

**FEDERATION OF SHARE REGISTRARS LIMITED**

Abacus Share Registrars Limited

27/F, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong

Tel: 2980-1705

Fax: 2527-6623



證券登記公司總會有限公司

23 December 2003

URGENT  
BY HAND

Hong Kong Exchanges and Clearing Limited  
7/F, Vicwood Plaza  
199 Des Voeux Road Central  
Hong Kong

For the attention of The Scripless Project Team

Dear Sirs

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

In response to the Consultation Paper published by your office in October 2003, the Federation of Share Registrars has prepared a Response Paper and we are enclosing a copy herewith.

The Federation has received responses from a total of 53 listed companies indicating that they are supportive of the Federation's Response Paper.

Yours faithfully

For and on behalf of  
FEDERATION OF SHARE REGISTRARS LIMITED  
By Abacus Share Registrars Limited  
As Honorary Secretary

Phyllis Leung

enclosure

**FEDERATION OF SHARE REGISTRARS**

**RESPONSE TO**

**CONSULTATION PAPER ON A PROPOSED OPERATIONAL MODEL  
FOR A SCRIPLESS SECURITIES MARKET – OCTOBER 2003**

**December 2003**

EXECUTIVE SUMMARY .....	3
2. BACKGROUND .....	5
3. GENERAL ISSUES .....	6
4. PROCESS FLOWS AND INFRASTRUCTURE .....	14
5. SPECIFIC ISSUES .....	17
6. CHAPTER 6 – SERVICES TO SHAREHOLDERS .....	19
7. CHAPTER 7 – IMPLICATIONS OF THE SCRIPLESS SECURITIES MARKET MODEL FOR MARKET OPERATORS .....	19

## EXECUTIVE SUMMARY

The Federation of Share Registrars has been a strong and active supporter of moves to transform the Hong Kong securities market by removing the need for certificates as evidence of legal title to shares in Hong Kong listed companies ("scripless"). Based on the Federation's experience in Hong Kong and other global markets, it has worked with the Securities and Futures Commission to develop models to implement scripless in Hong Kong and deliver to the Hong Kong market the cost, efficiency, transparency, security and convenience benefits that scripless has brought to other markets.

The Federation is and has been a strong supporter of the initiatives and proposals first put forward in the Financial Secretary's Steering Committee on the Enhancement of the Financial Infrastructure, and further developed in the SFC's Consultation Paper issued in February 2002 and the SFC's Consultation Conclusions published in September 2003.

This document is the Federation's response to the Consultation Paper on a Proposed Operational Model for a Scripless Securities Market published by Hong Kong Exchanges and Clearing Limited in October 2003.

It is not clear how the model proposed in the HKEx Consultation Paper will deliver some of the important benefits contemplated by the SFC Consultation Paper. Some aspects of the model may give rise to structural and operational difficulties.

The HKEx model does not provide much detail in the key area of CCASS Sponsored Accounts. These accounts would enable holders within CCASS to enjoy the protections, rights and benefits of legal title while retaining their close link to their broker or custodian. The Federation is concerned that, in the absence of CCASS Sponsored Accounts, a move to scripless may impose significant costs on participants in the Hong Kong securities market while not delivering in full many of the benefits that scripless offers.

The HKEx Paper raises questions about the safety of holdings on the Issuer Sponsored Sub-register. The SFC Paper said that this was an area requiring more work. In this response, the Federation analyses the safety of holdings under all of the various options offered in the SFC Paper and suggests a combination of optional PIN numbers and generating new SRNs where a holder sold only part of a holding to provide higher levels of safety of holdings on the Issuer Sponsored Sub-register.

The HKEx model may give rise to structural and operational difficulties in a number of important ways.

- HKEx proposes that distribution of corporate actions (rights issues, bonus issues, etc) be split between CCASS and the registrars. This seems unnecessarily costly and complex, and would make the vital reconciliation processes that are undertaken in such transactions very difficult if not impossible. It would also deny CCASS participants the benefit of effectively automating corporate action distribution to their clients (which would otherwise occur automatically through the CCASS Sponsored Account arrangements).
- HKEx proposes daily batch processing of movements between sub-registers. This would deny market participants credit for securities moved from the Issuer Sponsored Sub-register to the CCASS Sub-register for significant periods (more than one trading day). This degradation of current arrangements can be avoided by (ideally) real-time processing of movements between sub-registers. If a more incremental approach is thought desirable at the initial stage, multiple daily batch processing (as current happens within CCASS) will mitigate the problem. This response provides significant detail of processes that would address these issues.
- Daily updating of the share registrars' records with details of holdings on the CCASS sub-register is necessary to enable public inspection of the register of members, corporate communications and register reconciliation. HKEx proposes that this be achieved by share registrars being provided with a full download of the CCASS Register. This seems unnecessarily complex and an inefficient use of bandwidth that will involve unnecessary costs and will again make register reconciliation unnecessarily difficult if not impossible.

The Federation is concerned by the proposal by HKEx that registrars come under the supervision of CCASS. As the Federation is currently in one of the largest suppliers of share registration services in Hong Kong, the Federation believes that the SFC rather than CCASS is the appropriate body to supervise registrars.

All these issues are analysed at length in the following paper. As well, a range of more minor matters are identified and addressed.

The Federation remains a strong supporter of the benefits that scripless offers the Hong Kong market and will continue to work with the SFC and HKEx on ways to achieve the full potential benefits that are a key element in the SFC's model.

## BACKGROUND

The Financial Secretary's Steering Committee on the Enhancement of the Financial Infrastructure (SCEFI) recommended that Hong Kong move towards a secure, scripless securities market to improve efficiency and reduce risks.

Following publication of the SCEFI Report, the SFC invited representatives from HKSAR Government, HKEx/CCASS and the Federation to form an Implementation Working Group (IWG) that was chaired by SFC with the aim of considering options and making a recommendation for a revised framework and infrastructure that would support the proposals for a scripless securities market. The SFC published its proposals in February 2002 in a Consultation Paper on Proposals for a Scripless Securities Market (the SFC Consultation Paper). The Federation supported and still supports the proposals in the SFC Consultation Paper.

To progress the matters covered in the SFC Consultation Paper, the SFC established a Technical Working Group (TWG) to finalise the technical requirements of and implement the scripless market proposals. The Federation, along with representatives from HKEx/CCASS and other market participants, was an active participant of this Group.

The Federation drew on its experience in international markets as well as Hong Kong to present for discussion a range of processes and protocols to meet the needs of the Hong Kong market. The Federation provided access to expertise and experience in a range of markets that have already dealt (to greater or lesser extent) with the issues that moving to scripless raises, including the United Kingdom, the Peoples' Republic of China, New Zealand, Australia, South Africa and Canada.

The SFC published its conclusions following the consultation process in September 2003 in Consultation Conclusions on Proposals for a Scripless Securities Market (the SFC Conclusions).

In October 2003, Hong Kong Exchanges and Clearing Limited published a Consultation Paper on a Proposed Operational Model for a Scripless Securities Market (the HKEx Consultation Paper).

## GENERAL ISSUES

### Support for the SFC proposals

The Federation is a strong supporter of the proposals in the SFC Consultation Paper. The key elements of the SFC proposals are:

- The implementation of a Name on Register system;
- The creation of sub-registers;
- The gradual elimination of share certificates;
- The introduction of electronic transfers of title;
- Linking all Participants via a central communication hub.

These elements combine to offer the Hong Kong securities industry substantial improvements in efficiency and related costs provided that both the technology and the processes are designed in a way that delivers their full potential.

#### ***Name on register***

This is one of the most significant changes. The mechanism proposed by the SFC – allowing investors to hold registered title under CCASS sponsorship - offers shareholders whose securities are currently held for them beneficially by CCASS and its participants the option to enjoy, for the first time, the full benefits of legal title on the share register while retaining their close relationship with their CCASS participant. Of course investors will retain the option to only hold beneficial title as at present.

As a result of this change, communications between issuers and shareholders will be enhanced and shareholders will be able to attend company meetings and enjoy the other rights of share ownership directly.

#### ***Sub-registers***

This contemplates the division of the share register into two parts. This will deliver the advantage of certainty of title following settlement in contrast to the single register concept that requires manipulation of the Law to achieve this.

#### ***Elimination of certificates***

This proposal will improve efficiency and at the same time will reduce risk and should reduce costs going forward.

#### ***Electronic transfers of title***

The full potential of this change will be achieved once the critical mass of shareholdings have been dematerialised. When this is combined with the elimination of share certificates this will deliver efficiencies and reduce the risk from the settlement process.

#### ***Central communications hub***

This offers a substantial opportunity for improved efficiencies across all market participants.

### 3.2 Objectives of moving to a Scripless market

The HKEx model tends to replicate current process and does not take the opportunity of applying many advances in technology that have been developed in other world markets since CCASS was established in the early 1990s. As a consequence, the model in the HKEx Consultation Paper does not offer some of the potential benefits and does not meet a number of the original objectives of a scripless market. In the case of direct deposits, the HKEx proposals represent a retrograde step.

The SFC Consultation Paper sets out the objectives for a scripless market. The following table assesses the HKEx model against these objectives.

Objective	HKEx Model
To provide a convenient, secure and cost effective way for investors trading in Hong Kong securities to be registered members of a listed company.	This relates to the cornerstone element of a move to 'name on register'. While HKEx introduces the concept of CCASS sponsored accounts, the paper provides only a sketchy outline of that service. It does not address important questions of investor protection. Equally, HKEx does not explain the technology and process changes that will be needed for brokers to manage and administrate sponsored accounts. No indications of costs are provided.
To facilitate communications between listed companies and their members.	The lack of detail on mechanisms for holders to be sponsored by CCASS participants makes an assessment of communications between issuers and CCASS participant sponsored holders difficult. The model seems to assume that the bulk of holdings will remain held by CCASS participants as nominees. Communications between listed companies and these investors will remain as ineffective as they are now.
To provide uniform investor identification and authentication methods for registered securities holdings.	Not addressed in Consultation Paper.
To provide investors and intermediaries with a convenient and secure delivery versus payment capability.	Not addressed in Consultation Paper.
To provide efficient and secure ways for registered holdings to be used as collateral.	Not addressed in Consultation Paper.
To provide an appropriate transition from physical securities certificate system to a full scripless market.	The Paper addresses this issue in respect to HK domiciled companies but does not provide information on the situation of overseas domiciled companies listed in HK.
To enact legislative amendments to support the scripless market including where necessary arrangements to cater for listed companies that are not incorporated in Hong Kong.	Not addressed in Consultation Paper. However this is work that has already been undertaken by SFC in full consultation with members of the TWG.
To enhance the infrastructure for and promote competition in the provision of securities services consistent with their safe, efficient and cost effective delivery.	The SFC's recommended model provides a structure that is designed to maintain competition in the market. It should be noted however that, whilst it is possible in principle, for parties other than CCASS to provide sponsored accounts under the HKEx model, in practice it is unlikely to be feasible.



The Consultation Paper sets out principles and objectives to which HKEx has attached substantial importance in its proposed operational model. The following table assesses the model against these principles and objectives.

HKEx principle or criterion	HKEx model
The model should maintain the current choices provided to investors, including the choice to register their shareholdings either directly in their own names or through market intermediaries and financial services providers such as brokers and custodians.	The model does not provide much detail of the operation of the CCASS sponsorship component of the SFC model. Especially, it does not consider how that service will be promoted to investors. If the CCASS sponsorship component is not delivered and promoted, investors are likely to be denied a choice to hold through market intermediaries and financial service providers such as brokers and custodians while enjoying the rights and protections that attach to legal ownership.
The model should enhance market efficiency and thereby reduce costs.	The model offers limited improvements in market efficiency. It relies on single daily batch processing for non-CCASS maintained holdings, rather than real-time processing (as is the case in most markets with similar systems) or at least multiple daily batches. Delays in crediting stock moved between sub-registers, split corporate action processing, and full sub-register transfer to keep the two sub-registers in line (rather than transaction messaging or change balance notifications) are all areas where the model could be modified to provide more efficient and cost effective outcomes. The elimination of immediate credits for direct deposits seems likely to reduce efficiency and increase costs.
The model should facilitate fair allocation of costs through the user-pays principle.	The model provides no detail on how costs will be allocated.
The model should improve protection to investors and reduce the risk of misappropriation.	Except for the comments about SRNs (which was already acknowledged as an area needing more work before the HKEx Consultation Paper was released), there is little assessment of investor protection.
The model should uphold current market integrity and system reliability levels.	There is little information on this area.

### CCASS Participant Sponsored Accounts

In the current Hong Kong environment, legal title to the larger proportion by value of shares is held by HKSCC Nominees. The investor who has paid for the shares and has the beneficial ownership of them is removed from legal title by (typically) two layers – CCASS and its CCASS participant.

While this structure works well in terms of the clearing and settlement of trades, it comes at a cost to the market as a whole and to investors in particular. Costs are higher and efficiency is reduced as communications and distribution of corporate action benefits (such as payment of dividends to shareholders) are delayed as the information passes through the various layers. Charges are levied at multiple points in the process. These charges include payment for the custody of the shares and for the distribution of corporate actions.

The depository model, with its various layers of 'ownership', also makes it difficult for issuers to readily identify the true owners of the company.

The HKEx model does not examine ways in which brokers and their investors can access the benefits and cost-savings sought under the SFC Proposal. Whilst the model mentions the notion of Participant Sponsored Accounts, it provides little detail of the process or of the protections that can be afforded to investors who choose this service. There is no indication of indicative costs for sponsored accounts.

In addition, there is no consideration given to the nature of the changes that will be necessary within a broker's system, to accommodate the service beyond a reference in paragraph 7.12 that "such modifications will be relatively minor." International experience suggests that this will not necessarily be the case. In addition, there is no guidance on the way in which HKEx expects to promote CCASS Sponsored holdings prior to, during and after the implementation phases.

If implemented in its current form, it seems likely that the HKEx model would simply replicate the current shareholding structure with broker nominees and custodians taking legal title to shares and continuing to maintain the records of beneficial ownership. If that proved to be the case, significant costs would have been imposed on the market for almost no benefit.

### 3.4 SRNs and the safety of holdings

Under the SFC Scripless proposals, there will be five ways that investors can hold HKEx-listed securities. These are (numbered on the same basis as the boxes in the SFC structure chart<sup>1</sup>):

1. In dematerialized form as beneficial owners, with legal title held by CCASS Participants (brokers and custodians)
2. In dematerialized form as legal owners in CCASS Participant Sponsored Accounts
3. In dematerialized form as legal owners in CCASS Investor Participant Accounts
4. In dematerialized form as legal owners in Issuer Register Accounts
5. In certificated form as legal owners

The HKEx Consultation Paper introduces a 6<sup>th</sup> option that provides a service for IP account holders who choose to remain undisclosed.

<sup>1</sup> See Diagram 1 on page 5 of the SFC Conclusions

Each paragraph examines safety structures relating to each form of holding. Key areas are controls over movements of securities (what steps are needed to authorize movement, whether trading or other transfer), what information is given to holders about balances held and movements of securities, and what information is given to holders about events of value relating to their securities (eg, dividend payments, rights issues, etc).

Each of these subjects is examined for each type of holding. One enhancement is suggested – optional (at the holder's election) password protection for Issuer register holdings.

***Holding Type 1 - In dematerialized form as beneficial owners, with legal title held by CCASS Participants (brokers and custodians)***

*Controls over movements*

Movement is under the sole control of the CCASS Participant.

*Information about balances and movements*

The CCASS Participant provides information about movements and balances to investor. If the CCASS participant does not do so, the owner will not know that their holding has been transferred or sold.

*Information about events of value*

Information about the event passes from the Issuer's Registrar to CCASS, from CCASS to the CCASS Participant and from the CCASS Participant to the holder. If there is a holder response (eg, a voting proxy appointment and/or direction, or a rights subscription) the chain of multiple handling is reversed – the communication passes from holder to CCASS participant, from CCASS participant to CCASS and from CCASS to Registrar.

***Holding Type 2 - In dematerialized form as legal owners in CCASS Participant Sponsored Accounts***

*Controls over movements*

The HKEx paper does not address this situation. Indeed it provides almost no information about this type of holding. However the TWG was working on the idea of a Holder Identification Number (HIN) to control each participant sponsored account. The HIN could cover all positions in all stocks within the portfolio.

Movement with a HIN would be under the sole control of the CCASS Participant. As with Type 1 holdings, if there is a breakdown in internal controls within the participant, the securities can be sold or transferred at any time.

*Information about balances and movements*

Ad Hoc and periodic statements will be issued (although no guidance is provided on the period between periodic statements). The result would be that any unauthorized dealing would be promptly detected by the holder. This in turn means that long-term misappropriation (which has been the principal cause of broker default in HK) can be nipped in the bud.

*Information about events of value*

Again the HKEx paper does not address this situation. However the TWG was working on the idea that information would be sent directly from the Registrar to the holder. If there is a holder response (eg, a voting proxy appointment and/or direction, or a rights subscription) the process is reversed – the communication passes directly from the holder to Registrar.

***Holding Type 3 - In dematerialized form as legal owners in CCASS Investor Participant Accounts***

*Controls over movements*

CCASS Investor Participants will have their names on the CCASS register. In exactly the same way as for current IP Accounts, the investor has the control over any movements of shares in the account and submits these instructions by phone, internet or in person to CCASS.

*Information about balances and movements*

Statements will be sent to IP account holders ad hoc where a movement of shares has occurred, otherwise periodically.

*Information about events of value*

In similar fashion to type 2 holdings, the TWG was working on the idea that information would be sent directly from the Registrar to the holder on the record. If there is a holder response (eg, a voting proxy appointment and/or direction, or a rights subscription) the process is reversed – the communication passes directly from the holder to Registrar.

**Holding Type 4 - In dematerialized form as legal owners in Issuer Register Accounts**

*Controls over movements*

The TWG was working with a model where each holding has a unique holding identification number (SRN). The SRN would be the "key" that allows a broker to deal with the holding. So long as the holder kept the SRN confidential, no-one else could move their stock.

On sale or transfer, the holder would need to give the SRN to the selling or transferring organization. If a holding was only partly sold or transferred, a new SRN could be generated for the balance holding. If a holder was concerned that the confidentiality of the SRN was compromised, a replacement SRN could be generated.

Holders who want an additional level of protection could further protect their holding with a PIN. In this case, the PIN would need to be provided by the holder to the Registrar along with the SRN before a transfer or sale could be settled. This would, however, create issues for brokers who might worry that their capacity to settle trades might be prejudiced.

*Information about balances and movements*

In a similar fashion to type 2 holdings, the TWG was working on the idea that the Registrar would send to the holder a statement showing the new balance after any [month] in which there was a movement. Portfolio statements would also be sent [once] a year. In addition shareholders will be provided with the ability to freely check their holding balances through services delivered on the web and IVR. These services will be provided at no cost to the shareholder.

In addition, it is anticipated that investors will be able to routinely check their holding balances through web-based and IVR services that will be offered at no cost to the investor.

The result would be that any unauthorized dealing would be promptly detected by the holder. This in turn means that long-term misappropriation (which has been the principal cause of broker default in HK) can be nipped in the bud.

*Information about events of value*

In similar fashion to type 2 holdings, the TWG was working on the idea that information would be sent directly from the Registrar to the holder on the record. If there is a holder response (eg, a voting proxy appointment and/or direction, or a rights subscription) the process is reversed – the communication passes directly from the holder to Registrar.

**Holding Type 5 - In certificated form as legal owners**

*Controls over movements*

The certificate itself is prima-facie evidence of title, and the holder must make appropriate arrangements to safeguard the certificate.

If the holding is sold, the holder must deliver the certificate to the broker. Many brokers will insist on receiving the certificate before acting on a sell instruction for fear of settlement failure.

However, the investor will have the choice of first moving the shares onto the issuer sponsored sub-register. In this way the investor will avoid the need to deliver share certificates to the broker.

*Information about balances and movements*

While holders can check their balances with the Registrar at no cost to the shareholder, no statements or confirmations are sent to holders except for bonus issues and like events.

### 3.4 *Communication about events of value*

For those with certificated holdings today, information would be sent directly from the Registrar to the holder at no cost to the shareholder. If there is a holder response (eg, a voting proxy appointment and/or direction, or a rights subscription) the process is reversed – the communication passes directly from the holder to Registrar.

### 3.5 Inter-register movements

The SFC's TWG worked up detailed processes for electronic movements between the CCASS and Issuer's sub-register that both provided efficient and effective certainty of title in the settlement process and, at the same time, ensured equity of treatment for all shareholders.

The HKEx model (paragraph 3.26) takes a different path in its approach to these transactions and specifically precludes immediate crediting of shares deposited into CCASS. This seems a backward step for market efficiency.

Later paragraphs include an outline of proposals explored by the TWG under which same-day credit can be achieved with changes to process and the application of modern technology thinking.

### 3.6 Corporate action communication processing

There are a large number of corporate actions undertaken by Issuers that range from a simple dividend to more complex takeovers, rights issues and capital reconstructions.

A significant benefit of the 'name on register' structure concerns the way in which dividends and corporate actions can be managed.

At present CCASS, as the legal shareholder, receives and manages corporate actions in relation to its participants who, in turn receive and manage the distribution to the underlying beneficial holders. This process is costly to the industry. The costs are both direct and indirect. For instance, CCASS charges for its corporate action services.

Currently, any communication in relation to a corporate action has to pass through three channels before it gets to the target (the beneficial holder);

- (i) From Issuer to CCASS,
- (ii) From CCASS to Participant,
- (iii) From Participant to Beneficial Holder.

This multiple handling is inefficient. As an example, it is reflected in the current process timetables, which require CCASS participants to notify CCASS of their intentions well before shareholders on the issuer's register have to notify their intentions. The cut off for beneficial holders to notify their CCASS participants is earlier yet.

A 'name on register' structure allows benefits to be distributed directly to the shareholder, removing costs and delays.

The HKEx model is that CCASS will continue to be responsible for distribution of corporate actions to all shareholders on the CCASS sub-register. This seems likely to miss the potential for material cost savings.

The model's proposal that corporate action processing be split between Registrars and CCASS also gives rise to significant potential reconciliation issues, as there will no longer be a single point of consolidation. The reconciliation problems are exacerbated by the proposal in the model that CCASS not provide net movement details to the registrars for changes on the CCASS sub-register, proposing instead that a full copy of the CCASS register be downloaded every night. This is discussed further below.

### 3.7 Register updates and maintenance

The HKEx model contemplates a full download of the CCASS register as part of the end-of-day process in contrast to the more efficient approach of transmitting details of the net movements of CCASS participant accounts.

Paragraph 3.8 says that "For share registrars to track the movements during the day on the CCASS register, they will in effect have to perform the CCASS transactions all over again" and concludes that "We do not think it is cost effective to do so as the volume of data involved would be huge."

In fact, nightly download to track all movements that have occurred during the course of the day can be quite easily avoided.

Throughout the course of the day CCASS will transfer title between CCASS holders arising from the settlement of trades (intra-day CCASS movements). There will always be cases where the same account is added to and subtracted from as a result of settlement. For example a Custodian or an Institution's holding may well be the subject of multiple settlements during the day.

All that is needed is for CCASS to provide the registrars with details of net movements on accounts that result from the intra-day transfers. On receipt the registrar will apply these changes to the record of CCASS holders contained on the register.

Under this proposal the registrar will be able to perform a range of reconciliation functions that include:

- Ensuring that all records have been changed properly,
- Ensuring that the total of shares held on the CCASS register is reconciled, and
- Ensuring that the total of issued share capital is reconciled.

It seems quite unlikely that the volume of data involved in providing net movements of affected accounts will be significantly larger than the volume of data involved in transmitting the entire CCASS share register. It seems improbable that intra-day net movements would ever exceed the total number of shareholders in a company. In our opinion, when sponsored CCASS accounts become popular, a complete register download each night will, in any event, be an unmanageable task.

Paragraph 3.9 says that "we are unsure if the market would consider it appropriate for HKSCC to provide information of the CCASS transactions to a third party for non-regulatory matters."

There is no suggestion that information on CCASS transactions be provided to registrars, simply the results of those transactions.

### 3.8 Regulatory Oversight of Share Registrars

The HKEx model suggests that approved share registrars become participants in CCASS and therefore subject to CCASS regulation.

HKEx is a shareholder in a registrar, Computershare Hong Kong Investor Services Limited. The conflict of interest seems clear.

The Federation has no issue with the principle of regulatory oversight but would be far more comfortable if that lay with the SFC.

## PROCESS FLOWS AND INFRASTRUCTURE

### 4.1 Inter register movements

The key benefit that a sub-register delivers is certainty of title. Given this principle is crucial then it should properly be applied to all electronic transactions, including transactions that move shares from the issuer's sub-register to the CCASS sub-register. Under the HKEx model, some time elapses between the request and the fact. This would not only cause uncertainty, it would also provide a lower level of service for these shareholders as electronic transfers within the CCASS register will be real-time.

The combination of electronic transfer, sub-register and a central communication hub should be supported by a real-time framework that works in the interest of all investors and delivers certainty of title.

### 4.2 Movements between issuer's certificated sub-register and CCASS sub-register

The business reasons for these movements are as follows:

- The sale of shares held in certificated form on the issuer's register.
- Following a new sponsorship agreement between a shareholder on the issuer's certificated register and a broker.

The proposed HKEx model transaction flow for dematerialising stock seems unduly complicated and takes an unnecessarily extended time.

The following process would be simpler and quicker:

- A CCASS participant generates an electronic request to deposit shares from the issuers register to a named account in CCASS;
- CCASS passes this message through to the registrar (and maintains a record of the message);
- Registrar receives the message and validates to CCASS that a holding exists for the quantity requested;
- If the validation succeeds, the registrar holds in electronic "pending" file awaiting certificates;
- If the validation fails, a message is immediately sent to CCASS with a "reason for rejection" code;
- CCASS sends a rejection message to the CCASS participant electronically;
- On receipt of properly completed share certificate and following its authentication, the registrar actions the pending item, applying the transaction to the share register;
- Concurrently, the share registrar creates and sends an electronic message to CCASS confirming withdrawal from the issuer's register;
- On receipt CCASS applies the transaction to the CCASS sub-register and sends a confirmation message to the CCASS participant.

In this structure, there should be service standards that CCASS and participants are bound to meet. These

- maximum response times to messages received;
- Maximum times between broker generating deposit request and submission of documents to the share registrar;
- Maximum times for processing pending instructions once documents have been received by the registrar;
- Maximum times for the completion of client settlement;
- Maximum times for reporting of CCASS positions to brokers and registrars.

Such arrangements will result in routine same-day processing for deposits, timely transfer of legal title and certainty in the resulting settlement. It may well be possible to achieve this in the short-term through the introduction of multiple batch processing throughout the day although we favour a real-time approach.

### 4.3 Re-materialisation of shares

The business reasons for these movements are as follows:

- A buyer of shares who wants to be registered on the certificated issuer's share register.
- A sponsored investor who has renounced a sponsorship agreement and requires the shares to be registered on the issuer's certificated share register.
- A beneficial holder of shares held within a nominee who wants shares registered on the certificated share register.
- A holder within the IP account who wants to move shares to the certificated share register.

The following process could be fully electronic and achieve 'on the day' resolution:

- Participant submits an electronic instruction to CCASS to move the shares to the issuer's certificated register.
- CCASS validates the holding in the nominated CCASS account.
- If the details pass validation the holder is removed from the CCASS sub-register and;
- An electronic message is sent to the registrar to instruct the holding to be added to the certificated share register.
- The registrar sends confirmation message to CCASS.
- On the day following the entry of the holder, a certificate is produced and despatched to the holder.



movements between the Issuer Sponsored sub-register and the CCASS sub-register  
cause for these movements is the same as explained for dematerialisation.

The following process is made simpler in the absence of share certificates:

- The broker generates an electronic message requesting the transfer of shares from the holder's issuer sponsored holding into a specified CCASS account;
- CCASS receives the message and holds as "pending" in the system;
- CCASS passes this electronic message to the registrar;
- The registrar automatically checks the message and, if correct, executes the transfer from the holders issuer sponsored account and;
- Transmits an acceptance message to CCASS;
- On receipt CCASS applies the shares to the nominated CCASS account and;
- Transmits an acceptance message to the broker;
- If the details prove to be incorrect when received by the registrar, a rejection message is transmitted to CCASS with a reason for rejection code appended;
- CCASS deletes the pending message from its files and;
- Transmits the rejection message to the broker.

If real-time processes supported this transaction, it would be reasonable to suggest that overall processing time would be minimal and seamless from request to completion.

**SPECIFIC ISSUES**

**5.1 Chapter 3 – Proposed Operational Model for a Scripless Securities Market**

**Paragraph 3.2. – 4<sup>th</sup> bullet point**

Please refer to the General Issues Section under the heading "Register updates and maintenance".

**Paragraph 3.3. – 5<sup>th</sup> Bullet Point**

Does the reference to "registration at Broker level" refer to the Broker's settlement account within CCASS? If so, does this mean that registration at shareholder level (for example for a sponsored client) is also immediate and same day?

**Paragraph 3.3. – 5<sup>th</sup> bullet point**

This should also include certificated holders on the issuer's register.

**Paragraph 3.7.**

We are led to understand that both Bermuda and Caymen Islands are likely to accede to the necessary enabling legislation. Other countries may not be co-operative and as well as the solution put forward in the Paper there is also an option to create Depository Interests. Examples of this service can be found in both the UK and in Australia.

**Paragraph 3.8.**

Please refer to the Section - "Register updates and maintenance".

**Paragraph 3.10**

Legislative amendment may be needed to support this policy. Under the new model, CCASS will be operating on a legal register.

**Paragraph 3.13 - 3.15**

Please refer to the Section - "CCASS Participant Sponsored Accounts".

**Paragraph 3.16**

Please refer to the Section - 'Regulatory Oversight of Share Registrars'.

**Paragraph 3.21 - Non-disclosed IP Accounts**

The Federation makes the point that this service is simply a Nominee (Custody) service by another name. In the circumstances the Federation would question whether there is any real commercial need to create a further avenue for this type of service beyond that which is already available through the services offered by competing custodians in Hong Kong.

3-1, 3-6

refer to the Section - "Process Flows and Infrastructure".

**Paragraphs 3.41 – 3.42**

This document has already discussed the preferred option for real-time processing of deposits and withdrawals.

Benefits accruing through real-time processing include:

- Same day credit for deposits;
- Same day debit for withdrawals;
- Potential for CCASS to provide brokers, custodians and institutions with value-add services;
- A realistic opportunity to create a continuous net settlement environment;
- Needed for moves towards Straight Through Processing.

Whilst the Federation firmly believes that real-time is world's best practice and desirable, they acknowledge that multi-batch processing may be an acceptable interim step towards this being achieved.

**CHAPTER 5 – SERVICES TO SHAREHOLDERS**

Please refer to the Section - 'Corporate Action and communication processing'.

**7. CHAPTER 7 – IMPLICATIONS OF THE SCRIPLESS SECURITIES MARKET MODEL FOR MARKET OPERATORS**

**Paragraph 7.4**

Please refer to the Section - "CCASS Participant Sponsored Accounts".

**Paragraphs 7.5 and 7.13 (last sentence)**

The proposal says that "The CCASS participant as the sponsoring CCASS participant will handle corporate actions and entitlements on behalf of the holders of CCASS participant sponsored accounts".

We interpret this to mean that a sponsoring broker will handle corporate actions and entitlements on behalf of the registered owner of shares. This seems both unnecessary and inefficient in a 'name on register' system as already pointed out. As well as this it is questionable whether the share registrar (as agent for the issuer) has the legal power to deal with a third party in this way.

**Paragraphs 7.6 and 8.2**

This paragraph (and others scattered throughout the Consultation Paper) discusses the use of the Shareholder Reference number (SRN) for dematerialised holders on the issuer's share register. These issues are dealt with in the General Issues section under the heading "SRNs and the safety of holdings".

**Paragraph 7.12**

Whilst the changes necessary to support new transactions may be relatively minor, the important point that there will need to be significant changes to accommodate the recording and management of CCASS sponsored holders by brokers has been omitted.

**Paragraph 7.14**

Please refer to the Section - 'SRNs and the safety of holdings'.

**Paragraph 7.16**

Please refer to the Section - "Process flows and infrastructure".

**Paragraph 8.2**

Please refer to the Section - 'Corporate Action and communication processing'.