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Updates to HKMA requirements for share margin financing

December 2023

Updated circular on share margin financing introduces new terms and requirements in areas including credit limits, risk analysis and having clear polices and review procedures in place. This flyer summarises the major updates and what authorised institutions need to do to ensure they are compliant with the new requirements.

On 17 November 2023, the Hong Kong Monetary Authority (HKMA) issued a circular[1] announcing updates to the Supervisory Policy Manual on New Share Subscription and Share Margin Financing, known as CR-S-4[2]. This marks the first update to CR-S-4 since its initial release in January 2007.

In making these updates, the HKMA has taken into consideration the statutory requirements set by other regulatory bodies, as well as recent developments in the financial industry.

Key updates and impact to authorised institutions

The updates are in five main areas: definitions and terminologies, risk analysis of share margin financing, credit limits for financing initial public offering (IPO) subscriptions, roles as a designated or receiving bank in IPOs, and share margin financing

Revised CR-S-4 requirement	What authorised institutions need to do
Enhanced list of definitions	
• Updates to previously defined terms, and inclusion of new terms such as "designated banks" and the Fast Interface for New Issuance (FINI) online platform	• Authorised institutions that have been appointed as designated banks should identify the requirements apply and assess their compliance • As use of the FINI platform is mandatory for IPO market participants, impacted authorised institutions should review their processes to ensure they are equipped to handle the use of the platform according to the requirements
Credit limits for financing IPO subscriptions	
• Reference of statutory limits for locally incorporated AIs to consider when setting credit limits of total exposure to an IPO share issue has been updated from the Banking Ordinance to the limits in Part 7 of the Banking (Exposure Limits) Rules • Overseas incorporated authorised institutions should adopt prudential limits in a similar manner, in proportion to its business size, nature and risk profile	• Locally incorporated authorised institutions should review the statutory limits to ensure they have been appropriately updated • Overseas incorporated authorised institutions should review the appropriateness of any existing limits such as regional limits, ensuring they are in proportion to their business size, nature and risk profile

[1] *HKMA circular announcing updates:* https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2023/20231117e1.pdf
[2] *Updated CR-S-4 SPM:* https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CR-S-4.pdf

Revised CR-S-4 requirement	What authorised institutions need to do
Risk analysis of share margin financing	
• Lending authorised institutions with share margin financing business should have a formal definition of risk appetite, a holistic approach to risk management, and a robust risk management framework • Clearly defined escalation criteria and actions by senior management and/or relevant risk management committee • Clear policies and procedures for escalating issues in first and second lines of defence to senior management • Senior management should conduct periodic reviews and assessments of risk appetite and operational strategies, commensurate with their business and risk profile • Documented policies and procedures on underwriting standards, margin requirements, close-out and liquidation events • Review credit limits and exposure monitoring framework to reflect risk appetite, especially when there is a high concentration of share positions • Review due diligence process for adequate proof and verification of client financials	• Review risk appetite setting process, ensuring it is commensurate with its business • Review governance framework, including senior management responsibilities for periodic review and escalation procedures • End-to-end review of existing credit policies and procedures for the share margin financing business on: – Client due diligence – Underwriting process – Margin standards – Close-out and liquidation – Credit limits – Exposure monitoring, including for concentrated positions – Escalation management

Revised CR-S-4 requirement	What authorised institutions need to do
Share margin financing	
• Locally incorporated lending authorised institutions must comply with Part 8 (Connected Party) of the Banking (Exposure Limits) Rules • Guidance on key factors to consider when setting maximum loan-to-value (LTV) ratios, such as: – Credit risk appetite – Risk characteristics of individual stocks, including underlying financial strength, liquidity, price volatility, shareholding concentration of companies issuing stocks, and negative news about such companies – Expertise and proficiency in margin call management • Periodic review of maximum LTV ratios in light of changes in market conditions or key factors • Enhanced lending principles for lending authorised institutions engaging in share margin financing: – Adequate due diligence to understand investment strategies, risk profiles and financing relationships with other financial institutions when lending to investment funds and institutional investors – Mechanisms for identifying and monitoring borrowers with collateral portfolios with high concentration or wrong-way risk. These should be assessed in the overall credit assessment and mitigated, for example by adjusting the LTV ratio to a lower level or zero	• Review compliance against connected party requirements under the Banking (Exposure Limits) Rules, especially the process of identifying and maintaining a list of connected parties • Review methodology for setting maximum LTV ratios, including a process for periodic review of the maximum LTV due to any changes in market conditions or key factors • Enhance due diligence process of investment funds and institutional investors • Review and implement mitigation strategies for high concentration and/or wrong-way risk • Enhance stress testing on borrower's collateral portfolios for concentration and wrong-way risk

Revised CR-S-4 requirement	What authorised institutions need to do
Role as a designated or receiving bank in IPOs	
• IPO roles and responsibilities extended to designated banks • To hold application monies, designated banks must: – Have adequate procedures to ensure clearing participants comply with pre-funding and money settlement obligations – Ensure monies kept in the nominee account to meet the pre-funding requirements of IPO subscriptions are not transferred out prior to a settlement with the receiving bank for allocated shares – Ensure only the amount of monies in respect of allocated IPO shares is transferred from the nominee account on the application money settlement day • Requirements on a receiving bank's responsibilities in managing the application process of IPOs are removed, such as restrictions on the distribution of new share application forms and the handling and consolidation of application forms.	• Authorised institutions which have been appointed as designated banks should review existing policies and procedures for compliance against the new requirements • Authorised institutions which act as receiving banks should update their policies and procedures to the latest responsibilities where requirements have been removed

How KPMG can help

Gap Analysis

- Advise on the impact of the updated requirements on your share margin financing related products, related processes and internal controls. Such products include Lombard lending, single stock lending and prime financing.
- Benchmark processes and internal controls to market practices and regulatory expectations.

Model Review

- Advise on the design and parameters for models used to set LTVs
- Perform independent validation of models used to calculate LTVs for individual stocks.
- Benchmark and compare models to market practice and regulatory expectations.

RegTech

- Advise on RegTech solutions which can automate key aspects of the Lombard lending process including LTV setting, collateral monitoring, margin call process and portfolio liquidations.
- Advise on RegTech solutions which can automate key aspects of the credit decisioning and review process, satisfying the regulatory expectation that all accounts are reviewed at least annually.

Contact us

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