

**Response Paper to the Bills Committee on Securities and Futures and
Companies Legislation (Uncertificated Securities Market Amendment Bill) 2014**

1. This paper aims to provide the requested information to the Bills Committee in response to its letter to Hong Kong Exchanges and Clearing Limited (HKEx) dated 21 October 2014, and to facilitate discussion at the upcoming Bills Committee meeting scheduled on 17 November 2014 in relation to the proposed operational model of the uncertificated securities market (USM).
2. In April 2009, the Securities and Futures Commission (SFC) set up a Working Group with HKEx and the Federation of Share Registrars (FSR) to study a USM model for Hong Kong. HKEx has been working closely with the Working Group members to develop the proposed USM model and to provide comments on the Uncertificated Securities Market Amendment Bill 2014 (USM Bill). Although the final USM model agreed upon and published in the Consultation Paper was in our view not the most efficient model (in particular, maintaining the existing paper-based system and phasing in the uncertificated system for a prolonged period is challenging from a systems perspective), and the financial investment required from HKEx to build a new infrastructure is huge, HKEx is still supportive of the USM initiative. We believe that it will bring further efficiencies and other benefits to market intermediaries and investors and bring Hong Kong in line with international standards.

Role of Hong Kong Securities Clearing Company Limited (HKSCC) as System Operator

3. HKSCC, a subsidiary of HKEx, is a recognized clearing house under the Securities and Futures Ordinance. Apart from providing clearing and settlement services to its participants (CCASS Participants), it also provides depository and nominee services to CCASS Participants and investors who wish to hold securities through HKSCC (Investor Participants) as the central securities depository (CSD).
4. Under the proposed USM model, the register of members (ROM) of a listed issuer will be divided into the "certificated register" for the registration of shareholders who hold certificated shares, and the "uncertificated register" for the registration of shareholders who hold uncertificated shares. Share registrars will continue to act as the issuers' agent to update and maintain the certificated register of the ROM, while HKSCC will, subject to the approval of the SFC, take on the role of the system operator to update and maintain the uncertificated register of the ROM of listed issuers in phases in accordance with the USM Bill. For the uncertificated register of the ROM, investors can choose to be either direct shareholders with their names appearing as registered shareholders (via a CCASS Participant Sponsored Account (PSA) or an Investor Participant Account (IPA), or indirect shareholders with shares held through their own custodian agents such as banks and brokers via a CCASS Participant Account (CPA). Investors may also choose to open an Issuer Sponsored Account (ISA) with the share registrar (who themselves open a Register Participant Account (RPA) in the system). The ISA is a new type of account in which investors' names appear as registered shareholders and they interact with the share registrars directly via the RPA.

5. HKSCC's proposed role as the system operator is in line with the international practice that CSDs act as the system operator of the uncertificated register of the ROMs. For example, in the UK and Australia, CREST and CHESS respectively, both CSDs, act as the system operator of uncertificated securities.

Division of Work between HKSCC and Share Registrars with regard to Corporate Action Services

6. The Bills Committee's letter of 21 October 2014 asked HKEx to provide information on the division of work between HKSCC and the share registrars with regard to corporate action issues, such as dividend payment arrangements and the relevant fees, and how the arrangements will protect the interest of investors.
7. As explained below, we believe that the division of labour between HKSCC and share registrars in relation to the provision of corporate action services is clear and there is no confusion of roles.
8. Under the existing regime, in addition to maintaining the ROM of listed issuers as mentioned in 4 above, share registrars are responsible for providing secretarial services such as arranging shareholders' meetings, mailing proxies and other corporate communication materials, dealing with the payment of dividends to registered shareholders, and assisting issuers in processing various types of corporate actions. In carrying out these functions, share registrars receive instructions from direct shareholders, for example, on the form of dividends to receive (e.g. scrip or cash) and how to vote in a shareholder meeting. It is our understanding that the position will remain the same under the proposed USM regime as these functions have to be performed by issuers or their appointed agents under the existing regulations.
9. Currently, indirect shareholders (i.e. investors who choose to hold securities through banks, brokers and others) are free to choose any custodian agent to be their single point of contact to manage their portfolio of securities. In return for a fee, such agents generally serve their clients by (a) extracting the key information of corporate actions proposed by issuers from announcements and circulars (including, for example, deadline dates and the type of actions required from shareholders); and (b) collecting instructions or elections from their clients for onward transmission to various share registrars (as agents of the issuers) either directly if they are themselves registered shareholders or through other intermediary agent like HKSCC that are registered shareholders providing nominee services. Administration of responses to corporate actions on behalf of indirect shareholders, particularly institutional investors, is a common service provided by third party agents.
10. Under the existing regime, HKSCC provides services similar to the above to CCASS Participants and Investor Participants as indirect shareholders. This does not conflict with the share registrars' role.
11. Under the USM model, HKSCC intends to carry on providing similar corporate action services to CCASS Participants and Investor Participants as it is believed that such services would continue to provide convenience to the broker community and individual investors, and facilitate communications between listed issuers and their shareholders via one single system through electronic

means. Maintaining these services by HKSCC will not only achieve investor transparency, hence promote corporate governance, but will also enable participants (banks/brokers) to serve their clients more efficiently, as otherwise participants who hold on behalf of investors will have to set up their own systems to track the corporate actions of the issuers and provide the relevant instructions and confirmations to the issuers on behalf of their clients. Accordingly, we believe that by continuing to provide the corporate action services, HKSCC will assist the smooth transition of the Hong Kong market from the certificated regime to the uncertificated regime. This does not appear to conflict with the share registrars' role under the USM regime.

12. With regard to HKSCC's role, the main difference between the current and the future arrangement is that under the USM regime, HKSCC will not be a direct shareholder of the issuers itself, as the uncertificated shares will not be held in the CSD's own name but in the name of CCASS Participants (with respect to CPAs) and the investors (with respect to IPAs). Instead, HKSCC will provide corporate action services to CCASS Participants and Investor Participants as a service provider, to the extent that they choose to use its services. We believe that making such services available is consistent with international practice. In the UK, Euroclear UK & Ireland offers a corporate action processing service via the CREST platform.
13. So far as dividend payment or receipt is concerned, we do not currently anticipate that issues would arise. HKSCC envisages that in accordance with existing legal requirements, dividends will be paid by issuers directly to registered shareholders as is currently the case (i.e. under the USM regime, dividends will be paid directly to the bank accounts of the holders of CPAs and IPAs). HKSCC will act as the agent of the holders of CPAs and IPAs to collect participants' instructions regarding election (e.g. cash or scrip dividend, or which currencies to receive, etc.) through the CCASS system and then advise the issuers (via the share registrars) accordingly. It is envisaged that after an issuer declares a dividend, with the prior authorization of the holders of CPAs and IPAs who opt to use HKSCC's services, HKSCC will facilitate the payments to be credited to the bank accounts of the CPA and IPA account holders electronically. HKSCC does not itself receive any dividend payments into its own accounts. This seems more efficient and cost effective for investors and issuers than the current practice of effecting payment to direct shareholders through the issue of cheques.
14. It should be noted that during the market consultation on the USM model conducted in 2009, banks and brokers had expressed the view that the relevant services should continue to be provided by HKSCC after the USM model is implemented. The response from the Hong Kong Association of Banks is set out below for information:

"The current services provided by HKSCC Nominees Limited should continuously be made available to the market directly or through the registrars or equally adept administrator without compromising the quality of services and requiring additional or significant cost."
15. HKEx agrees with the comment as this would give the market more service providers to choose from.
16. Furthermore, the corporate action services described above are consistent with the arrangement explained in the proposed model outlined in the Consultation

Conclusions published in September 2010:

Paragraph 98 (b)

“Providing corporate action services – share registrars will continue to provide corporate action services to all registered holders, i.e. both certificated and uncertificated holders. For investors who hold uncertificated securities through a CPA, PSA or IPA, HKSCC will facilitate the provision of corporate action services via the CCASS infrastructure. In other words, HKSCC will collect instructions from securities holders and communicate them to issuers’ agents, collect subscription monies from securities holders and distribute entitlements to securities holders. Again, these are described in more detail in Appendix 4.”

A copy of Appendix 4 is attached to this paper for ease of reference.

17. In conclusion, it is submitted that the provision of corporate action services by HKSCC after the commencement of the USM regime as described above does not confuse the respective roles of the share registrars and HKSCC but gives investors and market participants alike more service providers to choose from. This is consistent with the original aim of the USM proposals and market feedback received thus far.

Fee Model under USM

18. As there are still a number of operational details and requirements that have to be determined under the current proposed model, HKSCC is still in the process of determining the fee proposal.
19. In the course of formulating the fee proposal, HKEx is mindful of the need to maintain the competitiveness of HKSCC’s services, and would cautiously assess factors such as the development and operating costs of the CCASS system needed to support the implementation of the USM initiative, as well as the potential implications on relevant stakeholders, including CCASS Participants, listed issuers and share registrars.

Hong Kong Exchanges and Clearing Limited

12 November 2014

Appendix 4

PROPOSED TABLE OF SERVICES AND PROCESSES IN RESPECT OF DISSEMINATING CORPORATE COMMUNICATIONS AND PROVIDING CORPORATE ACTION SERVICES TO SECURITIES HOLDERS UNDER THE PROPOSED SCRIPLESS MODEL

Item	Services and processes (to be finalised)
Disseminating corporate communications to securities holders e.g. corporate announcements, annual reports, annual accounts etc.	<ul style="list-style-type: none"> • Holders of uncertificated securities held in a CPA, PSA and IPA will receive corporate communications directly from share registrars as they are registered holders. • HKSCC will continue to extract essential information from corporate communications and provide receivable notices (on participant and account level), report and data files, etc. to CCASS Participants. • Brokers/banks/custodians which are CCASS Participants (and which hold securities in a CPA on behalf of clients) may continue to provide names and addresses of their clients (which are not registered holders) to HKSCC, which will pass these details to the relevant share registrar, which will then disseminate corporate communications to the client direct.
Collecting instructions from securities holders and passing them to share registrars in relation to corporate actions e.g. subscription of rights, acceptance of takeover offers etc.	<ul style="list-style-type: none"> • HKSCC will collect instructions from CPA and IPA holders (submitted via the CCASS platform), and then pass such instructions to the relevant share registrar. HKSCC will not consolidate the instructions (which it does currently) but will instead pass each individual instruction on to the relevant share registrar. • For PSA holders and investors who hold securities through a CPA, the relevant CCASS Participant will have to submit instructions to HKSCC.
Collecting subscription monies from securities holders	<ul style="list-style-type: none"> • In respect of each instruction (as mentioned above) which involves payment of subscription monies, HKSCC will generate an electronic payment instruction by debiting the subscription monies from the relevant CCASS Participant's designated bank account and crediting the same to the issuer's designated bank account. • For PSA holders and investors who hold securities through a CPA, payment of subscription monies will be made via the relevant CCASS Participant's designated bank account. Such investors will therefore need to ensure that subscription monies have been passed to the CCASS Participants in time.
Distributing cash entitlements to securities holders including dividend	<ul style="list-style-type: none"> • Issuers (or their agents) will send to HKSCC a file of the cash entitlement amounts for all accounts in CCASS. • HKSCC will verify the correctness of the file, and then generate an electronic payment instruction by debiting the cash entitlement amount from the issuer's designated bank account and crediting the same to the designated bank account of the CPA, PSA or IPA holder accordingly. • For investors who hold securities through a CPA, their cash entitlement will be credited to the relevant CCASS Participant's designated bank account.
Distributing non-cash entitlements to securities holders i.e. bonus issue	<ul style="list-style-type: none"> • The issuer (or its agent) will send to HKSCC a file of the non-cash entitlement quantities for all accounts in CCASS. • HKSCC will verify the correctness of the file, and then generate entries by crediting the allotted quantity to the relevant CPA, PSA or IPA accordingly. • For investors who hold securities through a CPA, their entitlement will be credited to the relevant CPA and registered in the name of the relevant CCASS Participant.