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28 April 2021

Legal Service Division
Legislative Council Secretariat
1 Legislative Council Road
Central, Hong Kong
(Attn: Miss Evelyn Lee)

Dear Miss Lee,

**Securities and Futures and Companies Legislation
(Amendment) Bill 2021**

Thank you for your letter on the above dated 9 April 2021.

Further to the discussion at the first Bills Committee meeting on 12 April 2021 during which we provided preliminary verbal response to the questions raised in your letter, I write to provide written response of the Administration as set out in Annex to facilitate your further scrutiny of the above Bill.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'George Tsoi', written over a circular stamp or seal.

(George Tsoi)

for Secretary for Financial Services and the Treasury

c.c.

Clerk to Bills Committee
Securities and Futures Commission
Law Draftsman

(Attn: Ms Connie Szeto)
(Attn: Mr Rico Leung)
(Attn: Miss Emma Wong)

**The Administration's Response to
Legislative Council Assistant Legal Adviser's Letter of 9 April 2021**

(A) Subsidiary legislation relating to the Uncertificated Securities Market regime (Paragraph 2 of the letter)

As explained in paragraph 10 of the LegCo brief, we will adopt a phased approach to implement the Uncertificated Securities Market (“USM”) regime. Our plan is to start implementing the USM regime from around end-2022, starting first with shares of Hong Kong-incorporated companies, and then shares of non-Hong Kong incorporated companies. We will also focus first on newly-listed shares (i.e. IPO shares), followed by converting existing shares held within the clearing and settlement system to uncertificated form, before turning to existing shares held outside the clearing and settlement system.

2. The Securities and Futures Commission (“SFC”) plans to make at least two sets of subsidiary legislation pursuant to the newly-added Part IIIAA of the Securities and Futures Ordinance (“SFO”) to provide for, among others, (i) the detailed operational and procedural matters relating to the USM regime (i.e. the “USM Rules”); and (ii) the details relating to the regulation of approved securities registrars (“ASRs”) (i.e. the “ASR Rules”) respectively.

3. Examples of matters to be covered by the USM Rules include details relating to (a) the allotment, redemption and transfer of prescribed securities; (b) the conversion of prescribed securities from certificated form to uncertificated form; (c) timelines for progressing the market to full dematerialisation, etc. Examples of matters to be covered by the ASR Rules include (a) the criteria and process for the approval of ASRs; (b) on-going regulatory obligations to be met by ASRs such as the standards and practices expected to be met; (c) arrangements for ceasing to provide securities registrar services, etc.

4. The SFC aims to conduct a public consultation on the draft subsidiary legislation mentioned in paragraph 2 above by end-2021 before tabling them before LegCo for negative vetting.

(B) Processing of ASR applications (Paragraph 3 of the letter)

5. According to the proposed section 101AAG of the SFO, the SFC may, in considering an application for providing securities registrar services (“SRS”), have regard to any information in its possession. The proposed section 101AAH of the SFO further specifies that before making a decision not to grant an approval, the SFC must give the person “a reasonable opportunity of being heard”. Such arrangement is in line with the procedures for refusing other applications under the SFO, such as an application for authorisation to provide automated trading services under section 95(4) of the SFO. A decision not to grant an approval under section 101AAG may be appealed to the Securities and Futures Appeals Tribunal according to section 217 and the amended Schedule 8 to the SFO.

6. The requirement for “a reasonable opportunity of being heard” does not necessarily refer to a physical hearing. It refers to a process whereby the SFC informs the applicant in advance of the reasons of its intention not to grant an approval, and the applicant is able to respond why the application should not be refused. The process is similar to that applicable for other applications to the SFC under the SFO, and is usually conducted through written correspondence. That said, meetings can also be arranged where requested and/or necessary. Applicants can seek legal advice and invite their legal advisers to attend any meetings with the SFC.

7. If the SFC were minded not to grant an approval for a person to provide SRS, it would inform the applicant of the reasons of the refusal in writing. While the SFC may not be able to inform applicants of the source of all of the information to which it has made reference (e.g. because some information may be provided in confidence), the substance of the information which the SFC has made reference to in coming to its view

would be presented to the applicant in a sufficiently clear manner to enable the applicant to respond.

(C) Inspection of records relating to ASRs' businesses (Paragraph 4 of the letter)

8. According to the proposed amendments to section 180 of the SFO, a person duly authorised by the SFC may, at any reasonable time and for the purposes of ascertaining whether an ASR has complied with the SFO, (a) enter the premises at which information or data relating to the SRS is processed or stored to inspect and make copies of any record relating to the business conducted by the ASR; and (b) require any person whom he / she has reasonable cause to believe has information relating to such record to give him / her access to such record.

9. Given the nature and operational requirements of ASRs' businesses¹, ASRs should provide the SRS, and process and store information / data relating to such services, on business premises but not domestic / residential premises. Even if certain work is conducted by an employee on domestic / residential premises (say, due to work-from-home arrangements), the SFC expects that the processing and master storage of information / data relating to the provision of SRS (say, the server), will still continue at the ASR's business premises, and it is these premises that are the focus of section 180(1)(a)(iii)(B).

10. In practice, if the SFC intends to conduct an inspection of an ASR's premises under section 180 of the SFO, the SFC would liaise with the ASR on the timing and arrangements of the intended inspection, thus enabling the ASR to arrange for appropriate staff to provide assistance at the time. It is therefore not necessary for the SFC to apply for a magistrate's warrant under

¹ The provision of SRS entails conducting certain front office functions (e.g. running counter services to attend to applications, requests and enquiries from investors), and certain back office functions (e.g. keeping and maintaining registers of holders of prescribed securities, operating UNSRT systems to facilitate the holding and transfer of prescribed securities without paper, etc.).

section 191 of the SFO in order to conduct inspection pursuant to section 180 in each and every case. Notwithstanding that, in some cases, such as where there is a risk of the information or data being destroyed, the SFC may apply for a magistrate's warrant under section 191 of the SFO and execute a search operation to seize such information or data.

(D) Code and guideline for ASR (Paragraph 5 of the letter)

11. Under the proposed section 193(1)(da) and section 193(3) of the SFO, the SFC shall not form any opinion that any act or omission is or is likely to be prejudicial to the interest of the investing public or to the public interest unless it has had regard to the relevant code or guideline published under section 399 of the SFO.

12. The code or guideline will set out in more detail the standards and practices expected of ASRs and will cover conduct and operational matters (such as honesty, fairness, diligence, capabilities, internal controls and risk management, conflict of interests, compliance with applicable laws and regulations, etc.) and system-related matters (such as the security, reliability, availability, adequacy, etc. of the systems operated and used by ASRs). Breaches of these standards could, depending on their nature and extent, have varying degrees of impact on the investing public. For example, a one-off failure which is rectified quickly may only cause minor inconvenience or delay in processing an instruction from an investor. However, repeated failures of a similar kind or nature of matter may be indicative of a more serious deficiency in the ASR's internal controls or risk management practices and is more likely to have a greater adverse impact on investors.

(E) "Client" of ASRs (Paragraph 6 of the letter)

13. Clause 16 of the Bill seeks to amend section 202 of the SFO which imposes requirements to transfer "records" upon revocation or suspension of

licence or registration of relevant bodies. The purpose of the proposed amendments is to require that an ASR must, upon revocation of its approval for conducting SRS, return certain “records” to its “client”.

14. In the course of providing SRS to an issuer such as maintaining the issuer’s register of holders, an ASR will not only be holding the issuer’s register of holders, but will also be communicating with and receiving information and documents from third parties (e.g. investors who are prescribed holders of the issuer). In doing so, the ASR acts as an agent of the issuer. It follows that any “records”, such as the register of holders and other information or documents received or held by the ASR are received or held in its capacity as the agent of the issuer. Any return of such “records” would therefore be referred to the issuer rather than to any of the persons from whom the information or documents were received. The term “client” is therefore intended to describe the issuer.

15. Having considered the above, we have defined “client” by reference to paragraph (a) of the definition of SRS (*viz.* the maintenance in Hong Kong of a register of holders of the prescribed securities). Indeed, it is the most fundamental SRS. Any other SRS provided by an ASR will be associated with the fundamental service covered by part (a) of the definition of SRS, and hence provided to the same issuer. In view of this, the definition of “client” should refer to paragraph (a) of the definition of SRS only.

(F) Proxies and “genuine purposes” (Paragraph 7 of the letter)

16. As explained in paragraph 15(c) of the LegCo brief, the existing section 596 of the Companies Ordinance (“CO”) allows shareholders to appoint multiple proxies without a limit. This provision applies to both individual and non-individual (e.g. brokerage firms) shareholders.

17. There has been market feedback in recent years of cases that individual shareholders of listed companies have used this provision to appoint numerous proxies not for the purposes of participating in discussions on proposed resolutions or voting at shareholders’ meeting but for other

attractions, such as doorgifts. As a matter of policy, we have no intention to limit shareholders' ability to exercise their rights or enjoy their entitlements. That said, to strike a balance and to ensure the smooth and orderly proceeding of shareholders' meeting of listed companies, we propose amending section 596 of the CO so that it imposes a limit on the number of proxies that may be appointed by individual shareholders of listed companies. The number of proxies to be appointed by non-individual shareholders (e.g. brokerage firms) will not be affected.

Financial Services and the Treasury Bureau
28 April 2021