Linklaters

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# Hong Kong - SFC Issues Consultation Conclusions on Proposed Guidelines for Securities Margin Financing Activities.

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## Overview

On 4 April 2019, the Securities and Futures Commission ("**SFC**") issued its conclusions to its consultation ("**Consultation Conclusions**") from August 2018 which proposed new Guidelines for Securities Margin Financing Activities (the "**Guidelines**"). The Guidelines aim to clarify, codify and standardise the risk management practices expected of brokers conducting securities margin financing ("**SMF**") activities. This applies to both (i) persons licensed for Type 1 (dealing in securities) activity who provide financial accommodation to their clients in order to facilitate acquisitions or holdings of listed securities by the persons for their clients; and (ii) persons licensed for Type 8 (securities margin financing) activity (together, "**SMF brokers**").

The SFC has **decided to proceed** with the implementation of the Guidelines, which will take effect on 4 October 2019. The Guidelines generally follow the draft provided in the initial Consultation, with some revisions and further guidance provided to the industry following feedback.

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The Guidelines provide guidance on the risk management practices expected of SMF brokers when they conduct SMF activities. The control measures specified in the Guidelines are the minimum standards expected of SMF brokers and are not meant to be exhaustive.

Some of the key aspects of the new Guideline are as follows:

- *Total margin loans controls* – An SMF broker may adopt a total margin loans-to-capital multiple benchmark up to five only if it has high quality margin loan portfolio and complies with all other applicable provisions in the Guidelines. An SMF broker with lower quality margin loan portfolio or weak SMF risk controls should adopt a lower total margin loans-to-capital multiples benchmark.
- *Margin client credit limit control* – An SMF broker should set prudent credit limits for individual margin clients or groups of connected margin clients to ensure the margin clients have the financial capability to meet their obligations. In setting the credit limits, an SMF broker should consider, among other things, its own liquidity profile and risk profile of its margin loan

portfolio as well as the financial situation of the clients, the quality of the credit support, the investment objectives, risk appetite and trading patterns of the clients, etc.

- *Margin client concentration controls* – An SMF broker should set prudent concentration limits to avoid building up excessive exposure to individual margin clients or groups of connected margin clients. In setting these limits, SMF brokers should consider, among other things, its own liquidity profile and capital, the financial situation of the clients, the quality of underlying collateral, client credit history, the potential impact on it of client default, etc.
- *Securities collateral concentration controls* – An SMF broker should set prudent concentration limits to avoid building excessive exposure to individual securities collateral or groups of connected major securities collateral. It should assess if any two or more of its major securities collateral are connected regularly (at least monthly).
- *Haircuts for securities collateral* – An SMF broker should set prudent haircut percentages for securities acceptable by it as collateral. In reviewing the securities, an SMF should consider the financial situation of the issuer, historical price volatility of the securities as well as any adverse news about the issuer of the senior management of the issuer.
- *Enforcement policies* – An SMF broker should prudently set the triggers for margin calls; for stopping further advances to, and further purchases of securities by, margin clients; and for forced liquidation of margin clients' securities collateral. These policies should, generally, be strictly applied.
- *Stress testing* – An SMF broker should conduct stress tests on its excess liquid capital and liquidity regularly (at least monthly) and upon occurrence of any material adverse market event or securities-specific event. In addition, stress tests should be conducted regularly (at least monthly) for the hypothetical stress scenario of a significant group of connected securities collateral losing all its value.

The Guidelines also require immediate notification to the SFC upon becoming aware of certain instances of non-compliance.

Finally, in response to feedback on the consultation, the Guidelines now clarify that IPO loans would not be treated as margin loans due to their different risk characteristics.

## Timing

The SFC has gazetted the Guidelines on 4 April 2019 and as noted above, the Guidelines will become effective on 4 October 2019. SMF Brokers should therefore start immediately assessing the impacts of the Guidelines on their SMF activities and carry out corresponding enhancements to ensure compliance with the Guidelines.

Please don't hesitate to reach out to any of your Key Contacts if you have any questions on the Guidelines – we would be delighted to assist.

## Contacts

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