

26 April 2019

Supervision of Markets Division
Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs

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

We refer to the above Consultation Paper issued by the Securities and Futures Commission (SFC), Hong Kong Exchanges and Clearing Limited (HKEx) and the Federation of Share Registrars (Federation) on 28 January 2019.

We support the implementation of a scripless securities market in Hong Kong to help enhance the overall efficiency and competitiveness of Hong Kong in the securities arena. We believe that this is an important step in maintaining Hong Kong's status as a leading financial centre. As a matter of principle, we consider 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 and protection.

In line with the above principles, we would like to highlight the following issues, which are of special concern to our bank:

1. The Consultation Paper is proposing a dual system for moving towards a scripless securities market in Hong Kong rather than a model for a fully scripless market. This should be clearly communicated within the Consultation Conclusions to investors and market participants to avoid any misconception that the entire market will become scripless from Day 1 of implementing the model.
2. We submit that the Government should commit to a target time table as to when Hong Kong will move completely from the current largely paper-based system to a mandatory scripless one. While we understand that a phased implementation

approach is being contemplated by the Government, we urge that the transition period should be as short as practicable, with clear milestones as to when it will expire to allow full dematerialization.

3. We suggest that the dematerialisation process should be kept simple and the costs to the community should be minimized as much as practicable in order to achieve a shorter transition period and also efficiency to the market.
4. Given the fact that there are two operating models during the transition period, to avoid market confusion, we would suggest cash entitlements payable in respect of securities held in an institutional investor's USS account to be paid to its sponsoring CP rather than to the institutional investor direct. Otherwise, it may be difficult for a USS account holder to distinguish when to contact the sponsoring CP and when to contact the share register should there be any issues regarding its cash entitlements.
5. To avoid different interpretations of the meaning of "Institutional Investor", we would suggest SFC to define it clearly. In particular, SFC may need to address the question whether collective investment schemes can open USS account given the fact that they are not legal entities.
6. Constant market communication remains another important topic in the meantime.

Our detailed comments on the specific issues raised in the Consultation Paper are set out in the enclosed Annex. We hope that the SFC, HKEx and the Federation will find the comments useful in finalising details of the operational model for implementing a scripless securities market in Hong Kong.

Yours faithfully,

For and on behalf of
Bank of China (Hong Kong) Limited

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Annex

Response to the Joint Consultation Paper on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong published by the Securities and Futures Commission, Hong Kong Exchanges and Clearing Limited and the Federation of Share Registrars Limited (Consultation Paper)

No.	Consultation Question	Response
1.	Do you agree that the Revised Model presents a better option for taking forward the USM initiative? If no, please provide details.	Yes, we agree.
2.	Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.	To help the CPs to decide if they would support USS accounts, clarity and more information are required in a number of areas, including but not limited to: 1. Responsibilities, legal obligations, liabilities etc. of a sponsoring CP. 2. Clarity or details on type of documents to be collected from client for opening USS accounts. 3. More guidelines on USS account holder KYC requirements. 4. Ongoing monitoring, reporting & other requirements of a sponsoring SP. 5. Proposed corporate action flows especially cash related events(???) have to be reviewed. 6. Connectivity between HKEX and share registrars' systems and the response time among such systems may affect the timing of 'change of ownership' is to take place, especially when cash consideration is not linked. 7. BCP for the 'end to end' linkage between HKEX system and registrar system.
3.	Do you have any concerns or comments about the	Further details about the following would be useful to the market:

No.	Consultation Question	Response
	key features of the USS account? If yes, please provide details.	<ol style="list-style-type: none"> 1. A clear definition of ‘Institutional Investor’. 2. USS account to be opened strictly in client's legal entity name? 3. Will collective investment schemes or funds be acceptable to open USS account given the fact that they technically are not ‘legal entities’? 4. How accounts can be opened? Will the procedures be the same as those of current SSA? 5. What information is to be ‘shared’ with registrar? 6. If KYC documents need to be submitted to HKEX, what documents will be required from client under different client categories – corporates, funds, private trusts, sovereign entities, etc? 7. Mode of communication will need to be clear to the public if information or documents will be shared with registrar. 8. Data security and confidentiality is also a concern of the market.
4.	Do you have any concerns or comments about the key features of the USI account? If yes, please provide the details.	No.
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, including institutional and retail investors? If yes, please provide details.	The definition of “institutional investor” may have impact on the USS and USI accounts classification.
6.	Do you agree with our expectation that institutional investors that open a USS account are unlikely to	Yes, we agree.

No.	Consultation Question	Response
	open or need to open a USI account as well? If no, please provide details.	
7.	Do you anticipate any difficulties or limitations in opening and managing USS accounts for retail investors? If yes, please provide details.	<p>Yes, we anticipate the following difficulties in opening and managing USS accounts for retail investors:</p> <ol style="list-style-type: none"> 1. Operationally it will be challenging to service retail customer under USS model. 2. Liability that comes with sponsoring retail customers. 3. For some custodians, the retail business is managed by another business unit and generally comfortable with the HKSCC-NOM structure. We cannot see any driver for custodians to manage USS accounts for retail investors.
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>Yes, we have the following concerns if cash entitlements payable in respect of securities held in an institutional investor's USS account have to be paid to the institutional investor direct, rather than to its sponsoring CP:</p> <ol style="list-style-type: none"> 1. While the sponsoring CP may not have information about whether their USS account clients received the cash entitlements in the correct amount, USS account clients will contact the sponsoring CP rather than the share registrar for follow up in case of non-receipt of cash entitlements or discrepancies of the amount received. Even if the share registrar is able to disclose the information to the sponsoring CP, the sponsoring CP can neither monitor the progress nor do anything for USS account clients, in particular if the cash account is not maintained by the sponsoring SP. 2. This creates confusion to USS investors because the IPO payments are paid via sponsoring CP, likewise for the IPO refund.

No.	Consultation Question	Response
9.	Do you have any concerns or comments about our proposals to require registered securities holders to provide a unique identification number to the issuer? If yes, please provide details.	No.
10.	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.	Yes, firstly, we would like to understand what is the methodology used for consolidation. Secondly, this will result in the handling of decimal entitlements across custodians and may lead to inefficient end-to-end processes, including regulatory restrictions in this regard in certain jurisdictions (eg. Japan).
11.	Do you have any concerns or comments about the proposals for establishing a Common Platform across all share registrars? If Yes, please provide details.	We would like to seek more information on the expected interface, and what will be the impact on the change of title if the system is down. It goes without saying that the stability of HKEX and Registrar systems is critical for transfer of title and settlement process.
12.	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.	No
13.	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.	No

No.	Consultation Question	Response
14.	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.	We would like to understand if this will be batch processing or real time. The proposed process may impact turn-around trades. Buyer, in addition to seller, will also be responsible for buy-in in case buyer has insufficient fund to settle the trade. HKEX may need to consider allowing buy-in exemption for payment failure.
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.	We suggest that securities borrowing and lending transactions that involve USS/USI should be taken into consideration.
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.	Custodians have no knowledge about whether clients' SI are on market or off market trades. How HKEX and the Registrar are to determine or restrict market SI need to be clarified as well.
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.	No
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.	We are of the view that this process should be the same as the current process for HKSCC NOM. Otherwise, it will create confusion to USS investors, and the reconciliation and processing at Custodian's end will be challenging and thus frustrating USS investors. Please also refer to our comments on Question 8 for the details. We would suggest HKEX to formulate an ad hoc process to deal with interim transfer of title to Sponsoring CP while the

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		securities are transferred by the Registrar to CP for further distribution to USS clients. We also suggest that market deadline for all CA events, especially voluntary events, to be unified for USS and HKSCC-Nom.
19.	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.	No.
20.	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.	No, but would like to understand more about how HKEX supports DR programmes.
21.	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.	No, but would like to understand more how each product works under the USM initiative, in particular, the process flow of transferring registers for dual-listed companies.
22.	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.	Yes, we agree. However, we would expect the timeline for moving to full dematerialization will not be too long. Otherwise, investors may be confused by two different operating models in market. To manage different models will also be challenging for all market participants and the costs will be high. As such, we suggest the USM working group to get in-principal agreement from listed companies from other countries, before starting for HK. More importantly, please check with other jurisdictions if their law will allow USM implementation and whether it is mandatory for all companies.

No.	Consultation Question	Response
23.	Do you have any concerns or comments about our proposals for requiring paperless IPOs only ? If yes, please provide details.	No.
24.	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.	We would like to understand more about the handling of cross listed securities and how cross listed securities will be processed, what will happen to unclaimed physical certificates and how delisted shares in uncertificated form will be addressed under this arrangement. The costs and charges involved for keeping the delisted shares in HKEX system may also be the investors' concerns.
25.	Do you have any concerns or comments about our proposal for dematerializing securities that are held in the new HKEX system? If yes, please provide details.	No. We however would expect the overall charges under the dematerialized environment to be lower than when in physical form.
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.	No.
27.	Do you have any concerns or comments about our proposals for encouraging issuers and registered securities holder to communicate electronically rather than in paper form? It yes, please provide details.	No.