

SLAUGHTER AND MAY

SUBMISSION BY SLAUGHTER AND MAY REGARDING
THE JOINT CONSULTATION PAPER ON A REVISED OPERATIONAL MODEL FOR IMPLEMENTING
AN UNCERTIFICATED SECURITIES MARKET IN HONG KONG

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We refer to the Joint Consultation Paper on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong (the **Consultation Paper**) jointly issued by the Securities and Futures Commission ("**SFC**"), Hong Kong Exchanges and Clearing Limited (**HKEX**) and the Federation of Share Registrars Limited (**FSR**), which seeks market feedback on the proposals discussed in the Consultation Paper and on related matters that might impact the proposals.

The comments of Slaughter and May on certain of the questions raised and on matters related to the proposals are set out below for the consideration of the SFC, HKEX and FSR. Unless otherwise specified, defined terms have the meaning given to them in the Consultation Paper.

1. The Revised Model

Question 2: Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.

- 1.1 We support the concept of moving towards a paperless model on the basis it will: (a) accommodate a fully electronic process for the issue and transfer of securities resulting in a more efficient securities market in Hong Kong; (b) encourage more investors to hold securities registered in their own name, which should enhance listed companies' corporate governance and shareholder engagement and offer investors more direct control and legal ownership of their securities; and (c) benefit the environment.
- 1.2 Market participants should be consulted on the cost implications of the new model (including who bears what costs). In particular, as the pool of ASRs will likely be limited in light of the high barrier of entry, the market should understand how ASR fees will be set or controlled. We understand more details on cost proposals will be released in due course.
- 1.3 It will be important to give sufficient assistance and information to help retail investors understand their options under the new model – please see our suggestions at paragraphs 3.3 and 3.4 below.
- 1.4 Whether the new regime will in practice encourage more investors to hold securities in their own name will depend on a number of factors, including: (a) the cost of holding securities in USS/USI accounts relative to holding via HKSCC-NOMS in the HKEX System; (b) the ease and speed for USS/USI holders to transfer legal title to HKSCC-NOMS (as this would be a required step before securities can be traded on the SEHK); and (c) how user-friendly investors find the Share Register System / Common Platform. We would welcome more information on these aspects from the SFC, HKEX and FSR, as well as on the more specific comments raised in paragraph 1.5 below.

Question 4: Do you have any concerns or comments about the key features of the USI account? If yes, please provide details.

- 1.5 As mentioned, we believe the cost, speed and ease of transferring from a USI investor to HKSCC-NOMS will be critical to the success of the new USI account. More specifically:
 - (A) we would like to understand if the relevant CP would be required to conduct fresh KYC on the USI investor or whether it can rely on the KYC previously conducted by the ASR. We believe the former would be a significant disincentive for investors to adopt USI accounts as it would greatly increase the time and effort required to transfer USI securities into the clearing and settlement environment for trading on the HKEX; and
 - (B) we note the transfer from a USI investor to HKSCC-NOMS will require the investor to pass on transfer instructions to both a CP and an ASR (whilst a USS

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investor would only have to liaise with its CP) - could this be configured such that a USI investor would only have to input the required transfer instructions once for the information to pass to both the CP and ASR?

2. Key processes under the revised model

Question 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.

2.1 See our comments at paragraph 1.5 above.

3. Scope and phased approach to full dematerialization

Question 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.

3.1 We would like more information on how rights issues will be included within the USM initiative. For example, will it allow provisional allotment letters to be issued and split electronically?

Question 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.

3.2 We agree with the general approach. However, listed issuers should be consulted on the timing of dematerialisation so they have sufficient time to review and amend their constitutional documents and other documentation (such as share option schemes and convertible securities) the terms of which may currently require the issue of paper certificates.

3.3 In addition to written explanatory materials, a dedicated hotline should be set up to take calls from investors if they need further explanation of the dematerialisation and their options.

3.4 The Consultation Paper states the option to hold securities in paper form will be available for a limited time only and ultimately there will be a "final" deadline by which they must be dematerialised. This may lead some investors to think their certificated securities will be invalid if they do not dematerialise before the deadline. Although investors can be encouraged to dematerialise by a certain time, it should be made clear that any certificated securities will remain valid and the ownership of shares by the relevant shareholder will not be affected, and will be reflected in the new electronic ROM even after the "deadline" (albeit that any such securities cannot be transferred until they are dematerialised).

3.5 We would like to understand whether there will be a period of time when an investor whose securities are being dematerialised would be unable to trade and how long that period is expected to be (e.g. between the time an investor submits its share certificates for cancellation and the holdings being recorded in the ROM).

3.6 We would also like to clarify how the regulators are proposing to deal with issuers and listing applicants incorporated in jurisdictions that still require share certificates.

Question 23: Do you have any concerns or comments about our proposals for requiring paperless IPOs only? If yes, please provide details.

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- 3.7 We welcome the ability to shorten the settlement time after IPO price determination to bring HK IPOs more in line with other major international markets, as the current settlement period of around 7 days is partly due to the need to print and post share certificates. Paperless IPOs will be further enhanced if payments under the retail tranche can only be made electronically so that we may further cut down the time required to clear cheques.
- 3.8 Furthermore, the proposals contemplate IPO shares being issued in uncertificated form, but do not appear to address the issue of hard copy IPO prospectuses (which require a vast amount of paper). Although existing rules permit the use of mixed media offers (**MMOs**) which are intended to cut down on hard copy prospectuses, MMOs do not appear to be heavily used. This could be due to the perceived risks associated with an MMO, as it requires issuers to satisfy certain conditions imposed under the Companies (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (the **MMO Conditions**).
- 3.9 We suggest the HKEX and SFC consult market participants on how listing applicants and their sponsors can be encouraged to adopt MMOs and evaluate whether the MMO Conditions should be amended.

4. Other related matters

- 4.1 The Consultation Paper proposes issuers will be required to send electronic confirmations to USS and USI investors to whom uncertificated securities have been successfully allotted or transferred. We would propose this confirmation should be issued directly by the ASR on behalf of, rather than, the issuer as it is the ASR who updates the ROM.
- 4.2 We would appreciate confirmation that the USM model is not expected to impact on issuers with principal and branch share registers and the movement of securities between these registers.

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