JOINT CONSULTATION CONCLUSIONS
ON
A REVISED OPERATIONAL MODEL
FOR IMPLEMENTING AN
UNCERTIFICATED SECURITIES MARKET
IN HONG KONG

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I. INTRODUCTION

1. On 28 January 2019, the SFC, HKEX and the FSR issued a joint consultation paper on a revised operational model for implementing an uncertificated securities market in Hong Kong.

2. The Consultation Paper explained the Revised Model in detail, noted the market concerns about the 2010 Model which prompted the need for changes, and invited views on various aspects of the model.

3. We engaged with various market participants and industry bodies, both before and after the issue of the Consultation Paper, to explain and exchange views on the Revised Model. The Panel on Financial Affairs of the Legislative Council was also briefed on the Revised Model in March 2019.

4. The consultation period lasted three months, ending on 27 April 2019. We received a total of 43 submissions. Respondents included brokers, custodians, investors, issuer representatives, law firms, and various professional and industry bodies. Comments received after the deadline were also considered.

5. A list of the respondents (other than those who requested to remain anonymous) is set out in the **Appendix** and the full text of their comments (unless requested to be withheld from publication) can be accessed via the websites of the SFC (www.sfc.hk), HKEX (www.hkex.com.hk) and the FSR (www.fedsrltd.com).

6. This Conclusions Paper summarises the issues and concerns raised, our responses to them and our conclusions and proposals for taking the USM initiative forward. This paper should be read together with the Consultation Paper and the comments received. Terms used in this paper are defined in the Glossary on page 47.

7. We take this opportunity to thank everyone who took the time and effort to submit comments and suggestions. Your feedback has been crucial in helping us refine some aspects of the Revised Model. As will be seen in the discussion below, much still remains to be done in terms of developing the Revised Model further and, ultimately, implementing the USM initiative. We will continue to work with the market and seek views and input at different stages as our work progresses, with a view to implementing the USM regime from 2022.

II. EXECUTIVE SUMMARY

General

8. The January 2019 Consultation Paper was triggered by market concerns about the operational model we were pursuing previously (i.e. the 2010 Model). The most significant of these was that the 2010 Model would compromise certain settlement efficiencies currently enjoyed by market participants, and have a significant impact on their liquidity needs. Extensive discussions were held with a wide range of market participants (including banks, brokers, custodians and others) to try and address these concerns within the confines of the 2010 Model, but without success. Eventually, the decision was taken to explore revising the operational model itself.

9. The decision to consult the market on abandoning the 2010 Model and pursuing the Revised Model was not taken lightly, particularly as it would mean preserving the existing central nominee structure and result in the repeal of much of the legislation enacted in 2015 (i.e. the USMO). It was, however, the appropriate decision. The

operational model for implementing the USM initiative will have far-reaching and long-term consequences for our securities market and all its stakeholders. It is imperative therefore that the operational model adopted be the right one for Hong Kong, taking into account its unique features and characteristics.

10. The consultation exercise also provided an opportunity to revisit the fundamental purpose of the USM initiative, and reassess how best to achieve it. With the benefit of the discussions with market participants over the last few years, and feedback from this latest consultation exercise, it is now clear that the Revised Model is more suitable for Hong Kong than the 2010 Model. To explain:

(a) Giving investors a *real* option: At its core, the USM initiative seeks to provide better investor choice and protection, and to enhance the efficiency and competitiveness of our securities market. As far as investor choice and protection is concerned, the current paper-based requirements present a real impediment because they make the process for effecting legal title transfers expensive, cumbersome and time-consuming. As a result, investors are compelled to choose between better protection and shareholder rights on the one hand (i.e. by holding securities in their own names in paper form), and greater convenience on the other (i.e. by keeping their securities in CCASS but registered in the name of HKSCC-NOMS). Invariably, most of them opt for the latter. A key objective of the USM initiative, therefore, is to ensure investors have a *real* option when it comes to deciding whether to hold securities in their own names or not. *Both* the 2010 Model and the Revised Model achieve this – it is only that they do so in different ways. Specifically:

(i) The 2010 Model introduces fundamental changes in that it removes the central nominee role and makes all accounts in the HKEX System name-on-register accounts, although such accounts can be in the name of an investor or a (bank/broker) nominee. Because all accounts are within the HKEX System, transfers can be much more efficient and cost effective than today. However, the removal of the central nominee role does not mean that investors will necessarily hold securities in their own names and that shareholder transparency will consequently be improved. In fact, our study of other markets shows that even where a name-on-register structure is adopted, many investors still opt to keep their securities in the name of a nominee rather than in their own names.

(ii) In contrast, the Revised Model requires changes that are much less fundamental. Specifically, it preserves the central nominee role within the HKEX System but also: (A) introduces options for investors to hold securities in their own names without paper, i.e. the USS and USI features; and (B) incorporates an electronic linkage between the HKEX System and ASRs' systems to enable efficient and cost effective transfers into and out the HKEX System. The Revised Model thus provides an effective option for investors to hold securities in their own names.

(b) Market concerns about liquidity needs: As mentioned above, despite considerable effort, it has not been possible to address the various market concerns about the 2010 Model, including in particular concerns about the significant impact that the 2010 Model would have on market participants' liquidity needs. While it is difficult to give a precise indication of the extent of such impact, estimates suggest it could be substantial. (This is elaborated further in paragraph 44 below.) This, in turn, will invariably increase market

participants' costs of doing business and affect Hong Kong's competitiveness. Over time, it could also impede the further development of Hong Kong's markets. Such concerns about liquidity and its potential consequences do not arise under the Revised Model.

(c) Central nominee structure has its benefits: The central nominee structure has allowed our securities market to benefit from certain flexibilities and efficiencies which it would not otherwise have enjoyed. Retaining this structure also means it will be possible to build on many of the existing processes and practices. The need to develop new systems and processes, or enhance existing ones, will therefore not be as substantial as compared to the 2010 Model. The central nominee structure also provides a simple and ready option for investors who *do* wish to hold securities in the name of a nominee. This is important given that, in reality, there will always be investors who, for various reasons, prefer to hold securities in the name of a nominee rather than in their own names. In contrast, the 2010 Model envisages intermediaries having to take on the role of nominee (i.e. as the registered holder of securities). This would subject them to new responsibilities and regulation, necessitate much more operational and systems change, and create much greater disruption and costs for the market.

On balance therefore, the Revised Model presents a more pragmatic way forward, in that: (i) it still provides a more efficient and cost effective transfer process than today, and consequently a *real* option for investors to hold securities in their own names; (ii) it will not impact market participants' liquidity needs in the way that the 2010 Model would; and (iii) the disruption and costs to the market will be much less as it builds on existing processes, operational flows and infrastructure. We are reinforced in this view by the fact that many respondents indicated a preference for the Revised Model. We are mindful that a few respondents did indicate a preference for the 2010 Model, and for this reason we spent some time to revisit the operational model again. All in all however, and for the reasons discussed above, we remain of the view that the Revised Model is more suitable than the 2010 Model.

11. We appreciate also that, at least at the initial stage, investors may still prefer to maintain the status quo and keep their securities registered in the name of a nominee. We are hopeful, however, that as more IPO securities are offered in uncertificated form only, investors will become increasingly familiar with the USM environment and its efficiencies. This, in turn, could incentivise them to hold securities in their own names. Hence, although it may take some time before we see noticeable changes in investor behaviour and a consequent rise in registered holdings, this should not deter us from pursuing the USM initiative. Moreover, the time is ripe to do so now given the growth and developments in our markets in recent years and HKEX's efforts to enhance its clearing and settlement infrastructure through development of the HKEX System.

12. The above said, we now turn to addressing the specific issues and concerns raised by respondents. In brief, the vast majority of respondents supported the USM initiative and the Revised Model. Many, however, also raised concerns and sought clarification on specific issues. We address respondents' feedback in more detail in Section III. This Section II, however, focuses on the key issues raised.

Revised Model

13. Many respondents indicated a preference for the Revised Model. They included investors, intermediaries, lawyers, issuer representatives and various industry bodies and associations. In general, they agreed that the Revised Model presents a better and more practical option for taking the USM initiative forward. Their reasons included

that the model will benefit investors by retaining certain existing flexibilities and efficiencies, result in a less impactful overhaul of HKEX's clearing and settlement system, minimise the impact on market participants and existing processes, and promote an orderly transition to full dematerialisation. The Panel on Financial Affairs of the Legislative Council also responded positively to the Revised Model when briefed on it in March 2019.

14. However, two respondents strongly opposed the Revised Model, and another (a professional body) noted that its members had mixed views. Those opposing the Revised Model criticised the model for not giving investors the option to hold securities in their own names within the HKEX System. They felt that investors would therefore have to either:

    (a) incur additional time and costs (i.e. to move their securities into/out of the HKEX System for the purpose of trading on the SEHK); or

    (b) continue to hold only a beneficial interest in their securities (i.e. if they keep their securities within the HKEX System).

15. We disagree that the lack of an option for investors to hold securities in their own names within the HKEX System creates a significant problem or limitation. As noted by one respondent, a principal advantage of the Revised Model is that it will provide an electronic interface between the HKEX System and ASRs' systems. This will facilitate the process for moving securities into and out of the HKEX System (e.g. for the purpose of trading on the SEHK), making it much quicker and more efficient than it is today. Related costs will also need to be kept low and commensurate with the service level requested. This includes not only costs charged by HKEX and ASRs but also others involved in the process of depositing/withdrawing securities into/out of the HKEX System. Investors will thus have a *real* choice to hold securities in their own names, and the fact that they cannot do so within the HKEX System should not be a deterrent. (See also the discussion on fees and costs below.)

16. The above said, we recognise that there will always be investors who, for their own reasons, prefer to hold securities in the name of a nominee and/or within the HKEX System. To that end, and as a separate exercise, the SFC is working with HKEX and the FSR to explore options for enhancing the position of these investors without creating undue costs or burden for them or their intermediaries. A main focus in this regard is to facilitate corporate communications and encourage participation in shareholder meetings and the voting process. Additionally, HKEX will shortly (i.e. within this year) be putting in place arrangements to enable such investors to requisition meetings, move resolutions and circulate statements relating to proposed resolutions. It is worth noting, however, that ultimately, a suitable balance must be struck so that enhancements to the position of beneficial owners do not have the unintended consequence of reducing shareholder transparency by encouraging investors to hold securities through HKSCC-NOMS instead of in their own names.

Fees and costs

17. Many respondents raised questions and concerns about fees and charges under the Revised Model and under the USM regime generally. In particular, respondents commented that: fees and charges to investors should be kept as low as possible and no higher than today; and that the fee structure should encourage rather than discourage investors from holding securities in their own names. Respondents also sought more clarity on: whether and how initial development costs will be passed down;

how certain charges will be set and controlled; and about specific fees, such as fees for dematerialisation, dividend collection and custody.

18. We understand and appreciate the market's concerns about fees and costs. As the operational and technical details of the Revised Model are still being developed, HKEX and share registrars are not yet in a position to finalise their respective fees and fee structures. It is therefore difficult to provide more specific information about fees and costs at this stage. That said, the concerns raised in the course of this consultation will be taken into account. More information will be shared with the market in due course and further input sought as necessary. In the meantime, we clarify as follows.

    (a) Initial development costs are expected to be borne largely by HKEX and share registrars.

    (b) Existing processes will, as far as possible, be retained under the Revised Model. We expect this will limit the cost impact on relevant stakeholders, including market participants and issuers.

    (c) We intend to keep fees and charges under the Revised Model fair, reasonable and conducive to encouraging the market's move to full dematerialisation. We also expect that savings will be realised as the market proceeds to full dematerialisation.

Phased approach

19. The Consultation Paper proposed a phased approach for implementing the USM initiative, both in terms of the product scope and the timeline to full dematerialisation. Many respondents supported this proposal.

20. In terms of phasing the product scope, a few respondents suggested that the initial phase should go beyond covering only listed shares in Hong Kong companies so as to have a more impactful launch and to focus the attention and energies of stakeholders. We will keep this suggestion in view as we progress work on reviewing the position of non-Hong Kong companies.

21. Separately, fund issuers noted that most ETF issuers do not currently give their unit/share holders the option to withdraw their fund units/shares from CCASS and register them in their own names. They asked if they will be mandated to offer such an option under the USM environment, noting that this will subject them to regulatory obligations that they are not currently subject to, and in turn drive up costs which will ultimately be borne by investors. We clarify that fund issuers will not be mandated to offer such an option.

22. In terms of phasing the timeline to full dematerialisation, several respondents commented that this should be kept as short as possible, with clear timelines for each phase. A few respondents also noted the need to clarify, early on, the position of non-Hong Kong companies. We clarify that we do aim to keep the transition period as short as possible, and to give sufficient advance notice at each stage to ensure market readiness. However, it will not be possible to clarify the position of all non-Hong Kong companies at the same time given the large number of jurisdictions concerned and the work involved in ensuring their compatibility with the USM initiative. We will therefore be focusing first on companies incorporated in Mainland China, Bermuda or the Cayman Islands as, together, they make up over 90%[1] of all non-Hong Kong companies listed on the SEHK (both by number and market capitalisation).

[1] The figure is based on the position as at the end of February 2020.

23. Separately, many respondents agreed that there should be no option to rematerialise uncertificated securities. Respondents also generally supported the proposal to gradually require IPO securities to be in uncertificated form only. There were also no major concerns about the proposals for dematerialising existing securities, apart from noting that sufficient advance notice must be allowed.

Regulation of ASRs

24. The Consultation Paper proposed that share registrars be regulated directly and more robustly under the USM environment given that they and their systems will take on additional responsibilities. Many respondents provided comments on this. Their feedback focused mainly on the regulatory standards to be met by ASRs, particularly in relation to their systems and processes, as well as related risks and liabilities. Several respondents also raised concerns about the impact that ASRs' new responsibilities may have on intermediaries and their businesses.

25. The SFC is in the process of developing the regulatory framework for ASRs. A key focus will be the integrity, security and adequacy of their systems and processes, including, in particular, their IT systems, infrastructure and interface with external parties. Other matters such as ASRs' governance, financial resources, internal controls and risk management will also be considered, as will the issue of risks and liabilities. While the overarching regulatory framework may be set out in the SFO, the detailed requirements are expected to be set out in subsidiary legislation and/or SFC codes/guidelines. The market will therefore be consulted on these details in due course. Additionally, it is expected that the regulatory framework for ASRs will empower the SFC to impose disciplinary sanctions (e.g. suspensions, revocations, fines and reprimands) and other restrictions on an ASR's business or operations.

26. As regards concerns about the potential impact on intermediaries and their businesses, we do not see ASRs' roles as overlapping with, or substituting, the roles of banks and brokers any more than today. As is the case today, ASRs will continue to act as agents of issuers in maintaining the ROM, and their status as an ASR will not, of itself, entitle them to engage in securities dealing activities.[2] Their rights as a "registrar participant" in the HKEX System will also be different from those of a "clearing participant".

Technical and operational details

27. The vast majority of comments received relate to operational and technical matters. We deal with these in detail under Section III. Below, however, we summarise our response to some key issues, and highlight aspects of our proposals that we have revised in light of the market's feedback.

28. **Account concept clarified:** There were many comments and questions regarding the USS and USI features. On reflection, it appears that our earlier use of the word "account" when discussing these features (i.e. USS/USI "account") may have caused some misunderstanding, and resulted in many of these comments and questions. We have therefore used different terminology when responding to the comments and concerns raised. (See paragraph 54 below for more details.)

29. **Any investor to be a USS or USI holder:** Contrary to what was proposed in the Consultation Paper, we no longer intend to restrict the USS feature to institutional

[2] As is the case today, share registrars who wish to engage in activities that fall within the scope of "dealing in securities" will need to be separately licensed for Type 1 regulated activity under Part V of the SFO.

investors. This means any investor may become a USS holder and/or a USI holder. (See paragraphs 62 to 64 below for more details.)

30. **Arrangements and relationships regarding USS feature:** Many respondents sought clarification on how the USS account will operate and the respective roles and liabilities of HKEX, ASRs and sponsoring CPs. We understand the need for clarity and certainty in this regard, and clarify that arrangements relating to the USS feature will be largely documented and governed by HKEX System rules and a sponsoring agreement between the USS holder and the sponsoring CP. (See paragraphs 55 and 56 below for more details.)

31. **Payment of cash entitlements:** In light of market feedback, we will work towards enabling sponsoring CPs to receive cash entitlements on behalf of USS holders. However, we will not mandate them to do so as we believe this should, ultimately, be a matter for USS holders and their sponsoring CPs to agree. (See paragraphs 65 to 68 below for more details.)

32. **Common Platform:** As the FSR is still exploring the feasibility of building a common platform, many operational details have yet to be worked out. That said, the questions and comments received will be taken into account as work in this regard progresses. (See paragraphs 90 to 93 below for more details.)

33. **IPO and transfer processes:** We received many comments and questions about processes under the Revised Model. We agree with the market's feedback that the efficiency and cost of transfers to and from HKSCC-NOMS will be critical and will therefore work towards providing sufficient flexibility and options in this regard. We also understand the market's concern regarding system failures and delays which may have implications for timely settlement. We will take these comments into account as we develop the technical and operational details for effecting transfers under the Revised Model. (See paragraphs 94 to 112 below for more details.)

34. **Corporate actions:** We received a wide range of comments and questions in relation to corporate actions. We note in particular respondents' requests to align the corporate action timelines for securities registered in the name of HKSCC-NOMS and for securities registered in the name of USS holders. We will explore the feasibility of achieving such alignment as far as possible. Separately, on the issue of prescribing a deadline for submitting proxy materials, in light of the feedback received, we no longer propose any change to the current position under the Companies Ordinance, i.e. as today, Hong Kong companies will not be able to prescribe a proxy deadline that is earlier than 48 hours before the meeting time.[3] (See paragraphs 113 to 122 below for more details.)

Way forward

35. A main objective of the current consultation exercise was to seek the market's views and broad consensus on the operational model for progressing the USM initiative. The consultation feedback indicates strong support for the Revised Model and a clear preference for it over the 2010 Model. In light of this, we can now work on further developing the model, in particular its more technical aspects as well as details of the USS/USI features, and putting in place the relevant regulatory framework to support it. The latter will include introducing amendments to both primary and subsidiary legislation, as well as to various SEHK and HKSCC rules and procedures. We will

[3] For non-Hong Kong companies, they will continue to be subject to the deadline (if any) specified under the laws of their home jurisdictions.

therefore continue to engage with the market in the coming months and welcome views and discussion with interested parties as we progress efforts to begin implementing the USM regime from 2022.

36. We also take this opportunity to note that many of the comments on operational or technical matters concern very specific details that have yet to be developed. One of the main aims of our consultation was to receive the market's views on such details. The feedback received is therefore much appreciated and will greatly assist the further development of the Revised Model, and finalisation of various details. That said, the market will still have an opportunity to comment on such details as many will feature in subsidiary legislation, SFC Codes or Guidelines and/or HKEX System rules, and will hence be consulted on in due course.

III. COMMENTS RECEIVED AND OUR RESPONSES

The USM initiative

37. **Strong support:** The vast majority of respondents strongly supported the USM initiative and recognised the benefits it will bring in terms of enhancing shareholder protection and transparency, overall efficiency, as well as Hong Kong's competitiveness and its status as a leading international financial centre.

38. **Few opponents:** Four respondents (all individuals) raised concerns about removing the paper option altogether, noting that some investors (e.g. older investors) may not be computer-savvy and that if ASRs' computer systems were hacked and the information in them lost, it may be difficult to prove legal ownership.

39. **Response to key concerns:** We welcome the strong support for the USM initiative. We also appreciate the concerns raised, particularly around system security. It is precisely for this reason that we propose to regulate share registrars more robustly than today, and with a focus on the integrity, security, adequacy and management of their systems and processes (including business continuity and back-up arrangements for meeting contingencies or emergencies). This is explained in more detail in paragraphs 155 and 157 below. Additionally:

    (a) As mentioned in the Consultation Paper, registered holders who hold securities in uncertificated form will receive regular electronic statements of their registered holdings. Electronic confirmations regarding the successful allotment or transfer of uncertificated securities will also be sent for added assurance.

    (b) As for concerns about certain investors' ability to adapt to the USM environment, we have tried to strike an appropriate balance by retaining the paper option for a limited period of time in respect of securities already held in certificated form. We also note that the public, generally, is becoming increasingly comfortable with making electronic payments, receiving e-statements and transacting online. We believe therefore that, over time, all investors will be able to transition smoothly to the USM environment. However, as an added measure, the FSR will encourage its members to enhance their existing public counter and telephone hotline facilities, as necessary, to cater for investors who need assistance in adapting to the USM environment, such as assistance in dematerialising securities and effecting transfers electronically. Likewise, HKEX will enhance its existing public counter services to cater for investor participants who need similar assistance. These enhancements will help

investors to adapt to the USM environment, even if they are unable to use, or do not have ready access to, computers.

Revised Model vs 2010 Model

40. The Consultation Paper explained the challenges presented by the 2010 Model, and proposed a Revised Model for taking the USM initiative forward. We asked:

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

41. **Strong support:** Many respondents indicated a preference for the Revised Model over the 2010 Model. Many also raised a number of questions and concerns (mainly regarding costs and detailed operational matters which we deal with elsewhere in this paper). However, in general, they agreed that the Revised Model is a better option for taking the USM initiative forward as it will retain certain flexibilities and efficiencies in the existing market infrastructure and practices, present a less impactful overhaul, promote an orderly transition to the USM regime, and ultimately benefit investors as well.

42. **Few opponents:** A few respondents voiced strong opposition to the Revised Model. We engaged with these respondents individually to better understand their concerns and to explain the limitations of the 2010 Model. As we understand it, these respondents' main objection is that the Revised Model does not give investors the option to hold securities in their own names *within* the HKEX System and that, as a result:

(a) investors who opt to hold securities in their own names (and hence *outside* the HKEX System), will need to first move their securities into the HKEX System before they can use those securities to settle trades executed on the SEHK and this will likely entail time and costs; and

(b) investors who opt to hold securities *within* the HKEX System will remain beneficial owners only and hence they will: (i) have to follow complex processes for receiving corporate communications and exercising voting rights; and (ii) be unable to exercise certain shareholder rights, including the right to requisition shareholder meetings, nominate directors, and petition for winding up.

43. **Addressing opponents' concerns:** We acknowledge that under the Revised Model: (i) investors who hold securities in their own names will need to first move their securities into the HKEX System (i.e. by transferring them to HKSCC-NOMS) before they can be used to settle trades executed on the SEHK; and (ii) investors who hold securities *within* the HKEX System will remain beneficial owners only. However, we disagree that this creates a significant problem or limitation.

(a) Under the Revised Model, there will be an electronic interface between the HKEX System and each ASR's system. Investors will therefore be able to move their securities into and out of the HKEX System (i.e. to transfer them to and from HKSCC-NOMS) much more quickly, seamlessly and efficiently than today. Our current expectation is that it will be possible for the process to be completed intraday, and that the associated costs will be reasonable and commensurate with the service level requested. Consequently, investors will have a *real* choice to hold securities in their own names (and thereby enjoy the full range of shareholder rights), and the fact that they cannot do so *within* the HKEX System should not be a deterrent.

(b) Irrespective of which operational model is adopted (i.e. the 2010 Model or the Revised Model), there will always be investors who, for their own reasons, prefer to hold securities through a nominee rather than in their own names, and thus remain beneficial owners only. While efforts have been made to enable such investors to exercise many of the rights conferred on registered holders, the SFC believes it is worth exploring if more can be done. To that end, and as a separate exercise from the USM initiative, the SFC is working with HKEX and the FSR to explore possible options for enhancing the position of beneficial owners who hold securities through CCASS (in future, the HKEX System). (More details on this are discussed in paragraph 123 below.)

44. **Doubts about reasons for changing operational model:** Two respondents questioned the market concerns that triggered a review of the operational model. We take this opportunity to recap and elaborate further on the challenges presented by the 2010 Model. (The paragraphs below should be read together with our earlier explanation of the market concerns, in paragraph 27 of the Consultation Paper.)

(a) Current flexibilities and efficiencies: Currently, HKSCC moves securities between accounts in CCASS in scheduled batches intraday, and before payment for them is made. However, in the case of securities moved for the purpose of settling CNS trades (i.e. CNS securities), these remain "on hold" and are only released to the receiving CP upon payment, i.e. if payment is made intraday, the securities are released intraday; if payment is made at day-end, the securities are released at day-end. This flexibility for HKSCC to move securities between accounts in CCASS (i.e. before payment and without resulting in any change in legal title or beneficial interest) is critical because it gives receiving CPs visibility as to which CNS securities are available in their accounts for release intraday. They can then select which to prepay and take delivery of intraday to use for other purposes (e.g. stock borrowing and lending, off-market transactions, etc), and which to take delivery of, and pay for, at day-end with the benefit of netting. The existing arrangements thus give market participants a degree of flexibility in terms of when and how they can use their CNS securities, while also keeping their financial obligations low and relatively simple to arrange.

(b) No such benefit under 2010 Model: Under the 2010 Model, the flexibilities and efficiencies described in paragraph (a) above would not be available.

(i) First, the model envisaged that securities movements between accounts in the HKEX System would constitute legal title transfers, and that payment would thus be made at or around the same time (rather than at day-end as is the case today). The upshot of this is that it would not be possible to move securities between accounts intraday without payment.

(ii) Consequently, market participants would have no visibility as to what CNS securities are available in their account for prepayment and delivery intraday, and hence no ability to select which securities to take delivery of intraday and which at day-end. As a result, market participants wishing or needing to take intraday delivery of any CNS securities would need to arrange for much more funding than today, and the process of doing so would also be much more challenging.

(c) Extent of impact on liquidity needs: It is difficult to give a precise indication of the impact that the 2010 Model would have on market participants' funding needs. This is because any such impact will ultimately depend on matters that

cannot be known in advance (such as the volume of securities that CPs wish to take early delivery of, and how early in the day these particular securities become available to the relevant receiving CP). Moreover, the exact impact will depend on CPs' obligations in respect of not only CNS trades but also their SI transactions. We can therefore only estimate what the funding impact might be. To that end, we have looked at the settlement figures for three days in 2019 (one in March, one in May and one in August). These indicate that:

- under the 2010 Model, the maximum total amount needed intraday on each of those days would have been over $100 billion; and
- in contrast, the actual amount paid on each of those days ranged from $12.9 billion to $20.3 billion, representing a five to eightfold difference.

As can be seen, the funding impact could be significant, and could vary from day to day. Moreover, these figures give only a market-wide picture. The actual impact on individual market participants could be greater, particularly if their existing funding lines are already relatively tight, and/or are needed for other competing purposes as well (such as large IPOs, index rebalancing exercises, etc[4]). The need for further funding would inevitably increase market participants' costs. There is also uncertainty about whether the banking system would always have ample liquidity available to support CPs' funding needs especially at times of high market turnover. This could also increase market participants' costs of doing business, and ultimately affect Hong Kong's competitiveness. Over time, this could impede the further growth of Hong Kong's markets.

45. **Alternative suggestions put forward:** One respondent suggested that the market concerns about settlement efficiencies and liquidity could be addressed without rejecting the 2010 Model. Specifically:

(a) Allowing legal title to pass without payment: It was suggested that the 2010 Model could be retained if legal title to securities could pass without money settlement occurring at or around the same time. We do not believe such an arrangement would be sound, primarily because it assumes that investors' behaviour patterns would remain unchanged (i.e. that they would continue to deliver securities early in the day and without payment notwithstanding that, unlike today, they would have to relinquish legal title in their securities, and relinquish it to someone with whom they have no relation). Such an assumption, however, ignores the fact that a key expectation of market participants, and in particular institutional investors, was that the 2010 Model would confer better protection precisely because investors would be able to receive payment when they relinquish legal title.

(b) Sending electronic message vs moving securities: Another option suggested was that HKSCC send electronic messages to receiving CPs to let them know which securities are available for settlement with HKSCC intraday and when. The idea was that this could give receiving CPs the necessary visibility without moving securities into their account. However, this fails to take into account how the settlement process works, i.e. that settlement between HKSCC and each CP is on a net basis and not on a transaction-by-transaction basis[5]. It

[4] Large IPOs can put pressure on available liquidity in the banking system, thereby impacting short term HIBORs. Index rebalancing exercises can increase demand for particular securities and hence the volume and size of transactions to be settled.

[5] To explain: Different clients of a CP may have bought and sold the same stock. However, the CP only settles the net position with HKSCC and not each transaction individually. To illustrate: assume a CP has 3 clients (X, Y and Z) all of whom executed trades in just one stock on a particular day, with X buying 10,000 shares @ HK$1, Y selling 20,000 shares @ HK$1.1 and Z selling 5,000 shares @ HK$0.90. The CP's obligation to HKSCC on settlement

follows that HKSCC cannot send electronic messages as suggested because it simply does not have information intraday about what securities are available for settlement by each CP and when.

46. **Other challenges with the 2010 Model:** Apart from the market concerns about settlement efficiencies and liquidity impact (which were the main reasons for proposing the Revised Model), the 2010 Model also presented other challenges which the Revised Model does not. These include: (i) operational challenges in making stamp duty declarations in respect of SI transactions; (ii) the need for intermediaries to take on new roles and responsibilities as registered holders and nominees in respect of securities held in a CPA; and (iii) the need for the market to maintain two systems for an unknown period, one catering for securities that have transitioned to the USM regime (and can thus be held under the 2010 Model which is a name-on-register model) and another catering for securities that have not yet so transitioned (and have to continue to be held under the existing central nominee structure). While none of these issues, per se, are insurmountable, they do reflect that implementing the 2010 Model is much more challenging in that it will necessitate much more operational change and result in much more costs and disruption to the market than the Revised Model.

47. **System stability, integrity and security:** Notwithstanding the strong support for the Revised Model, many respondents also noted that the stability, integrity and security of the systems supporting the Revised Model, including the interface between the HKEX System and ASRs' systems, will be critical. They emphasised the need for adequate oversight and supervision of the new arrangements, contingency measures for any emergencies, and clarity as to the consequences of system delays or failures. Many also requested that procedures be streamlined as far as possible to enhance operational efficiency. We take this opportunity to clarify that the USM infrastructure will largely comprise the HKEX System and ASRs' systems. We agree that the stability, integrity and security of these systems will be critical. The SFC already has regulatory oversight of systems operated by HKEX and will achieve the same in respect of ASRs' systems under the proposed ASR regime. We will also develop stringent standards and requirements for these systems, taking into account practices in other major jurisdictions and local circumstances.

Key features of the Revised Model

48. The Consultation Paper elaborated on the key features of the Revised Model and compared it to the current operational model and the 2010 Model. We asked:

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

49. We received a range of comments and questions on the key features of the Revised Model. The vast majority of these relate to aspects that are covered more specifically elsewhere in this paper. A few relate to other matters, which we discuss below.

50. **CCASS and HKEX System:** The Consultation Paper noted that the Revised Model will be introduced under the HKEX System, and not CCASS. A few respondents raised concerns about market participants having to manage processes across two platforms, i.e. CCASS and the HKEX System. HKEX takes this opportunity to clarify that the migration of functions from CCASS to the HKEX System will take place in phases. However, related processes will be migrated at the same time so as to minimise impact

day is to deliver 15,000 shares and collect $16,500 (minus relevant fees and charges). In other words, even though client X bought 10,000 shares, there is no obligation for HKSCC to deliver any shares to the CP on settlement day.

to the market, and allow operations to continue smoothly. It follows therefore that while it is possible that the two systems may be operating simultaneously, this will be for a limited period of time. Moreover, the two systems will always be used in respect of different functions, i.e. market participants will not have to manage the same function or process across two platforms.

51. **No obligation as to how securities are held:** One respondent asked whether there would be any rules or regulations mandating how investors hold their securities (i.e. in the name of HKSCC-NOMS, or as a USS/USI holder), or whether it would be a matter for investors to choose and for intermediaries to offer. We confirm that investors will be free to choose how they hold their securities. Similarly, market intermediaries will be free to decide whether or not to offer services as a sponsoring CP to investors who wish to hold securities as a USS holder.

52. **New "registrar participant" category:** Two respondents sought more information about the new "registrar participant" category to be introduced in the HKEX System, including its associated admission criteria, role and function, and rights and obligations. They also asked whether registrar participants would be able to provide clearing and custodian services. We clarify that the "registrar participant" category is intended to facilitate efficient and secure electronic communication between HKSCC and ASRs, and thereby facilitate various processes in the USM environment, most notably the transfer of securities (e.g. between a USS/USI holder and HKSCC-NOMS, between a USS holder and a USI holder, etc). Precise details of the admission criteria for the new registrar participant category, as well as their roles and responsibilities, have yet to be finalised. At a minimum, however, it is expected that only persons approved and regulated by the SFC as ASRs will be qualified to become registrar participants.[6] There is also no intention to permit registrar participants to provide either trading or clearing and settlement services of the kind currently provided by CPs in CCASS. However, they will be able to continue acting as eIPO service providers as they do today.

The USS and USI features

53. The Consultation Paper proposed that, under the Revised Model, investors wishing to hold securities in uncertificated form in their own names will be able to do so through either a USS account opened with a sponsoring CP, or a USI account opened with an ASR. The paper also described the process for opening and operating each of these account types. We asked:

Q3	*Do you have any concerns or comments about the key features of the USS account? If yes, please provide details.*
Q4	*Do you have any concerns or comments about the key features of the USI account? If yes, please provide details.*

Previous use of "account" — clarified and revised

54. Before turning to respondents' feedback, it is necessary to clarify our earlier use of the term "account" when discussing the USS and USI features under the Revised Model. The feedback received indicates that this choice of word was perhaps misleading and may have caused some confusion or misunderstanding. We take this opportunity to clarify that we did not mean to suggest that securities registered in the name of a USS or USI holder will be "held with" or "held in the custody of" a sponsoring CP (in the case of USS holders) or an ASR (in the case of USI holders), and certainly not in the sense

[6] The approval and regulation of persons as ASRs are discussed in more detail in paragraphs 154 to 159 below.

that intermediaries currently do when they open accounts to hold client securities. Rather, the USS and USI features essentially depict two options, under the Revised Model, for *managing* securities that are held in an investor's own name and in uncertificated form. Specifically: (i) investors opting for the USS feature (i.e. USS holders) will have to manage their securities via a sponsoring CP and the HKEX System; and (ii) investors opting for the USI feature (i.e. USI holders) will have to manage their securities directly. Ultimately however, both USS and USI holders will be the *registered* holders of their uncertificated securities and, as such, entitled to the same rights, including the same shareholder rights in the case of shares. To avoid further misunderstanding, we no longer use the terms "USS account" and "USI account" in this paper, and instead refer to the USS/USI "feature" or "service" as appropriate.

Operation of the USS feature

55. Respondents sought clarification on various matters regarding the USS feature, including:

(a) the role, responsibilities and liabilities of sponsoring CPs, including in terms of account opening procedures, e.g. know-your-client requirements and ongoing monitoring;

(b) the relationship among different parties, i.e. the USS holder, sponsoring CP, issuer and ASR;

(c) the information to be shared with ASRs for establishing the identities of USS holders and the authority of their sponsoring CPs;

(d) the range of communications that must be sent via the sponsoring CPs and the HKEX System rather than to the USS holders directly (given that USS holders will not have a direct electronic communication channel with ASRs);

(e) the sponsoring CP's role in handling corporate action entitlements; and

(f) the impact and handling of system delays and failures relating to the interface between the HKEX System and an ASR's system.

56. We understand the market's need for more clarification on the above matters. HKEX is in the process of developing the operational details of the USS feature, and in doing so will take into account the feedback received. More information will therefore be shared at a later stage, and market views sought as necessary. In the meantime, we clarify our current thoughts and expectations on the issues raised.

(a) Relationship among parties: The arrangements relating to the USS feature are expected to be documented and governed by, among other things, the following:

- the HKEX System rules, which will be binding on HKSCC and HKSCC participants (including therefore sponsoring CPs and the ASRs as registrar participants); and
- a sponsoring agreement between the sponsoring CP and each of its USS holders.

The HKEX System rules will prescribe certain terms which must be included in the sponsoring agreement. This is to ensure that the USS feature operates as envisaged, i.e. that the USS holder manages their holdings via the sponsoring CP and the HKEX System rather than directly with the relevant issuer or its ASR.

(b) Responsibilities of sponsoring CPs: It is expected that sponsoring CPs, as intermediaries, will continue to conduct account opening procedures for all of their clients, including those who wish to become USS holders. This will

therefore include performing know-your-client checks as they do today. Additionally, they will need to provide various services to facilitate communications between USS holders and the relevant issuer/its ASR. These may include communicating certain information and particulars relating to their USS holders (such as particulars to be entered in the ROM), facilitating the routing of certain processes and communications (described in paragraph (c) below), etc.

(c) Routing via sponsoring CPs and HKEX System: The following processes and communications will have to be routed via sponsoring CPs and the HKEX System:

- transfers of a USS holder's uncertificated securities (whether with or without payment);
- dematerialisation of a USS holder's securities into uncertificated form;
- distribution of entitlements to a USS holder (such as securities or cash dividends, interest payments, redemption proceeds, rights, bonus securities, and other properties);
- submission of a USS holder's instructions in respect of corporate action matters (such as rights, entitlements, proxy nomination, etc); and
- submission of a prospective USS holder's IPO application to the relevant ASR, and collecting/returning related monies.

We do however expect that certain documents may be sent to USS holders directly by the issuer or its ASR. These include regular reports (such as annual reports, interim reports, quarterly reports, summary reports) and various notices and circulars issued from time to time (such as those relating to meetings, share repurchases, privatizations, rights and other offers, etc).

(d) Interface between the HKEX System and the ASRs' systems: We recognise that the HKEX System and ASRs' systems, and the interface between them, will be critical in the USM environment. HKEX and the ASRs will therefore need to ensure that their respective systems are secure, robust and reliable and have the necessary business contingency arrangements in place to ensure the smooth operation of the USM infrastructure. The SFC will also have regulatory oversight of these systems (as noted in paragraph 47 above).

Operation of the USI feature

57. Respondents raised a number of questions regarding the USI feature as well. The key issues are summarised and clarified below.

58. **Reliance on checks by ASRs:** One respondent asked whether intermediaries will need to conduct fresh know-your-client checks on USI holders or whether they can rely on checks conducted by ASRs. They went on to note that the former will be a significant disincentive to becoming a USI holder as it will increase the time and effort needed to transfer securities into the HKEX System for trading on the SEHK. We clarify as follows.

(a) As indicated in the Consultation Paper, ASRs will only conduct certain basic checks for the purposes of establishing a prospective USI holder's identity and obtaining relevant information for entering into the ROM. This process will not be as complex or detailed as the know-your-client checks expected of intermediaries. It is therefore neither possible nor appropriate for intermediaries to rely on the checks done by ASRs.

(b) We also do not agree that intermediaries' inability to rely on checks by ASRs will discourage investors from becoming USI holders. The checks to be conducted by ASRs will be relatively basic and straightforward, and the FSR aims to keep the process as simple and convenient as possible.

59. **Need for physical presence:** One respondent asked whether investors will have to submit identification documents in person or whether the process of applying for the USI service can be completed online. We recognise that it may be challenging for some investors (e.g. those residing overseas) to apply for the USI service in person. We understand also that the market may expect an online process and see it as being in keeping with the broader objectives of the USM initiative, i.e. reducing paper and manual processes and enhancing efficiency. We are therefore looking into the feasibility of allowing an online process for the USI service.

60. **Number of USI "accounts" per investor:** A few respondents asked whether the USI feature will be holder-specific (i.e. an investor will have a single USI "account" which will reflect all securities registered in the name of that holder) or issuer-specific (i.e. an investor will need to maintain different USI "accounts" in respect of different securities). We recognise that our earlier use of the term "accounts" in this context may have contributed to this concern. We take this opportunity to clarify that investors will *not* need to apply for the USI service *separately* in respect of each stock (or other product) they hold in uncertificated form. At a minimum, their application for USI service can cover all securities handled by the same ASR.[7] We recognise however that it will be more user-friendly and convenient if all uncertificated securities registered in the name of an investor (i.e. even if they are handled by multiple ASRs) can be reflected and managed through a single access point. It is for this reason that the FSR is exploring the feasibility of building a Common Platform as indicated in the Consultation Paper.

61. **Maximum number of joint holders:** One respondent asked about the maximum number of people who may apply jointly for the USI service. This will depend on what (if any) restrictions apply in respect of the holdings in question (e.g. restrictions under the relevant the memorandum and articles of association, any applicable legislation, etc). In general, however, we expect the maximum to be no more than four persons. This would be in line with current practice.

Who may become USS or USI holders

62. The Consultation Paper proposed that only institutional investors may become USS holders while any investor may become a USI holder. We asked:

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

[7] To illustrate: Assume for example that Investor A holds shares in List Co X and then subsequently acquires shares in List Co Y and List Co Z; and that ASR-1 is appointed as the ASR for all three issuers. Once Investor A applies for the USI service, they can then manage their holdings in all three companies through the USI service. It will not be necessary for the investor to apply for the USI service separately in respect of their holdings in each company.

63. **Key issues raised:** We received mixed views on these issues. Respondents also sought clarification on some related aspects. The key issues are summarised below.

(a) Difficult to gauge institutional investors' interest without more information: Some respondents indicated that, without more information about the operation of the USS feature, it is difficult to gauge the likelihood of their institutional clients becoming USS holders.

(b) Possible interest from retail investors: Some respondents indicated that retail investors may also be interested to become USS holders, particularly private banking or wealth management clients and retail investors who are unable to manage their securities holdings themselves or prefer to have such matters handled by their intermediary.

(c) Different views on who may become a USS holder: Some respondents agreed that the USS feature should be offered only to institutional investors as it may be operationally challenging for them to provide services to USS holders who are retail investors. Other respondents, however, commented that the USS feature should be available to retail investors also so that they have the same rights as institutional investors to choose the type of service that suits their needs. One also added that even if institutional investors are unlikely to want to become both a USS holder and a USI holder, they should have the option to do so.

(d) Defining "institutional investor": Many respondents asked how the concept of "institutional investor" will be defined, and whether it will cover corporate entities, family trusts, high net worth individuals, funds, etc. It was also suggested that guidelines be issued to clarify who may or may not become a USS or USI holder.

64. **Revised proposal:** In view of the feedback received, we have revisited our earlier proposal and now propose that the USS and USI feature should be available to *all* investors. This will allow both retail and institutional investors to have the same options and to become USS and/or USI holders, as suited to their needs. It will also remove the need for any guidelines on who may or may not become a USS/USI holder. As for the concern that it may be operationally challenging for intermediaries to provide services to USS holders who are retail investors, we note that not all intermediaries may share this view. Moreover, intermediaries are under no obligation to offer USS services.

Payment of cash entitlements to USS holders

65. The Consultation Paper noted that cash payments arising from corporate actions (e.g. dividend payments) will be credited directly into a USI holder's designated bank account, but that, in the case of USS holders, there may be a preference for such payments to be paid to the relevant sponsoring CP instead. We therefore asked:

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 CP? If yes, please provide details.*

66. **Majority support for payment to sponsoring CP:** Most respondents submitted that cash entitlements should be paid to the sponsoring CP on behalf of the USS holder. Their main concerns about paying USS holders directly are as follows.

(a) Not in keeping with existing market practices: Currently, institutional investors typically appoint a global custodian who in turn appoints a local custodian in

each market to track, record and collect all corporate action entitlements on behalf of the global custodian and their clients. It would be in keeping with this established practice to allow local custodians to receive all cash entitlements.

(b) Not in keeping with established omnibus account structure: Crediting payments to institutional clients directly would necessitate segregated cash accounts, which would be contrary to the established omnibus cash account structure adopted by global custodians. This could create significant accounting and reconciliation challenges for CPs, global custodians and institutional investors.

(c) Operational challenges: Crediting payments directly to institutional investors would create operational challenges for local and global custodians. It would greatly hinder their ability to monitor and manage the income collection process, which is an integral part of their asset servicing responsibilities. It would potentially break the relationship and efficient reconciliation between cash and trade, and hence increase the potential that existing governance and control points are bypassed.

(d) Inability to net-off same day cash activities: Cash entitlements received are generally used by the sponsoring CP to net-off clients' other cash activities on the same day. If the cash is credited to the investor directly, the investor would need to instruct a fund transfer to the sponsoring CP in order to use such cash. The sponsoring CP may also incur additional funding costs which would be charged back to the investor.

(e) Potential for confusion: Crediting USS holders directly may also create confusion as the holder would likely contact the sponsoring CP rather than the ASR in the event of any issue arising in relation to cash entitlements (such as non-receipt or discrepancies in the amount received).

67. **A few supported payment to USS holders:** A few respondents indicated that they had no concerns about cash entitlements being paid to USS holders directly, while one commented that cash entitlements should be paid directly to registered shareholders, unless the intermediary/custodian has a valid subsisting authority to hold funds for the registered shareholder in question and the system allows the issuer making payment to verify that authority.

68. **Way forward:** The market feedback indicates a need to enable sponsoring CPs to receive cash entitlements on behalf of USS holders. We will therefore work towards achieving this, including enabling the issuer to verify the sponsoring CP's authority if necessary. However, we do not believe it would be appropriate to mandate that payment be made to the sponsoring CP in all cases, in particular now that the USS feature will be available to all investors. Ultimately, this should be a matter for the USS holders and their sponsoring CPs to agree.

69. **Additional point regarding securities entitlements:** A further point worth highlighting in this context concerns the distribution of securities entitlements. A few respondents commented that an ad hoc process is needed to deal with the interim transfer of title to sponsoring CPs before the securities entitlements are transferred by the sponsoring CP to the USS holder. We take this opportunity to clarify that securities entitlements will be credited *directly* to the USS holder's entry on the ROM. (It is only the communications in respect of securities entitlements that will be routed via the sponsoring CP and the HKEX System.) There is therefore no need for any ad hoc process as suggested by the respondents.

Other suggestions and comments relating to USS and USI features

70. **Whether holders must be legal persons:** A few respondents asked whether USS holders must be legal entities. We clarify that both USS and USI holders must be legal persons as they will be the registered owner of the securities in question, i.e. their names will be entered in the relevant ROM. In the case of funds structured as a corporate entity, the fund itself can be the USS/USI holder. For funds structured as trusts (or in other non-corporate form), the entity holding the assets of the fund (e.g. the trustee in the case of a trust) can be the USS/USI holder. That said, we do not intend to affect existing designation practices for the ROM.

71. **Whether holders must be the ultimate beneficial owner:** One respondent asked whether USS holders must be the ultimate beneficial owner of the securities registered in their name. The answer is no. As is the case today, the registered holders of securities (and hence the USS holder) can be nominees holding on trust for other persons. For example, the USS holder may be a local custodian holding on trust for a global custodian who in turn holds on trust for third parties. The same applies to USI holders as well. For example, the USI holder can be the trustee of a family trust holding on trust for the beneficiaries of that trust.

72. **Whether investors can become both a USS and USI holder:** The Consultation Paper noted that we do not expect institutional investors to become both a USS holder and a USI holder because the two serve different needs. While most respondents generally agreed with this, a few did not. In any case, we are now proposing that *any* investor may become a USS holder. In view of this, it will be possible for investors to become a USS holder or a USI holder, or both.

73. **Suggestion to have a central KYC agency:** One respondent suggested establishing an independent organisation to open single and consolidated accounts for investors and facilitate all KYC procedures. As noted in paragraph 58 above, ASRs will only be conducting basic checks to establish a USI holder's identity, and not the kind of detailed know-your-client checks required of intermediaries. That said, we understand that similar initiatives are being explored by others (such as the Government's Electronic Identity (eID) proposal). We will keep such initiatives in view and explore the feasibility of leveraging on them where possible.

74. **Whether any impact on shareholder-related obligations under the SFO:** A few respondents asked how certain shareholder-related obligations under the SFO (such as the disclosure of interests obligations under Part XV and the obligation to seek SFC approval to be a "substantial shareholder" of a licensed corporation under section 132) will apply in respect of USS holders and their sponsoring CPs. We do not see the Revised Model as having any impact on these obligations. The obligations will continue to apply as they do today. In general therefore, we expect that the position of USS holders will be similar to that of investors who today hold securities in their own names or through an intermediary, and the position of sponsoring CPs will be similar to that of CPs today. That said, this is ultimately a legal issue. Each case will therefore turn on its own facts and circumstances, and appropriate legal advice should be sought as necessary.

75. **No trading or clearing and settlement advantage from being housed in the HKEX System:** One respondent commented that a major difference between the USI feature and the USS feature is that USS holders will have direct access to HKEX's trading, clearing and settlement systems, while USI holders will not. Again, we believe this concern may have arisen from our earlier use of "account" to describe the USS and

USI features. We take this opportunity to clarify that although the securities of a USS holder will be managed via a sponsoring CP and the HKEX System, this will not result in any added benefit or advantage in terms of trading securities on the SEHK or clearing and settling them through the HKEX System. This is because both USS and USI holders will be registered holders of their securities. Both will therefore need to move their securities into their designated intermediary's account in the HKEX System (which means, in both cases, the securities will have to be transferred to, and registered in the name of, HKSCC-NOMS) before they can be used to settle any on-exchange trades.

76. **Whether USS/USI holders will be subject to withholding tax:** One respondent noted that investors who currently hold H shares in CCASS are subject to withholding tax as the securities are registered in the name of HKSCC-NOMS. They asked if USS holders will be subject to such withholding tax as well. Under the Revised Model, USS holders will be the registered holders of securities. The obligation of USS holders (and also USI holders) in respect of any withholding tax will be subject to applicable tax laws and regulations, and may vary due to factors such as their legal status, nationality and their country of domicile. Each case will therefore depend on its own facts, and investors should consider seeking appropriate legal advice as necessary.

77. **Confirmations of transfers and allotments:** The Consultation Paper noted that issuers will be required to send electronic confirmations to USS holders and USI holders to whom uncertificated securities have been successfully allotted or transferred. One respondent commented that such confirmations should be issued by the ASR (on behalf of the issuer) rather than by the issuer as it is the ASR who updates the ROM. We expect that, in practice, confirmations will likely be sent by an ASR, but this is by virtue of its role as an agent of the issuer. That said, we will keep this issue in mind when developing subsidiary legislation on technical and operational processes and procedures under the USM environment. Market views will therefore be sought in due course when a draft of such subsidiary legislation is exposed for public consultation.

78. **Factors affecting demand for USS/USI feature:** A few respondents noted that the demand for using the USS or USI feature will depend on many factors, including investors' trading practices and preferences, the associated costs and fees, and how easy and efficient it is to use. One respondent also noted that if the position of beneficial owners were enhanced, investors might be less inclined to become USS or USI holders as they may be content for their securities to remain registered in the name of HKSCC-NOMS. We agree that different factors will affect an investor's decision about whether to hold securities in their own names or not and if yes, whether to do so as a USS or USI holder. Our objective is to provide different options to suit the needs of different investors. As for the concern that enhancing the position of beneficial owners may discourage investors from becoming USS or USI holders, we note that enhancements, alone, are unlikely to sway investors. Matters such as costs, efficiency, convenience and investors' needs and preferences are likely to be equally, if not more, influential. That said, we are mindful that a suitable balance must be struck so that enhancements do not have the unintended consequence of encouraging investors to hold securities through HKSCC-NOMS rather than in their own names.

Requirement to provide unique identification number

79. The Consultation Paper proposed that registered securities holders be required to provide a unique identification number so that issuers can reliably and efficiently

identify and distinguish each holder from the other. It also elaborated on the types of identification numbers to be provided. We asked:

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.*

80. We received a range of comments on this issue as summarised and discussed below.

81. **General view and concerns:** In general, most respondents did not have concerns about this proposal. Many did however note the need for stringent regulations and controls to ensure a high standard of protection for personal data and privacy, and for any guidelines in this respect to be transparent to investors and sponsoring CPs. We agree. As noted in the Consultation Paper, we will put in place clear and stringent requirements and obligations to ensure that identification information provided by registered securities holders is only used for legitimate purposes, and properly protected from theft and unauthorised use or transfer. Compliance with relevant data privacy laws will also be required.

82. **Types of unique identification numbers proposed:** Regarding the types of unique identification numbers to be provided, two respondents noted that passport numbers may change over time and people may use different identification documents when applying to become USS or USI holders. One respondent asked which identification number is to be provided in respect of joint holdings, while another advocated the use of the Legal Entity Identifier (LEI)[8] for registered holders. Lastly, one respondent suggested that the SFC or HKEX prescribe acceptable identification numbers to be obtained by sponsoring CPs as it may be challenging for them to identify a specific type given the diverse geography and nature of foreign institutional investors in Hong Kong. In light of these comments, we clarify as follows.

(a) Types and order of priority will be prescribed: We confirm that we do intend to prescribe the types of identification numbers that may be provided. We are also considering specifying an order of priority such that investors who have more than one identification document will have to provide details of the identification document that is higher up in the order of priority. This should address concerns about investors using different identification documents, and provide sponsoring CPs more clarity about which types of identification numbers to obtain from institutional investors.

(b) Will accept other national identity documents: On the issue of passport numbers changing, we recognise that this is one of the limitations of relying on passports. To address this, we propose that individuals who do not have Hong Kong identity cards be allowed to provide details of any other national identity document that they hold (as these are generally more static). Only individuals who have neither will need to provide their passport numbers, and keep them up-to-date.

(c) All joint holders will need to provide identification numbers: As regards the identification numbers to be provided by joint holders, we clarify that each joint holder will need to provide their respective identification number. However, subject to the order of priority discussed in paragraph (a) above, it will not be necessary for joint holders to provide the same type of identification document.

[8] The LEI is a 20-digit, alpha-numeric code based on the ISO (International Organization for Standardization) 17442 standard.

(d) Details to be finalised and consulted on later: The above and other details regarding the provision of unique identification numbers to issuers will be finalised at a later stage and set out in rules or guidelines to be made by the SFC. The market will therefore be consulted in due course.

83. **Frequency of transmitting identification numbers:** A few respondents asked when and how frequently unique identification numbers will have to be transmitted, e.g. whether the identification numbers will be required on a one-off basis or regularly, such as on every transfer of securities. Our current expectation is that identification numbers will have to be provided only when the investor applies for the USS/USI feature (and thereafter updated as necessary), and not every time a transfer or other process is conducted. To facilitate this, ASRs are looking into developing a methodology for generating reference numbers that can be used when effecting transfers and other processes in the USM environment. More information on this will be provided at a later stage.

84. **Certificated securities holders:** The Consultation Paper proposed that existing registered holders (i.e. those holding securities in certificated form) will have to provide their unique identification numbers when applying for new securities or when seeking to transfer or dematerialise the securities they already hold. One respondent noted that it may not be reasonable to prevent existing registered securities holders from transferring their shares if, at the time of the transfer, they are unwilling to provide a unique identification number to the issuer. We acknowledge that it may be difficult to compel investors to provide identification numbers when transferring their existing certificated holdings. We will explore possible options for encouraging them to do so. In any event, as certificated holdings are intended to be phased out, this will be less of an issue over time.

85. **No relation to the SFC's Investor ID initiative:** A few respondents asked about the relationship between the proposal for investors to provide unique identification numbers, and the SFC's Investor ID initiative for Hong Kong. It was also suggested that the two initiatives be implemented around the same time so that market participants can make necessary changes in one go and thus save costs. We clarify that these initiatives are wholly separate and unrelated. The former is intended to help issuers better identify their registered holders, and thus verify the authenticity of instructions or requests received. On the other hand, while the SFC's Investor ID initiative remains under consideration and its details are yet to be finalized, we envisage that the investor information will be collected at the trading level and used solely for surveillance purpose. It is therefore neither possible nor necessary to synchronise the timing of these initiatives. We expect also that the system or process changes needed for the two initiatives will likely be different.

Consolidation of holdings for entitlements distribution

86. The Consultation Paper noted that, with the collection of identification numbers from registered holders, it will be possible for issuers to consolidate the holdings of its registered holders irrespective of whether these are held in certificated form or in uncertificated form as a USS or USI holder. We noted, however, that consolidation may not, in all cases, be appropriate for the purposes of calculating securities entitlements. We asked:

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.

87. **Most supported segregated calculation for USS holders:** Most respondents indicated that where a USS holder's securities are managed through multiple sponsoring CPs, their securities entitlements should be calculated separately. Many noted that consolidating the holdings of such a USS holder before calculating entitlements would result in having to deal with fractional distributions across different sponsoring CPs, and consequently, lead to inefficient end-to-end processes and, in some cases, difficulty in fulfilling regulatory requirements applicable to overseas investors.

88. **Other views:** Two respondents considered that securities entitlements should not be calculated separately, with one noting that the same treatment should be applied to both USS and USI holders to ensure equality and fairness. Another respondent however considered that calculating entitlements separately for USS holders whose securities are managed through multiple sponsoring CPs may seem to give USS holders an advantage over USI holders.

89. **Way forward:** We understand the concerns raised about fractional entitlements, and about treating USS and USI holders equally. We will keep these concerns in view as we continue to develop the technical and operational details of the USS and USI features.

Common platform

90. The Consultation Paper noted that the FSR is exploring the feasibility of building a Common Platform across share registrars to provide a web-based portal through which USI holders can manage their entire portfolio of registered securities holdings and communicate with multiple issuers and their share registrars. We asked:

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

91. **General support but request for more clarification:** Most respondents welcomed the idea of a Common Platform which will allow USI holders to have a consolidated view of their portfolio and manage their securities via a single access point. However, respondents also sought clarification on a range of operational and other matters, including: the platform's functions and capabilities; its maintenance (including in terms of data security and protection); its IT architecture, in particular whether the platform will hold a replica of the ROM data or merely provide a gateway to access such data; whether CPs can access the Common Platform; the impact on transfers if the platform cannot be accessed due to system failures; whether USI holders can receive a consolidated statement of their entire portfolio via the platform; etc.

92. As the FSR is still exploring the feasibility of building a Common Platform, many operational details (including those mentioned above) have yet to be considered. However, the FSR's preliminary thinking is as follows.

(a) System infrastructure: The aim is to develop the platform as a web-based portal across participating ASRs. It will provide a single webpage access point through which USI holders can log-in to manage their holdings.

(b) Functions: The platform is intended to deal with simple and straightforward functions only, e.g. managing the holders' basic profile information and viewing

portfolio balances. For actions requiring more specialised operations (e.g. securities transfers, exercising corporate action rights, etc), the USI holders will be directed to the relevant ASRs' web systems for further processing and handling. Sponsoring CPs and USS holders will not have access to the Common Platform.

93. More information about the Common Platform will be made available at a later stage as details are developed. The FSR will also seek market views as necessary.

Key processes under the Revised Model — IPO subscriptions

94. The Consultation Paper explained the key processes under the Revised Model including the process flows for IPO subscriptions. We asked:

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? If yes, please provide details.*
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.*

95. Most respondents indicated that they had no concerns or comments at this stage. We did however receive a few comments and requests for clarification, which are summarised and responded to below. (Again, for the reasons explained in paragraph 54 above, the discussion below no longer refers to USS and USI "accounts" but is now cast in different terms.)

96. **Whether sufficient time to apply for the USI service before IPO:** The Consultation Paper noted that applicants for IPO securities who wish to hold those securities as a USI holder must have completed certain processes at the time of submitting the application. One respondent was concerned that there may not be sufficient time for retail investors to complete such process. We clarify that investors will be able to apply for the USI service at any time and irrespective of whether they own any securities at the time or not. The FSR is also exploring the feasibility of an express service that would enable the application process for the USI service (for individuals in Hong Kong) to be completed within one business day. We believe therefore that there should be ample time for retail investors to apply for the USI service, and to receive and hold IPO securities in uncertificated form.

97. **Whether current IPO processes will be replaced:** One respondent asked whether the new process flows for IPO subscriptions will replace the existing CCASS E-IPO and white form e-IPO application processes that exist today. They also asked if the new process flows will change the current Public Offer tranche structure. We clarify that the new process flows will replace the current ones. In particular, the current process for paper applications will be removed, and the current electronic application processes (i.e. CCASS E-IPO and white form e-IPO) will be adapted. This may require some change to the Public Offer tranche structure. Further information will be shared in due course as necessary.

98. **Whether bank account can be changed:** One respondent asked whether USI holders will be allowed to change the bundled settlement bank account at any time post-registration. We clarify that, like today, investors will be able to change the details of their designated bank account (i.e. the bank account designated for receipt of cash entitlements such as dividends) at any time. We also clarify that USI holders will be

able to designate different bank accounts for different securities, but only one bank account in respect of each stock.

99. **Payment and refunds:** The Consultation Paper noted that for IPO securities to be credited to a prospective USS holder, the application form and subscription monies will have to be submitted via the relevant sponsoring CP and the HKEX System, and that any refund of subscription monies will be credited directly to the sponsoring CP's designated bank account. A few respondents commented that, in such cases, any payment or refund of IPO subscription monies should be debited from or credited to the sponsoring CP's cash account rather than the individual client's cash account. We clarify that this is consistent with what we are proposing, i.e. it will be open to sponsoring CPs to designate and use their cash accounts for the payment and refund of such subscription monies.

100. **Crediting of IPO securities:** One respondent suggested that IPO securities should also be credited to the sponsoring CP's account for further distribution to relevant USS holders. We disagree. Doing so would mean the IPO securities are allotted to sponsoring CPs rather than to their USS holders. This would be inconsistent with the name-on-register nature of USS holdings as proposed in the Consultation Paper. It would also unnecessarily complicate the IPO process because sponsoring CPs would then have to transfer the securities to the relevant USS holders. We therefore remain of the view that IPO securities should be credited directly to relevant USS holders. This will be done by updating the relevant ROM to reflect USS holders as the registered holders of the IPO securities allotted to them. The USS holders' balances with their sponsoring CPs (as reflected in the HKEX System) will also be updated correspondingly to reflect the allotment of IPO securities to them. This will ensure that sponsoring CPs have no difficulty in monitoring the proper receipt of IPO securities and following up on any discrepancies on behalf of USS holders.

101. **IPO settlement timetable:** The Consultation Paper noted that as a separate initiative, we are exploring options for shortening the IPO settlement timetable. Several respondents commented on this. A few noted that the timetable should be shortened to enable earlier trading of newly-listed shares and reduce market risk. Another however noted that the proposal only covers logistics for the Hong Kong public offer tranche and not the international/institutional tranche, adding that the current IPO settlement timeline is already very tight. We appreciate the feedback on this issue and will keep it in mind when developing the new timetable.

Key processes under the Revised Model – transfers

102. The Consultation Paper also explained the processes for various types of transfers that may occur in the USM environment. We asked:

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.*
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.*
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.*

103. We received a wide range of comments and questions regarding the process flows for transfers. The key issues and concerns are summarised and responded to below.

104. **Transfers to/from HKSCC-NOMS:** Many respondents sought more information about technical and operational details, particularly in relation to the process for transferring securities to/from HKSCC-NOMS. They asked about the time needed to complete such transfers, and whether transfers will be conducted on a real-time basis or same-day basis so as to match HKSCC's batch settlement runs. Many also asked about the response time between HKSCC's and ASRs' systems and whether there will be any possible fixes or flexibilities (e.g. buy-in exemptions) in the event that a delay or failure in these systems impacts their obligations under other related transactions. We understand the concerns and comments raised, and will take them into account as we develop the Revised Model further. We take this opportunity to clarify, however, that we agree that the process for effecting transfers to/from HKSCC-NOMS will be particularly critical, and that there is a need for some flexibility so as to cater for different needs and circumstances. To that end, we aim to provide options so that market participants can choose when to effect their transfers (e.g. on a real-time basis, same-day basis, next day basis, etc). Additionally, our current thinking is that transfers to/from HKSCC-NOMS will be processed in multiple batches throughout the day, each timed shortly before HKSCC's batch settlement runs for on-exchange trades so as to facilitate any related settlement obligations. We are also exploring the feasibility of permitting additional flexibilities, in certain limited cases, to address concerns about system delay or failure.

105. **Transfers and settlement of on-exchange trades:** One respondent asked whether a USS/USI holder will need to transfer their securities to their intermediary/HKSCC-NOMS before they trade them on the SEHK. We clarify that USS/USI holders will only need to ensure that the securities are transferred to HKSCC-NOMS in time for settlement within the current T+2 settlement period, i.e. they will not need to effect such transfers *before placing a sell order*. However, the concept of "immediate credit" will no longer apply. This means the transfer of securities to HKSCC-NOMS must be completed *before the end of the settlement period* if the securities are to be used to settle CNS trades.

106. **Transfers from a USI holder to HKSCC-NOMS:** One respondent commented that in the case of transfers from a USI holder to HKSCC-NOMS, the USI holder will need to send the transfer instructions to both their intermediary and the relevant ASR, whereas a USS holder will only need to send transfer instructions to their sponsoring CP. They asked if the process can be configured such that the USI holder only needs to send transfer instructions once for the information to be passed to both their intermediary and the relevant ASR. HKEX and the FSR will explore the feasibility of providing this option when developing the details of the process flows.

107. **Transfers between two USI holders:** One respondent asked what information a USI holder will have to provide to uniquely identify the other party to the transfer. Our preliminary thinking is that both parties will need to provide details of the transaction itself[9] as well as their own identification information[10]. Some details of the counterparty may also be required for authentication purpose.

[9] This refers to information that will enable the relevant ASR to match the transfer instructions submitted by the two parties to the transfer, such as the names of both parties to the transaction, a description of the securities and quantity of securities to be transferred, the consideration paid for the transaction, and confirmation as regards stamp duty.

[10] This refers to information (relating to the party) that has to be submitted to the issuer, such as the party's full name and address.

108. **Passing of beneficial interest only:** One respondent noted that it is unclear how, under the Revised Model, beneficial interest in securities can be passed without also passing legal title. Currently, such transactions are typically reflected only in the books of the registered holder (and any other person intermediating between that holder and the beneficial owner), but not on the ROM. Contract notes are nevertheless required to be prepared and stamped. We expect this practice to continue under the Revised Model. However, what may change is how the contract notes are prepared and stamped. Currently, unless stamp duty is paid via the SEHK, the contract notes must be in paper form. We are, however, working with the Stamp Office to develop a process that will allow the use of electronic contract notes for off-exchange securities transactions. (See paragraph 111 below for more details.)

109. **Intra-day settlement:** One respondent noted that as transfers of securities between a USS holder and HKSCC-NOMS may involve the passing of both legal title and beneficial interest, it was necessary to have an intraday, net cash settlement mechanism to address concerns about liquidity and insolvency risks. We clarify that, in general, transfers between a USS/USI holder and HKSCC-NOMS should be legal title transfers only, i.e. with no passing of beneficial interest. This is because, in most cases, the USS/USI holder will only be seeking to deposit securities into (or withdraw them out of) an account in the HKEX System where the securities are held for the benefit of the same USS/USI holder. The limited situation where beneficial interest may also pass is where the transfer is of securities from a USS/USI holder to another person who wishes to then hold the securities in their investor participant account in the HKEX System. However, in such cases, we expect the transfer to be either free of payment or made on a real-time delivery-versus-payment basis.

110. **Transfers on half-day trading days:** The Consultation Paper proposed that HKSCC will offer off-exchange trade settlement and transfer services on half-day trading days. The rationale for this proposal was to better align (i) the services offered by ASRs to all registered holders (including therefore USI holders) with (ii) the services offered by HKSCC in respect of USS holders. Many respondents raised concerns about the proposal, and a few were also unclear about the benefits it would bring. Most concerns and questions revolved around operational matters. There was concern that the proposal may result in inconsistent settlement practices and that this may lead to potential complications and confusion; that intermediaries may not be in a position to distinguish whether their clients' instructions related to on-exchange trades or off-exchange trades; that current system configurations cannot determine whether any given day is a settlement day for off-exchange trades only; and that there may be a potential impact on funding projections if transfers to/from HKSCC-NOMS are in scope. Respondents also sought more clarification on issues such as how the proposal will affect settlement instructions that are for facilitating the on-exchange trade settlement. In light of the many concerns and issues raised, HKEX will revisit this proposal and seek market views as necessary.

111. **Alternative stamping arrangements for off-exchange transactions:** The Consultation Paper indicated that we are working on putting in place alternative, electronic, arrangements to replace the current paper-based process for stamping off-exchange securities transactions. We also indicated that the arrangements will entail share registrars and/or intermediaries making declarations as to whether ad valorem stamp duty is chargeable on the transaction concerned, and if so, whether it has been paid. We received a range of comments and questions on this. The main points raised are summarised below.

(a) Request for more information and details: One respondent noted that market participants' role and responsibilities under the alternative arrangements should be clearly set out, including in particular the validation checks expected of them when making declarations, and their liability in respect of declarations made. Another respondent noted that the declaration requirement will impose an additional operational burden on intermediaries, and that the extent of this cannot be scoped without further details. We understand market participants' need for clarity regarding their responsibilities and potential liabilities. We will provide more information in due course when discussion on the details of the alternative arrangements reach a more advanced stage.

(b) Request for greater automation: One respondent commented that the alternative arrangements should focus not only on the transmission of stamp duty payment, but also on automating the end-to-end process including any stamp duty declaration involved. They added that the requirement to provide a stamp duty reference number before a transfer can be effected will create additional inefficiencies rather than moving towards a straight-through-processing model. We understand this concern. We expect most transfers to/from HKSCC-NOMS will be legal title transfers only, i.e. with no passing of beneficial interest[11], and hence stamp duty will not be chargeable. For transfers that do result in beneficial interest passing, to the extent that these are effected off-exchange and handled by intermediaries, it will be open to them to build in the desired level of automation.

(c) Time limit for stamping: One respondent noted that currently stamping can be arranged within 2 or 30 days after the contract note is executed (depending on where the sale or purchase is effected). They asked whether the new arrangements will require stamp duty to be paid before the transfer of shares can be instructed on the Common Platform. We clarify that the 2 or 30 day time limit will remain unchanged. In the USM context, this means that investors and their intermediaries will still have 2 or 30 days (as the case may be) from the date of the contract note to complete the stamping process. Where the transfer involves a change in legal title (and hence requires registration on the ROM), stamp duty can be paid before or at the time of submitting the transfer for registration. In both cases, however: (i) the payment must be completed within the 2 or 30 day time limit, as applicable; and (ii) the transfer can only be registered *after* such payment is completed.

(d) Other information sought: Respondents also asked whether the sponsoring CP or the USS holder will be responsible for making stamp duty payments in advance and obtaining the stamp duty reference number; and what will be the stamp duty payable for transfers from a USS/USI holder to HKSCC-NOMS, noting that the current charge is HK$5 per standard form of transfer. On the first point, we clarify that this will be a matter for the relevant sponsoring CP and USS holder to agree. It is also worth noting that intermediaries will not be obliged to provide services for facilitating stamp duty payment. On the issue of the HK$5 flat rate currently payable on instruments of transfer, we clarify that where the transfer is effected electronically in the USM environment, the HK$5 will not be payable[12].

[11] See paragraph 109 above.

[12] In the case of most transfers to/from HKSCC-NOMS, ad valorem duty will not be payable either since they will be legal title transfers only with no change in beneficial interest – see paragraph 109 above. However, if there is a change in beneficial interest (e.g. if the transfer is from a USS/USI holder to an investor holding in an investor participant account), ad valorem duty will be payable.

112. **SBL and margin financing:** Several respondents noted the need for the transfer process to take into account and facilitate SBL activity. In particular, they noted the need for timely (and potentially real-time) update of SBL transactions to meet onward delivery obligations under each batch settlement run, and the need for flexibility in allowing buy-in exemptions where necessary. We understand concerns about the potential impact on SBL activity, and will keep these concerns in mind as we develop the technical and operational details for the various transfer flows. One respondent also asked about the process for securities lending, and which party is entitled to the margin shares if a client defaults. In this connection, we engaged with a number of respondents and market participants to better understand their existing practices and procedures in this regard. We understand that intermediaries that advance funds against securities usually keep the securities within CCASS where they remain registered in the name of HKSCC-NOMS. We expect this practice will remain largely unchanged under the USM environment and that the processes for margin lending will therefore remain largely the same as today.

Corporate actions

113. The Consultation Paper briefly described the corporate action processes for USS and USI holders. We asked:

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.*
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.*

114. We received a number of comments on these issues, and mainly in relation to USS holders. The key issues raised and our response to these are summarised below. (Again, for the reasons discussed in paragraph 54 above, we have avoided the use of "accounts" in the discussion below.)

115. **Aligning cut-off times:** Many respondents requested that we align the corporate action cut-off times for securities registered in the name of USS holders and for securities registered in the name of HKSCC-NOMS. They noted that it would be operationally challenging for CPs to meet different cut-off times. We understand the reasons for this request and will explore the feasibility of aligning cut-off times as far as possible.

116. **Updating of securities entitlements:** One respondent asked whether corporate action entitlements will be updated to the ROM on a real-time basis to avoid any impact on USS holders who wish to sell such entitlements. In general, and like today, securities entitlements will be updated to the ROM on the distribution day designated for the entitlement in question. Securities entitlements for all registered holders (i.e. HKSCC-NOMS, USS holders, USI holders and any remaining certificated holders) will be updated at the same time.

117. **Crediting distributions in specie:** One respondent asked whether securities entitlements (such as securities distributed under a spin-off proposal) will be credited to the investor's existing USI account or to a separate USI account for the spun-off entity, noting that the latter would mean conducting a new round of account-opening. Again, we believe this concern arises from our earlier use of the term "account". As explained in paragraph 54 above, we did not mean to suggest that there would be an

account in which various securities are "held". As such, it is not the case that the securities will be "credited to" (or "debited from") any account. Rather, the USI holder's securities balance on the relevant ROM will be adjusted accordingly. In the case of a spin-off, an appropriate entry will be made on the ROM of the spun-off entity to reflect the share entitlements distributed to the USI holder. (See also paragraph 60 above which discusses whether a USI holder has to apply for the USI service in respect of each stock or other product held.)

118. **Safeguard against accidental or inadvertent instructions:** One respondent noted that, given the simplified processes involved in the USM environment compared to the more deliberate nature of paper-based actions, there should be sufficient flexibility built into the system to safeguard against instructions or confirmations being entered inadvertently or unintentionally and, thereafter, becoming irrevocable. We understand this concern and clarify that sufficient checks will be incorporated into the process flows to limit incorrect entries and facilitate rectification as soon as possible.

119. **Pledging:** A few respondents asked for more information about pledging in the USM environment. One asked if the existence of any "lock" on securities will remain private. Another asked about the arrangements among the pledgor, pledgee and ASRs, and what role the sponsoring CP will be expected to play. They also asked if there will be any change to current laws/procedures for creating mortgages/charges. One respondent suggested that key standard terms be mandated for inclusion in any agreement under such "locking" arrangement. We envisage that, as is currently the case, securities that are "locked" will not be reflected in the ROM as being locked. We understand also that services for "locking" securities to facilitate pledging are not new as some share registrars already provide such services today, although the detailed arrangements may vary among share registrars, and from case to case depending on the complexities involved. The FSR expects that practices similar to existing ones can be put in place for pledging in the USM environment. The SFC will also work with the FSR to explore the feasibility of developing certain standard provisions for inclusion in pledging agreements relating to securities held in uncertificated form. The SFC will also consider the need for legislation to facilitate pledging in the USM environment, and introduce appropriate amendments if necessary.

120. **Voting:** With respect to voting, one respondent recommended putting in place operational rules to regulate how USS holders may exercise their rights to attend and vote at meetings (including appointing proxies). Another respondent asked whether voting procedures will be streamlined, and if HKEX will build a feature to block shares for voting purposes. We welcome these suggestions and will take them into account when drafting relevant rules and regulations, and developing the Revised Model further.

121. **Reducing the number of proxies to two for individuals:** The Consultation Paper proposed reinstating the previous limit of appointing no more than two proxies (in the case of individuals) to address concerns of abuse by individuals who appoint a large number of proxies for no legitimate purpose. One respondent suggested that there may be other ways to address concerns about abuse by shareholders, such as imposing a higher limit on the number of proxies or requiring proxies appointed to be proportional to the size of the shareholding. The respondent also sought clarification as to the nature of the statutory amendment (e.g. whether shareholders will be able to split their holdings between the two proxies, and give both the right to attend, vote and speak at the meeting) and how the revised limit will work in practice (e.g. where the shareholder holds shares in both certificated form and uncertificated form). We clarify that the proposed amendments in this regard aim to reinstate the position under the

old Companies Ordinance[13], albeit only in respect of shareholders who are individuals. As to how the revised limit will work where an investor holds shares in both certificated and uncertificated form, our preliminary thinking is that even if the holdings are treated as belonging to two shareholders, this will not result in the kind of abuse currently faced. We are also considering whether further legislative amendment is needed in this regard.

122. **Changing the deadline for submitting proxy materials:** The Consultation Paper proposed amending the deadline for submitting proxy materials from 48 hours before the meeting time to one clear business day before the meeting day for better handling of proxy materials. One respondent commented on the proposal and noted that expressing the deadline in terms of "clear business day" is less clear and that office staff will not be available to deal with the submission of proxy documents if the deadline falls at midnight. We appreciate the concerns raised. We have considered further adjusting the deadline so that it falls at the close of business instead of midnight but that will further shorten the time for submitting proxy materials, which is not desirable for investors. In view of this, and on balance, we consider that the current 48-hour deadline should be maintained.

123. **Enhancing the position of beneficial owners:** The Consultation Paper noted that, as a separate exercise, the SFC is working with HKEX and the FSR to explore options for enhancing the position of investors whose securities are registered in the name of HKSCC-NOMS and who are thus beneficial owners only. In particular, we are exploring how to facilitate and encourage such investors' participation in the voting process without creating undue costs or burden for them or their intermediaries. Several respondents agreed that the position of such beneficial owners should be enhanced, with one noting that while this may be a separate initiative, it should be seen as part and parcel of a broader effort to upgrade and modernise the system. A few also noted the need to secure other shareholder rights for such investors as well, including the rights to requisition shareholders' meetings, nominate directors and petition for a company's winding-up. One respondent commented that it is important to ensure that all documentation intended for shareholders, particularly in relation to contentious takeover offers, is made available to beneficial owners promptly and in full. We understand the comments and concerns regarding the position of beneficial owners. We are hopeful that the USS and USI options under the Revised Model will encourage investors to hold securities in their own names and thus enjoy the full range of shareholder rights conferred by law. Ultimately, that will offer the best protection for investors. However, we also recognise that there will still be investors who, for various reasons of their own, prefer to keep their securities registered in the name of HKSCC-NOMS. The SFC and HKEX will continue to work on ways to enhance the position of such investors. To that end, HKEX will shortly (i.e. within this year) be putting in place arrangements to enable them to requisition meetings, move resolutions, and circulate statements relating to proposed resolutions.

Fees and costs

124. **Key concerns:** Many respondents raised questions and concerns about the fees and charges under the Revised Model and under the USM regime generally. While some raised questions about specific fees and charges, others raised more general issues. The main concerns and comments are summarised below.

[13] The old Companies Ordinance provided that a registered shareholder should have the right to appoint separate proxies to represent respectively such number of the shares held but the number of proxies appointed to attend on the same occasion shall not exceed two, unless the articles otherwise provide.

(a) Passing down cost savings to investors: One respondent commented that keeping investors' costs as low as possible must be a priority, noting in particular that cost savings from removing paper and paper-based processes should be passed down to investors.

(b) Should not deter investors holding in own name: Several respondents commented that the fees charged to investors should be kept as low as possible, in particular the costs of the USI service, and of effecting transfers to and from HKSCC-NOMS. They also added that the fee structure should not discourage investors from holding securities in their own names. Specifically, the costs of holding securities in investors' own names must not be greater than the costs of holding them within the HKEX System through an intermediary.

(c) Initial development costs: Several respondents were concerned about the initial development costs being passed on to either investors or listed issuers. In particular, listed issuers were concerned that, as ASRs' main customers and source of revenue, they may be asked to partially bear the initial costs incurred by ASRs (e.g. for developing new systems and processes to cater for the USM initiative and the proposed ASR regime). They added that this would not be appropriate as USM is an overall securities market initiative and cost recovery should be achieved over time. Intermediaries were also concerned about the costs to them of implementing the USM regime, adding that these should be kept as low as practicable.

(d) ASRs' charges: Several respondents were particularly concerned about ASRs' charges under the USM environment. They noted that the pool of ASRs may become much smaller as their responsibilities and regulation will increase, and that as a result they will be able to dictate pricing leaving issuers and investors little room to negotiate.

(e) Specific fees and charges: A few respondents sought information about specific fees and charges under the USM regime, including in particular fees for dematerialising existing holdings, effecting transfers (particularly transfers to/from HKSCC-NOMS), corporate action activities (such as dividend collection), and on-going costs (such as monthly custody fees).

125. **Our current thinking and approach:** We appreciate the market's concerns and requests for more clarity about fees and charges under the Revised Model. However, as the operational and technical details are still being developed, HKEX and share registrars are not yet in a position to finalise their respective fees and fee structures. More information in this regard will, however, be shared with the market in due course. That said, we take this opportunity to clarify the following:

(a) The initial development costs of the new systems to support the Revised Model will be borne largely by HKEX and ASRs as part of their commitment to the ongoing technological development of Hong Kong's markets. Moreover, existing processes will, as far as possible, be retained under the Revised Model, which we expect should limit the cost implications to market participants and issuers.

(b) We agree that cost savings from the reduction in paper and paper-based processes should, as far as possible, be passed on to investors, and that the fee structure should not discourage investors from holding securities in their own names or in uncertificated form. We also expect that savings will be realised as the market proceeds to full dematerialisation.

(c) We intend to keep fees and charges under the Revised Model fair, reasonable and conducive to furthering the objectives of the USM initiative. HKEX and the

FSR are also exploring the feasibility of adopting a tiered approach and/or setting caps in respect of certain fees.

Phased approach — product scope

126. The Consultation Paper proposed adopting a phased approach for implementing the USM initiative. This included phasing the product scope and the timeline to full dematerialisation. With respect to the former, we proposed starting with listed shares in Hong Kong companies followed by listed shares in non-Hong Kong companies. We also proposed that units or shares in SFC-authorised listed funds, as well as other "share-like" securities, be covered early on, but questioned whether certain securities such as CBBCs and DWs should be covered at all. We asked:

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.*
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.*
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.*

127. We received a range of comments on these issues. These are summarised and responded to below.

128. **Timing for including non-Hong Kong companies:** A few respondents commented that the initial phase should go beyond covering only Hong Kong companies. They noted that a more impactful approach for the launch will help focus the attention and energies of stakeholders, which is necessary to make the reform a success. Another respondent suggested that issues relating to the three main non-Hong Kong jurisdictions (i.e. Mainland China, the Cayman Islands and Bermuda) be clarified and resolved as soon as possible so that the first phase of implementation in 2022 can cover companies incorporated in these jurisdictions as well. We note the comments about expanding the scope of the initial phase. We will keep this issue under consideration as we progress work on reviewing the position of non-Hong Kong companies (particularly those incorporated in Mainland China, the Cayman Islands or Bermuda). More information on this will be provided in due course.

129. **More information on "share-like" securities:** Respondents generally agreed that the USM initiative should include as many types of listed securities as possible so as to enhance operational efficiency. However, noting that different "share-like" securities have their own unique features and processes, they asked for more details about the operational flows for individual products, including subscription offers, rights issues and depositary receipts. In general, the process flows for voluntary corporate actions (including rights issues) and subscription offers will be similar to today, except that the processes and documents involved (e.g. the provisional allotment letter in the case of rights) will be electronic, and the time frame may be shorter due to the interface between the HKEX System and ASRs' systems. Moreover, payments (e.g. subscription monies and any refunds) will have to be made electronically. As for depository receipts, these will be treated similar to shares, i.e. investors will be able to choose whether to hold their depositary receipts in physical form (albeit for a limited period) or in uncertificated form. For uncertificated depositary receipts, investors will be able to hold these in their own names (i.e. as a USS or USI holder), or hold them

through an intermediary in the HKEX System in which case they will be held in the name of HKSCC-NOMS.

130. **Application to Stock Connect:** One respondent asked if the USM regime will apply to Stock Connect securities. We clarify that the USM initiative will only apply to securities listed on the SEHK. It will therefore not affect how securities are traded and held under the Stock Connect arrangements. In particular, the USM regime will not apply to Mainland securities traded on the Shanghai Stock Exchange or Shenzhen Stock Exchange (i.e. A-shares). Hong Kong and international investors will be able to continue trading and holding such securities under Stock Connect as they do today. As for Mainland investors trading and holding SEHK-listed securities under Stock Connect, the USM regime will have no impact given that they do not have the option to withdraw the securities and register them in their own names, which means their securities must remain registered in the name of HKSCC-NOMS and they will not be able to become USS or USI holders.

131. **Shares in private companies:** One respondent asked if the USM initiative can apply to shares in private companies and suggested guidance to clarify 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. The USM initiative will cover only Hong Kong listed securities. Shares in private companies will therefore not be covered.

132. **SFC-authorised listed funds:** Respondents were generally supportive of including SFC-authorised listed funds within the USM initiative, but queried if this would mandate a change in terms of how units/shares of certain SFC-authorised listed funds are held. Specifically, units/shares of most ETFs are currently held under HKSCC-NOMS and investors do not have the option to withdraw their units/shares and register them in their own names. Respondents asked if the USM initiative will compel issuers to give investors such an option. They noted that this will subject them to regulatory obligations[14] that they are not currently subject to, and in turn drive up compliance costs which will ultimately be borne by investors. We clarify that the USM initiative does not seek to change current market practices beyond what is necessary to achieve dematerialisation. Accordingly, there is no intention to compel ETF issuers to give their unit/share holders the option to withdraw their units/shares from the HKEX System in the USM environment. Where no such option is offered, legal title to the units/shares will remain with HKSCC-NOMS at all times. We recognize that there will be little value in mandating such funds to participate in the USM initiative and their issuers to appoint an ASR to operate systems for effecting legal title transfers without paper documents. We will therefore scope the ASR and USM regimes accordingly, i.e. so that SFC-authorised listed funds whose units/shares are not withdrawable from the HKEX System are not compelled to participate in the USM initiative or appoint ASRs.

133. **Other listed products:** As for whether other listed products such as CBBCs and DWs should come within the scope of the USM initiative, most respondents did not have strong views. Many did however ask how these products will operate under the USM regime. We clarify that these products can continue to be traded and held as they are today, i.e. they will remain in the HKEX System, registered in the name of HKSCC-NOMS with no option for investors to withdraw and register them in their own names. As a result, they will not be covered by the USM initiative.

[14] These include obligations under the Foreign Account Tax Compliance Act, the Common Reporting Standards and various anti-money laundering obligations.

Phased approach — timeline to full dematerialisation

134. The Consultation Paper proposed setting clear timelines to help move the market to full dematerialisation. We asked:

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 dematerialisation? If no, please provide details.*
Q23	*Do you have any concerns or comments about our proposals for requiring paperless IPOs only? If yes, please provide details.*
Q24	*Do you have any concerns or comments about our proposal that there should be no option to rematerialise securities that are already in uncertificated form? If yes, please provide details.*
Q25	*Do you have any concerns or comments about our proposals for dematerialising securities that are held in the new HKEX System? If yes, please provide details.*
Q26	*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 dematerialised? If yes, please provide details.*

135. Most respondents agreed that full dematerialisation should be the ultimate goal. They did however raise some concerns and questions. These are summarised and clarified below.

136. **Transition period to full dematerialisation:** Several respondents noted that maintaining dual systems in parallel (one for the current paper-based regime and one for the USM regime) will be operationally challenging and costly for both investors and market participants. They urged therefore that full dematerialisation be implemented as soon as possible with clear timelines for each phase. In this context, a few respondents noted the need for clarity on the position of non-Hong Kong companies. One suggested that the USM initiative be implemented in respect of all securities at the same time, and another suggested getting in-principle confirmation on the position of non-Hong Kong companies before starting with Hong Kong companies. We understand the market's concerns about the time needed to transition to full dematerialisation. We clarify that timelines for different phases will be set by reference to market readiness and that sufficient advance notice will be given at each stage. We will also endeavour to keep the transition period as short as possible, taking into account the needs of and cost implications for different stakeholders. As for waiting until all non-Hong Kong companies are ready to transition to USM before implementing this initiative, we disagree. Such an approach will unnecessarily delay implementation of the USM initiative, particularly as the vast majority of listed companies are incorporated in a few main jurisdictions. Instead, as noted in the Consultation Paper, we propose to focus on three jurisdictions in particular (i.e. Mainland China, Bermuda and the Cayman Islands) as these together make up around 97% (by number) of all non-Hong Kong companies listed on the SEHK and around 94% (by market capitalisation[15]).

137. **Dual regime:** One respondent asked how we would deal with issuers and listing applicants incorporated in jurisdictions that still require share certificates. We clarify that the paper-based regime will need to be preserved for shares in companies

[15] The figures are based on the position as at the end of February 2020.

incorporated in jurisdictions whose laws either restrict or prohibit the holding and transfer of shares without paper documents.

138. **Ownership of securities after final deadline:** One respondent asked if securities held in certificated form will remain valid after the final deadline for full dematerialisation and how investors will be able to demonstrate ownership of securities. We clarify that securities in certificated form will remain valid after the final deadline. However, it will only be possible to receive securities entitlements in uncertificated form and effect transfers electronically. Investors who do nothing to dematerialise their securities after the final deadline will therefore not be prejudiced in that they will continue to be the owner of their existing securities and of any securities entitlements distributed (in uncertificated form) after the final deadline. However, if they wish to sell or dispose of any certificated securities, they will need to first dematerialise them. Thereafter, they will receive regular electronic statements of their dematerialised holdings. They will also be able to view their securities balance online at any time, albeit after completing relevant processes for becoming a USS or USI holder.

139. **Retaining the paper option:** One respondent suggested allowing investors to continue receiving printed corporate notices and dividend cheques, while still making efforts and offering incentives to persuade them to accept electronic communications or hold securities in uncertificated form. We clarify that we *do* intend to preserve this option, but only for a limited time. Ultimately however, we aim to remove the paper option particularly in respect of dividend payments and corporate communications that are not bulky. We will also explore other means to encourage investors to dematerialise their securities, such as through investor education and providing additional facilities to assist less computer-savvy investors. For instance, the FSR will encourage its members to enhance their existing public counter and telephone hotline facilities, as necessary, to cater for investors who need assistance in adapting to the USM environment, such as assistance in dematerialising securities and effecting transfers.

140. **Paperless IPOs only:** Respondents generally supported the proposal to gradually require IPO securities to be in uncertificated form only. One respondent suggested that all IPOs be handled via the E-IPO platform and that, at least for institutional investors, the form-based IPO applications be removed. As noted in paragraph 97 above, the new IPO process flows will replace the current ones, and paper-based processes will no longer be available. This will apply to all investors.

141. **Pre-IPO investors:** One respondent noted that companies seeking to be listed may need to inform their pre-IPO investors of the need to become a USS or USI holder, and to arrange to complete relevant processes in time. We agree. Prior to an IPO, existing investors in the company to be listed will be holding shares in certificated form. Under the USM environment, they will need to dematerialise their holdings. To that end, they will need to complete the relevant processes for becoming a USS or USI holder *before* the IPO process is complete and the securities become tradeable on the SEHK. Alternatively, if they wish to hold their securities in the HKEX System and through an intermediary, they will need to first transfer them to HKSCC-NOMS. We agree that pre-IPO investors will need to be informed of these options in advance, and believe the lawyers and other professionals advising on the IPO may be best placed to do so. The FSR will also consider what additional guidance can be provided as part of the IPO process.

142. **Mixed media offers:** One respondent noted that although existing rules permit the use of mixed media offers (MMOs), these are not commonly used. They suggested that

market participants be consulted on how listing applicants and their sponsors might be encouraged to adopt MMOs, and that the Conditions for MMOs be reviewed. We note the comment and will keep this in view when developing the timelines for encouraging the use of electronic communications.

143. **No rematerialisation:** Many respondents agreed that there should be no option to rematerialise securities once they have been dematerialised. However, they also sought clarification on the treatment of unclaimed physical certificates and delisted securities/untradeable securities. Details in this regard have yet to be worked out. More information will be made available in due course, and market views sought as necessary. In general however, the aim is to avoid using paper and paper-based processes wherever possible.

144. **Dematerialising securities within the HKEX System:** Respondents did not raise any particular concerns about the proposals for dematerialising securities held within the HKEX System. One respondent commented that sufficient advance notice should be given prior to each dematerialisation exercise and that the length of the notice period should take into account the time required for intermediaries to notify investors of their options[16] and to make necessary arrangements as per such instructions. We clarify that we do intend to provide sufficient advance notice for each dematerialisation exercise, and will take into account the time needed for investors and intermediaries to communicate in this regard.

145. **Dematerialising securities outside the HKEX System:** With respect to dematerialising securities outside the HKEX System, one respondent sought more information about the arrangements for holders who refuse to deliver their certificates for cancellation or to complete the processes for becoming a USS or USI holder. In particular, they asked how investors will be notified in respect of any "temporary" USI account opened in respect of their holdings. Again, we believe our earlier use of the "account" concept may have contributed to this concern. We take this opportunity to clarify. As noted in the Consultation Paper, investors will be encouraged to dematerialise their securities by a specified deadline. After such deadline, they will still be able to hold their existing securities in certificated form, and any subsequent securities entitlements due to them will be reflected in their securities balance on the ROM. However, such entitlements will no longer be distributed in paper form (i.e. no certificates will be issued). Additionally, for operational purposes, the relevant ASR will create a "temporary" USI record in their systems to reflect the distribution of such entitlements to a securities holder who has not completed the processes for becoming a USS or USI holder. ASRs will also, to the extent possible, endeavour to contact the relevant securities holder and urge them to complete these processes as soon as possible.

146. **Dematerialisation and trading:** One respondent asked whether the process for dematerialising securities will result in an investor being unable to trade their securities for a period of time, and if so, how long that period will be. We do not expect the process to interfere with investors' ability to trade their securities, i.e. the dematerialisation process will include options that facilitate same day transfers.

147. **Parallel trading arrangement:** Most respondents agreed that the existing "parallel trading" arrangement will be unnecessary in respect of securities that are

[16] The options referred to here are: (i) to keep the investor's securities within the HKEX System and registered in the name of HKSCC-NOMS; (ii) to complete the processes for becoming a USS or USI holder and hold the securities, in the investor's own name; or (iii) to withdraw the securities from the HKEX System and hold them in certificated form in the investor's own name.

dematerialised. One respondent noted, however, that without such arrangements, investors may trade on the basis of a particular stock quote without noticing that corporate actions relating to it have already taken effect, and that this may cause outstanding orders to be cancelled or amended. They suggested that further guidance be provided, noting also that intermediaries' systems may need to be enhanced. We clarify that we will allow sufficient time for the market to adapt and make any necessary changes. We will also provide guidance on the new arrangements as necessary.

Encouraging electronic communications

148. The Consultation Paper noted that to further encourage the market's move towards full dematerialisation, we proposed to gradually encourage issuers and registered securities holders to communicate electronically rather than in paper form. We asked:

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.*

149. The majority of respondents supported this proposal and regarded it as a positive development for the market. However, a few concerns were also raised. We summarise and respond to these below.

150. **Data integrity and security:** One respondent noted that the issue of data integrity and security associated with electronic communications should be fully addressed. Another commented that relying solely on electronic communications may impact contingency planning and suggested maintaining a separate paper channel as backup. We agree that data integrity and security are crucial, as is the need for adequate business continuity planning with back up to cater for contingency. HKEX and the FSR will take these into account when developing enhancements to their systems to facilitate communications between issuers and investors.

151. **Facilities for investors to communicate electronically:** Two respondents commented that it is necessary to allow shareholders access to printed documents, such as listing documents and annual reports, at designated and easily accessible locations as not all investors (in particular, elderly or disabled persons) may have electronic communication addresses or the ability to access electronic communications. We understand these concerns and will only mandate electronic communications after taking into account market readiness. We will also consider retaining the paper option in certain limited cases, e.g. for bulky documents such as annual reports.

152. **Routing USS holders' communications via sponsoring CPs:** One respondent suggested that sponsoring CPs be allowed to designate their own electronic communication details for USS holders so that communications between issuers and USS holders are routed via the sponsoring CPs. As noted in paragraph 56 above, it is intended that certain communications will have to be routed via the sponsoring CP and the HKEX System. These will be specified and will include communications in respect of the matters described in paragraph 56(c) above. In the case of other communications, we believe these should be a matter for the USS holder to agree with its sponsoring CP.

153. **Implied consent for electronic communications:** One respondent noted the need to deal with the issue of implied consent for electronic communications. In light of further discussions with the respondent, we understand that the respondent's request is to further simplify the existing requirements for electronic communications

(particularly website publication). Our current view is that the existing provisions for website publications by listed companies achieve a suitable balance between facilitating electronic communications and investor protection. That said, and as indicated in the Consultation Paper, our aim is to gradually mandate listed companies and their shareholders to use electronic communications in certain cases, and to achieve this by introducing appropriate legislative changes. In that context, we will review the feasibility of simplifying the requirements for communications by website publication.

Regulation of share registrars (as ASRs) in the USM environment

154. As noted in the Consultation Paper, share registrars and their systems will take on much greater responsibilities in the USM environment. The paper accordingly proposed putting in place a new regulatory regime for approving and regulating share registrars. We received a range of comments and questions in this regard. The key issues covered are summarised and clarified below.

155. **Details of the new regime:** One respondent asked for more details about the regulatory regime for share registrars and highlighted some of the key matters that should be covered or taken into account. We summarise these and our response below.

(a) Systems standards: It was suggested that minimum systems requirements should be introduced to ensure that investors are not disadvantaged as a result of having to rely on different ASRs, particularly as they are appointed by issuers. The SFC is in the process of developing the regulatory framework for ASRs. A key focus will be the integrity, security and adequacy of their systems and processes, including in particular their IT systems, infrastructure, and interface with external parties. Detailed requirements will be set out in SFC rules, codes and/or guidelines, and therefore consulted on in due course.

(b) Operational requirements: Similarly, it was suggested that the fitness and properness of directors/owners of an ASR operation, as well as its financial resources and internal controls, should be taken into account. The SFC clarifies that it does intend to take these matters into account when approving and regulating persons as ASRs.

(c) Protection for investors: It was suggested that there be a mechanism to avoid potential overcharging by ASRs. Also, as issuers will determine which ASRs to appoint, it was suggested that consideration be given to enabling shareholders to seek the removal of a particular ASR in extreme cases. The SFC understands the concerns around ASR fees and services, particularly as investors cannot choose which ASR to use. On the issue of overcharging, the SFC is considering whether, and to what extent, ASRs' fees can and should be regulated, without raising concerns about breaching anti-competition laws. However, on the issue of giving investors a specific right to remove an ASR, the SFC's current view is that this is not necessary or appropriate given that ASRs will be directly regulated by the SFC under the USM regime, and subject to disciplinary sanctions (see paragraph (d) below).

(d) SFC's powers: Lastly, it was also noted that the SFC must have sufficient supervisory, investigatory and regulatory powers, including the ability to impose a range of disciplinary sanctions for breaches. We agree. The SFC is working on introducing legislative amendments that will achieve this. In terms of sanctions, the SFC is considering sanctions similar to those that can be imposed on licensed corporations under the SFO, i.e. suspensions,

revocations, reprimands, fines and restrictions on the management and scope of an ASR's business or operations.

156. **Impact on intermediaries' business:** Several respondents raised concerns about the potential overlap in the role and responsibilities of ASRs and intermediaries as a result of the former becoming participants of the HKEX System under the new "registrar participant" category. This issue is addressed in paragraph 52 above. Separately, another respondent commented that the proposal to require USI accounts to be opened directly with ASRs is tantamount to transferring brokers' account opening function to ASRs, adding that this will adversely affect brokers' business and be a severe blow to the industry. The respondent also commented that brokers are better placed to conduct know-your-client checks for the purposes of account opening, and suggested that USI accounts be opened with banks or brokers. We disagree.

(a) First, we appreciate that our earlier use of the term "account" to describe the USS/USI feature may have contributed to these concerns. As explained in paragraph 54 above, we did not mean to suggest that the USI feature would result in the creation of an account where securities are "held" in the same way that securities are held with an intermediary. The role of an ASR is therefore very different from that of an intermediary.

(b) Secondly, as noted in paragraph 58(a) above, ASRs will only conduct certain basic checks rather than detailed know-your-client checks as their main objective is to collect information relevant to fulfilling their obligations, such as maintaining the ROM and being able to verify a securities holder's identity when necessary (e.g. when handling a transfer instruction).

(c) It is also important to keep in mind that the USI feature is essentially a mechanism for reflecting and managing securities held in uncertificated form, and thereby facilitating interaction between a securities issuer and its securities holders. The feature is not intended to subsume intermediaries' role of facilitating trading on the SEHK or providing custodian services. Consequently, securities will still have to be moved into the USI holder's intermediary's account in the HKEX System before they can be used for settling trades executed on the SEHK.

(d) Approval as an ASR will not constitute a licence or approval to carry on dealing in securities (for which a licence for Type 1 regulated activity under the SFO will still be required). Similarly, the new "registrar participant" category in the HKEX System will not confer the same rights and obligations as those currently conferred and imposed on CPs.

For all of these reasons, we do not agree that ASRs' role under the Revised Model will overlap with or substitute the role currently played by intermediaries, whether as CPs or otherwise.

157. **Protection against threats to ROMs:** A few respondents noted the need for sufficient safeguards against internal and external threats to ASRs' systems, so as to ensure the safety and integrity of the ROM. One respondent asked if the issuer or the ASR, or both, would be liable in the event of any error or fraud. Another asked if the ROM, in the USM environment, will be in electronic form with no stand-alone (physical) record which could remain unaffected by any catastrophic system failure. They too asked who would be the ultimate owner/risk bearer of the underlying electronic record, and noted the need to consider issues like insurance of titles. It is worth noting that, even today, ROMs of listed companies are generally maintained only in electronic form. Most share registrars therefore already have systems and processes in place to ensure the

security and integrity of the ROMs they maintain. That said, the SFC is looking into this issue more specifically and will introduce appropriate requirements under the proposed ASR regime to address concerns about the safety and integrity of ROMs, and consequently, liability also.

158. **Inspection of ROMs:** A few respondents commented on the inspection of ROMs. One asked for more detail about the type of information that would be available for public inspection and how that information would be made available. Another suggested that not all information in a ROM should be available for public inspection. In particular, they suggested that there was no need for holdings of USS holders to be visible day-by-day as they trade, adding that their privacy in this regard should be preserved particularly as directors and substantial shareholders are already subject to the disclosure of interests regime. On the other hand, one respondent suggested that the ROM should be made available for online inspection. We can understand why some investors, particularly institutional investors, may be concerned to keep changes in their holdings confidential. However, it is difficult to frame a fair and meaningful restriction in this regard, particularly as there may be legitimate reasons for someone to seek to inspect changes entered in a ROM. We can also understand the wish for greater convenience in exercising the right to inspect the ROM, although too much convenience may also be unnecessary and susceptible to abuse. On balance, we believe the current requirements and practices regarding the inspection of ROMs (including the process involved, the time limitations, and the requirement to pay fees in certain cases) achieve an appropriate balance between these conflicting requests. We therefore do not propose any change in this regard. We also clarify that, like today, the details that will be available for inspection will be the names and addresses of registered holders, and the number of securities registered as being held by them (as at the date of the ROM being inspected).

159. **Overlap with other regimes:** One respondent noted that some ASRs may be subject to regulation under other regimes (such as the regime for trust or company service providers), and suggested harmonising the requirements under such regimes and the proposed ASR regime. As different regimes tend to focus on different matters, it may not always be appropriate to harmonise the requirements. That said, the SFC will keep these concerns in mind when finalising the details of the ASR regime.

Other comments and suggestions

160. In addition to the various matters discussed above, respondents also submitted comments and suggestions on a range of other matters. These are summarised and discussed below.

161. **Cross-listed securities:** Some respondents asked how the USM initiative will affect cross-listed securities, in particular the processes for moving such securities between the principal and branch registers. We clarify that, in general, the securities will have to be registered in the name of the same holder both before and after the movement between registers. This means, if the securities are held within the HKEX System, they will need to be withdrawn first and registered in the name of the relevant investor. As to whether this withdrawal and registration process will require the issue of paper certificates, this will depend on whether the particular securities in question can be held in uncertificated form on both registers. In general, the aim will be to avoid the use of paper and paper-based processes wherever possible.

162. **Meetings:** One respondent noted that there is already a real and present problem in securing venues for shareholder meetings, and that the costs of doing so are high as

well. They suggested promoting the use of hybrid meetings (i.e. meetings that can be attended online or in-person). We understand the concerns raised. We note however that listed companies in Hong Kong have already begun to consider holding hybrid meetings. We will continue to follow this development closely.

163. **Make more use of technology:** A few respondents suggested applying new technologies, e.g. blockchain, when developing systems for the USM environment. We clarify that HKEX and the FSR will be considering different options when developing or enhancing systems for the USM environment. While costs will also be a consideration, ultimately the focus will be on system security, integrity and stability.

164. **The term "USM":** One respondent noted that the term "USM" is also widely used in Hong Kong to refer to the Government's Uniform Screening Mechanism for protection for refugees. They suggested using a different term to avoid confusion. We do not agree that there is a risk of confusion given the very different nature of the two matters. Moreover, the term "USM" has been used now for some time to refer to the initiative for dematerialising Hong Kong's securities market, and the market is familiar with it.

165. **Training and investor education:** One respondent suggested providing training to different parties (such as intermediaries and issuers) on the operational aspects of the new systems under the USM regime. The respondent also suggested that investor education be provided so that investors may better understand the USM initiative and its implications for them. We agree that training and investor education will be important to the smooth implementation of the USM initiative, and clarify that they will be provided.

IV. CONCLUDING REMARKS

166. We take this opportunity to thank the many respondents who took the time and effort to submit comments and suggestions. The feedback has been crucial in helping us refine some aspects of the Revised Model. More significantly, the conclusion of this consultation marks a key milestone in that it reflects strong support for the Revised Model and a clear preference for it over the 2010 Model. With this, we can now focus on putting in place the regulatory framework and taking forward the legislative exercise needed to support the Revised Model.

167. However, as discussed in this paper, much still remains to be done in terms of further developing the Revised Model and, ultimately, implementing the USM initiative. To that end, and as noted throughout this paper, we will be seeking further input from the market on various matters in due course. We also continue to welcome views and discussion with interested parties.

168. In terms of next steps:

(a) Our immediate focus will be on continuing efforts to develop the operational and technical details of the Revised Model. The SFC is also working with the Government on the amendments to the primary legislation to support the Revised Model.

(b) Thereafter, the SFC will work on the various subsidiary legislation and SFC Codes and Guidelines needed to support the Revised Model and the USM initiative. This will include introducing new subsidiary legislation to provide for the USM environment and the regulation of ASRs. Amendments will also be needed to various existing subsidiary legislation (such as the Securities and

Futures (Stock Market Listing) Rules, which currently deal with approved share registrars).

(c) At the same time, HKEX will work on relevant amendments to various SEHK and HKSCC rules and operational procedures. Simultaneously, HKEX and the FSR will work on the system developments and enhancements needed to support the Revised Model.

169. We will therefore continue to engage with the market in the coming months and seek views and input at different stages as work on the above matters progresses, with a view to implementing the USM regime from 2022.

Appendix – List of respondents

(in alphabetical order)

1. Asia Securities Industry & Financial Markets Association
2. Bank of China (Hong Kong) Limited
3. BNP Paribas Securities Services *(requested comments not to be disclosed)*
4. Chamber of Hong Kong Listed Companies, The
5. Charltons on behalf of Anglo Chinese Corporate Finance Limited and Asian Capital Limited
6. Clearstream Banking S.A., Hong Kong
7. Clifford Chance
8. Credit Suisse Securities (Hong Kong) Limited
9. Euroclear Bank SA/NV (Hong Kong Branch)
10. Financial Services Development Council
11. Global Legal Entity Identifier Foundation
12. Goldman Sachs Services (Asia) Limited
13. Hon Christopher Cheung Wah-fung, SBS, JP
14. Hong Kong Association of Banks, The
15. Hong Kong Institute of Certified Public Accountants
16. Hong Kong Institute of Chartered Secretaries, The
17. Hong Kong Investment Funds Association
18. Hong Kong Securities Association Limited
19. Hong Kong Securities Professionals Association
20. Hong Kong Society of Financial Analysts, The
21. Ken Wong
22. Law Society of Hong Kong, The
23. Margery Wong
24. Mayer Brown
25. Shareholder
26. Slaughter and May
27. Webb-site.com
28. 古春輝女士
29. 呂志清、潘筱群、岑溢倫
30. 雷景楊、曾展松、黃小瓊、岑越佳
31. to 41. 11 respondents who requested that their names be withheld from publication
42. to 43. 2 respondents who requested that both their names and submissions be withheld from publication

GLOSSARY

2010 Model	the operational model for implementing a USM regime that was consulted on in 2009/2010 — see paragraphs 35 to 36 of the Consultation Paper
ASR	a share registrar that has been approved by the SFC under the ASR regime
ASR regime	the proposed regime for approving and regulating share registrars under the USM environment — see paragraphs 128 to 131 of the Consultation Paper
beneficial interest / beneficial owner	investors hold only a *beneficial interest* in their securities (or are only *beneficial owners* of their securities) if they are not registered on the ROM as owners of the securities, and consequently: (i) have no relationship with the issuer; and (ii) must instead rely on the contractual arrangements with the registered owner, and any intermediating entities in between, to enjoy the rights and benefits of holding the securities
CBBC	callable bull/bear contract
CCASS	Central Clearing and Settlement System operated by HKSCC
CCP	central counterparty
certificated holder	registered holder of securities who holds the securities in certificated (paper) form
certificated holdings / certificated securities	securities held in certificated (paper) form
CNS securities	securities for settling CNS trades
CNS trade	a securities trade that is novated to and guaranteed by HKSCC as CCP, and settled in CCASS as part of its continuous net settlement process
CO	the Companies Ordinance (Cap. 622)
Common Platform	the common platform that the FSR is exploring to develop — see paragraphs 73 to 78 of the Consultation Paper
Consultation Paper	the consultation paper on a revised operational model for implementing an uncertificated securities market in Hong Kong, jointly issued by the SFC, HKEX and the FSR in January 2019
CP	a clearing participant or a custodian participant in CCASS, or in the HKEX System (as the case may be)
CPA	a CCASS participant account under the 2010 Model
DW	derivative warrant

ETF	exchange traded fund
FSR	the Federation of Share Registrars Limited
HKEX	Hong Kong Exchanges and Clearing Limited
HKEX System	the new system to be introduced by HKEX to replace CCASS — see footnote 10 of the Consultation Paper
HKEX System rules	the rules governing the use and operation of the HKEX System
HKSCC	Hong Kong Securities Clearing Company Limited
HKSCC-NOMS	HKSCC Nominees Limited
Hong Kong company	a company incorporated under the laws of Hong Kong
intermediary	bears the meaning given in Schedule 1 to the SFO
legal title	investors hold *legal title* to securities if they are registered with the issuer as the legal owner of the securities, and therefore have a direct relationship with the issuer, and receive rights and entitlements from the issuer directly
MMO	an offer process which allows an issuer of securities to distribute paper application forms without the related listing document provided certain conditions are fulfilled, including that an electronic copy of the listing document is made available on both the HKEX's and issuer's websites, and printed copies of the listing document are publicly available free of charge
non-Hong Kong company	a company incorporated under the laws of a place outside Hong Kong
Revised Model	the revised operational model for implementing a USM regime — see Section III of the Consultation Paper
ROM	the register of members or (in the case of securities other than shares) the register of securities holders registered with the issuer
SBL	stock borrowing and lending
SEHK	The Stock Exchange of Hong Kong Limited
SFC	the Securities and Futures Commission
SFO	the Securities and Futures Ordinance
SI transaction	a securities transaction between two CPs in respect of which HKSCC has no role as CCP, and which is settled in CCASS between the two parties directly by entering settlement instructions
sponsoring CP	in relation to a USS holder, means the clearing or custodian participant in the HKEX System via which the USS holder manages their uncertificated securities

uncertificated securities	securities held in uncertificated (paperless) form
USI feature	the feature (under the Revised Model) that will facilitate the holding of securities in uncertificated form, and require the registered holder of the securities to manage those securities directly (i.e. by communicating with the issuer, or the issuer's ASR, directly) — see also paragraph 54 above
USI holder	a registered holder of securities who, under the Revised Model, will be able to hold those securities in uncertificated form and have to manage them directly
USI service	the service to be provided by issuers through ASRs whereby securities held in uncertificated form can be managed by the registered holder of them directly — see also paragraph 54 above
USM initiative/regime	the initiative/regime for implementing an uncertificated securities market in Hong Kong
USMO	the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2015, enacted in March 2015
USS feature	the feature (under the Revised Model) that will facilitate the holding of securities in uncertificated form, and require the registered holder of the securities to manage those securities indirectly (i.e. by communicating with the issuer, or the issuer's ASR, via a sponsoring CP and the HKEX System) — see also paragraph 54 above
USS holder	a registered holder of securities who, under the Revised model, will be able to hold those securities in uncertificated form and have to manage them via a sponsoring CP and the HKEX System