiveness issues.

Question 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.

Answer: As mentioned in Q18 above, the same percentage should be applied to all hypothetical scenarios

Question 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.

Answer: No. Compared to HSI and HSCEI constituents, other index constituents are not authoritative, variant, and with huge difference in quality, which should not be treated equally.

Question 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.

Answer: According to the definition of significant group of highly correlated securities, market values of two or more securities will be summed up to compare the total market value of the collateral pool, as the price movement of correlated securities are not completely in a linear relationship which means that there still contains a diversification effect, we suggest adopting a threshold of 15% instead.

Question 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 repledged securities collateral"? Please provide the reason for your suggestion.

Answer: Suggest adopting 15 %, as the threshold for "a significant group of highly correlated re-pledge securities collaterals" should be higher than that of the "significant re-pledge securities collateral".

viii) Implementation timeline

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

Answer: 12-month transition period is more appropriate. SMF brokers would have sufficient time to review and update its system, policies and procedures, forms and current businesses model.

ix) Conclusion

Thanks for the great efforts made by the SFC to set the detailed requirements of the proposed guidelines for the SMF business, including total margin loans controls, margin client credit limit controls, securities collateral concentration controls, margin client concentration controls, haircuts for securities collateral, margin calls, stopping further advances, forced liquidation as well as stress testing. We sincerely hope that SFC will consider the feasibility of the guidelines for the brokerage industry so as to make the market more robust.

The subject matter of the Consultation Paper and the guidelines are of great importance to the whole market and we looks forward to the consultation conclusion issued by SFC after the two-month public consultation period.

We agree our submission will be published by the SFC, but please mask our company name from the publication.

Should you have any questions, please do not hesitate to contact at or at .

Yours faithfully,