



消費者委員會 CONSUMER COUNCIL

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來函檔號 YOUR REF.

本函檔號 OUR REF.

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20 December 2003

The Hong Kong Exchanges and Clearing Limited
7th Floor, Vicwood Plaza
199 Des Voeux Road
Central, Hong Kong
(Attn: The Scripless Project Team)

23 DEC 2003

Dear Sir/Madam,

**Consultation Paper on a Proposed Operational Model
for a Scripless Securities Market**

The Consumer Council would like to submit its views on the captioned consultation paper for the consideration of Hong Kong Exchanges and Clearing Limited. A copy of the Council's submission is attached with this letter.

Should you have any questions about the submission, please feel free to contact me on 2856 8585 or my colleague Vera Tam on 2856 8543.

Yours faithfully,

Mrs. CHAN WONG Shui
Chief Executive

Encl.

c.c. Financial Services Branch (Mr. Tony MILLER)
Securities and Futures Commission (Ms. Angelina KWAN)
Federation of Share Registrars

CONSUMER COUNCIL

RESPONSE TO HKEX CONSULTATION PAPER ON A PROPOSED OPERATIONAL MODEL FOR A SCRIPLESS SECURITIES MARKET

INTRODUCTION

1. In response to a consultation paper issued by Hong Kong Exchanges and Clearing Limited (HKEx) on a 'Proposed Operational Model for a Scripless Securities Market', the Consumer Council would like to provide its views on issues which relate to investor interests. In principle, the Council supports the concept of operating a scripless securities market in Hong Kong.
2. The Council previously responded to an earlier consultation paper issued by the Securities and Futures Commission (SFC) on this matter in May 2002 which raised general issues surrounding the concept of a scripless securities market. The current paper, issued by HKEx outlines specific working arrangements to be put in place to bring a scripless securities market into effect. It largely raises technical working procedures between intermediaries, shares registrars who maintain shares registers, the Hong Kong Securities Clearing Company Limited (HKSCC) and the Central Clearing and Settlement System (CCASS).
3. In the Council's initial response to the SFC, it raised a number of issues it felt were of direct concern to investors in order to gain investors' acceptance, that are also pertinent to the current paper issued by HKEx. The Council's responses to the current consultation paper are as follows.

COUNCIL RESPONSES

Some form of physical documentation be provided upon investor's request, and that the cost of obtaining documentation should not be prohibitive.

4. In its previous response to the SFC consultation paper, the primary concern expressed by the Council was that adopting a transitional approach is necessary to allow shifting from a physical share certificate system to a scripless system as this would provide market participants with time to adjust to the changes and lead to a more managed restructuring of the securities market.
5. Moreover, notwithstanding the proposal that a completely scripless system will eventually evolve, the Council reiterates its previous stance that some consideration should be given to retaining a facility whereby retail investors are still able, upon request, to obtain some form of physical documentation as to their holdings.
6. The Council notes that a transitional approach to dematerialisation is being adopted, and HKEx has set out in detail the working arrangements for

rematerializing' scrip, after dematerialization of scrip has taken place. This will only occur upon request from a shareholder to the HKSCC through CCASS participants; e.g. brokers, or to the share registrars for shares registered on the Issuer Register. In both cases, physical scrip will be issued by share registrars.

7. In view of the fact that a majority of share certificates are at present still paper-based and the cultural factor that many investors in Hong Kong would want to keep physical certificates, the Council reiterates its position that investors should be provided with choice to opt for some form of physical certificates and the level of fees to rematerialize uncertificated shares should not be prohibitive.

8. Furthermore, the Council considers that allowing sufficient time for investors and the market to gradually move to a scripless system is importance to its success. It therefore supports the HKEx's proposal of launching a pilot run to test the operation before a full implementation of a scripless securities market comes into place.

In view of the increasing trend for small retail investors to participate in the securities market, substantial efforts should be made to educate this class of investors to build confidence and trust.

9. Given the significant change in documentation, and the scope for confusion, the Council considers it extremely important that the workings of the scripless system should be as transparent as practicable. In addition it is of utmost importance that the views of shareholders, in particular small shareholders, will be taken into account when considering implementation details, given the confusion and possible distress that might arise in the public, should problems eventuate in the dematerialisation process.

10. The Council is willing to offer its assistance in regard to education and information dissemination activities to prepare market participants for the scripless securities market

Benefits of cost reduction in scripless trading be passed on to consumers

11. The earlier SFC consultation paper recommended that for scripless transfers within CCASS and on the Issuer Registers, there should be no registration fee payable by shareholders to the registers. This proposal is in line with overseas practice, i.e. scripless transfers would be covered within the service contracts between listed companies and share registrars and subject to competitive forces.

12. The HKEx paper notes that further discussion among HKEx, share registrars, issuers, market intermediaries and the SFC will be required on the allocation of costs for implementation of the system, and confirms that the issue of fees payable by investors will be dealt with through the normal operation of market forces. The Council reiterates its stance that benefits of

cost reduction in scripless trading should be passed on to investors in order to gain their acceptance of the use of scripless securities.

13. The recent work undertaken by the Council on increasing transparency of fees charged by brokers, supported by the SFC, should assist in ensuring transparency of process.

Further discussion is needed on Shareholder Reference Number (SRN)

14. The HKEx consultation paper has specifically requested comments on what it terms a potentially grave problem for investors arising from the use of a shareholder reference number (SRN) issued and managed by the share registrars. For each uncertificated shareholding on the Issuer Register, it is proposed that an investor will be given a unique SRN. When the investor sells shares, instructions referring to the SRN will have to be given to a broker to transfer shares from the Issuer Register to the CCASS Register. A number of issues arise.

Security concerns with the SRN

15. The proposed use of SRNs poses possible risks to investors, e.g. the risks of misappropriation of a shareholding by a third party such as an intermediary or an intermediary's staff, and security of mail contents that disclose the SRN. The Council notes from the consultation paper that apart from suggesting investors should carefully protect their SRNs from unintended disclosure, there is no information on what safeguards will be in place to enhance investor confidence on the security aspect of the SRN proposal, particularly as far as intermediaries who have access to SRNs is concerned.

Absence of historical observations

16. The consultation paper notes that the concept of a SRN has been adopted from the Australian market, that other markets have adopted a similar scripless model, and due to the absence of an alternative which is user-friendly, operationally simple, secure and inexpensive, it is suggested that the SRN should be similarly adopted in Hong Kong. An investor education programme is suggested to increase investors' awareness of the importance of adequately protecting their SRNs from unintended disclosure.

17. However, the Council notes that there is no indication given in the consultation paper of historical experiences of implementing the SRN system in other jurisdictions, to enable a more meaningful discussion on what sort of problems might emerge in Hong Kong, and in turn what sort of mechanisms might be suitable to address those problems.

Managing multiple SRNs

18. Under the SRN model, an investor will receive from the share registrar(s) different SRNs in respect of different uncertificated shares he or she holds. From an investor angle, the Council considers that the proposed model should be made user-friendly. For instance, it would cause inconvenience to those investors who are holding multiple shares to manage

multiple SRNs. The suggestion of allowing shareholders to change their SRNs may be worthy of further deliberation.

Security of transactions

19. The Council is also concerned as to how the proposed SRN will work in practice. In a scenario where an investor wants to sell only partial holdings, disclosing a SRN to an intermediary could increase the possible risk of misappropriation. The consultation paper has not addressed this issue in terms of discussing possible safeguards, for example through shareholder authentication of a transaction that might be put into practice; notwithstanding the apparent technical difficulties.

Mailing of SRNs

20. With regard to risks associated with mailing of SRNs to shareholders and scripless IPOs (where a large number of mails containing SRNs will be sent to shareholders around the same time), the Council considers that this will need to be carefully handled. In assuming that the SRN model will be adopted, the Council suggests there are two ways to approach this mail security issue

- a) Investors could be given the choice to either collect the SRN (similar to the options available in issuing credit cards) or to have the SRN mailed to them.
- b) In the event of mail outs of SRNs, share registrars should be required to use plain envelopes without markings that readily identify the mail as including a SRN, and that the envelopes should be of the smaller size so that they can easily be placed inside small post boxes, so as to avoid envelopes protruding outside the box, and therefore easily stolen.

21. The Council reiterates its concern of the use of SRNs and urges that further exploration and consultation on the safeguards that should be in place to reduce the risk of misappropriation and to ensure security of 'mail outs' of documentation that discloses the SRN, before finalizing the choice of a particular model.

22. As a matter of course, the Council offers its publicity and information services to assist related bodies in information dissemination to investors when and if the proposed system proceeds.

Consumer Council
December 2003