

立法會

Legislative Council

LC Paper No. CB(1)573/14-15

Ref : CB1/BC/9/13

Paper for the House Committee meeting on 27 February 2015

Report of the Bills Committee on Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014

Purpose

This paper reports on the deliberations of the Bills Committee on Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 ("the Bills Committee").

Background

The existing paper-based securities market regime and its limitations

2. Hong Kong's securities market is currently largely paper-based. The Companies Ordinance ("CO") (Cap. 622) requires the issue of paper certificates and the use of paper instruments of transfer in respect of shares and debentures. The Stamp Duty Ordinance ("SDO") (Cap. 117) requires the use of paper instruments of transfer in respect of units in a unit trust scheme. 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 operated by Hong Kong Securities Clearing Company Limited ("HKSCC")¹, a subsidiary company of Hong Kong Exchanges and Clearing Limited ("HKEx").

¹ 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.

3. The existing immobilized securities system has its shortcomings. Firstly, it is not completely electronic. Some transactions still require the use of paper, for example the Initial Public Offerings process to some extent still requires the use of paper. Secondly, to facilitate settlement of securities transactions, the paper securities deposited into the CCASS depository are 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. 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 will instead be exercised by submitting instructions indirectly via their broker/bank/custodian and HKSCC Nominees Limited.

Public consultation on proposals for an uncertificated securities market regime

4. In early 2009, a working group comprising representatives from the Securities and Futures Commission ("SFC"), HKEx, and the Federation of Share Registrars Limited ("FSR") (referred to Working Group hereafter) was established to study the proposals for implementing an uncertificated securities market ("USM") in Hong Kong, i.e. a regime allowing legal ownership in securities be held and transferred without paper documents (in uncertificated form). The Working Group issued a joint consultation paper in December 2009 to consult the market on the proposed operational model, and issued the consultation conclusions in September 2010. In view of the general positive feedback from the market, the Working Group recommended the Administration to make legislative amendments to enable the implementation of a USM regime in Hong Kong based on the operational model outlined in the consultation conclusions published in 2010.

Companies (Amendment) Ordinance 2010

5. Separately, to take forward the USM initiative, amendments were introduced under Part 7 of the Companies (Amendment) Ordinance 2010 (Ordinance No. 12 of 2010) to remove, or provide exceptions to, the limitations arising from the provisions in CO that compel the use of paper documents of title and paper instruments of transfer in relation to shares and debentures. These amendments are subsequently incorporated (as appropriate) into Schedule 8 to CO. The Government had made clear then that these amendments to CO would only come into operation when the market is ready to implement a USM

model and that further and more detailed requirements would still need to be worked out.²

The Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014

6. The Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 ("the Bill") was published in the Gazette on 13 June 2014 and received its First Reading at the Legislative Council ("LegCo") meeting of 25 June 2014.

7. The Bill seeks to amend the Securities and Futures Ordinance (Cap. 571) ("SFO"), CO and a few other ordinances including SDO to facilitate the establishment and implementation of the USM regime under which legal ownership in prescribed securities that are listed (or to be listed) on a recognized stock market can be held and transferred without paper instruments. The broad framework for the USM regime is set out in SFO and CO with details relating to the operation and regulation of the regime provided in new subsidiary legislation to be made under SFO, which are subject to the negative vetting procedure of LegCo. The major provisions of the Bill are set out in the following paragraphs.

Clauses 3 to 11

8. Clauses 3 to 11 amend Part III of SFO to further regulate a recognized clearing house ("RCH") and its controller where the RCH is also the system operator of a USM system so that the USM system will be properly operated and maintained by such RCH and its controller.

Clause 12

9. Clause 12 adds a new Part IIIAA to SFO to provide for the regulation of the USM regime which contains three divisions as follows:

- (a) Division 1 (new sections 101AA, 101AAB and 101AAC of SFO) contains interpretation provisions for certain words and expressions used in that Part, including "prescribed securities" and "uncertificated securities market system".

² The relevant amendments to CO, i.e. section 908 and Schedule 8, will be repealed on the commencement of clauses 49 and 50 of the Bill upon enactment.

- (b) Division 2 (new sections 101AAD to 101AAF of SFO) provides for the general principles to be adopted for the USM regime. Under the new section 101AAD, title to prescribed securities may be evidenced and transferred without an instrument. The purpose of section 101AAF is to apply the USM regime to securities of a non-Hong Kong company (i.e. a company incorporated in a place outside Hong Kong) listed on the Stock Exchange of Hong Kong ("SEHK") to the extent that the application is neither prohibited under nor in conflict or inconsistent with the relevant laws of the jurisdiction in which the company concerned is incorporated.
- (c) Division 3 (new sections 101AAG to 101AAO of SFO) provides for matters relating to the approval of an RCH to operate and maintain a USM system. The provisions therein also empower SFC to make rules relating to the regulation of the USM environment (i.e. the Uncertificated Securities Market Rules ("USM Rules")). Matters including those relating to the operation of a USM system, the keeping of the register of members (certificated shares) and register of members (uncertificated shares), the procedures for registering any allotment, transmission or transfer of prescribed securities through the USM system, the authorization and regulation of share registrars of participating companies, etc.

Clause 19

10. Clause 19 adds a new Schedule 3A to SFO to list the classes or descriptions of securities which, if listed or to be listed on a recognized stock market, are to be "prescribed securities" for the purposes of the USM regime.

Clauses 20 to 48

11. Clauses 20 to 48:

- (a) amend provisions of CO to provide for the interpretation of certain words and expressions used in CO in relation to the USM regime, including "participating shares" and "participating company";
- (b) amend other provisions in CO to re-define what constitutes the register of members of a participating company (i.e. that it will consist of the members register (certificated shares) and the members register (uncertificated shares)) (new section 626B of CO);

- (c) govern registration of allotment of shares in a participating company in uncertificated form (new sections 143A and 143B of CO); and
- (d) exclude certain existing requirements under CO relating to issue of share certificates and the delivery of instruments of transfer on various situations from applying to participating companies (amendments to sections 144, 150, 151, 152, 153 and 158 of CO).

Clauses 52 to 58

12. Clauses 52 to 58 amend SDO to provide mainly for a new stamping method for the collection of ad valorem stamp duty for off-Exchange transfers involving shares in uncertificated form.

The Bills Committee

13. At the House Committee meeting on 27 June 2014, members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**. Under the chairmanship of Hon Christopher CHEUNG Wah-fung, the Bills Committee has held five meetings to discuss with the Administration and SFC on the Bill, including one meeting to meet with deputations for views and another meeting with representatives of HKEx. The Bills Committee has also received ten written submissions from deputations. The list of deputations which have provided views to the Bills Committee is in **Appendix II**.

Deliberations of the Bills Committee

14. The Bills Committee supports the Bill in principle. The deliberations of the Bills Committee are summarized in the ensuing paragraphs.

Benefits of an uncertificated securities market regime

15. The Bills Committee welcomes the implementation of a USM regime in Hong Kong and notes the general support from deputations for the proposal. Members of the Bills Committee recognize the main benefits of a USM regime for Hong Kong. Firstly, the regime will modernize the financial infrastructure of Hong Kong and enhance overall efficiency of the securities market, as it can further reduce the use of paper, enable straight-through processing and enhance efficiency and the turnaround time for transactions. Secondly, the regime will facilitate direct ownership of securities since investors are given the option to

hold their securities in uncertificated form and in their own name (i.e. legal title of securities in the names of investors), thus securing an improved level of investor choice and protection which is not available under the current immobilized securities system. Direct ownership will help enhance shareholder transparency and enable corporate communications and corporate action services to be carried out directly and more efficiently. Thirdly, by implementing the regime, Hong Kong will be on a par with other leading markets. Markets including Australia, Mainland China, Japan and the United Kingdom ("UK") have already implemented a USM. In addition, the European Parliament has passed a legislative resolution which mandates that transferable securities issued after 1 January 2023 shall be in dematerialized (i.e. paperless) form and all transferable securities shall be in dematerialized form from 1 January 2025. The Bills Committee acknowledges that the benefits mentioned above would reinforce Hong Kong's competitiveness and position as an international financial centre, as well as provide greater opportunities for future linkages with other USMs.

Implementation of the uncertificated securities market model

Timetable for a fully uncertificated securities market regime in Hong Kong

16. The Bills Committee notes that the proposed USM regime will only apply to securities that are listed, or to be listed, on a recognized stock market³. It will not apply to unlisted securities (such as shares or debentures of private companies). A new term "prescribed securities" will be introduced in SFO to refer to securities covered by the USM regime. They will be specified by class or description in a new Schedule 3A to SFO. The USM regime will be implemented in phases, and initially will only cover shares of companies that are listed or to be listed on a recognized stock market. Other securities (e.g. debentures and unit trusts) that are listed or to be listed on such a stock market will be covered at a later stage. Therefore, under the Bill the new Schedule 3A will only specify shares at the outset. SFC will be empowered to amend Schedule 3A, after consultation with the Financial Secretary, by means of subsidiary legislation subject to negative vetting by LegCo. The USM regime will apply to shares of Hong Kong companies, and non-Hong Kong companies as and when the necessary approvals or laws of their home jurisdictions are in place. Moreover, there will be a transitional period during which a dual system will operate, i.e. during which the existing paper-based system will continue to operate in parallel with the proposed USM system. Investors will be able to choose whether to hold their securities with paper certificates issued or alternatively in uncertificated form. They will also be able to convert their holdings from one form to the other at any time. As such, the Bill will amend provisions in CO that currently (either expressly or implicitly) require the issue

³ "Recognized stock market" is defined under SFO as a stock market operated by a company recognized as an exchange company under section 19(2) of SFO.

of paper share certificates and the use of paper instruments to effect the transfer of shares. The amendments will simply remove the obligation to use paper documents, but not go on to prohibit such use.

17. The Bills Committee considers that the Administration should set a concrete timetable for implementing a fully USM in Hong Kong covering all listed securities not just shares, so as to provide clarity and certainty to market participants and investors and facilitate their early preparation. This will also avoid market confusion arising from operation of a dual system and facilitate early linkage in securities trading with other USMs. Members of the Bills Committee note that some deputations are of the view that the USM regime should be made mandatory at the outset. Some members have further urged for a concrete timetable for expanding the proposed regime to cover non-Hong Kong companies as these companies account for the majority of listed companies on SEHK.

18. The Administration has pointed out that given that the USM regime is a new initiative, it should be taken forward in a progressive manner. The Administration stresses that the dual system is an interim measure to facilitate the gradual implementation of the USM in Hong Kong, and assures members that the aim is to fully implement a USM regime as soon as practicable and shorten the transitional period, taking into account experience in system operation, market readiness, investors' adaption, and the need for a phased and orderly arrangement for Hong Kong listed companies to participate in the regime. The proposal to proceed with shares of Hong Kong incorporated companies first is because the Administration is in better control of the timetable for the legislative amendments required to give effect to the USM initiative. The timeframe for covering non-Hong Kong incorporated companies will depend on when the necessary approvals or law amendments of jurisdictions concerned will be given or put in place. In this regard, the Bills Committee notes that the Administration has initiated discussions with the Mainland and the UK, and conducted legal analysis to identify the extent to which the laws of Cayman Islands and Bermuda would enable the implementation of the USM regime, as companies incorporated in these four jurisdictions have made up the vast majority of non-Hong Kong companies listed on SEHK. The purpose is to cover companies from as many jurisdictions as possible under the USM regime when it starts to operate. Moreover, SFC will launch educational programmes to familiarize market participants with the USM regime, and HKEx and FSR will consider means to encourage market participants to use the model.

19. As regards coverage of prescribed securities under the USM regime, members of the Bills Committee have enquired about the reasons for excluding listed debentures and units in unit trust schemes in the initial stage, and the plan for extending the regime to cover these securities. The Administration and

SFC have explained that unlike shares, unit trusts are seldom held by investors in their own name outside CCASS. Moreover, shares raise the most concerns in terms of corporate governance and investor protection as compared to other securities like investors' interests associated with shares in terms of shareholders' rights (e.g. voting rights). In view of the complexity and expected larger volume of legislative amendments that are required for dealing with all listed securities at one time, it is considered appropriate to focus the present legislative exercise on shares first so as to avoid delaying the schedule of introducing the USM regime.

Timetable for implementing the uncertificated securities market regime in Hong Kong

20. The Bills Committee notes the concern of some deputations about the long preparatory time for implementing the USM regime, and sought details on the preparatory work and the timeframe for launching the USM regime.

21. The Administration and SFC have responded that preparation for the USM regime includes conducting market consultation on and making of the relevant subsidiary legislation (i.e. the USM Rules), finalization of operational model and technical specifications of information technology ("IT") infrastructure, and system enhancement and testing. Regarding the USM Rules setting out the operation and technical details of the USM regime, SFC plans to conduct market consultation in the second half of 2015. Depending on the outcome of consultation and the time required to fine-tune the proposals, the subsidiary legislation will be tabled at LegCo as soon as possible. In parallel, the Working Group would continue to discuss the operational details and take forward system enhancement (requiring about 18 months) and testing. Subject to system and market readiness, the USM regime is expected to be implemented in mid 2017 at the earliest.

Approval of an uncertificated securities market system operator

22. The proposed new sections 101AAG, 101AAH, 101AAI, 101AAJ, 101AAK, 101AAL, and 101AAN of SFO (clause 12) provide SFC with the power to approve an RCH⁴ and to operate and maintain a USM system and to withdraw such approval; the power to impose, amend or revoke conditions in granting approval to an RCH; and the power to direct an RCH to cease operating the USM system. The proposed provisions also lay down the procedures for SFC's giving of the relevant notices, and appeals against SFC's decisions to withdraw the approval or give a direction to cease operating the USM system. The proposed new sections 38(1A) and 63(1A) of SFO (clauses

⁴ An RCH is a company recognized as a clearing house under section 37(1) of SFO.

3 and 7) impose duties on an RCH which is also a USM system operator and the controller of the system operator for proper operation and maintenance of the USM system. The amended section 40 of SFO (clause 4) further empowers the USM system operator to make rules for the proper regulation and efficient operation of a USM system that it operates. Such rules are subject to SFC's approval.

23. Members of the Bills Committee have enquired about the reasons for:

- (a) not providing appeal to an RCH against SFC's refusal for granting approval to the RCH for operating a USM system;
- (b) not providing a USM system operator with an opportunity to be heard before SFC imposes or amends the conditions of approval; and
- (c) not imposing sanctions for operating a USM system without SFC's approval or providing penalties on a USM system operator and the controller of the system operator for failure to discharge their duties in relation to the operation of the USM system.

24. SFC has explained that the provisions on the approval of and conditions on a USM system operator are modelled on section 37 of SFO which provides for the recognition of a company as an RCH. While the Bill does not provide for appeal where SFC has refused to approve an RCH as a system operator, the affected party would nevertheless be entitled to seek redress through judicial review. This approach is sufficient and appropriate given that the approval process is already a detailed and thorough process, incorporating a number of procedural safeguards to protect the applicant-RCH. In particular, the proposed section 101AAG(5) provides an RCH with an opportunity to be heard before SFC makes a decision not to grant the approval, which will ensure that the RCH is informed of SFC's concerns and given an opportunity to address these concerns as best it can. The proposed section 101AAG(6) requires SFC to give the RCH written notice of its decision and reasons for not approving an RCH as a system operator. The requirement to give reasons ensures that the RCH is in a position to assess whether it is entitled to seek further redress through judicial review.

25. In respect of imposition of or amendment to SFC's conditions on approval, SFC has explained that although section 101AAH does not provide an opportunity for a USM system operator to be heard before SFC imposes or amends the conditions of approval, SFC would in practice give the operator such opportunity. Such an approach has the benefit of enabling SFC to ensure that the system operator will be able to meet and comply with the proposed conditions on an ongoing basis, and that any limitations or concerns are

properly addressed. That said, it is also important to ensure that the legislation allows for sufficient flexibility so that SFC is able to take prompt action in appropriate cases where conditions need to be imposed without delay. This is particularly important given that the USM system will be a key part of the financial market infrastructure. This approach is in line with other comparable provisions under Part III of SFO.

26. As regards sanctions for operating a USM system without SFC's approval, SFC has advised that the objective of SFC's approval under the new section 101AAG is to limit what systems may be used to effect a legal transfer of prescribed securities without using paper instruments. The legislation seeks to only confer benefits on an approved USM System (i.e. in the form of enabling such a system to be used to effect paperless transfers that are recognized at law as being legal transfers), but not prohibit the use of such systems without approval. As for the failure of an RCH and its controller in discharging their duties in relation to the operation of the USM system, notwithstanding that the Bill does not provide for any sanction, SFC has power to serve on a recognized exchange company ("REC"), RCH or a recognized exchange controller ("RXC") restriction notices under section 92 of SFO in the event of a failure by them to discharge their duties, and to make a suspension order under section 93 relating to the functions of the board or officers of an REC, RCH or RXC.

Withdrawal of approval of an uncertificated securities market system operator

27. Members of the Bills Committee have enquired about the main difference between withdrawing an approval for operating the USM system under the new section 101AAI of SFO and directing an RCH to cease operating the system under the new section 101AAK. They further note that while SFC's decisions on both matters above are subject to appeal (the new section 101AAN), only SFC's directions to cease operation of the USM operator will take immediate effect.

28. SFC has advised that the essential difference between a withdrawal under section 101AAI and a direction under section 101AAK is that a withdrawal will disable the RCH from acting as a system operator on a permanent basis and apply in respect of all services provided by the system operator. In contrast, a direction may disable the system operator to provide certain services only (e.g. in respect of a certain participating company or companies only), and/or for a limited time only. In the case of an RCH that has been directed to cease operating a USM system, the RCH would not need to apply to SFC to resume its operation of the USM system. It would be within SFC's power to specify in the direction how long the cessation is to stay in place.

29. Given that the exercise of the withdrawal power under section 101AAI of SFO has the effect of taking away the approval needed to operate a USM system and has a more permanent effect (in other words, the operator cannot operate its system again without going through the process of seeking approval once again), SFC considers it appropriate that the matter should be subject to appeal, and that the withdrawal should not take effect until the appeal is withdrawn, abandoned or determined. In contrast, the power to direct cessation under section 101AAK does not have the effect of taking away the approval to operate a USM system. Rather, it only limits what, or how, services or facilities may be provided. Moreover, such limitations may need to be implemented urgently. The power to direct cessation can also be used to facilitate an orderly winding down prior to withdrawal of an approval, i.e. SFC could use the powers under section 101AAI to limit or restrict the operations of a system operator before they are eventually wound down as the result of a withdrawal. Hence, it is not necessary to include a provision to provide for suspension of the cessation notice pending determination (or abandonment) of an appeal by the RCH.

The Uncertificated Securities Market Rules

30. The Bills Committee notes that the proposed new section 101AAO of SFO empowers SFC to make rules for the USM regime, i.e. the USM Rules, and has requested the Administration to provide details on the matters to be included in such rules.

31. The Administration has advised that the USM Rules will cover a wide range of technical and operational matters, including the followings:

- (a) the pre-requisites and processes for various matters, such as the conversion of shares in certificated form into uncertificated form, the entering of or amendments to details in the register of members (certificated shares) or register of members (uncertificated shares), including subsequent to an allotment, transfer or transmission; and the inspection and/or confirmation of entries in such registers;
- (b) the rights, obligations and liabilities of the system operator, issuers and share registrars, including in respect of various matters described in (a) above, and the keeping of the register of members (certificated shares) and the register of members (uncertificated shares);
- (c) the authorization and regulation of share registrars; and
- (d) penalties for breach.

32. The USM Rules are subsidiary legislation subject to the negative vetting procedure of LegCo. In view of the complexity of the Rules, the Bills Committee notes that deputations have stressed the needs to give adequate opportunity for the market to review and comment on the Rules before implementation, and to release the details as early as possible for conducting consultation with stakeholders. Some members of the Bills Committee are of the view that the Rules should be subject to the positive vetting procedure of LegCo in order to allow LegCo sufficient time to scrutinize them in detail.

33. The Administration has responded that section 398 of SFO requires SFC to publish a draft of any proposed rules and invite representations on them from the public. This requirement for public consultation will apply in respect of the USM Rules given that they will be made under SFO. The public consultation process will ensure that concerns from all relevant stakeholders are taken into account before the USM Rules are submitted to LegCo. On the preparation of the USM Rules, SFC has advised that public consultation on the proposals to be included under the Rules will be conducted in the second half of 2015. SFC assures members that ample time will be given for stakeholders to consider and comment on the draft Rules.

Investor protection issues

Trading/transfer of uncertificated securities under different account types

34. The Bills Committee is aware of some deputations' views that investors should be given a permanent option of holding certificated securities because investors may view securities in physical form more secure and as tangible proof of their holdings. Moreover, for protection of privacy, some investors may like to hold their uncertificated securities in the name of a nominee instead of in their own name in order to prevent disclosure of their names and other information (e.g. residential addresses) in the register of members of listed companies which is subject to public inspection under CO. In this regard, the Bills Committee has examined how share ownership is registered under the different account types for holding uncertificated securities under the USM regime, and how trading/transfer of uncertificated securities will be conducted.

35. The Administration and SFC recognize the investors' concerns in adapting to a USM environment and the need to consider measures to encourage the use of uncertificated securities including launching investor education programmes. Under the USM regime, an investor holding securities in the uncertificated form will have the choices to register the securities in his/her own name or to hold the securities in the name of a nominee. Investors will be able to hold uncertificated securities through four different account types as depicted

in the diagram in **Appendix III**. The operation of share ownership for trading/transfer will depend on the choice of individual investors as follows:

- (a) If an investor holds securities through a broker (i.e. CCASS Participant Account ("CPA")), the securities will be registered in the broker's name and operational arrangements will be more or less the same as now.
- (b) If an investor chooses to register shares in his/her own name, he/she can hold the shares in any of the following accounts -
 - (i) a segregated account with a broker (i.e. CCASS Participant Sponsored Account ("PSA"));
 - (ii) an account with the relevant share registrar (i.e. Issuer Sponsored Account ("ISA")) which is a new type of account under the USM regime; or
 - (iii) an account for investor participants with HKSCC (i.e. Investor Participant Account ("IPA")).

If securities are held via PSA, IPA or ISA, for trading purposes, the securities will need to be transferred from investors' account to an account held with their brokers (i.e. CPA). Investors will be able to hold or trade securities through different intermediaries or securities firms, as in the case of today. Moreover, under the USM environment, there will be arrangements and processes for enabling securities to be charged or mortgaged for margin financing and other purposes. The relevant details will be discussed in SFC's consultation on the USM Rules.

36. As for the concern about disclosure of shareholders' names and other information in relation to CO, the Administration has explained that under the USM regime, the register of members of a participating company will consist of two parts: one recording uncertificated securities (i.e. members register (uncertificated shares)); and the other recording certificated securities (i.e. members register (certificated shares)). The details to be entered in the two parts of the register of members will be set out in the USM Rules, and will include those matters currently required to be entered in a register of members under section 627 of CO, i.e. the name and address of a shareholder as well as the number of shares held. The Rules will also provide details on how the two parts of the register of members are to be kept and maintained, ensuring the accuracy of the two parts of the register, and the extent to which matters entered in them may be available for inspection.

Roles of HKSCC and share registrars with regard to corporate action services

37. Some members of the Bills Committee and some deputations, including FSR, have expressed concerns about the roles of HKSCC and the share registrars under the USM regime. Members have urged the Administration and SFC to ensure no overlap in the roles between the two parties thus minimizing the costs/fees of the USM system, a clear division of work between them with regard to corporate action services under the regime and availability of options for investors to choose the providers of services, so as to enhance protection of investors' interest.

38. On the respective roles of HKSCC and the share registrars, SFC has advised that HKSCC will be the system operator of the USM regime while the share registrars will continue to play the role of agents of issuers. As for the keeping and maintenance of the members register of a company, HKSCC will be responsible for the members register (uncertificated shares), and the share registrars will be responsible for the members register (certificated shares). In addition, the share registrars will also be responsible for keeping a complete record of all members of a company, which will be used for operational and inspection purposes.

39. As far as provision of corporate action services is concerned, HKSCC's main role in general will be to provide the USM system as a platform for facilitating the communication of information and instructions to and from share registrars and registered shareholders. This service can be used by investors who hold their shares in uncertificated form and in an account administered by HKSCC (i.e. CPA or IPA) or a broker participant (i.e. PSA). A share registrar's main role will be to act as an issuer's agent in sending and receiving communications and instructions to and from registered shareholders, including for the purposes of corporate actions. For those registered shareholders who hold their shares in uncertificated form in an account administered by a share registrar (i.e. ISA), the relevant share registrar will provide a means for the electronic communication of information and instructions with them. The details of the processes and the fees relating to the roles of HKSCC and the share registrars will be considered in the development of the relevant USM Rules. SFC assures the Bills Committee that it will continue to work with HKSCC and FSR towards ensuring that the interests of different investor groups are safeguarded and that competition is not impeded unnecessarily.

40. In this regard, the Bills Committee notes HKEx's response that during the market consultation in 2009, banks and brokers expressed the view that HKSCC should continue to provide corporate action services after implementation of the USM regime. HKEx has explained that under the existing regime, HKSCC provides services to CCASS Participants (i.e. CPA) and Investor Participants (i.e. IPA) as indirect shareholders. Such services

include extracting the key information of corporate actions proposed by issuers from announcements and circulars, and collecting instructions or elections from their clients for onward transmission to various share registrars. This does not conflict with the share registrars' role. Under the USM model, HKSCC intends to carry on providing similar corporate action services to CCASS Participants and Investors 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.

41. With regard to HKSCC's role, HKEx has pointed out that 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 name of HKSCC Nominees Limited but in the name of CCASS Participants (with respect to CPA) and the investors (with respect to IPA, ISA and PSA). Instead, HKSCC proposes to provide corporate action services to CCASS Participants and Investors Participants as a service provider, to the extent that they choose to use its services. After an issuer declared a dividend, HKSCC could facilitate the payments to be credited to their bank accounts electronically. Alternatively, investors may choose to open an ISA with the share registrar, in which investors' names will appear as registered shareholders, and they will interact with the share registrars directly. HKEx has also pointed out that HKSCC's role as the USM system operator is in line with the international practice that central securities depositories act as the system operator of the uncertificated register of the register of members, and the division of labour between HKSCC and share registrars in relation to provision of corporate action services is clear and there is no confusion of roles.

Fees and charges under the uncertificated securities market regime

42. The Bills Committee notes that whilst the market and investors welcome implementation of the USM regime on benefits of enhanced operational efficiency, there are concerns about costs on investors as those opt to hold their securities in paper form under the current paper-based system are able to collect dividends from issuers directly without paying fees, and on market intermediaries as they may need to develop new IT infrastructures and provide additional services to clients under the USM regime.

43. SFC has reiterated that under the USM regime, there will be different types of account for investors to choose for holding their securities having regard to their own needs and the fees and services associated with different account types. Whilst additional costs may be incurred by investors and market intermediaries under the USM regime in the initial stage, the costs would be lowered with benefits gained as a result of enhancement in market

efficiency and market competition in provision of services in the longer term. For instance, for share registrars, it is believed that the services provided and fees charged will be under a competitive environment. Besides, SFC has advised that an RCH is required to specify in its rules the fees to be imposed in its capacity as a USM operator. Notwithstanding that such rules are not subsidiary legislation, they are subject to SFC's approval as provided in the amended section 76 of SFO. SFC has stressed that in approving the fees under the USM regime, the guiding principles are that fees should be reasonable (for all parties concerned), commensurate with services provided, conducive to encouraging innovation and market development, and should not offset the longer term benefits of a USM environment. It is specifically provided in section 76 that in approving a fee, SFC shall have regard to, among other matters, the level of competition (if any) in Hong Kong for the matter for which the fee is to be imposed, and the level of fees imposed by similar bodies outside Hong Kong for the same or similar matter.

44. The Bills Committee notes HKEx's advice that HKSCC is still in the process of determining its fee proposal. HKEx has stressed that in the course of formulating the fee proposal, it 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.

A new stamping arrangement for the collection of ad valorem stamp duty

45. Under section 19(1) of SDO, any person who effects any sale or purchase of Hong Kong stock as principal or agent shall forthwith make and execute a contract note and cause the note to be stamped under the relevant head in the First Schedule to SDO. At present, ad valorem stamp duty (0.1% of the amount of the consideration or of value of the stock at the date on which the contract note falls to be executed) and \$5 fixed rate stamp duty are chargeable on the contract note and the instrument of transfer in respect of any sale or purchase of Hong Kong stock under head 2 of the First Schedule to SDO respectively. The ad valorem stamp duty is currently collected electronically through SEHK for transfers of shares effected through the trading system of SEHK pursuant to a collection agreement entered into between the Collector of Stamp Revenue ("the Collector") and SEHK under section 5A(1) of SDO.

46. Under the USM regime, participating shares (which are Hong Kong stock) may be transferred without an instrument of transfer, and therefore, the \$5 fixed duty will not be chargeable on such transfers. The chargeability of the ad valorem stamp duty will however not be affected, and the relevant stamp duty will continue to be collected electronically through SEHK for all

on-Exchange transfers in the same manner as it is currently collected. However, for off-Exchange transfers involving participating shares in uncertificated form, the new section 5AA of SDO (clause 54) will provide for a new stamping method for collection of ad valorem stamp duty.

47. On the need to make provisions for the new stamping method for collection of ad valorem stamp duty, the Administration has explained that the proposal is a tax-neutral measure to allow electronic payment of ad valorem stamp duty for off-Exchange transfers in the USM environment. In the absence of such an arrangement, it would be necessary to create a paper document for physical stamping at the Stamp Office. This would be a regressive step and inconsistent with the USM initiative.

48. As regards views from the industry that practical guidance for market participants in plain language, together with appropriate "frequently asked questions", should be put in place to facilitate compliance with the new stamping arrangement, the Bills Committee notes that the Inland Revenue Department ("IRD") will issue a Stamp Office Interpretation and Practice Note to elaborate on the proposed stamping arrangement for transfers of uncertificated securities and the related compliance issues, and upload the relevant information onto IRD's website.

Committee Stage amendments

Related amendments to the Electronic Transactions Ordinance

49. Noting that the Electronic Transactions Ordinance (Cap. 553) ("ETO"), which aims at providing legal certainty to matters done in electronic form rather than paper/physical form, may have impact on the operation of the USM system; the Bills Committee has invited the Administration to consider the need to make provision in the Bill to exclude the application of ETO (or any part of it) to the USM system.

50. The Administration has pointed out that provisions of the Bill do not conflict with the key provisions of ETO, and by virtue of sections 14 and 16 of ETO, the provisions of the Bill prevail if otherwise⁵. Nonetheless, after review, the Administration considers it necessary to make a Committee Stage amendment ("CSA") to amend paragraph 4 of Schedule 1 to ETO for the purpose of the new stamping arrangement under SDO. The effect of the CSA is to provide legal certainty that contract notes which are to be stamped under

⁵ Section 14 of ETO provides that the key provisions in the Ordinance should not override provisions in other legislation that also provide for how matters are to be done in electronic form, and section 16 provides that the key provisions in the Ordinance should not have effect if their operation affects the operation of other statutory requirements.

the new section 5AA(2) of SDO (i.e. pursuant to a new stamping arrangement approved by the Collector) can be made and executed in electronic form.

51. As regards sections 18 and 19 of ETO which relate to the attribution and time of sending or receipt of electronic records, the Bills Committee notes the Administration's advice that although no such provisions are included in the Bill, the matter is expected to be covered in the USM Rules, as appropriate. The Administration undertakes to further consider the matter in the preparation of the Rules.

Other Committee Stage amendments proposed by the Administration

52. In light of comments of the Legal Adviser to the Bills Committee and after reviewing the drafting of some provisions, the Administration will move other CSAs to the Bill to make technical amendments which are explained in the following paragraphs.

Commencement of the provisions in the Bill (clause 1)

53. Clause 1(2) provides that the Bill, if enacted, will come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette. The Administration will move CSAs to add new clause 1(2) and (3) to provide that certain provisions, including clause 17(7) will come into operation on the day on which the Bill is published in the Gazette as Ordinance (i.e. Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2014) ("Amendment Ordinance"). Clause 17(7) of the Bill adds a new section 14 to Part 1 of Schedule 1 to SFO which aims to provide flexibility in drafting subsidiary legislation. The CSAs will enable the new section 14 to come into effect upon enactment of the Bill as the Amendment Ordinance so as to make available the flexibility provided by the new section 14 early.

Proposed section 101AAO of SFO (clause 12)

54. The Administration will move a CSA to amend the proposed section 101AAO(2)(k). The effect is to extend the applicability of the section to brokers and custodians who, together with share registrars, fall under the definition of system participants in the Bill, so that SFC's rule-making power under that provision can be used comprehensively to provide for the rights, duties and liabilities of the system operator and all system participants.

55. The Notes proposed under sections 152 and 633 of CO (clauses 28 and 42) refer readers to the rules to be made by SFC under the new section 101AAO of SFO for certain powers of the Court. However, it is noted that the new section 101AAO does not specifically authorize SFC to make rules relating to

such powers of the Court. Hence, the Administration will move a CSA to add a new subsection (2A) to the proposed section 101AAO. The proposed new subsection (2A)(a) seeks to make explicit, and thus put beyond doubt, that rules made by SFC under the new section 101AAO may provide for the making of applications to the Court in relation to any of the activities or matters mentioned in subsection (1) or (2) of the new section 101AAO (e.g. allotment or transfer of prescribed securities, conversion of prescribed securities in certificated form into uncertificated form or vice versa) and for the Court's functions on receiving such applications. The proposed new subsection (2A)(b) seeks to make explicit that such SFC rules may cover matters that relate or are incidental to the matters described in section 101AAO(1), (2) or (2A)(a).

56. The Bills Committee has examined and supports the CSAs proposed by Administration in paragraphs 50 and 53 to 55 above. A full set of the CSAs to be moved by the Administration is in **Appendix IV**. The Bills Committee will not make any CSA to the Bill.

Resumption of Second Reading debate on the Bill

57. The Bills Committee supports resumption of the Second Reading debate on the Bill. The Administration has indicated that it will resume the Second Reading debate on the Bill at the LegCo meeting of 18 March 2015.

Consultation with the House Committee

58. Members are invited to note the deliberations of the Bills Committee above and the recommendation in paragraph 57.

Appendix I

Bills Committee on Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014

Membership list

Chairman Hon Christopher CHEUNG Wah-fung, SBS, JP

Members Hon CHAN Kam-lam, SBS, JP
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon Starry LEE Wai-king, JP
Hon Charles Peter MOK, JP
Hon Kenneth LEUNG
Hon Dennis KWOK (since 18 July 2014)
Hon SIN Chung-kai, SBS, JP

(Total : 10 members)

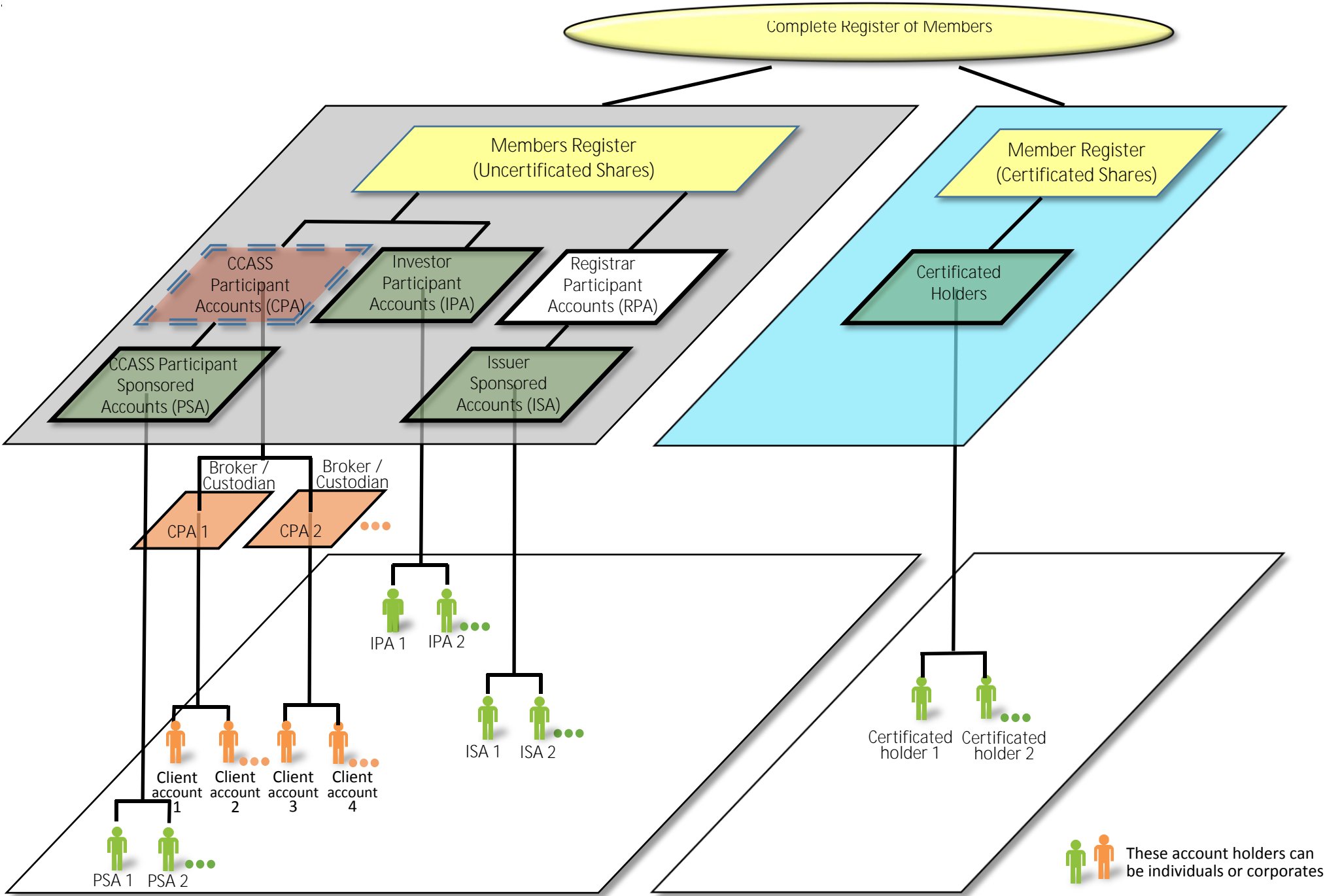
Clerk Ms Connie SZETO

Legal Adviser Mr YICK Wing-kin

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

**List of organizations from which the Bills Committee
has received views**

1. CLP Holdings Limited
2. Consumer Council
3. Federation of Share Registrars Limited
4. The Hong Kong Association of Banks
5. Hong Kong Bar Association
6. Hong Kong Exchanges and Clearing Limited
7. The Hong Kong Institute of Chartered Secretaries
8. Hong Kong Securities Association
9. The Law Society of Hong Kong
10. The Lion Rock Institute



(Source: Adapted from the Annex to the Administration's paper (CB(1)2035/13-14(10))

Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014

Committee Stage

Amendments to be moved by the Secretary for Financial Services and the Treasury

<u>Clause</u>	<u>Amendment Proposed</u>
1	<p>By deleting subclause (2) and substituting—</p> <p>“(2) Subject to subsection (3), this Ordinance comes into operation on the day on which it is published in the Gazette.</p> <p>(3) Section 2(2) and (3), Part 2 (except section 17(7)) and Parts 3 and 4 come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.”.</p>
12	<p>In the proposed section 101AAO(2)(k), by adding “and of persons who are system participants” after “(j)”.</p>
12	<p>In the proposed section 101AAO, by adding—</p> <p>“(2A) Without limiting subsection (1), rules made under that subsection may also—</p> <p>(a) provide for a court’s functions in relation to any of the activities or matters mentioned in subsection (1) or (2); and</p> <p>(b) provide for activities and matters that are related or incidental to any of the activities, matters or functions mentioned in subsection (1) or (2) or paragraph (a).”.</p>
New	<p>In Part 4, by adding—</p> <p>“Division 4A—Amendment to Electronic Transactions Ordinance (Cap. 553)</p>

60A. Schedule 1 amended (matters excluded from application of sections 5, 5A, 6, 7, 8 and 17 of this Ordinance under section 3 of this Ordinance)

Schedule 1, section 4—

Repeal

“other than a contract note to which an agreement under section 5A of that Ordinance relates.”

Substitute

“, other than—

- (a) a contract note to which an agreement under section 5A of that Ordinance relates; and
- (b) a contract note that is to be stamped under section 5AA(2) of that Ordinance.”.”.