

# MAYER | BROWN

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By Fax Only

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

25 April 2019

Your ref:  
 Our ref:

Dear Sir

### RESPONSE TO THE JOINT CONSULTATION PAPER ON REVISED OPERATIONAL MODEL FOR IMPLEMENTING AN UNCERTIFICATED SECURITIES MARKET ("USM") IN HONG KONG

Q1	Do you agree that the Revised Model presents a better option for taking forward the USM initiative? If no, please provide details.
MB	We agree that the Revised Model (which retains the nominee system and achieves USM via changes to how the register of members ("ROMs") is maintained) presents a less impactful overhaul of HKEX's clearing system as compared to the 2010 Model (which attempted to achieve USM via changes to how clearing of listed securities is carried out).
Q2- Q4	Do you have any concerns or comments about the key features of the proposed Revised Model? If yes, please provide details.
	Do you have any concerns or comments about the key features of the USS account? If yes, please provide details.
	Do you have any concerns or comments about the key features of the USI account? If yes, please provide details.
MB	We offer the following high-level observations: <ul style="list-style-type: none"> <li>USI account: Holders of the USI account (within the Share Registrar system) will comprise shareholders who are today holders of share certificates. We believe that this population comprises a relatively high proportion of retail investors. The Revised Model aims to bring these shareholdings into a paper-</li> </ul>

less environment as far as proof of title is concerned only. In other words, the Revised Model is not designed to bring their shareholdings into the trading, settlement and clearing system. This appears to be different from the USS account set-up, which is within the new HKEX system and intended to be part of the settlement and clearing system. To better manage expectation, we believe this difference between USS account and USI account is a point worth emphasising and clarifying, especially during the course when electronic communications are being promoted amongst prospective USI account holders: i.e. these account holders would not as a result of the USM initiative automatically gain access to HKEX's trading, settlement and clearing systems.

- USS account: The USS account arrangement appears to be able to (a) retain the benefits and efficiency afforded to investors under a nominee system; and (b) allow direct registration of investors on the ROM. This is achieved via connection between the Share Registrar system and the HKEX system. We are conscious that the present consultation is not directly related to real-name registration of stock owners, which, if it is to be considered at all, should fall under a separate policy initiative. We believe that in case real-name registration of stock owners would be considered, the issues involved (especially the technical aspects) concerning the feasibility of real-name registration would be closely related to the registration of investors on ROMs, and the USS account arrangement appears to be a relevant reference.
- Ownership and processes of ROMs: We believe the elevated role of share registrars in maintaining and administering ROMs is inevitable under the Revised Model. We would, however, like to seek clarification as to whether the Revised Model also seeks to dematerialise the ROMs.

We believe that this is likely the intention but noted that dematerialising the ROMs would mean that the underlying electronic records will become conclusive evidence of proof of title. There will no longer be a stand-alone (physical) record of registered shareholders, which is separate from the Share Registrar system and which, in catastrophic situations like system-failure and liquidation of a share registrar, can arguably remain unaffected. Therefore, dematerialising the ROMs begs the question as to who is the ultimate owner/risk bearer of the underlying electronic record. If the share registrars are to become the ultimate owner/risk bearer of the underlying electronic records of dematerialised ROMs, the role of share registrars is arguably more important than a system operator. If share registrars are to become permanent central depository of legal titles, issues like insurance of titles and safeguards against the aforesaid catastrophic situations should also be considered.

	We also take this opportunity to call on the relevant regulators and the Government to look into the possibility of employing block-chain technology to enhance independence, security and reliability of relevant electronic registries of titles.
Q5	Do you have any concerns or comments about our proposal that USS accounts be limited to institutional investors, and USI accounts be available to all investors, including institutional and retail investors? If yes, please provide details.
MB	As mentioned above, we believe that confusion could arise as to the features of USI account and USS account. That is, USI account would not give investors direct access to HKEX's trading, settlement and clearing systems. For retail investors, we agree that not making available to them USS accounts may be a clear-cut way to avoid the confusion when the USM initiative is first introduced.
Q6	Do you agree with our expectation that institutional investors that open a USS account are unlikely to open or need to open a USI account as well? If no, please provide details.
MB	We agree.
Q7	Do you anticipate any difficulties or limitations in opening and managing USS accounts for retail investors? If yes, please provide details.
MB	No. However, it remains unclear whether the USI account is holder-specific (i.e. once an individual/entity has opened an account – all registered holdings of different securities will be held via that USI account) or issuer-specific (i.e. a holder will need to maintain different USI accounts in respect of different securities). We assume that the USI account will be holder-specific.
Q8	Do you have any concerns if cash entitlements payable in respect of securities held in an institutional investor's USS account had to be paid to the institutional investor direct, rather than to its sponsoring CP? If yes, please provide details.
MB	No. We agree that payment should be made direct to registered shareholders, unless the custodian has valid subsisting authority to hold fund for the registered shareholder in question and the system allow the issuer making payment to verify that authority.
Q9	Do you have any concerns or comments about our proposal to require registered securities holders to provide a unique identification number to the issuer? If yes, please provide details.
MB	No. We agree with the prospective approach.
Q10	Do you have any concerns or comments about our proposals on consolidating holdings belonging to the same registered securities holders but calculating securities

	entitlements separately in the case of USS holders with multiple USS accounts? If yes, please provide details.
MB	We are unclear as to the rationale for calculating securities entitlements separately in relation to consolidated holdings, and believe that entitlements calculation should not be separate.
Q11	Do you have any concerns or comments about the proposals for establishing a Common Platform across all share registrars? If yes, please provide details.
MB	No.
Q12- Q13	Do you have any concerns or comments about the proposed process flows for IPO applications in respect of securities that are to be credited to a USI account? If yes, please provide details.
	Do you have any concerns or comments about the proposed process flows for IPO applications in respect of securities that are to be credited to a USS account? If yes, please provide details.
MB	No particular comments.
Q14- Q16	Do you have any concerns or comments about the proposed process flows for effecting transfers to or from HKSCC-NOMS under the Revised Model? If yes, please provide details.
	Do you have any concerns or comments about the proposed process flows for effecting other transfers under the Revised Model (i.e. between two USI holders, between two USS holders or between a USI and USS holder)? If yes, please provide details.
	Do you have any concerns or comments about our proposal to offer off-exchange trade settlement and transfer services on half-day trading days? If yes, please provide details.
MB	No but please see our response to Q2 - Q4 above.
Q17	Do you have any concerns or comments about the proposed process flows for effecting corporate actions in respect of holdings in a USI account? If yes, please provide details.
MB	We assume that the USI account will be holder-specific, and that securities entitlements (e.g. distribution of specie in a spin-off proposal) will be credited to an existing USI account as opposed to a new issuer-specific USI accounts for the spun-off entities (which calls for a new round of account-opening). See our response to Q7 above.

	If the pledge of shares falls under exempt security interest under Part XV of the SFO, the pledgee's interest, for the purpose of notification, would be disregarded. We assume that the proposed "locking arrangement" under such circumstances would remain "private".
Q18	Do you have any concerns or comments about the proposed process flows for effecting corporate actions in respect of holdings in a USS account? If yes, please provide details.
MB	No.
Q19- Q21	Do you have any concerns or comments about including SFC-authorized listed funds within the USM initiative at an early stage? In particular, do you perceive any difficulties in doing so? If yes, please provide details.
	Do you have any concerns or comments about including rights issues, subscription warrants and depositary receipts within the USM initiative at an early stage? If yes, please provide details.
	Do you have any views as to whether the USM initiative should be extended to cover other products, in particular CBBCs and DWs? If yes, please provide details.
MB	We agree and note that the discussion in the consultation for "share" should provide a good working model for these "share-like" securities.
Q22- Q27	Noting the general market consensus that Hong Kong should move to a USM regime, do you agree with the general approach for moving the market to full dematerialization? If no, please provide details.
	Do you have any concerns or comments about our proposals for requiring paperless IPOs only? If yes, please provide details.
	Do you have any concerns or comments about our proposal that there should be no option to rematerialize securities that are already in uncertificated form? If yes, please provide details.
	Do you have any concerns or comments about our proposals for dematerializing securities that are held in the new HKEX System? If yes, please provide details.
	Do you have any concerns or comments about our proposal to cease the parallel trading arrangement for securities held within the new HKEX System that have already been dematerialized? If yes, please provide details.
	Do you have any concerns or comments about our proposals for encouraging issuers and registered securities holders to communicate electronically rather than in paper form? If yes, please provide details.

MB	We support the initiatives.
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Yours faithfully

Mayer Brown