

Comments from JPMorgan to the proposed operational model for implementing a scripless securities market in Hong Kong.

## **SUMMARY**

While the objectives for a scripless market are clear and welcome, the desire to satisfy all stakeholders and requirements in a comprehensive manner may carry the risk of higher costs and inefficiency when considering the transition. In order to mitigate risk, ensure smooth transition and optimize the cost and benefit towards a scripless market, a transition strategy will be required with the participation of major stakeholders in due course.

One main point of concern is the dual approach. It may create unnecessary risk of fraud and uncertainty. It may also force the local intermediaries to maintain dual operations that may result in the rise of overall cost that would offset the planned efficiency gains envisioned. We are in favor of a one-shot approach and the concerns stated in paragraph 36 may be mitigated by an extended transition period and careful communication to the investor community. One possible option for transition could be to pre-deposit certificates at CCASS.

The development of a transition strategy becomes critical when taking a one shot approach and points such as alignment of registry data to real ownership, planning around existing processes related to certificates, longer preparation period and public communication to manage the perception on share certificates would be the typical points of consideration.

Typical questions that require clear answers from an earlier stage include:

- Would trading of stocks be restricted around the transition date?
- Would there be liquidity impacts?
- What types of corporate events would be restricted?
- How would trading in pre-IPO stocks be affected?
- How would the delisting procedure change?
- What happens to my share certificate?

Finally, a formal sunset date is required. Otherwise there is no incentive for the market to change.

**Response to Annex 4 – List of specific issues on which feedback is sought**

	Specific Issues	Comments
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?	No, because it may create unnecessary risk of fraud and legal uncertainty. It may also force the local intermediaries to maintain dual operations that may result in the rise of overall cost that would offset the planned efficiency gains envisioned.
2	Do you agree that the scripless system should eventually be made compulsory and the paper-based option removed altogether? If not, why not?	No. The scripless system should be made compulsory in one go instead of being made “eventually” in order to mitigate the risks and costs mentioned above.
3	Do you agree that implementation of a scripless securities market should proceed in phases? If not, why not?	Yes. Phases help to manage the risk of transition but would only make economic sense when it introduces efficiency such as difference in instrument or actors. e.g. if certain classes of equities have different types of investors intermediaries or IT systems, then phasing makes good sense.
4	Do you agree with the proposed phasing, i.e. dematerialising securities in batches, and dematerialising Hong Kong securities first? If not, why not?	Yes, but it depends on how the batches are defined as concerns stated above.
5	Do you have any views on the proposed dematerialisation process and HKSCC Nominees Limited’s diminishing role?	No comment
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?	While the law would be clear about ownership rights, there will be a period where people turn up with share certificates, unknown share holders / dislocated shareholders. Would the issuer want another category of owners to be able to manage this group?

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7	Do you agree with the proposal to facilitate name-on-register within CCASS? If not, why not?	Yes. We understand that this is only optional.
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?	No. The best solution seems not to run the dual aspects of paper and scripless.
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?	Please see response to Q.8
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?	Yes
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?	Yes
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?	No. Standard requirements for such ID numbers as well as associated documentation need to be defined and communicated first.
13	Do you agree with the proposal to introduce a new Registrar Participant category in CCASS? If not, why not?	No comment
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?	No comment

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15	Do you consider that a graduated approach should be taken towards regulating share registrars (i.e that 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?	We have no comment to this specific question. However, areas where high level principles expect to be built around may include governance, fiduciary duties, risk management and control.
16	Do you have any views on the proposed changes to the IPO process?	In order to achieve the overall goal, commercial disincentives should be attached to paper based application.
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 CBBCs)?	Yes. It also needs to come in line with delisting procedures.
18	If not, to what extent should the scope be limited, and why?	Please see response to Q.17
19	What are your views on the costs and benefits of introducing a scripless securities market in Hong Kong?	Benefits include increase in market efficiency and the elimination of costs for handling paper. The cost of changes is only for one time, while the benefits accumulate over time.
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?	No comment