

FSDC Response to SFC/HKEX/FSR Joint Consultation on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong

Introduction

The Financial Services Development Council (the “Council”) welcomes the issue of the captioned SFC / HKEX / FSR joint consultation paper in January 2019 (the “Consultation Paper”). The introduction of an uncertificated securities market is one of the infrastructural reforms proposed in the Council’s Paper No. 09 “Positioning Hong Kong as an International IPO Centre of Choice” of 2014 (the “FSDC Paper”).

The Council is appreciative of the regulators’ efforts over a long period of time to balance different interests and to find the best solution to various technical issues, as described in the Consultation Paper. In the Council’s view, the current approach is a positive step in the development of the Hong Kong market.

The Council’s recommendations

The Council notes that the project has taken a substantial number of years to mature. While a number of issues remain subject to further consultation, the regulators clearly feel that the plans are in an appropriate state to be rolled out. The current proposal is to apply the new regime to new listings before moving on to already-listed companies, and to Hong Kong-incorporated companies before other jurisdictions.

Roll-out of market reforms by phases is an approach to which our market has been well accustomed in recent years. For the project at hand, the Council believes there is scope for a more robust initial phase.

According to the statistics quoted in paragraph 103 of the Consultation Paper, as at the end of 2018 there were a total of 217 Hong Kong companies listed on the Hong Kong Stock Exchange, representing less than 10% of the total number of listed companies. In contrast, there were 1,265 Cayman Islands companies, 519 Bermuda companies and 267 People’s Republic of China (“PRC”) companies. Based on our own research, in 2017, a total of four Hong Kong companies were admitted to the Main Board out of a total of 94 listings (including listings by introduction and transfers of listings from GEM to the Main Board). The figure for 2018 was three Hong Kong companies out of 143 Main Board listings.

Under the roll-out plan outlined in the Consultation Paper, which focuses first on Hong Kong-incorporated IPO cases, the reform will initially affect no more than a handful of companies each year. This does give the market an opportunity to fix any issues that may arise before the regime is applied more generally, but detracts materially from the impact and momentum required for the successful launch of a project of this nature.

Given that the market dematerialisation initiative has involved and will continue to involve a considerable amount of work on the part not only of the parties directly affected (regulators, share registrars, securities intermediaries and listed issuers) but also legislators, the company secretarial and legal advisory communities, and possibly others groups, the Council believes that a more impactful approach for the launch will be more appropriate, as it will help focus the attention and energies of stakeholders to make the reform a success.

In the Council's view, there is room for expanding the scope of the first phase roll-out beyond what is currently suggested. Granted, not-yet-listed companies are the group that can easily tailor their structures to a paperless environment, but even on the part of already-listed issuers, only relatively simple steps (e.g. those specified in paragraph 20(c) of the Consultation Paper) should be necessary for these companies to migrate to the new environment.

If the regulators are nevertheless minded to apply the initial phase to IPO listing applicants before moving onto listed companies, the Council is of the view that it is not necessary to limit this phase to Hong Kong-incorporated companies. As stated above, the actual number of Hong Kong-incorporated new listing applicants each year is so small that the suggested phasing approach would tend to snuff out rather than engender any sense of an epoch-making upgrade of our market.

As stated in the FSDC Paper, introducing a paperless securities regime is an important aspect of Hong Kong's drive to position itself as the world's IPO centre of choice. It is also an important element of stepping up Hong Kong's corporate governance regime, by making investors holders of the legal title to their shares and hence having a direct relationship with the companies they have invested in.

The regulatory spirit clearly spelt out in the Consultation Paper, with which the Council agrees, is that there will be no rematerialisation and that ultimately all paper-based securities holding and trading (at least for shares and share-liked securities) will be a thing of the past. In this spirit, it would be important to give the market a clear message that, once the project is launched and even during transition, dematerialisation will be the norm rather than the exception. It is therefore crucial to give the first phase its due weight and "noise" by applying it to a sufficiently wide community of companies.

Based on preliminary enquiries, the Council is not aware of any technical or legal hurdle to including in the first phase, for instance, Cayman Islands companies. This is by far the largest group of listed companies in Hong Kong and many are already listed in New York and other dematerialised markets. In this connection, we note that section 40B of the Cayman Islands Companies Law gives companies a high degree of flexibility to adopt modes of evidence of share title as required by relevant stock exchanges. The position may be similar for the next largest group, Bermudan companies.

As for the third largest group, PRC companies, we note from the 2009 joint consultation paper on scripless market that certain regulations (e.g. the Mandatory Provisions for Articles of Associations of Companies Listed Overseas) will have to be amended before these companies can emigrate to a dematerialised environment. However, we believe there should be no major legal hurdle under general company law, as the PRC domestic market is itself dematerialised (except in respect of a small number of joint stock companies, in particular companies that have H shares listed in Hong Kong).

This is an aspect that the Council would encourage the regulators to explore further, with a view to ensuring that the roll-out will have a suitable impact on the market and create a strong momentum for the subsequent phases.

Conclusion and the road ahead

The Council is positive towards the proposals set out in the Consultation Paper and believes that the reform will be an important development for the Hong Kong securities market.

We appreciate that the proposals described in the Consultation Paper have far-reaching impact on the Hong Kong market, and involve intricate technical and operational issues. They are likely to have varied impact on different stakeholders. We hope that this consultation exercise would enable the regulators to engage the stakeholders closely, in order to pin down a viable model as soon as possible. We encourage market participants to actively respond to the Consultation Paper with constructive views, so that all the issues could be flushed out and appropriately addressed, to avoid losing time in the future to re-calibrate the overall model. Once a viable framework is identified, it is important that phasing and the timing of the next steps be designed to generate the maximum impetus for this important reform.

Financial Services Development Council

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