



Supervisory Policy Manual

CR-S-4

New Share Subscription and Share Margin Financing

V.2 – 17.11.2023

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To set out the minimum standards expected of AIs which are engaged in IPO activities, including: (i) financing their clients' subscription for IPO shares; (ii) performing the role of a designated bank/ receiving bank in an IPO; or (iii) providing share margin financing to their clients.

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

CR-S-4 “New Share Subscription and Share Margin Financing” (V.1) dated 26.01.07

Application

To all AIs

Structure

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HONG KONG MONETARY AUTHORITY
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1. Introduction

1.1 Terminology

1.1.1 In this module, the following abbreviations and terms have the meanings set out:

- “SFO” means the Securities and Futures Ordinance;
- “associated entity” has the meaning set out in Schedule 1 of the SFO;
- “BELR” means the Banking (Exposure Limits) Rules;
- “CAR” means capital adequacy ratio which has the meaning given by section 3 of the Banking (Capital) Rules;
- “HKEX” means Hong Kong Exchanges and Clearing Limited, where in the context requires, includes The Stock Exchange of Hong Kong Limited (SEHK);
- “HKSCC” means Hong Kong Securities Clearing Company Limited, a subsidiary of HKEX;
- “CCASS” means the Central Clearing and Settlement System operated by HKSCC;
- “CP” means a participant of HKSCC, admitted to participate in CCASS as a direct clearing participant, a general clearing participant or a custodian;
- “IPO” means the initial public offering of a newly listed stock on SEHK;
- “EIPO” means Electronic Initial Public Offering, a service offered by HKSCC for public offer share subscription;
- “FINI” means Fast Interface for New Issuance, an online platform operated by HKSCC that is mandatory for admission to trading and, where



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applicable, the collection and processing of specified information on subscription in and settlement for all new listings;

- “SFC” means the Securities and Futures Commission;
- “SFC Code” means the Code of Conduct for Persons Licensed by or Registered with the SFC;
- “SFO” means the Securities and Futures Ordinance;
- “RI” means an AI which is a registered institution under the SFO;
- “designated bank” means a designated EIPO bank appointed by a CP to facilitate the CP’s money settlement obligations with respect to IPO subscription;
- “lending AI” means an AI which extends credit facilities to its clients for the purpose of: (i) facilitating their subscription for IPO shares; (ii) financing their acquisition or holding of shares in listed stocks (in the case of lending to investors); or (iii) financing their business operations (in the case of lending to stockbrokers);
- “licensed corporation” means a corporation which is granted a licence by the SFC under §116 or §117 of the SFO;
- “receiving bank” means a bank which performs the role of a receiving bank in an IPO. For an IPO with more than one receiving bank, the receiving bank is the main receiving bank or a sub-receiving bank, as the case may be;
- “relevant individual” has the meaning set out in §20(10) of the Banking Ordinance¹;
- “securities” have the meaning set out in Schedule 1 of the SFO;

¹ In generic terms, a relevant individual is an individual who carries out any regulated function in a regulated activity of an RI.



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- “securities margin financing”, in relation to a person carrying on the business of securities margin financing under the SFO, has the meaning set out in Schedule 5 of the SFO²; and
- “share margin financing”, in relation to a lending AI, means the provision of credit facilities by the AI to its clients, who may be investors or stockbrokers, whereby the facilities provided are: (i) used for financing their investments in the stock market or their business operations (in the case of stockbrokers in respect of their business of securities margin financing); (ii) collateralised by shares listed on a stock exchange (which may be located in or outside Hong Kong); and (iii) subject to margin requirements³ prescribed by the AI.

1.1.2 The legal terms and regulatory requirements mentioned or explained in this module, particularly those pertaining to securities-related activities regulated by the SFC under the SFO, are for AIs’ reference only. AIs should seek legal advice if precise interpretation is required.

1.2 Background and scope

1.2.1 As an international financial centre with close business and trading links with Mainland China, Hong Kong has been one of the world’s largest equity fundraising centres. In particular, the listing of a number of Mainland companies on the HKEX (some of which were large IPO shares with record over-subscription rates) has boosted the level of IPO activity in Hong Kong.

² Broadly speaking, securities margin financing refers to the provision of financial accommodation in order to facilitate the acquisition of securities listed on a stock exchange and, where applicable, the continued holding of those securities, whether or not those or other securities are pledged as security for the accommodation, but does not include, inter alia, the provision of financial accommodation by an AI for the purpose of facilitating acquisitions or holdings of securities by the AI’s clients.

³ The facility limit is normally expressed as a prescribed percentage of the market value of shares pledged with the lending AI. For example, a prescribed percentage of 40% means that the AI requires a lending margin of not less than 60% of the market value of the share collateral. If the required margin cannot be met due to a decline in the market value of the share collateral, the borrower will be obliged to top up the margin immediately.



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- 1.2.2 To modernise the IPO settlement process, the HKEX has launched a new platform called “FINI” to manage the end-to-end settlement process for IPO, which will help improve the overall IPO settlement workflow and shorten the time gap between IPO pricing and trading⁴.
- 1.2.3 The active IPO market in Hong Kong has provided Als with more opportunities to participate in IPOs, whether as a lending AI to finance the subscription for IPO shares, as a designated bank to facilitate money settlement for IPO share allotments or as a receiving bank. Some Als have also actively engaged in the business of providing share margin financing to their clients (including stockbrokers who obtain bank borrowing to finance their operations).
- 1.2.4 Als which play a key part in the IPO process, or the provision of credit and liquidity in the above-mentioned activities are required to have an adequate understanding of the potential risks that they may be exposed to and to be capable of managing those risks.
- 1.2.5 This module is aimed at:
- highlighting the major risks that Als should be aware of if they are involved in IPO shares as a lending AI, as a designated bank or as a receiving bank, or in the provision of share margin financing to their clients (see sections 2 and 3); and
 - specifying the minimum business and control standards expected of Als in managing such risks (see sections 4, 5 and 7).

⁴ FINI is a common platform for all key IPO-related interactions between relevant market participants (e.g. IPO sponsors and distributors, retail brokers, designated banks, share registrars, etc.), clearing house (i.e. HKSCC) and regulatory authorities (e.g. SEHK listing division, SFC, etc.). Under the new IPO settlement mechanism, all application monies will be kept in the nominee accounts of designated banks, until after pricing and balloting. Only the amount for allotted shares will then be settled with the IPO receiving bank(s). (For details, please refer to the [HKEX website](#).)



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In addition, the preventive measures that AIs should observe in handling IPO refund cheques for their clients are discussed in section 6.

1.2.6 In developing this module, the HKMA has had regard to:

- the guidelines and circulars previously issued by the HKMA on IPO share subscription and share margin financing;
- relevant materials and requirements issued by the HKEX related to the IPO settlement process;
- relevant standards and requirements issued by the SFC on securities margin financing⁵; and
- current industry practices.

1.2.7 For the avoidance of doubt, this module is not applicable to AIs' subsidiaries which are licensed and regulated under the SFO, unless otherwise specified.

1.2.8 AIs may wish to refer to [SB-1](#) "Supervision of Regulated Activities of SFC-Registered Authorized Institutions" on the HKMA's approach to supervising securities-related activities of AIs. See also other modules in the Supervisory Policy Manual (such as those relating to internal controls and credit risk management) that have a general application.

1.3 Supervisory approach

1.3.1 The HKMA has no objection in principle to AIs taking a role in an IPO, whether as a lending AI, a designated bank or a receiving bank. However, AIs involved in such activity need to demonstrate their ability to conduct such activity prudently and efficiently by having the necessary resources, systems and controls to manage

⁵ Under the SFO, any person carrying on the business of securities margin financing is required to be licensed by the SFC, and be subject to the requirements set out in Schedule 5 of the SFC Code on securities margin financing. AIs are exempted from such requirements.



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the associated risks.

- 1.3.2 The HKMA would expect an AI which has not previously acted as a receiving bank in an IPO, or which is proposing to act as a receiving bank in an IPO that is much larger than those it normally handles, to discuss the proposal with the HKMA well in advance. In considering the proposal, the HKMA would, in particular, wish to be satisfied that the AI has adequate systems and manpower resources for cooperating with relevant parties in the IPO process and is capable of recycling the application monies arising from the IPO in an efficient manner.
- 1.3.3 If an AI intends to act as a designated bank or receiving bank in a large-scale IPO, the HKMA would expect the AI to have acquired sufficient experience and maintained a good track record in acting as a designated bank or receiving bank, and be able to adequately plan for and manage the recycling process involving substantial amounts of application monies.
- 1.3.4 In determining whether an IPO is of a large size for the purposes of paras. 1.3.2 and 1.3.3, an AI should benchmark the scale of the IPO against its own financial strength (e.g. capital base). Other factors to be considered include the estimated amount of application monies to be recycled, the overall sentiment in the stock market at the time of the IPO and the expected level of demand from retail investors.
- 1.3.5 The HKMA would also expect AIs involved in an IPO (as a lending AI, a designated bank or a receiving bank) or in providing share margin financing to their clients to exercise adequate management oversight of such activities and observe the minimum business and control standards set out in this module.
- 1.3.6 Moreover, AIs, regardless of whether they are involved in an IPO, should institute the measures set out in section 6 to ensure proper handling of IPO refund cheques deposited or encashed by their clients.



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1.3.7 The HKMA will monitor Als' compliance with the minimum standards set out in this module through on-site examinations and off-site reviews (including regular analysis of relevant information submitted by Als in their statistical returns).

2. Risk analysis of an IPO

2.1 General

2.1.1 Als may participate in an IPO as a sponsor, an underwriter, a designated bank or a receiving bank, the respective roles and functions of which are described below:

- Sponsor – a sponsor is mainly responsible for preparing, coordinating and controlling the whole process of an IPO and dealing with relevant authorities (e.g. the SFC and the HKEX) on all matters arising from the IPO. In discharging these functions, the sponsor should be able to give impartial advice to its clients and comply with all applicable regulations, codes and practices (e.g. the relevant rules and guidelines issued by the HKEX or the SFC);
- Underwriter – an underwriter (or a syndicate of underwriters) of an IPO is a person (or a group of persons) who agrees to take up any shares left unsold after the IPO;
- Designated bank – the major responsibilities of a designated bank may include:
 - collecting and holding of application monies from CPs for settlement of the IPO shares with the receiving bank;
 - confirming the funds provided by each CP are sufficient to meet the IPO pre-funding requirement set by HKSCC;



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- recycling of application monies in the interbank money market; and
 - releasing the unused application monies (resulting from unsuccessful or partially successful applications, IPO cancellation, etc.) to CPs.
- Receiving bank – although the functions of a receiving bank may vary from case to case, they generally cover the following:
 - collecting and holding of application monies from designated banks for settlement of the IPO shares;
 - recycling of application monies in the interbank money market; and
 - arranging of refund to CP's designated bank account if the IPO is cancelled during or after the money settlement with designated banks.
- 2.1.2 As well as the above roles, an AI may act as a lending AI by providing short-term loans or stagg⁶ finance to its clients to facilitate their subscription for IPO shares.
- 2.1.3 This section focuses on analysing the major risks associated with AIs' involvement in an IPO as a lending AI, a designated bank or a receiving bank.

2.2 Major risks to lending AIs

- 2.2.1 Credit risk is incurred by lending AIs when they finance their clients to subscribe for IPO shares. Lending AIs may also be exposed to credit concentration risk if appropriate limits are not imposed to control the level of exposure to individual clients, or in respect of each IPO share issue. If the IPO share issue is heavily over-subscribed, the credit risk involved can be substantially reduced. This is because the actual lending to those borrowers subscribing for IPO shares would be reduced to the credit needed to finance the

⁶ Stagg^{ing} refers to the practice of buying IPO shares at the offering price and then selling them once trading has begun.



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allotted shares, the number of which may be a small fraction of the total number of shares applied for. However, it is difficult for a lending AI to predict accurately the subscription rate of an IPO. If the actual subscription rate is far lower than its estimate, the application monies may not be available to reduce the borrowers' outstanding loans to the lending AI.

2.2.2 Lending AIs may incur credit risk to the designated bank and receiving bank as well. The exposure to the designated bank (in terms of the total amount of unused application monies) may be larger in size than their total exposure to individual borrowers.

2.2.3 With the allotted shares as the underlying collateral, lending AIs are exposed to the risk that the market value of the IPO shares may fall below the subscription price if the borrower defaults and the lending AI has to rely on the disposal of the allotted shares to collect its loan. This risk will increase if the subscription rate of the IPO share issue turns out to be lower than expected and, in particular, if the IPO share issue is under-subscribed. In principle, this market risk can be covered by a margin requirement.

2.2.4 Lending AIs may be exposed to the legal risk of not being able to hold onto the unused application monies on the unsuccessful and partially unsuccessful applications for discharging the borrowers' outstanding loans and to protect their interest in such unused application monies from the winding-up or bankruptcy of the borrowers. In this regard, the use of "specific purpose" trust arrangements⁷ could provide a legal safeguard for lending AIs.

⁷ The use of "specific purpose" trust arrangements is based on a well-established legal principle that a lender continues to have an equitable interest in the proceeds of a loan made for a specified purpose until the loan is utilised for the intended purpose. In terms of IPO subscriptions, this means that the portion of a loan which is not utilised for the purchase of IPO shares will not form part of the borrower's assets available for distribution on his bankruptcy. In other words, if the application is unsuccessful or partially unsuccessful, the unused application monies will be held in trust for the lending AI, which could use the amounts to discharge the borrower's outstanding loan. The trust arrangement effectively deems the lending AI to be the ultimate beneficial owner of the unused application monies.



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2.3 Major risks to designated banks and receiving banks

- 2.3.1 Although the sponsor bears the ultimate responsibility for the overall management of an IPO, the public image or reputation of a designated bank or receiving bank may be seriously damaged if the IPO is not managed well. Moreover, a poorly managed IPO may lead to disruption of the designated bank or receiving bank's normal business and operations.
- 2.3.2 The designated bank or receiving bank may be exposed to operational risk by being liable to fines, claims or damages if there is any breach of the terms and conditions of relevant contracts and agreements or any operational error or mistake which gives rise to losses to other parties.
- 2.3.3 Owing to the role in recycling application monies, the designated bank or receiving bank incurs credit risk to other counterparties (mainly AIs) to which it has recycled the application monies. The level of such exposures may be significantly higher than the normal credit limits on those counterparties as the designated bank or receiving bank will likely increase the limits during the share subscription period to facilitate its recycling of application monies.
- 2.3.4 Without adequate planning for the recycling process (including a reasonable estimation of the amount of application monies to be recycled or the amount of temporary increase in interbank credit limits to be sought from other AIs), the designated bank or receiving bank may face substantial pressure in recycling the application monies to other AIs within prescribed credit limits (including prudential limits agreed with the HKMA in advance for such purpose).
- 2.3.5 The lack of adequate planning for the recycling process could also have an adverse impact on meeting the applicable statutory and supervisory requirements by the designated bank or receiving bank. For example,



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a significant increase in credit exposures to other AIs during money recycling in the interbank market may result in a substantial decline in the designated bank or receiving bank's CAR. If the decline leads to a breach of the bank's minimum CAR or other statutory requirements, regulatory consequences would ensue.

- 2.3.6 The designated bank or receiving bank may also face liquidity risk arising from the default of major counterparties (which may include lending AIs) to which it had lent the application monies for money recycling, especially in the case of a large and heavily over-subscribed IPO share issue. Given the substantial amounts involved, it is possible that the designated bank or receiving bank will not have adequate cash resources of its own to continue the settlement process for allotted shares or (in the case of a designated bank) release the unused application monies to IPO applicants. In particular, the designated bank may find it difficult to collect the amounts due from other lending AIs it had funded, as such AIs may try to set off their interbank borrowings from the designated bank against the amounts that are expected to be collected from the designated bank as release of unused application monies.
- 2.3.7 Despite the fact that the designated bank or receiving bank may hold the application monies in a nominee account or trust (where applicable) for the applicants, it could take time for the courts to resolve the respective rights and obligations of the various parties in the case of a dispute. Moreover, the assets in which the application monies are held form an indistinguishable part of the assets of the designated bank or receiving bank, thus making it difficult for the designated bank or receiving bank to use such assets to meet its financial obligations before the dispute is settled.
- 2.3.8 There is also a strategic risk for AIs which plan to act as designated banks or receiving banks, as doing so may require a long-term and continuous investment in AIs' operational and manpower resources in order to keep



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pace with the market. If the IPO activities in the stock market are far below original expectations, Als may not have a sufficient return from this business to cover their investment cost.

3. Risk analysis of share margin financing

3.1 General

- 3.1.1 Share margin financing is a type of formula lending commonly extended by Als to their clients to facilitate investments in listed stocks. Such lending is analogous to securities margin financing which is regulated by the SFC under the SFO. However, Als do not fall within the SFC's regulatory regime for securities margin financing. The HKMA remains responsible for supervising share margin financing activities undertaken by Als.
- 3.1.2 Lending Als, in their provision of share margin financing, will generally prescribe different margin requirements for different types of shares (e.g. blue-chips, second or third liners).
- 3.1.3 In order to protect the interest of a lending AI, shares pledged as collateral will normally be transferred into the name of the AI's nominee company, irrespective of whether the shares are held in physical form (i.e. with a share certificate) or with CCASS⁸.
- 3.1.4 Some lending Als are also engaged in the business of providing share margin financing to stockbrokers and/or investment companies (including asset management firms) for their operational needs (particularly in respect of financing their business of securities margin financing)

⁸ CCASS was introduced in June 1992 and is operated by the Hong Kong Securities Clearing Company Limited. Individual investors who opt to keep their holdings in CCASS can do so through a participant of HKSCC. This arrangement reduces scrip circulation by effecting the transfer of title through the transfer of stock balance from the CCASS account of the CP acting for the vendor to the CCASS account of the CP acting for the buyer, thus obviating the need for any physical transfer of sharescrip.



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and to other non-bank financial institutions (“NBFIs”).

- 3.1.5 Failure to manage the risks arising from share margin financing could result in substantial losses to lending AIs and may pose risks to the stability of the financial system⁹.
- 3.1.6 It is essential for a lending AI to have a formal risk appetite, holistic risk management approach, and robust risk management framework for share margin financing business (and other similar business activities), with clearly defined escalation criteria and actions, as well as adequate oversight of the risk management process.
- 3.1.7 Clear policies and procedures should be in place for escalating issues within both the first line of defence (e.g. relevant business lines and support functions) and the second line of defence (e.g. risk management function, compliance function). The issues identified should be clearly articulated (along with relevant supporting management information) and escalated in a timely manner to senior management and, where necessary and applicable, a relevant risk management committee of the AI.
- 3.1.8 The senior management of a lending AI should conduct periodic reviews and assessments of their risk appetite and operational strategies for the share margin financing business. The evaluation should take into account such as available resources, expertise, infrastructures, and risk management practices. The scope and depth of the review should be appropriately commensurate with the lending AIs’ specific business and risk profiles.
- 3.1.9 This section analyses the major types of risk faced by lending AIs in their provision of share margin financing to investors, stockbrokers and/ or investment

⁹ For example, the default of Archegos Capital Management (which was an investment firm heavily concentrated in a small number of U.S. and Chinese technology and media companies) in March 2021 resulted in over USD10 billion of reported losses across several international banks.



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companies.

3.2 Major risks to lending AIs

Credit risk

- 3.2.1 Like other types of lending, credit risk is incurred by lending AIs engaged in the business of share margin financing. The level of credit risk assumed varies, depending on the lending AI's underwriting standards, particularly with respect to the margin requirements established for different types of stocks. Therefore, lending AIs should ensure that their underwriting standards and margin requirements are documented and articulated clearly in formal policies and procedures, and make sure these requirements are commensurate with the nature of the stocks as collateral and risk profiles of the borrowers.
- 3.2.2 The level of credit risk in share margin financing could be relatively low if a lending AI has established prudent underwriting standards and lending limits, and adhered to and properly monitored such standards and limits. Deviations from such standards and limits would increase credit risk to the extent of the degree, significance and frequency of deviations.
- 3.2.3 Single borrower limits and the maximum amount of a listed company's shares which a lending AI may take as collateral will also affect the level of credit risk in share margin financing. To effectively manage the risk associated with different types of client portfolio exposure, especially those with a high concentration of share positions, lending AIs should ensure that their credit limits and exposure monitoring frameworks are comprehensive enough to reflect their risk appetite. Additionally, lending AIs should have a default procedure manual that outlines the various scenarios, roles and responsibilities for close-out and liquidation events. Lending AIs should also evaluate their due diligence processes to ensure that adequate proof, supporting assurances, and verification are sought



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regarding client financial conditions.

- 3.2.4 Lending AIs which provide share margin financing to stockbrokers and/ or investment companies (or their related finance companies) may be subject to additional credit risk if those stockbrokers and/ or investment companies have borrowed excessively from lending AIs (e.g. to finance their speculative activities) by improper pledging of their clients' shares with the lending AIs (see also para. 3.2.10), thereby increasing their default risk¹⁰. To address these risks, the SFC has issued "Guidelines for Securities Margin Financing Activities" to supplement the relevant conduct requirements in its rules and the SFC Code. Lending AIs should take these requirements and guidance into account in the provision of share margin financing to stockbrokers and/ or investment companies (or their related finance companies).

Market risk

- 3.2.5 Although the value of share collateral is continuously affected by changes in the share prices of such collateral, there is no direct market risk to the lending AI. Market risk only becomes a factor if the borrower defaults and the lending AI has to rely on the disposal of the share collateral to collect its loan.
- 3.2.6 If the share collateral to be disposed of is concentrated in the shares of a single company or a group of related companies, the lending AI could experience a sharp decline in the share prices if it tries to sell the shares in the market within a short period of time. In these circumstances, the level of market risk will be high even if the lending AI carries out effective marking-to-market procedures on the share collateral held.

¹⁰ The collapse of C.A. Pacific Securities Limited and C.A. Pacific Finance Limited in January 1998 revealed the risk to clients and lending AIs arising from the improper pledging to lending AIs of clients' shares by stockbrokers or their related finance companies (e.g. unauthorized pledging of the shares of cash clients). Since the C.A. Pacific incident, the SFC has implemented measures to bring the provision of securities margin financing within its regulatory framework.



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Operational risk

3.2.7 Operational risk in share margin financing refers, in particular, to the risk of potential loss arising from inadequate systems, procedures and controls for:

- monitoring the collateral positions of each of the outstanding share margin loans; and
- controlling the safe custody, deposit and withdrawal of pledged shares (see section 7 of [CR-G-7](#) “Collateral and Guarantees” for more guidance).

3.2.8 The level of operational risk incurred by a lending AI would depend, among other things, on how effective its systems, procedures and controls are in responding quickly to shortfalls in collateral value during the course of a business day and in preventing or minimising operational oversight or lapses in the management of share collateral.

Legal risk

3.2.9 As share margin financing is a mature financial product in Hong Kong with fairly standard documentation, the legal risk involved should generally be low. However, there could be special situations in which the legal risk assumed by individual lending AIs is increased.

3.2.10 Legal risk may arise if a lending AI has accepted share collateral from stockbrokers (or their related finance companies) which have improperly pledged the shares of their clients with the lending AI. For example, the stockbroker may not have obtained the necessary authorization from its clients to pledge their shares.

3.2.11 Legal risk could also increase if a lending AI has to sell a client’s shares at a depressed price to meet a margin call and immediately afterwards the share price increases significantly. The client may institute legal action against the AI for improper selling of his shares.



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Such risk can be reduced if the AI's standard documentation covers this eventuality. For example, the client agreement should clearly specify the circumstances in which a client's positions may be closed without the client's consent.

- 3.2.12 A lending AI should be particularly mindful of the legal risk that may arise from any selective selling of a client's pledged shares at forced sale prices to meet the margin requirement. To better manage such risk, the lending AI should have adequate policies and procedures in place to govern its forced sale actions, and ensure that such policies and procedures are adhered to. Where necessary, legal advice should be sought on the suitability of such policies and procedures.

Reputation and compliance risks

- 3.2.13 As share margin financing involves contacts with clients when a lending AI conducts the procedures on margin call, forced liquidation of shares and collection of remaining debt from clients, complaints from clients about the AI's handling of each of these cases could easily emerge. Any adverse publicity about the AI's handling of such cases may affect its reputation and market perception.

- 3.2.14 Other sources of adverse publicity may stem from misconduct or malpractice on the part of a lending AI's staff, including soliciting clients to borrow for the purpose of speculating in the stock market or engaging in rat-trading, insider dealing, front running or late allocation of deals. Such misconduct or malpractice, if substantiated, will have regulatory consequences.

- 3.2.15 To reduce reputation and compliance risks, lending AIs should maintain adequate policies and procedures for handling client complaints and ensuring compliance with relevant regulatory standards and requirements, including the Code of Banking Practice and, where applicable, the SFC Code.



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4. Financing subscription for IPO shares

4.1 Policies and procedures

4.1.1 Lending AIs should maintain well-documented policies and procedures for the financing of IPO shares, which should adequately address the risks described in subsection 2.2.

4.1.2 The policies and procedures must be approved by the Board (or a committee with delegated authority) or senior management, as appropriate, and be regularly reviewed and updated to keep abreast of changing market developments.

4.2 Prior analysis and approval

4.2.1 Prior to financing the subscription for IPO shares, lending AIs should conduct a thorough analysis covering, among other things, the following:

- the potential impact on the statutory requirements (e.g. CAR, liquidity ratios, concentration limits) applicable to the lending AI;
- the likely market response to the IPO (e.g. the estimated subscription rate);
- the overall sentiment in the stock market; and
- the competence, reliability and reputation of the relevant parties (e.g. sponsor(s), overall coordinator, underwriter(s), designated bank(s) (where applicable), receiving bank(s), etc.) of the IPO.

Lending AIs should also have regard to other risk factors affecting the issuer (e.g. its financial strength or



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business outlook) based on available information in their analysis.

- 4.2.2 Lending AIs are expected to have general policies and guidelines approved by the Board (or a committee with delegated authority) or senior management to govern the criteria for financing the subscription for IPO shares. Deviations from such general policies and guidelines in respect of individual financing programmes should have the approval of the appropriate authority.

4.3 Credit limits

Total exposure in an IPO share issue

- 4.3.1 There should be an overall limit to control a lending AI's total exposure to investors and stockbrokers in an IPO share issue. This limit should be properly determined and approved according to the AI's established policies and procedures, having regard to the results of analysis referred to in para. 4.2.1. In setting this limit, lending AIs should not be swayed by fads or by what is fashionable (e.g. new concept business).
- 4.3.2 As the exposure of a lending AI to the designated bank (where the lending AI and the designated bank are not the same entity) and receiving bank in an IPO share issue is effectively short-term and unsecured, the overall limit for the new share issue should also be set in relation to the lending AI's normal credit limit on the designated bank and receiving bank. As a general principle, the lending AI should not take on a much larger exposure during the IPO than it would be prepared to accept for short-term unsecured lending to the designated bank and receiving bank in the normal course of business.
- 4.3.3 A lending AI should therefore carefully consider and justify any plan to increase its exposure to the designated bank and receiving bank of an IPO (e.g. by raising its existing credit limits), albeit only for a short



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period of time during the IPO. In particular, the lending AI should ensure that:

- the increase in exposure to the designated bank and receiving bank is supported by the financial strength of the designated bank and receiving bank, the expected outcome of the IPO, and prevailing market conditions; and
- the AI has the capacity to withstand the credit and liquidity risks arising from the increase in exposure to the designated bank and receiving bank (taking into account any available contingency funding arrangements).

Exposure to individual clients

4.3.4 Lending AIs should specify in their credit policies a limit on the maximum exposure that they are prepared to incur on lending to individual clients, taking into account the risk of concentrated lending.

4.3.5 In setting such limits, a locally incorporated AI should also take into consideration the relevant statutory and supervisory requirements (e.g. Part 7 of the BELR if applicable). It should however be noted that those statutory limits set the upper cap for each individual exposure. Lending AIs should consider whether a lower limit is more appropriate with regard to the creditworthiness of each client.

4.3.6 An overseas incorporated AI should adopt a similar prudential limit that is proportionate to its business size, nature and risk profile.

4.4 Specific lending arrangements

4.4.1 The use of specific purpose trusts (see also para. 2.2.4) and nominee companies (see para. 4.4.3) is important in helping lending AIs reduce the risks arising from the financing of IPO share subscriptions.



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4.4.2 Lending AIs should structure their lending arrangements so that they are legally protected, as far as possible, from the winding-up or bankruptcy of the issuer, the designated bank (where applicable), the receiving bank, or their clients in an IPO. Among other things, the loan documentation (e.g. client lending agreements) should make it clear that the application monies are lent on purpose trusts, and refund of unused application monies are therefore held on trust for the lending AI. Lending AIs should take their own legal advice on this matter.

4.4.3 In addition, a lending AI is encouraged to have all applications submitted via, and release of unused application monies received by, a nominee company owned by the AI (“lender nominee company”). In other words, the borrower should be required to apply for the IPO shares in the name of the lender nominee company. This arrangement enables the lending AI to keep track of and control the movement of the application and unused application monies. Where a lender nominee company is not used by the lending AI, separated accounts should be used for holding the application and unused application monies and proper track records should be kept to control the movements of those monies.

4.5 Margin requirement

4.5.1 Lending AIs should apply a reasonable margin requirement on their lending to individual clients after taking into account relevant factors such as the risk characteristics of the IPO shares, credit quality of the borrowers, and normal market practices¹¹. This requirement may be satisfied by the deposit of collateral (in the form of cash or securities) with the lending AIs or by setting an appropriate loan-to-value ratio.

4.5.2 The margin requirement should also apply to lending to stockbrokers connected with a lending AI. The lending

¹¹ Generally speaking, the market norm is for a 10% margin to be imposed on such lending.



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AI is required to ensure that a reasonable margin is applied by its connected stockbrokers to lending to their clients as well.

4.6 Prior funding arrangements

- 4.6.1 Lending AIs should follow their normal credit standards, and limit their total exposure in each IPO share issue to an amount which is well within their ability to obtain funding to meet their obligations on the IPO funding confirmation date.

5. Acting as designated bank or receiving bank in IPOs

5.1 Business strategy

- 5.1.1 AIs which plan to engage in the business of acting as a designated bank or receiving bank (or both) in IPOs should carefully consider whether this activity fits their business strategy and objectives. They should conduct a comprehensive cost-benefit analysis to evaluate whether such business is commercially justified, taking into account the projected returns and the costs of the initial and continuous investment in both operational and manpower resources.
- 5.1.2 An AI should only take on the role of a designated bank and/ or receiving bank in an IPO which is manageable in relation to the AI's operational and financial capacity. It is also important for the AI to conduct a thorough analysis in advance of the potential financial impact, particularly on its compliance with statutory requirements (e.g. CAR, liquidity ratios, concentration limits), arising from the IPO if it were to act as the designated bank and/ or receiving bank in the IPO.
- 5.1.3 In the circumstances specified in para. 1.3.2, the AI should discuss with the HKMA well in advance of its plan to be the receiving bank of an IPO.

5.2 Role and responsibilities



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For designated banks and receiving banks

- 5.2.1 Designated banks and receiving banks should have a clear understanding of their respective roles and responsibilities in an IPO. These matters should be clearly specified in the relevant terms and conditions for designated banks and Receiving Bank Agreement respectively. Designated banks should refer to the Bank User Supplement of the FINI terms and conditions issued by HKSCC. Receiving banks should also refer to Chapter 3A of the Listing Rules issued by the SEHK, paragraph 17 of the SFC Code and the Corporate Finance Adviser Code of Conduct issued by the SFC, which detail the responsibilities and standard of conduct expected of a sponsor of IPOs. Paragraph 21 of the SFC Code also details the standard of conduct expected of an overall coordinator and a capital market intermediary in IPOs.
- 5.2.2 Some designated banks and receiving banks may have securities business handling IPO applications for their customers. If these banks use the Internet to collect applications from their clients or the general public for subscription for IPO shares, they should comply with “Guidelines for Electronic Public Offerings” issued by the SFC and “Operational Procedures for EIPO Applications Submitted via Banks/ Stockbrokers” issued by the Federation of Share Registrars Limited.

For receiving banks

- 5.2.3 As a general principle, the sponsor bears ultimate responsibility for the overall management of an IPO, and the receiving bank’s role is to act as an agent of the sponsor and to follow the sponsor’s instructions. If, however, the receiving bank is not comfortable with the sponsor’s instructions, it should endeavour to make this known to the sponsor and make recommendations where appropriate.
- 5.2.4 Receiving banks should ensure that the IPO process



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runs smoothly by maintaining close cooperation, good communication and a climate of trust with the sponsor.

5.3 Initial assessment by receiving banks

5.3.1 A receiving bank should ensure that it is given as much information on the IPO share issue as possible to the extent that confidentiality restrictions do not preclude this. This will help the receiving bank in forming its own view of the likely response to the IPO share issue and the adequacy of manpower and operational resources it has made available to handle the processing of application monies.

5.3.2 There should be as accurate an assessment as possible of the likely popularity of the IPO share issue. This should be kept in view throughout the process and revised accordingly. While this is primarily a matter for the sponsor, if the receiving bank is uncomfortable with the estimates made by the sponsor, it should make this known clearly to the sponsor.

5.4 Management of application process

5.4.1 For designated banks and receiving banks which have securities business offering IPO application services, they should ensure that sufficient resources, including management resources, are devoted to the process. For popular issues, they may establish a command centre to coordinate the receipt of information about the subscription and to escalate issues to senior management should that prove necessary.

5.4.2 These banks should also arrange suitably trained staff to answer enquiries from their own clients or the general public in relation to matters arising from an IPO. Enquiries relating to dealing in securities or investment advice should be referred to and answered by “relevant individuals” (within the meaning of §20 of the Banking Ordinance).



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5.4.3 Staff members of the banks who are responsible for handling an IPO should be fully conversant with the IPO process as well as the relevant bank policies, so that they can provide accurate and clear information in handling IPO-related enquiries¹².

5.4.4 The banks should ensure that their “relevant individuals” strictly observe the restrictions on unsolicited calls when interacting with potential investors in an IPO. Specifically, such staff members should not approach any person who is not one of the bank’s existing securities clients and request him to subscribe for IPO shares through the bank.

5.5 Contingency plan

5.5.1 Designated banks and receiving banks should put in place a formal contingency plan for coping with unexpected incidents or extreme cases (e.g. application monies settlement failure, IPO cancellation during the subscription period, pre-funding confirmation period or after monies settlement for allotted shares).

5.5.2 Designated banks and receiving banks should work closely together with the sponsor, should there be any question as to whether contingency measures should be triggered. While this is primarily a matter for the sponsor, if a designated bank or receiving bank has any concerns, it should communicate the concerns to the sponsor proactively.

5.5.3 A designated bank or receiving bank should promptly notify the HKMA of any major problems arising from the IPO.

5.6 Specific arrangements for holding application monies

Designated bank

¹² Such information includes the closing times for different purposes such as the bank’s internal closing time for its own securities clients to submit applications through the bank.



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- 5.6.1 A designated bank should set up a nominee account to hold application monies from its designating CPs for the sole purpose of IPO subscription. The bank should have adequate procedures in place to facilitate the designating CPs to comply with the pre-funding requirement and money settlement obligations with respect to an IPO issue.
- 5.6.2 Unless the relevant IPO is cancelled, postponed or under specific circumstances allowed by the relevant authorities (e.g. money recycling in the interbank market), the monies kept in the nominee account to meet the pre-funding requirement of IPO subscription should not be transferred out before the settlement with receiving bank for allocated shares.
- 5.6.3 On the application money settlement day, only the amount of monies in respect of allocated IPO shares will be transferred from the nominee account of a designated bank to the IPO issuer's receiving bank. Generally, the remaining balance of the unused application monies should be released to the CPs as soon as practicable (unless individual CPs provide instructions to reuse the monies for another IPO subscription).

Receiving bank

- 5.6.4 A receiving bank is usually required under the Receiving Bank Agreement to hold the monies for the allotted shares transferred from designated banks in a New Issue Account for the applicants through its nominee company. This means that the monies in the New Issue Account belong beneficially to the applicants and the issuer is entitled to receive the amount which represents payment for the allotted shares once the IPO issue has become unconditional and any right of termination under the underwriting agreement has not been exercised. If, due to exceptional circumstance, the IPO is cancelled during or after the allotment settlement, the receiving bank should arrange for the refund of the application monies received for the allotted



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shares to the designated banks as soon as practicable.

5.7 Recycling of application monies

- 5.7.1 Designated banks and receiving banks should use their best efforts to recycle the application monies received during the IPO process in the money market. The aggregate exposure of a designated bank or receiving bank to individual AIs for recycled application monies and other types of financial exposure should not exceed the normal credit limit for each AI, subject to para. 5.7.2.
- 5.7.2 In cases where the normal credit limit of a designated bank or receiving bank on an AI is relatively low, the designated bank or receiving bank may raise such limit for a short period of time to facilitate the recycling of application monies provided that any such increase is carefully justified and controlled, and supported by senior management approval.
- 5.7.3 Although exposures of a receiving bank to AIs are exempt under rule 48(1)(I) of the BELR¹³, the receiving bank should still need to manage its credit limit on counterparties in a prudent manner.
- 5.7.4 Where there is more than one receiving bank in an IPO, depending on the relevant contractual arrangements, sub-receiving banks should ensure that they will have sufficient funds for effecting the transfer of application monies for allotted shares to the main receiving bank (or the IPO issuer) at the scheduled time agreed with the main receiving bank (or the IPO issuer).

6. Handling of IPO refund cheques

¹³ The HKMA is currently proposing some amendments to the BELR, including among others, modification to the exemption set out in rule 48(1)(I) and adding a similar exemption in respect of designated banks, with a view to facilitating their recycling of IPO application monies. The AIs concerned should make sure that they are complying with the latest requirements prescribed in the BELR.



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6.1 Security measures for IPO refund cheques

6.1.1 In the light of some fraud cases¹⁴ involving stolen IPO refund cheques in the past, AIs should exercise due care in handling IPO refund cheques for their clients.

6.1.2 To prevent misappropriation of IPO refund cheques, the banking and securities sectors have implemented the following security measures for paper-based applications:

- Partial disclosure of ID/ passport number – part of the Hong Kong identity card (“ID”) number or passport number, as the case may be, of an IPO subscriber will be printed below the subscriber’s name (i.e. the payee) on the refund cheque. The remaining digits of the number are deliberately masked and replaced by asterisks for privacy reasons; and
- Verification of ID/ passport number – the IPO subscription forms will draw the subscribers’ attention to the fact that their bankers may require verification of their Hong Kong ID number or passport number before encashment of their refund cheques.

6.1.3 AIs should have procedures in place to handle instructions from clients to deposit or encash their IPO refund cheques. Specifically, an AI should cross-check both the name and the printed part of the Hong Kong ID/ passport number of the payee shown on the refund cheque against their records (i.e. the corresponding information of the holder of the account in which the cheque is to be deposited). If the disclosed portion of the ID/ passport number shown

¹⁴ In these cases, after stealing the refund cheques from the mail boxes of the IPO subscribers, the culprits opened new deposit accounts in the name of the cheque payees, generally by presenting genuine identity documents after a formal change of name (i.e. “Acknowledgement of Application for a Hong Kong Permanent Identity Card” which is a temporary identity document issued by the Immigration Department). The stolen cheques were later deposited into the new accounts, and funds were subsequently withdrawn from the accounts in the form of cash.



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on the refund cheque cannot be matched against the AI's records (e.g. where a different identity document of the payee is maintained in the AI's records), the AI should request the client to produce the relevant identity document for verification.

6.1.4 AIs should ensure that their policies and procedures for verification of the identity of the payee of the IPO refund cheques provide clear guidance to staff as to the circumstances in which such cheques should be accepted or rejected.

6.1.5 For the effective implementation of the above security measures, AIs should:

- ensure their front-line staff¹⁵ who may be involved in handling IPO refund cheques are adequately educated of the required checking procedures; and
- be alert to any irregularity identified when they conduct the required customer due diligence on clients of newly opened accounts¹⁶. This will help ascertain whether accounts opened are for genuine purposes.

7. Share margin financing

7.1 Policies and procedures

7.1.1 Lending AIs should maintain well-documented policies and procedures for share margin financing, which should be adequate to guard against the risks described in subsection 3.2.

¹⁵ These should include all staff members who are responsible for handling cheque deposits, regardless of the means of depositing the cheques, e.g. through counters, drop-in boxes or ATM machines.

¹⁶ See also the "customer due diligence" requirements specified in the Guideline on Prevention of Money Laundering and its Supplement issued by the HKMA.



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7.1.2 The policies and procedures should be approved by the Board (or a committee with delegated authority) or senior management, as appropriate, and be regularly reviewed and updated to ensure that they remain appropriate and are compatible with changing market circumstances.

7.1.3 In particular, lending AIs should regularly review their policies and procedures in the light of changes in the relevant legislation and codes, such as the SFO, the Banking Ordinance, the Code of Banking Practice and the SFC Code (see also para. 3.2.4) and assess the implications of such changes on the AIs' exposures. If necessary, legal advice should be sought.

7.1.4 The policies for share margin financing should, among other things, include the following:

- Overall exposure limit on share margin financing (e.g. as a percentage of total loans);
- Credit assessment criteria – lending AIs should set out the criteria and information used for assessing borrowers' financial capacity and setting credit limits;
- List of stocks that may be accepted as share collateral – lending AIs should draw up a list of acceptable stocks in different categories (e.g. blue chips, second liners, and third liners, etc.), which should be subject to regular review and updating;
- Maximum loan-to-value ratio for each category of stocks – lending AIs may adopt different ratios depending on their level of expertise and proficiency in share margin financing. However, they should exercise prudence in setting the ratios and give due regard to some key factors such as:
 - their credit risk appetite;



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- the risk characteristics of individual stocks, including their underlying financial strength, liquidity, price volatility and other relevant factors (e.g. shareholding concentration of and negative news about the companies issuing the stocks); and
- their expertise and proficiency in margin call management.

The maximum loan-to-value ratios should be subject to regular review and reassessed in light of changes in market conditions or any of the above-mentioned key factors.

- Minimum margin requirement – if the market value of the share collateral, or the portfolio of share collateral, pledged by the borrower falls below this level, the borrower should be asked to top up the margin immediately;
- Limits to control concentration risk, including:
 - the maximum aggregate exposure to a single counterparty or a group of counterparties (in any case the limit should not exceed the relevant requirements related to exposure limits prescribed in Part 7 of the BELR);
 - the maximum proportion of shares in a single company that can be accepted as collateral (e.g. no more than 5% of the issued shares of any company); and
 - the maximum proportion of shares in a single company or a category of stocks which can be included as share collateral.
- Compliance with rule 27(1) and (2) of the BELR – lending AIs should ensure that these statutory



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requirements which respectively prohibit an AI from lending against the security of its own shares and against the security of the shares of any holding company, subsidiary or fellow subsidiary of the AI are met;

- Credit authorities (and their limits) for approving share margin financing (including those for approving deviations from policies);
- Method and frequency of collateral revaluation, e.g. the portfolio of share collateral is to be marked to market at least daily, and more often during the day if the stock market is highly volatile (see para. 7.5.1);
- Conditions triggering margin call and forced liquidation of accounts, and the approach adopted for margin call monitoring and forced liquidation;
- Relevant management information (e.g. MIS reports) to be produced, including the flow of information, the nature of each MIS report, the responsible persons who review these reports and the frequency of review;
- Measures to enhance investor protection which are relevant to the share margin financing activities of AIs (e.g. the handling of clients' assets). In addition, in order to enhance the quality and timeliness of disclosure of account information, lending AIs are expected to adopt standards comparable to those requirements set out in the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules applicable to securities margin financing clients; and
- Procedures for handling customer complaints (see [IC-4](#) "Complaint Handling Procedures" for further guidance).



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7.2 Lending principles

- 7.2.1 Lending AIs should ensure that credit facilities granted for share margin financing are subject to prudent credit-granting criteria¹⁷ applicable to other types of credit. See [CR-G-1](#) “General Principles of Credit Risk Management” and [CR-G-2](#) “Credit Approval, Review and Records” for further guidance.
- 7.2.2 In the case of lending to NBFIs, it is important for lending AIs to maintain an adequate understanding of their financial conditions (including their leverage position and funding structure) as well as business and management practices, and be alert to any signs of deterioration in their creditworthiness or market standing. In assessing the financial conditions of stockbrokers (or their related finance companies), lending AIs should consider soliciting from these entities for review copies of financial returns that they have submitted to the SFC under section 56 of the Securities and Futures (Financial Resources) Rules. For lending to investment funds and institutional investors, it is particularly important for lending AIs to perform adequate due diligence to understand their investment strategies, risk profiles (e.g. risk concentration, level of leverage) and financing relationships with other financial institutions on an ongoing basis.
- 7.2.3 Share margin facilities should be granted with an acceptable margin value of pledged shares. Lending AIs should determine the acceptable margin value for different categories of stocks. The list of acceptable stocks in different categories, and their respective margin requirements, should be regularly reviewed, updated and approved by the relevant officer (e.g. Chief Credit Officer) or committee with delegated authority (e.g. Credit Committee), taking into account the liquidity

¹⁷ In respect of share margin financing, the focus is put on the laying down of well-defined criteria for granting credits, obtaining sufficient understanding of the borrowers’ financial background and maintaining up-to-date information on the borrowers to facilitate credit monitoring.



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and volatility of those stocks under prevailing market conditions.

7.2.4 In assessing the suitability of the list of acceptable stocks, lending AIs should also pay special attention to stocks in particular industries or stocks with a common nature (such as Internet or technology-related stocks, property-related stocks, and energy or mineral-related stocks) and determine whether their respective loan-to-value ratios remain appropriate, having regard to the volatility in the price and trading of such stocks, the financial strength and prospects of individual companies as well as the stage of the business cycle such industries or companies are in.

7.2.5 Lending AI should have an effective mechanism to identify and monitor borrowers with collateral portfolios that exhibit a material degree of concentration risk or wrong-way risk (i.e. where the collateral value has a material positive correlation with the credit quality of the borrower). For such borrowers, lending AIs should assess the implications of the concentration or wrong-way risk as part of the overall credit assessment and evaluate the need to mitigate the risk exposures (e.g. adjusting the LTV ratio of the relevant stock(s)) to a lower level or even zero.

7.2.6 Lending AIs should ensure that any share margin facilities granted to connected parties are at arm's length. The terms and conditions of such facilities (e.g. in terms of interest rates charged, collateral and repayment terms) should be based on normal business terms and in compliance with established policies and procedures (see [CR-G-9](#) "Exposures to Connected Parties" for more guidance). A locally incorporated lending AI must also comply with relevant requirements set out in Part 8 (Connected Party) of the BELR.

7.3 Credit monitoring and reporting systems

7.3.1 Share margin account positions should be monitored (e.g. by account officers) and revalued (e.g. by the back



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office) on a daily basis. See [CR-G-3](#) “Credit Administration, Measurement and Monitoring” for general guidance.

7.3.2 Lending AIs should have adequate procedures to govern margin call, top-up and liquidation requirements for their share margin financing business (see subsection 7.5).

7.3.3 Lending AIs should maintain an effective system for generating management reports which are detailed enough for senior management review and for identifying exceptions in a timely manner. Management reports for share margin financing should give adequate and timely information on the market value of shares pledged, utilisation of facilities and any need for margin calls. They should include:

- margin call and excess reports which highlight all share margin accounts with outstanding balances exceeding the respective authorized credit limits or loanable values based on the market value of share collateral held (see also para. 7.5.1);
- analysis of share collateral by type and margin ratios; and
- concentration of exposure to share collateral or clients.

Such reports should be generated and reviewed by designated officers on a daily basis.

7.3.4 Lending AIs should initiate follow-up actions (or margin calls) immediately when the outstanding account balance of a client exceeds its authorized credit limit or margin limit. Such actions should be properly documented.

7.3.5 Lending AIs should maintain adequate systems for dealing with a sudden fall in the stock market, and



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should carry out regular stress tests on their share margin portfolio to assess the resilience of the portfolio to a significant decline in stock prices (see [IC-5](#) “Stress-testing” for further guidance). They should ensure that the share margin portfolio is not subject to excessive market risk.

7.3.6 There should be a system of regular internal audits or independent reviews of lending AIs’ share margin financing business, with findings reported to senior management for instituting prompt remedial action.

7.3.7 The Board and senior management should be regularly apprised of the performance of the share margin financing portfolio and relevant risks and controls through periodic management reports and meetings.

7.4 Acceptance and management of share collateral

7.4.1 In accepting clients’ shares from stockbrokers (or their related finance companies) as collateral, lending AIs should ascertain that the entities concerned are licensed under the SFO for carrying on business in dealing in securities or securities margin financing.

7.4.2 In addition, lending AIs should, on a best efforts basis, conduct the following precautionary measures to mitigate the risk of unauthorized pledging of clients’ shares by the entities mentioned in para. 7.4.1:

- obtain written confirmation from the entities that they have obtained proper client authorization for the pledged shares;
- conduct sample checking of the proof of clients’ authorization, to the extent practicable, upon the initial extension of credit facility to the entities and thereafter on an annual basis;
- review copies of the annual external auditors’ compliance reports requested from the entities that they have submitted to the SFC under



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section 4 of the Securities and Futures (Accounts and Audit) Rules¹⁸ to understand their state of compliance with the Securities and Futures (Client Securities) Rules¹⁹; and

- review any other information useful for analysing the entities' positions in securities margin financing (e.g. by obtaining from the entities for review copies of financial returns the entities have submitted to the SFC under section 56 of the Securities and Futures (Financial Resources) Rules).

Where necessary, lending AIs should solicit own legal advice on how to minimise the risks of unauthorized pledging of shares associated with such lending.

7.4.3 Lending AIs should have adequate procedures to control the safe custody, deposit and withdrawal of pledged shares (see [CR-G-7](#) "Collateral and Guarantees" for more guidance).

7.4.4 Lending AIs should ensure that loan and collateral documents are properly prepared and verified, and all pledged shares are held in the name of lending AIs' nominee companies to protect their legal interests.

7.4.5 Lending AIs should keep proper records of the location of share collateral and conduct independent stock counts regularly. Clients' accounts maintained with CCASS or other custodians should be reconciled against the AI's records by independent staff on a timely basis and any discrepancies should be dealt with

¹⁸ Under the Securities and Futures (Accounts and Audit) Rules, licensed corporations and their associated entities are required to submit external auditors' compliance reports to the SFC. This auditors' report must contain a statement of the auditor's opinion as to whether, during the financial year in question, the firm (i) had systems of controls in place that were adequate to ensure compliance with sections 4(4), 5, 10(1) and 12 of the Securities and Futures (Client Securities) Rules, and (ii) has complied with these provisions.

¹⁹ Lending AIs should note that the external auditors' compliance reports are intended solely for submission by the entities to the SFC. As such, review of these reports is for reference only, and the auditors do not have any duty, responsibility or liability under these reports to anyone (including lending AIs) but their clients.



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promptly.

7.5 Monitoring of collateral value

7.5.1 As share margin financing is based on the value of shares pledged, there should be established procedures to monitor the market value of the share collateral for making margin calls to clients. As the stock market can be volatile, lending AIs' systems should be capable of revaluing the portfolio intraday at short notice or on a continuous basis whenever there is a need to do so. At a minimum, the portfolio value of each account should be revalued every day. Accounts with insufficient margin should be required to be topped up immediately.

7.5.2 Lending AIs which are actively involved in share margin financing should designate officers at the appropriate level to keep a close watch on the share margin portfolio and review the position every morning before the market opens. Senior management should also review such positions under exceptional circumstances (e.g. when the market is extremely volatile). Clients who have failed to top up the margin should not be allowed to continue using the facility, and consideration should be given to liquidating their positions if the situation warrants.

7.5.3 Pursuant to subsections 7.3 and 7.4, lending AIs should ensure that:

- the value of shares held as collateral for each share margin transaction at all times exceeds the loan amount by the margin required under the lending AI's share margin financing policies;
- the lending AI has a good title to the collateral (i.e. pledged shares are held in the name of the lender nominee company); and
- other safeguards (e.g. an effective mark-to-market system and controls to avoid



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concentration risk) are in place.

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