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**Panel on Financial Affairs**

**Meeting on 19 March 2019**

**Background brief on development of an  
uncertificated securities market regime in Hong Kong**

**Purpose**

This paper provides background information on development of an uncertificated securities market ("USM") regime in Hong Kong. It also summarizes the major views and concerns expressed by Members when related issues were discussed by the Bills Committee on Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 ("the Bills Committee") and the Panel on Financial Affairs ("FA Panel") since the 2013-2014 legislative session.

**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"), a subsidiary company of Hong Kong Exchanges and Clearing Limited ("HKEX").

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<sup>1</sup> The Companies Ordinance (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 (Cap. 117) requires the use of paper instruments of transfer in respect of units in a unit trust scheme.

<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, the Central Clearing and Settlement System ("CCASS") serves as the central depository and securities settlement system.

3. The immobilized system has shortcomings. Firstly, it is not completely electronic. Some transactions still require 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, i.e. they are not registered holders and do not hold legal title of the securities.<sup>3</sup> Unlike registered holders, such investors do not generally receive corporate actions directly from issuers, nor can they respond directly to the issuers on these matters. For example, in exercising voting rights, such investors must submit instructions indirectly via their broker/bank/custodian and the CCASS nominee (i.e. HKSCC Nominees Limited ("HKSCC-NOMS")).

4. The Securities and Futures Commission ("SFC"), HKEX, and the Federation of Share Registrars Limited ("FSR") established a working group in early 2009 ("Working Group") to study proposals for implementing a USM regime in Hong Kong, i.e. a regime enabling investors to hold securities in their own name without paper documents (i.e. hold the legal title to the securities in uncertificated form). The Working Group released a joint consultation paper in December 2009 to consult the market on the proposed operational model for implementing the USM regime and issued the consultation conclusions in September 2010. In view of the positive feedback from the market, the Working Group recommended to the Administration that legislative amendments be made to enable the implementation of a USM regime in Hong Kong based on the operational model outlined in the consultation conclusions published in 2010 ("2010 Model").

### **Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2015**

5. The Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2015 ("the Amendment Ordinance 2015") enacted in March 2015 provides the legal framework for introducing a USM regime in Hong Kong based on the 2010 Model.<sup>4</sup> The Amendment Ordinance 2015 amends the Securities and Futures Ordinance (Cap. 571)

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<sup>3</sup> The paper securities deposited into the CCASS depository are registered in the name of HKSCC Nominees Limited ("HKSCC-NOMS"). So long as the securities stay in CCASS, legal title (i.e. the legal ownership) to them remains vested in HKSCC-NOMS.

<sup>4</sup> The Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Ordinance 2015 came into operation on 27 March 2015, except section 2(2) and (3), Part 2 (except section 17(7)), Part 3 and Part 4 which 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.

("SFO"), the Companies Ordinance ("CO") (Cap. 622) and a few other ordinances including the Stamp Duty Ordinance ("SDO") (Cap. 117) to facilitate establishment and implementation of the USM regime under which investors can hold securities that are listed (or to be listed) on a recognized stock market in their own name and transfer the securities without paper instruments. The broad framework of the USM regime is set out in SFO and CO with details on 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 the Legislative Council.

6. The main features of the USM regime as set out in the Amendment Ordinance 2015 are highlighted as follows:

- (a) Securities to be covered under the USM regime: The USM regime will cover listed shares of and shares to be listed by Hong Kong incorporated companies in the initial stage. Other securities (e.g. debentures and unit trusts) that are listed or to be listed on a stock market will be covered at a later stage.
- (b) Dual system for securities market: The USM regime will be implemented in phases, and there will be a transitional period during which a dual system will operate, i.e. the existing paper-based system will continue to operate in parallel with the 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. Only when the market is ready, and after further consultation, will the USM regime for listed shares be made compulsory.
- (c) Register of members of companies: Under the USM regime, the register of members of a listed company will consist of two parts: one recording uncertificated shares which will be kept and maintained by the system operator of the USM system (i.e. HKSCC) ("members register (uncertificated shares)"), and the other recording certificated shares which will be kept and maintained by the relevant share registrar as agent of the listed company ("members register (certificated shares)"). Investors holding shares in uncertificated form will have the option to register their shares in their own names or hold their uncertificated shares in the name of a nominee.
- (d) Regulatory oversight and rules: Regulatory and operational matters relating to the new USM environment will be overseen by

SFC which will be empowered to make relevant rules and prescribe penalties for breach.

## **Revised operational model for implementing an uncertificated securities market in Hong Kong**

7. In the course of developing the details of the 2010 Model, there were market concerns about the limitations of the Model, e.g. it would compromise certain settlement efficiencies currently enjoyed by market participants, and has a significant impact on their liquidity needs. In view of the market concerns, SFC, HKEX and FSR have revisited the 2010 Model and identified an alternative approach. A joint consultation paper on "A revised operational model for implementing an uncertificated securities market in Hong Kong" was published on 28 January 2019 for a three-month consultation to gauge views on the Revised Model. The main features of the Revised Model as proposed in the Consultation Paper are highlighted below –

- (a) Nominee structure retained: The existing nominee structure in CCASS will be retained (i.e. investors who hold securities through CCASS in the way they do today, will continue to hold only a beneficial interest as HKSCC-NOMS will remain the registered owner and hold legal title to such securities).
- (b) Options for holding paperless holdings: Investors will still have the option to hold securities in their own name and in uncertificated form. Two new account types, "USI account"<sup>5</sup> and "USS account"<sup>6</sup> will be introduced for this purpose.
- (c) No split register: The register of members or register of securities holders will be kept and maintained by the issuer's share registrar, instead of being kept in two parts, with one part maintained by HKSCC and the other by the issuer's share registrar as under the 2010 Model.

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<sup>5</sup> The acronym "USI" is intended to denote that the account and holdings in question belong to an uncertificated shareholder, and that the account is opened by an investor with the issuer's share registrar. The investor will be the legal owner of the securities (i.e. hold legal title to them) in a USI account and will be able to manage their holdings directly.

<sup>6</sup> The acronym "USS" is intended to denote that the account and holdings in question belong to an uncertificated shareholder, and that the account is opened by an institutional investor with a sponsoring clearing or custodian participant ("sponsoring CP"). Securities reflected in a USS account will be registered in the name of the institutional investor. The account will be administered by the relevant sponsoring CP, and the institutional investor will have to manage its holdings through such sponsoring CP.

- (d) Role change for HKSCC and share registrars: Following (c) above, share registrars' systems will be used for evidencing, and effecting transfers of, legal title to securities. HKSCC will no longer play the role of "system operator".
- (e) Interface between HKSCC's and share registrars' systems: The process of moving securities into and out of the clearing and settlement environment will be electronic rather than paper-based. An interface or connection will therefore be needed between HKSCC's systems and share registrars' systems.

8. The Consultation Paper in 2019 is hyperlinked in **Appendix I**. Diagrams illustrating the 2010 Model and the Revised Model are in **Appendices II** and **III** respectively. In view of the differences between the 2010 Model and the Revised Model, legislative amendments will be required. Legislative amendments are also required to facilitate full dematerialization in the securities market including encouraging electronic communications between issuers and registered securities holders.

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

9. The major views and concerns expressed by the Bills Committee and FA Panel on issues relating to development of the USM regime in Hong Kong are summarized in the ensuing paragraphs.

#### Timeframe for a fully uncertificated securities market

10. Noting that the initial stage of the USM regime would cover only the shares of Hong Kong incorporated listed companies, some Members questioned its cost-effectiveness. Members opined that given that companies incorporated in other jurisdictions accounted for the majority of listed companies in Hong Kong, there should also be a concrete timetable for expanding the USM regime to cover such companies so as to provide clarity and certainty to market participants and investors, and to facilitate them in making preparation early. Furthermore, a clear timetable for implementing a full USM regime would avoid market confusion arising from operation of a dual system.

11. The Administration and SFC advised that as the USM regime was a new initiative, it should be taken forward in a progressive manner. The dual system was an interim measure to facilitate the gradual implementation of USM in Hong Kong, and the ultimate aim was to achieve a fully uncertificated securities market as soon as practicable and shorten the transitional period. In implementing the USM regime, the Administration and SFC would take into account the operational experience of the dual system, market readiness,

investors' adaption, and the need for a phased and orderly arrangement for companies to participate in the regime. As regards the timeframe for covering the shares of non-Hong Kong incorporated listed companies under the USM regime, this would depend on when the necessary approvals or law amendments of the jurisdictions concerned would be given or put in place. The Administration and SFC had commenced discussions with the relevant authorities of other jurisdictions in parallel with the legislative exercise in Hong Kong.

12. In response to Members' enquiries about the reasons for excluding listed debentures and units in unit trust schemes from the initial stage of the USM regime and the plan for extending the regime to cover these securities, the Administration and SFC advised that unlike shares, unit trusts were seldom held by investors in their own name outside CCASS. Moreover, shares raised the most concerns in terms of corporate governance and investor protection issues (such as investors' interests associated with shareholders' rights like voting rights) as compared to other securities. In view of the complexity and expected larger volume of legislative amendments that were required for dealing with all listed securities at one time, it was considered appropriate to focus the legislative exercise on shares first so as to avoid delaying the schedule of introducing the USM regime.

#### Trading or transfer of uncertificated securities under different account types

13. Members noted that some investors might consider holding securities in paper form more secure and as a tangible proof of their holdings. Some investors might 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 was subject to public inspection under CO. There were enquiries about how share ownership was registered in respect of different types of accounts for holding uncertificated securities under the USM regime, and how trading or transfer of such securities were conducted.

14. The Administration and SFC advised that under the USM regime, investors holding securities in the uncertificated form would have the choices to register the securities in their own name or hold the securities in the name of a nominee. Investors would be able to hold uncertificated securities through four different account types. The operation of share ownership for trading or transfer would depend on the choice of individual investors as follows:

- (a) If an investor held securities through a broker (i.e. CCASS Participant Account ("CPA")), the securities would be registered in the broker's name and operational arrangements would be more or less the same as now.

- (b) If an investor chose to register shares in his/her own name, he/she could 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 was 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 were held via PSA, ISA or IPA, for trading purposes, the securities would need to be transferred from investors' account to an account held with their brokers (i.e. CPA). Investors would be able to hold or trade securities through different intermediaries or securities firms, as in the case of today.

15. As regards the concern about disclosure of shareholders' names and other information, the Administration explained that under the USM regime, the register of members of a listed company would 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 would be set out in the Uncertificated Securities Market Rules ("USM Rules"), and would 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 USM Rules would also provide details on how the two parts of the register of members were to be kept and maintained including the extent to which matters entered in the register might be available for inspection.

#### Cost impact on investors and market participants

16. Some Members expressed concerns about the cost impact on investors because if investors opted to hold securities in paper form under the paper-based system, they were able to collect dividends from issuers directly without paying fees. There was also a cost impact on market participants because they had to invest in new system infrastructures and provide additional services to clients under the USM regime.

17. SFC advised that under the USM regime, there would 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 types of

account. Whilst additional costs might be incurred by investors and market participants 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. The fees of HKSCC (in its capacity as a USM operator) would be subject to SFC's approval. In approving the fees under the USM regime, the guiding principles were 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. As regards the fees to be charged by share registrars, banks and securities firms, they would be subject to market forces.

### **Latest development**

18. The Administration will brief the FA Panel on the latest developments in implementing the USM regime in Hong Kong at the meeting on 19 March 2019.

### **Relevant papers**

19. A list of relevant papers is in **Appendix I**.

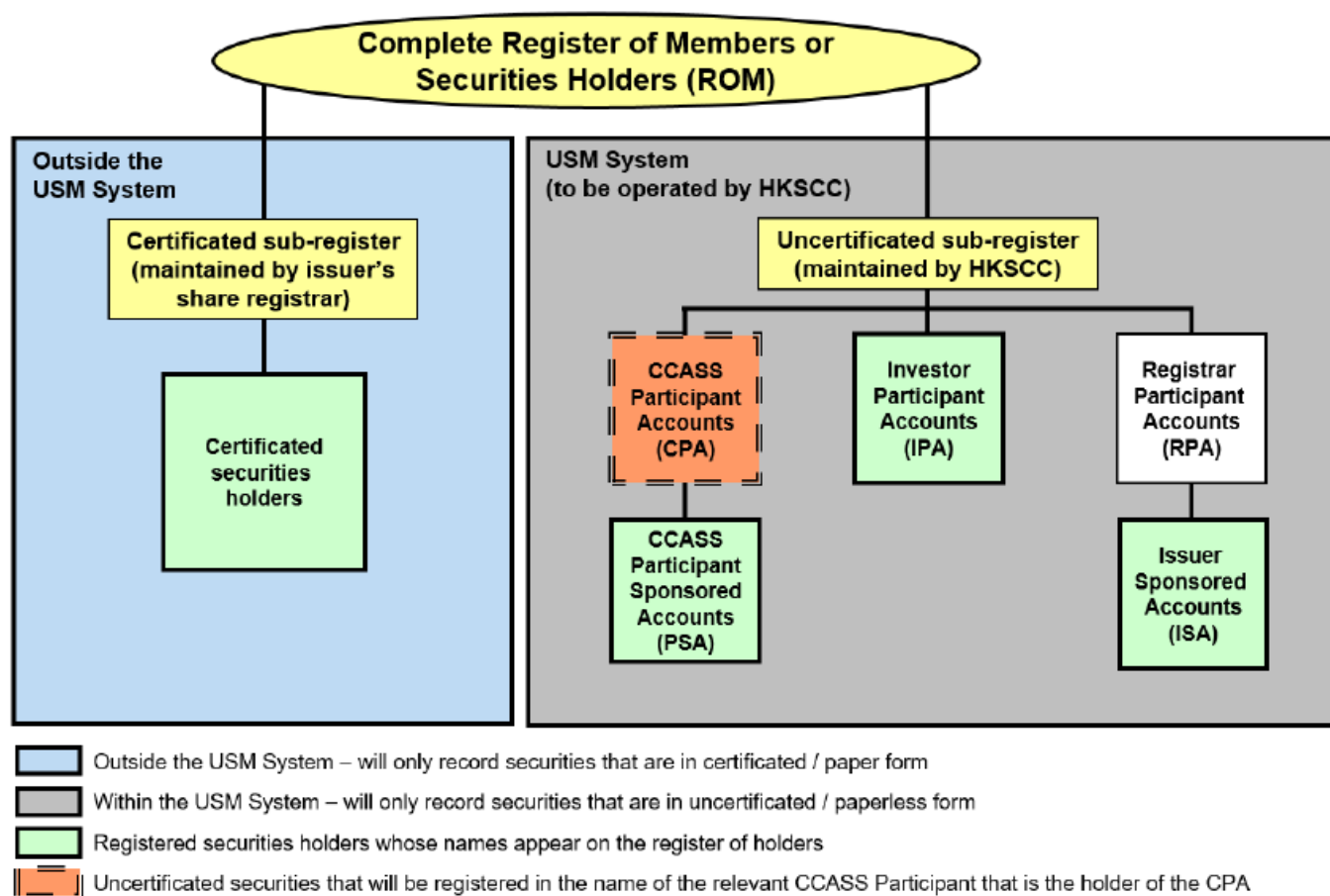
Council Business Division 1  
Legislative Council Secretariat  
15 March 2019



## List of relevant papers

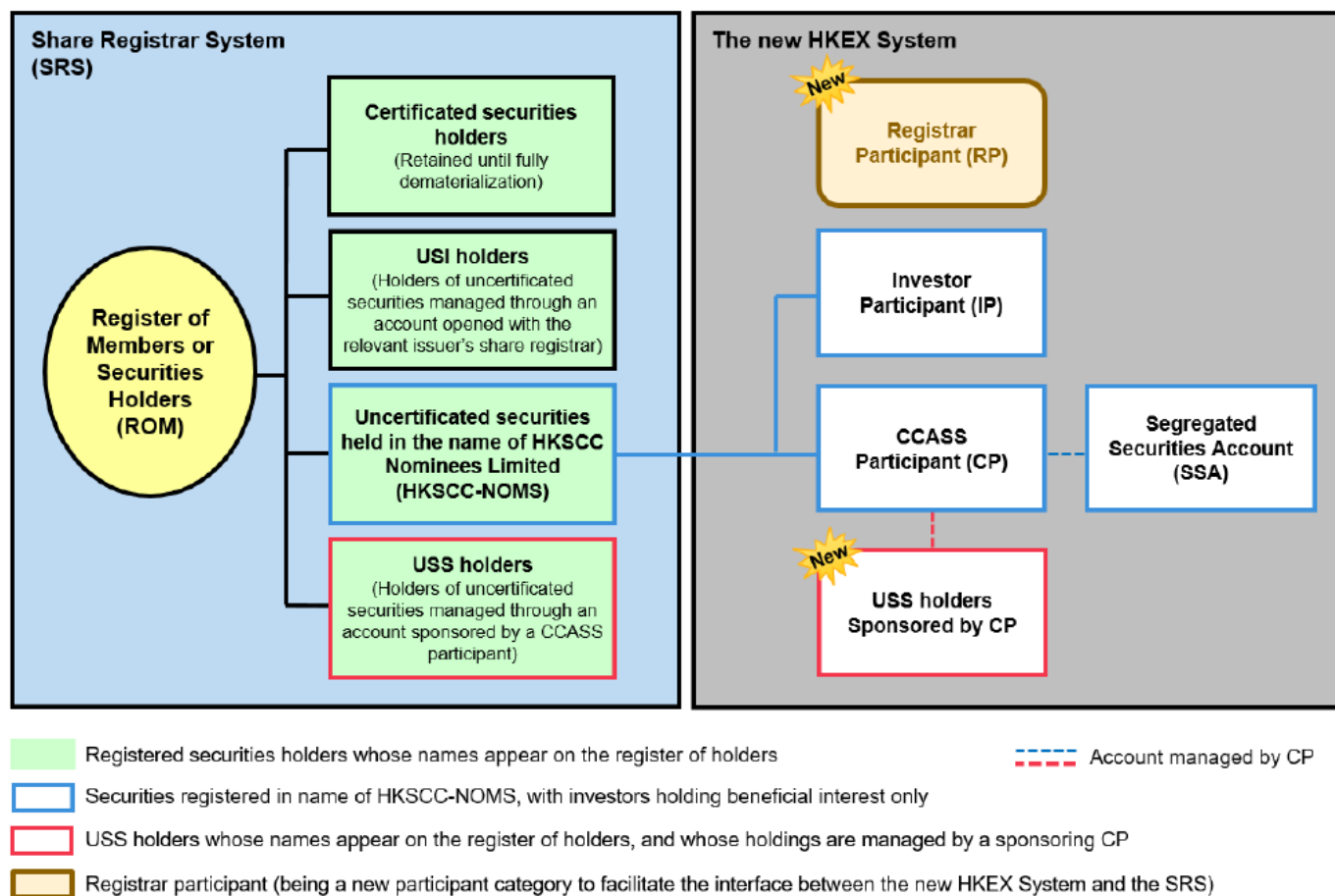
Date	Event	Paper/Minutes of meeting
30 December 2009 and 21 September 2010	Joint consultation paper and consultation conclusions on a proposed operational model for implementing a scripless securities market in Hong Kong	<a href="#">Consultation paper</a> <a href="#">Consultation conclusions</a>
1 February 2010	Meeting of the Panel on Financial Affairs ("FA Panel")	<a href="#">Administration's paper</a> (LC Paper No. CB(1)978/09-10(05))  <a href="#">Minutes</a> (LC Paper No. CB(1)1493/09-10)
1 November 2010	Meeting of FA Panel	<a href="#">Administration's paper</a> (LC Paper No. CB(1)217/10-11(05))  <a href="#">Background brief</a> (LC Paper No. CB(1)215/10-11)  <a href="#">Minutes</a> (LC Paper No. CB(1)906/10-11)
April 2013	Special meeting of Finance Committee for examination of Estimates of Expenditure 2013-2014	<a href="#">Written question raised by Hon Christopher CHEUNG</a> (Reply serial number: FSTB(FS)035)
6 January 2014	Meeting of FA Panel	<a href="#">Administration's paper</a> (LC Paper No. CB(1)625/13-14(06))  <a href="#">Background brief</a> (LC Paper No. CB(1)625/13-14(07))  <a href="#">Minutes</a> (LC Paper No. CB(1)1310/13-14)

<b>Date</b>	<b>Event</b>	<b>Paper/Minutes of meeting</b>
18 March 2015	The Legislative Council passed the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014	<a href="#">Hansard</a> <a href="#">The Bill passed</a> <a href="#">Report of the Bills Committee (LC Paper No. CB(1)629/14-15)</a>
28 January 2019	Joint consultation paper on a revised operational model for implementing an uncertificated securities in Hong Kong	<a href="#">Consultation paper</a>

2010 Model

*(Source: Adapted from para. 35 of the joint consultation paper on a revised operational model for implementing an uncertificated securities market in Hong Kong.)*

**Revised operational model**



*(Source: Adapted from para. 37 of the joint consultation paper on a revised operational model for implementing an uncertificated securities market in Hong Kong.)*