

**Securities and Futures Commission, the Federation of Share Registrars Limited and
Hong Kong Exchanges and Clearing Limited**

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

Submission of The Hong Kong Association of Banks

26 April 2019

Introduction

The SFC, FSR and HKEX have invited The Hong Kong Association of Banks (“**HKAB**”) to comment on the Joint Consultation Paper on a Revised Operational Model for Implementing an Uncertificated Securities Market (“**USM**”) in Hong Kong (“**Consultation Paper**”).

Assisted by King & Wood Mallesons, this paper sets out HKAB’s views in response to the Consultation Paper. Our key suggestions are summarised in the “Executive summary”, with our substantial comments set out in “HKAB’s response” which follows the question format that the SFC, FSR and HKEX have adopted. To ensure that this submission is useful, we provided our functional comments by reference to each paragraph and question as set out in the Consultation Paper.

We would be pleased to engage in further discussions with the SFC, FSR and HKEX in relation to the proposed changes, and provide further industry input where necessary.

Unless otherwise defined, terms used in this letter have the meaning given to them in the Consultation Paper, as applicable.

Executive summary

HKAB has consistently supported the implementation of a USM in Hong Kong. As set out in our previous submission dated 16 April 2010, we believe that a USM will help to enhance the overall efficiency and competitiveness of Hong Kong’s securities market. We continue to believe that implementing a USM is an important step in maintaining Hong Kong’s status as a leading international financial centre. And as a matter of principle, we have continuously maintained that there should be a balance between enhancing the overall efficiency and competitiveness in the securities market and securing an appropriate and improved level of investor choice.

Generally, we view the Revised Model as presenting a better option for taking forward the USM initiative than the 2010 Model. However, timing is a key concern. We therefore request that sufficient time be allocated to enable the industry to build and implement the necessary technology, policies and processes to support the implementation of the USM initiative in Hong Kong. In addition, clarification of specific cases is required, and certain adjustments are needed to ensure that the USM initiative does not unfairly impact particular customer segments.

Further details are set out in the “HKAB’s response” section below.

Please let us know if you have any questions.

HKAB's response

No	Question	HKAB's response
1	<p>Do you agree that the Revised Model presents a better option for taking forward the USM initiative? If no, please provide details.</p>	<p>HKAB generally agrees that the Revised Model presents a better option for taking forward the USM initiative than the 2010 Model.</p> <p>In particular, we support the proposal to retain the existing nominee structure in CCASS. This retention will minimise impact on market participants, and promote an orderly transition to a USM.</p> <p>However, we are concerned that the Revised Model may increase the implementation costs incurred by intermediaries. In general, our view is that these costs should be kept as low as practicable. To this end, a phased approach with clear timelines should be adopted to ensure market readiness, coupled with further consultation before implementation. We also suggest that the Revised Model be supported wherever possible by clear statutory and regulatory provisions, as well as practical guidance, to help create a robust and easily accessible framework.</p> <p>As noted below, our more fulsome perspectives on the USM are contingent on understanding the detail. We ask that further consultation be undertaken in relation to that detail in due course.</p> <p>We would be pleased to engage further with the SFC, FSR and HKEX regarding implementation of the Revised Model.</p>
2	<p>Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.</p>	<p>Stamp duty</p> <p>We have concerns about the application of the SDO under the Revised Model. In particular, we understand the intention to rely on declarations from intermediaries as to whether any <i>ad valorem</i> stamp duty is chargeable in respect of a transaction. This imposes an operational burden on intermediaries, the extent of which cannot be fully scoped without further details.</p> <p>While we acknowledge the intention of the SFC, FSR and HKEX to provide further details regarding stamp duty at a later</p>

		<p>stage,¹ these details are required before we can fully assess the feasibility of the Revised Model.</p> <p><i>“Registrar participants”</i></p> <p>We are also concerned about the introduction of “registrar participants” as a new participant category in the HKEX System. We would appreciate a clear description of the rights and obligations of this new participant category, which is currently lacking from the Consultation Paper.</p> <p><i>Interaction with Investor ID</i></p> <p>We would be grateful for confirmation regarding the relationship between the Revised Model and the Northbound Investor ID Model for Stock Connect, which may be expanded to southbound trading. We would appreciate further consultation on this topic going forward.</p> <p>Please also see our response to question 9 in relation to unique identification numbers, which is also applicable here.</p>
3	Do you have any concerns or comments about the key features of the USS account? If yes, please provide details.	<p>At this stage, HKAB has no concerns about the key features of the USS account.</p>
4	Do you have any concerns or comments about the key features of the USI account? If yes, please provide details.	<p>At this stage, HKAB has no concerns about the key features of the USI account.</p> <p>We would, however, appreciate further information regarding the maximum number of people that may open a joint USI account.²</p>
5	Do you have any concerns or comments about our proposal that USS accounts be limited to institutional investors, and USI accounts be available to all investors,	<p>We are concerned that the public may be confused by the proposed eligibility requirements regarding USS and USI accounts.</p>

¹ Consultation Paper, page 16, paragraph 43.

² Consultation Paper, page 17, paragraph 51.

	including institutional and retail investors? If yes, please provide details.	As such, we suggest appropriate guidance being issued in due course.
6	Do you agree with our expectation that institutional investors that open a USS account are unlikely to open or need to open a USI account as well? If no, please provide details.	HKAB agrees with the expectation that institutional investors who open a USS account are unlikely to open or need to open a USI account as well.
7	Do you anticipate any difficulties or limitations in opening and managing USS accounts for retail investors? If yes, please provide details.	<p>We anticipate significant operational difficulties would arise if USS accounts were available to retail investors.</p> <p>These difficulties would arise due to the large scale of retail customers. As such, we believe that major system enhancements would be required to facilitate the instructions to the issuer pertaining to securities if retail investors had access to USS accounts. The cost of these enhancements would be significant.</p>
8	Do you have any concerns if cash entitlements payable in respect of securities held in an institutional investor's USS account had to be paid to the institutional investor direct, rather than to its sponsoring CP? If yes, please provide details.	<p>We have concerns about this proposal. As the USS account is administered by the sponsoring CP, we suggest that it would be more appropriate for the cash entitlement to be paid to this sponsoring CP. The sponsoring CP could then transfer it to the institutional investor.</p> <p>We believe that this procedure would be consistent with the method of handling electronic statements for USS holders.</p> <p>Please also see our concerns raised in question 18 in relation to cash entitlements, which are also applicable here.</p>
9	Do you have any concerns or comments about our proposal to require registered securities holders to provide a unique identification number to the issuer? If yes, please provide details.	<p>In regard to USI account holders, we have no concerns about the proposal to require them to provide a unique identification number ("UIN") to the issuer.</p> <p>However, with respect to securities holding via an intermediary, HKAB expects that the issuer or share registrar</p>

		<p>would not require submission of any UIN upon share transfer. We suggest clarifying this issue.</p> <p>There are numerous other practical issues to address here, including:</p> <ul style="list-style-type: none"> ▪ how changing passport numbers are handled; ▪ how to reconcile accounts that belong to the same person, where the first was opened using a HKID as the UIN but the second was opened using the passport number as the UIN; and ▪ which UIN will be used in respect of joint USI accounts. <p>We further suggest that consideration of the application of the Personal Data (Privacy) Ordinance (Cap. 486 of the Laws of Hong Kong) (“PDPO”) to the Revised Model is necessary. Guidance from the Privacy Commission for Personal Data would also be appreciated in due course.</p>
10	<p>Do you have any concerns or comments about our proposals on consolidating holdings belonging to the same registered securities holders but calculating securities entitlements separately in the case of USS holders with multiple USS accounts? If yes, please provide details.</p>	<p>We generally agree that holdings belonging to the same registered securities should be consolidated, although we would be grateful for further clarifications and details regarding the proposal.</p> <p>In particular, we are concerned that fractionalised shares may present difficulties, given that the entitlements arising from fractionalised shares are typically combined.</p> <p>Further, the potential ramifications of calculating entitlements separately needs to be fully assessed. For example, in the case of a single institutional investor with multiple USS accounts, the impact of separate entitlement calculation on market information and perceptions should be considered carefully. Depending on the results of this assessment, it may be appropriate to consolidate entitlements for certain USS accounts.</p> <p>Accordingly, we request further clarification of the treatment of fractionalised shares, and additional details regarding the distribution and calculation of entitlements, under the Revised Model. This will enable our members to better assess the feasibility of the proposal.</p>

11	<p>Do you have any concerns or comments about the proposals for establishing a Common Platform across all share registrars? If yes, please provide details.</p>	<p>While we acknowledge the intention of the FSR to provide further details regarding the Common Platform at a later stage,³ these details are required before we can fully assess the feasibility of the Common Platform.</p> <p>As a preliminary comment, we suggest that PDPO compliance should be a key item to be addressed during the development and deployment of the Common Platform.</p>
12	<p>Do you have any concerns or comments about the proposed process flows for IPO applications in respect of securities that are to be credited to a USI account? If yes, please provide details.</p>	<p>We are concerned that, depending on the final timetable adopted by the SFC, FSR and HKEX, that there will not be sufficient time for retail investors to open USI accounts before IPO applications become available for USI account holders.</p> <p>We further suggest that USI account holders should enjoy the flexibility to change the bundled settlement bank account at any time post registration.</p>
13	<p>Do you have any concerns or comments about the proposed process flows for IPO applications in respect of securities that are to be credited to a USS account? If yes, please provide details.</p>	<p>At this stage, HKAB has no concerns about these proposed process flows.</p>
14	<p>Do you have any concerns or comments about the proposed process flows for effecting transfers to or from HKSCC-NOMS under the Revised Model? If yes, please provide details.</p>	<p>We are concerned that, while change of beneficial ownership is possible under the current model, it is unclear how it would operate under the Revised Model. We would be grateful for further clarification regarding how changes of beneficial ownership would occur under the Revised Model.</p> <p>We would also be grateful for further clarity on how transfers under the USM initiative can be completed on a same-day basis – and, in particular, how transfers of securities under the USM initiative can be effected on a free-of-payment basis in both real-time and batching modes.</p> <p>Please also see our concerns raised in question 2 in relation to stamp duty, which are also applicable here.</p>

³ Consultation Paper, page 22, paragraph 17.

		We expect that significant lead times will be required for market participants to enhance operational processes and systems to support the proposed process flows.
15	Do you have any concerns or comments about the proposed process flows for effecting other transfers under the Revised Model (i.e. between two USI holders, between two USS holders or between a USI and USS holder)? If yes, please provide details.	Please also see our concerns raised in question 14 in relation to lead times, which are also applicable here.
16	Do you have any concerns or comments about our proposal to offer off-exchange trade settlement and transfer services on half-day trading days? If yes, please provide details.	At this stage, HKAB has no concerns about this proposal. However, we would appreciate further clarification regarding the differentiation between on- and off-exchange trade settlement under the Revised Model.
17	Do you have any concerns or comments about the proposed process flows for effecting corporate actions in respect of holdings in a USI account? If yes, please provide details.	We generally have no concerns about the proposed process flows for effecting corporate actions in respect of holdings in a USI account.
18	Do you have any concerns or comments about the proposed process flows for effecting corporate actions in respect of holdings in a USS account? If yes, please provide details.	Generally, we suggest that further clarifications are needed of the roles and responsibilities among sponsoring CPs and registrars with respect to USS accounts. We are concerned that reconciling corporate actions in respect of holdings in a USS account may not be able to be reflected in our members' systems. In particular, if securities entitlement are credited to the relevant USS account, then client documentation and arrangement between the USS holder and its sponsoring CP

		<p>will govern when and how the USS account holder is informed of any changes.</p> <p>This presents difficulties for sponsoring CPs, who will need to be aware of the credit of the securities entitlement and ensure updates in the system.</p> <p>Further consideration should also be given to:</p> <ul style="list-style-type: none"> • cash entitlements, as our members' may not be able to monitor and confirm the completion of deposit of cash entitlements. In particular, if cash entitlements are to be credited directly, further guidance is needed on the role and responsibilities of the sponsoring CP with respect to reconciliation and confirmation of payments. • operational issues, where different accounts with different deadlines are held by the same intermediary. • electronic communications, and the potential for relevant deadlines to be aligned. <p>Please also see our concerns raised in question 8 in relation to entitlement payments, which are also applicable here.</p>
19	<p>Do you have any concerns or comments about including SFC-authorized listed funds within the USM initiative at an early stage? In particular, do you perceive any difficulties in doing so? If yes, please provide details.</p>	<p>At this stage, HKAB has no concerns about this proposal.</p> <p>However, we request clarifications and consultation regarding the SDO amendments that will be required prior to USM implementation.</p> <p>We also request clarification regarding the ROM for these particular products, given that no share registrar is typically engaged.</p>
20	<p>Do you have any concerns or comments about including rights issues, subscription warrants and depositary receipts within the USM initiative at an early stage? If yes, please provide details.</p>	<p>We suggest that, as depositary receipts already require their underlying securities to be held within CCASS, it is not impactful for the USM initiative to cover those particular products.</p> <p>Please also see our request for clarification raised in question 19 in relation to share registrars, which is also applicable here.</p>

21	<p>Do you have any views as to whether the USM initiative should be extended to cover other products, in particular CBBCs and DWs? If yes, please provide details.</p>	<p>We suggest that, as CBBCs and DWs already require their underlying securities to be held within CCASS, it is not impactful for the USM initiative to cover these particular products.</p> <p>Please also see our request for clarification raised in question 19 in relation to share registrars, which is also applicable here.</p>
22	<p>Noting the general market consensus that Hong Kong should move to a USM regime, do you agree with the general approach for moving the market to full dematerialization? If no, please provide details.</p>	<p>HKAB shares the general market consensus.</p> <p>However, we suggest that greater clarity is required with respect to timelines. It is pivotal that all market participants have sufficient time to prepare before the USM initiative is implemented.</p> <p>In addition, we are concerned that customers may face uncertainty and complications during implementation. Accordingly, we suggest that a single regulatory body (ie either the SFC or HKEX) provide a dedicated function to support customer inquiries and issues during implementation. In particular, our members' are concerned about the potential impact of the USM initiative on elderly customers, who may not be as accustomed to electronic trading and communications.</p>
23	<p>Do you have any concerns or comments about our proposals for requiring paperless IPOs only? If yes, please provide details.</p>	<p>At this stage, HKAB has no concerns about these proposals.</p>
24	<p>Do you have any concerns or comments about our proposal that there should be no option to rematerialize securities that are already in uncertificated form? If yes, please provide details.</p>	<p>At this stage, HKAB has no concerns about this proposal.</p> <p>We recognise that this aligns with the general reduction of paper and manual processes that the USM initiative aims to achieve.</p> <p>However, should this proposal be implemented, we would expect CCASS to continue holding any delisted or untradeable shares and to advise if there is any corporate action for those shares, given that rematerialisation would be precluded. We suggest clarifying this issue.</p>

		We further suggest that a “write-off” option be considered, such that clients be allowed to close accounts in respect of delisted or untradeable shares without opening a USI account.
25	Do you have any concerns or comments about our proposals for dematerializing securities that are held in the new HKEX System? If yes, please provide details.	<p>We would be grateful to receive details of the specific handling of dematerialised securities in the context where holders refuse to deliver up their certificate for cancellation or open a USI or USS account.</p> <p>In particular, we request further clarification on the establishment and operation of the “temporary” USI account,⁴ and how notifications will take place in respect of this account.</p>
26	Do you have any concerns or comments about our proposal to cease the parallel trading arrangement for securities held within the HKEX System that have already been dematerialized? If yes, please provide details.	We are concerned that without parallel trading, customers may trade on the basis of a particular stock quote without noticing that corporate actions already taken have affected that stock. This may cause outstanding orders to be cancelled or amended. We suggest providing further guidance on this issue, as intermediaries’ system enhancement will be required, and market practice and customer education have to be established.
27	Do you have any concerns or comments about our proposals for encouraging issuers and registered securities holders to communicate electronically rather than in paper form? If yes, please provide details.	<p>While we generally support this proposal, we are concerned that not all customers (in particular, elderly customers) will have email addresses or the ability to access electronic communications.</p> <p>Accordingly, we suggest that provisions be made for elderly customers, as well as people with disabilities (such as visual impairment) to obtain paper-based communications without incurring additional costs.</p> <p>We are also concerned that reliance solely on electronic communications may impact on contingency planning. We suggest that the feasibility of maintaining a separate paper channel should be considered as a redundancy measure.</p>
28	Other comments	<p>We have the following additional comments:</p> <ol style="list-style-type: none"> Transition for uncontactable customers - Certain members are concerned that in circumstances where customers are uncontactable or deceased, further specific

⁴ Consultation Paper, page 33, paragraph 121(b).

		<p>guidance will be required on how to handle these customers' securities as the USM initiative is implemented.</p> <ol style="list-style-type: none"> 2. Untradeable or delisted shares - We also suggest that consideration be given to establishing a mechanism to handle untradeable or delisted shares, and account closures. Under the current regime, the physical certificates can be withdrawn to such clients. However, as the USM initiative is implement, we suggest that it will be necessary to be able to "write off" these securities in the ROM. 3. Share registrars – In the enhanced system for regulating share registrars, we suggest considering whether there should be any reference to the trust or company service provider ("TCSP") licensing regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615 of the Laws of Hong Kong). We expect there may well be a number of share registrars that may undertake duties that fall within both regimes. This might lend itself at least to a level of harmonisation of rules (eg KYC). 4. Private company shares – In due course, we would welcome further development of the USM to apply to private company shares. If this is not possible, we would at least appreciate the issuance of guidance that puts beyond doubt that electronic records of share certificates are possible and that transfers can be effected provided that the formalities required for stamp duty are complied with. We believe there is a general low level of understanding about electronic records and this could provide a timely opportunity to clarify the issue. 5. DLT – We suggest that the USM systems be implemented having regard to the possibility that distributed ledger technology ("DLT") could be used by share registrars or other participants. DLT is already being explored by HKEX and we believe that there are significant opportunities for market soundness and efficiencies. DLT could be used for a variety of purposes, including to facilitate back-end processes, corporate actions and voting. However, this requires the relevant implementing legislation and guidelines to be sufficiently flexible and principles-based. We would be pleased to discuss this separately if helpful.
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		<p>6. “USM” – Finally, we note that the term “USM” is also used in Hong Kong widely to refer to the Hong Kong Government’s Uniform Screening Mechanism for protection for torture and persecution victims seeking non-refoulement protection. We suggest that adopting a different term (eg “Digital Securities Market” or “DSM”) could be useful to avoid confusion and to ensure that persons seeking information about their rights are able to locate this swiftly. The second benefit is that an alternate title could provide a more plain language and positive description to the average person about the system – for example, a “digital” system, rather than an “uncertificated” one.</p>
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Next steps

Thank you for the opportunity to provide feedback on the Consultation Paper. HKAB would be delighted to discuss any aspect of our comments or to provide feedback on any further proposals.

Supplementary information

From: The Hong Kong Association of Banks

Received date: 20 Aug 2019

Thank you for your email of 24 July 2019. Please find some supplementary information in relation to the two responses on Question 12 of our submission as below for your perusal.

The period for IPO application is usually short, normally within a few days therefore retail investors may not be able to open "new" USI accounts before applying for IPO subscription.

In addition, USI account holders may want to change the bundled settlement bank account after registration to enjoy the best rate or services from another bank.