

BY HAND & BY E-MAIL (scripless@sfc.hk)

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Attention: Supervision of Markets Division

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Dear Sirs

JOINT CONSULTATION PAPER ON A PROPOSED OPERATIONAL MODEL FOR IMPLEMENTING A SCRIPLESS SECURITIES MARKET IN HONG KONG (CONSULTATION PAPER)

Allen & Overy appreciates the opportunity to express its views on the Consultation Paper. Our responses to the questions set out in the Consultation Paper are set out below. We would be pleased to discuss the issues below further, or to assist in any way that the Securities and Futures Commission (SFC), the Federation of Share Registrars Limited and Hong Kong Exchanges and Clearing Limited (HKEx) deem appropriate.

Question 1: Do you agree that investors should be given the option to hold securities in paper form and to rematerialise securities that have been dematerialised? If not, why not?

We agree with the dual system and phased approach suggested in the Consultation Paper - investors should be given the option to hold securities in paper form and to rematerialise securities that have been dematerialised, given that many investors in Hong Kong may want to keep physical certificates. The dual system will allow investors to switch to the scripless system at their own pace.

Question 2: Do you agree that the scripless system should eventually be made compulsory and the paper-based option removed altogether? If not, why not?

Subject to the market's reaction and readiness to adopt to a scripless system, we support that the scripless system should be made compulsory in due course. However, we agree that this should only happen gradually

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and further market consultation is necessary before implementing a full scripless system and such a system should only be made compulsory when the market is for the most part ready and willing to accept this. We agree that this may take up to a few years (and there will always be some market participants who would not accept this).

Question 3: Do you agree that implementation of a scripless securities market should proceed in phases? If not, why not?

We agree that the implementation of the scripless securities market should be carried out in phases. A transitional approach is necessary to allow moving from a physical share certificate system to a scripless system since this would provide market participants with time to adjust to the changes and lead to a more managed restructuring of the securities market. The changes will inevitably require a substantial system and operations overhaul (which may be costly) and this should be factored in when implementing the scripless securities model and setting the time frame for such implementation.

Question 4: Do you agree with the proposed phasing, i.e. dematerialising securities in batches, and dematerialising Hong Kong securities first? If not, why not?

We agree that dematerialisation should occur in batches since it will be easier to carry out the changes and will also provide the transitional approach necessary to allow moving from the physical share certificate system to the scripless system. We agree that Hong Kong securities should be dematerialised first since the issues relating to dematerialisation of Hong Kong securities will be governed by Hong Kong law hence it will be a legislatively easier process of implementation and it will allow the Hong Kong market to have an efficient workable system in place before introducing the system to overseas securities. As noted in the Consultation Paper, dematerialisation of overseas securities depends on various factors and the positions for overseas securities as set out in Part IV are different, and e.g. for the UK, a scripless system may not be possible for shares in UK companies. It will therefore be a long and difficult process to implement and consider alternative options where necessary. By implementing dematerialisation for Hong Kong securities first, we can gain valuable insights and experience and these can then be applied to the overseas securities. As decisions have yet to be made on the parameters of the batches, further market consultation is necessary before batched dematerialisation.

Question 5: Do you have any views on the proposed dematerialisation process and HKSCC Nominees Limited's diminishing role?

We generally support the proposed dematerialisation process.

Question 6: Do you agree with the proposal that the formal register comprise two parts as discussed in paragraphs 49 to 53 of the paper? If not, why not?

We support the proposal that the formal register comprise two parts as set out in the Consultation Paper. Since it is proposed that a dual system be maintained, in that the existing paper based regime will run parallel with the scripless regime, the proposed split register is an effective way of recording holdings within the Central Clearing and Settlement System (CCASS) and those outside CCASS. We also agree with the proposed arrangement that CCASS records should be part of the formal register to avoid any delay in the legal transfer of securities and to avoid any gap between settlement in CCASS and registration in the register of holders.

Question 7: Do you agree with the proposal to facilitate name-on-register within CCASS? If not, why not?

We agree that there are benefits to the investors being able to hold securities in their own names and therefore have the full benefits of legal ownership. We also agree that it should not be compulsory and that parties should be able to hold their securities in the name of a nominee where they prefer to do so.

Question 8: Do you consider that the proposed arrangements for addressing any concerns arising from the removal of the immediate credit arrangement are adequate? If not, why not?

Although we note that removal of immediate credit may be a by-product of the name-on-register feature, we consider that, even with the amended proposals, the efficiency of the scripless system would be affected by this removal. More consideration and consultation as to how this would work to effect a coherent and efficient system is therefore necessary.

Question 9: Do you think the proposed model provides enough options (in terms of account types) for investors? If not, what other options do you think should be provided and why?

We agree that the proposed model provides sufficient account options for investors.

Question 10: Should broker/bank/custodian nominees in CCASS be allowed to appoint multiple representatives so that their investor-clients can attend and vote at meetings? If not, why not?

We broadly agree with the ability to appoint representatives in order to allow investors to attend and vote at meetings, as this is already in place and it would appear to be a natural replacement of role played by HKSCC Nominees Limited. It is important that investors are provided with the ability to represent themselves and their interests at meetings but further market consultation will be necessary on the operational systems for the brokers/banks/custodian nominees in respect of this additional role to build in safeguards in that regard.

Question 11: Should broker/bank/custodian nominees in CCASS be allowed to appoint both proxies and multiple representatives in respect of the same meeting? If not, why not?

We agree, in principle, that CCASS should be allowed to appoint both proxies and multiple representatives in respect of the same meetings and that this is possibly a missing provision of the current system relating to HKSCC Nominees Limited, which could be rectified under the new operational system. It is important that investors are provided with the ability to represent themselves and their interests at meetings. However, further market consultation will be necessary to establish how these additional roles would work together in practice.

Question 12: Do you agree that investors should be required to provide a unique identification number irrespective of whether they obtain their securities by way of a transfer or through an IPO?

Although we agree that there should be a standardised identification method, to resolve the current inconsistency in the systems, there will be security and data protection issues associated with the release of this type of information further. There will also be cost implications in installing a further identification system to initially set up the system and ongoing costs relating to the collection of the information. We agree that strict surveillance measures should be in place to guard against investors attempting to use more than one identification number.

Question 13: Do you agree with the proposal to introduce a new Registrar Participant category in CCASS? If not, why not?

This issue is more of a registrar issue, however, we note the benefits set out in the Consultation Paper of making share registrars CCASS Participants and we are generally supportive of this new category. The admission of share registrars into HKSCC will enable them to perform transactions in CCASS and enable HKSCC and the share registrars to define and enforce the technical and operational requirements under the scripless securities market model.

Question 14: Do you agree that share registrars who provide scripless related services should be more directly and robustly regulated than they are today? If not, why not?

We suggest that during the initial stage of the implementation of the scripless securities market, the existing regulatory regime for share registrars should be maintained but closely monitored and reviewed. Should there be a need in the future for more direct and robust regulations, the market should be further consulted before any such implementation.

Question 15: Do you consider that a graduated approach should be taken towards regulating share registrars (i.e. that the level of regulation should vary according to the type and range of scripless related services provided), or that a uniform approach should be taken such that a common standard is applied in all cases?

As the role of share registrars would vary according to the services provided, we agree that it would be logical for the regulation to vary according to the type and range of services provided. This issue is more of a registrar concern however and generally this proposal would raise some legislative and regulatory issues as well as potential cost implications. Further market consultation would be necessary before implementing any legislation to regulate share registrars.

Question 16: Do you have any views on the proposed changes to the IPO process?

We have no comment at this time.

Question 17: Do you agree that the scope of the scripless operational model should extend to all publicly traded securities in Hong Kong (including therefore securities such as derivative warrants and CBBCs¹)?

While the scripless operational model in general could apply to a wider scope of listed securities, we are of the view that the current arrangements for listed structured products such as warrants and CBBCs has worked well for market participants and we have reservations in extending the model to such products.

Currently securities such as warrants and CBBCs already take the scripless form and can only be issued electronically within CCASS with HKSCC Nominees Limited being the registered holder. Also, one of the major reasons for the current proposals is to address the complexities involved in shareholders' meetings and the indirect/cumbersome method in which voting occurs or where notices need to be given (between the company and its shareholders) where shareholders only hold the beneficial interest in shares. However, since warrant and CBBC holders are not entitled to any voting rights in respect of the underlying companies to which the share warrants and CBBCs are linked, and do not have right of attendance at those meetings, nor do they have right to make elections when corporate action occurs in respect of the underlying company, any possible benefit of the said proposal does not apply to them. While we note that, under the terms of the warrants and CBBCs, the holders can hold a meeting to consider any matter affecting their interest and whether a modification to the terms of the product is required, it is very rare in practice that such meetings take place due to the standardised nature of the terms of the warrants. We are therefore of the view that, due to the difference in the nature of such products as compared to shares, there would be little benefit afforded to warrant and CBBC holders in extending the scripless operational model to such products. Moreover, the current practice of publishing notices to holders on the HKEx's website has worked well for the parties involved and such communication by website is a more transparent, open and cost effective method which is appropriate for structured products.

However, if it is decided that the scripless model will be applied to such securities, the implementation of the scripless securities market to incorporate these types should be carried out in phases. A transitional approach is necessary to allow moving to a scripless system and to allow market participants time to adjust to the

¹ Please note that we have concentrated our discussion here on cash settled warrants and CBBCs as they are predominately/solely issued in such form in the last few years.

changes and lead to a more managed restructuring of the securities market. There will be cost implications in this proposal to initially set up systems to manage this change as well as ongoing costs. More consideration and market consultation would therefore be necessary before implementing this type of system.

In particular, to facilitate a smooth implementation, we would appreciate more guidance and clarity on how the proposed scripless operational model will impact on warrant issuers and registrars as the Consultation Paper has not provided the details of how the model would affect these securities. For example, paragraph 54 of the Consultation Paper states that the Hong Kong Securities Clearing Company Limited (HKSCC) will provide share registrars with a day-end record of all holdings on the uncertificated sub-register. Would the same apply for warrants and CBBCs if the scripless model is made applicable to them? That is, would HKSCC provide the warrant registrar with a day-end record of all holdings (for such products there would presumably be only one register as unlike shares there would not be a certificated register). Some of our clients (the issuers) appoint an affiliate company to be the registrar for the warrants and CBBCs that they issue and therefore they are keen to understand more about how the proposed model (if implemented) would affect and impact on their role as registrar. In addition to the additional obligations and duties imposed on warrant and CBBC registrars, legal documentation for such products would be affected resulting in further cost implications for issuers of these products. For example, currently the warrants and CBBCs are issued in registered form subject to and with the benefit of a global certificate by way of a deed poll. It is likely that the global certificate would no longer be necessary if the proposed model is implemented. If this is the case, a separate deed poll would have to be executed by the issuer to constitute the warrants and CBBCs. We are keen to work with the SFC and the HKEx to develop a standard approach and language to ensure consistency in the structured products market should the market participants support the proposed changes.

In any event, if this is to be implemented for listed structured products, we suggest that this should be done after the implementation has been carried out for shares and debentures so that the initial implementation is not held up by attempting to cater for structured products and, as appropriate, any relevant experience obtained from the initial roll-out can be used as a reference for other types of securities.

Question 18: If not, to what extent should the scope be limited, and why?

Please refer to our comments in Question 17 above.

Question 19: What are your views on the costs and benefits of introducing a scripless securities market in Hong Kong?

Certain costs will be incurred by HKSCC, share registrars, market intermediaries and issuers during the dematerialisation process. There will also be substantial costs which are associated with setting up and implementing new operational systems and the on-going costs of system maintenance. Further discussion among HKEx, share registrars, issuers, market intermediaries and the SFC will be necessary to consider how the costs of dematerialisation (and other costs) could be borne in a fair and reasonable manner.

We agree that sensitivity is important. However, given that many investors in Hong Kong may in practice want to keep physical certificates, investors should be given the option, in the first phase, to hold securities in paper form and to rematerialise securities that have been dematerialised. We support that the scripless system may be made compulsory in due course but only when the market proves for the most part to be ready and willing, and in any event only gradually and with further market consultation.

Question 20: Regarding the dematerialisation of shares and debentures of overseas companies, do you agree with the proposed approach to focus first on Bermuda, Cayman Islands, Mainland China and UK companies? If not, why not?

We agree that dematerialisation should occur in batches focusing, after the Hong Kong securities dematerialisation, on securities of companies incorporated in Bermuda, Cayman Islands, Mainland China and the UK. It would make sense to devote time and resources on these jurisdictions as these securities

constitute a significant proportion of overseas incorporated companies (by number or by market capitalisation) listed in Hong Kong.

Please do not hesitate to contact us if you have any questions or wish to discuss any of the above matters.

Yours faithfully,

A handwritten signature in cursive script that reads "Allen & Overy".

Allen & Overy