



**By email (usmconsult@sfc.hk) and by hand**

3 May 2019

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

Dear Sirs,

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

The Hong Kong Institute of Certified Public Accountants welcomes the opportunity to comment on the Joint Consultation Paper ("JCP") on a Revised Operational Model for Implementing an Uncertificated Securities Market ("USM") in Hong Kong.

We agree with the direction of travel and that to maintain its standing as an international capital market, Hong Kong must move to a scripless system. Given that the proposal was first put forward over 10 years, it is overdue. However, it will be important how various issues are addressed, including the way in which the transition to full "dematerialisation" is handled and the length of the transition, as well as the initial and ongoing costs under the new system, the integrity of the system, and whether investors will reap material benefits in terms of efficiencies and, ultimately, cost savings.

As regards the current proposals on the operational model for implementing a USM in Hong Kong, our responses to some of the specific questions are provided below.

**Q1 – Do you agree that the Revised Model presents a better option for taking forward the USM initiative?**

**Q2 – Do you have any concerns or comments about the key features of the proposed Revised Model?**

The Revised Model should retain certain flexibilities and efficiencies in the current system within the USM, which will benefit investors and address obstacles that emerged in the 2010 Model. At the same time, it gives significant new responsibilities to share registrars ("SRs") and, therefore, investors and other market participants will want to be assured of, amongst other things, the stability, integrity and security of the proposed system, including the interface between the SRs' and HKSCC's systems, and that there will be adequate oversight and supervision of the new arrangements.



**Q7 – Do you anticipate any difficulties or limitations in opening and managing USS accounts for retail investors?**

Making the option of opening a USS account available to retail investors could be one means to encourage shareholders, such as the older generation of retail investors, who may be reluctant to give up their paper certificates to convert to scripless securities. (See our response to Q22, below.) This is because, in principle, with a USS account, they would be able to retain the securities in their own name without at the same time having to worry about maintaining an e-communication channel directly with the issuer/ issuer's SR.

**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?**

We see some challenges with this proposal. It is stated that the proposal will apply only prospectively because of the practical difficulties in obtaining unique identification numbers from already registered securities holders. Under the proposal, registered securities holders will be required to provide a unique identification number when, for example, effecting transfers of securities. However, it may be open to question whether it would be seen to be reasonable to prevent existing registered securities holders from transferring their shares if, at the time of the transfer, they were unwilling to give a unique identification number to the issuer for the issuer's future retention.

Given that, under the Revised Model, it seems likely that a significant proportion of securities will continue to be registered in the name of nominees, although issuers will have a more accurate picture of their registered shareholders, they will not necessarily be better informed about the beneficial ownership of their shares.

Investors who do provide a unique identification number will need to be given adequate assurance as to the integrity and security of the issuers' and SR' systems in terms of the protection of personal data.

**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?**

We understand that institutional investors could hold multiple USS accounts through different sponsoring clearing or custodian participants. However, by not consolidating the securities entitlements of such institutional investors, this would seem to be giving preferential treatment to institutional investors over retail investors, at least to those institutional investors that hold USS accounts, where there may not be strong justification for doing so beyond, perhaps, practical considerations. This arrangement could also have the effect of discouraging institutional investors from opening USI accounts, as they would then be treated less favourably than institutional investors holding USS accounts.



**Q11 – Do you have any concerns or comments about the proposals for establishing a Common Platform across all share registrars?**

The proposed common platform should facilitate USI holders' interactions with SRs and the market and, as such, it is supported. Proper measures and safeguards to ensure system integrity and security, as mentioned in paragraph 75 of the JCP, will be of paramount importance.

**Q12 – 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?**

**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?**

We note the proposal to remove the current options of submitting IPO applications in paper form, and paying subscription monies by cheque or cashier order will make it more feasible to shorten the IPO settlement timetable. The JCP points out, at paragraph 83, that shortening the IPO timetable will also depend on the revised workflow and processes of a number of different parties. It is to be hoped, therefore, and there may well be a reasonable expectation on the part of investors, that by introducing a USM, overall processing times will be reduced. This should mean that, e.g., investors can expect faster refunds of surplus subscription monies.

**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?**

**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?**

Given the simplified processes involved in some corporate actions when they are performed electronically, in contrast to the more deliberate nature of paper-based actions, and that some decisions will result in "locking" of a shareholder's shares, there should be sufficient flexibility built into the system to safeguard against "decisions" being made inadvertently or unintentionally and, thereafter, becoming irrevocable.

We note from paragraph 98 of the JCP that, separately from the USM initiative, "the SFC is working with HKEX to explore options for alternatives that would enhance the position of investors who hold a beneficial interest only, particularly in terms of facilitating and encouraging their participation in the voting process, albeit without creating undue costs or burden for them or their intermediaries." The JCP indicates that this would also benefit investors holding only a beneficial interest in the USM environment. We believe that this is important from corporate governance point of view and note that, while it is a separate issue from introducing a USM, all these developments should be seen as part and parcel of a broader upgrading and modernisation of the system.



**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?**

We have some concern that the proposals for full dematerialisation may not have taken sufficient account of the situation of the older generation of retail investors. The JCP states, at paragraph 17(c): "A date will be specified by when securities held by investors in their own name in certificated form (i.e. *outside* the clearing and settlement environment) must be converted into uncertificated form". We anticipate that some investors, especially elderly retail investors, who have all along retained their share certificates may be resistant to "going electronic" or holding an account through a nominee. Rightly or wrongly, they may take comfort from holding a paper share certificate as evidence of their ownership. Such investors would tend be reluctant to open a USI account and convert their securities to a paperless form. They may also be concerned about having to pay custodian fees and, potentially, additional charges if all their transactions are subsequently handled via intermediaries. This is one reason why it is important to provide more details about the charges that are expected to be levied and, hopefully, to be able to demonstrate that the new system will not increase, and will actually help reduce, investors' costs in the long run.

Overseas individual investors may also find costly and time-consuming if they have to come to Hong Kong to open a USI account to convert a limited number of share certificates into paperless securities.

We note that the JCP does not mention how the share certificates will be treated after the "specified" date if they are not converted into paperless securities. In our view, it may be necessary to have a long transition period and/or to allow the limited number investors who may be particularly reluctant to convert to a scripless system to retain their old certificates or, possibly, deposit them for safekeeping with a custodian, for minimal or no charge. They should also be permitted to continue to receive printed corporate notices and dividend cheques, although efforts should continue to be made, and incentives offered, where appropriate, to persuade them to accept electronic communications or hold their securities through a nominee account. Meanwhile, new initial public offerings ("IPOs") could proceed to be become scripless, thus progressively reducing the proportion of the market using paper securities.

Therefore, in respect of share certificates that do not get converted into paperless securities, we consider that they should continue to be treated as valid and that the shareholders should retain their full shareholder rights to bonus issues, dividends, etc. Furthermore, while shareholders should be encouraged to convert, their rights should be fully protected and benefits should not, for example, be credited to them but frozen until they actually convert.

To give more assurance to shareholders used to treating share certificates as material evidence of their ownership, and give them greater confidence in the USM, it may be worthwhile to explore the possibility of enabling individual shareholders to trace/ show their ownership of securities by, e.g., providing an option of issuing them with a receipt containing a unique code or "fingerprint", after converting their shares into a paperless form.



**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?**

While, in principle, this would seem to be right direction, it may, nevertheless, be reasonable to ensure shareholder and investors can have access to printed documents, such as listing documents and annual reports, at designated, easily accessible locations. Many people balk at reading documents of several hundred pages online, even where they do not intend to read the entire document word by word.

**Other related matters**

We note that one of the key benefits of the USM initiative is to enhance greater efficiency. As such, we consider that HKEX, the SFC and the Federation of Share Registrars should continue to explore the feasibility of streamlining processes generally, including those relating to conversion of share certificates into paperless securities, opening of accounts, shortening the settlement times for share transactions and transfers, streamlining the transaction of shares on the market and issuing of new shares.

***Fees and charges***

Paragraph 100 of the JCP states: "We appreciate that there may be concerns about the fees and charges associated with having a USI account or USS account, including for the various processes mentioned above. Our aim remains to ensure that fees are reasonable, fair, transparent and commensurate with services provided in the USM environment. Further information will be provided at a later stage after the operational model is confirmed and fee models finalized."

More information about the likely fees and charges to be imposed on different parties, especially retail investors, is certainly needed. As implied above, it would not be a satisfactory outcome if system streamlining, improvements and efficiencies resulted in increased charges to investors, as a way of, for example, recovering the development costs. The concern is about both one-off charges for dematerialisation when an investor surrenders share certificates for scripless securities, and also the ongoing maintenance costs (e.g., share registrar services, system upkeep). Investors, particularly retail investors will be discouraged from opening a USI/ USS account, if the fees and charges are set too high.

***Training for market participants and investor education***

We suggest that extensive training on the operational aspects of the new system should be provided by the SFC, HKEX and the Federation of Share Registrars to different parties, such as institutional nominees, brokerage firms, custodians and issuers, to ensure that they are well prepared ahead of time. This should of course include information on IT system requirements and specifications for those that need to interface electronically with other participants in the USM. Clearly, extensive trials and testing of the system will need to be carried out before the system is formally launched, and sufficient lead time allowed for this, to ensure a smooth implementation from the start.



The regulators should provide investor education in terms of information and seminars to educate the public about the scripless system. This would need to include face-to-face events, in addition to any online material, in order to get the message out to the non-tech savvy. The opportunity could be taken during these events to promote the advantages of the USM and of investors holding e-accounts, as well as to encourage retail investors to convert their securities into a paperless form.

### ***Regulation of share registrars***

As indicated above, given the significant new responsibilities placed on SRs, proper oversight and supervision will be important factors in gaining the confidence of investors. Paragraph 8(d) of the JCP indicates that there will be a new regime for regulating SRs and, paragraph 20(d), that the SFC will oversee the new approved SR regime. Other than paragraphs 128 to 131, which set out the rationale for having the new regime and the powers of the SFC, little detail is provided at this stage. We hope that more information on these proposals will be made available to the public and that views will be sought on them.