香 港 上 市 公 司 商 會
THE CHAMBER OF HONG KONG LISTED COMPANIES

26 April 2019

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

BY EMAIL AND BY HAND

Dear Sirs,

Re: Response to Joint Consultation on a Revised Operational Model for Implementing an Uncertificated Securities Market ('USM") in Hong Kong

The Chamber of Hong Kong Listed Companies ("CHKLC") is pleased to submit its views towards the USM consultation.

The USM is an on-going initiative of the Government which can be traced back to a decade. Its objectives, especially in providing better legal protection and transparency, and in creating greater efficiency through straight through processing and removal of manual processes, are worth-supporting.

From the perspectives of the investment community, we particularly welcome the prospects of a shortened IPO settlement timetable as the market moves into a paperless environment, as a result of the implementation of USM. This enables trading of newly-listed shares to commence earlier and closer to pricing, thus reducing market exposure.

In this submission, we do not intend to answer the questions listed out in the consultation paper one by one. Many of the questions are concerned with the user account operations, e.g. in transferring shares, effecting payment, evidencing titles, etc. While these are important market operation matters, they are of lesser impact on listed companies. For issues that have more relationship with companies, such as obtaining and maintaining unique identification numbers from shareholders or how to process entitlement distribution, we do not have big concerns at this stage and trust that sound arrangements can be worked out with share registrars.

Rather, we would like to take this opportunity to discuss issues that would affect the reasonableness of the USM implementation and practicality of its moving forward, and their cost implications to listed companies, if any.

Investor readiness for USI and USS accounts

To listed companies, one purported benefit of USM is shareholder transparency. Retail and institutional investors can elect to open an USI and USS account and claim legal title of the shares, allowing listed companies to identify them and build better investor relationship.

But that depends on investors' readiness, and willingness, and the perceived benefits of having their own accounts. Retail investors, especially those in the older age-groups who are not computer-savvy, may find operating an electronic account troublesome. On the other hand, investors who deal in shares frequently may also find it cumbersome having to move their shares from their USI account to HKSCC-NOMS every time they wish to effect a sale. In both cases, they may prefer holding their shares with their brokers and be satisfied with beneficiary interests.

The consultation paper stated that fees and costs for investors to open and maintain their own accounts would only be available at a later stage. While we believe they would not be prohibitively high, they will still be a factor affecting investors' decisions.

The consultation paper also pointed out that the Securities and Futures Commission ("SFC") and HKEX are exploring options for alternatives that would enhance the position of investors who hold a beneficial interest only, particularly in terms of facilitating and encouraging their participation in the voting process. If investors can participate in voting without holding legal title, the incentive for them to open an USI account would be further reduced.

While costs should not be a concern to institutional shareholders, but for various reasons, they may not wish to reveal their shareholdings in a particular stock but prefer withholding their identity under a nominee structure.

If in the end, many investors choose not to open the USI and USS accounts, the objective of USM in promoting shareholder transparency would be lost, and benefits to listed companies are much reduced. We wonder if the USM Working Group has any assessment of this that could be shared with the market.

Costs to share registrars and its implications to listed companies

On the surface, the USM would present cost saving opportunities to listed companies by reducing printing costs of share certificates, having simpler processes related to corporate actions, and shifting to electronic communications with shareholders. However, we are wary of the possibility that listed companies would be passed on some of the development costs of USM.

Under the USM environment, share registrars will need to operate a new Share Registrar System that are capable of handling additional work procedures, e.g. declaring stamp duty on behalf of investors, and interfacing with the HKEX system for all necessary share transfer and settlement, and payment procedures. It can be imagined that it is a complex system involving high development costs. It is also said that a Common Platform across all share registrars would be built, the costs of which would even be higher.

Share registrars operating under the USM environment will need to be approved by the SFC and their systems and processes subject to regulator's direct oversight. That would mean higher internal and compliance costs for share registrars.

We wonder whether share registrars would be looking to listed companies - their main customers and source of revenue, for recouping part of these costs. This is a concern to listed companies and so far there is no discussion of this.

Under USM, only share registrars approved by the SFC will be allowed to operate and provide services. It is possible that some smaller share registrars will not be approved or are not willing to make the necessary investments to upgrade their systems and operation procedures. The crowding out of smaller share registrars might create an oligarchical market where a very small number of registrars will dominate the market and dictate pricing of services. Listed companies will have little room to negotiate service fees under this scenario.

<u>Speed to full dematerialization and its costs implications</u>

We understand that dematerialization will be introduced in phases, the first phase being shares of IPO companies incorporated in Hong Kong, followed by shares of Hong Kong-incorporated listed companies. But we note that very few newly listed companies are registered in HK and it seems it will stay this way in the future. At the same time, only 217 listed companies are Hong Kong-incorporated out of a total of 2,321 (as at the end of December 2018). There is a long way ahead to reach full dematerialization.

And this has cost implications too. For discussion's sake, let's assume the share registrars do attempt to recoup their system development costs partly from adjusting their service fees upwards. If the fee adjustments apply only to their clients whose shares have been dematerialized, the effects would be small since the number of companies is not high. If the fee raise are to apply to all their clients, including those whose shares are not yet dematerialized, it would be unfair to those non-dematerialized companies as they are not users of the new Share Registrar system.

This is just to illustrate our worry whether and how listed companies would be required to partly bear the USM development costs in an indirect and non-transparent way. If the USM Working Group does not envisage this to be the case, an assurance would be helpful to allay the worry.

The USM working group needs also to have a clear timetable for rolling out dematerialization to companies incorporated in other jurisdictions. We understand Bermuda (subject to conditions) and Cayman Islands are ready for dematerialization but there involves necessary law changes in those jurisdictions, the process of which could be long and subject to their Governments' legislative priorities. Apart from these two, there are still 11 jurisdictions, excluding Hong Kong and PRC, needed to go through the same process. Full dematerialization cannot be achieved unless they are all onboard. Before then, our market has to operate a parallel system, for an uncertain period of time. This is not ideal because of the costs and operational inefficiencies involved. The USM Working Group needs to project a feasible timetable to achieve full dematerialization. This would help the market to determine the practicality in moving the USM project forward.

Conclusion

In conclusion:

- CHKLC is in support of the objectives of the USM.
- We, however, are not sure about investors' readiness and willingness to open the USI and USS accounts for the full benefits of USM to be felt by listed companies.
- We are not informed of any cost implications to listed companies: whether the development costs of the IT infrastructure will be shifted over or having to face a more oligarchical share registration services market
- We are concerned about the time needed to achieve full dematerialization of all companies listed on HKEX, until then the market needs to bear additional costs and inefficiencies from running a parallel system.

Yours faithfully,
For and on behalf of
The Chamber of Hong Kong Listed Companies