



**JOINT CONSULTATION ON A REVISED
OPERATIONAL MODEL FOR IMPLEMENTING
AN UNCERTIFICATED SECURITIES MARKET IN HONG KONG**

THE LAW SOCIETY'S SUPPLEMENTAL SUBMISSIONS

The Law Society of Hong Kong provided responses to a "*Joint Consultation Paper on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong*" ("Consultation Paper") on 7 May 2019 ("The First Submission").

The following is the Law Society's supplemental submissions in response to further enquiries from the Securities and Futures Commission ("SFC") of 28 May 2019 on The First Submission.

Unless otherwise defined, the abbreviations in this Supplemental Submission follow those adopted in the Consultation Paper.

SFC Question (1)

"We note that one group of your members views the Revised Model as being regressive. The responses to Q1 and Q2 [*in The First Submission*] suggest that their main concerns revolve around the challenges faced by "beneficial shareholders" (i.e. investors in listed company who hold shares through CCASS/HKEX System, and whose shares are therefore registered in the name of HKSCC Nominees Limited rather than in their own name) in terms of receiving corporate communications and attending and voting at listed company meetings. Specifically:

- the response to Q1 (at the end of page 1 [*of The First Submission*]) notes the group's view "... that the Revised Model's proposals is regressive, as the inability of listed company shareholders to enjoy the full benefits of legal title to their shares (in relation to voting and issuer communications in particular) is seen as a significant step back from the 2010 Model, with the consequent continuance of the complex and antiquated arrangements for voting and shareholder communications"; and
- the response to Q2 (at paragraph 2 on page 2 [*of The First Submission*]) notes

that although there will be a more stringent regime in respect of share registrars, this will not suffice to “*resolve the problem of enabling beneficial owners to exercise legal rights over their shares*”.

The SFC would like the Law Society to clarify if its understanding, as set out above, is correct. If yes, the SFC asked the Law Society to clarify whether this group would regard the Revised Model as being acceptable if solutions can be developed to address the aforesaid challenges faced by beneficial shareholders, and if not, why not.”

Law Society’s response:

The concerns of this group of members whose views the SFC refers to relate to the ability of shareholders holding uncertificated shares to attend and vote in their own names at shareholder meetings and also to exercise other rights such as the right to requisition a shareholders’ meeting, petition for a winding up of the listed company and to nominate a person for appointment as director.

Of particular concern are the statements in paragraph 10 of the Consultation Paper:

“10....we appreciate that there will be investors who (for various reasons) prefer to hold securities within the clearing and settlement environment, and hence in the name of HKSCC-NOMS. These investors will continue to hold only a beneficial interest in their securities. In the context of shares, this means they will, as today, continue to have to rely on HKSCC-NOMS, and any intermediating entities in between, to pass any benefits on to or exercise any rights for them. We are mindful that the process for this can, in some cases, be inconvenient and inefficient. A prime example is the process for exercising the right to vote and/or attend meetings of a listed company. The current processes for these are largely paper-based and cumbersome, and hence not conducive to participation in the voting process. It would be in the interest of investors, and consistent with the USM objective of removing paper documents and manual processes, to develop an electronic alternative that facilitates and encourages participation in the voting process, but without creating undue costs or burden for either investors or their intermediaries. Any such alternative would benefit investors under the current market infrastructure also, and should therefore be implemented separately from the USM initiative and as soon as possible.

11. The SFC is working with HKEX to explore options in this regard, and will seek further views from the market in due course. In the meantime, we welcome any suggestions market participants may have.”

As set out in paragraph 9 of the Consultation Paper, one of the key differences between the current proposals and those of the 2010 Model is that the Revised Model will not allow shareholders to hold uncertificated securities in their own

names within the Central Clearing and Settlement System (i.e. CCASS). Shareholders wanting to hold shares in their own names in an USI account (in order to be able to vote in their own names) will thus have to transfer their shares electronically into CCASS if they want to sell them on the Exchange.

The statement in paragraph 10 of the Consultation Paper accepts that there will be investors who prefer to hold securities within CCASS despite the fact that the processes for attending and voting at shareholders' meetings are inefficient and inconvenient. The relevant members, whose views are noted in our consultation response, are concerned that for this group of investors, the Revised Model does not represent an improvement on, and can be regarded as regressive in comparison to, the 2010 Model which would have allowed shareholders to hold securities in their own names within CCASS.

A major concern for these members is that CCASS will not accept instructions from shareholders to exercise certain rights, for example the right to requisition a shareholders' meeting, petition for the winding up of a company or to nominate a person for appointment as a director which are all fundamental shareholders' rights. It would seem then that if a shareholder wants, for example, to nominate a person as a director, he or she would have to open a USI account and arrange for the shares to be transferred from HKSCC-NOMs into the shareholder's USI account. The Revised Model requires shares to be transferred between USI accounts and HKSCC-NOMs in order for shareholders to exercise certain shareholders' rights and to sell shares on the HKEX. The members concerned consider this to be an unnecessary complication which would have been avoided under the 2010 Model. Those members feel that whether or not the Revised Model is workable will depend on the efficiency and cost of transfer. It is imperative that fees are kept to a minimum so that they do not disincentivise shareholders from opting to hold shares in their own names in USI accounts, so that those shareholders who opt to hold shares within CCASS are not deterred from transferring them back into their own names in order to exercise their rights as shareholders.

The Consultation Paper does not mention the likely level of fees for making electronic transfers between HKSCC-NOMS and USI accounts. The cost of electronic transfers should be nominal and thus the transfer fees charged must reflect this. This should perhaps be highlighted to the relevant parties (i.e. share registrars and HKSCC-NOMs) to ensure that they are aware that fees must be kept to a minimum.

SFC Question (2)

“The response to Q2 (at paragraph 1 on page 2 *[of The First Submission]*)

acknowledges the structural differences in the UK but goes on to note that “*this should not be allowed to delay the inevitable implementation of the full-scale changes necessary to provide a fully dematerialised market with legal title for securities holders*” (emphasis added). However, the Revised Model does in fact provide options for investors to hold legal title to their securities, i.e. via a USI or USS account, and it is unclear why these options are considered insufficient. Further clarification of your members’ concerns in this regard would therefore be appreciated.”

Law Society’s response:

The first point to note is that even with the provision of legal title through USI/USS accounts, the Revised Model will not provide a dematerialised market as was advocated in 2003 by the G30 and in the 2010 Model. The G30 recommended that immobilisation should be implemented where regulatory obstacles to full dematerialisation exist, and that it should be a stepping-stone to dematerialisation rather than an end in itself. With the statutory changes already implemented in preparation for the implementation of the 2010 Model, there is no regulatory impediment to dematerialisation, only the trading/settlement systems obstacle noted in the Consultation Paper. The members’ point was simply that if the 2010 Model could be made to work with a system upgrade, then this would be preferable to the Revised Model given that the 2010 Model allows legal title to be held within CCASS avoiding the time and expense that will be incurred in transferring shares between USI accounts and CCASS under the Revised Model.

The second point is that, as noted in response to Question 1 above, some investors will continue to hold through CCASS and will remain subject to problems in exercising their full rights as shareholders (e.g. to requisition a meeting) because they hold beneficial titles only to their shares. Those shareholders will suffer inconvenience in having to transfer their shares to a USI account in order to exercise rights which CCASS is not willing to exercise on their behalf.

Whether or not this model can operate satisfactorily will likely depend on the cost and efficiency of making transfers between USI accounts and HKSCC-NOMS. If transfers are fast and incur minimal fees, which should be achievable with electronic transfers, the model may be sufficient. Our members would like to see further discussions held with registrars to gain some assurance as to fee levels before the Revised Model is formally adopted.

**The Law Society of Hong Kong
17 July 2019**