

LCQ12: Initial public offering settlement platform "FINI"

Following is a question by the Hon Robert Lee and a written reply by the Secretary for Financial Services and the Treasury, Mr Christopher Hui, in the Legislative Council today (November 15):

Question:

The Hong Kong Exchanges and Clearing Limited will launch "FINI", a new digitised initial public offering (IPO) settlement platform, on the 22nd of this month. In this connection, will the Government inform this Council:

(1) as some members of the industry have relayed that the authorities have not formulated clear guidelines on FINI with respect to accounting issues of IPO share subscriptions and the calculation of liquid capital required under the Securities and Futures (Financial Resources) Rules, causing confusion among brokerage firms, how the authorities will co-ordinate with the regulators and the relevant accounting professional bodies to provide clear guidelines and advice to the industry;

(2) whether it knows if the regulators have assessed if the following situation will arise: the overwhelming response to individual IPO share subscriptions under the FINI mechanism has led to excessive financing, which in turn triggers a systematic financial risk; if they have, of the details; if not, the reasons for that; and

(3) whether it knows if the regulators will consider setting a minimum deposit ratio for investors in IPO financing and requiring brokerage firms to set aside additional provisions for IPO financing in order to prevent the occurrence of excessive IPO financing?

Reply:

President,

To continuously strengthen the competitiveness of Hong Kong's listing platform, the Government has been working with the Hong Kong Exchanges and Clearing Limited (HKEX) and financial regulators to enhance the depth, vibrancy and diversity of Hong Kong's securities market. Efforts have been made to increase trading and settlement efficiency in the primary market in line with the international trend of going paperless and digitalisation, thereby consolidating Hong Kong's position as a major international fundraising, risk management and trading hub.

Hong Kong's public offering market, developed over years, has gradually promoted a paperless operation, including introducing electronic subscription of initial public offerings (IPOs). To further enhance procedural efficiency,

HKEX will soon launch the new digitalised IPO settlement platform, FINI (Fast Interface for New Issuance), to comprehensively modernise and simplify the IPO settlement process. The new platform will facilitate different market participants, including sponsors, underwriters, legal advisors, banks, clearing participants, share registrars, regulators, etc. to deliver their respective duties simultaneously on a single electronic platform and optimise work co-ordination. The arrangement will shorten the lead time between pricing of an IPO and trading of shares from the current five business days (T+5) to two business days (T+2), significantly enhancing the efficiency of IPO settlement and reducing the associated market and operational risks. It will also strengthen the financial market infrastructure, and enhance the attractiveness of Hong Kong's listing platform to issuers and investors.

On the operational process of FINI, HKEX has completed multiple rounds of testing, market practice sessions and rehearsals with IPO market participants, and will provide ongoing support to them. The new platform will be officially launched on November 22. Relevant materials including the launch arrangements (Note 1); user guides for clearing participants (Note 2), banks (Note 3), sponsors, intermediaries and legal advisors (Note 4); application programming interface user guide (Note 5); transitional arrangements (Note 6); and frequently asked questions (Note 7) are uploaded to HKEX's dedicated webpage (Note 8).

In consultation with HKEX and the Securities and Futures Commission (SFC), my reply to the three parts of the question is as follows:

(1) The Securities and Futures (Financial Resources) Rules (FRR) prescribe the financial resources requirements applicable to licensed corporations. The main function is to ensure that licensed corporations have sufficient liquid assets to address the risks arising from their regulated activities.

Under the FRR, liquid capital is one kind of the financial resources that a licensed corporation is required to maintain, which can be quickly converted into cash to meet liabilities as they fall due. The FRR requires licensed corporations to maintain minimum liquid capital at a certain amount. The computation methods and accounting basis are specified in detail in the FRR and relevant guidelines published by the SFC.

As regards the computation of liquid capital for IPO subscription services, brokers are required to prepare their accounts in accordance with generally accepted accounting principles, and on this basis compute the liquid capital in accordance with the requirements under the FRR. The SFC has issued a circular on November 8 (Circular) (Note 9) to further explain the requirements to licensed corporations and also the computation basis for liquid capital.

The SFC has proactively communicated with the securities sector over the past few months, so as to understand brokers' work process as well as their capital and financial computation arrangements, etc. for IPO subscription services upon the launch of FINI, and to consult them on the Circular in draft. At the same time, the SFC has advised the Hong Kong Institute of

Certified Public Accountants to provide guidelines to its members when needed, and brokers should also follow the relevant guidelines when preparing the accounts.

(2) and (3) To assist the market in managing the risks and costs of IPO settlement more effectively, the FINI platform will enhance the pre-funding mechanism for public offering by introducing a new pre-funding model. Under the enhanced mechanism, a clearing participant responsible for handling the subscription of new shares may opt to lock a maximum of cash balance (pre-funding) equivalent to the highest possible share allotment value in the nominee account of its designated bank before the ballot of new shares. The pre-funding can consist of all cash, or cash together with the funding drawn from the credit facilities committed by the bank.

After the ballot, the clearing participant's designated bank will only need to transfer funds corresponding to the value of the allotted shares to the issuer's receiving account for settlement. As compared to the existing arrangement (Note 10), the enhanced pre-funding mechanism will alleviate the situation of liquidity crunch resultant from over-subscription of large-scale IPOs, avoid unnecessary large-scale interbank fund transfers, and reduce potential counter-party and concentration exposures, thereby mitigating financial systemic risks.

In addition, a clearing participant will only need to hold on deposit an amount of funds corresponding to the maximum number of shares that it can be allotted, without locking the entire amount of funds for over-subscription. This model will lower the related funding costs and reduce the settlement default risk for clearing participants.

While FINI will adopt a new pre-funding model, clearing participants must still ensure that their clients have sufficient funds (cash or credit facilities) to settle the full subscription amount for public offerings as present. Based on the risk profiles of different clients, clearing participants can require clients to pre-fund their orders in full, or collect from clients a certain percentage of their subscription values as margin and provide them with credit to cover the rest, alongside appropriate collateral and lien arrangements for any shares that may be allotted to clients.

Given clearing participants' different financial conditions, the cost of seeking bank credit facilities varies and their clients' risk profiles also vary. Therefore, the pre-funding model under FINI will provide flexibility for clearing participants to, having regard to their business operations and risk management needs, set appropriate margin levels and adopt necessary measures to ensure that their clients have sufficient funds or credit to pay for the allotted shares. This can better suit industry needs than establishing a uniform ratio for all investors.

Separately, the SFC has pointed out in the Circular that brokers should implement effective risk management for their IPO subscription services, so as to guard against improper high-risk activities such as excessive financing. The Circular also outlines the requirements for risk management

measures in respect of client risk control, brokers' capital arrangement and financial assessment. It reiterates that brokers must formulate a prudent credit policy for IPO financing, and set appropriate credit limits for clients taking into account the brokers' and clients' financial capability, the IPO subscription arrangements and the prevailing market conditions.

The SFC and HKEX will, upon implementation of FINI, continue to closely monitor the management of client funds and public offering lending activities by licensed corporations and registered institutions, assess relevant risks, and maintain financial market stability.

Notes:

1. Please refer to the following link for the presentation:
[www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-Launch-Arrangements-Webinar-EN-\(5-July-2023\).pdf](http://www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-Launch-Arrangements-Webinar-EN-(5-July-2023).pdf).
2. Please refer to the following link for the user guide:
www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-User-Guide-for-HKSCC-Participants.pdf.
3. Please refer to the following link for the user guide:
www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-User-Guide-FINI-Banks.pdf.
4. Please refer to the following link for the user guide:
www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-User-Guide-FINI-Sponsors-Intermediaries-and-Legal-Advisers.pdf.
5. Please refer to the following link for the user guide:
www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-API-User-Guide.pdf.
6. Please refer to the following link for the user guide:
www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-Transition-Arrangements-Guide.pdf.
7. Please refer to the following link for the frequently asked questions:
www.hkex.com.hk/-/media/HKEX-Market/Services/Next-Generation-Post-Trade-Programme/Fini/FINI-Information-Pack-EN.pdf.
8. Please refer to the following link for the webpage:
www.hkex.com.hk/Services/Platform-Services/FINI?sc_lang=en.
9. Please refer to the following link for the Circular:
apps.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=23EC54.
10. Under the existing arrangement, clearing participants and share registrars are required to transfer their clients' full subscription amount in cash to the issuer's receiving account before the ballot, and will receive

a refund in respect of the subscriptions that do not receive a share allotment after the ballot.