

LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

**A PROPOSED OPERATIONAL MODEL FOR IMPLEMENTING
A SCRIPLESS SECURITIES MARKET IN HONG KONG**

Purpose

In June 2009¹, Members were informed that the Securities and Futures Commission (**SFC**) together with Hong Kong Exchanges and Clearing Limited (**HKEx**) and the Federation of Share Registrars Limited (**Federation**) were working on the operational model for implementing a scripless securities market in Hong Kong, and that a joint consultation paper on this subject would be issued in the fourth quarter of 2009. This paper updates Members of the developments since then.

Benefits of implementing a scripless securities market

2. The main benefits of implementing a scripless securities market (i.e. a market where legal ownership in securities can be held and transferred without paper documents) are as follows –

- (a) first, it will modernize the financial infrastructure of Hong Kong and enhance overall efficiency in our securities market. Our stock market has grown significantly in recent years and today ranks the 7th largest in the world. By further reducing the use of papers, we can increase opportunities for straight-through processing and enhance the efficiency and turnaround time of transactions.
- (b) secondly, it will enhance corporate governance, and ultimately secure an improved level of investor choice and protection. Through facilitating direct ownership, shareholder transparency can be enhanced and corporate communications and corporate action services can be carried

¹ A discussion paper dated 11 June 2009 (Ref : CB(1)1829/09-09(01)) was prepared to inform Members of, amongst others, legislative proposals intended to be included in the Companies (Amendment) Bill 2009. One of the proposals is pertaining to technical amendments to the Companies Ordinance to pave the way for a scripless securities market.

out directly and more efficiently. All of these can contribute to better corporate governance and ultimately achieve better protection for investors; and

- (c) thirdly, it will ensure that Hong Kong is in keeping with other leading markets that have already implemented dematerialisation. This together with the other benefits of improved efficiency, enhanced corporate governance and better investor protection, will ensure Hong Kong's competitiveness and position as a leading market.

3. The implementation of a scripless securities market in Hong Kong is also timely. After years of market development, online banking and securities trading are now commonplace in Hong Kong. Investors are accustomed to operating their finances, including trading securities and operating their accounts electronically. They are also used to receiving corporate communications and announcements electronically.

Previous consultations and developments since then

4. Previously, the SFC and HKEx had separately consulted the market on proposals for implementing a scripless securities market in Hong Kong. There was difficulty in reaching consensus on the operational model. This notwithstanding, the Companies Ordinance re-write exercise and recent developments in the market have provided fresh impetus to move this project forward.

5. A working group (**Working Group**) – comprising representatives from the SFC, HKEx and Federation – was established in early 2009 to revive discussion on the operational model for a scripless market. On 30 December 2009, the SFC, HKEx and Federation jointly issued a consultation paper entitled *A Proposed Operational Model for Implementing a Scripless Securities Market in Hong Kong* (**Consultation Paper**). The consultation period will last for three months, i.e. until 31 March 2010. A copy of the Consultation Paper is at **Annex A**.

6. The Consultation Paper summarises the results of the Working Group's study and discussions, and seeks views on various aspects of a proposed operational model which has been put together by the Working Group. A main difference between the model proposed in this paper and the models proposed in earlier consultations is that this model is one that all three parties – i.e. the SFC, HKEx and the

Federation – believe is likely to be acceptable to market participants and the investing public.

7. In developing the proposed model, the Working Group considered in particular the models adopted in the UK and Australia. This was because both are common law jurisdictions and their laws previously included provisions similar to those in Hong Kong compelling the use of paper documents of title and instruments of transfer. Secondly, both have implemented a dematerialised market to different degrees. Their models therefore share many similarities, but there are also differences.

Key aspects of the proposed operational model

8. Members may wish to refer to Part II of the Consultation Paper for a description of the existing market structure, and to Part III of the paper for a discussion of the key aspects of the proposed operational model. For easy reference, the diagrams depicting the existing market structure and the proposed operational model are reproduced at **Annexes B and C**.

9. The key aspects of the proposed operational model are as follows -

- (a) Dual system and a phased approach: The Working Group proposes that the existing paper-based regime will co-exist with the new scripless regime at the initial stage, and the paper-based regime will only be eliminated when the market is ready to go wholly scripless. *[Paragraphs 35 to 41 of the Consultation Paper]*
- (b) Certificated sub-register and uncertificated sub-register: The Working Group proposes that all uncertificated securities will be held in the Central Clearing and Settlement System (CCASS) and all certificated securities will be held outside CCASS. The register of holders will thus consist of two parts -
 - (i) an uncertificated sub-register, which will record all uncertificated holdings inside CCASS ; and
 - (ii) a certificated sub-register which will record all certificated holdings outside CCASS.
[Paragraphs 49 to 53 of the Consultation Paper]

- (c) Name on register: The Working Group proposes that investors be able to hold securities in CCASS in their own name. In other words, investors will have the option to become the legal or registered owner of securities held in CCASS and enjoy the full benefits of legal ownership, while also enjoying the convenience of holding their securities electronically rather than in physical form. *[Paragraphs 58 and 59 of the Consultation Paper]*
- (d) Investor choice: The Working Group proposes that investors will have a wider range of options to choose from in terms of the form, type of ownership and extent of control over their holdings. *[Paragraphs 64 to 72 of the Consultation Paper]*
- (e) Share registrars to become CCASS participants: A new CCASS participant category – Registrar Participant – will be introduced. This will allow share registrars to use the existing CCASS infrastructure to communicate directly with CCASS, intermediaries and investors who hold securities through a broker/bank/custodian that is a CCASS Participant. It will also allow the setting up of accounts for holding securities in dematerialised form with the share registrar direct. Share registrars are thus expected to take on a more active and involved role in the scripless environment and hence it is also proposed that they be more robustly regulated than they are today. *[Paragraphs 73 to 77 of the Consultation Paper]*
- (f) Scope of coverage: The proposed operational model could in general apply to all securities that are publicly traded in Hong Kong. Nevertheless, in the Consultation Paper, the Working Group seeks the public's views as to whether the model should be extended to cover all securities (including therefore securities such as derivative warrants and Callable Bull/Bear Contracts). *[Paragraphs 89 and 90 of the Consultation Paper]*

Position of companies incorporated overseas but listed in Hong Kong

10. Hong Kong is unique in that the vast majority of companies listed here (about 84%) are incorporated overseas. For ease of reference

we reproduce below the table (found at page 30 of the Consultation Paper) which shows the profile of companies listed in Hong Kong as at the end of November 2009.

Place of incorporation	Number of HK-listed companies (Number) (%)		Market share (in terms of market capitalisation)* (HK\$M) (%)	
Bermuda	465	35.55	1,601,912	9.15
Cayman Islands	482	36.85	2,816,871	16.08
Hong Kong	203	15.51	6,413,265	36.62
Mainland	154	11.77	4,697,213	26.82
United Kingdom	2	0.16	1,969,509	11.24
Australia	1	0.08	16,238	0.09
Canada	1	0.08	-	-
Total:	1,308	100.00	17,515,008	100.00

* The aggregate market capitalisation shown in the table does not include companies that are incorporated outside Hong Kong and have a majority of its business outside Hong Kong and Mainland China. (The excluded companies are essentially a few incorporated in Bermuda, a few incorporated in Cayman Islands and one incorporated in Canada.)

11. The Consultation Paper therefore also specifically considers the position of overseas incorporated companies in Part IV. In particular, the Working Group is considering whether shares and debentures of overseas incorporated companies can be held in dematerialised form and whether legal title to them can be transferred electronically within CCASS without an instrument of transfer. The initial focus has been on companies incorporated in Bermuda, Cayman Islands, Mainland China and the UK since these make up the overwhelming majority of all overseas incorporated companies listed in Hong Kong. The Working Group's preliminary findings in respect of these jurisdictions are set out in paragraphs 111 to 115 of the Consultation Paper.

Legislative changes required

12. Part V of the Consultation Paper summarises the legislative changes that are required to implement a scripless securities market in Hong Kong. Essentially -

- (a) the first step will be to amend provisions in the Companies Ordinance that compel the use of paper certificates and instruments of transfer. This is a relatively simple step, but crucial to laying the foundation for implementing a scripless securities market in Hong Kong. To indicate its support for a scripless market, the Government has included such amendments into the Companies (Amendment) Bill 2010 due to be introduced into the Legislative Council in February 2010. This would help focus the market on the scripless model during the consultation; and
- (b) it will be necessary to set out the framework for regulating the scripless environment, and those that will play a key role in that environment. This will be a more complex exercise and the specific legislative amendments will depend very much on the operational model that is eventually adopted, and hence on the outcome of this consultation. In addition to the Companies Ordinance, other legislations that will require amendments include the Securities and Futures Ordinance and the Stamp Duty Ordinance.

13. Further, various non-statutory rules and codes will also need to be amended accordingly, including the Listing Rules of the Stock Exchange of Hong Kong, the General Rules of CCASS and the SFC's Code of Conduct for Share Registrars.

Timetable

14. The consultation period will end on 31 March 2010. The SFC aims to issue consultation conclusions in the second quarter of 2010, and finalise the operational model as soon as practicable thereafter. Once the operational model is finalised, it will be possible to prepare the legislative amendments. There will be further consultation on the relevant legislative amendments. The Government has pledged its support to facilitate the process.

Concluding remarks

15. The proposed new model will set the foundation for how a scripless securities market may operate in Hong Kong. It represents an important first step towards further strengthening our market infrastructure and facilitating the long-term development of our financial markets.

**Working Group on Scripless Securities Market
January 2010**

JOINT CONSULTATION PAPER

ON

**A PROPOSED OPERATIONAL
MODEL FOR IMPLEMENTING A
SCRIPLESS SECURITIES MARKET
IN HONG KONG**



30 December 2009

TABLE OF CONTENTS

TABLE OF CONTENTS	i
FOREWORD.....	iii
PERSONAL INFORMATION COLLECTION STATEMENT	iv
I. INTRODUCTION AND EXECUTIVE SUMMARY	1
Purpose and objective	1
Background	1
Previous consultations and latest developments	2
Main features of the proposed model	3
Benefits of implementing a scripless market	4
Comments invited	6
Layout of paper	6
II. EXISTING MARKET STRUCTURE	7
How securities are currently held	7
How investors are currently served	9
III. PROPOSED OPERATIONAL MODEL.....	11
Diagram summary of existing and proposed models.....	11
Dual system and a phased approach	13
Dual system.....	13
Phased approach	14
Dematerialisation process	15
Issuers' obligation.....	15
Register to comprise two parts.....	16
Uncertificated sub-register and certificated sub-register	16
Provision of day-end records to facilitate inspection, etc.....	17
Corporate action processing and securities reconciliation	17
Name on register	17
Optional	17
Immediate credit.....	18
Investor choice	18
Methods of holding securities	18
Features of five account types.....	19
Multiple representatives and proxies	20
Unique identification	20
Corporate actions and corporate communications	21
Share registrars to become a new category of CCASS Participants	21
Guiding principles vis-à-vis Fees	22

IPOs	23
Scope.....	26
Benefits and implications for different stakeholders	26
Investors.....	26
Brokers, banks and custodians	27
CCASS	28
Issuers and share registrars.....	28
Market as a whole	28
IV. POSITION OF OVERSEAS SECURITIES.....	30
Bermuda and Cayman Islands	30
Mainland China and the UK.....	31
Other jurisdictions	32
Practice in the UK and Australia.....	32
V. LEGISLATIVE CHANGES.....	33
Summary of the changes needed	33
Amendment process.....	34
VI. TIMETABLE.....	35
ANNEX 1 – SUMMARY OF THE UK AND AUSTRALIAN MODELS	36
ANNEX 2 – FEATURES AND CHARACTERISTICS OF THE FIVE ACCOUNT TYPES	39
ANNEX 3 – FUNCTIONS THAT MIGHT BE PERFORMED THROUGH THE CCASS PLATFORM	44
ANNEX 4 – LIST OF SPECIFIC ISSUES ON WHICH FEEDBACK IS SOUGHT.....	45

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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 the Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

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¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

² Defined in Schedule 1 of the Securities and Futures Ordinance (Cap. 571) (**SFO**) to mean provisions of the SFO and subsidiary legislation made under it; and provisions in part II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.

Enquiries

Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or 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, 8/F Chater House, 8 Connaught Road Central, Hong Kong.

I. INTRODUCTION AND EXECUTIVE SUMMARY

Purpose and objective

1. This paper invites views on a proposed operational model for implementing a scripless securities market in Hong Kong, i.e. a market where legal ownership in securities can be held and transferred without paper documents.
2. The main objectives of implementing a scripless securities market are to enhance overall efficiency and competitiveness in the securities market, and secure an appropriate and improved level of investor choice and protection.

Background

3. Investors today can hold and transfer securities in electronic form through the Central Clearing and Settlement System (**CCASS**), which is operated by Hong Kong Securities Clearing Company Limited (**HKSCC**) which in turn is a recognized clearing house. However, because CCASS is an immobilised securities settlement system¹, it is only the beneficial interest in the securities that can be held and transferred through CCASS, not legal title.
4. A main reason for CCASS being an immobilised system is that Hong Kong's securities market is still largely paper-based –
 - (1) for certain Hong Kong securities (such as shares and debentures of Hong Kong incorporated companies), the law compels the issue of paper certificates and documents of title (which serve as evidence of legal title), and the use of paper instruments to effect transfers of legal title, and
 - (2) for overseas securities, in some cases the laws of their home jurisdiction do not compel the use of paper but in some cases they do – see generally Section IV of this paper.
5. The existing immobilised system has served Hong Kong well. It has greatly reduced scrip circulation, and consequently the risks associated with having to use paper certificates (e.g. delay, loss, theft, etc). It has also improved speed and efficiency in the trading and settlement process, and thus contributed to the rapid growth and development of our securities market.
6. However, the system also has its shortcomings. First, it is not completely electronic. Some transactions still require the use of paper – e.g. the IPO² process to some extent still requires the use of paper (see paragraphs 83

¹ An immobilised securities system is one in which securities are issued in paper form and deposited with a central depository which is electronically linked with a settlement system. The paper securities are immobilised in the central depository in the sense that they are held by the depository at all times and do not need to be moved or re-registered to effect a transfer within the system. In Hong Kong, CCASS serves as the central depository and securities settlement system. The paper securities are deposited into the CCASS depository and registered in the name of HKSCC Nominees Limited. So long as the securities stay in CCASS, legal title to them remains vested in HKSCC Nominees Limited. Investors who hold securities in CCASS therefore hold only a beneficial interest in the securities – they are not registered holders and do not hold legal title. Likewise, when investors transfer securities in CCASS, they transfer only the beneficial interest in the securities – legal ownership of the securities remains with HKSCC Nominees Limited.

² The term IPO refers to initial public offerings.

to 88 below). Secondly, as already mentioned earlier, investors who hold securities within CCASS hold only the beneficial interest in the securities. As a result, unlike registered holders, they do not generally receive corporate actions directly from issuers, nor can they respond directly to the issuers, for example, to exercise voting rights, which must instead be exercised by submitting instructions indirectly via their broker/bank/custodian and the CCASS nominee (i.e. HKSCC Nominees Limited).

7. It is therefore proposed that Hong Kong implement a scripless securities market (or dematerialisation³ as it is also commonly known). This means –
 - (1) enhancing the existing operational model so that when securities are held and transferred electronically within CCASS, it is the legal title that can be held and transferred and not just the beneficial interest,
 - (2) reviewing the position of overseas securities listed in Hong Kong, and putting in place, where necessary and to the extent possible, changes that will allow them to be issued and held in dematerialised form, and legal title to them to be transferred electronically, and
 - (3) introducing appropriate amendments to legislation and non-statutory rules and codes to support the new operational model and position of overseas companies – this includes removing obstacles in the existing legislation and rules that prevent the implementation of a scripless securities market (such as requirements compelling the issue of paper certificates and documents of title and the use of paper instruments of transfer), and putting in place a framework for regulating the scripless environment.

Previous consultations and latest developments

8. Both the SFC and HKEx have previously consulted the market on proposals for implementing a scripless securities market in Hong Kong⁴ –
 - (1) the SFC issued a consultation paper in February 2002 and a consultation conclusions paper in September 2003, and
 - (2) HKEx issued a consultation paper in October 2003 and a consultation conclusions paper in May 2004.
9. The Companies Ordinance re-write exercise, and recent developments in the market, have provided fresh impetus to progress this project. Accordingly and with the encouragement of Government, a working group – comprising representatives from the SFC, HKEx and the Federation – (**Working Group**) was established earlier this year to discuss the operational model for implementing a scripless securities market in Hong Kong.
10. The Working Group's mandate was to develop an operational model that –
 - (1) is generally acceptable to major stakeholders including market operators, issuers, share registrars, intermediaries and investors,

³ The terms "scripless" and "dematerialised" (or "dematerialisation") are thus used interchangeably in this paper.

⁴ The consultation papers and conclusions are accessible via the SFC and HKEx websites.

- (2) provides investor choice so that investors can choose whether to hold their securities in paper form or scripless form, and whether to hold their securities in their own names or through a nominee,
 - (3) allows for the gradual implementation of a scripless securities market taking into account the needs and readiness of the market,
 - (4) is conducive to enhancing shareholder transparency and corporate communication, and
 - (5) encourages and facilitates an increasingly wider use of scripless securities and the related infrastructure.
11. This paper summarises the results of the Working Group's study and discussions, and seeks views on various aspects of a proposed operational model which has been put together by the Working Group members collectively. It is perhaps worth highlighting here that a main difference between the model proposed in this paper and the models proposed in earlier consultations is that this model is one that all three parties – i.e. the SFC, HKEx and the Federation – believe is likely to be acceptable to market participants and the investing public.

Main features of the proposed model

12. The main features of the proposed model may be summarised as follows –
- (1) Dual system and a phased approach: Implementation will proceed gradually so that investors can transition to the scripless regime at their own pace. First, there will initially be a dual system in that the existing paper-based regime will be retained and run parallel to the new scripless regime. Investors will thus be able to continue holding paper securities if they prefer, and rematerialise any securities that are in scripless form. During this time, IPO issuers will also be able to offer a scripless option. Eventually however, when the market is ready – and this may take a number of years – we will consider making the scripless regime compulsory. The paper-based regime will then be eliminated and rematerialisation will no longer be an option. IPOs will also have to be in scripless form only. Secondly, the actual dematerialisation of existing securities will proceed in phases, and Hong Kong securities will be dematerialised first.
 - (2) Register to comprise two parts: All uncertificated securities will be held in CCASS and all certificated securities will be held outside CCASS. The register of holders⁵ will thus be made up of two parts – an uncertificated sub-register (which will record all holdings in CCASS) and a certificated sub-register (which will record all holdings outside CCASS). To facilitate inspection, corporate action processing and corporate action entitlements calculation, share registrars will keep a record of the complete register.

⁵ The register of holders, in relation to securities, means the register of holders of those securities, and includes the register of members and register of debenture holders kept under the Companies Ordinance.

- (3) Name on register: Investors will be able to hold securities in CCASS in their own names, i.e. they will have the option to become the legal owner (i.e. registered owner) of the securities and to enjoy the full benefits of legal ownership.
- (4) Investor choice: Investors will have a wider range of options to choose from in terms of the form, type of ownership and extent of control over their holdings. In particular, investors will be able to choose whether to hold their securities –
- (a) form – in paper form or in scripless (i.e. dematerialised) form,
 - (b) ownership – in their own names or in the name of a nominee (including a broker/bank/custodian nominee that is a CCASS Participant), and
 - (c) control – through an account that they can control directly or through an account controlled by their broker, bank or custodian.
- (5) Share registrars to become CCASS Participants: A new CCASS Participant category – Registrar Participant – will be introduced. This will allow share registrars to use the existing CCASS infrastructure to communicate directly with other CCASS Participants and handle instructions relating to uncertificated securities. It will also allow the setting up of accounts for holding securities in dematerialised form with the share registrar direct rather than through a broker/bank/custodian or as an Investor Participant⁶.
- (6) Scope: Hong Kong law currently requires the use of paper certificates and instruments of transfer for certain securities only (such as shares, debentures and units in unit trust schemes⁷). The Working Group considers however that the scripless operational model could in general apply to all securities that are publicly traded in Hong Kong (i.e. all securities that are listed or traded on the Stock Exchange of Hong Kong, **SEHK**).⁸ This includes therefore not only listed shares and debentures of Hong Kong incorporated companies but also to other listed securities such as derivative warrants, callable bull/bear contracts (**CBBCs**), etc, as well as (to the extent possible) shares and debentures of overseas incorporated companies that are listed or traded on the SEHK. However, in so doing, the market must not be forced to move in a backward direction – e.g. by being compelled to offer a paper option for securities that are today essentially scripless.

Benefits of implementing a scripless market

13. The Working Group believes the proposed model will not only address the shortcomings of the existing system but also bring a number of other benefits. Specifically –

⁶ Investor Participants are a category of CCASS Participants.

⁷ The Companies Ordinance requires the issue of paper certificates and the use of paper instruments of transfer in respect of shares and debentures. The Stamp Duty Ordinance requires the use of paper instruments of transfer in respect of units in unit trust schemes.

⁸ The reference here to securities listed or traded on the SEHK means the proposed model will not apply to private companies or to public companies that are not listed or traded on the SEHK.

- (1) Enhance corporate governance: By enabling investors to hold and transfer securities within CCASS and in their own names, shareholder transparency can be enhanced. Moreover, as legal owners of securities, investors will be able to enjoy a direct relationship with issuers.
- (2) Provide investor choice: The proposed model will allow investors to choose whether to hold their securities in paper form or in scripless form. Investors who opt to hold securities in scripless form will also have a range of account types to choose from – the different account types will provide different options in terms of whether the investor holds legal title or only a beneficial interest in the securities, and whether the account is administered by the investor directly or by the investor’s broker/bank/custodian. By allowing these choices, the proposed model will allow investors to transition to the scripless system at their own pace, and in line with their own needs and preferences. This however also means that issuers will be obliged to allow their securities to be dematerialised.
- (3) Enhance market efficiency: By further reducing the need for paper documents, and bringing share registrars into CCASS by making them a new category of CCASS Participants, the proposed model will increase opportunities for straight-through-processing, and enhance efficiency for transactions that currently still require paper – e.g. the IPO process. Moreover, the proposed model will help improve turnaround time for corporate actions.
- (4) In line with the global trend: The elimination of the use of physical certificates has been an internationally recognised objective for the last twenty years. The *CPSS-IOSCO Recommendations for Securities Settlement Systems* in November 2001 indicated that for both safety and efficiency reasons, securities should be immobilised or dematerialised in central securities depositories to the greatest extent possible.⁹ In its 2003 report however, the Group of Thirty (i.e. G30) collectively endorsed dematerialisation as the preferred solution and indicated that while immobilisation may be quicker and more efficient in some cases, it was only an interim solution towards achieving full dematerialisation.¹⁰ A number of leading markets around the world have already implemented a scripless securities market (i.e. dematerialisation) including the UK, Australia and Mainland China. It would be in Hong Kong’s interest to keep in line with this trend. Moreover, adopting dematerialisation could also provide greater opportunity for future linkages with other scripless markets.
- (5) Promote environmental friendliness: By further reducing the need for paper, the proposed model promotes environmental friendliness, and

⁹ See Recommendation 6 of the CPSS-IOSCO report for further information.

¹⁰ The report, entitled *Global Clearing and Settlement – A plan of action*, states: “Dematerialization of securities certificates – converting all paper ownership records into electronic format – is the preferred solution. However, in practice immobilization – where ownership is recorded through electronic book entry and the underlying paper certificate is kept in a central security depository – realises many of the benefits of dematerialization. Therefore, if immobilization can be achieved more quickly and efficiently than dematerialization, it is an acceptable step on the way to full dematerialization”. (emphasis added)

as such, will be in line with other similar initiatives such as permitting listed companies to make announcements in electronic form, and permitting corporate communications to be sent electronically.

Comments invited

14. The implementation of a scripless securities market in Hong Kong will have various consequences for the market and its participants. The operational model that is eventually put in place will be pivotal.
15. Accordingly, in putting together a proposed model for consultation, the Working Group has tried to take into account the interests and concerns of different stakeholders including investors, intermediaries and issuers. Feedback from these and other interested parties is important to progressing the development of the operational model. To this end, we have raised a number of specific issues on which we would appreciate feedback. These have been set out in the body of the paper and again at the end (see **Annex 4**) for easy reference.
16. The Working Group urges market participants and other interested parties to submit their written comments to this proposal. **The deadline for submission is 31 March 2010.**

Layout of paper

17. This paper is divided into the following sections –
 - (1) Existing Market Structure – this describes briefly the existing operational model and the roles played by different parties,
 - (2) Proposed Operational Model – this is the crux of the paper and it highlights and elaborates on specific aspects of the proposed operational model for Hong Kong,
 - (3) Position of Overseas Securities – this explains how we propose to deal with Hong Kong listed securities of overseas incorporated companies,
 - (4) Legislative Changes – this gives a brief overview of the legislative changes that will be needed to implement a scripless securities market in Hong Kong,
 - (5) Timetable – this gives an indication of the timeline for implementing a scripless securities market in Hong Kong, and
 - (6) Annexes.

II. EXISTING MARKET STRUCTURE

How securities are currently held

18. As mentioned earlier, Hong Kong's securities market is currently largely paper-based¹¹, and CCASS is an immobilised securities settlement system¹².
19. Investors can therefore hold most securities in one of two ways – in paper form outside CCASS or in electronic form within CCASS. Some securities however – such as derivative warrants, CBBCs and Exchange Fund Notes – can currently only be held in electronic form inside CCASS.
20. The current trade off between holding securities in paper form outside CCASS and in electronic form inside CCASS is essentially one between convenience and legal ownership.
 - (1) Investors who hold securities in paper form outside CCASS, and in their own names, hold as registered or legal owners and their names appear on the register of holders¹³. However, paper securities can be inconvenient as they need physical safe-keeping, can be lost or stolen, and must be deposited back into CCASS to settle a trade on the SEHK.
 - (2) Investors who hold securities in electronic form inside CCASS hold only a beneficial interest in the securities. Legal title remains with the CCASS nominee (i.e. HKSCC Nominees Limited). The register of holders therefore shows HKSCC Nominees Limited (and not the investor) as the registered holder. However, holdings in CCASS are electronic and hence more convenient as investors do not need to make arrangements for physical safe-keeping. Trading on the SEHK is also more convenient as the securities are already in CCASS. Moreover, investors have different options for holding their beneficial interests – they can hold their interests directly through an IP account¹⁴ or indirectly by depositing them with a broker, bank or custodian that is a CCASS Participant. Additionally, fully paid for securities deposited with a broker, bank or custodian may be held in an omnibus client account (where an investor's interests are held together with the interests of other clients) or in a separate segregated account where the investor's interests are identified and held separately from those of other clients¹⁵.

¹¹ As noted above, the law compels the use of paper in respect of shares, debentures and units in unit trust schemes. Additionally, the Listing Rules also require the issue of a global certificate for certain securities. Some securities however – like Exchange Fund Notes – are wholly scripless.

¹² See footnote 1 above.

¹³ Investors holding securities outside CCASS can also elect to hold the securities in the name of a chosen nominee, in which case the nominee would be the registered owner and his name would appear on the register of holders.

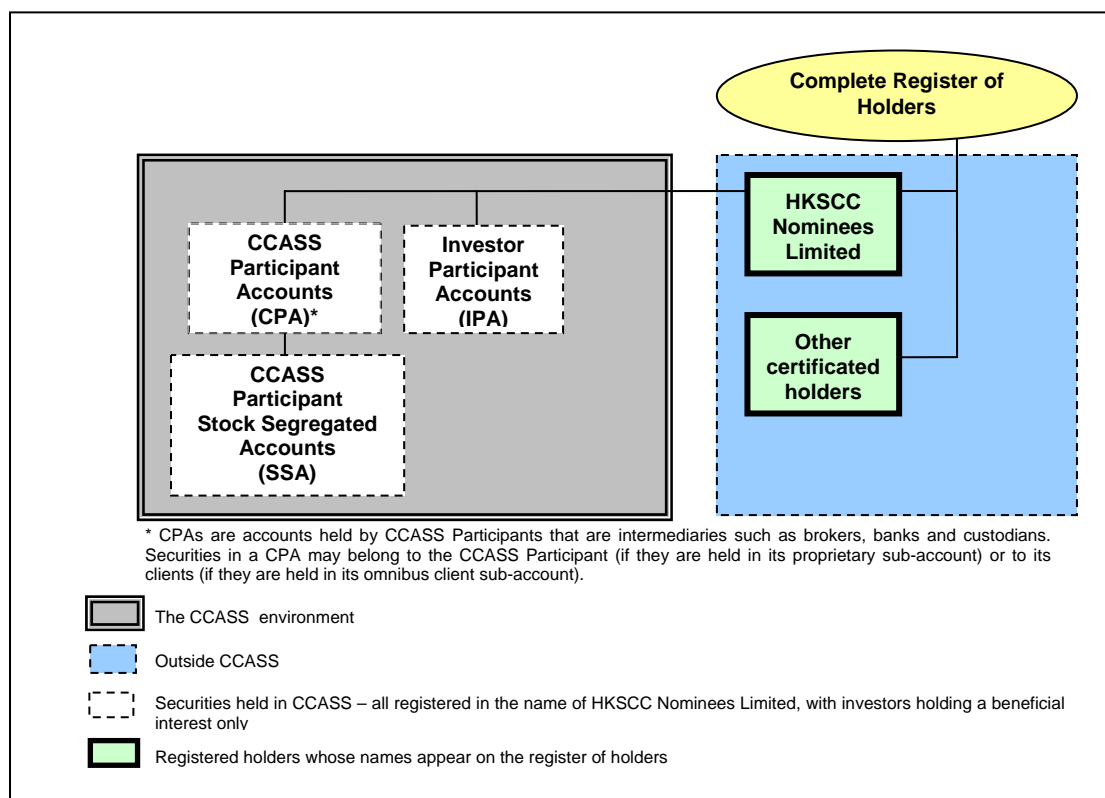
¹⁴ An IP account is an account held by an Investor Participant in CCASS.

¹⁵ Although a segregated account can provide better investor protection by keeping the investor's interests separate, there may be other reasons why an investor chooses to keep his interests in his broker's omnibus client account – e.g. convenience.

21. Diagram 1 below illustrates the existing market structure. As can be seen –

- (1) Securities held within CCASS (represented by the white boxes on the left with broken-line borders) can be held in an IP account (shown as IPA in the diagram), or in an account held through a broker/bank/custodian and this may be an omnibus account (shown as CPA in the diagram) or a segregated account (shown as SSA¹⁶ in the diagram).
- (2) The register of holders includes only HKSCC Nominees Limited, and others who hold their securities outside CCASS (both represented by the boxes on the right with bold borders). Securities held within CCASS are all reflected in the register of holders as being held by HKSCC Nominees Limited, with the investor holding only the beneficial interest.

Diagram 1 – existing market structure



22. The following are some statistics on how securities were held in Hong Kong as at the end of November 2009 –

- (1) securities deposited into the CCASS depository (including shares, structured products, debts, unit trusts and rights) accounted for approximately 49% of all issued securities by value and 70% by quantity,

¹⁶ An SSA is a sub-account that may be opened by a CCASS Participant for clients who wish to have their securities segregated from those belonging to the CCASS Participant's other clients. SSAs are controlled by the CCASS Participant and securities in them are registered in the name of HKSCC Nominees Limited. Investors are not recognised by HKSCC as holders of SSAs. However, CCASS notifies the investor whenever there is any movement of securities in the relevant SSA.

- (2) in terms of equity securities (i.e. ordinary shares and preference shares), the immobilisation rate was 47% in terms of market capitalisation and 44% in terms of issued shares, and
- (3) the CCASS depository held 6.4 million share certificates, accounting for approximately 30% of all issued share certificates.

How investors are currently served

23. Currently, investors are served in different ways, to a different extent, and by different parties depending on whether they hold their securities in CCASS or not, and the instructions they give to their broker/bank/custodian.
24. For investors who hold their securities outside CCASS, they (or their nominee, if the securities are held in the name of a nominee) are served by the issuer's share registrar. The share registrar, which acts as the issuer's agent, provides corporate communications directly to, and processes corporate actions directly with, these investors (or their nominees). In the case of shares, investors receive information regarding meetings from the share registrar direct and are able to attend the meeting and vote in person or by proxy.
25. However, for investors who hold their securities inside CCASS, the position is more complex as they may be served by the CCASS nominee, their CCASS Participant (i.e. their broker/bank/custodian which is a CCASS Participant), and the share registrars. The following explains.

- (1) Corporate actions

For corporate actions, investors in CCASS rely primarily on the CCASS nominee and (if they are not Investor Participants) their CCASS Participant.

- Where the share registrar has sent out information on corporate action events, the CCASS nominee (as registered owner) will receive such information. The CCASS nominee also obtains additional information from various sources such as the issuer's website and the HKExnews website. The CCASS nominee then notifies the CCASS Participant, which then may notify the investor subject to the level of service provided by the CCASS Participant to that investor.
- Where instructions may be given regarding the exercise of corporate action rights and entitlement options, share registrars seek these from registered holders (including therefore the CCASS nominee in the case of securities held in CCASS). This is usually done via mailed communications. The CCASS nominee then seeks instructions from relevant CCASS Participants via CCASS. CCASS Participants may then – depending on the type of corporate action involved and level of service provided – seek instructions from their investor-clients.¹⁷ Instructions are conveyed back in the same way, i.e. from investors to CCASS Participants, to the CCASS nominee, and then to the share registrar.

¹⁷ It is understood that many CCASS Participants do not proactively seek voting instructions from their retail investor-clients.

- As a registered holder, the CCASS nominee receives corporate action entitlements from the share registrar. It calculates how these should be divided among relevant CCASS Participants and distributes them accordingly. The CCASS Participant then passes these on to the investor.

(2) Corporate communications

For corporate communications, investors in CCASS rely on the CCASS nominee, their CCASS Participant and the share registrar.

- Investors who wish to receive corporate communications from the issuer's share registrar direct must inform their CCASS Participant, which will then pass the investor's name and address to the CCASS nominee, which will then provide a list of the names and addresses of all such investors to the share registrar. (For investors who are Investor Participants (and hence also CCASS Participants), they may relay their request to the CCASS nominee direct.)
- The share registrar will then mail corporate communications to the investors direct.
- Additionally, corporate communications are posted on HKExnews website. Investors can therefore refer to that for such information also.

(3) Meeting and voting

In the case of shares, investors who wish to attend and vote at a shareholders' meeting may request their CCASS Participant (which in turn requests the CCASS nominee) to arrange for the investor, or a person nominated by the investor, to be appointed as a representative for the purpose of attending and voting at such meetings. (For investors who are Investor Participants (and hence also CCASS Participants), they may relay their request to the CCASS nominee direct.) The CCASS nominee will then appoint the relevant person as a representative to attend and vote at the meeting. This is possible because section 115 of the Companies Ordinance and the Memorandum and Articles of Association of listed companies enable the CCASS nominee to appoint multiple representatives at general meetings of listed companies.

Alternatively, investors may send their voting instructions to their CCASS Participant which will in turn pass the instructions to the CCASS nominee. The CCASS nominee will then appoint a proxy to attend and vote at the meeting as per the investors' instructions.

26. The above existing arrangements for investors in CCASS address, to some extent, the shortcomings of an immobilised system under which investors can hold only a beneficial interest. However, it cannot be disputed that the arrangements are rather complex. The Working Group believes that the proposed model – which is discussed in more detail in the following section – may help address these and other concerns highlighted earlier.

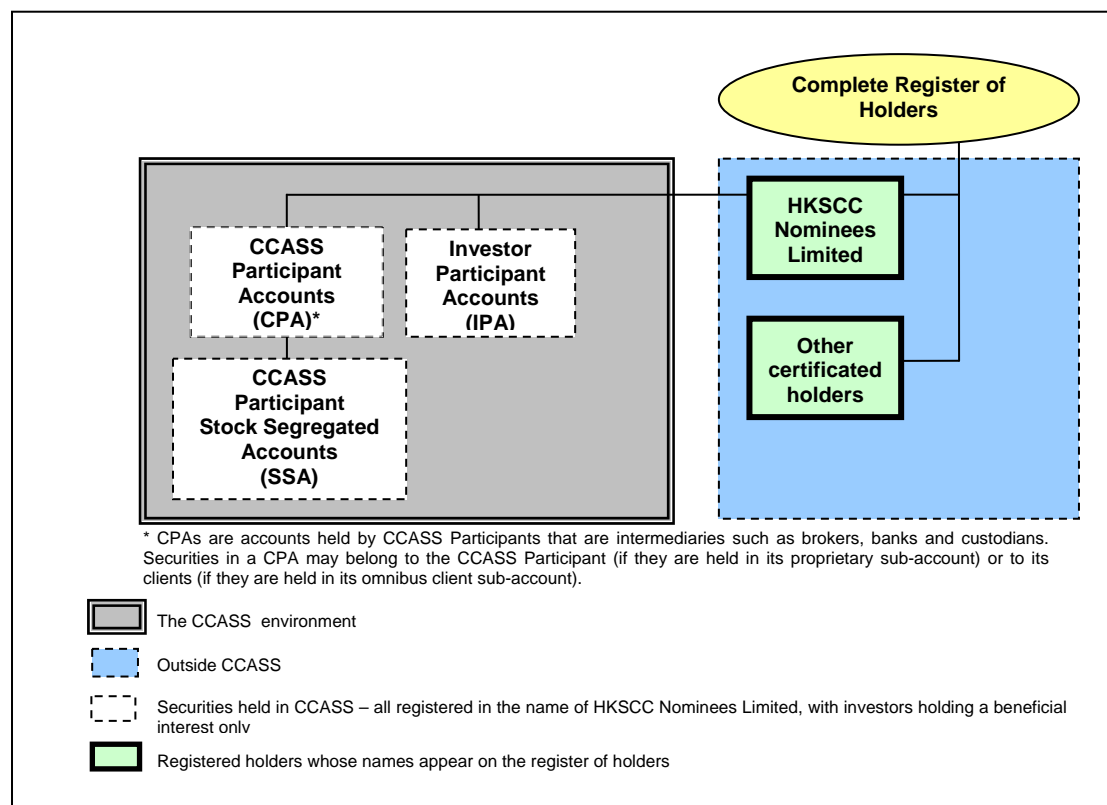
III. PROPOSED OPERATIONAL MODEL

27. This section discusses the proposed operational model in detail. In developing the proposed model, the Working Group considered in particular the models adopted in the UK and Australia. We focused on these two because first, both are common law jurisdictions and their laws previously included provisions similar to those in Hong Kong compelling the use of paper certificates and documents of title as well as paper instruments of transfer. Secondly, although both have implemented a dematerialised market, this has been to different degrees. Their models therefore share many similarities, but there are also differences. A more detailed description of the UK and Australian models is set out in **Annex 1** for reference.

Diagram summary of existing and proposed models

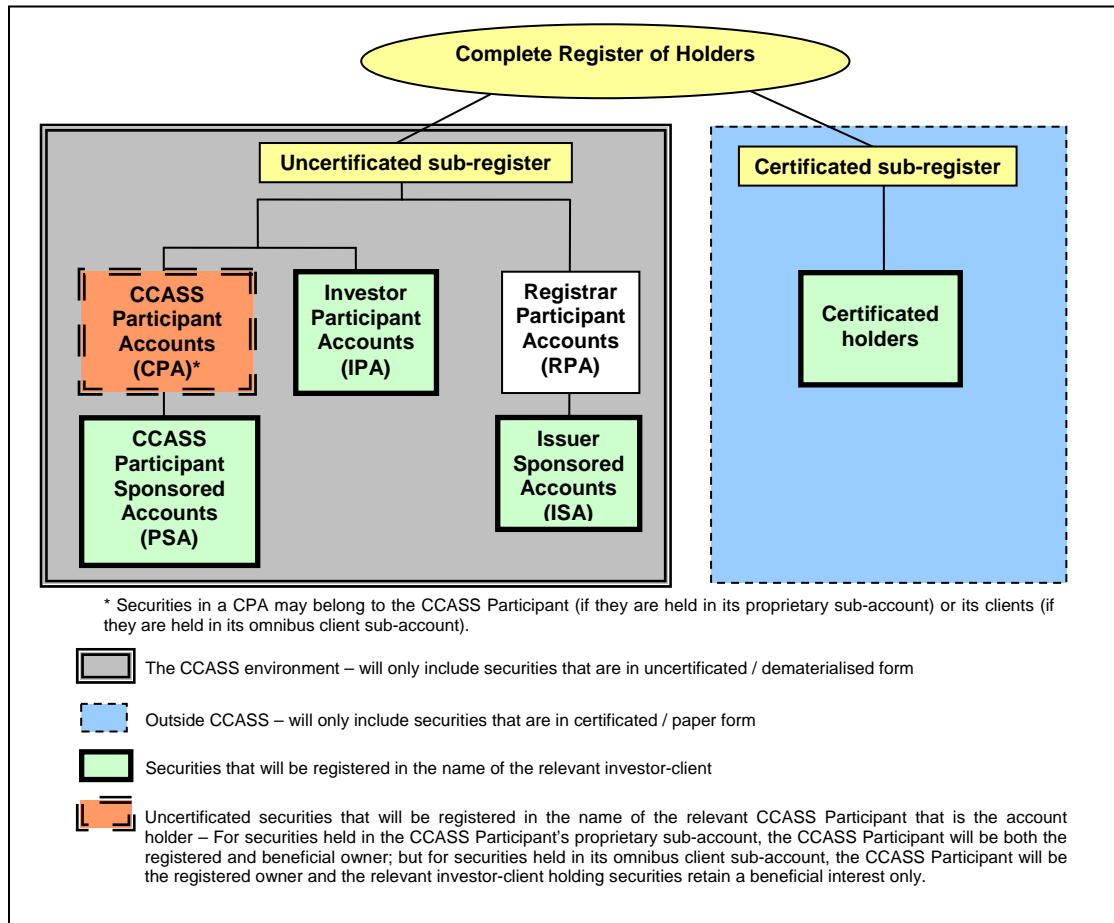
28. The two diagrams below summarise how securities are currently held, and how they might be held under the proposed operational model. The boxes with bold borders in Diagram 1 and Diagram 2 represent registered holdings.

Diagram 1 – existing market structure



29. Diagram 1 above shows that currently investors can only be registered holders of their securities if they hold them outside CCASS. If they choose to hold their securities within CCASS (e.g. through a broker, bank or custodian that is a CCASS Participant or as an Investor Participant in CCASS), then the securities must be registered in the name of HKSCC Nominees Limited. In such cases, the investor has a beneficial interest only and no legal title.

Diagram 2 – structure under proposed model



30. Diagram 2 shows that under the proposed model, investors will be able to continue holding their securities in certificated form as they do now – see box at far right of the diagram. Alternatively, they can hold their securities in uncertificated form either –
- (1) through a nominee account with their broker, bank or custodian (i.e. **CPA** in Diagram 2) – in which case they would hold the beneficial interest only,
 - (2) through a segregated account with their broker, bank or custodian (i.e. **PSA** in Diagram 2) – in which case they would be the registered holder,
 - (3) through their IP account in CCASS (i.e. **IPA** in Diagram 2) – in which case they would be the registered holder, or
 - (4) through an account with the relevant share registrar (i.e. **ISA** in Diagram 2) – in which case they would be the registered holder.
31. The CPA and IPA under the proposed model are largely similar to the CPA and IPA under the existing structure (compare Diagram 1 and Diagram 2). The main difference is that, under the proposed model, securities in these accounts will not be registered in the name of HKSCC Nominees Limited (as they are today), but rather as follows –

- (1) securities in the CPA will be registered in the name of the broker/bank/custodian that is the CCASS Participant (and holder of the CPA), and
 - (2) securities in the IPA will be registered in the name of the Investor Participant that is the holder of the IPA.
32. The PSA under the proposed model is largely similar to the SSA under the existing structure except that securities in the PSA will be registered in the name of the relevant investor rather than HKSCC Nominees Limited.
 33. The ISA is a new account type and is similar to the PSA in terms of account structure in that the ISA will be opened with the share registrar direct whereas the PSA will be opened with a broker/bank/custodian that is a CCASS Participant.
 34. The various account types are discussed in greater detail in paragraphs 64 to 66 below and in Annex 2.

Dual system and a phased approach

Dual system

35. As shown in Diagram 2 above, we do not propose compelling investors to dematerialise their securities. Rather, we believe investors should be able to choose whether to hold their securities in certificated form or in uncertificated form, and to convert from one form to the other as per their needs and preferences. Accordingly, we propose retaining the existing paper-based system for now so that it runs in parallel with the scripless system. Investors will thus have the option to keep their securities in paper form if they wish. They will also have the option to rematerialise any securities that have already been dematerialised.
36. This dual system approach will allow investors – particularly individual investors who hold securities long term rather than trade them regularly (and who may hence be unwilling to bear any additional asset servicing costs), or who may otherwise be reluctant to relinquish their paper certificates – to transition to the scripless system at their own pace.
37. However, eventually, when the scripless system has been up and running for a period of time and any teething issues have been resolved, and when the market as a whole is ready, we will consider adopting a wholly scripless system and removing the paper-based option altogether. We expect however that this may take some time, possibly years. In any event, we will consult the market further before taking any steps to eliminate the paper-based regime.

Q1: Do you agree that investors should be given the option to hold securities in paper form and to rematerialise securities that have been dematerialised? If not, why not?

Q2: Do you agree that the scripless system should eventually be made compulsory and the paper-based option removed altogether? If not, why not?

Phased approach

38. The Working Group also proposes a gradual and phased approach to implementing a scripless securities market in Hong Kong. Specifically, existing certificated securities will be dematerialised in batches and Hong Kong securities (e.g. shares and debentures of Hong Kong incorporated companies) will be dematerialised first.
39. We propose dematerialising securities in batches as that will facilitate logistical arrangements. We have yet to decide the parameters for defining the batches. Essentially however, the various lines of securities will be grouped on the basis of certain factors (e.g. in alphabetical order based on their names, or by reference to the number of holders of that line of securities, and/or other factors) and each group will then be dematerialised in turn. For issuers, once a particular line of securities is called up for dematerialisation, the issuer of those securities must allow holders of those securities to hold the securities in scripless form if they so wish. To illustrate, when Company XYZ is called up for dematerialisation, all shareholders of that company will have to be allowed the option to hold their XYZ shares in paper form or scripless form. Company XYZ will not be able to insist that its shares be held in paper form only.¹⁸
40. We also propose dematerialising Hong Kong securities first because any limitations to the dematerialisation of these securities will be governed by Hong Kong law, which we are in a better position to try to amend. In the case of overseas securities however, the position is different. Much will depend on whether the laws of the issuer's place of incorporation, and whether the issuer's constitutional documents, permit dematerialisation and are compatible with the scripless operational model proposed for Hong Kong; and if they are not, whether the necessary amendments can be implemented and how quickly. (The position of overseas securities is discussed in more detail in Section IV of this paper.)
41. One additional point to note here is that once a particular line of securities is called up for dematerialisation, all such securities held inside CCASS will have to be dematerialised, i.e. there will be no option to hold securities in paper form inside CCASS – this feature of the proposed model is discussed in greater detail in paragraphs 49 to 51 below. However, for securities held outside CCASS, it will be up to the securities holder to decide whether and when to dematerialise. Hence, taking the earlier example, once Company XYZ is called up for dematerialisation, all XYZ shares in CCASS will have to be dematerialised. However, investors who hold XYZ shares outside CCASS will be able to dematerialise their shares as and when they want to. It follows therefore that, to some extent, dematerialisation will occur first within CCASS.

Q3: Do you agree that implementation of a scripless securities market should proceed in phases? If not, why not?

Q4: Do you agree with the proposed phasing, i.e. dematerialising securities in batches, and dematerialising Hong Kong securities first? If not, why not?

¹⁸ Please also see paragraphs 47 and 48 which discuss in more detail the issuer's obligation to allow dematerialisation.

Dematerialisation process

42. Dematerialisation will entail producing existing paper certificates for cancellation and recording the holdings in the register of holders as uncertificated holdings.
43. Investors who are registered holders (i.e. they currently hold their securities outside CCASS) and who wish to dematerialise their paper securities will need to approach the following persons depending on how they want to hold their securities after dematerialisation –
 - (1) their broker/bank/custodian – if they wish to hold the securities in a PSA or CPA,
 - (2) CCASS – if they wish to hold the securities in an IPA, and
 - (3) the share registrar – if they wish to hold the securities in an ISA.
44. For securities held in CCASS, HKSCC Nominees Limited (as the registered holder of these securities) will have to produce the certificates for cancellation by the share registrars. The dematerialised securities will then be held in the relevant CPA, PSA or IPA, and for this purpose investors who do not already hold their securities in a CPA will be given the opportunity to indicate if they wish to do so.¹⁹
45. The establishment of the various account types discussed in paragraph 30 above will thus be a pre-requisite to dematerialisation.
46. A further point to note is that if a phased approach is adopted, HKSCC Nominees Limited's role as registered holder of securities in CCASS will diminish gradually. This is because it will only continue to serve as registered holder for securities in CCASS that have not yet been dematerialised, and continue to act as the nominee for any unclaimed CCASS entitlements.²⁰ Eventually however, the nominee role and custody functions will become minimal (as compared to the overall size of the market). At the same time however, HKSCC will take on a different role and different responsibilities.

Q5: Do you have any views on the proposed dematerialisation process and HKSCC Nominees Limited's diminishing role?

Issuers' obligation

47. If investors are to be given the option to dematerialise their securities, it necessarily follows that issuers must allow their securities to be held in either paper form or dematerialised form. In other words, issuers will not be able to

¹⁹ This is so as to allow such investors the opportunity to hold their securities as an undisclosed beneficiary if they prefer.

²⁰ Unclaimed CCASS entitlements stem from withdrawals of securities from CCASS. In the past, it was common for investors to withdraw their securities from CCASS but not subsequently register them in their own (or any other) name. In such cases, the securities remain in the register of holders as being registered in the name of HKSCC Nominees Limited. Entitlements stemming from such securities are therefore also issued to HKSCC Nominees Limited which may hold them for a limited time to be claimed by the relevant investor. These subsequent entitlements are referred to as unclaimed CCASS entitlements.

issue new securities in only paper form or in only dematerialised form, nor will they be able to disallow the dematerialisation or rematerialisation of existing securities once they come within the batch that has been called up for dematerialisation.

48. However, this does not mean that issuers of securities that can currently only be held in electronic form inside CCASS – such as derivative warrants, CBBCs, Exchange Fund Notes, etc – must offer a paper option. To do so would be a regressive step. It will therefore be possible for such securities to be offered in scripless form only.

Register to comprise two parts

Uncertificated sub-register and certificated sub-register

49. Under the proposed model, all uncertificated securities will be held within CCASS and all certificated securities will be held outside CCASS. The formal register of holders will thus consist of two parts –
- (1) an uncertificated sub-register, which will record details of all holdings within CCASS, and
 - (2) a certificated sub-register, which will record details of all holdings outside CCASS.
50. The uncertificated sub-register will essentially be the CCASS records, i.e. records showing movements of securities into and out of the various accounts in CCASS (**CCASS records**). This is to ensure that transfers of securities into accounts in CCASS constitute registered transfers and confer legal title to the transferee account holders, and that there is no gap between settlement in CCASS and registration in the register of holders. If the CCASS records are not part of the formal register, a legal transfer will be delayed until the transfer is recorded in the formal register of holders. There would thus be a gap between settlement in CCASS and registration in the register of holders, and this could create doubt and confusion as to who is the true owner of the securities at any particular point in time.
51. The certificated sub-register will be kept and maintained by the issuer's share registrar and will record all holdings outside CCASS, i.e. all securities held in certificated form.
52. Although the complete register of holders will comprise two parts (i.e. the two sub-registers described above), an issuer will only need to appoint one share registrar.
53. To facilitate inspection, corporate action processing and corporate action entitlements calculation, share registrars will also be required to keep a record of the complete register. This is discussed in greater detail below.

<p>Q6: Do you agree with the proposal that the formal register comprise two parts as discussed in paragraphs 49 to 53 above? If not, why not?</p>

Provision of day-end records to facilitate inspection, etc

54. To facilitate inspection of the complete register, HKSCC will provide share registrars with a day-end record of all holdings on the uncertificated sub-register. This record will be provided daily and will include the names and addresses of individual CPA, PSA, IPA and ISA holders, their respective securities balances, and any other information which is required by legislation to be entered in the register. The day-end record sent to share registrars will only show the day-end position and will not show all intra-day transfers between the various accounts (although intra-day transfers will still constitute legal transfers).²¹
55. Share registrars will then make this day-end record, together with their certificated sub-register, available for inspection. The documents made available will therefore show the position as at the end of the previous day.

Corporate action processing and securities reconciliation

56. The provision of day-end records by HKSCC to the share registrar will also facilitate corporate action processing and entitlements calculation, as well as securities reconciliation. The latter will help ensure that the total uncertificated holdings in CCASS together with the total certificated holdings outside CCASS tally with the total number of issued securities and with the share registrar's record as to how many of the issued securities are in certificated form and how many are in uncertificated form.
57. Additionally, if a corporate action results in a change in the total number of issued securities (e.g. in the case of a rights issue or bonus issue), the share registrar will send relevant details to HKSCC so that an updated record of the uncertificated sub-register is in place before market opening on the business day that the change becomes effective.

Name on register

Optional

58. A key aspect of the proposal is that it will facilitate name on register for securities held within CCASS, i.e. investors holding securities in CCASS will have the option to register their securities in their own names, and thus enjoy the full benefits of legal ownership. This is currently not possible because all securities held within CCASS must be registered in the name of HKSCC Nominees Limited.
59. However, the name on register feature will not be compulsory. Investors who prefer to hold their securities in the name of a nominee will be able to do so.

²¹ To clarify, securities may have passed through several hands in the course of the day. All these will be registered in the uncertificated sub-register and hence constitute legal transfers. However, the day-end record that is passed to the share registrar will not show all these transfers. It will only show the day-end position. For example, if during a particular day, A sold all his 800 shares in Company XYZ; B bought and sold 300 XYZ shares; C bought 500 XYZ shares and sold 200; and D (who originally held 700 XYZ shares) bought a further 200 XYZ shares and sold 400. The day-end record will not show all these transactions. It will only show that A has no XYZ shares, C has 300 XYZ shares, and D has 500 XYZ shares. However, all transactions will have been registered in the uncertificated register, and hence all will be legal transfers constituting change in legal ownership.

Q7: Do you agree with the proposal to facilitate name on register within CCASS? If not, why not?

Immediate credit

60. One point worth highlighting here is that with the name on register feature in CCASS, the existing immediate credit arrangement²² will no longer be available. The following explains.
61. The immediate credit arrangement does not today run the risk of inadvertently inflating the total number of issued securities. This is because today the CCASS record itself is not part of the register of holders. Accordingly, any deposit of securities into an account in CCASS, and hence changes in the CCASS record, does not affect entries in the register.
62. In the scripless environment however, immediate credit will not be possible without running the risk of inflating the total number of issued securities. This is because the CCASS records will be the uncertificated sub-register and form part of the formal register of holders. Credit entries to the CCASS record (and hence to the uncertificated sub-register) must therefore have a corresponding debit entry in the certificated sub-register. If they do not, then the total number of issued securities will be inflated.
63. The absence of the immediate credit arrangement should not raise concerns about delay in the transfer process as share registrars will provide an option for expedited services for the dematerialisation process so that certificated securities can be dematerialised and deposited into the relevant CPA, PSA, IPA or ISA within the settlement period. For their part, CCASS Participants will also need to ensure that any certificated securities deposited for settlement purposes are collected in time for them to be dematerialised and available for settlement within the T+2 settlement period.

Q8: Do you consider that the proposed arrangements for addressing any concerns arising from the removal of the immediate credit arrangement are adequate? If not, why not?

Investor choice

Methods of holding securities

64. Another key aspect of the proposed model is that it will provide maximum investor choice. Specifically, investors will have the option to –
 - (1) choose between holding their securities in paper form or in scripless (i.e. dematerialised) form,

²² Subject to certain risk management measures and HKSCC's right of rejection, paper securities can be immediately credited to the account of a CCASS Participant (other than an Investor Participant) without having to complete the process of registering the securities in the name of HKSCC Nominees Limited. This is referred to as the immediate credit arrangement. The immediate credit arrangement is not available to Investor Participants.

- (2) choose between holding their securities in their own names or in the name of a nominee (including a broker/bank/custodian nominee that is a CCASS Participant), and
- (3) choose between holding their securities through an account that they can control directly or through an account controlled by their broker, bank or custodian.

65. These various options are reflected in the five account types that the investor can choose from, i.e. CPA, PSA, IPA, ISA and certificated holdings – see Diagram 2 under paragraph 29 above.

Features of five account types

66. The features and characteristics of these five account types are elaborated in greater length in **Annex 2** and summarised in the table below.

	CPA	PSA	IPA	ISA	Certificated holdings
Is investor the registered owner?	Yes where the investor is the CCASS Participant No, in all other cases, but the investor will have a beneficial interest in the securities	Yes	Yes	Yes	Yes
Who administers the account?	The CCASS Participant	The CCASS Participant	The Investor Participant	The investor	The investor
Can the investor view his holdings at any time?	No, unless the CCASS Participant provides such facility	Yes, via the CCASS Internet System and CCASS Phone System	Yes, via the CCASS Internet System and CCASS Phone System	Yes, through either the CCASS Internet System or an on-line service provided by the share registrar	Yes, through an on-line service provided by the share registrar
Must the investor initiate a transfer of the securities to another one of the five account types (e.g. CPA, PSA, IPA, ISA) to settle SEHK trades?	No	No	Yes, the investor must initiate a transfer of the securities to his executing broker's CPA	Yes, the investor must initiate a transfer of the securities to his executing broker's CPA	Yes, the investor must first deposit his securities with his executing broker for dematerialisation and credit into the broker's CPA

Q9: Do you think the proposed model provides enough options (in terms of account types) for investors? If not, what other options do you think should be provided and why?

Multiple representatives and proxies

67. One point worth highlighting here is that securities held through a CCASS Participant account (i.e in a CPA, PSA and IPA) will no longer be registered in the name of HKSCC Nominees Limited. Rather, they will be registered in the name of the relevant CPA, PSA or IPA holder. In the case of investors who hold their securities through a broker/bank/custodian nominee in CCASS (i.e. investors who hold their securities in a CPA), this means their securities will be registered in the name of their broker/bank/custodian. If these investors are to enjoy the same right to attend and vote at meetings that investors in CCASS currently enjoy – as to which see paragraph 25(3) above – it will be necessary to allow the brokers/banks/custodians in CCASS to appoint multiple representatives, just as HKSCC Nominees Limited is currently permitted to do under section 115 of the Companies Ordinance. The Working Group welcomes views on whether such right should be given or whether investors wishing to attend and vote at meetings should be required to hold their securities in their own names through one of the other accounts (i.e. PSA, IPA or ISA).
68. A related issue that arises is whether CCASS Participants should be allowed to both appoint proxies and corporate representatives in respect of the same meeting. Currently this is not possible – not even for HKSCC Nominees Limited. Hence, if HKSCC Nominees Limited receives both instructions to vote by proxy, and requests to nominate persons to attend as corporate representatives, it cannot simply appoint the Chairman of the meeting to act as proxy in respect of those investors who do not wish to attend as corporate representatives. Rather, it must itself send a representative to attend and represent the interests of those investors who have given instructions to vote by proxy.

Q10: Should broker/bank/custodian nominees in CCASS be allowed to appoint multiple representatives so that their investor-clients can attend and vote at meetings? If not, why not?

Q11: Should broker/bank/custodian nominees in CCASS be allowed to appoint both proxies and multiple representatives in respect of the same meeting? If not, why not?

Unique identification

69. The detailed account opening processes have yet to be worked out. However, one aspect that the Working Group is considering and would welcome views on is the question of whether all investors should be asked to provide a unique identification number – such as their Hong Kong identity card number, passport number, etc.

70. Currently, there is no requirement for securities holders to provide any identification number when they acquire securities by way of a registered transfer. However, if they acquire securities through an IPO, they have to provide such information in the IPO application form as such information is needed to help prevent multiple applications. The record of securities holders is therefore not uniform.
71. To standardise the practice vis-à-vis the collection of investors' identification numbers, the Working Group is considering requiring all investors to provide such information as part of the account opening process. For investors who hold securities in certificated form only, and who have not opened either a CPA, PSA, IPA or ISA, alternative arrangements would have to be made to collect such information. Any obligation to provide identification numbers would have to be carefully drafted to guard against a single investor using more than one identification number. There would also be strict restrictions as to who may access such information and how it may be used. It would also not in any event be available for public inspection.

Q12: Do you agree that investors should be required to provide a unique identification number irrespective of whether they obtain their securities by way of a transfer or through an IPO?

Corporate actions and corporate communications

72. Under the proposed model, share registrars will continue to provide services to registered holders. However, as regards uncertificated holders, HKEx and the Federation are still discussing the detailed arrangements for handling corporate actions and corporate communications, and how best to divide the related responsibilities. Further information in this regard will be provided when specifics are agreed.

Share registrars to become a new category of CCASS Participants

Registrar Participant category

73. A key feature of the proposed model is the introduction of a new category of participants in CCASS called Registrar Participants. This will allow share registrars – who meet relevant admission criteria – to become CCASS Participants.
74. Making share registrars CCASS Participants will enhance the scripless environment and provide increased opportunities for straight-through-processing. In particular, it will facilitate electronic communication between share registrars and other CCASS Participants, and hence between securities issuers and securities holders. It will also facilitate the processing of transactions involving dematerialised securities (including the movement of securities between different accounts), and allow corporate action responses and benefits to be received and distributed more efficiently. Using the CCASS infrastructure may also allow for some time and cost savings as it will provide an established and secure environment that market participants are already familiar with and connected to.

75. As noted in paragraph 72 above, the specific functions to be performed by share registrars is still under discussion. However, **Annex 3** sets out some of the functions that could be performed through the CCASS platform.

Q13: Do you agree with the proposal to introduce a new Registrar Participant category in CCASS? If not, why not?

Regulation of share registrars

76. In any event, it is envisaged that share registrars will take on a more active and involved role in the scripless environment. Their systems too will play a more critical role in the market. Accordingly, it is proposed that share registrars who provide scripless related services²³ should be more directly and robustly regulated than they are today.²⁴
77. The Working Group notes that some share registrars may provide only minimal, scripless related services. In some cases, this may also depend on the nature of the securities in question. The Working Group would welcome views on whether a graduated approach should be taken towards regulating share registrars (i.e. whether the level of regulation should vary according to the type and range of scripless related services provided), or whether a uniform approach should be taken such that a common standard is applied in all cases.

Q14: Do you agree that share registrars who provide scripless related services should be more directly and robustly regulated than they are today? If not, why not?

Q15: Do you consider that a graduated approach should be taken towards regulating share registrars (i.e. that the level of regulation should vary according to the type and range of scripless related services provided), or that a uniform approach should be taken such that a common standard is applied in all cases?

Guiding principles vis-à-vis Fees

78. The Working Group appreciates that, as with any new initiative, a key concern of the market and its participants will be the cost implications for them.
79. As may be expected, to some extent a reallocation of costs and charges will be unavoidable. However, the proposed model is still at a developing stage and key aspects have yet to be finalised – including in particular the question of how best to divide responsibilities of serving uncertificated holders (see paragraph 72 above). Moreover, the initial development costs, implementation costs and on-going maintenance costs for CCASS and share registrars (including any costs to share registrars for using the CCASS platform) will also depend on the final model that is adopted, and will be

²³ The term “scripless related services” refers to services provided in the scripless environment such as maintaining the uncertificated or certificated sub-register, processing dematerialisation and rematerialisation requests, and handling paperless transfers.

²⁴ Currently share registrars are only required to be a member of an association approved by the SFC under section 12 of the Securities and Futures (Stock Market Listing) Rules, and are regulated only by the SFC’s Code of Conduct for Share Registrars.

relevant to setting any tariffs and fees. It is therefore not possible at this stage to definitively identify and propose the specific tariffs and fees to be charged by CCASS and the share registrars.

80. The Working Group believes however that this should not hold back consultation on the proposed model at this stage, particularly as it provides an opportunity to discuss the fundamental features of the model with the market. Feedback on these fundamentals will be critical to the Working Group's consideration of how to develop the model further. If there are significant concerns regarding the fundamentals of the proposed model, these should be addressed at the earliest opportunity.
81. Moreover, while the primary responsibility for promoting the cost efficiency of the scripless market lies with the system owners and market operators, the Working Group generally agrees that fees should be set in line with the following general guiding principles –
- (1) CCASS Participants must continue to be able to receive the same services and levels of services that they do now, irrespective of who provides such services and how.
 - (2) Fees will be commensurate with services provided by market operators in the scripless environment, in particular HKSCC and share registrars.
 - (3) Currently, most fee changes introduced by HKSCC need to be approved by the SFC. In addition, some of the fees charged by share registrars to investors directly (e.g. for share transfers and replacement of certificates) are contained in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (**Listing Rules**), which are also subject to approval by the SFC. The SFC will consider which fees imposed on investors by key market operators after implementation of the scripless market should be subject to SFC oversight. This may help ensure that the service costs of the scripless market are at a reasonable level and conducive to encouraging innovation and market development.
82. Having said that, when the model is developed to a more advanced stage, further information on tariffs and fees will be provided to the market. In the meantime, the SFC will continue to discuss this matter with HKEx and the share registrars.

IPOs

83. At present, there are four ways to apply for an IPO – by submitting a white form,²⁵ a white form eIPO,²⁶ a yellow form²⁷ or a CCASS EIPO²⁸. Of the four, the CCASS EIPO option requires the least use of paper.

²⁵ Here the application is submitted by the investor direct and in paper form. Successful applicants are issued paper certificates.

²⁶ Here too the application is submitted by the investor direct but in electronic form via the Internet. Successful applicants are issued paper certificates. It is worth noting however that the white form eIPO option is available at the issuer's discretion only and hence not offered in all cases.

84. In 2008, over 85% of the total number of shares applied through IPOs were applied through the CCASS EIPO channel. Although this figure may to some extent be influenced by the number of investors who apply for IPOs using margin financing facilities from their broker, it still suggests a strong preference for an electronic option. Having said that, a lot of retail investors (about 30% to 50% in terms of number of applications, i.e. number of applicants) applied through the white form option, which is the wholly paper option. This suggests that a large portion of the retail investor base still prefers a paper option and/or prefers to have securities registered in their own names.
85. Under the proposed model, all four existing options will be retained in largely their existing form – at least initially²⁹. The main differences will be as follows –
- (1) Applicants under the white form and white form eIPO options will be able to choose if their securities should be issued in certificated form or uncertificated form³⁰ – provided of course that the issuer has offered a scripless IPO option (see paragraph 87 below). If they choose the latter, their uncertificated securities will then be credited to their chosen PSA, CPA, IPA or ISA (as the case may be).
 - (2) It will be possible to have wholly electronic options for the IPO process. Currently a wholly electronic option is not possible for most securities because paper certificates must be issued. Hence, even if the application form and payment can be submitted electronically, some paper may still be necessary.
86. The above will be consistent with the proposal to have a paper-based system running in parallel with the scripless system at the outset.
87. Additionally, and in line with the proposed phased approach discussed above, we propose that initially, there could be a pilot period during which some willing issuers might agree to test the scripless IPO option (i.e. they would offer new securities in both certificated and uncertificated form). When market participants and investors are comfortable with the new process, implementation of the scripless IPO option could be extended to all IPOs and eventually we could consider requiring all IPOs to be in scripless form only.
88. The tables below summarises the options under the existing and proposed models and illustrates their differences.

²⁷ Here again the application is submitted by the investor direct in paper form, but securities of a successful applicants are credited directly into his broker's/bank's account in CCASS and HKSCC Nominees Limited is issued the paper certificates.

²⁸ Here the application is submitted electronically by a CCASS Participant on behalf of the investor. Securities of a successful applicant are then credited directly into his account in CCASS and HKSCC Nominees Limited is issued the paper certificates. It is worth noting that the CCASS EIPO option also is available at the issuer's discretion only and hence not offered in all cases.

²⁹ We say initially here because eventually – and in line with the phased approach discussed above – we may compel IPOs to be offered in dematerialised form only – see paragraphs 38 to 41 above.

³⁰ Applicants using the yellow form or CCASS EIPO option will necessarily be issued uncertificated securities – provided of course that the issuer has offered a scripless IPO option (see paragraph 87) – as their securities will be deposited in an account in CCASS.

White form application

	Applicant	Application	Payment	Allotment	Any refund
Existing practice	Investor on own behalf	Paper form	By cheque	Paper certificates issued to applicant	By cheque
Practice under proposed model	<i>same</i>	<i>same</i>	<i>same</i>	Paper certificates issued to applicant or uncertificated securities credited to his ISA	<i>same</i>

White form eIPO

	Applicant	Application	Payment	Allotment	Any refund
Existing practice	Investor on own behalf	Via the Internet	Electronic	Paper certificates issued to applicant	By cheque or electronic refund
Practice under proposed model	<i>same</i>	<i>same</i>	<i>same</i>	Paper certificates issued to applicant or uncertificated securities credited to his ISA	<i>same</i>

Yellow form

	Applicant	Application	Payment	Allotment	Any refund
Yellow form	Investor on own behalf	Paper form	By cheque	Credit entries into account of the CCASS Participant specified by applicant, and paper certificates issued to HKSCC Nominees Ltd	By cheque
Practice under proposed model	<i>same</i>	<i>same – although an electronic version may be offered</i>	<i>same – although an electronic option may be offered</i>	Uncertificated securities credited to applicant's designated CPA, PSA or IPA	<i>same – although an electronic option may be offered</i>

CCASS EIPO

	Applicant	Application	Payment	Allotment	Any refund
CCASS EIPO	CCASS Participant (including Investor Participant) on own or client's behalf	Electronically via CCASS terminals or (in the case of Investor Participants) via CCASS Phone System and CCASS Internet System	Debited from CCASS Participant's designated bank account	Credit entries into account of the CCASS Participant specified by applicant, and paper certificates issued to HKSCC Nominees Ltd	Credited to CCASS Participant's designated bank account
Practice under proposed model	<i>same</i>	<i>same</i>	<i>same</i>	Uncertificated securities credited to designated CPA, PSA or IPA	<i>same</i>

Q16: Do you have any views on the proposed changes to the IPO process?

Scope

89. The Working Group considers that the scripless operational model could in general apply to all securities that are publicly traded in Hong Kong (i.e. all securities that are listed or traded on the SEHK). This includes therefore not only listed shares and debentures of Hong Kong incorporated companies but also –
- (1) other listed securities that are not currently subject to legislation compelling the use of paper documents of title and paper instruments of transfer – e.g. derivative warrants, CBBCs, etc, and
 - (2) shares and debentures of overseas incorporated companies that are listed or traded on the SEHK.
90. Applying the operational model to all securities would avoid inefficiencies and confusion which might otherwise arise if different rules, requirements and processes were to apply to different types of securities. That said, the Working Group is concerned to ensure that there are no unintended consequences.³¹ We therefore welcome views on whether the proposed model should apply to all securities, or whether certain aspects of the model should be limited to certain securities only, and if so why and to what extent.

Q17: Do you agree that the scope of the scripless operational model should extend to all publicly traded securities in Hong Kong (including therefore securities such as derivative warrants and CBBCs)?

Q18: If not, to what extent should the scope be limited, and why?

Benefits and implications for different stakeholders

91. The implementation of a scripless securities market will necessarily bring changes to existing rules, operations and processes. While these will bring benefits, it will also necessitate adjustments. The following paragraphs highlight some of the benefits and adjustments for key stakeholders under the proposed model.

Investors

92. For investors, a main benefit under the proposed model is that it will offer choice and better investor protection. They will also be able to enjoy the convenience of holding and transferring their securities electronically.
93. Investors will have the option to hold their securities in the form and manner that they prefer – i.e. certificated or dematerialised, directly or through a

³¹ For example – as discussed in paragraph 48 – the implementation of scripless should not result in issuers having to offer a paper option where today only a scripless option is offered to investors. To do so would be to take a regressive step.

CCASS Participant, and in their own names or in the name of a nominee. Investors will also have the option to dematerialise and rematerialise their securities at any time. Moreover, they will also be able to hold some of their securities in certificated form and some in dematerialised form.

94. The option for investors to hold securities in uncertificated form in their own names means they will no longer be forced to choose between convenience and legal ownership – see paragraph 20 above. They will be able to enjoy the convenience of an electronic holding while also benefiting from the added investor protection that will come with becoming a legal owner.
95. In the case of some securities (such as H-shares), a withholding tax on dividends is currently applied to shareholders who are not individuals. Hence, investors who hold such securities in CCASS (and whose securities are thus registered in the name of HKSCC Nominees Limited), are currently subject to the withholding tax. Under the proposed model however, individual investors will have the option to hold such securities in CCASS in their own names and thus not be subject to the 10% withholding tax.

Brokers, banks and custodians

96. For brokers and custodians, the proposed model will require some system adjustment to cater for the new account types and their features, although these will be kept to a minimum as far as possible. In particular, changes will be needed in relation to the handling of PSAs and effecting transfers with ISA holders.
97. At the same time however, the proposed model will also enable brokers, banks and custodians to offer more competitive services to their clients. For example, intermediaries will be able to follow the issuer's cut-off time for submitting corporate actions instructions rather than having to follow the earlier cut-off time set by HKSCC Nominees Limited as is currently the case. Moreover, individual investors holding securities that are subject to the PRC withholding tax, will be able to benefit from the exemption from such tax without having to withdraw their securities from CCASS. This may help intermediaries retain client relationships.
98. The proposal will also offer other service opportunities. For example, brokers, banks and custodians who hold securities for their clients in a CPA will need to provide nominee services to their clients since these securities will no longer be registered in the name of HKSCC Nominees Limited but will instead be registered in the broker, bank or custodian's name. In other words, the broker, bank or custodian will become the registered owner of the securities and will thus need to themselves serve as nominee and deal with matters such as the appointment of proxies or corporate representatives instead of just channelling these through HKSCC Nominees Limited.
99. There will also be opportunities for reducing the administrative work that brokers currently undertake. For example, as issuers increasingly offer a scripless option for IPOs, and investors increasingly take up such scripless option, physical settlement will become less common. For brokers, this will mean less administrative work as they will not receive large quantities of physical certificates from individual investors who have successfully applied for the IPO using the white form or white form eIPO. In addition, the risk of

receiving defective physical certificates from investors will also be reduced significantly.

CCASS

100. For CCASS, the proposed model will require system adjustment to cater for the various account types and their new features, and the introduction of a new Registrar Participant category. CCASS rules and procedures will also need to be amended to provide for the scripless environment and operational model.
101. With the gradual reduction in HKSCC Nominees Limited's role as nominee, the depository and nominee services currently provided will also gradually become obsolete. However, until all securities in CCASS are dematerialised, it will be necessary for CCASS to continue operating two systems – one in respect of securities in CCASS that are dematerialised and in respect of which HKSCC Nominees Limited no longer acts as nominee; and the other in respect of securities in CCASS that are not yet dematerialised and in respect of which HKSCC Nominees Limited still acts as nominee.
102. At the same time however, CCASS will take on new roles and provide new services. These will include in particular providing for a new class of participants in the form of the share registrars. Additionally, CCASS may continue to provide services to its other participants by handling corporate actions for CPA, PSA and IPA holders, although as mentioned in paragraph 72 above, the precise ambit and extent of such services has yet to be finalised.

Issuers and share registrars

103. For issuers, one impact is likely to be an increase in the number of registered holders of their securities. Having said that, bearing in mind that there are currently about 500 CCASS Participants (excluding Investor Participants) and about 13,000 Investor Participants with holdings (and most Investor Participants will likely hold only a small number of the over 1,000 listed securities available), the immediate increase in the number of registered holders is likely to be limited.
104. While an increase in the number of registered holders may increase issuers' costs slightly, it will also enhance shareholder transparency, improve shareholder communication, and ultimately result in better corporate governance. Moreover, there will also be cost savings brought about by the reduced use of paper and increased use of electronic communication.
105. For share registrars, the proposed model will require system development or enhancement – e.g. to provide services via the CCASS infrastructure, to serve ISAs and to provide scripless related services such as dematerialisation and rematerialisation, etc.

Market as a whole

106. In general, the implementation of a scripless market in Hong Kong will bring a number of benefits to Hong Kong including enhanced market efficiency and corporate governance, improved investor choice and protection, and compliance with global trends and standards.

107. These qualities will in turn enhance the status of Hong Kong's securities market making it more attractive to international investors and better able to participate in the globalisation of world capital markets. Ultimately, these will benefit all stakeholders in the market.

Q19: What are your views on the costs and benefits of introducing a scripless securities market in Hong Kong?

IV. POSITION OF OVERSEAS SECURITIES

108. Hong Kong is unique in that the vast majority of companies listed here (about 84%) are incorporated overseas – see the table below for a profile of companies listed on the SEHK as at the end of November 2009.

Place of incorporation	Number of HK-listed companies	Market share (in terms of market capitalisation)* (HK\$M)	(%)
Bermuda	465	1,601,912	9.15
Cayman Islands	482	2,816,871	16.08
Hong Kong	203	6,413,265	36.62
Mainland China	154	4,697,213	26.82
United Kingdom	2	1,969,509	11.24
Australia	1	16,238	0.09
Canada	1	-	-
Total:	1,308	17,515,008	100

* The aggregate market capitalisation shown in the table does not include companies that are incorporated outside Hong Kong and have a majority of its business outside Hong Kong and Mainland China. (The excluded companies are essentially a few incorporated in Bermuda, a few incorporated in Cayman Islands and one incorporated in Canada.)

109. The implementation of a scripless securities market will therefore have limited value if it applies only to Hong Kong incorporated companies.
110. We have therefore looked into whether shares and debentures of overseas incorporated companies can be held in dematerialised form and legal title transferred electronically within CCASS without an instrument of transfer. In particular, we have focused on companies incorporated in Bermuda, Cayman Islands, Mainland China and the UK since these make up the vast majority of overseas incorporated companies (by number or by market capitalisation). However, we are also looking into the position of other overseas incorporated companies.

Bermuda and Cayman Islands

111. On the basis of information available thus far, we understand the position to be as follows –

(1) Issue of new shares and debentures in uncertificated form

It is possible for new shares and debentures in both Bermuda and Cayman Islands companies to be issued in uncertificated form. However, for Bermuda companies the conditions of issue must expressly provide that the shares and debentures can be issued in uncertificated form.

(2) Conversion of existing shares and debentures – dematerialisation and rematerialisation

It is possible for existing shares and debentures in both Bermuda and Cayman Islands companies to be converted from certificated to uncertificated form (i.e. dematerialised) and vice versa (i.e. rematerialised). However, for Bermuda companies, dematerialisation (and rematerialisation, if applicable) will require the consent of the relevant shareholder or debenture holder (and subsequent transferees, if the shares or debentures are subsequently transferred).

(3) Transfer of legal title without instruments of transfer

It is possible for legal title to shares and debentures in both Bermuda and Cayman Islands companies to be transferred without an instrument of transfer, within CCASS, and in accordance with procedures prescribed in CCASS rules, provided the constitutional documents do not prescribe a different procedure for effecting transfers. Additionally, in the case of Bermuda companies, it will be necessary for CCASS (or other appropriate transfer agent) to first be approved by the Bermuda Ministry of Finance as an “appointed agent” under section 272A of the Bermuda Companies Act.

(4) Maintaining the branch register

There is no express provision in either Bermuda or Cayman Islands law that provides for a register of holders comprising two parts. The Working Group is seeking advice as to whether it is nevertheless possible for companies to maintain two branch sub-registers. If this is not possible, the Working Group will explore other alternatives including seeking amendments to the relevant Bermuda or Cayman Islands laws, or requiring the branch register to be updated immediately upon settlement occurring in CCASS.

112. To the extent that the constitutional documents of the Bermuda or Cayman Islands companies prohibit or are inconsistent with the above, they would need to be amended by special resolution first.

Mainland China and the UK

113. We are also looking into the position of companies incorporated in Mainland China (as there are a significant number of Mainland companies listed here) and the UK (since one of the two UK incorporated companies is HSBC Holdings Plc which has a significant shareholder base in Hong Kong).
114. For Mainland China companies, it may be necessary to seek amendments to certain documents – such as the Special Regulations on the Overseas Offering and Listing of Shares by Joint Stock Limited Companies (國務院關於股份有限公司境外募集股份及上市的特別規定) and the Mandatory Provisions for the Articles of Association of Companies Listed Overseas – Prerequisite Clauses (到境外上市公司章程必備條款). This may also require amendments to the existing constitutional documents of these companies. We are still studying what changes or actions may be needed.
115. As for UK companies, it appears that under the law as it stands, it may not be possible for shares in UK companies to be held or transferred in scripless form in CCASS. This is because under UK law, shares in UK companies can

only be held and transferred in registered form without paper documents if they are held in a “relevant system” and CREST is the only such system.

Other jurisdictions

116. We have not yet obtained information on the position of the other overseas incorporated companies. As mentioned above, we propose to focus first on the other four jurisdictions (i.e. Bermuda, Cayman Islands, Mainland China and the UK) given that they are likely to have a greater impact on the scripless proposals. In any event, the existing immobilised system will continue to apply until the securities of the overseas incorporated companies can be dematerialised or a different and better alternative can be identified.
117. We will keep the market informed of developments in this regard.

Practice in the UK and Australia

118. For completeness it is noted that the UK and Australia treat shares in overseas incorporated companies differently from shares in locally incorporated companies. Specifically, interests in foreign securities can be held and transferred electronically through the settlement system (i.e. CREST and CHESS) but in the form of a depositary interest only. Investors do not therefore hold legal title to these securities.
119. In the case of Hong Kong, given the large number of overseas securities in our market, the preference would be to explore options that would allow investors to hold legal title to the securities. However, if this is not feasible, the Working Group will consider whether it is better to retain the status quo for such securities or to follow the approach adopted in the UK and Australia.

<p>Q20: Regarding the dematerialisation of shares and debentures of overseas companies, do you agree with the proposed approach to focus first on Bermuda, Cayman Islands, Mainland China and UK companies? If not, why not?</p>
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V. LEGISLATIVE CHANGES

Summary of the changes needed

120. If Hong Kong is to implement a scripless securities market along the lines proposed in this paper, a number of legislative changes will be needed – primarily to the Securities and Futures Ordinance (**SFO**), the Companies Ordinance (**CO**) and the Stamp Duty Ordinance (**SDO**).
121. First, it will be necessary to amend existing provisions which compel the use of paper certificates and documents of title, and paper instruments of transfer. Currently these appear in the CO (in relation to shares and debentures) and the SDO (in relation to units in unit trust schemes).
122. Secondly, it will be necessary to provide for the formal register of holders to comprise two sub-registers. This will include –
 - (1) enabling the register of holders to be kept and maintained in two parts (comprising a certificated sub-register and an uncertificated sub-register), and clarifying how and by whom this is to be done,
 - (2) providing a mechanism to facilitate inspection of the register, and
 - (3) reviewing existing references to the register of holders, and clarifying whether this refers to both the certificated sub-register and uncertificated sub-register together, or to the certificated sub-register and the day-end record prepared for inspection, or something else.
123. Thirdly, it will be necessary to provide for the regulation of the scripless environment. In particular, this will include specifying the processes and procedures for –
 - (1) conferring legal title, effecting registered transfers, and conducting other transactions and activities in the scripless environment (such as dematerialising, rematerialising, charging/mortgaging, etc), and
 - (2) keeping and maintaining the certificated and uncertificated sub-registers.
124. It will also be necessary to provide for the regulation of persons who play a key role in the scripless environment. In particular, this will include share registrars since they and their systems will play a critical role in the scripless environment.
125. Additionally, if share registrars are to be able to effect registered transfers electronically between two ISAs, it will be necessary to enable them to enter into stamp duty collection agreements with the Collector of Stamp Revenue.³² Appropriate amendments in this regard will hence be needed as well.

³² Currently, the SDO only allows the Collector of Stamp Revenue to enter into stamp duty collection agreements with a recognized exchange company or an authorized provider of automated trading services. That section will hence have to be extended if share registrars are to be permitted to enter into similar stamp duty collection agreements.

126. At this stage, we envisage that the primary legislation will only set out a general framework and that the detailed processes, procedures and requirements will be incorporated in subsidiary legislation.
127. As mentioned earlier, the scripless proposals are intended to cover only securities that are publicly traded – that essentially means securities that are listed or traded on the SEHK. There is no intention to affect the position of securities in private companies or public companies that are not listed or traded on the SEHK. The legislative amendments will therefore be crafted so as not to affect or prejudice the position of such securities.

Amendment process

128. The bulk of the scripless legislation will be incorporated in the SFO (including subsidiary legislation made thereunder), the CO and the Stamp Duty Ordinance.
129. The legislative amendments for implementing a scripless securities market will be as follows.
 - (1) An initial first step will be to amend provisions in the CO that – expressly or impliedly – compel the use of paper certificates and instruments of transfer. This will be a relatively simple and straightforward step, but crucial to laying the foundation for implementing a scripless securities market in Hong Kong.
 - (2) Additionally, it will be necessary to set out the framework for regulating the scripless environment, and those that play a key role in that environment. This will be a more complex exercise and the specific legislative amendments will depend very much on the operational model that is eventually adopted, and hence on the outcome of this consultation.
130. For completeness, it is noted that various non-statutory rules and codes will need appropriate amendment also including the Listing Rules, the General Rules of CCASS and the SFC's Code of Conduct for Share Registrars.

VI. TIMETABLE

131. The timetable for implementing a scripless securities market in Hong Kong will depend largely on when the operational model is finalised. This paper aims to initiate discussion on the operational model. The consultation period will last for three months, i.e. until 31 March 2010. Given that the operational model may have significant implications for market participants and investors, we believe a three-month consultation period is necessary.
132. Subject to the volume and nature of comments received, we aim to issue a consultation conclusions paper in the second quarter of 2010, and to finalise the operational model as soon as practicable thereafter.
133. Once the operational model is finalised, it will be possible to finalise the more substantive legislative amendments. This means finalising both the detailed subsidiary legislation and amendments to primary legislation.
134. At this stage, we expect to allow for a lead time between the relevant amendments being passed (including amendments to non-statutory rules) and implementation of the scripless regime. The duration of the lead time will depend on a number of circumstances. However, we will ensure that market participants have ample time to make any system or other changes to their operations and processes.

ANNEX 1 – Summary of the UK and Australian models

The UK model

Voluntary vs compulsory

1. Dematerialisation was first implemented in the UK in 1996. It however continues to be voluntary in that –
 - (1) investors can still choose whether to hold their securities in certificated or in uncertificated form, and
 - (2) they can also choose to dematerialise or rematerialise their securities at any time.
2. In the UK, some 34 million shareholdings are owned by approximately 12 million shareholders. Of these, about 9 million hold paper certificates and this represents about 15% of the total value of the UK share market. The remaining 85% is traded electronically³³.

Register

3. In the UK, uncertificated securities are held through the CREST system while certificated securities are held outside the CREST system. CREST is an electronic system operated by Euroclear UK & Ireland Limited (**EUI**)³⁴. The register in the UK consists of –
 - (1) a CREST register which is kept and maintained by EUI and which records all uncertificated holdings held through CREST, and
 - (2) an issuer register which is kept and maintained by the registrar appointed by the issuer of the relevant securities and which records all certificated holdings held outside CREST.
4. The two registers together make up the complete register of securities.

Transfers

5. Uncertificated securities must be transferred within CREST and do not require an instrument of transfer. The legal title of uncertificated securities passes to the transferee at the point at which the transferee's name is registered on the CREST register.

Name on register

6. CREST offers a name on register facility, i.e. investors holding uncertificated securities in CREST can hold the securities either in their own names or in the name of a broker nominee.

³³ These statistics are extracted from a consultation paper issued by the UK Institute of Chartered Secretaries and Administrators on 6 April 2006.

³⁴ EUI was formerly known as CREST Co Limited (the name was changed in July 2007). CREST Co was formed in September 1994 and acquired by the Euroclear group in September 2002. The parent company of EUI is now Euroclear SA/NV. EUI is a recognised clearing house regulated by the Financial Services Authority in the UK.

Corporate actions

7. In the UK, share registrars provide all corporate action services and act as paying agents to certificated and uncertificated holders. Corporate action communications are sent via CREST to uncertificated holders and in electronic or paper form to certificated holders.

Overseas securities

8. CREST does not support foreign securities, even if the relevant foreign jurisdiction supports uncertificated holdings. In this regard, CREST cannot be used directly for the holding and transfer of securities of issuers incorporated overseas. These securities are dealt with in one of two ways, depending on whether the issuers are incorporated in countries whose central securities depositories (**CSDs**) have established links with EUI.
 - (1) For securities of issuers incorporated in countries whose CSDs have established links with EUI (these are mainly EU countries), EUI will enter into arrangements whereby EUI effectively holds the securities through the CSD of that country (EUI acts as the depository of those securities) and in turn, EUI issues to the UK investors depository receipts called "CREST Depository Interests". These CDIs are uncertificated securities which can be held and transferred through CREST and they represent interests in the securities of that issuer.
 - (2) For securities of issuers incorporated in countries whose CSDs do not have established links with EUI, a similar arrangement is created except that EUI does not hold the securities. Rather they are held by registrars appointed in the UK by the issuer which, in turn, issue to the UK investors "Depository Interests". These Depository Interests can be held and transferred through CREST as uncertificated securities.

The Australian model

Voluntary vs compulsory

9. Australia achieved full dematerialisation for securities of all its domestic issuers at the beginning of 1999. Investors no longer have the option of holding domestic securities in certificated form.

Register

10. Unlike the UK, investors in Australia can hold their uncertificated securities either within or outside CHESS. CHESS stands for the Clearing House Electronic Sub-register System, and is the system through which products traded on the Australian Securities Exchange are settled.
11. CHESS is operated by ASX Settlement and Transfer Corporation (**ASTC**), which in turn is an approved clearing house and a wholly owned subsidiary of the Australian Securities Exchange.
12. Uncertificated securities held within CHESS are recorded on the CHESS sub-register which is maintained directly on the clearing system while

uncertificated securities which are held outside CHESS are registered on the issuer sponsored sub-register.

13. The two sub-registers together form the complete register of securities.

Transfers

14. Transfers of uncertificated securities (whether within the CHESS sub-register or to and from the CHESS sub-register and the issuer sponsored sub-register) are effected electronically and take effect when the name of the transferee is registered on the CHESS sub-register or the issuer sponsored sub-register.

Name on register

15. CHESS also offers a name on register facility. As in the UK, investors in Australia holding uncertificated securities in CHESS can hold the securities either in their own names or in the name of a broker nominee.

Corporate actions

16. In Australia, most communications between issuers and holders of securities (whether in certificated or uncertificated form) in relation to corporate actions, such as the notification of entitlements or obligations and the lodgement of applications, elections of any monies payable, occur directly between the issuer's appointed share registrar and the holder without the involvement of CHESS.

Overseas securities

17. CHESS does not support foreign securities, even if the relevant foreign jurisdiction supports uncertificated holdings. In this regard, CHESS cannot be used directly for the holding or transfer of securities of issuers incorporated overseas.
18. To overcome this difficulty, CHESS Depositary Interests (**CDIs**) were created. They can be used for debt (Depositary Interests) or equity securities (CHESS Units of Foreign Securities).
19. CDI holders can choose to hold their CDIs within CHESS and have the CDIs registered on the CHESS sub-register or be held outside CHESS and be registered on the issuer sub-register.

ANNEX 2 – Features and characteristics of the five account types

1. The proposed model offers investors five ways of holding their securities. Specifically, they can hold them in certificated form outside CCASS, or in uncertificated form within CCASS through one of four different account types (i.e. a CPA, PSA, IPA or ISA as depicted in Diagram 2 under paragraph 29 of the paper). We summarise the main features of each of these options below.

Certificated holdings outside CCASS

2. This is basically no different from the existing option for holding securities in certificated form (i.e. where a paper certificate is issued to the investor). The holdings may be registered in the name of the investor or his chosen nominee (if he wishes to hold the securities through a nominee). The investor or his nominee (as the case may be) will thus be the securities holder, and his name will be recorded in the certificated sub-register.
3. However, if the investor wishes to sell the securities on the SEHK and settle the trade through CCASS, he will need to first dematerialise and deposit the securities into a CPA for settlement in CCASS – the process for dematerialising and depositing the securities into CCASS can be done at the same time. (This is of course subject to the phased approach.³⁵)

Uncertificated holdings through a CPA in CCASS

4. CPA refers to the account maintained in CCASS by a CCASS Participant that is a broker, bank or custodian. Securities in a CPA may belong to the broker/bank/custodian participant (if they are held in its proprietary sub-account) or to its clients (if they are held in its omnibus client sub-account). However, irrespective of who the securities belong to, they will be reflected in the register of holders as held by the broker/bank/custodian that is the CCASS Participant. Hence, an investor-client whose securities are in a CPA will have a beneficial interest only and his name will not appear on the register.
5. This option is therefore similar to how securities are held in CCASS today except that instead of the securities being registered in the name of HKSCC Nominees Limited, they will be registered in the name of the broker/bank/custodian that is the CCASS Participant. Moreover, as is the case today, the CPA will be administered by the broker/bank/custodian participant on instructions from the investor-client, i.e. movements of securities into and out of the CPA will be controlled by the broker/bank/custodian that is the CCASS Participant on instructions from the investor-client, and not by the investor-client direct.
6. Investors holding securities through a CPA will not be able to view their holdings through CCASS at any time, and will instead have to rely on

³⁵ To explain – If the investor wishes to sell 800 shares in Company XYZ but Company XYZ has not yet been called up for dematerialisation under the phased approach, then there will be no need for the investor to dematerialise his 800 XYZ shares before using them to settle trades on the SEHK. However, once Company XYZ is called up for dematerialisation, the investor must dematerialise and deposit his XYZ shares into CCASS before he can use them to settle trades on the SEHK.

statements issued by their brokers/banks/custodians or other facilities provided by them.

Uncertificated holdings through a PSA in CCASS

7. PSA refers to a participant sponsored account. This account is essentially similar to the current broker/bank/custodian participant's stock segregated account with statement service (or **SSA account**) which will be eliminated under the proposed model.³⁶
8. The PSA will have most of the features of the existing SSA except that securities held in a PSA will be registered in the name of the investor-client on whose behalf the PSA was opened, and not in the name of HKSCC Nominees Limited (as is the case now for securities held in an SSA). As such, holdings in a PSA will not form part of the CCASS Participant's holdings (as is the case now for holdings in an SSA).
9. Movements of securities into and out of a PSA will be administered (i.e. controlled) by the broker/bank/custodian that is the CCASS Participant on instructions from the investor-client, and not by the investor-client direct. However, a PSA holder will be able to –
 - (1) access his PSA via the CCASS Internet System and CCASS Phone System to enquire about account movements and balances,
 - (2) receive activity statements from CCASS showing movements of securities in his PSA, and monthly statements of account balances in his PSA, via mail (albeit at a fee) or through the CCASS Internet system, and
 - (3) opt to receive email and SMS alert messages from CCASS whenever there is any movement of securities in his PSA.

Uncertificated holdings through an IPA in CCASS

10. IPA refers to an Investor Participant account. The IPA, which is an existing account type in CCASS, will operate in much the same way under the proposed model as it does now, except that securities in an IPA will be registered in the name of the relevant Investor Participant rather than HKSCC Nominees Limited. This will give the investor direct control and legal title over his securities, but trading will still have to be effected via brokers.
11. As is the case today, the investor will administer his own IPA, i.e. he will control the movement of securities into and out of his IPA. Additionally, an IPA holder will be able to –
 - (1) access his IPA via the CCASS Internet System and CCASS Phone System to manage his account activities and to enquire about account movements and balances as well as corporate announcements,

³⁶ An SSA is a sub-account that may be opened by a CCASS Participant for clients who wish to have their securities segregated from those belonging to the CCASS Participant's other clients. SSAs are controlled by the CCASS Participant and securities in them are registered in the name of HKSCC Nominees Limited. Investors are not recognised by HKSCC as holders of SSAs. However, CCASS notifies the investor whenever there is any movement of securities in the relevant SSA.

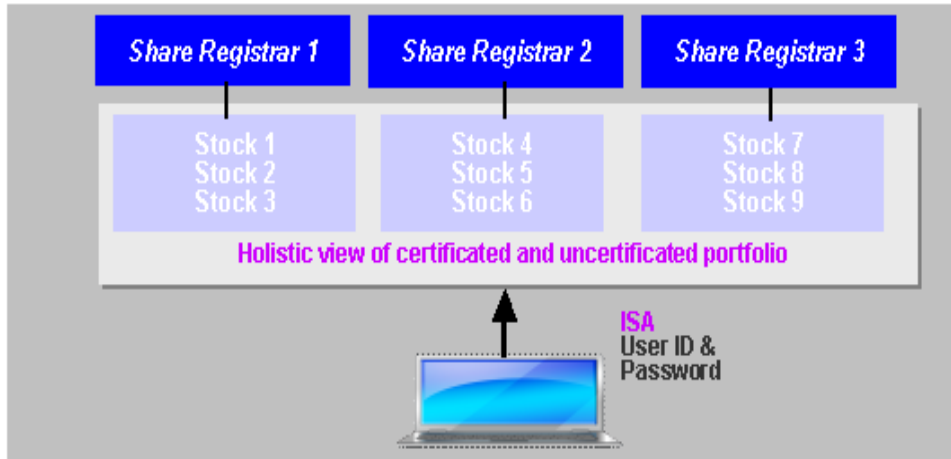
- (2) on an electronic basis, execute share transfers between his IPA and his broker's/bank's account in CCASS, perform rights subscriptions, dividend election and voting, subscribe to IPO shares, tender for EFNs, and receive cash dividends which will be credited directly into his designated bank account,
- (3) receive activity statements from CCASS showing movement of securities in his IPA, and monthly statements of account balances in his IPA, via mail (albeit at a fee) or through the CCASS Internet system, and
- (4) opt to receive SMS alert messages from CCASS whenever there is any movement of securities in his IPA.

Uncertificated holdings through an ISA in CCASS

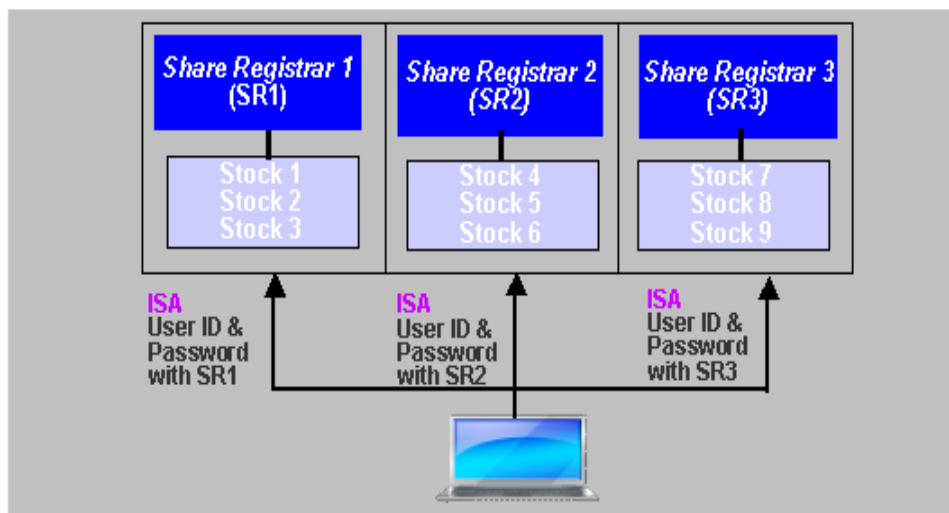
12. ISA refers to an issuer sponsored account. This is a new account type which will be offered by share registrars, on behalf of listed issuers, and which will reside within the CCASS environment. ISAs will be opened under the proposed new Registrar Participant category – see paragraphs 73 to 75 of the paper, which discusses this new category in greater detail.
13. The Federation is considering alternatives for how an ISA may be opened. Two options are currently being considered –
 - (1) Through the Federation
A single ISA number (ISN) with Personal Identification Number (PIN) will be provided to investors by the Federation on initial registration. Such service will be handled and supported by share registrars that are Registrar Participants of CCASS. Investors will only need to complete the registration process once and at the office of any share registrar that is a Registrar Participant. Their records will then be stored by the Federation.
 - (2) Through individual share registrars
Alternatively, investors may go through the account opening process with individual share registrars that are Registrar Participants of CCASS. Each such share registrar will then provide an ISN (with PIN) to the investor. Consequently, investors who have multiple securities that are handled by different share registrars, will need to register separately to open ISAs with different share registrars.
14. Under the first option above, the ISA holder will have a more holistic view of his portfolio as he will be able to use his ISN and PIN to access a single web-based platform through which he will be able to view all his certificated holdings and all his uncertificated holdings that are held in ISAs. This will allow the investor to view and enquire about his entire ISA portfolio from a single point irrespective of how many share registrars manage securities within his ISA portfolio.
15. Under the second option above, the ISA holder will have a holistic view of his certificated and uncertificated shareholdings handled by a particular share registrar by accessing web-based platform maintained by the relevant share registrar.

16. The diagram below illustrates the account structure and access of ISAs under the two options described above.

Possible Alternatives for ISA Account Opening and Access



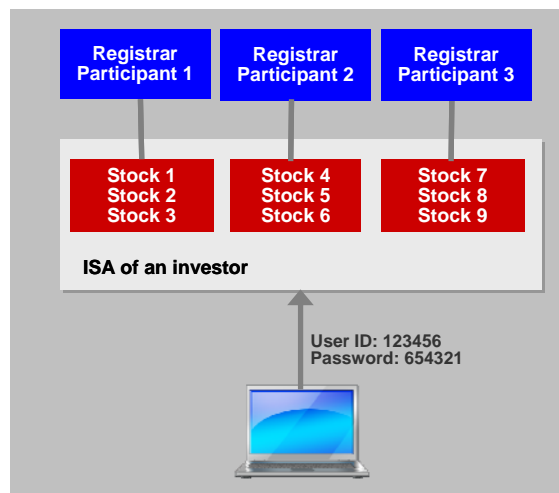
OR



17. By using an ISN and PIN, ISA holders can administer their ISA(s), make enquiry and manage the securities held in their ISA(s). Confirmation on all changes/transactions will be sent to an ISA holder via email, SMS or letter as appropriate.
18. It should be noted however that a share registrar will only maintain an investor's ISA holdings in those securities that the share registrar manages. It will therefore only be able to handle movements of, and respond to enquiries about, those securities in accordance with instructions from the ISA holder.
19. Moreover, to move securities into and out of an ISA, the ISA holder will need to instruct both his broker/bank/custodian and the share registrar – this will provide added security. Only matched instructions will be carried out and the

share registrar will also inform the ISA holder when the securities movement is completed.

20. Although ISAs will reside on the CCASS platform, there will be no contractual relationship between CCASS and ISA holders. Notwithstanding this, it is proposed that CCASS will be an alternative channel for ISA holders to view their ISA portfolio. Accordingly, during the ISA account opening and registration process, ISA holders will also receive user IDs (with password/PIN) issued by share registrars to enable ISA holders to log into CCASS, as an alternative channel for viewing their portfolio.
21. One final point to note is that although share registrars will have certain data and information about an ISA holder (such as his name, address, any standing instructions, and any information that has to be included in the register of holders), the PIN will in fact be generated by the computer systems directly and hence will not be available to staff of the share registrars. For added security, ISA holders will be recommended to change their PIN upon receipt.
22. The following diagram illustrates the account structure of ISAs within CCASS.



ANNEX 3 – Functions that might be performed through the CCASS platform

As Registrar Participants, share registrars will be able to carry out functions through the CCASS platform although they may also use their own platform. These may include –

- (1) opening and closing ISAs for investors,
- (2) maintaining profiles of ISA holders,
- (3) moving securities from an investor's ISA as instructed (e.g. to a CPA or PSA designated by that investor in connection with a sale),
- (4) receiving securities into an investor's ISA as instructed (e.g. from a CPA or PSA after effecting a purchase),
- (5) effecting transfers between two ISA holders,
- (6) downloading the day-end record of the uncertificated sub-register (for the securities that that share registrar manages),
- (7) downloading reports and/or data files containing details of any corporate action responses given by holders of a CPA, PSA or IPA – e.g. voting instructions, subscription applications, etc
- (8) distributing via CCASS the corporate action entitlements that holders of a CPA, PSA or IPA are entitled to in accordance with the corporate action responses received as described above,
- (9) uploading reports and data files containing details of corporate action entitlements of holders of a CPA, PSA, IPA and ISA,
- (10) distributing corporate action entitlements to ISA holders, and
- (11) distributing corporate communications to all registered holders of uncertificated securities, i.e. to all holders of a CPA, PSA, IPA or ISA.

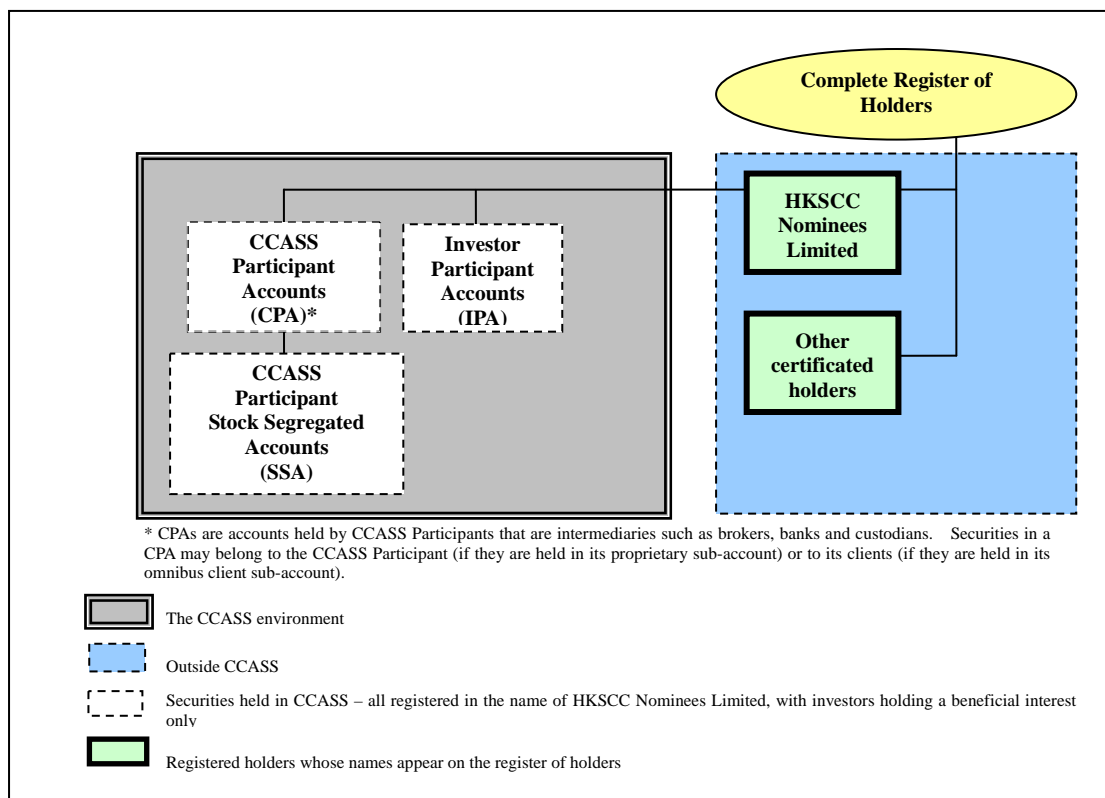
ANNEX 4 – List of specific issues on which feedback is sought

1. Do you agree that investors should be given the option to hold securities in paper form and to rematerialise securities that have been dematerialised? If not, why not?
2. Do you agree that the scripless system should eventually be made compulsory and the paper-based option removed altogether? If not, why not?
3. Do you agree that implementation of a scripless securities market should proceed in phases? If not, why not?
4. Do you agree with the proposed phasing, i.e. dematerialising securities in batches, and dematerialising Hong Kong securities first? If not, why not?
5. Do you have any views on the proposed dematerialisation process and HKSCC Nominees Limited's diminishing role?
6. Do you agree with the proposal that the formal register comprise two parts as discussed in paragraphs 49 to 53 of the paper? If not, why not?
7. Do you agree with the proposal to facilitate name-on-register within CCASS? If not, why not?
8. Do you consider that the proposed arrangements for addressing any concerns arising from the removal of the immediate credit arrangement are adequate? If not, why not?
9. Do you think the proposed model provides enough options (in terms of account types) for investors? If not, what other options do you think should be provided and why?
10. Should broker/bank/custodian nominees in CCASS be allowed to appoint multiple representatives so that their investor-clients can attend and vote at meetings? If not, why not?
11. Should broker/bank/custodian nominees in CCASS be allowed to appoint both proxies and multiple representatives in respect of the same meeting? If not, why not?
12. Do you agree that investors should be required to provide a unique identification number irrespective of whether they obtain their securities by way of a transfer or through an IPO?
13. Do you agree with the proposal to introduce a new Registrar Participant category in CCASS? If not, why not?
14. Do you agree that share registrars who provide scripless related services should be more directly and robustly regulated than they are today? If not, why not?
15. Do you consider that a graduated approach should be taken towards regulating share registrars (i.e. that the level of regulation should vary

according to the type and range of scripless related services provided), or that a uniform approach should be taken such that a common standard is applied in all cases?

16. Do you have any views on the proposed changes to the IPO process?
17. Do you agree that the scope of the scripless operational model should extend to all publicly traded securities in Hong Kong (including therefore securities such as derivative warrants and CBBCs)?
18. If not, to what extent should the scope be limited, and why?
19. What are your views on the costs and benefits of introducing a scripless securities market in Hong Kong?
20. Regarding the dematerialisation of shares and debentures of overseas companies, do you agree with the proposed approach to focus first on Bermuda, Cayman Islands, Mainland China and UK companies? If not, why not?

Existing market structure



Structure under the proposed operational model

