

The Hong Kong Institute of Chartered Secretaries

Submission:

Joint Consultation Paper (JCP) on a Revised Operational
Model for Implementing an Uncertificated Securities
Market (USM) in Hong Kong

15 April 2019

By email only: usmconsult@sfc.hk

Supervision of Markets Division
Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs

Submission on the Joint Consultation Paper (JCP) on a Revised Operational Model for Implementing an Uncertificated Securities Market (USM) in Hong Kong

About HKICS

The Hong Kong Institute of Chartered Secretaries (HKICS) is an independent professional institute representing Chartered Secretaries and Chartered Governance Professionals as governance professionals in Hong Kong and Mainland China with over 6,000 members and 3,200 students. HKICS originates from The Institute of Chartered Secretaries and Administrators (ICSA) in the United Kingdom with 9 divisions and over 30,000 members and 10,000 students internationally. HKICS is also a Founder Member of Corporate Secretaries International Association Limited (CSIA), an international organisation comprising 14 national member organisations to promote good governance globally.

HKICS Supports USM regime

Subject to the observations under this Submission, HKICS expresses its general support for the implementation of the revised USM operation model in Hong Kong under the JCP proposed by the SFC, HKEX and FSR¹.

The underlying rationales for supporting the implementation of an USM regime in Hong Kong are that (1) this would enhance the reputation of Hong Kong as an international financial centre based on the

¹ All capitalised terms are as defined under the JCP unless the context requires otherwise

enhanced market efficiencies in settling securities trade under the proposed USM regime; and (2) the opportunities that exist under the USM regime for developing further governance related initiatives – for example, with the potential use of distributed ledger technology to manage cyber risks and other investor related protection initiatives – dependent on a safe and stable electronic platform.

As to the revised model for securities settlement under the proposed USM, HKICS recognises that as a practical matter because of the large number of brokers in Hong Kong and lack of liquidity to support them for a delivery versus payment (DVP) model (requiring gross real time settlement of securities trade for clients) there is need for securities settlement to be brought back to the current net settlement approach. At the appropriate time this issue could be revisited as a DVP model does theoretically reduce counterparty risks as part of investor protection.

Observations on USM regime

While HKICS supports, in general, the implementation of the USM regime there are a number of governance related and other issues that need to be addressed. These include:

- **Costs.** For the listed issuer, there is a cost concern with implementation of the USM Regime. The assumption is that there are set-up costs for implementing the USM regime. In this connection, HKICS believes that it is not appropriate to push down any up-front costs to the listed issuers when this is an overall securities market initiative and cost recovery could only be achieved over time. The cost issue needs to be explained further and HKICS reserves its right to comment on this issue if a disproportionate burden is to be borne by listed issuers.
- **Cyber Risk.** The cyber risk management relating to the USM regime is of critical importance. This is because with dematerialisation the integrity of the electronic ROM is the centrepiece to the implementation of the USM regime. It would be helpful for the appropriate parties under the JCP to explain how this issue would be addressed, including, for example, the licensing requirements for participants under the USM regime, and how are they to practically manage the cyber risk on a continuous basis.
- **Shareholder Communication.** HKICS submits that materialisation and dematerialisation of a share certificate is neither here or there in terms of investor protection. Rather, the major practical issue for listed issuers and their company secretaries from the governance point of view is the

increased demands for shareholder communications. The assumption is that with the increase in the number of shareholders on record under the USM regime (from USI and USS holders) there will correspondingly be increased participation by shareholders at shareholder meetings.

There is already a real and present problem in securing venues to hold shareholder meetings which are becoming increasingly costly for listed issuers. As such, HKICS submits that with the implementation of the USM regime regulators should promote the concept of hybrid meetings which ICSA/HKICS has adopted as a global thought leadership project.

In Hong Kong, this also means that the related issue of implied consent for electronic communication needs to be dealt with. That is, section 833 of the Companies Ordinance (Cap 622) has to be amended which HKICS has noted to SFC and HKEX on a number of occasions. In this connection, HKEX has recognised that: *Whilst there is general support for shareholders' consent to be implied for electronic dissemination of corporate communications by issuers, we would not propose to adopt such implied consent regime until Hong Kong's company law is amended to permit implied consent for corporate communications².*

With the implementation of the USM regime, HKICS calls upon the regulators to consult the market further on electronic communications to both support the USM initiative and for Hong Kong to do its part as a sustainability issue in reducing paper communication in favour of electronic communications.

JCP Questions

HKICS has highlighted the issues from the governance perspective and does not have any specific comments to the JCP questions which are best left to brokers, other intermediaries and market participants.

²Paragraph 18, Consultation Conclusions, Review of the Corporate Governance Code and Related Listing Rules, 27th July 2018, [http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2017-Review-of-the-CG-code-and-Related-LRs/Conclusions-\(July-2018\)/cp2017111cc.pdf?la=en](http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2017-Review-of-the-CG-code-and-Related-LRs/Conclusions-(July-2018)/cp2017111cc.pdf?la=en)

Yours faithfully,

The Hong Kong Institute of Chartered Secretaries