

Hong Kong Exchanges and Clearing Limited ("HKEx")

Consultation Paper on a Proposed Operational Model for a Scripless Securities Market

welcomes the proposal for a scripless securities market as a scripless market infrastructure is essential to the continued development of Hong Kong securities market.

This document comprises two parts. Part I outlines a general comment on the proposed operational model as described in the consultation paper and Part II provides more technical views and concerns on the operational aspects of the proposed model.

Part I

- 1) Under the proposed model, investors are given the option to rematerialize their shares. While rematerialization gives investor an option for handling their securities, this is not consistent with the objective of establishing a scripless securities environment in Hong Kong and unnecessarily create a complex operational structure.
- 2) The proposed operational model tends at market participants. However, it cannot provide a full picture as the procedures for investor to deal with the registrar are not fully described (e.g. when registered holders deposit physical shares directly to Issuer Register for own SRN, how does the SRN holder instruct on the change of address?). This should be included in the proposal for discussion.
- 3) The SRN approach, as mentioned in Chapter 8 of the consultation, exposes both brokers and investors to a potential risk of misappropriation of client securities, which is against the principle stated in 3.2 (i.e. the model aims to enhance investor protection and reduce the risk of misappropriation). It also puts Exchange Participants to a higher error risk as all instructions for EDI only act on the sole instruction of CCASS participants without matching. Part II contains more discussion in this regard.
- 4) Brokers will assume additional responsibility and potential liability in relation to stamp duty arrangement for EDI and EWI under the proposed model. This is not consistent with the S/I approach where investor himself remains liable for stamp arrangement.
- 5) The abolishment of immediate credit currently provided by HKSCC for physical shares deposit is regarded as a big step backward. It elongates the turnaround time and reduces settlement efficiency, which is against the principle stated in 3.2 (the aim of the proposed model is to enhance market efficiency and thereby reduce costs). The introduction of EDI further reduces efficiency as it runs in a day-end batch basis. As T+1 will be the latest time for CP to input EDI for settlement on T+2, any failure will result in compulsory buy-in by CCASS even if investors have sufficient stock in their SRN.
- 6) would like to express our concern with the infrastructure cost associated with the development of the proposed model and the associated administration cost if and once the model is implemented.

... of having two registrars (i.e. the CCASS Register and Issuer Register – uncertificated share register) recording shareholdings in uncertificated form which unnecessarily creates a complex operational structure, we propose to use the current CCASS-IP approach.

- 8) The concept of CCASS IP is very similar to the proposed SRN but the former has a better control / built-in mechanism in verifying instruction (e.g. Internet, IVRS). Given the risk inherent in SRN, IP is a preferable option.

Part II

Operational Aspect

1. Referring to point 3 above, the following table describes five potential risk scenarios on SRN.

No.	Nature	Associated risk	Party being liable
A	Clients give wrong SRN and shares were successfully transferred via EDI from that wrong SRN. However, this result in the failed settlement as the (wrong) SRN has no stock for settlement of its own trades	Buy-in at the wrong SRN	Holder of wrong SRN → Broker → Client
B	Broker participant inputs wrong SRN however shares successfully transferred via EDI from that wrong SRN. The (wrong) SRN have no stock for settlement of its own trades	Buy-in at the wrong SRN	Holder of wrong SRN → Broker
C	Broker inputs wrong SRN for EDI	Shares were delivered to a third party which became aware of this only when the buying client chases for settlement (likely when receiving month end statement from Issuer Register)	Broker
D	SRN address changed, however the client has not informed Broker participant for the change of S/I.	Trade failed (will there be any new rules on buy-in exception?) then compulsory buy-in kicks in	Holder of SRN ? Broker ?
E	SRN information being disclosed and the address was changed by a third party (Need clear requirement on the procedures for change of address request for SRN)	Price risk (investor may miss the market opportunity until the identity was clarified (Need exact requirement and procedure)	SRN holder

For scenarios A, B, C and D, both the investor and broker participant will be exposed to higher risk of settlement error since under the proposed model, there will be no instruction matching mechanism to prevent such incidents from happening.

Scenario E, the proposed model will expose the market to an insecure environment.

2. Issues require further clarification

- a) Will there be 1 SRN per 1 registrar house for 1 investor , or 1 SRN for 1 listed company per investor ?
- b) Paragraph 3.15 on page 15. What kind of corporate communication Issuer will send to CP Sponsored Account? (Note: issuer election deadline for Voluntary Event always differs from CP and this may create confusion).
- c) For non-disclosed IP, how to transfer shares between broker participant when a trade was executed? Who is responsible to verify the beneficial ownership and the payment of stamp duty?
- d) Diagram 3-2 on page 18. When investors make physical deposit into CCASS Depository for dematerialization, there will be a time gap between which registration process is completed. Within this processing period,, shares are still registered in name of the transferor. Our concerns are:
 - i) Will there be any cut-off for CCASS when there is an upcoming book close date? If not, how will the client know who is the registered holder (himself or CP) entitled to the event?
 - ii) Since CCASS will not credit CP account till several days later, CP in turn will not credit client account at such moment. From investors' perspective, how can they prove their ownership in such asset during this period as there will not be any statement or position report provided by CP or CCASS. Will CCASS issues any reports as evidence of the process and position?
- e) EDI - what kind of document is required so that the registrar is empowered to release shares without shareholders' authorization?
- f) EWI - will CCASS lock the shares for valid EWI? If not, what priority will CCASS take if there are not sufficient shares? e.g. the CCASS records 10m shares but it receives 3 EWIs, each claiming for 3m , 4m & 5m respectively.
- g) What is the verification needed for IR to take shareholder instruction to change address?
- h) Paragraph 3.47 of Page 29 on rematerialisation:
 - i) what is the exact procedure?
 - ii) any signature required from the transferee ?
 - iii) will the registrar keep the specimen records ?
- i) Paragraph 5.10 of Page 39 on Voting
 - i) for CP and CP Sponsored Account, as they are themselves the registered holder? how can they appoint corporate representative (through CCASS or Registrar House?)
 - ii) if CP and CP Sponsored Account holders directly deal with Registrar House , what verification required if registrar do not have any specimen records for both .

j) Page 66, Appendix 2C. The proposal should include clear procedures and flow on how transfer be happened between SRNs in Issuer Register. What instruction will SRN give? How will the Registrar verify the transfer?

k) The proposal should include a description of the exact procedure of how to handle the removal of register - which currently requires delivery of physical share certificate to registrar.

For example, in order to remove HSBC Holdings Plc from HK register to UK register, existing practice requires investor to withdraw physical share certificate (HK register) via CP from CCASS, then deliver to HK registrar together with 'removal form'. HK registrar will thereafter cancel all physical shares and confirm to UK registrar for their issuance of shares in UK register. For future model, we would like to suggest the adoption of scripless delivery throughout such removal process.

l) For IPO or Placement - will the new shares be issued in issuers' name in first place and then allocated to allottees' SRNs? Or will the shares go straight to allottees' SRN?

- End-