

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

The following response to the Joint Consultation on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong (the “Consultation Paper”) is submitted on behalf of Anglo Chinese Corporate Finance Limited and Asian Capital Limited (the “Group”). Capitalised terms not otherwise defined have the same meanings as in the Consultation Paper.

Q1. Do you agree that the Revised Model presents a better option for taking forward the USM initiative? If no, please provide details.

No. While the Group fully supports the move to a completely paperless, that is a fully dematerialised, securities market, it is extremely disappointed in the approach adopted by the Revised Model which it regards as regressive in stepping back from the 2010 proposals to remove HKSCC’s nominee role and allow investors to hold legal title to uncertificated securities through CCASS. Instead, HKSCC will remain as nominee and legal title holder of all securities held in CCASS by CCASS Participants. Individual shareholders will only be able to hold legal title to their shares either:

- (i) where they hold paper shares outside CCASS, but then only: (a) for a limited period until paper shares are phased out; and (b) if the particular issuer has not elected to issue new shares only in uncertificated form (on IPO or post-listing);¹ or
- (ii) where they hold shares through a USI account with the share registrar outside the HKEx System. In this case, inconvenience will arise for investors wanting to sell shares through HKEx, since the shares must first be transferred into CCASS. The 2010 Model was preferable to the Revised Model in this respect since it would have allowed all investors to hold and transfer legal title to electronic securities through CCASS.

Institutional shareholders under the Revised Model will be allowed to be registered as legal owners of shares in USS accounts opened with sponsoring CPs within the HKEx System. However, the convenience of allowing the transfer of legal title to securities within CCASS as proposed by the 2010 Model, has now been removed. Transfers of uncertificated securities between USI and USS account holders will instead involve both the HKEx System and the Share Registrar System. The Revised Model is highly complicated entailing three different models for transfers of uncertificated securities (between two USI holders, between two USS holders and between a USI and USS holder) and a further model for holders of certificated securities to sell via HKEx.

The Group’s primary criticism of the Revised Model is that it fails to adequately deliver the “fundamental objective of the USM initiative, which is to give investors the option to hold securities in their own name *and* without paper documents”.² Instead, legal title to uncertificated securities held through CCASS will continue to be held by HKSCC-NOMS, as currently. The

¹ See paragraph 20(a) of the Consultation Paper.

² As described at paragraph 30 of the Consultation Paper.

SFC's 2002 Consultation³ counted the benefits of a registered shareholding (i.e. a shareholding registered in the issuer's register of shareholders) as including "*holding the safest form of legal title*" and "*the highest level of protection from broker insolvency*". That this possibility has been removed from the latest proposals is thus profoundly disappointing.

The Group is also concerned that the proposed reforms will do nothing to improve transparency in the ownership of listed shares and the true identity of listed company shareholders. The Revised Model would implement a regime which is far more complicated than equivalent regimes in other international markets, for example Singapore, which has allowed scripless trading since 1987, Australia and the UK. That the retention of the nominee model, and the discarding of the 2010 proposal to allow legal title to securities to be held within CCASS, should necessitate such a complex and antiquated system must surely support the original 2010 proposals. Alternatively, a solution to the problems caused by the nominee model must be sought. In Singapore, for example, while listed shares are registered in the name of the Central Depository Pte. Limited ("CDP"), the problems faced in Hong Kong with regard to shareholders being unable to attend and vote at shareholders meetings in their own name were dealt with by amendments to the Singaporean Companies Act which, despite the registration of listed securities in the name of CDP, deem the depositors in the CDP's register to have all the rights as if they were shareholders of the issuer and issuers are obliged to treat them accordingly.⁴ Further, the maintenance of a single register of shareholders with the CDP has the advantage of enabling shareholder information to be accessed at a single location.

If Hong Kong is to retain its status as a leading international securities market, the Group considers it essential that it modernises to implement an USM which facilitates the holding of legal title to paperless securities. In the 18 years since an USM for Hong Kong was first discussed, paperless trading has been implemented in the world's leading securities markets: paperless markets now operate in London, New York, Shanghai and Shenzhen as well as in many Asian markets, including Singapore, the Philippines and India. A dematerialised market, rather than an immobilised market, was identified as the preferred option for securities markets by the G30 as long ago as 2003.⁵

The Group acknowledges that implementing a regime allowing legal title to uncertificated securities within CCASS may necessitate changes to Hong Kong's trading infrastructure. However, a fully dematerialised regime which facilitates the registration of uncertificated securities in the names of their holders cannot be put off indefinitely. Given the global trend towards dematerialisation, and the inevitability of ultimately having to allow legal title to uncertificated securities, the Group considers that Hong Kong must now take the further steps to dematerialise the market to improve efficiency, enhance transparency and investor protection and ensure that Hong Kong is not seen to be reluctant to modernise. Even from a cost perspective, the cumulative cost of piecemeal reforms may in the long-run exceed a one-off shift to a fully dematerialised market.

³ SFC. "*Consultation Paper on Proposals for a Scripless Securities Market*". February, 2002.

⁴ Paragraph 4.1 of the SFC's "*Consultation Paper on Proposals for a Scripless Securities Market*". February 2002.

⁵ The Group of Thirty. "*Global Clearing and Settlement – A plan of action*". 2003.

Q2. Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.

Yes, the Group has a number of concerns in addition to those outlined in its response to Question 1 above. These include the following:

1. Failure to simplify current regime

As described in the 2009 Consultation Paper, as a result of shareholders holding only a beneficial interest in their shares, the arrangements for voting at shareholders' meetings, and for listed companies to communicate with shareholders, are extremely complicated. The Revised Model will perpetuate this problem for all shares which continue to be held within CCASS. While the Revised Model will allow investors to have shares registered in their own name through USI and USS accounts, as noted above, the proposed model is considerably less efficient than that proposed in 2010, which would have allowed legal title to shares to be held and transferred through CCASS, avoiding the need under the Revised Model for shares held outside the HKEx System in USI accounts to be transferred first into CCASS.

2. Need to address shareholder recognition to facilitate exercise of voting rights in hostile circumstances

Both the current and previous consultation papers fail to address the key issue of recognising shareholders for the purpose of requisitioning meetings under the articles of association of listed companies. Currently, CCASS will not take instructions to requisition meetings, which results in shareholders having to reregister their shares in their own names, which is unnecessarily and inordinately expensive and time consuming. The same is true where shareholders wish to nominate a person for appointment as a director or petition for a winding-up of the listed company. Shareholders' ability to exercise their voting rights and attend meetings in contested or hostile circumstances must be addressed as a matter of urgency. It is fundamental that all shareholders, whether they hold certificated shares in their own name, or uncertificated shares through CCASS, an USI or USS account, should have the same legal rights as shareholders. The current situation where CCASS will not requisition meetings when instructed to do so must be rectified.

Whichever model is ultimately adopted, there needs to be a commitment to making the electronic transfer of shares from a CCASS CP account to an USS or USI account, as speedy and cheap as possible, so that shares can be voted directly and holders can participate fully in a meeting of shareholders. A criticism of the current proposals, is that while they deal with the movement of paper shares into the HKEx system for sale, they do not contemplate any improvement to the movement of shares in the opposite direction – from uncertificated shares held in CCASS to paper shares held in investors' own names. As highlighted above, this process is unnecessarily expensive and slow.

3. Lack of justification for not moving to dematerialisation

The Group is particularly concerned that despite pointing to “market concerns” as the justification for abandoning the 2010 Model after making legislative changes to facilitate it, those market concerns are neither attributed nor adequately explained in the Consultation Paper. The 2010 Model’s proposals for legal title to be held and transferred within CCASS seem to be the most efficient method of implementing a fully dematerialised securities market without immobilisation. If that model is not to be pursued, and the legislative changes implemented to facilitate it are now to be reversed, the Group would recommend that full details are given of the “market concerns” referred to in the Consultation Paper, and that alternative means of countering those concerns should be fully explored before the 2010 Model is dropped.

The Group is also concerned that the unnecessarily complex Revised Model and the increased number of parties involved might increase inefficiencies and costs. Keeping investors’ costs (i.e. the fees and charges for opening accounts and transferring shares) as low as possible must be a priority. In particular, the cost of holding shares registered in investors’ own names must not be greater than the cost of holding shares through CCASS to avoid investors being discouraged from opening accounts enabling shares to be registered in their own names.

4. Concerns relating to share registrars’ enhanced role

The Revised Model proposes that non-institutional investors should hold their uncertificated shares through an USI account operated by a share registrar. Share registrars will assume a much greater role under the Revised Model with responsibility for effecting transfers of uncertificated listed shares and evidencing legal title to them. Issuers’ share registrars, rather than HKSCC, will thus play a major role in the Hong Kong securities market.

The Consultation Paper envisages the introduction of more stringent regulation of share registrars. The need to draft new subsidiary legislation and amend the SFC’s existing Codes and Guidelines and the Stock Exchange’s Listing Rules, and to consult on the new legislative proposals and regulatory changes, will mean that the USM regime will not be ready for implementation until early 2022. Given the amount of work involved, the Group would question whether the Revised Model would satisfy a cost-benefit analysis, and whether it would be more economical and advantageous generally to proceed immediately to full dematerialisation but through CCASS rather than share registrars. Without share registrar involvement, there would be no need for an enhanced share registrar supervision regime, which would save the time that implementing the necessary legislative and regulatory changes would take.

Moreover, the Group has concerns regarding the potential risks involved in making share registrars solely responsible for the transfer and proof of title to uncertificated shares. There is surely an argument that the potential risks involved (e.g. of fraud, negligence etc.) outweigh the concerns the Revised Model seeks to rectify (e.g. the cost of the infrastructure and system upgrades).

5. Restrictions on investor choice

The options open to investors under the Revised Model are far more limited than under the 2010 Model. As noted in the Consultation Paper, the 2010 Model contemplated giving investors multiple options for holding securities in their own name both within and (for a limited period) outside CCASS.

6. Failure to improve provision of corporate information to shareholders

A key objective of a scripless market noted in the SFC's 2002 consultation⁶ was to facilitate more efficient communications between issuers and their members and improvements in corporate action processing including through the use of electronic means and optional short form communications.

The Group considers it vital that the revised regime ensures that all documentation intended for shareholders, particularly in relation to contentious takeover offers (shareholders' circulars etc.) should be made available promptly and in full to listed company shareholders. This could presumably be easily achieved through electronic messaging providing links to relevant documents. The 2002 consultation highlighted that CCASS Participants "*may or may not notify clients [i.e. the ultimate beneficial owners of shares] of corporate communications or solicit clients' voting instructions; it depends on the relationship they have.*"⁷ If this remains true today, it is clearly a major defect of the current system which could be addressed by allowing shareholders to be registered directly as legal title holders through CCASS and allowing direct electronic communications between issuers and their shareholders.

7. Need for further detail on facilitating pledging of paperless shares

The Consultation Paper proposes a "locking arrangement" whereby share registrars will lock pledged uncertificated shares and administer them according to terms agreed between the pledgor, pledgee and the share registrar as to the treatment of dividends and other entitlements and the exercise of voting rights.⁸

The Group would suggest that key standard terms be mandated for inclusion in such agreements providing, for example, for the benefits of ownership of pledged shares to accrue to the pledgor for the duration of the pledge.

8. Limited roll out of new proposals

While the Group does not agree with the revised approach adopted in the latest consultation, if this approach is to be adopted, it would echo the concerns expressed by the

⁶ At page 4 of the SFC's "*Consultation Paper on Proposals for a Scripless Securities Market*". February 2002.

⁷ At paragraph 23 of the SFC's 2002 Consultation Paper.

⁸ At paragraph 99(f) of the Consultation Paper.

FSDC in their response to the 2019 Consultation Paper in relation to the very limited effect the reforms will have if dematerialisation is applied initially only to the minority of IPO issuers that are incorporated in Hong Kong. Given the time it has taken for any progress to be made in relation to dematerialisation, and as noted above, the very limited nature of the proposals which do not facilitate shareholders' legal title to paperless securities held through CCASS, the further restriction to IPOs of Hong Kong issuers gives the impression of a rather unambitious reform proposal, and a missed opportunity to address some of the problems caused by the current nominee model.

9. Amendments relating to the appointment of multiple proxies

The Group would welcome clarification as to the nature of the statutory amendments proposed to limit to two the number of proxies a shareholder is entitled to appoint.

Section 596(3) of the Companies Ordinance currently allows a shareholder to appoint separate proxies to represent different chunks of his shareholding as specified in each proxy's instrument of appointment. There is currently no limit on the number of proxies a shareholder may appoint and each such proxy is entitled to attend, speak and vote at general meetings with respect to the number of shares for which he has been appointed proxy.

The old Companies Ordinance (section 114D(2)) provided:

“The right of a member of a company having a share capital to appoint a proxy shall include the right to appoint separate proxies to represent respectively such number of the shares held by him as may be specified in their instruments of appointment; but (without prejudice to the appointment of alternates) the number of proxies so appointed by any person to attend on the same occasion shall not, unless the articles otherwise provide, exceed 2.”

It thus entitled shareholders to split their shareholding into two and appoint two proxies, one for each chunk of their shareholding, and gave both proxies the right to attend, vote and speak at the general meeting. The limit was removed in 2014 because it was considered to be unnecessarily restrictive⁹; as the current Consultation Paper notes, the objective behind its removal was to “enable investors who hold shares through nominees to participate in the affairs of the company by being able to attend company meetings, and to speak and vote on resolutions considered at such meetings”.¹⁰

The Group acknowledges the type of abuse noted in the Consultation Paper (e.g. registered shareholders appointing a proxy for each of their shares to cause disruption at shareholders' meetings). However to prevent shareholders from appointing separate proxies for different chunks of their shareholdings would seem to be an excessive response when there must surely be other means of countering it. For example, a higher limit on the number of

⁹ Hong Kong Companies Registry. “New Companies Ordinance Briefing Notes on Part 12: Company Administration and Procedure”. April 2013. Paragraph 21(f).

¹⁰ “Joint Consultation Paper on A Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong”. January 2019. Paragraph 127(e).

proxies could be imposed, or perhaps more fairly, the number of proxies capable of being appointed could be made proportional to the size of the shareholding.

Greater clarification is needed as to how the proposed limit will work in practice. For example, how would it apply to a shareholder who holds shares in the same company both in certificated form outside CCASS, in uncertificated form through CCASS, and/or in uncertificated form through an USI or USS account? If the shareholder is unable to attend a general meeting, is he then restricted to just two proxies for his entire shareholding – both shares in and outside CCASS and both certificated and uncertificated? Or would a shareholder be allowed to attend and vote his certificated shares but appoint two proxies for his uncertificated shares?

10. Amendments to the deadline for submitting proxy materials

The Group disagrees with the proposed change in the deadline from 48 hours before the meeting to one clear business day before the meeting day. A deadline expressed in hours before the meeting makes it clear at what time the deadline expires. The “clear business day” deadline, on the other hand, would allow the submission of proxy documents up to midnight on the day which is 2 days before the date of the meeting (i.e. assuming that midnight is what is meant by the “end of” Monday as referred to in footnote 56 to the Consultation Paper), at which time office staff will not be available to deal with them.

11. Possibility of trading suspended shares outside HKEx

The Group would like to ask whether it would be possible under the revised regime to trade suspended shares outside the Hong Kong Stock Exchange.

Q3. Do you have any concerns or comments about the key features of the USS account? If yes, please provide details.

Yes, please see the points made above regarding the excessively complex arrangements for transferring shares from an USS account for sale, which would be avoided if the 2010 Model were adopted allowing legal title to paperless shares to be held and transferred within CCASS. The issue of cost is especially important and some assurance should be given that there will be no substantial increase in the fees and charges payable for transferring shares into and out of USS accounts.

Q4. Do you have any concerns or comments about the key features of the USI account? If yes, please provide details.

Yes. The Group would raise the same issue in relation to fees and charges as mentioned in the response to question 3 above. USI accounts will exist outside the HKEx system, thus necessitating a complex series of instructions and transfers where shares are to be transferred from an USI to an USS account or where shares are to be sold on HKEx. In addition, the Revised Model provides a lesser degree of protection to investors than the 2010 Model. As noted in the Consultation Paper, “As the IPA and ISA under the 2010 Model were to be controlled and managed by the investor

directly, they would have provided the greatest degree of control and protection. As between the CPA and the PSA, the latter would have provided more protection since it would have been a segregated account and securities in them would have been registered in the name of the investor”.¹¹

Q5. 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.

Yes. Given the extent of retail participation in the Hong Kong market, the Group considers that retail investors should have the same rights as institutional investors to open either USS or USI accounts. All investors should also have the freedom to have both types of account, and to hold certain shares in a USS account and others in a USI account.

Q6. 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.

This may well be the case. Nevertheless, in order to give investors the broadest choice possible, we consider that all investors should be able to choose the type of accounts in which they hold their investments.

Q7. Do you anticipate any difficulties or limitations in opening and managing USS accounts for retail investors? If yes, please provide details.

No.

Q8. 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 clearing or custodian participant? If yes, please provide details.

No.

Q9. 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.

No.

Q10. 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.

No.

¹¹ Footnote 25 to the Consultation Paper.

Q11. Do you have any concerns or comments about the proposals for establishing a Common Platform¹² across all share registrars? If yes, please provide details.

No. The Group considers that this would be extremely beneficial and should be implemented at the earliest opportunity if the decision is made to proceed with the Revised Model.

Q12. Do you have any concerns or comments about the proposed process flows for initial public offering ("IPO") applications in respect of securities that are to be credited to a USI account? If yes, please provide details.

No.

Q13. 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.

Q14. 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.

The Group is concerned to ensure that investors do not face any increase in fees and charges by virtue of the implementation of the Revised Model. Greater clarification as to the likely charges under the Revised Model as compared to the current model and the 2010 Model would be extremely useful.

Q15. 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.

Yes. Again, the Group's primary concern relates to ensuring that the Revised Model is more efficient and cheaper than the existing model. The main advantages of technology in transferring electronic securities should be in terms of speed and cost. These cost savings must be passed on to investors.

Q16. 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.

No.

Q17. 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.

Yes. Please see the Group's response to Question 2 above and its comment that shareholders holding uncertificated shares must be able to exercise their rights to requisition shareholders'

meetings, nominate persons for appointment as directors and petition for a company's winding-up. Holders of uncertificated securities in CCASS do not currently have the rights to exercise all their rights as shareholders and this must be rectified in order to ensure proper investor protection. The 2010 Model would have facilitated this, which is one of a number of reasons why the Group considers that to be a better model than the Revised Model the subject of the current consultation.

Q18. 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.

Yes, the proposals are unnecessarily complex and as discussed in the previous response, do not give holders of uncertificated shares the right to exercise all shareholders' rights which is clearly unacceptable.

Q19. 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.

Q20. 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.

Q21. 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.

Q22. 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.

No. As discussed in the responses to Questions 1 and 2, the Group views the ability to hold and transfer legal title to uncertificated shares through CCASS (or an alternative clearing system) to be fundamental and would stress the importance of seeking to achieve this, notwithstanding the possible costs involved in upgrading systems, provided that these are not passed on to shareholders. Dematerialisation of the Hong Kong market has been under discussion since 2001. As highlighted above, market immobilisation should be a step towards dematerialisation and not a goal in its own right. If Hong Kong is to be seen as a modern international market, it should seek to implement best international practices and ensure it does not lag its competitor markets. Allowing legal title to uncertificated shares must be inevitable given the global trend in that direction and the greater protection it offers shareholders. The Group considers therefore that further delay in dematerialising the market would be to the detriment of the Hong Kong securities market, both in terms of failing to improve efficiency and transparency, as well as from an environmentally-friendly perspective. The greatest danger of further delay, however, is likely to

be the perceptual danger that Hong Kong is seen as a market which is unwilling to modernise to provide the best protection for investors, which could damage how the Hong Kong market is perceived internationally. Moreover, it is potentially damaging to the market if the SFC and HKEx now choose to reject the proposals made in 2010, after they had been consulted on and legislation had been implemented to effect them.

Q23. Do you have any concerns or comments about our proposals for requiring paperless IPOs only? If yes, please provide details.

No. The Group welcomes this initiative and is keen to see its early adoption.

Q24. 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.

No, subject to a satisfactory solution being found to allowing shareholders to exercise the full rights of legal owners of uncertificated shares.

Q25. 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.

No.

Q26. Do you have any concerns or comments about our proposal to cease the parallel trading arrangement for securities held within the new HKEX System that have already been dematerialized? If yes, please provide details.

No.

Q27. 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.

No. The Group's view is that these proposals will be welcomed by investors and issuers, alike. From investors' point of view, the use of electronic communications in sending links to issuers' documents, should increase the likelihood of shareholders receiving important issuer documentation and communications which must be a positive development.