

# 立法會

## *Legislative Council*

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### **Panel on Financial Affairs meeting on 1 November 2010**

### **Background brief on proposal to implement a scripless securities market in Hong Kong**

#### **Purpose**

This paper provides background information and summarizes the views and concerns expressed by members of the Panel on Financial Affairs (FA Panel) on the proposal to implement a scripless securities market in Hong Kong.

#### **Background**

2. Hong Kong's securities market is currently largely paper-based<sup>1</sup>. However, investors can hold and transfer securities in electronic form through the Central Clearing and Settlement System (CCASS), which is an immobilized securities settlement system<sup>2</sup> and is operated by Hong Kong Securities Clearing Company Limited (HKSCC).

3. The existing immobilized 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. However, the system also has its shortcomings. First, it is not completely electronic. Some transactions still require

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<sup>1</sup> 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.

<sup>2</sup> An immobilized 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 immobilized 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.

the use of paper, e.g. the Initial Public Offerings process to some extent still requires the use of paper. Secondly, 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).

### **Public consultation on proposals for a scripless securities market**

4. The Securities and Futures Commission (SFC) and the Hong Kong Exchanges and Clearing Limited (HKEx) had separately consulted the market on proposals for implementing a scripless securities market in Hong Kong in 2002 and 2003. There was however difficulty in reaching consensus on the operational model on those occasions. In early 2009, a working group, i.e. the Working Group on Scripless Securities Market, comprising representatives from SFC, HKEx and the Federation of Share Registrars Limited (FSR) was established to revive discussion on the operational model for a scripless market. On 30 December 2009, the three bodies jointly issued a consultation paper on a proposed operational model to introduce a scripless securities market in Hong Kong. The consultation lasted for three months.

5. The main features of the proposed operational model are as follows -

- (a) *Dual system and a phased approach:* 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.
- (b) *Register to comprise two parts:* All scripless securities will be held inside CCASS while all paper 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.
- (c) *Investor choice:* Investors will have a wider range of options in terms of the form, type of ownership and extent of control over their holdings. Specifically, investors may choose between -
  - (i) holding their securities in paper form or in scripless (i.e. dematerialised) form;
  - (ii) 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

- (iii) holding their securities through an account that they can control directly or through an account controlled by their broker, bank or custodian.
- (d) *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.
- (e) *Scope of coverage:* The proposed operational model is proposed to be applied to all securities that are publicly traded in Hong Kong. Thus, apart from listed shares and debentures of Hong Kong incorporated companies, the scripless operational model would also extend to –
  - (i) 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, Callable Bull/Bear Contracts, etc, and
  - (ii) shares and debentures of overseas incorporated companies that are listed or traded on the Stock Exchange of Hong Kong.

6. According to the Administration, the main benefits of implementing a scripless securities market are as follows –

- (a) it will modernize the financial infrastructure of Hong Kong and enhance overall efficiency in our securities market;
- (b) it will enhance corporate governance, and ultimately secure an improved level of investor choice and protection; and
- (c) it will ensure that Hong Kong is in keeping with other leading markets that have already implemented dematerialisation.

### **Legislative amendments in the Companies (Amendment) Bill 2010**

7. As a first step in the entire legislative process for implementing the scripless initiative, the Administration, introduced technical amendments, through the Companies (Amendment) Bill 2010, to remove, or provide exceptions to, the

limitations arising from provisions in the Companies Ordinance (Cap. 32) that compel the use of paper documents of title and paper instruments of transfer in relation to shares and debentures. The Bill was passed on 7 July 2010. The Administration assured the relevant Bills Committee that the technical amendments would not pre-empt the scripless operation model, and would be brought into operation only when there was general market consensus on, and readiness to implement, the proposed scripless operational model.

### **Members' views and concerns**

8. The Administration briefed the FA Panel on the proposed operational model for implementing a scripless securities market in Hong Kong on 1 February 2010. Members expressed the following views and concerns:

- (a) how the proposed operational model for Hong Kong compared with the operational models in other places;
- (b) what arrangements would be put in place to ensure the accuracy and safety of shareholders' information in CCASS in a scripless environment;
- (c) whether and how the proposed operational model would cater for situations where banks and brokers held shares provided by clients for collateral purposes;
- (d) the fees and charges to be borne by investors should not be higher than the current level; and
- (e) as the scripless initiative might bring about significant changes to the ways investors hold and trade securities, there should be extensive consultation with market participants on the detailed arrangements.

9. Subsequent to the Panel meeting, the Working Group on Scripless Securities Market provided a comparison (**Appendix**) between the scripless arrangements for the securities markets in the United Kingdom and Australia and those proposed for Hong Kong. Regarding members' concerns mentioned in (b) to (d) above, SFC advised at the meeting that the regulatory authority and HKEx would ensure that the records in CCASS would be accurately maintained, and back-up systems would be established for safe storage of the records. The scripless regime would include arrangements to cater for situations where banks or brokers held shares provided by clients for collateral purposes. The detailed administrative procedures and fee schedules for CCASS and the share registrars would be worked out after the consultation exercise, and the fee level would be reasonable and set having regard to the acceptance of market participants.

## Recent developments

10. On 21 September 2010, SFC, HKEx and FSR jointly published the consultation conclusions on the proposed operational model for implementing a scripless securities market in Hong Kong. It was mentioned in the relevant press release that the scripless regime would come into effect following the necessary legislative changes and when the market infrastructure, key operators and market participants were ready. SFC would consult the public in early 2011 on a new subsidiary legislation which would set out in more detail how the scripless environment and those that played a key role in that environment would be regulated. It was expected that the first phase of the scripless regime would be implemented in late 2013.

11. The Administration and the Working Group on Scripless Securities Market will brief the FA Panel on the consultation conclusions at the Panel meeting on 1 November 2010.

## Relevant papers

12. The relevant papers are available at the following links:-

Administration's paper for the FA Panel meeting on 1 February 2010

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0201cb1-978-5-e.pdf>

Minutes of the FA Panel meeting on 1 February 2010 (paragraphs 53 to 61)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/minutes/fa20100201.pdf>

Report of the Bills Committee on Companies (Amendment) Bill 2010 and Business Registration (Amendment) Bill 2010 (paragraphs 41-42)

<http://www.legco.gov.hk/yr09-10/english/bc/bc03/reports/bc03cb1-2392-e.pdf>

Companies (Amendment) Ordinance 2010 (Part 7)

<http://www.legco.gov.hk/yr09-10/english/ord/ord012-10-e.pdf>

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## Appendix

The following sets out, in tabular form, information on the scripless arrangements for the securities markets in the UK and Australia and those proposed for Hong Kong -

|                                | <b>UK</b>   | <b>Australia</b>   | <b>Proposal for HK</b>  |
|--------------------------------|---|--|---|
| <b>System</b>                  | CREST Co Limited ("CREST")  | The Clearing House Electronic Sub-Register System ("CHES")   | The Central Clearing and Settlement System ("CCASS")  |
| <b>Voluntary vs compulsory</b> | Voluntary - investors have the option to hold domestic securities in paper form   | Compulsory - investors do not have the option to hold domestic securities in paper form  | Voluntary - investors will have the option to hold domestic securities in paper form  |
| <b>Register</b>                | Register is made up of two parts, and uncertificated securities must be held within CREST   | Register is made up of two parts, and uncertificated securities may be held within or outside CHES   | Register will be made up of two parts, and uncertificated securities must be held within CCASS  |
| <b>Name on register</b>        | Securities in CREST can be held in the name of the investor   | Securities in CHES can be held in the name of the investor   | Securities in CCASS can be held in the name of the investor   |
| <b>Corporate action</b>        | Share registrars provide all corporate action services and corporate action communications are sent via CREST to uncertificated holders and in electronic or paper form to certificated holders | Most communications between issuers and investors occur directly between the issuer's share registrar and the investor without the involvement of CHES | To be discussed further within the Working Group - see paragraph 72 of the Joint Consultation Paper on a Proposed Operational Model for Implementing a Scripless Securities Market in Hong Kong (the "Consultation Paper") <sup>1</sup> |
| <b>Overseas securities</b>     | Investors cannot directly hold and transfer overseas securities through CREST, and must instead hold and transfer depository interests  | Investors cannot directly hold and transfer overseas securities through CHES, and must instead hold and transfer depository interests                  | To the extent that the laws of the jurisdictions outside HK allow, investors will be able to directly hold and transfer overseas securities through CCASS   |

<sup>1</sup> The Consultation Paper was issued by the Working Group on Scripless Securities Market on 30 December 2009, a copy of which was attached to the paper for the Legislative Council Panel on Financial Affairs for discussion at its meeting on 1 February 2010.

*Note: The above is a brief comparison only. For further details of the UK and Australian models, please see Annex 1 of the Consultation Paper.*

**Working Group on Scripless Securities Market**

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