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China to launch securities margin trading soon

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China's securities regulator announced Sunday that it will soon launch margin trading business for securities firms, which has long been expected by the market.

The business, allowing traders to borrow part of the money necessary to buy a security or borrow security to sell, and practiced in most bourses across the world, would change the current one-way trade on both Shanghai and Shenzhen stock markets and serve as a risk aversion tool for investors.

Sources with the China Securities Regulatory Commission (CSRC) identified the principle of starting the business as "test run first and to be extended gradually".

Securities firms are only allowed to use its own capital and securities for the experiment margin trading in China. The initial margin will be set at 50 percent of the purchase price when buying eligible securities or 50 percent of the proceeds of a short sale.

The maintenance margin, or the sum required to be maintained on deposits at all times in case of liquidity crunches, will be at least 30 percent of the financed equity value.

Although margin trading would expand the business and broaden the use of capital and securities of securities firms, a CSRC official said on the background that window guidance or moral persuasion by the regulators would alert securities firms to be more conservative with their investment.

They could ward off the risks in line with their actual situations by raising the threshold of their clients and lifting up moderately the margin requirements, said the official.

The financial leverage, or the degree to which a business is utilizing borrowed money or securities to fund its operation would only be twice as much as its own equity, the official said.

The CSRC will handpick the first batch of eligible securities firms by scrutinizing their net capital, a key measurement for solvency and operation capability, track of records in compliance audit, current risk of control indexes and their plans for the upcoming test run.

A CSRC statement released on Sunday said that the experimental project was open to all kinds of securities firms across the whole country.
If the experiment proves smooth, margin trading would be normalized in all securities firms, it said.

The CSRC will clarify the qualifications and criteria later and promise to bring in an expert panel to handle applications in an open and transparent manner.
As the business can multiply both profits and losses, CSRC officials urged securities firms not to jump at the project before acquainting themselves with the rules and thinking well of the potential risks.

The CSRC sources told Xinhua the authorities would tighten supervision to forbid any individual or institution to start margin trading without authorization.

Given that the business will amplify capital and securities demand as well as turnover, analysts regard the move as a latest incentive from the regulators to activate the market.
On the last trading day before the week-long National Day holiday, China's benchmark Shanghai Composite Index closed at 2,293.78 points, after plummeting nearly 70 percent from the record high of 6,124 points last October to the new low of 1,802.33 points in September.

The new move came after the country scraped the tax upon share purchases and allowed Central Huijin, a government investment arm, to buy in the stocks of the country's three biggest banks, namely the Industrial and Commercial Bank, China Construction Bank and Bank of China.

The lift of restrictions preventing controlling shareholder to buy back shares also gave a boost to the mainland stock markets shrouded by lingering fear over economic uncertainties.
The CSRC Sources did not expect massive short sales to come but instead regard the trading as a tool to secure "rational prices" by optimizing the pricing mechanism of stock markets.
A CSRC official told Xinhua on anonymity that the risks of margin trading experiment were "controllable" because margin lending would outweigh short selling.

"Massive short sales were barely possible considering the large proportion taken by money in the assets of securities firms. "The securities eligible for sale are relative small," said the official.

Director Cheng Wenwei of the Research Institute of the Hongyuan Securities said that stronger upward momentum would depend on government policies and the performance of peripheral markets.

Attributing the market tumbling over past months to insufficient demand and gloomy expectation over business profits, he said that the rising prices of raw materials, strengthening Yuan, slowing exports, higher labor costs and credit tightening had concurred to cause the rapid decline in corporate net profits.

"Once reasonable returns come in sight, long-term capitals would be lured into the market while the current oversupply on the second market would be reversed," he said.

If the $850-billion rescue package of the United States government could spur local and peripheral markets, mainland A-share market would also feel the positive ripple effect, he said.(China Daily)