

SECTION 2: QUESTIONS FOR RESPONSE

Please indicate your views by providing comments as appropriate. Where there is insufficient space, please use additional sheets of paper as necessary.

HKEx's Proposal 1: Revise HKEx Stress Testing Assumptions

Comments

1. Do you support the proposed revision of the Price Movement assumptions in stress testing?

Yes

2. Do you support the proposed revision of the Counterparty Default assumption in stress testing?

Yes

It is suggested that the proposal should be implemented when CPs are ready to deal with the impact on working capital as a result of the proposed revision of the Price Movement assumptions.

Questions

3. Do you agree with the proposed margining arrangements at HKSCC?

We support the move of HKSCC to improve the risk management system of HKSCC and to reduce the impact of overseas financial crisis on the local securities market. As a result, the shareholders of HKSCC, Hong Kong investors, CPs and Hong Kong as an international financial centre will all be benefited by the prudent risk management system.

The rules of margin requirements of HKCC worked well and widely accepted in the industry. It is therefore suggested that the proposed margining arrangement will also work well if the same practice is adopted by the industry.

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Our Client Margin

According to the practice of margin requirements for futures contracts, CPs require their clients to place the margin deposit in order to meet margin requirements of HKCC. If HKSCC is to impose the proposed margining arrangements, we will also require our clients to place the margin deposit for securities transactions. We therefore need to receive clients' consent on the new margin deposit requirements and to amend the relevant terms of client agreements. It will take time to explain to and persuade our clients. We however expect that clients' reaction may not be favourable and the clients may not accept such new arrangement in a short period of time. In addition, the investors of Hong Kong securities market may not be ready to accept such brand new practice in securities trading and any aggressive or unfavourable reaction of the investors (especially institutional investors which will be required to deliver the securities sold to CPs on T+1 day) will affect the image of Hong Kong as an international financial centre.

Before accepting the proposed margin requirements, we need to ensure that all clients will accept such new margin deposit practices. It is therefore suggested that HKEX first explains to the public about the implementation of the proposed margining arrangement which will result in CPs' requirements on clients to place margin deposit for their securities transactions before the settlement day. It is our view that the market awareness on such implications may not be so high for the time being.

Our Own Capital

At this moment, we cannot comment on the likely impact on our own working capital in detail before evaluating the willingness of our clients to place margin deposits to us according to the proposed margining arrangement. In principle, any use of additional funding of a CP to meet margin requirements of a clearing house is seen as extra financial obligations in addition to the FRR's requirements. Such extra obligations may not be predictable as clients' transaction volume may fluctuate. In general, the pressure on working capital of a CP may be significant and unpredictable.

If clients are requested by CPs to deposit margins or shares according to the proposed margining requirements, any loss on the margins due to the default of other CPs will be unacceptable to clients. In practice, there may be dispute among the clients and the CPs as to the sharing of loss in case of default of other CPs.

Margin Credit

The introduction of Margin Credit which is set at HK\$5million is a good sign of HKSCC's kind awareness of additional burden of working capital on CPs.

Intra-day margin

For mandatory Intra-day Margin (IDM), HKSCC may not need to strictly follow the arrangement of HKCC and SEOCH as the nature of Securities and Derivative dealing is different, and derivative trading in general involves higher risk in comparison with equity trading. While our clients accept that margin deposit is required in the case of derivatives trading, they may not accept that securities trading should have the same requirement.

Provided that we can get clients' consent to allow us to deposit their securities pledged to us to HKSCC, we also suggest HKSCC to accept stocks deposited by stockbrokers as collateral in CCASS to reduce the workload and time pressure involved in satisfying the IDM.

Confidence Interval

We suggest to review the confidence interval of 99.73% which is considered to be a bit high.

4. Do you agree with the proposed Dynamic GF model at HKSCC?

We support HKSCC to use the proposed Dynamic GF model as a tool to reduce the system risk. The introduction of Dynamic GF model will strengthen the ability of HKSCC as a whole to withstand any unexpected market situation and give more confidence to ultimate shareholders of HKSCC, Hong Kong investors, CPs and Hong Kong as a whole.

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Proposed Dynamic GF Credit

We agree to the introduction of proposed Dynamic Credit, which is seen as a move of HKSCC to recognize its liability in response to benefits of ultimate shareholders of HKSCC as a whole.

However, the amount proposed for the proposed Dynamic Credit will not exempt from the needs of CPs to raise funds to meet with the Dynamic Credit. In many cases, CPs' ability to raise funds to meet with the Dynamic Credit in a short period of time is very limited especially after CP raised funds to meet with FRR test. It will create uncertainties on the CPs business.

Sharing of default amount by non-defaulting CPs and HKEX

The proposed sharing of potential loss of HKEX due to a defaulting CP by non-defaulting CPs does not accord with both fairness principles as well as legal principles.

Fairness Principles

HKEX and its shareholders but not the non-defaulting CPs are benefited by previous trades and participation of a defaulting CP. The non-defaulting CPs have no collateral or control over admission or capital requirement of any defaulting CP. It is HKEX's decision to admit a CP and benefit from CP's participation. The depletion of Dynamic GF, depending on chance of default by the CP, will mean that other non-defaulting CPs need more capital to contribute to the depleted Dynamic GF. In this case, CPs' working capital requirement will depend on other defaulting CP.

Legal Principles

When a CP is defaulted, HKEX is entitled to claim loss and damages from the defaulting CP. However, if the loss is contributed by non-defaulting CPs, the non-defaulting CPs have no recourse to the defaulting CP.

HKEx's Proposal 3: Revise HKCC Reserve Fund Calculation

Questions

- 5. Do you support the proposed revisions to the HKCC Collateral assumption?**

Yes, we support the move of HKSCC to improve the risk management system of HKSCC.

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Please see above mentioned rationale and suggestions if applicable.

- 6. Do you support the use of HKCC Contingent Advance in relieving burden of CPs?**

Yes, we support the move of HKSCC to improve the risk management system of HKSCC.

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Please see above mentioned rationale and suggestions if applicable.

Questions

7. What is your view on allowing RF contribution to be counted as liquid capital? Will this help your company in terms of reducing liquid capital funding burden?

We support the proposal of allowing RF contribution to be counted as liquid capital.

This will reduce our liquid capital funding burden.

HKEx's Proposal 4: Revise SEOCH Reserve Fund Calculation

Questions

8. Do you support the proposed revisions to the SEOCH Collateral assumption?

Yes, we support the move of HKSCC to improve the risk management system of HKSCC.

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Please see above mentioned rationale and suggestions if applicable.