

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



January 2019

# TABLE OF CONTENTS

|  |            |
|--|------------|
| <b>TABLE OF CONTENTS</b> .....   | <b>i</b>   |
| <b>FOREWORD</b> .....  | <b>iii</b> |
| <b>PERSONAL INFORMATION COLLECTION STATEMENT</b> .....                             | <b>iv</b>  |
| <b>I. EXECUTIVE SUMMARY</b> .....  | <b>1</b>   |
| <i>Purpose</i> .....   | 1          |
| <i>The USM initiative</i> .....  | 1          |
| <i>Key benefits of the USM initiative</i> .....                                    | 1          |
| <i>Work done previously</i> .....  | 2          |
| <i>Revised Model</i> .....   | 2          |
| <i>Revised Model vs 2010 Model</i> .....   | 3          |
| <i>Need for further legislative amendment</i> .....                                | 4          |
| <i>Scope and phased approach</i> .....   | 5          |
| <i>Implications for different stakeholders</i> .....                               | 5          |
| <i>Comments invited</i> .....  | 7          |
| <i>Layout of this paper</i> .....  | 7          |
| <b>II. DEVELOPMENT OF THE OPERATIONAL MODEL</b> .....                              | <b>8</b>   |
| <i>The 2010 Model</i> .....  | 8          |
| <i>Challenges presented by the 2010 Model</i> .....                                | 8          |
| <i>Need for a different approach</i> .....   | 9          |
| <b>III. THE REVISED MODEL</b> .....  | <b>10</b>  |
| <i>Comparison with current model and 2010 Model</i> .....                          | 10         |
| <i>Stamp duty</i> .....  | 15         |
| <i>New accounts for uncertificated holdings – USI and USS</i> .....                | 16         |
| Account opening .....  | 16         |
| Account operation and communications with the issuer .....                         | 17         |
| Electronic statements and confirmations .....                                      | 18         |
| ROM entries in respect of uncertificated securities holders.....                   | 18         |
| Relationship with issuer and HKSCC.....  | 18         |
| <i>Requirement to provide unique identification number</i> .....                   | 19         |
| Proposal and purpose .....   | 19         |
| Types of unique identification number .....  | 20         |
| Difficulty in obtaining numbers from existing certificated securities holders..... | 20         |
| <i>Consolidation of holdings for entitlements distribution</i> .....               | 21         |
| <i>ROM reconciliation</i> .....  | 21         |
| <i>Common platform</i> .....   | 21         |
| <b>IV. KEY PROCESSES UNDER THE REVISED MODEL</b> .....                             | <b>22</b>  |

|   |           |
|---|-----------|
| <i>IPO</i> .....  | 23        |
| <i>Transfers</i> .....  | 24        |
| Transfers of securities within the HKEX System.....   | 24        |
| Transfers of uncertificated securities to or from HKSCC-NOMS.....                                   | 25        |
| Other transfers of uncertificated securities.....   | 25        |
| Transfers of certificated securities .....  | 26        |
| Transfers on half-day trading days.....   | 26        |
| <i>Corporate actions</i> .....  | 26        |
| <i>Fees and charges</i> .....   | 28        |
| <b>V. SCOPE AND PHASED APPROACH TO FULL DEMATERIALIZATION.....</b>                                  | <b>28</b> |
| <i>Product scope</i> .....  | 28        |
| Shares .....  | 29        |
| Listed funds and share-like securities.....   | 30        |
| Other listed products .....   | 30        |
| <i>Timeline to full dematerialization</i> .....   | 30        |
| Paperless IPOs only.....  | 31        |
| No option to rematerialize .....  | 31        |
| Existing securities held within the new HKEX System .....   | 32        |
| Existing securities held outside the HKEX System.....   | 32        |
| <i>Encouraging electronic communications</i> .....  | 33        |
| <b>VI. FURTHER LEGISLATIVE AMENDMENTS NEEDED.....</b>   | <b>34</b> |
| <i>Amendments stemming from changes to the operational model</i> .....                              | 34        |
| <i>Other amendments to facilitate implementation of the USM initiative</i> .....                    | 35        |
| <i>Regulation of share registrars in the USM environment</i> .....                                  | 36        |
| <i>Other non-statutory amendments</i> .....   | 38        |
| <b>VII. PROPOSED TIMETABLE AND NEXT STEPS.....</b>  | <b>38</b> |
| <b>VIII. COMMENTS INVITED .....</b>   | <b>38</b> |
| <b>ANNEX 1: HIGH-LEVEL COMPARISON OF OPERATIONAL MODELS.....</b>                                    | <b>40</b> |
| <b>ANNEX 2: HIGH-LEVEL COMPARISON OF USI ACCOUNT AND USS ACCOUNT .....</b>                          | <b>41</b> |
| <b>ANNEX 3: PROCESS FLOWS FOR IPO .....</b>   | <b>42</b> |
| <b>ANNEX 4: PROCESS FLOWS FOR TRANSFERS TO AND FROM HKSCC-NOMS<br/>UNDER THE REVISED MODEL.....</b> | <b>44</b> |
| <b>ANNEX 5: PROCESS FLOWS FOR OTHER TRANSFERS UNDER THE REVISED<br/>MODEL.....</b>                  | <b>46</b> |
| <b>LIST OF QUESTIONS .....</b>  | <b>49</b> |
| <b>GLOSSARY .....</b>   | <b>51</b> |

## FOREWORD

This consultation paper is issued jointly by the Securities and Futures Commission (**SFC**), Hong Kong Exchanges and Clearing Limited (**HKEX**) and the Federation of Share Registrars Limited (**FSR**). Market participants and interested parties are invited to submit comments on the proposals discussed in this paper and on related matters that might impact the proposals. Persons submitting comments on behalf of an organisation should provide details of the organisation whose views they represent.

Comments should be submitted by no later than **27 April 2019** and in writing as follows:

|                                 |  |
|---------------------------------|--|
| By mail or hand<br>delivery to: | Supervision of Markets Division<br>Securities and Futures Commission<br>35/F Cheung Kong Center<br>2 Queen's Road Central<br>Hong Kong |
| By fax to:                      | (852) 2521 7917  |
| By online<br>submission at:     | <a href="http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/">http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/</a>  |
| By Email to:                    | usmconsult@sfc.hk  |

**Please note that the names of the commentators and the contents of their submissions may be published, in whole or in part, on the website of the SFC, HKEX and/or the FSR, as well as in other documents to be published by any of them. In this connection, please read the SFC's Personal Information Collection Statement on the following two pages.**

**You may not wish your name or submission to be published. If this is the case, please state that you wish your name, submission or both to be withheld from publication when you make your submission.**

28 January 2019

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### Purpose of collection

2. The personal data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
  - (a) to administer the relevant provisions<sup>2</sup> and codes and guidelines published pursuant to the powers vested in the SFC;
  - (b) to perform its statutory functions under the relevant provisions;
  - (c) for research and statistical purposes; and
  - (d) for other purposes permitted by law.

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3. Personal data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper, together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC during the consultation period or at its conclusion.
4. Additionally, the personal data collected by the SFC in response to this consultation paper will be disclosed to HKEX and the FSR for the purposes of this consultation. HKEX and the FSR may publish, on their websites and in other documents, the names of persons who submit comments on the consultation paper together with the whole or part of their submissions.

### Access to data

5. You have the right to request access to and correction of your personal data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your personal data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

### Retention

6. Personal data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

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<sup>2</sup> The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

## **Enquiries**

7. Any enquiries regarding the personal data provided in your submission on this consultation paper, requests for access to personal data or correction of personal data should be addressed in writing to:  
The Data Privacy Officer  
The Securities and Futures Commission  
35/F Cheung Kong Center  
2 Queen's Road Central  
Hong Kong
8. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

## I. EXECUTIVE SUMMARY

### *Purpose*

1. This consultation paper is issued jointly by the Securities and Futures Commission (**SFC**), Hong Kong Exchanges and Clearing Limited (**HKEX**) and the Federation of Share Registrars Limited (**FSR**). It seeks views on proposals for revising the operational model for implementing an uncertificated securities market in Hong Kong (**USM**), and related matters.

### *The USM initiative*

2. Hong Kong law currently still requires the use of paper documents to evidence and transfer *legal title* to certain securities, including in particular shares. Because of this limitation, as well as other practical business and operational considerations, most investors in listed securities hold and transfer their securities through the Central Clearing and Settlement System (**CCASS**) where the securities are “immobilised”<sup>1</sup> and held under the name of a single nominee (i.e. HKSCC Nominees Limited, **HKSCC-NOMS**). However, this also means that investors only hold and transfer the *beneficial interest* in the securities, and not *legal title* to them<sup>2</sup>. In other words, the securities are not held in the name of the investor concerned.
3. Being only beneficial owners, investors holding securities through CCASS have no direct relationship with the issuer. In the context of shares, this also means they are not conferred shareholder rights under the law. They must instead rely on the registered owner (i.e. HKSCC-NOMS), and any intermediating entities in between, to exercise these rights on their behalf (such as any voting rights), and to pass on any entitlements (such as dividends, bonuses, etc) to them.

### *Key benefits of the USM initiative*

4. A main aim of the USM initiative is to enable investors to hold securities, and in particular shares, in their own name *and* without paper documents. This can bring a number of benefits.
  - (a) Better legal protection and transparency: As indicated above, investors who hold securities in their own name enjoy a direct relationship with the issuer and better legal protection. From the issuer’s perspective, there is better transparency in terms of the real owners of its securities.
  - (b) Greater efficiency: The elimination of paper will result in the digitisation of securities holdings. This in turn will allow for the removal of manual processes, facilitate straight-through-processing, and ultimately further enhance efficiency.<sup>3</sup>

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<sup>1</sup> Securities held within CCASS are “immobilised” in the sense that, so long as the securities remain in CCASS, they continue to be registered in the name of a single nominee, i.e. HKSCC-NOMS. Transfers of securities within CCASS therefore do not need to be re-registered with the issuer, and do not require the movement of any underlying paper certificates.

<sup>2</sup> Investors who hold *legal title* to securities are registered with the issuer as the legal owner of the securities. They therefore have a direct relationship with the issuer, and receive rights and entitlements from the issuer directly. Investors who hold *beneficial interest* in securities are not registered with the issuer, and have no relationship with the issuer. They must instead rely on the contractual arrangement with the registered owner, and any intermediating entities in between, to enjoy the rights and benefits of holding the securities.

<sup>3</sup> More specifically, transfers of legal title will no longer depend on manual processes such as the physical delivery and stamping of paper certificates, instruments of transfer and contract notes. Instead, through the creation of secure communication links among key stakeholders (including the central depository, intermediaries, issuers (via

- (c) Enhanced financial market structure: The above will also facilitate the establishment of more efficient and direct communication linkages between key stakeholders (i.e. Hong Kong Securities Clearing Company Limited (**HKSCC**), issuers (through their share registrars), intermediaries and investors). This, in turn, will elevate our financial market infrastructure, enhance our global competitiveness, and pave the way for the further growth and development of our markets such as through increased integration with other markets, including the Mainland markets.
- (d) Ecological impact: Reducing the need for paper and manual processes is also environmentally friendly, and in line with efforts to promote greener markets and practices.

### ***Work done previously***

- 5. There are several components to implementing the USM initiative, including: (i) reaching consensus on the operational model; and (ii) enacting relevant legislation to support the model. To that end, the market was previously consulted (in 2009/2010) on a possible operational model (**2010 Model**). As the feedback was generally positive, work proceeded on the basis of that model, including work on enacting relevant primary law amendments.
- 6. Subsequently however, in the course of developing the details of the 2010 Model, market concerns were raised about the limitations of that model. Specifically, there were concerns that the model would compromise certain settlement efficiencies currently enjoyed by market participants, and have a significant impact on their liquidity needs. In view of this, we have had to revisit the 2010 Model and identify an alternative approach.<sup>4</sup> A key purpose of this paper therefore is to explain the concerns raised, describe the changes needed and seek views on the revised operational model that is now proposed (**Revised Model**).

### ***Revised Model***

- 7. The Revised Model is described and discussed in more detail under [Section III](#). That section also describes the current operational model and the 2010 Model to facilitate comparison with the Revised Model.
- 8. Briefly, the main changes under the Revised Model (as compared with the 2010 Model) are as follows:
  - (a) Nominee structure retained: The existing nominee structure in CCASS will be retained. This means investors who hold securities through CCASS in the way they do today, will continue to hold only a beneficial interest as HKSCC-NOMS will remain the registered owner and hold legal title to such securities. (The reasons for retaining the nominee structure are explained in more detail in paragraphs 27 to 32 below.)
  - (b) Options for holding paperless holdings: Investors will still have the option to hold securities in their own name *and* in uncertificated form (i.e. without paper). However, these securities will not be managed and administered through any of the existing account types in CCASS. Instead, two new account types will be introduced for this purpose:

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their share registrars) and investors), it will be possible to transfer legal title safely, efficiently and wholly electronically.

<sup>4</sup> The challenges presented by the 2010 Model are discussed in more detail in paragraphs 27 to 29.



- (i) Investors will be able to open a “**USI account**” with the issuer’s share registrar. Securities reflected in a USI account will be registered in the name of the investor that has opened the account, which means the investor will be the *legal* owner of the securities and hold *legal* title to them. The account will be administered by the relevant share registrar, and the investor will be able to manage their holdings directly.<sup>5</sup>
- (ii) Institutional investors (in particular funds) will be able to open a “**USS account**” with a sponsoring clearing or custodian participant (**sponsoring CP**). Securities reflected in a USS account will be registered in the name of the institutional investor that has opened the account, which means it will be the *legal* owner of the securities and hold *legal* title to them.<sup>6</sup> The account will be administered by the relevant sponsoring CP, and the institutional investor will have to manage its holdings through such sponsoring CP.<sup>7</sup>

The features and functions of the USI account and USS account are explained in more detail in paragraphs 45 to 62 below.

- (c) No split register: The 2010 Model envisaged that the register of members or register of securities holders (**ROM**) would be kept in two parts, with one part maintained by HKSCC and the other by the issuer’s share registrar. Under the Revised Model however, the entire ROM will be kept and maintained by the issuer’s share registrar.
- (d) Role change for HKSCC and share registrars: Flowing from the above, share registrars’ systems will be used for evidencing, and effecting transfers of, legal title to securities. HKSCC will not play the role of “system operator” under the USM environment as was envisaged under the 2010 Model. As a result, share registrars, and their systems, will take on additional responsibilities, and it will be necessary for the SFC to regulate them more directly and robustly than today. A new regime for regulating share registrars will therefore be introduced.<sup>8</sup>
- (e) Interface between HKSCC’s and share registrars’ systems: The process of moving securities into and out of the clearing and settlement environment will, as today, constitute legal title transfers. However, unlike today, the transfer will be electronic rather than paper-based. An interface or connection will therefore be needed between HKSCC’s systems and share registrars’ systems. To that end, HKSCC will introduce a new “registrar participant” category for share registrars.

### **Revised Model vs 2010 Model**

9. A key difference between the 2010 Model and the Revised Model is that the former offered investors the option to hold uncertificated securities in their own name *within* the clearing and settlement environment (i.e. within CCASS), while the latter only allows them to do so *outside* that environment. It follows that, under the Revised Model, investors who opt to hold uncertificated securities in their own name, and who wish to

<sup>5</sup> The acronym “USI” is intended to denote that the account and holdings in question belong to an uncertificated shareholder, and that the account is opened with the issuer’s share registrar.

<sup>6</sup> For example, in the case of funds, the corporate entity (where the fund is structured as a corporate vehicle) or the trustee (where it is structured as a trust) may be registered as the legal owner.

<sup>7</sup> The acronym “USS” is intended to denote that the account and holdings in question belong to an uncertificated shareholder, and that the account is opened with a sponsoring CP.

<sup>8</sup> This new regime is described and discussed under paragraphs 128 to 131 below.

sell them on The Stock Exchange of Hong Kong Limited (**SEHK**), will (similar to today) need to first move them into the clearing and settlement environment by transferring the securities to HKSCC-NOMS. However (unlike today), the process for effecting such transfers will be electronic rather than paper-based, which means it will be much simpler and faster than it is today, as well as more efficient and convenient. The need to effect transfers should not, therefore, deter investors from opting to hold securities in their own name.

10. The above said, we appreciate that there will be investors who (for various reasons) prefer to hold securities within the clearing and settlement environment, and hence in the name of HKSCC-NOMS. These investors will continue to hold only a beneficial interest in their securities. In the context of shares, this means they will, as today, continue to have to rely on HKSCC-NOMS, and any intermediating entities in between, to pass any benefits on to or exercise any rights for them. We are mindful that the process for this can, in some cases, be inconvenient and inefficient. A prime example is the process for exercising the right to vote and/or attend meetings of a listed company. The current processes for these are largely paper-based and cumbersome, and hence not conducive to participation in the voting process. It would be in the interest of investors, and consistent with the USM objective of removing paper documents and manual processes, to develop an *electronic* alternative that facilitates and encourages participation in the voting process, but without creating undue costs or burden for either investors or their intermediaries. Any such alternative would benefit investors under the current market infrastructure also, and should therefore be implemented separately from the USM initiative and as soon as possible.
11. The SFC is working with HKEX to explore options in this regard, and will seek further views from the market in due course. In the meantime, we welcome any suggestions market participants may have.

#### ***Need for further legislative amendment***

12. In light of the fundamental differences between the 2010 Model and the Revised Model, a number of primary law amendments enacted in March 2015 to support the 2010 Model will no longer be appropriate, and will require further amendment. In particular, provisions predicated on there being a “split ROM” will need amendment. Amendments will also be needed to reflect that the electronic systems for evidencing, and effecting transfers of, legal title to securities will be operated by share registrars rather than by HKSCC.
13. The opportunity is also taken to introduce additional amendments to further facilitate the implementation of a USM regime and the market’s move towards full dematerialization. These include:
  - (a) amendments to enable the SFC to encourage the use of electronic communications, and to set clear timelines towards full dematerialization;
  - (b) amendments relating to settlement finality;
  - (c) amendments to enable listed funds to be brought within the USM initiative; and
  - (d) amendments relating to the appointment of proxies.
14. The proposed amendments are discussed in more detail under [Section VI below](#).

### **Scope and phased approach**

15. As before, the intention remains that the USM initiative will focus only on *listed* securities, and in particular *listed* shares. References in this paper to securities and shares therefore refer only to *listed* securities and *listed* shares.
16. The initiative will also be implemented in phases, starting with shares of Hong Kong incorporated companies, and then shares of overseas incorporated companies. Units or shares in SFC-authorized listed funds will also be covered early on, as will “share-like” securities such as rights issues, subscription warrants and depositary receipts.
17. We also propose to set clear timelines, in phases, to help move the market to full dematerialization. Specifically:
  - (a) IPOs: A date will be specified after which initial public offerings (**IPOs**) can no longer be for securities in paper form, i.e. the IPO securities must be in uncertificated form. This will be done in phases (e.g. the first phase may be limited to shares in Hong Kong incorporated companies).
  - (b) Existing securities with HKSCC: A date will be specified by when securities held in the clearing and settlement environment (i.e. in the name of HKSCC-NOMS) will be converted into uncertificated form. Again, this will be done in phases (e.g. shares in certain Hong Kong incorporated companies as specified).
  - (c) Existing securities with public: A date will be specified by when securities held by investors in their own name in certificated form (i.e. *outside* the clearing and settlement environment) must be converted into uncertificated form. Again, this will be done in phases (e.g. shares in certain Hong Kong incorporated companies as specified).
  - (d) No rematerialization option: There will be *no* rematerialization option, i.e. securities that are in uncertificated form will not be convertible back into paper form. So, for example, where IPO securities have been offered in uncertificated form, it will not be possible for investors to subsequently convert them into certificated form.
  - (e) Electronic communications: It is also proposed to gradually require investors and issuers to communicate electronically rather than in paper form.
18. Each of the above timelines will be implemented after ensuring market readiness and giving sufficient notice in advance to allow for the completion of relevant preparation work. Moreover, regard will be had to securities that are unable to participate in the USM initiative due to legal limitations (e.g. where the securities are issued under overseas laws that permit securities to be held and transferred in paper form only).
19. The scope and phased approach for implementing USM is discussed in more detail under [Section V](#) below.

### **Implications for different stakeholders**

20. The Revised Model will have the following implications for the following stakeholders.
  - (a) Investors:
    - Investors will be able to hold securities in their own name and without paper documents. They will however need to first open a USI account with a share registrar or a USS account with a sponsoring CP.
    - Investors will also be able to hold securities through their intermediaries, as they do today, in which case their securities will continue to be registered

in the name of HKSCC-NOMS (or their intermediaries, where that is the arrangement) and the investors will hold only a beneficial interest in them.

- Investors who already hold securities in certificated form will be able to continue to do so, but only for a limited period. In the case of newly issued securities however (e.g. IPO securities or securities entitlements), investors may not always have the option to obtain these in paper form (e.g. where the issuer has opted to issue them in uncertificated form only).<sup>9</sup>

(b) Intermediaries:

- Intermediaries may continue to provide services to clients as they do today. Securities held through intermediaries' accounts with HKSCC will continue to be registered in the name of HKSCC-NOMS.
- The introduction of USS accounts will provide new business opportunities for intermediaries to serve institutional clients who wish to hold securities in their own name but have them managed by a custodian.
- Intermediaries may, but will not be compelled to, provide services as a sponsoring CP for USS account holders. However, if they choose to do so, enhancements to operational processes and systems will likely be needed. For intermediaries who do not opt to provide services as a sponsoring CP, their operations will continue largely unchanged from today. All intermediaries will however need to migrate to the new system to be introduced by HKEX to replace CCASS (**HKEX System**), and which will support the USM initiative.<sup>10</sup>

(c) Issuers:

- Once a particular class or description of securities is required to be dematerialized within a specified timeline (as described in paragraph 17(b) or 17(c) above), issuers of securities falling within that class or description will need to take the necessary steps to facilitate dematerialization within that timeline. This includes: (i) initiating amendments to their constitutional documents or other terms of issue, where necessary; and (ii) appointing a share registrar approved by the SFC under the new share registrar regime to maintain the ROM and operate the system for evidencing, and effecting transfers of, legal title to securities electronically.

(d) Share registrars:

- Only share registrars approved under the new share registrar regime (**ASR**) will be able to operate systems for evidencing, and effecting transfers of, legal title to securities without paper documents, and subject to any conditions or limitations imposed by the SFC.
- ASRs and their systems and processes will be subject to direct regulatory oversight by the SFC.

(e) HKEX:

- System changes will be needed to support the Revised Model. Among other things, this will include introducing two new features in the clearing and settlement environment, i.e.: (i) the USS account feature; and (ii) a new

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<sup>9</sup> The ability to acquire newly issued securities in certificated form will be phased out over time as discussed under [Section V below](#).

<sup>10</sup> HKEX is undertaking a comprehensive upgrade of its post-trade infrastructure across all post-trade business processes and systems, including central counterparty clearing, securities settlement, central securities depository, risk and collateral management, and nominee functions. It is proposed that the HKEX System will replace CCASS.

participant category for share registrars. These features will be incorporated in the HKEX System.

### ***Comments invited***

21. We consider that the Revised Model presents a viable solution for implementing a USM regime in Hong Kong. First, it achieves one of the core objectives of the USM initiative, which is to enable investors to hold securities in their own name and without paper. Secondly, it preserves the efficiencies and benefits currently enjoyed by the market. As a result, the Revised Model can be implemented with minimal market disruption. The implementation costs for intermediaries will also be low as many of the existing processes and arrangements can be retained.
22. We appreciate however that, ultimately, the successful implementation of the Revised Model will depend on its technical and operational details, and the impact that these will have on different market participants. We have therefore expanded on these in detail in this paper. We have also raised specific issues on which we would appreciate feedback. These are set out in the body of the paper and repeated at the end for easy reference.
23. We urge market participants and other interested parties to submit written comments to the proposals discussed in this paper. **The deadline for submissions is 27 April 2019.**

### ***Layout of this paper***

24. This paper is divided into the following Sections:
  - (a) [Section II](#) explains why it is necessary to substantially change the operational model previously proposed;
  - (b) [Section III](#) describes the Revised Model in detail, and how it compares with the current operational model and the 2010 Model;
  - (c) [Section IV](#) explains the key process flows under the Revised Model, including the process flows for IPO applications, legal title transfers and corporate actions;
  - (d) [Section V](#) describes the scope of the USM regime and the phased approach for implementing it;
  - (e) [Section VI](#) describes the further legislative amendments proposed in light of the changes to the operational model;
  - (f) [Section VII](#) gives an indication of the next steps for taking the USM initiative forward; and
  - (g) the Annexes provide various high-level comparisons relating to the Revised Model, and illustrate the key process flows under it.

## II. DEVELOPMENT OF THE OPERATIONAL MODEL

### *The 2010 Model*

25. In 2009/2010, the SFC, HKEX and FSR jointly consulted the market on an operational model for implementing a USM regime in Hong Kong (i.e. the 2010 Model)<sup>11</sup>. Its key features included the following:
- (a) Investor choice: Investors would have the option to hold securities in certificated form or in uncertificated form. Moreover, all securities in uncertificated form would be held *within* CCASS.
  - (b) Name on register in CCASS: Securities held within CCASS would cease to be held in the name of a single nominee (i.e. HKSCC-NOMS), and would instead be held in the name of investors or their intermediaries.
  - (c) HKSCC's role as system operator: Movements of securities between accounts in CCASS would constitute legal title transfers. CCASS would thus be the sole system for evidencing, and effecting transfers of, legal title to securities without paper documents. In view of this, HKSCC would take on the role of operator of the system for the USM environment, and be subject to new regulatory requirements.
  - (d) Split register: Consequent to the above, the CCASS records would need to become part of the ROM. The ROM would therefore have to be split into two parts as follows: (i) one part would record all certificated holdings and be maintained by the issuer; and (ii) the other part would record all uncertificated holdings and be maintained by HKSCC.
26. The 2010 Model received wide support, and hence we proceeded to work on the primary law amendments needed to support it. This culminated in the enactment of the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2015 (**USMO**) in March 2015.

### *Challenges presented by the 2010 Model*

27. Thereafter, our efforts turned to developing the 2010 Model in more detail. In the course of doing so, concerns were raised that the model would compromise certain settlement efficiencies and benefits that market participants enjoy today. To explain:
- (a) Today, securities settlement occurs on a gross basis intraday while money settlement generally occurs on a net basis at day-end, resulting in a high settlement efficiency of around 99.9%. The process entails moving securities between accounts in CCASS during the day (i.e. from the delivering accounts to the receiving accounts) and, in the case of settlement of on-exchange trades, putting the securities on hold pending receipt of related settlement monies. Settlement monies are generally received at day-end but market participants who wish to take delivery of their securities (or some of them) earlier can do so by making payment earlier. This gives market participants a degree of flexibility

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<sup>11</sup> The [2009 Consultation Paper](#) and [2010 Consultation Conclusions Paper](#) can be downloaded from the SFC's website at [www.sfc.hk](http://www.sfc.hk).

in terms of when and how they can use their securities<sup>12</sup>, but also keeps their financial obligations low and relatively simple to arrange<sup>13</sup>.

- (b) Under the 2010 Model however, securities and money settlement would have to occur at or around the same time. This means securities cannot even be *moved* between accounts in CCASS intraday unless settlement monies relating to the movement are *already* available. If securities cannot be moved, market participants can have no visibility as to which securities are available for settlement intraday, and consequently, cannot choose which to take delivery of and settle earlier, and which to take delivery of and settle on a net basis at day-end. Furthermore, even if a participant were to pay the entire gross amount of monies payable in respect of *all* the securities it hoped to take delivery of that day, it would not be guaranteed to receive particular securities early enough in the day to recycle them. In other words, a participant's readiness to provide additional funding would increase its intraday costs but without necessarily ensuring the intended benefit (i.e. receiving the securities needed).<sup>14</sup> The efficiencies and benefits they currently enjoy would therefore be compromised.

28. Accordingly, between 2015 and 2017, much effort was made to find a solution that would preserve the above efficiencies and benefits, but within the confines of the 2010 Model. Possible solutions were developed and discussed at length with a range of market participants (including banks, brokers, custodians and clearing participants). However, the feedback indicated that these did not go far enough to addressing the concerns about efficiency. Moreover, both also required significant changes to the current market infrastructure, and hence would result in substantial costs and disruption to the market.

29. The fundamental challenge with the 2010 Model lay in its removal of HKSCC's nominee role within CCASS. This presents a dilemma. On the one hand, it is only by removing this nominee role that investors are able to hold securities within CCASS in their own name. On the other hand however, it is precisely HKSCC's nominee role that allows market participants to enjoy the efficiencies and benefits described in paragraph 27 above.

### ***Need for a different approach***

30. In view of the above, we considered that a better option would be to revise the operational model such that it retained HKSCC's nominee role but still achieved the fundamental objective of the USM initiative, which is to give investors the option to hold securities in their own name *and* without paper documents. Accordingly, from

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<sup>12</sup> Subject to making the relevant payment in the case of settlement of on-exchange trades, market participants can take delivery of securities during the day and use them for other purposes such as off-market transactions, stock borrowing and lending, etc. In some cases, a market participant's ability to take delivery of securities intraday may, in turn, impact their counterpart's ability to settle other transactions in CCASS (whether these be on-exchange trades or not).

<sup>13</sup> Because money obligations are settled at day-end and on a net basis (except where early payment is made to take delivery of securities), the amount to be funded is greatly reduced. Moreover, the amount to be paid is known in advance, which makes it easier to plan and arrange for the necessary funding.

<sup>14</sup> The availability of securities ultimately depends on when they are delivered by the delivering participant. A receiving participant's ability or readiness to provide funding upfront on a gross basis therefore *increases* its own costs, but without any *added* assurance of whether or when the securities will be available. In contrast, under the current system, the receiving participant has a clearer picture of how much monies to put up, when, and for which of the available securities. As a result, its funding requirements are much lower and its funds can be deployed more efficiently.

November 2017 to September 2018, the SFC, HKEX and FSR worked to develop such a model (i.e. the Revised Model).

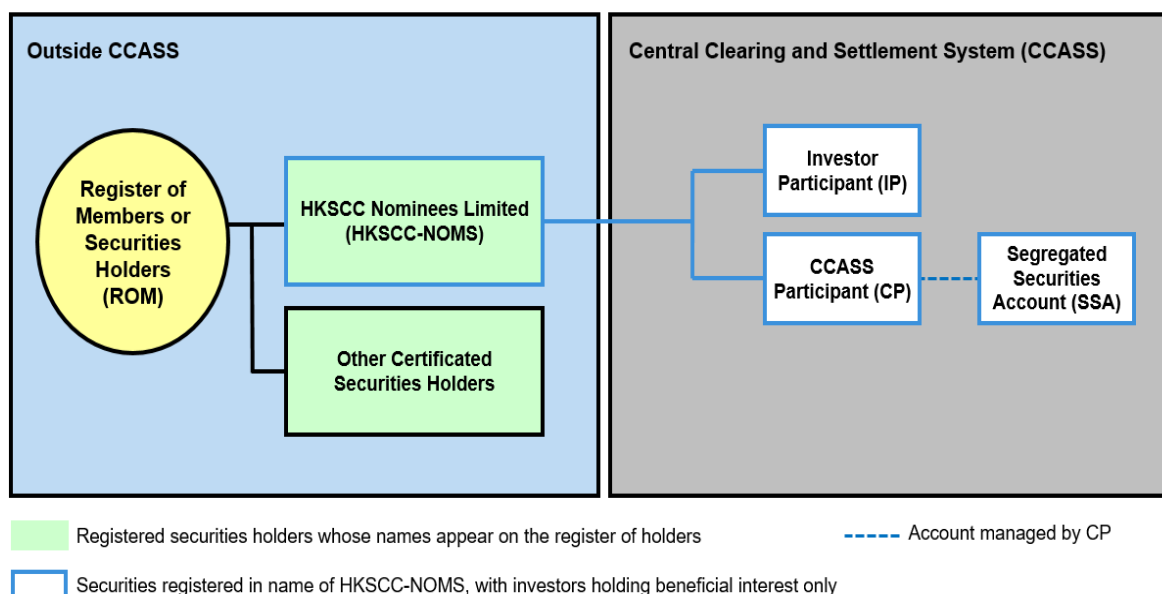
31. In October and November 2018, the Revised Model was exposed to a range of market participants (including brokers, custodians, clearing participants, as well as various issuer-related associations) for preliminary comments. Their response was generally supportive and positive.
32. For completeness, we note that in the course of trying to address the limitations of the 2010 Model, we also made reference to practices in other major markets to see if these might present a possible solution. Our finding was that their operational models vary greatly, having evolved in light of local market practices and characteristics. The US, for example, still adopts a nominee structure similar to ours while the UK and Australia do not. In the UK, securities and money settlement occur simultaneously throughout the day. Implementing such an arrangement in Hong Kong would require wide scale infrastructural changes, i.e. to systems, operational processes and flows, regulations, etc. Moreover, even then, the necessary funding may not be fed down to all market participants as ultimately this is a commercial decision for settlement banks. In Australia, securities and money settlement also occur simultaneously but only once a day. The funding issue therefore does not arise, but then the flexibility to take and use securities intraday is lost as well.

### III. THE REVISED MODEL

#### *Comparison with current model and 2010 Model*

33. Diagram 1 below illustrates the current operational model.

*Diagram 1 – current operational model*





34. The key features of the current model are as follows:
- (a) Nominee structure: All securities held within CCASS are registered in the name of a single nominee, i.e. HKSCC-NOMS. Investors holding securities through CCASS therefore hold only a beneficial interest in them.
  - (b) Account types in CCASS: Investors holding securities through CCASS can do so in any of the following ways:
    - (i) through a **CP account**<sup>15</sup> – being an account opened in CCASS by a person who has been admitted by HKSCC as a clearing or custodian participant (**CP**) and used for holding securities of multiple investors;
    - (ii) through an **SSA**<sup>16</sup> – being a stock segregated account with statement service opened in CCASS by a CP and used for holding securities of a specific investor; or
    - (iii) through an **IP account**<sup>17</sup> – being an account opened in CCASS by an investor who has been admitted by HKSCC as an investor participant (**IP**) and used for holding the IP's own securities (**IP account**).

Each account type provides a different level of protection and control<sup>18</sup>.
  - (c) Option to hold in own name: Investors who wish to hold securities in their own names can do so (where permitted)<sup>19</sup>, but only in paper form and outside of CCASS.
  - (d) Entire ROM in one place: The entire ROM is kept and maintained solely by the issuer's share registrar.
  - (e) No electronic interface between CCASS and share registrars' systems: There is no electronic interface between CCASS and share registrars' systems. The deposit/withdrawal of securities into/out of CCASS (which constitutes legal title transfers<sup>20</sup>) is therefore a paper-based process.

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<sup>15</sup> A CP account is an omnibus account that can be opened in CCASS by an intermediary. The intermediary is the holder of the CP account. It also manages and controls the account. Being an omnibus account, securities in a CP account belong to multiple investors, i.e. an investor's securities are not segregated from those of other investors. All securities in a CP account are registered in the name of HKSCC-NOMS.

<sup>16</sup> An SSA is a segregated account that can be opened in CCASS by an intermediary for a particular client-investor. As with a CP account, the intermediary is the holder of the SSA. It also manages and controls the account. Securities in an SSA are also all registered in the name of HKSCC-NOMS. However, unlike a CP account, securities held in an SSA belong to a single investor, i.e. one for whom the SSA was opened.

<sup>17</sup> An IP account is a segregated account that can be opened by an investor directly. The investor is the holder of the IP account, and also manages and controls the account. However, as with other accounts in CCASS, all securities in an IP account are registered in the name of HKSCC-NOMS.

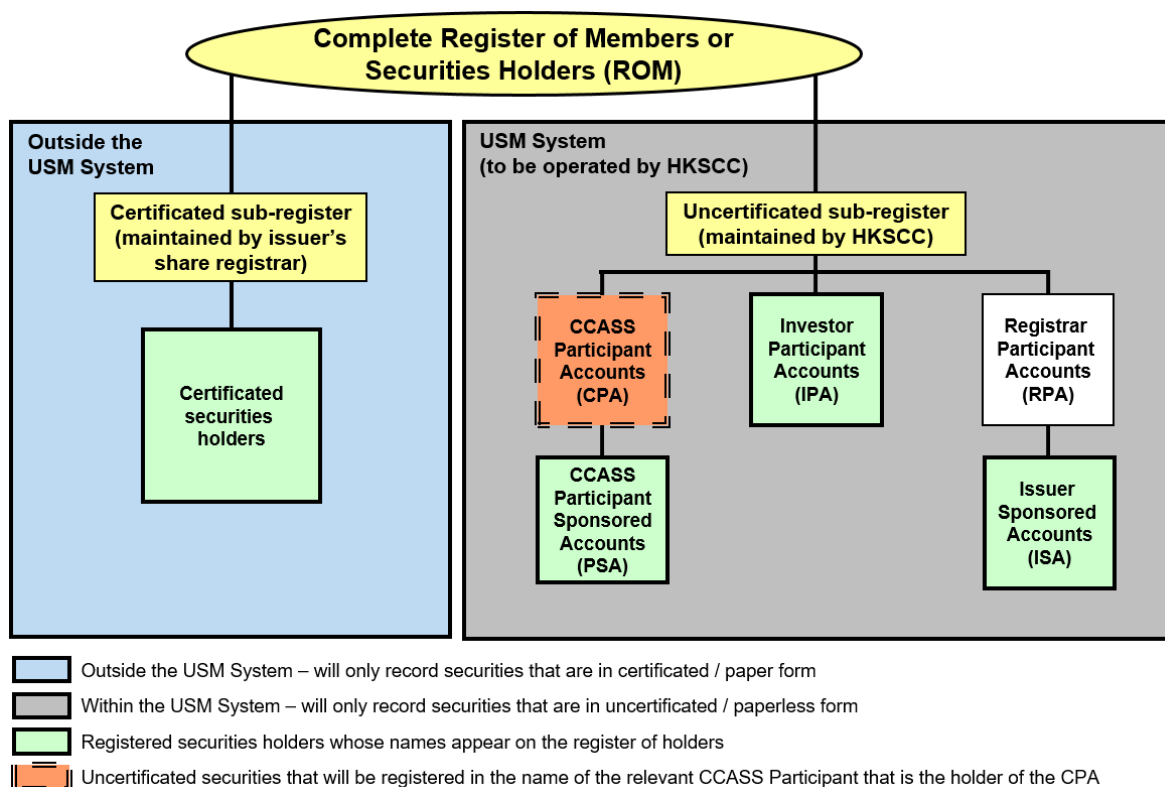
<sup>18</sup> The IP account (being controlled and managed by the investor directly) provides the greatest degree of control and protection, while the CP account (being an omnibus account, and managed and controlled by the intermediary) provides the least.

<sup>19</sup> Not all securities can be withdrawn from CCASS and held in an investor's own name. For example, currently issuers of callable bull bear warrants and derivative warrants require their securities to be held within CCASS.

<sup>20</sup> The deposit of securities into CCASS requires that the securities be transferred into the name of HKSCC-NOMS. The process requires the delivery of paper certificates and a signed instrument of transfer to the relevant share registrar. Similarly, the withdrawal of securities out of CCASS constitutes a transfer of the securities from HKSCC-NOMS to the investor who is withdrawing them. A similar paper-based process applies.

35. Diagram 2 below illustrates the 2010 Model.

Diagram 2 – 2010 Model



36. The key features of the 2010 Model were as follows:

- Name on register structure:** Securities held within CCASS would have ceased to be registered in the name of a single nominee, and would instead have been registered and held in the name of investors or their intermediaries. Investors holding securities through CCASS would therefore have been able to hold legal title to the securities.
- Account types in CCASS:** Investors holding securities through CCASS would have been able to do so through any of four account types: (i) a “CPA”<sup>21</sup>; (ii) a “PSA”<sup>22</sup>; (iii) an “IPA”<sup>23</sup>; or (iv) an “ISA”<sup>24</sup>. Each of these account types would have provided different levels of protection and control<sup>25</sup>, and investors’ choice

<sup>21</sup> A CPA (standing for “CCASS participant account”) under the 2010 Model was intended to be the same as a CP account under the current model, except that any securities held in it would have been registered in the name of the CP that had opened the CPA, rather than in the name of HKSCC-NOMS.

<sup>22</sup> A PSA (standing for “participant sponsored account”) under the 2010 Model was intended to be similar to an SSA under the current model, except that any securities held in it would have been registered in the name of the investor for whom the PSA had been opened, rather than in the name of HKSCC-NOMS.

<sup>23</sup> An IPA (standing for “investor participant account”) under the 2010 Model was intended to be the same as an IP account under the current model, except that any securities held in it would have been registered in the name of the investor opening the IPA rather than in the name of HKSCC-NOMS.

<sup>24</sup> An ISA (standing for “issuer sponsored account”) was a new account type that was designed to be similar to a PSA in that it was to be a segregated account, opened for a particular investor. Moreover, all securities held in an ISA were to belong to, and be registered in the name of, that investor. However, unlike a PSA, the ISA was to be opened by a share registrar instead of an intermediary.

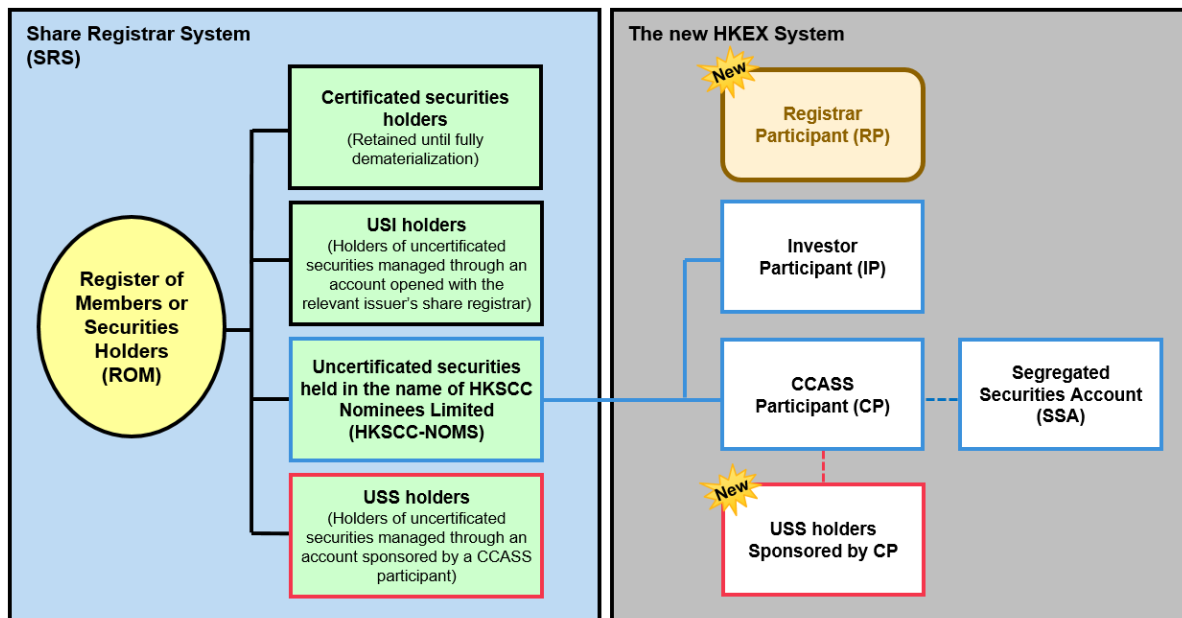
<sup>25</sup> As the IPA and ISA under the 2010 Model were to be controlled and managed by the investor directly, they would have provided the greatest degree of control and protection. As between the CPA and the PSA, the latter would have provided more protection since it would have been a segregated account and securities in them would have been registered in the name of the investor. In contrast, the CPA would have been an omnibus account, and securities in them registered in the name of the intermediary.

would have depended on: (A) whether they wanted to hold securities in their own name or in the name of their intermediary; and (B) whether they wanted their account to be serviced and administered by their intermediary, HKSCC or the issuer's share registrar.

- (c) Option to hold in own name: Investors would have had multiple options for holding securities in their own names. Specifically, they would have been able to do so in uncertificated form within CCASS (i.e. through a PSA, IPA or ISA), or (for a limited period) in certificated form outside of CCASS.
- (d) Split ROM: The ROM would have been split into two parts. One part would have recorded certificated holdings and been maintained by the issuer's share registrar. The other part would have recorded uncertificated holdings and been maintained by HKSCC.
- (e) HKSCC's role as system operator: All uncertificated securities would have been held within CCASS, and all movements of securities between accounts in CCASS would have constituted legal title transfers. As a result, CCASS would have become the sole system for evidencing, and effecting transfers of, legal title to securities without paper documents. In view of this, HKSCC would have taken on the role of sole "system operator" in the USM environment and been subject to new regulatory requirements.
- (f) Interface between CCASS and share registrars' systems: There would have been an electronic interface between CCASS and share registrars' systems. This would have facilitated the movement of securities to and from an ISA, as well as the dematerialization of securities.

37. Diagram 3 below illustrates the Revised Model.

Diagram 3 – Revised Model



- Registered securities holders whose names appear on the register of holders
- Securities registered in name of HKSCC-NOMS, with investors holding beneficial interest only
- USS holders whose names appear on the register of holders, and whose holdings are managed by a sponsoring CP
- Registrar participant (being a new participant category to facilitate the interface between the new HKEX System and the SRS)
- Account managed by CP

38. The key features of the Revised Model are as follows:
- (a) New system platform: A first point to note is that, if adopted, the Revised Model will be introduced under the new HKEX System, and not under CCASS.
  - (b) Current nominee structure retained: The current nominee structure will be retained under the Revised Model. This means securities held with intermediaries and through the HKEX System will remain registered in the name of HKSCC-NOMS, as today. This contrasts with the 2010 Model where the nominee structure was to be removed.
  - (c) Existing account types retained: The account types under the HKEX System will also remain largely the same as those in CCASS today, i.e. there will be CP accounts, SSAs and IP accounts.<sup>26</sup> Holdings in these accounts will continue to be registered in the name of HKSCC-NOMS as they are now. In addition, a new “USS” account will also be introduced – see paragraph (d)(iii) below.
  - (d) Options for investors: Investors will be able to hold securities in certificated form (albeit for a limited period only) or in uncertificated form. In the case of uncertificated holdings, there will be the following options:
    - (i) Investors may hold uncertificated securities through a CP account, an SSA or an IP account. In each case, the securities will be registered in the name of HKSCC-NOMS and the investor will hold only a beneficial interest in them.
    - (ii) Investors may hold uncertificated securities in their own name, and manage them through an account opened with the issuer’s share registrar (i.e. a **USI account**)<sup>27</sup>. The features and operation of a USI account are discussed in more detail in paragraphs 45 to 62 below.
    - (iii) Investors who are institutional investors will have the option to hold uncertificated securities in their own name, and manage them through an account within the HKEX System (i.e. a **USS account**)<sup>28</sup> opened with a clearing or custodian participant who will “sponsor” the account (i.e. the sponsoring CP). The features and operation of a USS account are discussed in more detail in paragraphs 45 to 62 below.
  - (e) No split ROM: Under the Revised Model, there will be no need to split the ROM into two parts as was proposed under the 2010 Model. This is because the movement of securities between accounts within the HKEX System will, in most cases, entail no change in legal title<sup>29</sup>, which means there is no need for the records of such movements to constitute part of the ROM. The ROM will therefore continue to be kept and maintained *solely* by the issuer’s share registrar as is the case today.
  - (f) Share registrars’ enhanced role: HKSCC’s systems will not be used for evidencing, and effecting transfers of, legal title to securities without paper documents as was proposed under the 2010 Model. Instead share registrars’ systems will take on this role. Share registrars will therefore take on greater

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<sup>26</sup> See paragraph 34(b) and footnotes 15 to 18 above.

<sup>27</sup> See footnote 5 above, which explains what the acronym “USI” is intended to denote.

<sup>28</sup> See footnote 7 above, which explains what the acronym “USS” is intended to denote.

<sup>29</sup> All securities held through accounts in the HKEX System (apart from the new USS account) will be held in the name of HKSCC-NOMS. It follows that all movements of securities between accounts (except movements to or from a USS account) will entail no change in legal title.

responsibilities under the Revised Model than was envisaged under the 2010 Model.<sup>30</sup>

- (g) Link/interface between share registrars' and HKSCC's systems: As with the 2010 Model, it will be necessary to establish an electronic interface between HKSCC's and share registrars' systems so as to facilitate communication regarding the movement of uncertificated securities into/out of the HKEX System (i.e. communication regarding the transfer of legal title to uncertificated securities to/from HKSCC-NOMS without paper documents). To that end, a new participant category will be introduced in the HKEX System, i.e. "registrar participants". Given that the role and functions of share registrars are very different from those of other clearing or custodian participants, it follows that their rights and obligations within the system will also be very different.

### **Stamp duty**

39. Currently, any stamp duty payable in respect of securities transactions effected on the SEHK, is collected and paid through the SEHK. This is done electronically and does not require paper documents to be produced to the Stamp Office for physical stamping. Instead, intermediaries that are so authorized, may "stamp" the relevant contract note<sup>31</sup> (which may be in electronic form) and arrange for the relevant stamp duty to be paid through the SEHK.
40. For off-exchange transactions however, the stamp duty is generally collected and paid directly to the Stamp Office by the parties concerned or their intermediaries. The process for this entails producing the relevant instrument of transfer and/or contract notes to the Stamp Office for physical stamping, and making the stamp duty payment at the same time. Such a paper-based process would not be in keeping with the objectives of the USM initiative. Alternative arrangements are therefore needed to facilitate the stamping of off-exchange securities transactions in the USM environment.
41. To that end, the USMO introduced amendments to the Stamp Duty Ordinance (Cap. 117, **SDO**) to enable such arrangements to be put in place<sup>32</sup>. It is expected that the arrangements will facilitate the collection and payment of stamp duty through share registrars and/or intermediaries. The details in this regard have yet to be finalised. However, they will in any event require the making of declarations as to whether any ad valorem stamp duty is chargeable in respect of the transaction, and if so, whether the stamp duty has been paid.
42. These declarations will have to be made by the intermediaries and/or share registrar concerned. Specifically:
- (a) In the case of transfers involving the movement of securities into or out of a CP account, an SSA or a USS account, the declarations will have to be made by the intermediary that opened the account (based on information provided by the relevant client whose securities are being transferred).
  - (b) In the case of transfers involving the movement of securities into or out of a USI account, the declarations will have to be made by the relevant share

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<sup>30</sup> It was always envisaged that, in the USM environment, share registrars' systems would take on a more significant role than today. However, with the change in the operational model, this role will be even greater than previously envisaged.

<sup>31</sup> The term "contract note" bears the meaning given in the SDO. Such notes are also sometimes referred to as bought and sold notes.

<sup>32</sup> See section 54 of the USMO, which introduces new sections 5AA and 5AAB of the SDO.

registrar (based on information provided by the holder of the relevant USI account).

- (c) In the case of transfers involving the movement of securities into or out of an IP account, the responsibility for making declarations will depend on where the securities are moved from or to. For example, if the securities are moved from a CP account to the IP account, the declarations will have to be made by the intermediary that opened the CP account (based on information provided by the relevant IP account holder).

43. More details on the stamp duty arrangements will be provided at a later stage.
44. [Annex 1](#) sets out a high-level summary comparing the key features of the current model, the 2010 Model and the Revised Model.

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|-----------|--|
| <b>Q1</b> | <b><i>Do you agree that the Revised Model presents a better option for taking forward the USM initiative? If no, please provide details.</i></b> |
| <b>Q2</b> | <b><i>Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.</i></b>         |

### ***New accounts for uncertificated holdings – USI and USS***

45. Holdings in uncertificated securities will have to be reflected and managed through an account structure. To that end, two types of accounts will be introduced, i.e. the **USI account** and the **USS account**.
- (a) The USS account is specifically designed to meet the needs of institutional investors (e.g. global funds) who, for regulatory or other reasons, may need to hold securities in their own name but also have them managed by a local custodian. It will therefore only be available to institutional investors. The USS account will be housed in the new HKEX System.
- (b) The USI account however will be available to all investors including institutional investors. It will be housed in the relevant issuer's share registrar's systems (**Share Registrar System**), and hence be outside of the HKEX System.
46. It is worth highlighting that the USS account is essentially designed for institutional investors that need to hold securities in their own name but also have them managed by a custodian. Such investors would be unable to use a USI account because they would then have to manage their securities themselves. It follows that we do not expect institutional investors to open both a USS account and a USI account.
47. The above said, the USI account and USS account are intended to function in broadly the same way in that both will reflect, and be used to manage, uncertificated securities that are registered in the name of an investor. There will however be some differences. The key features of these two account types are discussed in more detail in paragraphs 48 to 62 below. A high-level summary is also set out at [Annex 2](#).

### Account opening

48. Any person will be able to open a USI account with any ASR, and irrespective of whether they hold any uncertificated securities at the time or not.<sup>33</sup> The account

<sup>33</sup> The USI account is simply a means to enable an investor to hold securities in uncertificated form in their own name, and may therefore be opened in advance of acquiring any uncertificated holdings.

opening process will entail some basic checks by the ASR so as to enable it to establish the person's identity<sup>34</sup>, and obtain relevant information for entering in the ROM<sup>35</sup>. As with any other account opening process, we expect this process will include the ASR obtaining and retaining the investor's identification number (e.g. their Hong Kong identity card number, passport number, etc).

49. In the case of the USS account, as mentioned, only institutional investors will be entitled to open such accounts and will have to do so through a sponsoring CP. The account opening process will be conducted by the sponsoring CP and is expected to be largely similar to the current process for opening a SSA in CCASS.
50. Additionally, relevant details relating to institutional investors (including their identification numbers) will have to be passed by the sponsoring CP (via the HKEX System) to the relevant ASR to enable the latter to establish each such investor's identity and the sponsoring CP's authority, and to enter the necessary details in the ROM.
51. For the avoidance of doubt, we clarify that there is no intention to prevent investors from holding securities in joint names as today. Accordingly, joint holders may open a joint USI account to reflect and manage their joint holdings.

#### Account operation and communications with the issuer

52. A main difference between the two account types will be their channel for communicating with the issuer. For investors holding securities through a USI account (**USI holders**), they will communicate with the issuer through its share registrar. To facilitate this, the FSR is looking into building a common online platform to provide a single access point for communicating with multiple issuers and their share registrars. This is discussed in more detail in paragraphs 73 to 78 below.
53. For investors holding securities through a USS account (**USS holders**), they too will communicate with the issuer through its share registrar, but this will be done via their sponsoring CP and the new HKEX System. In particular, all instructions to the issuer pertaining to securities reflected and managed through a USS account, including those relating to each of the following matters, will have to be routed via the sponsoring CP and the HKEX System:
  - (a) applications for IPO securities that are to be credited to the USS account upon allotment;
  - (b) the disposal of securities, where the securities are already reflected in the USS account;
  - (c) the acquisition of securities, where the securities are to be credited to the investor's USS account upon completing the acquisition;
  - (d) the receipt of corporate communications from the issuer;
  - (e) the submission of voting instructions (including the appointment of proxies as permitted), and any confirmations to attend general meetings of the issuer;
  - (f) the exercise of other common corporate action rights (e.g. election of scrip or cash dividend, subscription of rights, etc); and

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<sup>34</sup> See also paragraphs 63 to 69 below on the proposal to provide identification numbers.

<sup>35</sup> These would include information such as the name and address of the investor. (See also paragraphs 59 to 60 which describe some of the additional information that might be required.)

- (g) the receipt of securities (i.e. non-cash) entitlements from the issuer (e.g. bonus issues, rights, subscription warrants, etc).
54. In the case of cash entitlements, it is understood that there may be legal limitations that prevent these being paid to a USS holder via its sponsoring CP (and require them to instead be paid to the institutional investor direct). We welcome market participants' views on how critical any such limitation would be, and why. Depending on the feedback received, we will consider whether it is necessary to address these limitations and if so how.

#### Electronic statements and confirmations

55. Both USI holders and USS holders will receive regular statements of their registered holdings. In the case of USI holders, these will be provided by the relevant issuer's ASR. In the case of USS holders, these will be provided by its sponsoring CP via the HKEX System. In line with the spirit of the USM initiative, we expect such statements to be in electronic form.
56. Additionally, we propose to require issuers to send an electronic confirmation to investors to whom uncertificated securities have been successfully allotted or transferred in their own name.
57. The confirmation would set out information about the securities allotted, or transferred, and have to be sent within a reasonable time after the allotment or transfer. Moreover, in the case of USS holders, any confirmations would have to be sent via the sponsoring CP and through the HKEX System.
58. We believe this requirement can provide added comfort to investors that the allotment or transfer process has been duly completed, and that the securities in question have been duly registered in their names.

#### ROM entries in respect of uncertificated securities holders

59. Both USI holders and USS holders will be reflected in the relevant ROM as registered owners of *uncertificated* securities. In the case of USS holders, the ASR will also keep a note of its sponsoring CP although this may not be set out in the ROM itself and will not in any event be open for public inspection.
60. Where an investor holds both securities in certificated form and securities in uncertificated form (whether reflected in a USI account or in a USS account), the ROM will show their *total* holdings and reflect how many are held in certificated form and how many in uncertificated form.

#### Relationship with issuer and HKSCC

61. Irrespective of whether an investor's uncertificated holdings are reflected and managed through a USI account or a USS account, fundamentally these persons are registered securities holders, and as such will necessarily have a relationship with the issuer.
62. On the other hand, neither will have any direct relationship with HKSCC. Even investors who have a USS account will have no direct contractual relationship with HKSCC, and will not be a party to HKSCC's rules or operational procedures. They may nevertheless (indirectly) be subject to those rules and procedures by virtue of the client documentation and arrangements governing their relationship with their sponsoring CP.



|           |   |
|-----------|---|
| <b>Q3</b> | <b><i>Do you have any concerns or comments about the key features of the USS account? If yes, please provide details.</i></b>   |
| <b>Q4</b> | <b><i>Do you have any concerns or comments about the key features of the USI account? If yes, please provide details.</i></b>   |
| <b>Q5</b> | <b><i>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.</i></b>        |
| <b>Q6</b> | <b><i>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.</i></b>   |
| <b>Q7</b> | <b><i>Do you anticipate any difficulties or limitations in opening and managing USS accounts for retail investors? If yes, please provide details.</i></b>  |
| <b>Q8</b> | <b><i>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.</i></b> |

### **Requirement to provide unique identification number**

63. Currently issuers do not have a complete record of all registered securities holders' identification numbers<sup>36</sup>. This is because such information is generally only required in an IPO application and not in an instrument of transfer.
64. The absence of such identification numbers can at times affect an issuer's ability to accurately identify and distinguish one registered securities holder from another, or verify the authenticity of any instructions or requests received<sup>37</sup>. It can also affect the accuracy of the ROM<sup>38</sup> and raise other practical issues.<sup>39</sup> Consequently, the title documents (e.g. the share certificates in the case of shares) may also need to be produced in some instances.

### Proposal and purpose

65. It is proposed that, going forward, registered securities holders should be required to provide a unique identification number to the issuer to enable the latter to reliably and efficiently identify and distinguish them from one another. This will be particularly critical in the USM environment where processes will be conducted electronically, which means issuers will not be able to rely on physical signatures or the production

<sup>36</sup> By identification numbers we mean numbers such as a Hong Kong identify card number or passport number (in the case of an individual), or their business registration number or certificate of incorporation number (in the case of a corporate entity), etc.

<sup>37</sup> This can occur as a result of the registered securities holder having used initials instead of their full name, or having failed to keep their address details up-to-date, or being unable to recall or reproduce the signature previously provided.

<sup>38</sup> For example, an investor may have acquired securities on two separate occasions and identified himself slightly differently each time, e.g. first as "Mr. John T.M. Chan" and later as "Mr. John Chan Tai Man". The address provided on the two occasions may also be different. However, because the names and addresses are not identical, the issuer will have treated his record as belonging to two different registered securities holders.

<sup>39</sup> Where entries relating to the same investor are treated as belonging to two separate registered securities holders, inequities can arise. For example, in the context of shares, inequities can arise where shareholder benefits are distributed on a per shareholder basis rather than pro rata to their shareholdings. Issuers' costs can also be increased unnecessarily as corporate communications will be sent to the same investor twice.

of share certificates. The ability to use and rely on unique identification numbers will also provide an added check for ensuring that securities are transferred from and to the correct account. This, in turn, will contribute to the overall integrity of the USM environment.

66. For the avoidance of doubt, we clarify that the identification number of securities holders will not be included in the ROM and hence will not be open to public inspection. Additionally, we will put in place clear and stringent requirements and obligations to ensure that such identification information is used for legitimate purposes only, and properly protected from theft and unauthorized use or transfer. The collection, storage, use, disclosure and transfer of identification information will also need to comply with relevant personal data and privacy laws.
67. A point to highlight is that the proposal to provide unique identification numbers to issuers is intended to apply in respect of *registered* securities holders only, i.e. it will not apply to investors who hold securities through their intermediaries and hence hold only a beneficial interest in them.

#### Types of unique identification number

68. As regards the types of unique identification number to be provided, we propose as follows:
- (a) individuals who are Hong Kong residents should provide their Hong Kong Identity Card number;
  - (b) other individuals should provide details of their most recently issued passport; and
  - (c) companies should provide an acceptable identifier, such as their Hong Kong company registration number if they are registered in Hong Kong, or its equivalent in the case of other companies.

#### Difficulty in obtaining numbers from existing certificated securities holders

69. We appreciate that issuers may face practical difficulties in obtaining the unique identification numbers of existing certificated securities holders, i.e. persons who are already registered securities holders when the requirement to provide unique identification information is implemented *and* who hold their securities in certificated form<sup>40</sup>. Such persons may not be diligent in providing their identification numbers to the issuer, and it may be difficult to impose any meaningful penalty for such failure. Accordingly, our current thinking is that the requirement to provide unique identification information should only apply prospectively, e.g. when applying for securities issued after the implementation of the requirement to provide identification numbers, or when effecting transfers of securities after such implementation, etc.

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| <b>Q9</b> | <b><i>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.</i></b> |
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<sup>40</sup> There should be no such difficulty in respect of persons who hold securities in uncertificated form (i.e. through a USI or USS account) because, as noted in paragraphs 48 to 50 above, their identification number will have been provided to the issuer already.

### **Consolidation of holdings for entitlements distribution**

70. Under the Revised Model, investors who wish to hold securities in their own names will be able to do so:
- (a) in certificated form (albeit for a limited time only<sup>41</sup>);
  - (b) through a USI account; or
  - (c) (in the case of institutional investors) through a USS account opened with a sponsoring CP.
71. The proposal to require registered securities holders to provide identification numbers will enable issuers to consolidate holdings belonging to the same registered holder, thereby enhancing the accuracy of the ROM. However, the question arises: Should any securities entitlements (e.g. rights issues, share dividends, bonus shares, etc) *also* be calculated on the basis of such consolidated position? And if yes, how should these entitlements be distributed? We welcome market participants' views in this regard. Our preliminary thoughts are as follows:
- (a) In the case of investors who hold securities in both certificated form and in a USI account, their securities entitlements should be calculated on the basis of their total registered holdings. Moreover, *all* securities entitlements thus calculated should then be credited to the investor's USI account.
  - (b) In the case of institutional investors, we expect they are unlikely to hold securities in certificated form. We also expect that they may need or wish to hold securities through multiple USS accounts, each held with a different sponsoring CP. For such investors we propose that their securities entitlements be calculated separately in respect of each USS account, and distributed accordingly. In the event that they do hold securities in certificated form, the securities entitlements for these should be calculated separately also.

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| <b>Q10</b> | <b><i>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.</i></b> |
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### **ROM reconciliation**

72. The securities balances of USS holders will be reflected in both the relevant ROM and the relevant USS account. It will be crucial to the integrity of the USM environment as a whole to ensure that the balances in these two records are identical, particularly as they will be managed by different persons<sup>42</sup>. HKSCC and the relevant ASR will therefore conduct daily reconciliations of the two records with a view to ensuring this.

### **Common platform**

73. The FSR is exploring the feasibility of building a common platform across share registrars (**Common Platform**). The aim is to provide a web-based portal that can serve as a single access point through which USI holders can manage their *entire*

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<sup>41</sup> See [Section V](#) below.

<sup>42</sup> The ROM will be managed by the relevant ASR while the USS account will be managed by its sponsoring CP, and housed within the new HKEX System.

portfolio of registered securities holdings (i.e. whether held in certificated form or uncertificated form), and communicate with multiple issuers and their ASRs.

74. Among other things, the Common Platform is intended to enable USI holders to:
- (a) review their securities holding position, and any historical data relating to their position that may still be held with the share registrar;
  - (b) review their personal information and any standing instructions, such as details of their address, dividend instructions, etc;
  - (c) initiate certain processes, such as the process of subscribing for IPOs, effecting legal transfers without paper documents, exercising corporate action rights etc<sup>43</sup>;
  - (d) participate in corporate actions and (where applicable) provide related instructions;
  - (e) receive corporate communications and account statements; and
  - (f) communicate with share registrars on any other matters relating to their securities holdings.
75. Any Common Platform put in place will adopt and incorporate appropriate measures and safeguards to ensure system integrity and security. In particular, robust authentication and data encryption methods and technology will be deployed to ensure that access to the platform is restricted to authorized persons only and that communications and transfers effected through are secure.
76. Although the Common Platform is mainly intended for USI holders, it may also provide certain limited functions for certificated holders.
77. The FSR will provide further details of the Common Platform in due course, which will take into account feedback to this consultation.
78. A final point to note is that the Common Platform is different from the Share Registrar Systems mentioned in paragraph 45 above, although the two will be connected. The former essentially aims to serve as a common access portal to the Share Registrar System of each ASR. So, for example, an investor who wishes to send certain instructions to the share registrar of List Co A (e.g. instructions to pay cash dividend into a particular bank account) may enter those instructions via the Common Platform. The instructions will then be fed, through the Common Platform, to List Co A's ASR who will process them.

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| <b>Q11</b> | <b><i>Do you have any concerns or comments about the proposals for establishing a Common Platform across all share registrars? If yes, please provide details.</i></b> |
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#### **IV. KEY PROCESSES UNDER THE REVISED MODEL**

79. This section describes how key processes such as IPO subscriptions, legal title transfers and corporate actions will be conducted under the Revised Model.

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<sup>43</sup> These processes are discussed in more detail in [Section IV](#).

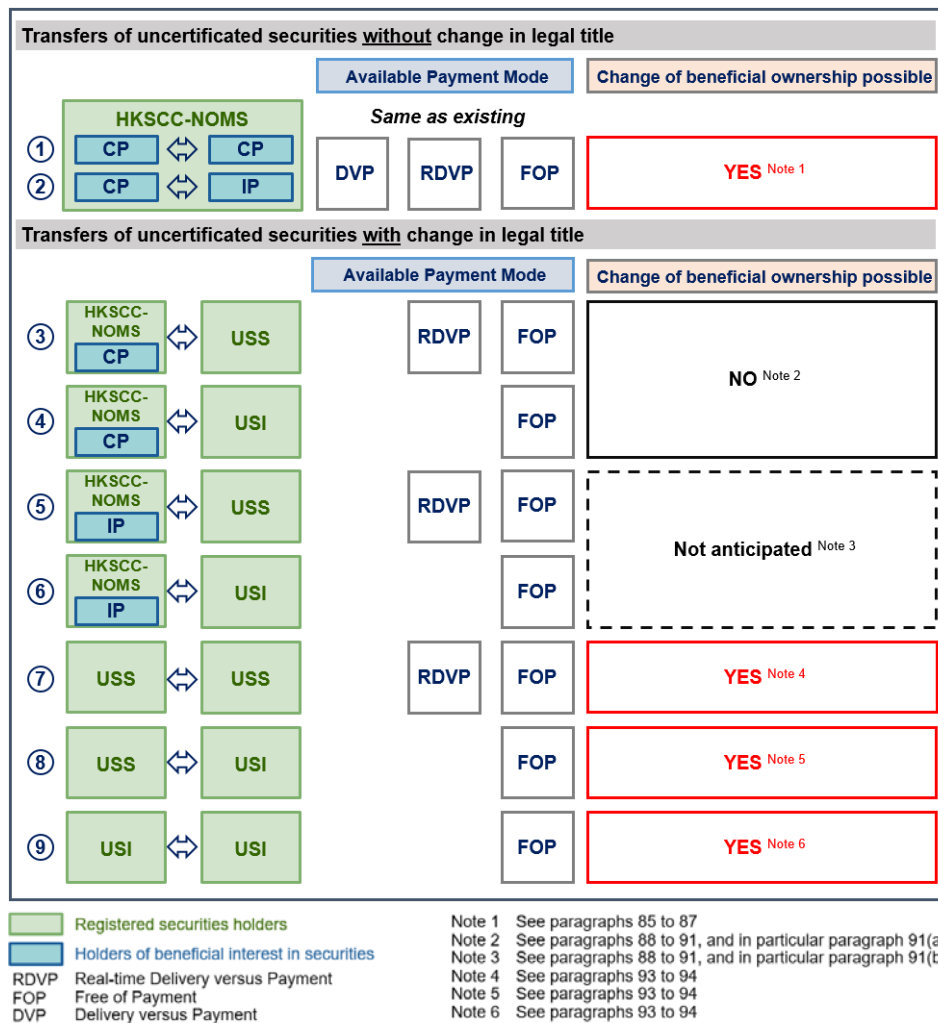
## **IPO**

80. Under the Revised Model, investors applying for securities in an IPO will be able to have them credited into an IP account, a CP account, a USI account or a USS account. The application process in respect of IPO securities to be credited into an IP account, CP account or SSA will be largely the same as it is today except that paper application forms and the use of paper cheques and cashier orders will be phased out. This is discussed in more detail in [Section V below](#) on phased implementation.
81. For IPO securities to be credited to a USI or USS account, the process will be broadly the same although there will be some key differences. In particular:
- (a) In both cases, the account (i.e. the USI account or USS account) must already have been opened at the time of submitting the application.
  - (b) For securities to be credited to a USI account:
    - (i) The application form and subscription monies will have to be submitted electronically via the system designated by the issuer. There will be *no* option for submitting paper application forms or for paying the subscription monies by cheque or cashier orders.
    - (ii) Any refund of subscription monies will be credited directly to the bank account designated by the USI holder.
  - (c) For securities to be credited to a USS account:
    - (i) The application form and subscription monies will have to be submitted via the relevant sponsoring CP and through the new HKEX System. Again, there will be *no* option for submitting paper application forms or for paying the subscription monies by cheque or cashier orders.
    - (ii) Any refund of subscription monies will be credited directly to the sponsoring CP's designated bank account.
  - (d) In both cases, multiple applications from the same investor, regardless of whether they are a USI or USS holder, will be rejected. This is no different from the practice today.
  - (e) When securities are allotted on the business day prior to the listing day, the relevant share registrar will update the provisional ROM with conditional holdings. These will become unconditional on the listing day. Similar to the practice today, this will facilitate the submission of settlement instructions (in respect of holdings in a CP account, IP account or USS account) in advance for delivery on the listing day.
82. The process flows for IPO applications to be credited to a USI or USS account are illustrated and explained in more detail in [Annex 3](#).
83. It is worth highlighting that the proposal to *remove* the current options of submitting IPO applications in paper form, and paying subscription monies by cheque or cashier order will make it more feasible to shorten the IPO settlement timetable. However, shortening the IPO timetable will also depend on the revised workflow and processes of a number of different parties. The SFC, HKEX and FSR are currently exploring possible options for shortening the IPO settlement timetable, which is ongoing separately from the USM initiative and could potentially be implemented before USM.

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| Q12 | <b>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.</b> |
| Q13 | <b>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.</b> |

### Transfers

84. The table below summarises the various types of transfers that may occur in the USM environment, and the available options for settling the corresponding money leg.



### Transfers of securities within the HKEX System

(Transfers ① and ② in the diagram above)

85. These refer to the movement of securities between different CP accounts, IP accounts and SSAs in the HKEX System. The transfers will *not* result in any change in legal title as the securities will remain registered in the name of HKSCC-NOMS at all times. This is no different from the position today vis-à-vis transfers between accounts in CCASS.

86. The process for such transfers will remain largely the same as today and be conducted entirely within the HKEX System. Options for settling the money leg will also remain the same, as will the process for collecting and paying any related stamp duty.
87. Additionally, as today, to the extent that the transfers entail a change in beneficial interests, ad valorem stamp duty will be payable.

#### Transfers of uncertificated securities to or from HKSCC-NOMS

(Transfers ③ to ⑥ in the diagram above)

88. These refer to the deposit/withdrawal of securities into/out of a CP account, IP account or SSA in the HKEX System by a USI or USS holder. Such transfers *will* result in a change in legal title. The process for this will be electronic and effected through both the HKEX System and the relevant Share Registrar System.
89. The process flows for such transfers will vary slightly depending on whether the transfers are by a USI holder or a USS holder. In terms of the money leg, USS holders will have the option to transfer securities on a free-of-payment (**FOP**) basis or on a real-time-delivery-versus-payment (**RDVP**) basis. However, USI holders will only be able to transfer their securities on a FOP basis.
90. As for stamp duty, irrespective of whether the transfers entail any change in beneficial interest or not, the relevant sponsoring CP (in the case of movements to or from a USS account) or share registrar (in the case of movements to or from a USI account) will have to make declarations as to whether stamp duty is payable and whether it has been paid. Their declarations will be based on confirmations received from the relevant counterparties to the transfer.<sup>44</sup>
91. It is also worth highlighting here that most transfers between a CP account/IP account/SSA and a USI/USS account are not expected to entail a change in beneficial interest and hence are not expected to require stamp duty collection. To explain:
- (a) In the case of movements between a CP account/SSA and a USI/USS account, we expect these to be for the account of the same investor, i.e. we expect the movements would simply constitute deposits into or withdrawals out of the HKEX System by an investor for the purposes of trading on the SEHK. It should not therefore involve any change in beneficial interest. This will ensure there is no ad valorem stamp duty implication and hence facilitate the process for such movements.
- (b) We appreciate that the position may however be different in the case of movements between an IP account and a USI/USS account, i.e. such movements may involve a change in beneficial interest (since the movements are not merely to facilitate the investor's trading activities). However, we expect such cases to be rare.
92. The process flows for transfers to and from HKSCC-NOMS are illustrated and explained in more detail in [Annex 4](#).

#### Other transfers of uncertificated securities

(Transfers ⑦ to ⑨ in the diagram above)

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<sup>44</sup> See paragraphs 39 to 43 above for more details about the stamp duty arrangements under the USM environment.

93. These refer to transfers between two USI holders, between two USS holders or between a USI holder and a USS holder. These transfers, too, will result in a change in legal title and be effected electronically. However, unlike transfers to and from HKSCC-NOMS, these transfers will likely entail a change in beneficial interest, and hence will be subject to ad valorem stamp duty.
94. Where the transfer involves only USI holders, it will be conducted entirely through the relevant Share Registrar System. However, where the transfer involves a USS holder, it will be conducted through both the HKEX System and the relevant Share Registrar System. The process flows will also differ, including in terms of the collection and payment of stamp duty.
95. The process flows for these transfers are illustrated and explained in more detail in [Annex 5](#).

#### Transfers of certificated securities

96. There will still be some securities that have not yet been dematerialized<sup>45</sup>. The transfer process for such securities will continue to be paper-based like today. This is however subject to any timeline specified for phasing out certificated holdings as discussed in paragraphs 120 to 121 below.

#### Transfers on half-day trading days

97. Currently share registrars receive and process securities transfers on all (Hong Kong) business days. This service level will be maintained under the USM environment. To align with this, it is proposed that securities settlement and transfers within the HKEX System should also be available on all (Hong Kong) business days. This means off-exchange trade settlement and transfer services will be offered on half-day trading days as well, i.e. on Christmas Eve, New Year's Eve and Chinese New Year's Eve.

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| <b>Q14</b> | <b><i>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.</i></b>   |
| <b>Q15</b> | <b><i>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.</i></b> |
| <b>Q16</b> | <b><i>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.</i></b>   |

#### **Corporate actions**

98. Under the Revised Model, corporate action processes will remain largely unchanged for investors holding securities through a CP account or IP account, i.e. HKSCC-NOMS will remain the registered holder and hold legal title to these securities while investors will continue to only hold a beneficial interest in them. All corporate action instructions and entitlements will also continue to be routed through the HKEX System, similar to

<sup>45</sup> This may be because the investor has opted not to dematerialize the securities yet, or because they cannot be held in uncertificated form (e.g. because they are issued under the laws of an overseas jurisdiction, and those laws require securities to be held in certificated form only).



today. The deadline for confirming instructions will therefore also remain slightly earlier than the issuer's deadline, as is the case today. Additionally, and separate from the USM initiative, the SFC is working with HKEX to explore options for alternatives that would enhance the position of investors who hold a beneficial interest only, particularly in terms of facilitating and encouraging their participation in the voting process, albeit without creating undue costs or burden for them or their intermediaries. Any such alternative developed would also benefit investors holding only a beneficial interest in the USM environment.

99. As for holdings in a USI or USS account, the aim is for these to be treated as equally as possible. However, there will be differences in terms of how instructions and entitlements are routed. Specifically:
- (a) Conveying instructions: USI holders will be able to convey their corporate action instructions through the relevant Share Registrar System. USS holders will have to route their corporate action instructions via their sponsoring CP and the HKEX System.
  - (b) Securities entitlements: For corporate actions that affect a holder's securities balance (e.g. rights issues, share dividends, bonus shares, share splits or consolidations, etc), these will:
    - (i) in the case of a USI holder, be credited to the relevant USI account and the relevant share registrar will notify the USI holder of the change by day-end on payment date; and
    - (ii) in the case of a USS holder, be credited to the relevant USS account, and the client documentation and arrangement between the USS holder and its sponsoring CP will govern when and how the holder is informed of the change.

Additionally, to the extent that securities entitlements are in the form of rights, the provisional allotment letters will be issued in electronic form once rights are brought within the USM regime – see paragraph 105(b).

- (c) Cash entitlements: For corporate actions that result in cash payments (e.g. dividend payments), these will be credited directly to the relevant USI holders designated bank account. In the case of USS holders, we understand that, for operational purposes, market participants may prefer that these be paid to the sponsoring CP rather than to the USS holder direct. However, as noted in paragraph 54 above, there may be legal limitations to this. We welcome views on how critical any such limitation would be, and why, so that we may consider how best to address any such limitations.
- (d) Voting: Both USI holders and USS holders will have the right to vote and to attend and speak at meetings of the issuer. Both will also be entitled to appoint proxies. Subject to the relevant sponsoring CP's operation, arrangements and service level, it may need to apply an earlier cut off time for those of its clients who are USS holders.
- (e) Takeovers: Currently, shareholders who accept a takeover offer (whether conditional or unconditional) are required to surrender their share certificates and signed instruments of transfer when accepting the offer. This will not be possible in respect of shareholders who hold their shares in uncertificated form as they will not be holding certificates or required to sign instruments of transfer. In the case of USI and USS holders, we propose that they must instead agree to the shares in their USI or USS account being earmarked and "locked" until the offer is declared unconditional, meaning that the shares should remain

registered in the name of the relevant USI or USS holder but cannot be moved or transferred. Consent to “lock” the shares will have to be given at the time of accepting the offer through the relevant Share Registrar System (in the case of USI holders) or the sponsoring CP and the HKEX System (in the case of USS holders). We also propose that the transfer of shares to the offeror should not be registered until payment has been made to accepting shareholders.

- (f) **Pledging:** Currently, shareholders can pledge their shares by delivering the share certificates and signed instruments of transfer to the pledgee. With the removal of paper documents, alternative arrangements will have to be put in place to facilitate pledging in the USM environment. In this regard, we propose to introduce a “locking arrangement” similar to the one described in subparagraph (e) above, i.e. pledged shares that are in uncertificated form will be “locked” by the relevant ASR and administered by them in accordance with terms agreed among the pledgor, pledgee and ASR<sup>46</sup>.

### **Fees and charges**

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

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| <b>Q17</b> | <b><i>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.</i></b> |
| <b>Q18</b> | <b><i>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.</i></b> |

## **V. SCOPE AND PHASED APPROACH TO FULL DEMATERIALIZATION**

101. We propose to adopt a phased approach to implementing the USM initiative. To that end, we propose to phase the product scope and the timeline to full dematerialization. We also propose to introduce other requirements to facilitate the market’s move to full dematerialization. This section discusses our proposals in this regard.

### **Product scope**

102. The USM initiative is intended to apply to listed securities that are prescribed by the SFC. The aim is to prescribe securities in phases, and thus extend the scope of the USM initiative gradually as appropriate, taking into account market readiness. Securities will be prescribed by subsidiary legislation, and type of securities (e.g. shares) rather than individually (e.g. shares in List Co A).

<sup>46</sup> Such terms may provide for matters such as how various shareholder related matters are to be handled, including any transfer instructions, dividend or other entitlements, voting rights, etc.

## Shares

103. As indicated in our previous consultation, we propose to focus first on shares, starting with shares in Hong Kong incorporated companies and then shares in overseas incorporated companies. We consider both to be equally important given that the vast majority of companies listed on the SEHK are incorporated overseas. However, the ability to extend the USM initiative to such companies will depend on whether the laws of their place of incorporation, and their constitutional documents, are compatible with their participation under the Revised Model.<sup>47</sup> In this regard, we are focusing on three overseas jurisdictions in particular, i.e. the Cayman Islands, Mainland China and Bermuda. As will be seen from the table below, the majority of overseas companies listed on the SEHK (whether by number, market capitalisation or market turnover) are from these three jurisdictions.

*Table 1 – Details of SEHK-listed companies by place of incorporation*

### **Market capitalisation (by place of incorporation)**

(as at the end of December 2018)

| Jurisdiction          | No of listed companies | Market capitalisation *   |              |
|-----------------------|------------------------|---------------------------|--------------|
|                       |                        | (HK\$)                    | (%) of total |
| Australia             | 3                      | 1,037,523,302             | 0.00         |
| Bermuda               | 519                    | 2,211,834,966,532         | 7.40         |
| BVI                   | 10                     | 24,978,848,991            | 0.08         |
| Canada                | 5                      | 5,123,074,451             | 0.02         |
| Cayman Islands        | 1,265                  | 10,822,296,723,659        | 36.18        |
| England               | 3                      | 1,516,006,274,936         | 5.07         |
| Hong Kong             | 217                    | 9,158,712,323,703         | 30.62        |
| Israel                | 1                      | 1,764,200,844             | 0.01         |
| Italy                 | 1                      | 66,017,659,200            | 0.22         |
| Japan                 | 3                      | 7,881,902,184             | 0.03         |
| Jersey                | 2                      | 45,111,149,282            | 0.15         |
| Luxembourg            | 2                      | 52,959,021,396            | 0.18         |
| PRC                   | 267                    | 5,942,006,482,195         | 19.87        |
| Singapore             | 17                     | 53,691,436,622            | 0.18         |
| USA - Nasdaq stocks** | 6                      | -                         | -            |
| <b>Total</b>          | <b>2,321</b>           | <b>29,909,421,587,297</b> | <b>100</b>   |

\* Dual listing foreign companies and stock suspended over 1 year are excluded.

\*\* Trading only stocks.

104. Previous work done to ascertain the position of companies incorporated in these three jurisdictions suggests that it should be possible to bring them within the USM regime, subject to completing certain formalities or procedures. We will however be reviewing this in light of the Revised Model, and will keep the market informed of developments

<sup>47</sup> So, for example, a key issue will be whether the laws of an overseas jurisdiction permit companies incorporated under those laws to issue shares in uncertificated form, and transfer them without paper documents, and if yes, whether this must be done in a particular way or can be done through a Share Registrar System as envisaged under the Revised Model.

in this regard. For completeness, we note that we will also be looking into the position of other overseas incorporated companies in due course.

Listed funds and share-like securities

105. After shares, our next focus will be on listed funds and “share-like” securities.
- (a) In the case of listed funds, this will cover SFC-authorized listed funds such as open-ended exchange traded funds, leveraged and inverse products, closed-ended funds and REITs. This will require certain amendments to the SDO<sup>48</sup> which are discussed in more detail in paragraph 127(a) below).
  - (b) In the case of “share-like” securities, this will include rights issues, subscription warrants and depositary receipts. As these securities are very close in nature to shares, we believe they should be brought within the USM initiative sooner rather than later. As with shares, we will focus first on those issued under Hong Kong law, and then on those issued under overseas laws.

Other listed products

106. We are also considering whether the USM initiative should extend to other listed products such as callable bull bear contracts (**CBBCs**) and derivative warrants (**DWs**). Currently, issuers of these products do not give investors the option to withdraw them from CCASS and register them in the investors’ own names. In view of this, there may be little value in extending the USM initiative to such products.

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| <b>Q19</b> | <b><i>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.</i></b> |
| <b>Q20</b> | <b><i>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.</i></b>                             |
| <b>Q21</b> | <b><i>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.</i></b>  |

***Timeline to full dematerialization***

107. We appreciate that while most investors are keen to move to dematerialization quickly, a small population may need more time to adjust to the new paperless environment. We acknowledge therefore that it will be necessary to retain a paper option. However, we are also mindful that, ultimately, the aim is to remove the paper option entirely. If this is to be achieved, it will be necessary to set some limitations around the paper option so as to facilitate the market’s transition to the USM environment. To that end, we propose as follows.

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<sup>48</sup> The SDO requires the use of paper instruments of transfer to effect transfers of units in unit trust schemes. This limitation will need to be uplifted in order for listed funds that are structured as a unit trust scheme to participate in the USM initiative.

### Paperless IPOs only

108. First, we propose to gradually require all IPO securities to be in uncertificated form only. Consistent with the proposals in paragraphs 102 to 106 above, we will start first with shares in Hong Kong companies, and then progress to other shares and securities.
109. To implement this, we propose to specify a date from which a specified class or description of IPO securities (e.g. IPO shares in Hong Kong companies) may only be in uncertificated form. In other words, from that date onwards, it will no longer be possible to issue or receive IPO securities of the specified class in paper form. Investors who wish to acquire such securities in their own names will instead have to do so in uncertificated form through a USI account or a USS account. It follows that multiple dates will be specified, each for a different class or description of IPO securities.
110. There will also be no option to convert these IPO securities into certificated form after they are issued. This means investors who have acquired the IPO securities through an intermediary, and who wish to subsequently hold the securities in their own names, will also hold them in uncertificated form through a USI or USS account.
111. For completeness, we would clarify that interested issuers can, prior to the relevant specified date, offer IPO securities in paperless form only if they so wish, i.e. they will not need to wait till the specified date to do so. Additionally, HKEX may invite prospective issuers to consider offering a paperless IPO during a “pilot” period to test the process.
112. We believe this proposal will facilitate the market’s transition to the USM environment. It will offer investors an opportunity to become accustomed to the new environment at their own pace as it will not affect their existing holdings.

### No option to rematerialize

113. Secondly, we propose that there should be *no* option to rematerialize securities that are in uncertificated form. This means:
  - (a) new securities that are *issued* in uncertificated form can never be held in certificated form; and
  - (b) existing securities that have been *converted* into uncertificated form cannot subsequently be converted back into certificated form, even if they are transferred to another person.
114. We consider this proposal to be critical to moving the market to full dematerialization. Without it, there may always be a small group of investors who remain unwilling to relinquish their certificates. Some impetus is needed to encourage them to transition to the new environment.
115. We are mindful that this proposal differs from the position taken in the 2009/2010 consultation. At that time, there were mixed views on whether investors should be given the option to rematerialize their securities. Since then however, we have received views from multiple parties urging the removal of this option, noting that it is regressive, will compromise efficiency in the USM environment, and ultimately delay full implementation of the USM initiative. We note also that the market, and the population generally, is now much more comfortable with the absence of paper documents, i.e. reliance on electronic payments, e-statements and online transacting is now far more common and widespread than it was at the time of the last consultation. We believe

therefore that any demand for the rematerialization option is also likely to be much lower than before. It would be opportune therefore to remove this option.

#### Existing securities held within the new HKEX System

116. Securities held within the HKEX System and registered in the name of HKSCC-NOMS will represent a substantial percentage of the issued securities. In view of this, we propose that they should be dematerialized early on and in batches. Again, consistent with the proposals in paragraphs 102 to 106 above, we expect such dematerialization to be carried out in phases, starting first with shares in Hong Kong companies. HKEX may also consider inviting interested companies to participate in an initial “pilot” batch to test the process.
117. The process of dematerializing securities held in the HKEX System in the name of HKSCC-NOMS will largely entail HKSCC returning any title documents relating to the securities (e.g. share certificates in the case of shares) to the relevant share registrar for cancellation, and the latter recording in the relevant ROM that the securities are held in uncertificated form. The process itself will therefore have little if any impact on investors.
118. That said, given that there will no longer be any option to rematerialize securities once they are dematerialized (see paragraph 113(b) above), it follows that once a particular stock or securities issue held within the HKEX System in the name of HKSCC-NOMS has been dematerialized, it will no longer be possible for investors holding such stock or securities issue to withdraw them from the HKEX System and hold them in *certificated* form. Advance notice will be given prior to each dematerialization exercise so that investors may make necessary arrangements, including opening a USI account or USS account if they wish to hold the dematerialized securities in their own name.
119. A related point to highlight here is that once shares of a particular stock, or units of a particular securities issue, have been dematerialized within the HKEX System, it will no longer be necessary to apply the existing “parallel trading”<sup>49</sup> arrangement in respect of that stock or securities issue. This is because once the stock or securities issue is dematerialized, any change in denomination will be implemented electronically in respect of securities held in the name of HKSCC-NOMS within the HKEX System, or in the name of the relevant investor in a USI or USS account. As such holdings will likely represent the vast majority of shares or units of the dematerialized stock or issue, there is little (if any) need to preserve the parallel trading arrangement. Removing such arrangement in respect of that stock or securities issue would also help simplify and streamline market operations, and thus be in keeping with the USM objectives.

#### Existing securities held outside the HKEX System

120. As for existing securities held outside the HKEX System, as noted above, we propose to allow investors the option to continue holding these in paper form if they prefer. However, this option will be available for a limited time only, i.e. ultimately there will be a “final” deadline by when securities held outside the HKEX System must also be dematerialized. Again, consistent with the proposals discussed in paragraphs 102 to

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<sup>49</sup> “Parallel trading” refers to the arrangement whereby securities that are in the process of a share consolidation, subdivision or change in board lot size are traded under two stock codes (i.e. its normal stock code and a temporary stock code) for a brief period of approximately three to five weeks. This aims to give investors an interim period during which they can deliver, for settlement, certificates bearing either the old or new denomination. After the interim period, only certificates bearing the new denomination may be delivered for settlement. Certificates bearing the old denomination need to be submitted to the share registrar for replacement before they can be delivered for securities settlement.

106 above, this will be implemented in phases starting first with shares in Hong Kong companies. This means there will be multiple final deadlines, each for a different class or description of securities.

121. We appreciate that there may be practical limitations to implementing this as there will be little that an issuer can do if a registered securities holder refuses to deliver up their certificates for cancellation and open a USI or USS account (or hold them through an intermediary). In view of this, and to avoid such actions holding up full dematerialization, we propose that after the relevant final deadline:
- (a) any transfer of securities held in certificated form will have to incorporate a dematerialization process, i.e. the transferee will have to hold them in uncertificated form;
  - (b) any new securities issued to the certificated securities holder (e.g. as a result of a bonus or dividend distribution) will be issued in uncertificated form and credited to a USI account opened by the certificated holder or (if the holder has not opened such an account) to a “temporary” USI account opened by the issuer on behalf of the certificated holder; and
  - (c) any cash entitlements payable to the certificated holder in the meantime shall be paid into their designated bank account, or (if no bank account has been designated) paid by cheque.

|            |   |
|------------|---|
| <b>Q22</b> | <b><i>Noting the general market consensus that Hong Kong should move to a USM regime, do you agree with the general approach for moving the market to full dematerialization? If no, please provide details.</i></b>              |
| <b>Q23</b> | <b><i>Do you have any concerns or comments about our proposals for requiring paperless IPOs only? If yes, please provide details.</i></b>   |
| <b>Q24</b> | <b><i>Do you have any concerns or comments about our proposal that there should be no option to rematerialize securities that are already in uncertificated form? If yes, please provide details.</i></b>                         |
| <b>Q25</b> | <b><i>Do you have any concerns or comments about our proposals for dematerializing securities that are held in the new HKEX System? If yes, please provide details.</i></b>   |
| <b>Q26</b> | <b><i>Do you have any concerns or comments about our proposal to cease the parallel trading arrangement for securities held within the HKEX System that have already been dematerialized? If yes, please provide details.</i></b> |

### ***Encouraging electronic communications***

122. To further encourage the market’s move towards full dematerialization, we also propose to gradually encourage issuers and registered securities holders to communicate electronically rather than in paper form. This may include:
- (a) requiring issuers and holders of uncertificated securities to designate an email address for certain specified communications, and to keep such addresses up-to-date;
  - (b) restricting which documents investors may request to receive in paper form (e.g. voluminous documents like annual reports, listing documents, etc);
  - (c) allowing issuers to impose fees or charges for providing certain documents in paper form;

- (d) requiring corporate action instructions (e.g. proxy and corporate representative appointments) to be made via designated e-communication channels rather than in paper form; and
  - (e) requiring corporate action entitlements (e.g. cash/share dividends) to be delivered electronically into a specified account rather than delivered in paper form (i.e. in the form of cheques/share certificates).
123. We believe this proposal would be in line with the objective of reducing reliance on paper and manual processes so as to facilitate straight-through-processing and enhance overall efficiency. We appreciate however that there may be mixed views on this matter, and therefore welcome the market's feedback in this regard. We would emphasise also that any requirement of the kind described above would only be implemented after public consultation and taking into account market readiness.
124. In the meantime however, and with respect to shares, we propose to uplift certain restrictions in the Companies Ordinance (Cap. 622, **CO**) so as to enable the SFC to introduce requirements of the kind described above in future. (These amendments are described in more detail in paragraph 127(d) below.)

|            |   |
|------------|---|
| <b>Q27</b> | <b><i>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.</i></b> |
|------------|---|

## **VI. FURTHER LEGISLATIVE AMENDMENTS NEEDED**

125. Further legislative amendments will be needed to implement the USM initiative as discussed above. These include amendments to both primary and subsidiary legislation, as well as the introduction of new subsidiary legislation. Some of the amendments stem from the change in the operational model, while others are needed to facilitate the market's move to full dematerialization. The key amendments are summarised below.

### ***Amendments stemming from changes to the operational model***

126. As discussed above, the Revised Model will preserve the current nominee structure within CCASS. Consequent to this: (i) HKSCC will not operate the system for evidencing, and effecting transfers of, legal title to securities without paper documents; and (ii) the entire ROM will be kept and maintained by the issuer's share registrar rather than being "split" into two parts. In view of this:
- (a) No "split" ROM: Provisions in the USMO predicated on issuers having to have a "split" ROM will need to be amended. It will also be necessary to introduce additional ROM-related requirements and notification requirements in respect of allotments and transfers of shares so as to deal with matters such as those discussed under paragraphs 55 to 60 above.
  - (b) No "system operator" role for HKSCC: Provisions envisaging that HKSCC will take on the role of "system operator" (i.e. the role of providing and operating the system for evidencing, and effecting transfers of, legal title to securities without paper documents) will have to be amended.
  - (c) Enhanced regulation of share registrars: Additionally, and flowing from the above, share registrars and their systems will take on greater significance and



responsibilities in the USM environment. It will be necessary therefore to expand and supplement provisions relating to their approval and regulation. (The regulation of share registrars is discussed further in paragraphs 128 to 131 below.)

### ***Other amendments to facilitate implementation of the USM initiative***

127. The following further primary law amendments are also proposed to help facilitate the market's move to full dematerialization.

- (a) Amendments to bring listed funds within the USM initiative: The focus here is on provisions in the SDO that impede the implementation of the USM initiative in respect of listed funds that are structured in the form of a trust (e.g. listed REITs). Essentially, these provisions require the use of paper instruments of transfer, and define the matters to be entered in the ROM. Amendments are needed to remove such impediments, and to align the ROM requirements with those for companies whose shares can be held in uncertificated form. This will enable us to bring listed funds within the scope of the USM initiative irrespective of whether they are structured as a corporate vehicle or a trust.
- (b) Amendments to set definitive timelines towards full dematerialization: The focus here is to introduce rule-making powers that will enable the SFC to specify dates so as to gradually move the market towards full dematerialization along the lines discussed under paragraphs 107 to 121 above. The ability to set out such dates in rules (i.e. in subsidiary legislation) will provide greater flexibility and allow the SFC to take into account market readiness at each stage.
- (c) Amendments relating to settlement finality: The aim here is to ensure that there is adequate protection and finality in respect of instructions relating to the transfer of securities without paper documents, particularly where these involve the movement of securities into and out of the clearing and settlement environment (i.e. transfers to and from HKSCC-NOMS). This will be crucial to ensuring the continued smooth operation of the clearing and settlement operations, and consequently, the integrity of our markets as a whole.
- (d) Amendments to encourage the use of electronic communications: The focus here is on provisions in the CO that permit the use of paper documents in communications between companies (including listed companies incorporated in Hong Kong) and their shareholders. Essentially, the aim is to amend these provisions so that the SFC can, by rules, mandate such companies and their shareholders to use electronic communications in certain cases.<sup>50</sup> We view such amendments as being in keeping with the USM initiative's objective of reducing the use of paper and manual processes so as to facilitate straight-through-processing and further enhance the overall efficiency of the Hong Kong securities market. A point to emphasise in this context is that the proposed amendments are "enabling" only, i.e. they do not themselves mandate the use of electronic communications, but merely enable the SFC to make rules that would mandate such use.
- (e) Amendments relating to the appointment of multiple proxies: The focus here is to reinstate a limit on the number of proxies that may be appointed by a shareholder of a listed company. The law previously limited the number of

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<sup>50</sup> So, for example, the amendment would make it possible for the SFC to make rules requiring uncertificated shareholders to provide and use email addresses for communications with an issuer or its share registrar.

proxies to 2, but this limit was removed in 2014 as part of the Companies Law revamp exercise. A main objective of doing so was to enable investors who hold shares through nominees to participate in the affairs of the company by being able to attend company meetings, and to speak and vote on resolutions considered at such meetings. Since then however, there have been numerous cases of abuse<sup>51</sup> where individual (i.e. non-corporate) shareholders, not being nominees, have sought to appoint multiple proxies but not for genuine company business purposes<sup>52</sup>. These proxies use different means to disrupt the meeting if their requests are denied. These disruptions often put pressure on the staff of issuers and share registrars and cause unnecessary delay and disruption to the meeting proceedings, which issuers are powerless to prevent. There have even been instances where police assistance had to be sought. Such incidents of abuse reflect negatively on our markets as a whole, and could not have been foreseen when the previous 2-proxy limit was removed. The amendments seek to reinstate this previous limit, but only in respect of individual shareholders. It follows that the original intent of the amendment (i.e. enabling investors who hold shares through nominees to attend meetings and vote on resolutions) will be preserved.

- (f) Amendments relating to the deadline for submitting proxy materials: The focus here is to amend the deadline for submitting proxy materials from 48 hours before the meeting time to one clear business day<sup>53</sup> before the meeting day. The current deadline (which is expressed in hours rather than days<sup>54</sup>) is challenging to implement as multiple companies may be holding meetings on the same day but at different times. This creates unnecessary complications and increases the potential for error, particularly if a large volume of proxy documents is received closer to the deadline. The amendment will generally result in investors having more time than today to submit their proxy materials (because the deadline will be pushed back), but in some cases (i.e. where there is an intervening Saturday) the time will be shortened.<sup>55</sup>

### ***Regulation of share registrars in the USM environment***

128. Currently, there is no requirement for share registrars to be approved by the SFC. Instead, the SFC has only an indirect regulatory handle over them by virtue of Part 4 of the Stock Market (Listing) Rules (**SMLR**). That Part requires every corporation whose securities are, or are to be, listed must be or employ a share registrar<sup>56</sup> who is

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<sup>51</sup> All of the large share registrars have encountered incidents of investors abusing the right to appoint multiple proxies and disrupting meeting proceedings. One share registrar estimated that such cases of abuse were encountered in 80% of its clients' general meetings.

<sup>52</sup> For example, there have been cases of a single individual registered shareholder appointing one proxy for every share held by them – e.g. 600 proxies in respect of 600 shares held.

<sup>53</sup> Business day in this context is intended to mean any day other than a Saturday or public holiday.

<sup>54</sup> Currently, companies cannot require proxy materials to be received more than 48 hours before the meeting.

<sup>55</sup> For example, if a meeting is scheduled for 4:30 pm on a Monday, section 598 of the CO currently requires the proxy documents to reach the company by 4:30 pm on the preceding Friday (because Saturday is currently counted as part of the 48 hours). However, with the proposed amendment, the deadline would be brought earlier, i.e. to the end of Thursday (because we propose to exclude Saturdays). On the other hand, if the meeting is scheduled for 4:30 pm on a Wednesday, section 598 currently requires the proxy documents to reach the company by 4:30 pm on the preceding Monday. However, with the proposed amendment, the deadline would be pushed back, i.e. to the end of Monday.

<sup>56</sup> The term "share registrar" is defined in the SMLR to essentially mean any person who maintains in Hong Kong the register of members of a Hong Kong listed company (i.e. "a person who maintains in Hong Kong the register of members of a corporation the securities of which are listed, or proposed to be listed, on a recognized stock market").

a member of an association approved by the SFC. Only one association has been approved by the SFC to date, i.e. the FSR.

129. Going forward however, this minimalist approach to regulating share registrars will not suffice because:
- (a) Share registrars to take on more significant role: Share registrars will take on much greater responsibilities in the USM environment. In particular, their systems and processes will take on the role of evidencing, and effecting transfers of, legal title to listed securities without paper documents. As such, they will be critical to establishing and tracing investors' proprietary rights in such securities.<sup>57</sup> Their Share Registrar System may also interface with the HKEX System and thus have the potential to affect the integrity of the wider market infrastructure. It is necessary therefore to introduce a regime for regulating share registrars directly, and more robustly than today, with a focus on the integrity, security, adequacy and management of share registrars' systems and processes (including arrangements for meeting contingencies or emergencies).
  - (b) Share registrars' role to cover larger range of securities than today: The current requirement (under the SMLR) that corporations appoint an approved share registrar applies only to corporations that issue listed shares. As discussed in paragraphs 102 to 106 above, the USM initiative is intended to cover not only shares but also certain other listed securities such as units or shares in listed funds, share rights, subscription warrants and depositary receipts. It will be necessary therefore for issuers of these other securities to also appoint a regulated share registrar (i.e. an ASR), even though they may not currently do so. That said, the requirement to appoint an ASR will not apply in respect of listed funds if all units or shares of such funds listed in Hong Kong are held within CCASS (or the new HKEX System) and cannot be withdrawn and registered in the name of the investor concerned.
130. The above said, we are also mindful that, internationally, the regulation of share registrars is not common<sup>58</sup>, and that share registrars' businesses can vary greatly in both size and scope<sup>59</sup>. Any regime for regulating share registrars cannot therefore be too prescriptive, and must allow for sufficient flexibility. It must also ensure that the SFC has sufficient supervisory, investigatory and regulatory powers, including the ability to impose a range of disciplinary sanctions for breach. This will be crucial to ensuring effective oversight of share registrars' activities.
131. To that end, it is proposed that the approval and regulation of share registrars be set out in a new piece of subsidiary legislation, and that the primary law provisions

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<sup>57</sup> Currently, investors holding legal title to securities can prove title to such securities by producing the relevant title document – e.g. the share certificate in the case of shares. In the USM environment however, unless an investor keeps full and complete records of their securities transactions, it may be difficult for them to prove their holdings at any particular point in time. The position is much like a depositor's bank account records – a depositor may not always keep a full and complete record of all cash withdrawn and deposited, and is likely to rely instead on the bank being able to provide proof of their balance or cash movements over a particular period of time.

<sup>58</sup> Share registrars are not regulated in most other major markets – as far as we are aware, only the US and India have regulations relating to the activities of share registrars. Such regulation will also be new to Hong Kong when introduced.

<sup>59</sup> In particular, some share registrars may only serve as share registrar in respect of one stock or security, while others may be part of a global share registrar business. Moreover, some registrars may not wish or be able to provide and operate a system for evidencing, and effecting transfers of, legal title to securities without paper, and may prefer instead to leverage on the systems of other more established share registrars.

providing the framework for approving and regulating share registrars be appropriately expanded to enable this. In particular, it is proposed that:

- (a) the SFC's investigation and supervision powers under Part VIII of the Securities and Futures Ordinance (Cap. 571, **SFO**) be suitably expanded so as to cover the regulation of share registrars; and
- (b) the rule-making powers under the SFO that provide for the approval and regulation of share registrars, be more specifically set out for better clarity and certainty.

### ***Other non-statutory amendments***

132. In addition to the above amendments to primary and subsidiary legislation, amendments will also be needed to relevant SFC Codes and Guidelines, as well as various HKEX rules, including in particular Listing Rules issued by SEHK (**Listing Rules**) and the General Rules of CCASS and the CCASS Operational Procedures issued by HKSCC (**CCASS Rules**). The market will be consulted on these amendments at a later stage.

## **VII. PROPOSED TIMETABLE AND NEXT STEPS**

133. This consultation will be open for 3 months until 27 April 2019. Subject to the feedback received, we aim to issue a conclusions paper by July 2019. Thereafter, we will be working on the following:
- (a) The SFC will continue to work with the Government on the drafting of the further primary law amendments needed.
  - (b) Separately, the SFC will work on the drafting of the various pieces of subsidiary legislation needed to support the USM regime. These will focus on technical and operational processes and procedures under the USM environment, and the regulation of ASRs. Thereafter the subsidiary legislation will need to be introduced into the Legislative Council for negative vetting.
  - (c) Amendments will also be needed to relevant SFC Codes and Guidelines. In parallel, HKEX will work on drafting the amendments needed to relevant HKEX rules, and consulting on those amendments.
  - (d) Lastly, HKEX and FSR will work on developing the systems needed to support the USM environment. It is anticipated that this will require about 18 months.
134. Based on the above, our current assessment is that the USM regime may start to be implemented in early 2022.

## **VIII. COMMENTS INVITED**

135. We believe the Revised Model presents a viable solution for implementing a USM regime in Hong Kong. First, it achieves one of the core objectives of the USM initiative, which is to enable investors to hold securities in their own name and without paper. Secondly, it preserves the efficiencies and benefits currently enjoyed by the market. As a result, the Revised Model can be implemented with minimal market disruption. The implementation costs for intermediaries will also be low given that many of the existing processes and arrangements can be retained, except where they choose to provide services as a sponsoring CP for USS holders, in which case enhancements to operational processes and systems will likely be needed.

136. Ultimately however, the successful implementation of the Revised Model will depend on its technical and operational details, and the impact that these will have on different market participants. We have therefore expanded on these in much more detail in this paper. We have also raised specific issues on which we would appreciate feedback. We urge market participants and other interested parties to submit written comments to the proposals discussed in this paper. **The deadline for submissions is 27 April 2019.**

## ANNEX 1: HIGH-LEVEL COMPARISON OF OPERATIONAL MODELS

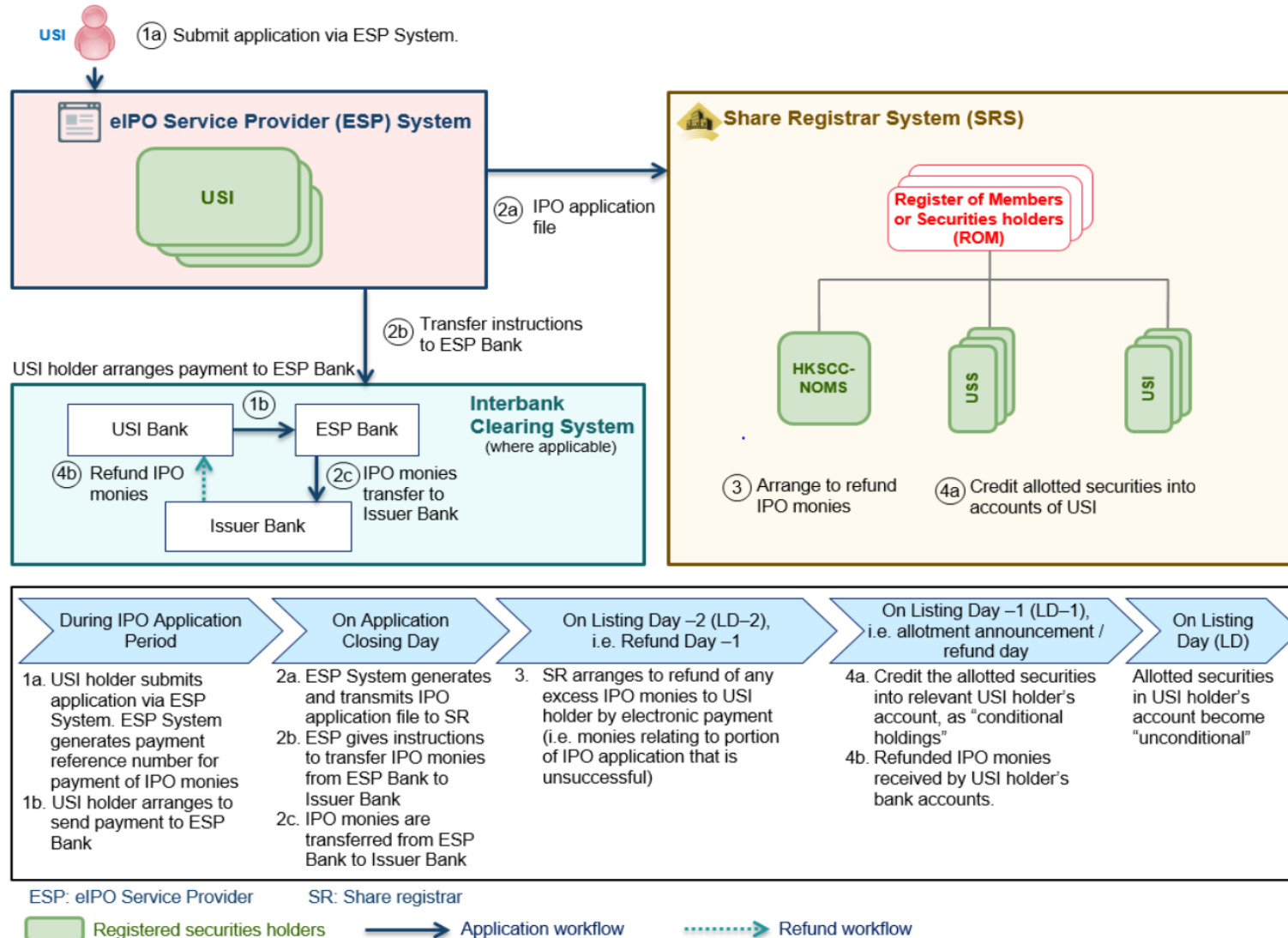
|   | Existing Model  | 2010 Model   | Revised Model  |
|---|---|--|--|
| Structure within the clearing and settlement system               | <ul style="list-style-type: none"> <li>Nominee structure</li> </ul>   | <ul style="list-style-type: none"> <li>No nominee structure</li> </ul>   | <ul style="list-style-type: none"> <li>Nominee structure</li> </ul>  |
| Account types within the clearing and settlement system           | <ul style="list-style-type: none"> <li>CP account</li> <li>SSA</li> <li>IP account</li> </ul>   | <ul style="list-style-type: none"> <li>CPA</li> <li>PSA</li> <li>IPA</li> <li>ISA</li> </ul>   | <ul style="list-style-type: none"> <li>CP account</li> <li>SSA</li> <li>IP account</li> <li>USS account</li> </ul>   |
| Account types outside the clearing and settlement system          | <ul style="list-style-type: none"> <li>Nil</li> </ul>   | <ul style="list-style-type: none"> <li>Nil</li> </ul>  | <ul style="list-style-type: none"> <li>USI account</li> </ul>  |
| Options for investors to hold securities in own name              | <ul style="list-style-type: none"> <li>In certificated form only</li> </ul>   | <ul style="list-style-type: none"> <li>In certificated form (to a limited extent)</li> <li>In uncertificated form</li> </ul>   | <ul style="list-style-type: none"> <li>In certificated form (to a limited extent)</li> <li>In uncertificated form</li> </ul>   |
| Structure of the register of members or register of holders (ROM) | <ul style="list-style-type: none"> <li>Single ROM</li> <li>Maintained solely by relevant share registrars</li> </ul>  | <ul style="list-style-type: none"> <li>Split ROM</li> <li>Maintained partly by HKSCC and partly by share registrars</li> </ul>   | <ul style="list-style-type: none"> <li>Single ROM</li> <li>Maintained solely by relevant ASR</li> </ul>  |
| Interface between HKSCC's systems and share registrars' systems   | <ul style="list-style-type: none"> <li>No</li> </ul>  | <ul style="list-style-type: none"> <li>Yes</li> </ul>  | <ul style="list-style-type: none"> <li>Yes</li> </ul>  |
| Stamp duty collection   | <ul style="list-style-type: none"> <li>On exchange transactions: via SEHK</li> <li>Off exchange transactions: In paper form direct with Stamp Office</li> </ul> | <ul style="list-style-type: none"> <li>On exchange transactions: via SEHK</li> <li>Off exchange transactions: electronically via intermediaries and/or share registrars</li> </ul> | <ul style="list-style-type: none"> <li>On exchange transactions: via SEHK</li> <li>Off exchange transactions: electronically via intermediaries and/or share registrars</li> </ul> |

## ANNEX 2: HIGH-LEVEL COMPARISON OF USI ACCOUNT AND USS ACCOUNT

|                          | USS account  | USI account  |
|--------------------------|--|--|
| Account opening and KYC  | <ul style="list-style-type: none"> <li>- Account to be opened with a sponsoring CP</li> <li>- Account opening, and relevant KYC, to be carried out by sponsoring CP</li> <li>- Relevant KYC information to be shared with relevant ASR</li> </ul>              | <ul style="list-style-type: none"> <li>- Account to be opened with the relevant ASR</li> <li>- Account opening process, and relevant KYC, to be carried out by relevant ASR</li> </ul> |
| Account operation        | By investor but via sponsoring CP and HKEX System  | By investor directly through the Share Registration System (or Common Platform, if successfully developed)   |
| Cash distributions       | Views sought – see paragraphs 54 and 99(c) above   | To be credited to the investor’s designated bank account   |
| Non-cash distributions   | To be credited to the USS account  | To be credited to the USI account  |
| Relationship with issuer | The investor will be recorded on the ROM as the registered owner of the securities reflected in the USS or USI account. They will therefore hold legal title to the securities, and be entitled to all rights and entitlements in respect of those securities. |  |

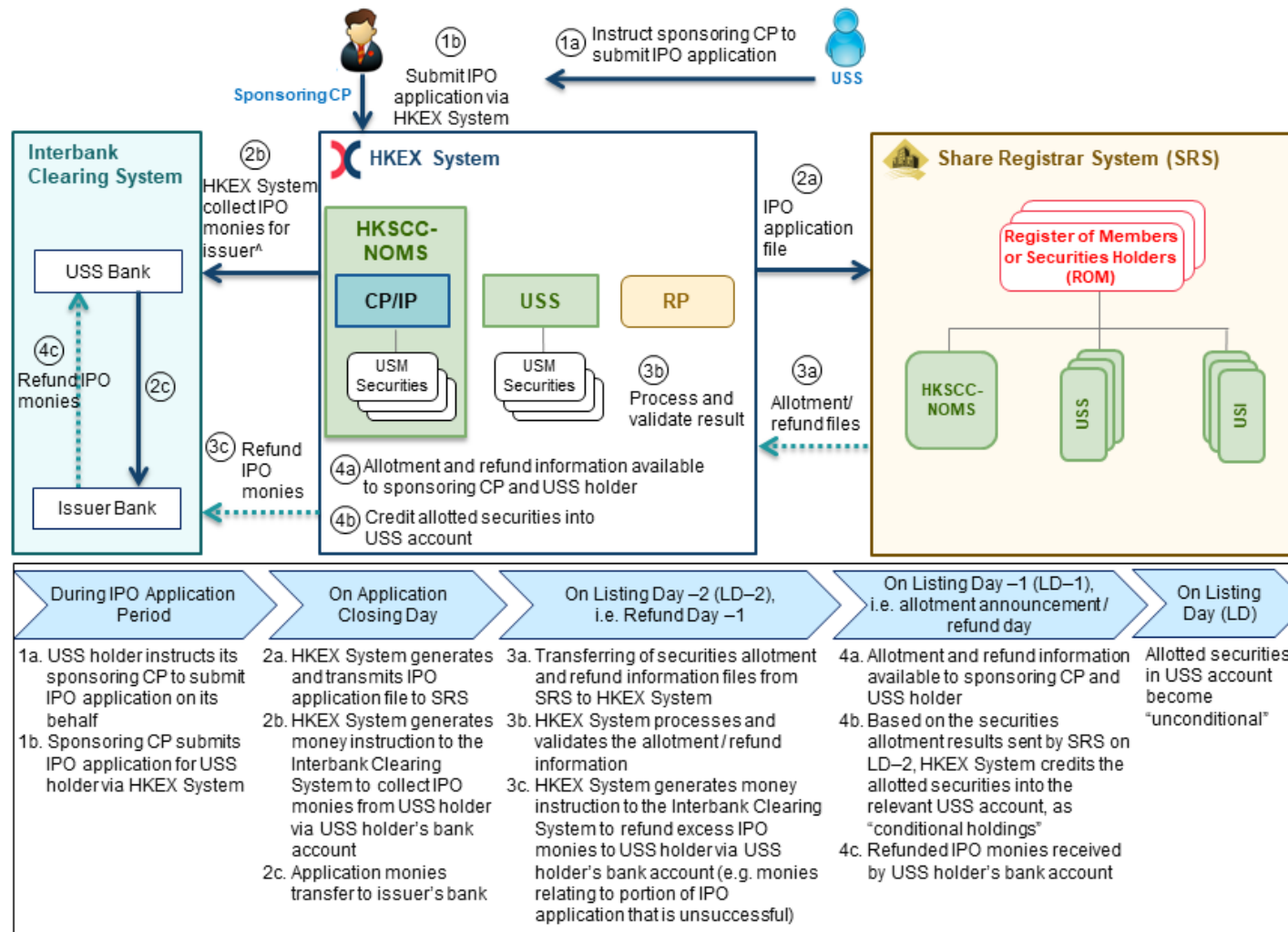
# ANNEX 3: PROCESS FLOWS FOR IPO

## IPO application through USI account



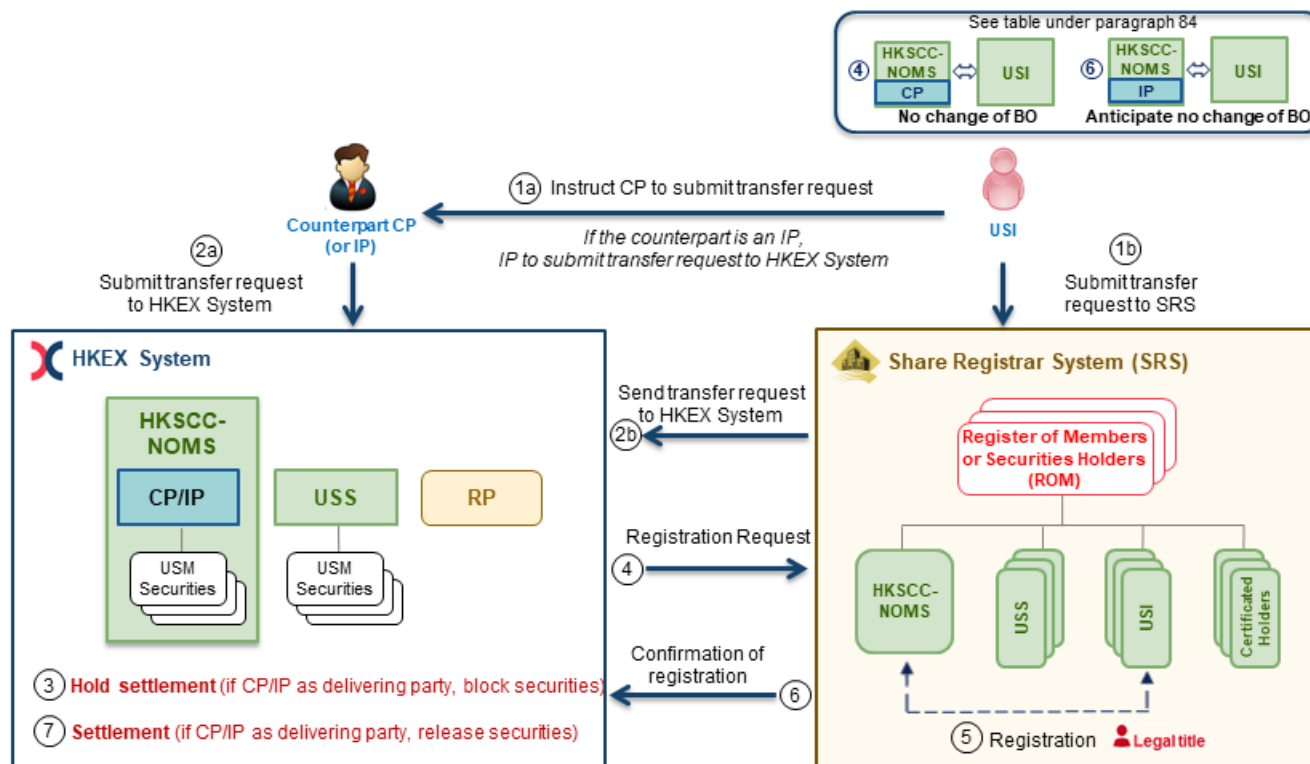


## IPO application through USS account



## ANNEX 4: PROCESS FLOWS FOR TRANSFERS TO AND FROM HKSCC-NOMS UNDER THE REVISED MODEL

### Transfers between a USI holder and HKSCC-NOMS



#### Steps:

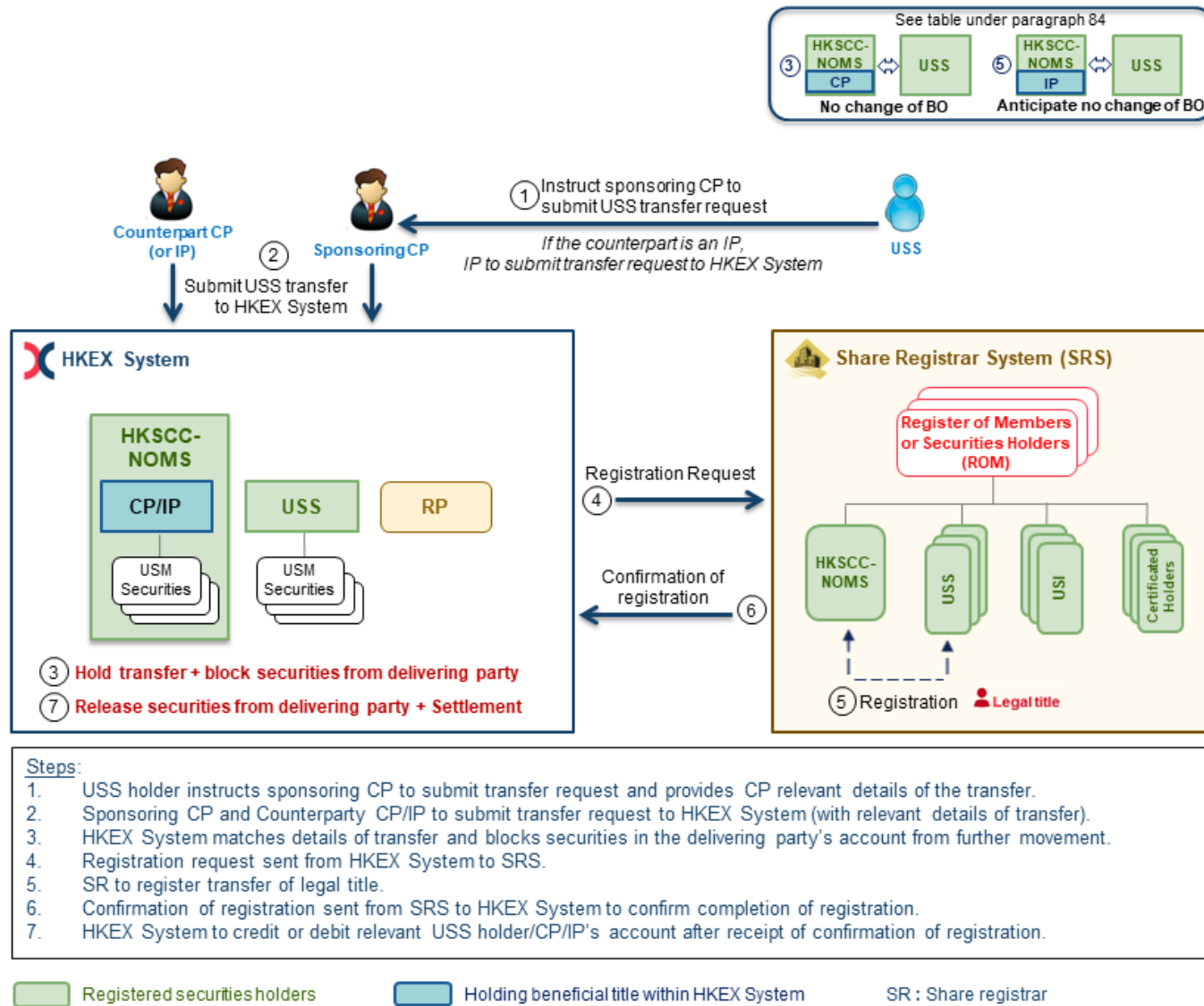
- 1a. USI holder instructs CP to submit transfer request and provides CP relevant details of the transfer.
- 1b. USI holder submits transfer request together with relevant details of the transfer via SRS. SR verifies the identity of the USI holder and where USI holder is the delivering party, SR conducts relevant checks (e.g. ensure sufficient number of securities are available and not "locked" nor subject to restriction).
- 2a. CP/IP to submit transfer request to HKEX System (with relevant details of transfer).
- 2b. Transfer request sent from SRS to HKEX System together with relevant details of the transfer.
3. HKEX System matches details of transfer and blocks securities in the delivering party's account from further movement.
4. Registration request sent from HKEX System to SRS.
5. SR to register transfer of legal title.
6. Confirmation of registration sent from SRS to HKEX System to confirm completion of registration.
7. HKEX System to credit or debit CP/IP's account after receipt of confirmation of registration.

Registered securities holders

Holding beneficial title within HKEX System

SR : Share registrar

## Transfers between a USS holder and HKSCC-NOMS



**Steps:**

1. USS holder instructs sponsoring CP to submit transfer request and provides CP relevant details of the transfer.
2. Sponsoring CP and Counterparty CP/IP to submit transfer request to HKEX System (with relevant details of transfer).
3. HKEX System matches details of transfer and blocks securities in the delivering party's account from further movement.
4. Registration request sent from HKEX System to SRS.
5. SR to register transfer of legal title.
6. Confirmation of registration sent from SRS to HKEX System to confirm completion of registration.
7. HKEX System to credit or debit relevant USS holder/CP/IP's account after receipt of confirmation of registration.

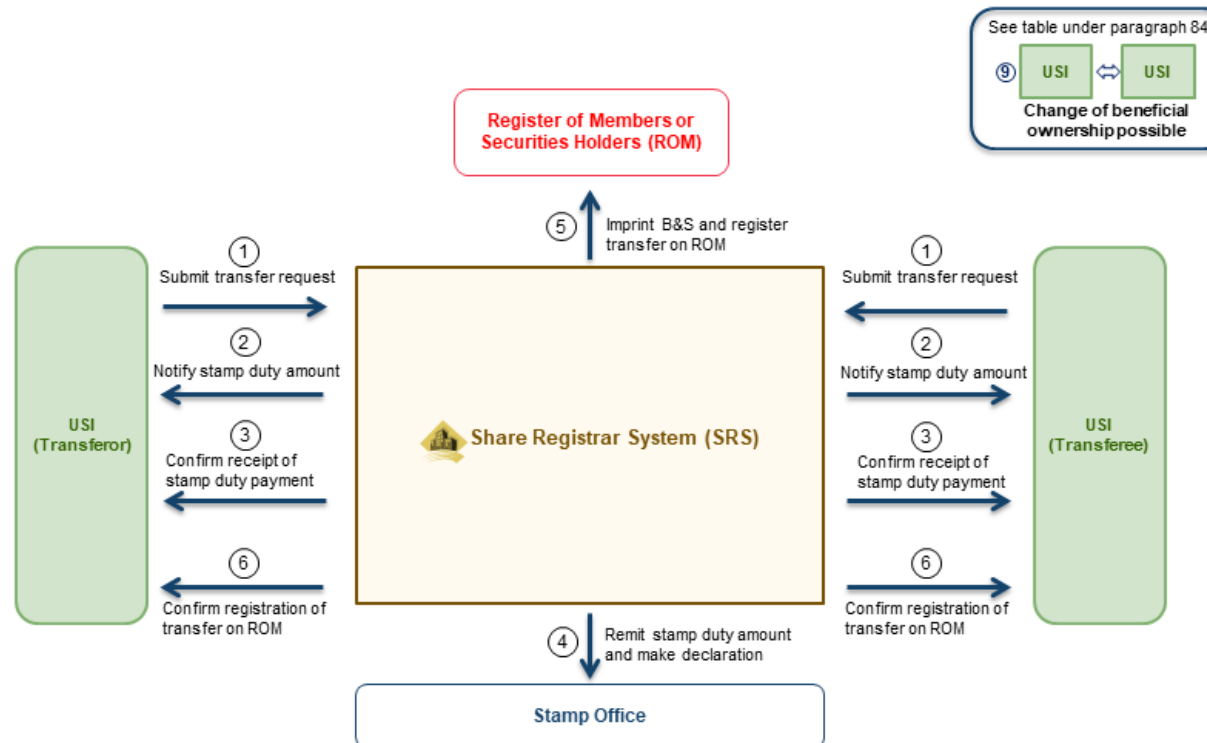
Registered securities holders

Holding beneficial title within HKEX System

SR : Share registrar

## ANNEX 5: PROCESS FLOWS FOR OTHER TRANSFERS UNDER THE REVISED MODEL

### Transfers between two USI holders

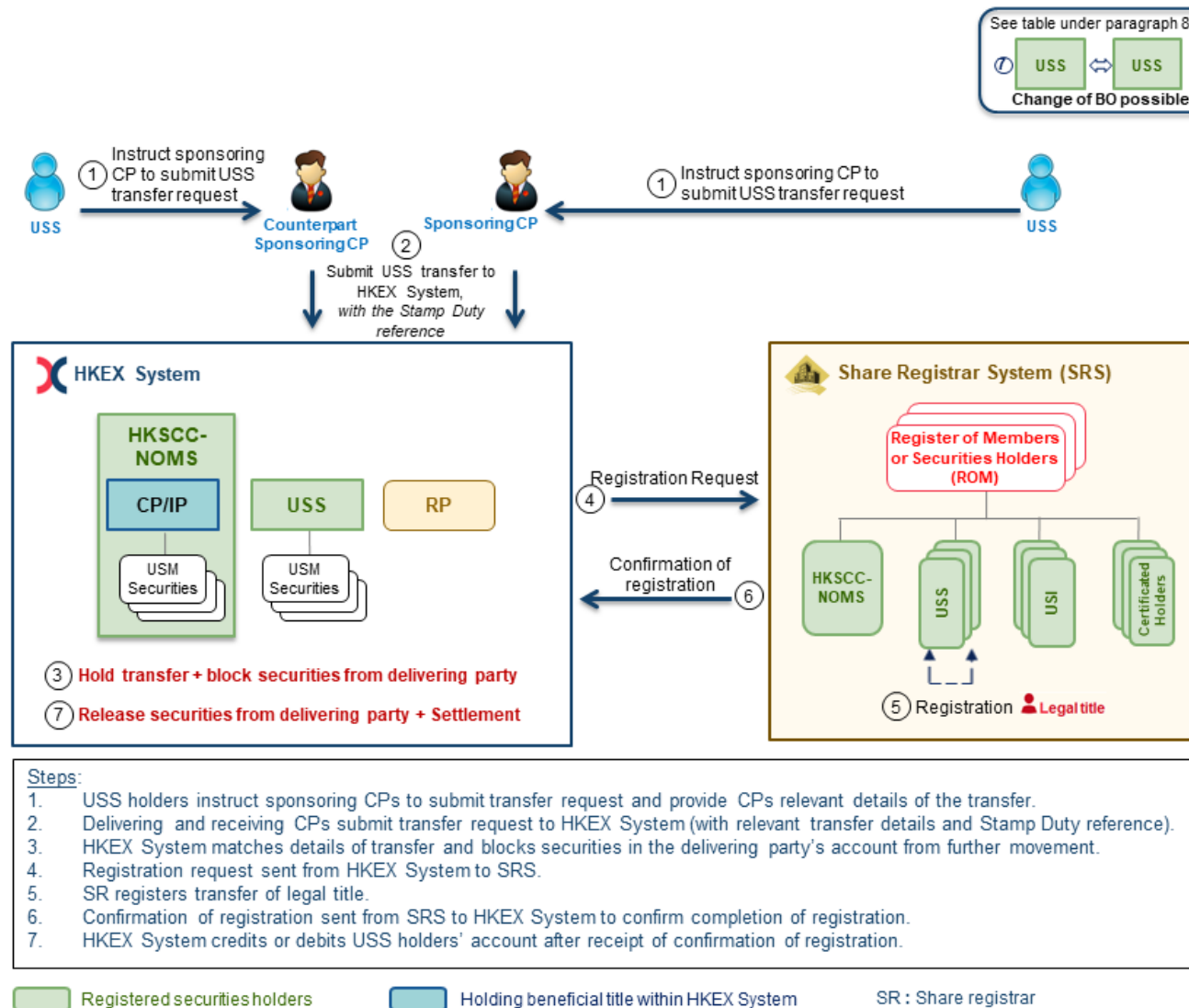


#### Steps:

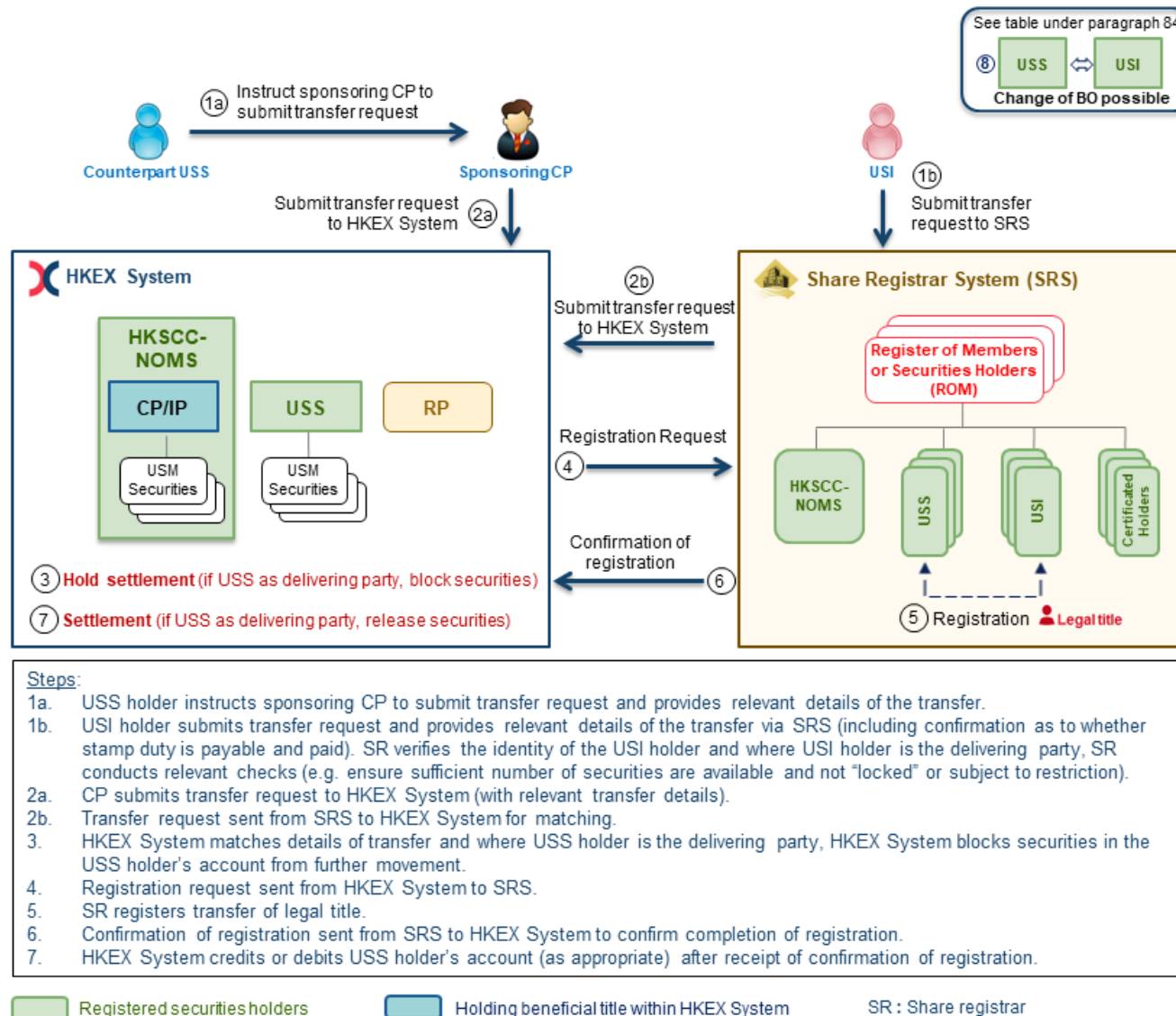
1. USI holders submit transfer request via SRS together with: (i) the Bought and Sold Notes (**B&S**); and (ii) details of the transfer (including confirmation as to whether stamp duty is payable and paid). Additional supporting documents may be required from USI holder who declares no change of beneficial ownership. SR verifies the identity of the USI holder and conducts relevant checks (e.g. ensure sufficient number of securities available and not "locked" nor subject to other restriction.)
2. Where a transfer involves change of beneficial ownership, SR to notify USI holders of the stamp duty amount payable.
3. Upon receipt of stamp duty payment, SR will send confirmation to transferor and transferee.
4. SR to remit the stamp duty amount and make declarations to the Stamp Office based on confirmations from USI holders.
5. SR to imprint B&S and register transfer of legal title.
6. SR to send statements to transferor and transferee confirming registration of transfer on ROM.

Registered securities holders SR : Share registrar

## Transfers between two USS holders



## Transfers between a USI holder and a USS holder



## LIST OF QUESTIONS

- Q1 *Do you agree that the Revised Model presents a better option for taking forward the USM initiative? If no, please provide details.*
- Q2 *Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.*
- 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.*
- 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.*
- 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.*
- 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.*
- 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.*
- 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.*
- 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.*
- 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.*
- 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.*
- 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.*
- Q22 *Noting the general market consensus that Hong Kong should move to a USM regime, do you agree with the general approach for moving the market to full dematerialization? If no, please provide details.*
- 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 rematerialize securities that are already in uncertificated form? If yes, please provide details.*
- Q25 *Do you have any concerns or comments about our proposals for dematerializing securities that are held in the new HKEX System? If yes, please provide details.*
- Q26 *Do you have any concerns or comments about our proposal to cease the parallel trading arrangement for securities held within the new HKEX System that have already been dematerialized? If yes, please provide details.*
- 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.*



## GLOSSARY

|   |  |
|---|--|
| <b>2010 Model</b>                             | the operational model for implementing a USM regime that was consulted on in 2009/2010 – see paragraphs 35 to 36 above   |
| <b>ASR</b>                                    | a share registrar that has been approved by the SFC under the new share registrar regime discussed under paragraphs 128 to 131 above   |
| <b>Beneficial interest / beneficial owner</b> | investors hold <i>beneficial interest</i> in securities (or are <i>beneficial owners</i> of securities) if they are not registered with the issuer, have no relationship with the issuer, and must instead rely on the contractual arrangement with the registered owner, and any intermediating entities in between, to enjoy the rights and benefits of holding the securities |
| <b>CCASS</b>                                  | Central Clearing and Settlement System operated by HKSCC   |
| <b>CCASS Rules</b>                            | the General Rules of CCASS and the CCASS Operational Procedures issued by HKSCC  |
| <b>CO</b>                                     | the Companies Ordinance (Cap. 622)   |
| <b>Common Platform</b>                        | the common platform that the FSR is exploring to develop – see paragraphs 73 to 78 above   |
| <b>CP</b>                                     | a clearing participant or a custodian participant in CCASS, or in the HKEX System (as the case may be)   |
| <b>FSR</b>                                    | the Federation of Share Registrars Limited   |
| <b>HKEX</b>                                   | Hong Kong Exchanges and Clearing Limited   |
| <b>HKSCC</b>                                  | Hong Kong Securities Clearing Company Limited  |
| <b>HKSCC-NOMS</b>                             | HKSCC Nominees Limited   |
| <b>HKEX System</b>                            | the new system to be introduced by HKEX to replace CCASS – see footnote 10 above   |
| <b>legal owner / legal title</b>              | investors hold <i>legal title</i> to securities (or are the <i>legal owner</i> of 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  |
| <b>Listing Rules</b>                          | the Main Board Listing Rules and the GEM Listing Rules of the SEHK   |
| <b>Revised Model</b>                          | the revised operational model for implementing a USM regime that is the subject of this paper – see <a href="#">Section III</a>  |
| <b>ROM</b>                                    | the register of members or (in the case of securities other than shares) the register of securities holders registered with the issuer   |
| <b>SDO</b>                                    | the Stamp Duty Ordinance (Cap. 117)  |
| <b>SEHK</b>                                   | The Stock Exchange of Hong Kong Limited  |
| <b>SFC</b>                                    | the Securities and Futures Commission  |
| <b>Share Registrar System</b>                 | the system operated by an ASR to evidence, and effect transfers of, legal title to securities without paper documents  |
| <b>SMLR</b>                                   | the Securities and Futures (Stock Market Listing) Rules (Cap. 571V)  |

|                              |  |
|------------------------------|--|
| <b>sponsoring CP</b>         | in relation to a USS account, means the clearing or custodian participant in the new HKEX System through which the account is opened, and that sponsors that account |
| <b>SSA</b>                   | the stock segregated account with statement service opened with HKSCC via a CP   |
| <b>USI account</b>           | an account opened by an investor with an ASR to reflect uncertificated securities registered in the name of the investor   |
| <b>USI holder</b>            | the holder of a USI account  |
| <b>USS account</b>           | an account opened by an institutional investor with a sponsoring CP to reflect uncertificated securities registered in the name of the institutional investor        |
| <b>USS holder</b>            | the holder of a USS account  |
| <b>USM initiative/regime</b> | the initiative/regime for implementing an uncertificated securities market in Hong Kong  |
| <b>USMO</b>                  | the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2015   |