

**C L I F F O R D  
C H A N C E**

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Dear Sirs

**Joint Consultation Paper on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong**

We welcome the opportunity to comment on the Consultation Paper on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong ("**Consultation Paper**") issued by the Securities and Futures Commission ("**SFC**") on 28 January 2019.

Set out below are some specific comments we have on the proposals in the Consultation Paper where we have a view. Our comments revolve around the proposed USS account.

Unless otherwise defined, terms used in this letter shall have the meaning ascribed to them in the Consultation Paper.

***USS account holders' right to attend and vote at meetings***

Under the current model, HKSCC-NOMS is the legal owner of the shares that are deposited into CCASS in trust for the investing public. Investors who hold securities in CCASS therefore hold only a beneficial interest in the securities. They are not registered holders and do not hold

legal title. We understand the investors may do the following in relation to their rights to attend and vote at the general meetings:

- a. investors who wish to attend and vote at a shareholders' meeting may request their CCASS participant (which in turn requests HKSCC-NOMS) to arrange for the investor (or its nominee) to be appointed as a representative for the purpose of attending and voting at such meetings. For investors who are "investor participants" (and hence also CCASS participants), they may relay their request to HKSCC-NOMS direct. HKSCC-NOMS will then appoint the relevant person as a representative to attend and vote at the meeting; or
- b. alternatively, investors may send their voting instructions to their CCASS participant which will in turn pass the instructions to HKSCC-NOMS. (Again, for investors who are "investor participants", they may relay their voting instructions to HKSCC-NOMS direct.) HKSCC-NOMS will then appoint a proxy to attend and vote at the meeting as per the investors' instructions.

In either case, investors are exercising their rights to attend and vote at the meeting as the beneficial shareholders. None of the CCASS participants (including investor participants) can vote.

Under the Revised Model, institutional investors (in particular funds) will be able to open a "USS account" with a sponsoring CP. Securities being held in a USS account will be registered in the name of the institutional investor that has opened the account, which means it will be the legal owner of the securities and hold legal title to them. The account will be administered by the relevant sponsoring CP, and the institutional investor will have to manage its holdings through such sponsoring CP. USS account holders will have the right to vote and to attend and speak at meetings of the issuer. We recommend the SFC put in place operational rules to regulate on how USS account holders may exercise their rights to attend and vote at the meetings (including the appointment of proxies).

### ***Settlement arrangements***

We would also like to clarify the settlement arrangement for trades involving USS accounts. The transfer of securities to and from USS accounts will involve transfer of legal title and, in certain cases, beneficial ownership. Absent an intraday, net cash settlement mechanism, we do have insolvency risk and liquidity concerns in respect of those transfers that would involve a change in the beneficial ownership in the underlying securities.

### ***Enforcement of SFC restriction notices***

In the Lehman Brothers Minibond saga, the SFC issued restriction notices on four Lehman entities to preserve the assets of the Lehman entities and their clients, and to protect the interests of these clients and the investing public. The restriction notices were issued pursuant to sections 204 and 205 of the Securities and Futures Ordinance. From an investor protection perspective, we would recommend the SFC put in place a mechanism within the HKEX System to efficiently enforce any restriction notices that SFC may issue in response to unforeseen market circumstances.

***Implications on regulated industries***

We would like to clarify whether the "substantial shareholder" approval requirement under section 132 of the SFO would apply to an USS account holder and/or its sponsoring CP in the situation where the securities in a particular licensed corporation that the USS account holder (who will be the legal owner of the underlying securities) controls, on an aggregated basis, exceed the statutory threshold (i.e. 10% for direct shareholding and 35% - 10% for indirect shareholding). We believe an exemption will need to be drawn up in appropriate cases e.g. where the relevant USS account holder holds securities in the licensed corporation for a vast number of clients.

The substantial shareholder / controller considerations are not limited to the SFC licensed entities. For example, banks under the Banking Ordinance, insurance companies under the Insurance Ordinance and telecommunications companies under the Telecommunications Ordinance; even HKEX under section 61 of the SFO.

***DI implications and custodian rules***

As a general note, the application of the disclosure of interest compliance regime to the new USM environment and the relevant parties will need to be clarified. In particular, we would recommend the SFC issue guidance on the disclosure of interest requirements for the holder of the USS account (who will be the legal owner of the underlying securities) and, in particular, the sponsoring CP and whether any exemptions will apply.

Also, the interaction of USS account holders and their sponsoring CPs (in particular, the related custodian operations) will need to be consistent with the requirements under the Securities and Futures (Client Securities) Rules.

Yours faithfully

**Clifford Chance**