

**CONSULTATION CONCLUSIONS ON A  
PROPOSED OPERATIONAL MODEL FOR A  
SCRIPLESS SECURITIES MARKET**

**May 2004**



**Hong Kong Exchanges and Clearing Limited**

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# EXECUTIVE SUMMARY

## The Consultation Conclusions

On 24 October 2003, Hong Kong Exchanges and Clearing Limited (“HKEx”) published a Consultation Paper on a Proposed Operational Model for a Scripless Securities Market (the “HKEx Consultation Paper”) to invite market comments. This Consultation Conclusion Report summarises the views and the issues raised in response to the consultation exercise and our comments thereon. It also recommends a way forward for the scripless initiative in Hong Kong in the light of market comments.

This Consultation Conclusion Report comprises four chapters. Chapter One briefly recapitulates the background of the HKEx consultation exercise on the scripless initiative. Chapter Two highlights the key issues and concerns raised by the market in response to the HKEx Consultation Paper and our responses thereto. Chapter Three describes in detail the proposed modifications to the Split Register Model in response to market concerns and a progressive approach on implementation. Chapter Four provides a conclusion on the consultation exercise and sets out the proposed way forward for the scripless initiative in Hong Kong.

## Consultation Results and HKEx’s Responses

We received a total of 26 submissions from issuers, brokers, banking and brokers associations, custodian banks, professional bodies, the Federation of Share Registrars, the Consumer Council and individuals. A list of respondents is contained in Appendix 1. Copies of the submissions have also been posted on the website of HKEx at [www.hkex.com.hk](http://www.hkex.com.hk) for public reference. The comments received have been categorised mainly into the following areas:

- Implementation of a Scripless Securities Market;
- Register of Members (“ROM”);
- The Central Clearing and Settlement System (“CCASS”) Register;
- Registrar Participantship and Regulation of Share Registrars;
- Removal of Immediate Credit;
- Clearing and Settlement Services;
- Inter-register Transfers;
- Dematerialisation;
- Rematerialisation;
- Services to Shareholders;
- Shareholder Reference Number (“SRN”); and
- Cost Implications for Market Participants.

Appendix 2 describes the above comments and our responses thereto.

Chapter Two of this Consultation Conclusion Report discusses the key issues raised by the respondents. Nearly half of the respondents in principle supported the scripless initiative. However, there were also concerns over some of the features of the originally proposed operational model, including the fragmentation of ROM, the removal of the immediate credit policy, the Registrar Participantship and the SRN. Some respondents had concerns over the cost implications for market participants and the timing of the implementation of the scripless initiative in Hong Kong. Some of them considered the current immobilisation model already very efficient and questioned whether this was the right time to introduce significant changes to the securities market.

Comments received from the market were helpful to us in understanding the market's concerns about the scripless initiative and re-evaluating the Split Register Model and the originally proposed operational model. While we still believe the Split Register Model is feasible and generally sound, some modifications would seem desirable in response to market's concerns.

One major modification we propose to make is to maintain the CCASS on a nominee basis and not to convert it into a "sub-register" as originally proposed under the Split Register Model. Shares deposited into the CCASS Depository will therefore continue to be registered in the name of HKSCC Nominees Limited ("HKSCC Nominees"), similar to depositing shares with broker/custodian nominees. We believe this should address market's concerns about fragmentation of the ROM, thus avoiding complexities and potential risks arising from the need for register reconciliation, and the removal of the immediate credit policy. To distinguish the revised model from the Split Register Model, we refer to the revised model as the "Issuer Register Model". Another theme of our proposed way forward is a progressive approach on implementation. We hope this would address market's concerns about the timing and pace of implementation of the scripless initiative.

We noted that most respondents commenting on the proposed Registrar Participantship did not favour the idea. One possible alternative we have considered is to set out the terms of co-operation and operational requirements in an agreement between Hong Kong Securities Clearing Company Limited ("HKSCC") and share registrars. We are happy to consider any other suggestions which may also serve as the basis for better co-ordination between HKSCC and share registrars in the support of uncertificated shares.

Many market comments raised concerns about the security and user-friendliness of the SRN. We understand that the Federation of Share Registrars is reviewing the SRN proposal and considering other possible alternatives. We believe market comments will be fully taken into account before such a measure is finalised.

Another area of major concern to the market is the cost implications of implementing the scripless initiative. We will respond to those concerns in another section of this Executive Summary.

## **The Revised Proposal and a Progressive Approach on Implementation**

Chapter Three describes in detail the Issuer Register Model and the progressive approach on implementation.

### ***Key features of the Issuer Register Model***

Under the Issuer Register Model, there will be one ROM for each company listed in Hong Kong – the Issuer Register maintained by a share registrar as it is the case currently. However, in addition to certificated shareholdings, the ROM will also record uncertificated shareholdings after the introduction of uncertificated shares. HKSCC will continue to operate on a nominee basis, which means all shares deposited by CCASS Participants will continue to be registered in the name of the HKSCC Nominees on the Issuer Register. The current clearing and settlement operations of HKSCC will remain largely unchanged and the immediate credit policy of HKSCC will continue. The Issuer Register Model will retain all the existing shareholding options for investors and on top of them introduce the scripless choice. The roles and functions of share registrars will also remain fundamentally unchanged under the revised proposal as they are currently.

### ***Services to shareholders***

Share registrars will serve all registered shareholders on the ROM, including HKSCC Nominees, in relation to corporate communications and corporate actions. HKSCC Nominees, as the registered shareholder, will continue to perform corporate actions for CCASS Participants, including Investor Participants (“IPs”), in relation to their shares deposited into the CCASS Depository. These arrangements are the same as currently.

## *Progressive Implementation*

To address the market concern over the timing of the implementation of the scripless initiative in Hong Kong, we propose that a progressive approach driven by market demand be adopted on the implementation of a scripless securities market in Hong Kong. In essence, we propose beginning the dematerialisation exercise with the CCASS Depository, then gradually extending the exercise by making dematerialisation an option for other registered shareholders. Subject to market demand, electronic linkages between CCASS and systems of individual share registrars may be established in the further development of the scripless initiative to facilitate deposits and withdrawals of uncertificated shares into and from the CCASS Depository. The functionality of the linkages should be less complicated than that proposed under the Split Register Model.

## *Initial Phase*

The initial phase will dematerialise a portion of the shares in the CCASS Depository. We will start by dematerialising approximately 550,000 odd lots and jumbo certificates (certificates of large denomination) of locally incorporated Hong Kong-listed companies (representing approximately 15% of total market capitalisation) as well as shares of listed companies incorporated overseas whose jurisdictions also allow the issue of uncertificated shares.

HKSCC will continue to allow deposits and withdrawals of physical scrip by its Participants. Like today, the deposited scrip will be delivered to share registrars for re-registration in the name of HKSCC Nominees, but after the introduction of uncertificated shares, such scrip will also be dematerialised at the point of re-registration. The CCASS Depository will maintain a vault to keep physical scrip of smaller denominations to meet requests of withdrawal of physical certificates, which we expect would still be important particularly for retail investors and their brokers. Where necessary, HKSCC Nominees may rematerialise its uncertificated shares to meet withdrawal demands.

In order to raise the level of shareholding transparency at the CCASS Participants (other than IPs) level, it is proposed that HKSCC Nominees be able to make available to the public the shareholding information of CCASS Participants (other than IPs) subject to a fee under the user-pays principle.

## *Further Development*

One of the main enhancements to be considered in the further development of the scripless initiative is the implementation of electronic linkages between CCASS and share registrars' systems to enable electronic deposits and withdrawals of uncertificated shares into and from CCASS. In parallel with the implementation of the initial phase of the scripless initiative, we will continue the discussion with the Securities and Futures Commission ("SFC") and the Federation of Share Registrars on the details of the further development and work out an implementation plan. The pace of the further development will take into account market needs.

## *Implications of the Proposal for the Market*

The progressive approach on implementation means that the up-front development costs and impact on operations for market intermediaries is minimal. The only obvious additional cost for market intermediaries and investors is the dematerialisation fee if they wish to dematerialise their scrip. The dematerialisation fee will be determined by share registrars, in consultation with the SFC.

With the gradual dematerialisation of the shares in the CCASS Depository, we expect that some of the existing CCASS fees, including the scrip fee, custody fee and withdrawal fee, will have to be reviewed. New fee items (such as deposit fee) may also have to be considered. Overall, we hope that the efficiency of the Hong Kong securities market will increase and costs will be lowered, ultimately bringing benefits to the investing public.

## **Conclusions and Proposed Way Forward**

We believe removal of scrip is an important and unavoidable development in the evolution of the securities market as we pursue higher efficiency and shareholder transparency and lower costs. While its benefits will take time to be fully realised, we believe they will be long-lasting.

In the light of market comments, we propose modifying the Split Register Model to maintain CCASS on a nominee basis, i.e. the Issuer Register Model. Our proposal preserves the unity of the ROM and enables HKSCC to maintain the immediate credit policy. A progressive approach on implementation will allow time for the investing public and other market participants to adjust to the scripless environment and allow market forces to determine the pace of further development.

We estimate that the dematerialisation of the 550,000 odd lots and jumbo certificates in the CCASS Depository could be completed in approximately 12 to 18 months' time. The commencement of the dematerialisation programme is subject to the enactment of the enabling legislation and the readiness of the share registrars to support uncertificated shares. It will also require system development on the part of HKSCC. We will provide input and support to the Government and the SFC in drafting the necessary amendments to the Companies Ordinance to enable a scripless securities market along the proposed model design set out in this Consultation Conclusion Report. We look forward to the early introduction of the Companies (Amendment) Bill into the legislature in the next session. In parallel with the implementation of the initial phase, we will continue to discuss with the SFC and the Federation of the Share Registrars further development of the scripless initiative, in particular the electronic linkages between CCASS and share registrars' systems and dematerialisation of shares of listed companies incorporated overseas. We will also proceed with the review of CCASS fees.

We fully recognise the importance of investor education in the promotion of the scripless initiative and will work closely with the SFC and other stakeholders in this regard.

We have discussed the proposed way forward with the Federation of Share Registrars and sounded out the Consumer Council and the major user community of CCASS, including brokers associations and CCASS Custodian Participants. Without any intention to prejudice their positions, the feedback we received suggests to us that the proposal is generally workable and acceptable. We have also discussed the proposal with the SFC and they have indicated that they support taking the proposal forward. We hope the proposal will gain general market support and serve as a basis for Hong Kong to move forward on the scripless initiative.

## **Chapter One**

### **Introduction**

- 1.1 On 24 October 2003, Hong Kong Exchanges and Clearing Limited (“HKEx”) published a Consultation Paper on a Proposed Operational Model for a Scripless Securities Market (the “HKEx Consultation Paper”) to invite market comments on the details of the implementation and operation of a scripless securities market in Hong Kong. The operational model set out in the HKEx Consultation Paper was based on the Split Register Model put forward in an earlier consultation paper published by the Securities and Futures Commission (“SFC”) in February 2002 (the “SFC Consultation Paper”).
- 1.2 The HKEx consultation ended on 23 December 2003. We received a total of 26 submissions from the market (including one no-comment submission and five late submissions). These 26 submissions included two submissions from issuers, one from the Federation of Share Registrars, four from banking and brokers associations, three from professional bodies, one from the Consumer Council, 13 from the Central Clearing and Settlement System (“CCASS”) Participants, and two from individuals. A list of respondents is contained in Appendix 1. Comments varied in range and in depth, with some focusing on broad principles and others on points of detail and clarification. All of these 26 submissions have been posted on our website at [www.hkex.com.hk](http://www.hkex.com.hk) for public reference.
- 1.3 The comments received have been categorised mainly into the following areas:
- Implementation of a Scripless Securities Market;
  - Register of Members (“ROM”);
  - The CCASS Register;
  - Registrar Participants and Regulation of Share Registrars;
  - Removal of Immediate Credit;
  - Clearing and Settlement Services;
  - Inter-register Transfers;
  - Dematerialisation;
  - Rematerialisation;
  - Services to Shareholders;
  - Shareholder Reference Number (“SRN”); and
  - Cost Implications for Market Participants.

Appendix 2 describes the above comments and our responses thereto.

- 1.4 This Consultation Conclusion Report summarises the views and the issues raised in response to the consultation exercise and our comments thereon. It also recommends a way forward for the scripless initiative in Hong Kong in the light of market comments.

## **Chapter Two**

### **Consultation Responses**

#### **Overview**

2.1 We received a total of 26 market submissions on the HKEx Consultation Paper. Nearly half of the respondents in principle supported the scripless initiative. However, there were also concerns about certain features of the originally proposed operational model. We highlight in this chapter concerns raised in respect of a few key issues:

- Timing of implementation of the scripless initiative;
- Fragmentation of the ROM;
- Removal of the immediate credit policy;
- Registrar Participantship and regulation of share registrars;
- Security of the SRN; and
- Cost implications for market participants.

#### **Specific Comments**

##### *Timing of Implementation of the Scripless Initiative*

2.2 While the respondents generally supported the scripless initiative, some had reservation about implementing it now for various reasons. Some respondents considered the current immobilisation model adopted by Hong Kong Securities Clearing Company Limited (“HKSCC”) already very efficient and able to meet the needs of the market. They therefore did not consider it necessary to adopt a model which was drastically different from the current one. Some respondents questioned if it was the appropriate time to introduce significant changes to the securities market when the Hong Kong economy was just recovering from a prolonged downturn.

##### *Fragmentation of the ROM*

2.3 As its name implies, the Split Register Model will split the ROM into two “sub-registers” – one maintained by share registrars on behalf of issuers (the “Issuer Register”) and the other maintained by HKSCC (the “CCASS Register”). Some respondents considered this fragmentation of the ROM undesirable and preferred a central record of shareholdings. Some respondents were also concerned about the additional costs and potential risks arising from the reconciliation process between the two “sub-registers” which will have to be performed at least on a daily basis. One of them considered the daily transmission of the CCASS Register to share

registrars for the compilation of the complete ROM unnecessarily complex and inefficient, causing unnecessary cost for the market. There was comment that fragmentation of the ROM would likely cause confusion to investors and issuers.

### ***Removal of the Immediate Credit Policy***

- 2.4 A prime concern identified in comments received related to the removal of the immediate credit policy of HKSCC. Respondents commented that the proposal was a step backward as it would seriously affect the efficiency of selling shares in scrip form.

### ***Registrar Participanship and Regulation of Share Registrars***

- 2.5 Most respondents commenting on the proposal for Registrar Participanship did not favour the idea. Some respondents commented that there would be a possible conflict of interest because HKEx was a shareholder in a registrar company; a respondent considered the concept of Registrar Participanship clumsy as most of the CCASS Rules would be inappropriate for share registrars.
- 2.6 In a related matter, some respondents considered that the future regulation and supervision of share registrars was crucial because share registrars would be involved in the transfer of shares. One of the respondents commented that by allowing share registrars to operate the Issuer Registers, share registrars would be acting as mini “CCASSes” and therefore should be regulated and supervised no less strictly than HKSCC.

### ***Security of the SRN***

- 2.7 An overwhelming majority of the respondents were concerned about the security risk and user-friendliness of SRNs. There was comment that when an investor wanted to sell only part of his or her holdings, the disclosure of the SRN to an intermediary could increase the risk of misappropriation. Brokers themselves would also have to take additional control measures to mitigate the risk of possible misuse of the SRN and misappropriation of clients’ shares. Some respondents were concerned about the lack of safeguards to prevent an investor from giving sell orders for the same lot of shares to different brokers. A respondent commented that the proposal would cause inconvenience to investors in managing multiple SRNs when they held shares in several companies.

- 2.8 There were suggestions relating to SRNs in some submissions. They included the use of an optional Personal Identification Number (“PIN”) for authentication purposes and a replacement SRN for partial sales, encryption of the SRN, affirmation from investors on transfers of shares, inclusion of the investor’s Hong Kong ID card number for verification, the option of collecting the SRN in person and the use of plain and smaller envelopes for sending SRNs to shareholders.

### ***Cost Implications for Market Participants***

- 2.9 A major area of concern to the market was the cost implications of implementing the scripless initiative. There were comments that market participants might have to enhance their current systems and the related capital costs as well as on-going system maintenance costs would be a great concern to them. A respondent commented that if investors and issuers were required to share the costs of development and operations, the costs would be similar to a public utility and future tariffs should be subject to prior approval.
- 2.10 Some respondents considered that the proposal would bring higher costs to issuers. Fees currently paid by issuers to share registrars might also increase if the number of registered shareholders increased as a result of the scripless initiative.
- 2.11 Certain respondents were concerned about the fees of CCASS and the share registrars. There were comments that HKSCC should review its CCASS fees and share registrars should put forward the tariffs it would charge. Other respondents raised concerns over the costs of dematerialisation and rematerialisation.

### **Responses to Market Comments**

- 2.12 Comments received from the market were helpful to us in understanding the market’s concerns about the scripless initiative and re-evaluating the Split Register Model and the originally proposed operational model. While we still believe the Split Register Model is feasible and generally sound, some modifications would seem desirable in response to market’s concerns.
- 2.13 We propose modifying the Split Register Model to maintain CCASS on a nominee basis as it is currently. This modification addresses market’s concerns about the fragmentation of the ROM as the CCASS record will not become a “sub-register”. The unity of the ROM is preserved and the complexities and potential risks of daily register reconciliation can therefore be avoided.

- 2.14 As explained in the HKEx Consultation Paper, there were technical reasons for the removal of the immediate credit policy under the originally proposed operational model. Physical certificates deposited into CCASS would only be credited into the CCASS accounts after the relevant shares were debited from the Issuer Register maintained by share registrars. Otherwise, the total number of shares on the CCASS Register and the Issuer Register would exceed the number of issued shares. Under the revised proposal, the immediate credit policy can be maintained because the CCASS record will not become a “sub-register”.
- 2.15 The revised model will require minimum changes to the current market structure and practices and preserve all existing investor choices of forms of shareholdings. To distinguish this revised model from the Split Register Model, we refer to it as the “Issuer Register Model”. Details of this model are set out in Chapter Three.
- 2.16 We note that most respondents commenting on the proposal of Registrar Participantship in CCASS did not favour the idea. As noted in the HKEx Consultation Paper, this is not the only way to achieve the objective of better co-ordination between HKSCC and the share registrars in relation to the support of uncertificated shares and the associated transactions. We have an open mind on this issue. One possible alternative we have considered is to set out the terms of co-operation and operational requirements in an agreement between HKSCC and share registrars. We are open to any other suggestions from the market and the share registrars. We would also like to clarify that the proposal was not meant to subject share registrars to the regulation of HKEx. The registrars’ systems are now covered by the SFC’s Code of Conduct for Share Registrars. In the light of this, we have passed market comments on the future regulation of share registrars to the SFC for its consideration.
- 2.17 Many respondents raised concerns about the SRN. We understand that the Federation of Share Registrars is currently reviewing the SRN and considering other possible alternative measures to serve as a mean for identification of uncertificated shareholdings as well as authentication for transfers. We believe market comments will be fully taken into account before such a measure is finalised and implemented.
- 2.18 We fully appreciate the market’s concerns about the cost implications of implementing the scripless initiative. We believe a progressive approach on implementation (please see paragraphs 2.21 and 3.12 to 3.22) would help manage the cost impact more effectively. Through this approach, we expect the up-front capital investment required of market intermediaries should be minimal.

- 2.19 With the gradual dematerialisation of shares in the CCASS Depository, we expect review of certain CCASS fees would be necessary. New fee items (such as deposit fee) may also have to be considered. Any amendments to CCASS fees are subject to approval by the SFC as required under the Securities and Futures Ordinance. Dematerialisation and rematerialisation of shares may be subject to fees to be determined by the share registrars in consultation with the SFC. Overall, we hope that the efficiency of the Hong Kong securities market will increase and costs will be lowered, ultimately bringing benefits to the investing public.
- 2.20 Fees charged by share registrars for their services to issuers are commercial matters between those parties and are outside the jurisdiction of HKEx/HKSCC. However, one of our reasons for choosing the Split Register Model and the current revised model is to preserve competition in the share registration market. So long as that market remains competitive, market forces should be able to regulate costs and charges effectively. Everything being equal, it is for the market to decide whether an increase in fees due to an increase in the number of registered shareholders is a fair price to pay for better corporate governance.
- 2.21 In response to comments concerning the timing and pace of the implementation of the scripless initiative, we propose that a progressive approach be adopted, with minimal changes at the initial stage of implementation. Chapter Three also elaborates on the implementation plan.

## **Chapter Three**

### **The Revised Proposal and a Progressive Approach on Implementation**

#### **Model Evaluation**

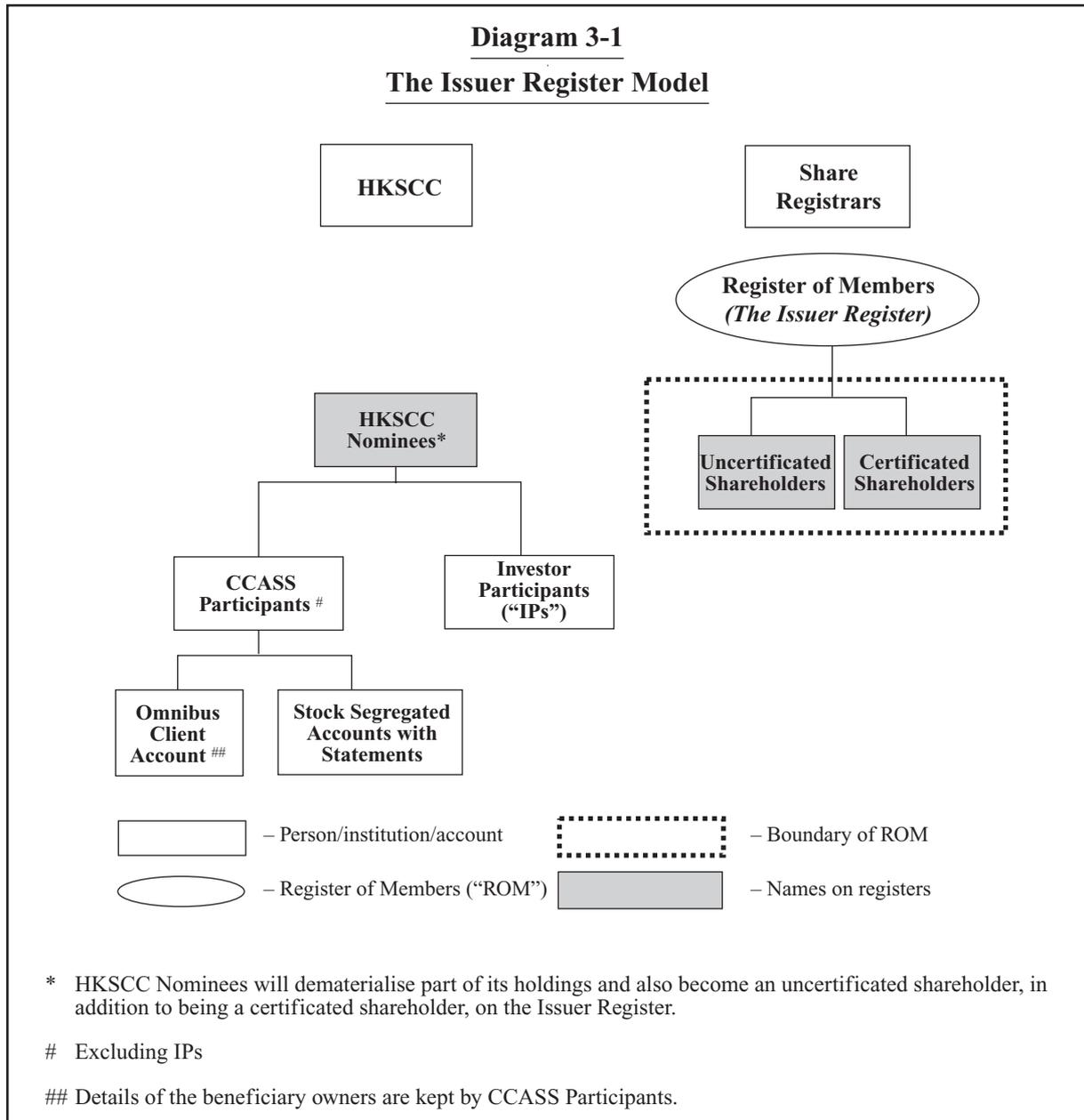
- 3.1 Submissions on the HKEx Consultation Paper generally supported the scripless initiative and agreed that removing scrip is the right direction to go for Hong Kong. However, the market also raised a number of key concerns over the originally proposed operational model. We discussed these concerns and set out our responses in some detail in Chapter Two.
- 3.2 In response to market feedback, we have re-evaluated the Split Register Model and consider some modifications to the Split Register Model desirable. In essence, we propose maintaining CCASS on a nominee basis, without converting it into a “sub-register” so as to preserve the unity of the ROM. With this modification, shares deposited into the CCASS Depository will continue to be registered in the name of the HKSCC Nominees Limited (“HKSCC Nominees”), similar to shares deposited with broker/custodian nominees. The model, as revised, is referred to as the “Issuer Register Model”, signifying that there will only be one ROM for each company listed in Hong Kong, to be maintained by a share registrar on behalf of its issuer. We describe the key features of the Issuer Register Model in the subsequent section of this chapter.

#### **The Issuer Register Model**

##### ***Key Features of the Issuer Register Model***

- 3.3 Under the Issuer Register Model, the ROM will continue to be kept by share registrars on behalf of their issuers as it is the case now. However, in addition to certificated shareholdings, the ROM will also record uncertificated shareholdings after the introduction of uncertificated shares. Shares deposited into the CCASS Depository will continue to be registered in the name of HKSCC Nominees. Diagram 3-1 below is a high-level illustration of the Issuer Register Model.

**Diagram 3-1**  
**The Issuer Register Model**



3.4 The key features of the Issuer Register Model are as follows:

- Dematerialisation will be optional. Investors may continue to hold certificates if they so desire;
- There will be one ROM for each company listed in Hong Kong – the Issuer Register maintained by a share registrar. Share registrars will continue to make the ROM available for public inspection;
- The ROM will consist of certificated shareholdings and, in addition, uncertificated shareholdings when uncertificated shares are introduced;

- HKSCC will continue to operate on a nominee basis, which means all shares deposited by CCASS Participants will continue to be registered in the name of the HKSCC Nominees on the ROM, similar to depositing shares with brokers/custodian nominees;
- Share registrars will serve all registered shareholders on the ROM, including HKSCC Nominees, in relation to corporate communications and corporate actions;
- HKSCC Nominees, as the registered shareholder, will continue to perform corporate actions for CCASS Participants, including Investor Participants (“IPs”), in relation to their shares deposited into the CCASS Depository, similar to services provided by CCASS Participants (other than IPs) to their clients;
- The current clearing and settlement operations of HKSCC will remain largely unchanged;
- The immediate credit policy of HKSCC will continue; and
- The market functions of HKSCC and share registrars will remain largely unchanged.

3.5 Under this model, individual investors will have six options for holding their shares directly and indirectly:

- (i) In electronic form with their brokers/custodians, in turn deposited into CCASS and registered in the name of HKSCC Nominees;
- (ii) In electronic form in an IP Account with CCASS and registered in the name of HKSCC Nominees;
- (iii) In electronic form in nominee names of their brokers/custodians on the Issuer Register;
- (iv) In electronic form in their own names on the Issuer Register (when the share registrars are ready as stated in paragraph 3.16);
- (v) In certificated form in nominee names of their brokers/custodians on the Issuer Register; and
- (vi) In certificated form in their own names on the Issuer Register.

### *Electronic linkages between CCASS and share registrars' systems*

- 3.6 Electronic linkages (which will be considered in the further development of the scripless initiative – see paragraph 3.22) between CCASS and systems of individual share registrars will facilitate deposits and withdrawals of uncertificated shares into and from the CCASS Depository. The functionality of the linkages will be similar to that proposed under the Split Register Model except that change of legal title as a result of the transfer will happen exclusively on the Issuer Register maintained by share registrars.

### *Transaction types under the Issuer Register Model*

- 3.7 Types of transactions within the Issuer Register will include the following:
- (i) Certificated transfer (transfer of certificated shares from one shareholder to another);
  - (ii) Dematerialisation (converting certificated shares into uncertificated form); and
  - (iii) Rematerialisation (converting uncertificated shares back to certificated form).

Transaction type (i) exists today and transaction types (ii) and (iii) are new.

- 3.8 Types of transactions within CCASS will include the following:
- (i) Settlement Instruction, or SI (transfer of shares between CCASS Participants, other than IPs);
  - (ii) Investor Settlement Instruction, or ISI (transfer of shares between an IP and other CCASS Participants);
  - (iii) Account Transfer Instruction, or ATI (transfer of shares within the sub-accounts of a CCASS Participant, other than an IP);

All the above transaction types exist at present.

3.9 Types of transactions between CCASS and Issuer Register will include the following:

- (i) Deposit of physical certificates (which requires re-registration of the deposited shares into the name of HKSCC Nominees);
- (ii) Withdrawal of physical certificates;
- (iii) Electronic deposit of uncertificated shares; and
- (iv) Electronic withdrawal of uncertificated shares.

Transaction types (i) to (ii) exist at present. Transaction types (iii) and (iv) are new ones resulting from the introduction of uncertificated shares. These new transaction types will be introduced following the implementation of the electronic linkages between CCASS and share registrars' systems.

### ***Services to Investors***

3.10 Share registrars will continue to provide corporate communications and corporate action services to all registered shareholders on the Issuer Register. Investors whose shares are deposited into the CCASS Depository may also request through CCASS Participants (other than IPs) to receive corporate communications directly from share registrars. HKSCC Nominees will consolidate such requests and pass the detailed information (including names and addresses of the beneficial shareholders) to the relevant share registrars. IPs may submit their requests directly to HKSCC.

3.11 HKSCC Nominees as registered shareholder receives share entitlements such as dividends and exercises shareholders' rights in areas such as voting, rights issues, cash offers and warrant conversions. When HKSCC Nominees receives share entitlements, it credits them to the accounts of CCASS Participants (including IPs) in proportion to their shareholdings in CCASS. In the case of shareholders' rights such as voting, HKSCC Nominees consolidates voting instructions from the CCASS Participants (including IPs) and votes accordingly on their behalf.

## **A Progressive Approach on Implementation of the Issuer Register Model**

### ***The General Concept***

3.12 Some market submissions on the HKEx Consultation Paper indicated concerns about the timing of the implementation of a scripless securities market in Hong Kong. Some of them questioned whether it was the right time to introduce significant changes to the securities market. To address these market concerns, we propose that a progressive approach be adopted on the implementation of the scripless initiative in Hong Kong. In essence, we propose beginning the dematerialisation exercise with the CCASS Depository, then gradually extending the exercise by making dematerialisation an option for other registered shareholders. Further development of the scripless initiative, including the establishment of electronic linkages between CCASS and share registrars' systems, will be considered in parallel with the implementation of the initial phase, taking into account market needs.

### ***Initial Phase***

3.13 Under the initial phase of implementation, HKSCC will gradually and partially dematerialise the shares in the CCASS Depository, with a view to downsizing its vault to an extent whereby it would still be able to accommodate requests from its Participants for withdrawal of physical certificates.

3.14 We propose to gradually dematerialise scrip in the CCASS Depository and turn them into uncertificated shareholdings registered in the name of HKSCC Nominees on the Issuer Register. At the beginning, this would involve mainly Hong Kong-listed companies incorporated in Hong Kong and those incorporated overseas whose jurisdictions allow the issue of uncertificated shares. At present, the CCASS Depository has approximately six million certificates, which we estimate represent approximately 20% of the total number of share certificates in Hong Kong. Among the six million certificates, there are 1.6 million certificates of locally incorporated listed companies, representing a total value of about HK\$1,000 billion or 50% of the total value of all shares in the CCASS Depository.

- 3.15 We will start by dematerialising approximately 550,000 odd lots and jumbo certificates (certificates of large denomination) of locally incorporated Hong Kong-listed companies (representing approximately 15% of total market capitalisation) as well as shares of listed companies incorporated overseas whose jurisdictions also allow the issue of uncertificated shares. These odd lots and jumbo certificates are seldom used in the daily operation of the CCASS Depository and their dematerialisation will have little impact on HKSCC.
- 3.16 We propose to focus on the CCASS Depository at the beginning of the initial phase, then gradually extending the dematerialisation option to market intermediaries such as custodians and brokers and eventually to the investing public at large when share registrars are ready. The experience in dematerialising the shares in the CCASS Depository should serve as a useful reference when dematerialisation is introduced to the rest of the market.
- 3.17 HKSCC will continue to accept deposits of physical scrip by its Participants. After deposit, such scrip will be delivered to share registrars for re-registration in the name of HKSCC Nominees and dematerialised at the same time. The shares will then be recorded by share registrars as uncertificated shareholdings.
- 3.18 HKSCC will also continue to permit physical withdrawals of shares by its Participants while only a portion of the shares in its Depository is dematerialised. The CCASS Depository will maintain a vault to keep physical scrip of smaller denominations to meet requests of withdrawal of physical certificates, which we expect would still be important particularly for retail investors and their brokers. Where necessary, HKSCC Nominees may rematerialise its uncertificated shares into certificated form to meet withdrawal demands.
- 3.19 As noted above, the roles and functions of share registrars will remain largely the same as at present. They will continue to be the agents of issuers. There will also be only one ROM for each issuer of shares listed in Hong Kong and the ROMs will be maintained by share registrars. Reconciliation of multiple ROMs for the same stock will therefore not be necessary.

3.20 CCASS Participants (other than IPs) will deposit their clients' shares into the CCASS Depository. Some may also choose to register their clients' shares in nominee names directly on the Issuer Register. In those cases, their nominee shareholding information would be available for public inspection. In order to raise the level of shareholding transparency at the CCASS Participant (other than IPs) level, we propose that HKSCC Nominees be able to make available to the public the names of the CCASS Participants (other than IPs) and their shareholdings in CCASS (since nominee shareholding information available on the ROM does not include information of their underlying beneficiary clients, therefore shareholding information of IPs is not included in our proposal). At present, HKSCC provides upon request shareholding reports to issuers at a fee of HK\$500 per report. We are considering, under the user-pays principle, imposing a similar fee for public access to the shareholding information of CCASS Participants (other than IPs) in future.

3.21 In the future, we expect a large portion of the newly issued shares allotted to HKSCC Nominees (i.e. to CCASS Participants) will be uncertificated.

#### ***Further Development***

3.22 One of the main enhancements we will consider in the further development of the scripless initiative is the implementation of electronic linkages between CCASS and share registrars' systems. The main purpose of such linkages is to enable electronic deposits and withdrawals of uncertificated shares into and from CCASS. Before any decisions are made on further development, the technical details will need to be finalised among the major stakeholders, in particular HKEx/HKSCC and the share registrars. Some of the work that has been done in preparing the originally proposed operational model for the Split Register Model would be relevant in this context, and feedback from the market to the HKEx Consultation Paper will also be useful as well. In parallel with the implementation of the initial phase, we will continue the discussion with the SFC and the Federation of Share Registrars on the details of the further development and work out an implementation plan. The pace of the further developments will take into account market needs.

### *Issues concerning Implementation*

3.23 Dematerialisation of the shares in the CCASS Depository will require legislative amendments to enable issuers to issue uncertificated shares to HKSCC Nominees and other shareholders. Amendments to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited may also be required.

3.24 It will also require the operational support of share registrars in relation to the handling of uncertificated shares. A number of implementation issues will require further discussion with the SFC and the Federation of Share Registrars, including:

- One-time dematerialisation of the shares in the CCASS Depository;
- Ad hoc dematerialisation of shares for deposits into the CCASS Depository by CCASS Participants;
- Dematerialisation of shares of overseas incorporated companies;
- Fees for dematerialisation;
- Evidence of proof for HKSCC Nominees in respect of its uncertificated shareholdings;
- Identification and evidence of proof of shareholding for other uncertificated shareholders;
- Registration of uncertificated shares on the Issuer Register;
- Provision by share registrars of HKSCC Nominees' uncertificated shareholding balance by end of day to CCASS for control and reconciliation purposes; and
- Rematerialisation of uncertificated shares.

None of these issues should present insurmountable difficulties in taking the scripless initiative forward. Discussion with the SFC and the Federation of Share Registrars on the above issues will continue.

3.25 Additional issues to be resolved prior to any further development of the initiative include:

- Security issues relating to holdings and electronic transfer of uncertificated shares. Concerns expressed by the market about the SRN, if still be relevant, would need to be fully considered;
- Functional specifications for the electronic linkages between CCASS and share registrars' systems;
- The electronic deposit/withdrawal process and any associated fees; and
- The appropriate forms to set out the details of co-operation and operational requirements between HKSCC and share registrars.

### ***Implications of the Proposal for the Market***

3.26 The Issuer Register Model is largely similar to the Split Register Model except that the CCASS record will not become a “sub-register”. This adjustment was in response to market concerns about the fragmentation of the ROM and the associated risks and complexities. Necessary changes to market structure and operations will be minimal under the revised model.

3.27 The progressive approach on implementation means that the up-front development costs and impact on operations for market intermediaries is minimal. In fact, the only obvious additional cost for market intermediaries and, for that matter, investors is the dematerialisation fee payable to share registrars if they wish to dematerialise their scrip. The exact level of the dematerialisation fee will be determined by share registrars in consultation with the SFC.

3.28 With the gradual dematerialisation of the shares in the CCASS Depository, we expect that some of the existing CCASS fees, including the scrip fee, custody fee and withdrawal fee, will have to be reviewed. New fee items (such as deposit fee) may also have to be considered. Overall, we hope that the efficiency of the Hong Kong securities market will increase and costs will be lowered, ultimately bringing benefits to the investing public.

3.29 Many comments we received from the consultation exercise related to the security of the SRN. While the SRN should not be a major concern under the initial phase of implementation of the Issuer Register Model, it is likely to be relevant if electronic transfers of uncertificated shares become an option in the further development of the scripless initiative. We understand that the Federation of Share Registrars is reviewing the SRN proposal and considering alternatives to the SRN to address market concerns. We believe market comments will be fully taken into account before such a measure is finalised.

### *Merits of the Proposal*

3.30 We believe that a progressive approach on the implementation of the scripless initiative in Hong Kong has the following merits:

- It serves as the first and a key step towards dematerialisation for Hong Kong. When the partial dematerialisation of the shares in the CCASS Depository is completed, 15% of the total market capitalisation of Hong Kong will be dematerialised. The dematerialisation rate will increase as more and more shares are deposited into CCASS and when investors and other market participants also dematerialise their scrip;
- It streamlines the CCASS Depository operations;
- The up-front development costs and impact on operations for market intermediaries is minimal. The initial phase will be largely transparent to market intermediaries and investors;
- The existing operations of CCASS remain largely unaffected;
- Immediate credit of share deposits into CCASS can be maintained; and
- It will allow more time for the market to resolve issues relating to the electronic linkages between CCASS and share registrars' systems without causing further delay to dematerialisation in Hong Kong.

## **Chapter Four**

### **Conclusions and Proposed Way Forward**

- 4.1 We believe removal of scrip is an important and unavoidable development in the evolution of the securities market as we pursue higher efficiency and shareholder transparency and lower costs. While its benefits will take time to be fully realised, we believe they will be long-lasting.
- 4.2 In the light of market comments, we propose modifying the Split Register Model to maintain CCASS on a nominee basis so we can preserve the unity of the ROM and maintain HKSCC's immediate credit policy. We also believe a progressive approach on implementation will allow time for the investing public and other market participants to adjust to the scripless environment and allow market forces to determine the pace of further development.
- 4.3 We estimate that the dematerialisation of the 550,000 odd lots and jumbo certificates in the CCASS Depository could be completed in approximately 12 to 18 months' time. The commencement of the dematerialisation programme is subject to the enactment of the enabling legislation and the readiness of the share registrars to support uncertificated shares. It will also require system development on the part of HKSCC. We will provide input and support to the Government and the SFC in drafting the necessary amendments to the Companies Ordinance to enable a scripless securities market along the proposed model design set out in this Consultation Conclusion Report. We look forward to the early introduction of the Companies (Amendment) Bill into the legislature in the next legislative session.
- 4.4 In parallel with the implementation of the initial phase, we will continue to discuss with the SFC and the Federation of the Share Registrars further development of the scripless initiative, in particular the electronic linkages between CCASS and share registrars' systems and dematerialisation of shares of listed companies incorporated overseas. We will also proceed with the review of CCASS fees. The pace of further development will largely depend on how quickly the various stakeholders, in particular HKEx and the Federation of Share Registrars, can resolve the various issues including those identified in Chapter Three, as well as market acceptance of dematerialisation and market needs.

- 4.5 Prior to the publication of this Consultation Conclusion Report, HKEx has discussed the proposed way forward with the Federation of Share Registrars. We have also sounded out the Consumer Council and the major user community of CCASS, including brokers associations and CCASS Custodian Participants. Without any intention to prejudice their positions, the feedback we received suggests to us that the proposal is generally workable and acceptable. We have also discussed the proposal with the SFC and they have indicated that they support taking the proposal forward.
- 4.6 Investor education will be important to the promotion of uncertificated shareholdings and a smooth implementation of the scripless model. HKEx will work closely with the SFC and other market stakeholders to educate the investing public on the operation of a scripless securities market and other matters of their concern such as security issues. This will be particularly important when the electronic linkages between CCASS and share registrars' systems are established. We are particularly grateful to the Consumer Council for offering its assistance and service in this regard.
- 4.7 Finally, we would like to express our sincere gratitude to those who have responded to our consultation, as well as the SFC, the Federation of Share Registrars, the Consumer Council, the brokerage community and the CCASS Custodian Participants for their invaluable input and comments in the discussion of the Issuer Register Model and the implementation approach. We hope the proposal will gain general market support and serve as a basis for Hong Kong to move forward on the scripless initiative.

## **Glossary of Terms**

<b>Account Transfer Instructions (ATI)</b>	means instructions of a Participant other than an IP to effect book-entry movements of Eligible Securities between different stock accounts of the Participant in CCASS;
<b>Broker Participant</b>	means a Participant admitted to participate in CCASS as a Broker Participant;
<b>CCASS</b>	means the Central Clearing and Settlement System established and operated by HKSCC;
<b>CCASS Depository</b>	means one or more securities depositories for CCASS, providing safe-keeping facilities for Eligible Securities held in CCASS as well as to cater for withdrawals and deposits of Eligible Securities by CCASS Participants;
<b>CCASS Operational Procedures</b>	means the Operational Procedures of HKSCC in relation to CCASS, containing the practices, procedures and administrative requirements relating to the operations and functions of CCASS, as from time to time in force;
<b>CCASS Participants or Participants</b>	means brokers, custodians, clearing agencies, stock lenders, stock pledgees and investors admitted by HKSCC as participants under CCASS, enabling them to participate in the book-entry clearing and settlement system under CCASS;
<b>CCASS Participant Sponsored Account</b>	means an account in CCASS opened for an investor and sponsored by a CCASS Participant other than an IP under the Split Register Model;
<b>CCASS Register</b>	means a register reflecting the shareholdings of CCASS Participants, holders of CCASS Participant Sponsored Accounts and IPs under the Split Register Model;

<b>CCASS Rules</b>	means the General Rules of CCASS which set out the terms and conditions regulating the use of CCASS;
<b>Custodian Participant</b>	means a Participant admitted to participate in CCASS as a Custodian Participant;
<b>Dematerialisation</b>	means the process whereby a certificated shareholding is converted to an uncertificated shareholding;
<b>Electronic Deposit Instruction (EDI)</b>	means an instruction of a Participant to move Eligible Securities in uncertificated form from the Issuer Register to the CCASS Register under the Split Register Model;
<b>Electronic Withdrawal Instruction (EWI)</b>	means an instruction of a Participant to move Eligible Securities in uncertificated form from the CCASS Register to the Issuer Register under the Split Register Model;
<b>Eligible Security</b>	means an issue of securities which is from time to time accepted as eligible by HKSCC for deposit, clearing and settlement in CCASS, in accordance with the CCASS Rules, and where the context so requires shall include any particular security or securities of such an issue;
<b>Federation of Share Registrars</b>	means the Federation of Share Registrars Limited approved by the SFC under the Securities and Futures (Stock Market Listing) Rules;
<b>HKEx</b>	means Hong Kong Exchanges and Clearing Limited;
<b>HKSCC</b>	means Hong Kong Securities Clearing Company Limited, a wholly owned subsidiary of HKEx;
<b>HKSCC Nominees</b>	means the HKSCC Nominees Limited or such other nominee company as may be used by HKSCC from time to time in relation to the provision of nominee services to CCASS Participants (including IPs);

<b>Immobilisation</b>	means the holding of certificates in a vault in order to eliminate physical delivery for the purpose of settlement of transactions. In the case of CCASS, certificates with signed transfer forms attached are deposited by Participants with HKSCC and are reflected in the Participants' CCASS stock accounts to facilitate book-entry settlement (by debit and credit entries to the relevant stock accounts);
<b>Investor Participant (IP)</b>	means a person admitted to participate in CCASS as an IP who may be an individual, joint individuals or a corporation;
<b>Investor Settlement Instructions (ISI)</b>	means instructions of an IP relating to transactions in Eligible Securities for non-SEHK Trades to be settled in CCASS;
<b>Issuer</b>	means any company or other legal person any of whose securities are the subject of an application for listing or some of whose securities are already listed;
<b>Issuer Register</b>	means a register maintained by the share registrar for the issuer;
<b>Issuer Register Model</b>	means a share registration system under which the Issuer Register will hold all the uncertificated and certificated shareholdings;
<b>Register of Members (ROM)</b>	means a register, held in a book, ledger card or computer print form, which contains details of the shareholders of a company and their shareholdings;
<b>Rematerialisation</b>	means the process whereby an uncertificated shareholding is converted into a certificated shareholding;
<b>SEHK</b>	means The Stock Exchange of Hong Kong Limited, a wholly owned subsidiary of HKEx;

<b>SEHK Trade</b>	means a trade in an Eligible Security between two Broker Participants effected on or reported to SEHK;
<b>Settlement Instructions (SI)</b>	means instructions of a Participant (other than an IP) relating to transactions in Eligible Securities for non-SEHK Trades to be settled in CCASS;
<b>SFC</b>	means the Securities and Futures Commission;
<b>Shareholder Reference Number (SRN)</b>	means a number to be issued by the share registrar to the registered shareholders in relation to each of his or her uncertificated shareholdings on the Issuer Registers;
<b>Share Registrar</b>	means a person appointed by an issuer for the purpose of maintaining its ROM; and
<b>Split Register Model</b>	means a share registration system under which the ROM consists of a CCASS Register which holds uncertificated shares deposited into CCASS to be maintained by HKSCC and an Issuer Register which holds both uncertificated and certificated shareholdings outside of CCASS to be maintained by share registrars.

## **Appendix 1**

### **List of Respondents (in alphabetical order)**

#### **A. Respondents having no objection to the publication of their names and the contents of their submissions.**

Listed Companies	(1) CLP Holdings Limited (2) The Hongkong and Shanghai Banking Corporation Limited
Share Registrars	(3) Federation of Share Registrars Limited
Government Related Organisation	(4) Consumer Council
Professional Bodies	(5) Hong Kong Society of Accountants (6) The Hong Kong Institute of Company Secretaries (7) The Law Society of Hong Kong
Banking and Broker Associations	(8) The Hong Kong Association of Banks (9) The Hong Kong Association of Online Brokers (10) The Hong Kong Stockbrokers Association Limited. (11) The Institute of Securities Dealers Limited
Broker Participants	(12) Christfund Securities Limited (13) DL Brokerage Limited (14) Excalibur Securities Limited (15) Hani Securities (HK) Limited (16) Quam Securities Company Limited (17) Tisco Securities Hong Kong Limited (18) Tung Tai Securities Company Limited and Tung Tai Futures Limited
Custodian Participant	(19) HSBC Custody and Clearing Services
Individual	(20) Zhao Da Jun

**B. Respondents requesting their submissions to be published on a “no-name” basis.**

- (21) A Broker Participant
- (22) A Broker Participant
- (23) A Broker Participant
- (24) A Custodian Participant
- (25) An Investor Participant

**C. (26) An Anonymous Respondent**

**Total: 26 Submissions**

## **Appendix 2**

### **Summary of Comments on HKEx Consultation Paper and HKEx's Responses**

*(Note: The table includes the key comments received during the public consultation. It has been prepared for easy reference only. Readers are advised to read the summary in conjunction with the full submissions of the respondents which can be found on the HKEx's website at [www.hkex.com.hk](http://www.hkex.com.hk).)*

#### **Implementation of a Scripless Securities Market**

##### **1. Respondents' Comments**

- The respondents generally supported the scripless initiative in principle.
- Some respondents considered that the current immobilisation model was functioning efficiently and was able to meet the needs of different investors. Therefore it was not necessary to adopt a model which was drastically different from the existing one.
- Some other respondents felt that it was not appropriate to implement the proposal when the Hong Kong economic conditions were just becoming better after a prolonged downturn.
- A respondent was concerned that a scripless securities market might cause further layoffs of settlement and supporting staff.
- Some respondents saw marginal benefits from the proposed model and one of them questioned whether the proposed operational model would improve the overall market efficiency and deliver the benefits of cost reduction and better risk control.

##### ***HKEx's Response***

- We believe removal of scrip is an important and unavoidable development in the evolution of the securities market as we pursue higher efficiency and shareholding transparency and lower costs. While its benefits will take time to be fully realised, we believe they will be long-lasting.
- We believe a progressive approach on implementation will allow time for the investing public and other market participants to adjust to the scripless environment and allow market forces to determine the pace of further development.

## **Register of Members (“ROM”)**

### **2. *Respondents’ Comments***

- It was suggested that for investor protection, regardless of whether the court would retain the power to rectify the ROM or if suitable investor compensation remedies would be made available to an aggrieved shareholder, information (such as the ROM) would be critical to a shareholder seeking redress.

#### ***HKEx’s Response***

- We concur with the above comments. Currently, share registrars will make the complete ROM available for public inspection as required under the law. This will remain unchanged under the scripless model.

### **3. *Respondents’ Comments***

- It was put forward that if changes to foreign laws were not possible, then some of the benefits of the proposals could be achieved by enforced, rather than voluntary, immobilisation. It was also recommended that consideration be given regarding the movement of securities across the principal and branch registers, especially in the context of a dual-listed overseas-incorporated company.

#### ***HKEx’s Response***

- As stated in section 15 of the consultation paper published by the SFC in February 2002, the SFC will further discuss with the relevant overseas authorities their support for the use of uncertificated shares in Hong Kong. We will further discuss the comment regarding securities movements across the principal and branch registers with the SFC and the Federation of Share Registrars.

### **4. *Respondents’ Comments***

- Some respondents were concerned about the reconciliation process between the registers. One of them considered a full download of the Central Clearing and Settlement System (“CCASS”) Register unnecessarily complex and that an inefficient use of bandwidth would involve unnecessary costs and make register reconciliation unnecessarily difficult. It suggested that Hong Kong Securities Clearing Company Limited (“HKSCC”) could provide the share registrars with details of net movements on accounts that result from the intra-day transfers.

- A respondent suggested that it would be preferable if further investigations could be made into ways in which the ROM could be less fragmented than what was proposed in the HKEx Consultation Paper.
- A respondent claimed that issuers, in general, would like to have one consolidated ROM for each stock.
- Another respondent also cautioned that the reliability of the reconciliation process might affect the shareholders' positions and malfunctions might cause disputes. To address the potential problem, the respondent suggested providing a means of recourse to aggrieved shareholders/listed issuers/HKSCC/share registrars, perhaps through a dispute tribunal or panel.

### *HKEx's Response*

- We accept respondents' concerns and in response we propose modifying the Split Register Model to maintain CCASS on a nominee basis. Shares deposited into the CCASS Depository will continue to be registered in the name of HKSCC Nominees Limited ("HKSCC Nominees"), similar to shares deposited with broker/custodian nominees. Under this proposal, there will be a single ROM for each listed company to be maintained by a share registrar. This preserves the unity of the ROM and avoids the complexities and potential risks which may otherwise arise from register reconciliation.

## **5. Respondents' Comments**

- A respondent was concerned that the complexity of the proposed model would make it difficult to educate all parties to follow the proposed model without causing any confusion and market risks.

### *HKEx's Response*

- We fully recognise the importance of investor education to the promotion of uncertificated shareholdings and a smooth implementation of the scripless model. We will work closely with the SFC and other market stakeholders to educate the investing public on the operation of a scripless securities market and other matters of their concern such as security issues. This will be particularly important when the electronic linkages between CCASS and share registrars' systems are established. We are particularly grateful to the Consumer Council for offering its assistance and service in this regard.

## **6. *Respondents' Comments***

- There was preference for providing only the CCASS Register and maintaining the Investor Participant (“IP”) Account. Some respondents suggested that it would be more efficient for HKSCC to operate the complete ROM in view of the difficulty in the synchronisation of the records of the CCASS Register and the Issuer Registers throughout the many batch-processing cycles during the day.
- A respondent questioned if it was really necessary to have both uncertificated shareholders and IP Accounts for the investors. In connection with this, a respondent was also concerned that the proposed model would be a duplication to the IP Account service of CCASS and the clients who preferred nominee service would continue to use the existing nominee service of stockbrokers or banks.
- Some respondents did not support the proposal for uncertificated shareholdings on two registers. They were concerned about the risks of using the SRN. One of them also stated that IP Account was a preferred option because the CCASS IP Account Service had a better control/built-in mechanism for verifying instructions.

### ***HKEx's Response***

- The above comments tend to suggest HKSCC should maintain the CCASS Register which holds all the uncertificated shareholdings. However, we understand that this model has given rise to concerns that it may reduce competition in the market and require the granting of another monopoly (to operate the single scripless ROM) in Hong Kong, and is therefore not preferred. The revised scripless model (the Issuer Register Model) currently proposed will also achieve the objectives of preserving the unity of the ROM and avoiding its fragmentation.

### **The CCASS Register**

## **7. *Respondents' Comments***

- A respondent commented that the HKEx Consultation Paper did not address the important question of investor protection nor did it explain the technology and process changes that would be needed for brokers to manage the CCASS Participant Sponsored Accounts. The respondent was also concerned about the cost for and the promotion of these accounts.

### *HKEx's Response*

- Under the Issuer Register Model, there will be no CCASS Participant Sponsored Accounts. The comments are therefore no longer relevant.

### **8. *Respondents' Comments***

- Some respondents considered the Non-disclosed IP Account type unnecessary. A respondent felt that there was no real commercial need to create Non-disclosed IP Accounts since the type of service beyond that was already available through the services offered by competing custodians in Hong Kong.

### *HKEx's Response*

- Under the Issuer Register Model, the nature of HKSCC IP Account will remain the same. Since CCASS will continue to operate on a nominee basis, shares held in the IP Accounts will continue to be registered in the name of HKSCC Nominees. The above comments are therefore no longer relevant.

## **Registrar Participanship and Regulation of Share Registrars**

### **9. *Respondents' Comments***

- Some respondents commented that there would be a possible conflict of interest because HKEx was a shareholder in a registrar company. One respondent considered the concept of Registrar Participanship clumsy as most of the CCASS Rules would be inappropriate for share registrars. Another respondent felt that the regulation of share registrars should be the SFC's responsibility.
- Some respondents moreover thought that the future regulation and supervision of share registrars would become a very crucial issue because share registrars would be involved in the transfer of shares. One of the respondents commented that by allowing share registrars to operate the Issuer Registers, share registrars would be acting as mini "CCASSes" and therefore should be regulated and supervised no less strictly than HKSCC.

### *HKEx's response*

- We wish to clarify that the proposal was not meant to subject share registrars to the regulation of HKEx/HKSCC. The main objective of the proposed Registrar Participanship was to provide a basis (under the CCASS Rules and Operational Procedures) for setting out the technical and operational requirements of share registrars in respect of the operation of the scripless model. We have an open mind on the issue. One possible alternative we have considered is to set out the terms of co-operation and operational requirements in an agreement between HKSCC and share registrars. We would be happy to discuss any other suggestions which may achieve the same objective.
- The registrars' systems are now covered by the SFC's Code of Conduct for Share Registrars. Therefore, we have passed market comments on the future regulation of share registrars to the SFC for its consideration.

### **Removal of Immediate Credit**

#### **10 Respondents' Comments**

- Respondents commented that the proposal was a step backward as it would seriously affect the efficiency of selling shares in scrip form. A respondent suggested that real-time processing movements between sub-registers could help solve the problem and added that if a more incremental approach was thought desirable at the initial stage, multiple daily batch processing (as currently happening with CCASS) would mitigate the problem.

### *HKEx's Comments*

- We accept the market's concerns. As explained in the HKEx Consultation Paper, there were technical reasons for the removal of the immediate credit policy under the originally proposed operational model. Physical certificates deposited into CCASS would only be credited into the CCASS accounts after the relevant shares were debited from the Issuer Register maintained by share registrars. Otherwise, the total number of shares on the CCASS Register and the Issuer Register would exceed the number of issued shares. Under the Issuer Register Model, HKSCC's immediate credit policy for deposit of physical shares can be maintained because the CCASS record will not become a "sub-register".

## **Clearing and Settlement Services**

### ***11 Respondents' Comments***

- Some respondents were concerned about the issue of cash finality when the legal title of securities would change upon completion of the CCASS settlement. A respondent suggested that the use of Real Time Gross Settlement be made mandatory for securities cash settlement to align more closely the change of securities title with the receipt of cash.

### ***HKEx's Response***

- Under the revised proposal, the clearing and settlement functions of CCASS will remain as they are now. Since CCASS will continue to operate on a nominee basis, share settlement in CCASS will involve change in beneficiary ownership but not legal title. We agree with the suggestion in principle and we have been examining under a separate project possible means to align the timing and finality of payment and securities settlement in CCASS.

## **Inter-register Transfers**

### ***12. Respondents' Comments***

- Respondents considered the proposed day-end batch processing unacceptable. They favoured real-time processing but accepted multiple intra-day batches as an interim solution. A respondent suggested that there should be an intra-day transfer mechanism to ensure that errors could be rectified during the processing day to mitigate settlement risk.
- A respondent was concerned that the overnight batch model would prevent investors and/or their agents from effectively and efficiently managing their holdings between the registers and would therefore restrict the scope for offering investors choices.
- A respondent commented that brokers would assume additional responsibility and potential liability in relation to stamp duty arrangement for Electronic Deposit Instructions and Electronic Withdrawal Instructions. The respondent commented that the proposal should include clear procedures and workflow on how transfers would take place between shareholders on the Issuer Register.

### *HKEx's Response*

- Under the Issuer Register Model, the CCASS accounts will not become name-on-register. Change in legal title arising from transfer of securities will therefore take place exclusively on the ROM maintained by share registrars. This will simplify the interaction between HKSCC and share registrars.
- Electronic transfer of uncertificated shares between HKSCC and share registrars will require electronic linkages between their systems. Under the proposed progressive implementation of the scripless initiative, such electronic linkages will be introduced in the further development of the scripless initiative and be subject to market demand. This will allow us more time to consider the functionality of the linkages along with the mode of processing of transactions between CCASS and systems of share registrars. There will also be more time for the Federation of Share Registrars to address market concerns about the security of the SRN in relation to transfers of uncertificated shares. Market comments will be fully taken into account.

### **Dematerialisation**

#### **13. Respondents' Comments**

- Some respondents were concerned that the securities market could not be completely dematerialised because it was likely that many investors would still prefer to hold physical scrip for various reasons.
- Some of them thought the proposed 12-month dematerialisation programme was too optimistic.
- A respondent commented that investors were eager to know about the schedule for the dematerialisation process.

### *HKEx's Response*

- We acknowledge the concerns of the respondents and understand that market acceptance and market readiness are critical factors for the successful implementation of the scripless proposal. As stated in the HKEx Consultation Paper, it will up to the Government to judge when the market was ready for full implementation of a scripless securities market. Until then, we expect the market will support both scrip and uncertificated shares.

- Under our revised proposal, we expect it will take roughly 12 to 18 months to complete the CCASS dematerialisation programme after the enactment of the enabling legislation. The timetable is indicative in nature only and will be adjusted taking into account experience when the programme is implemented and readiness of share registrars and issuers. We will provide sufficient advance notice of the CCASS dematerialisation schedule to the market before actual implementation.
- The scripless option will be made available to market intermediaries and the investing public when share registrars are ready. We believe details will be provided by the share registrars in due course prior to implementation.

#### ***14. Respondents' Comments***

- A respondent suggested that lost scrip would need to be replaced before dematerialisation. This could give better protection to the market as all dematerialised shares would have been backed up by physical certificates before the commencement of dematerialisation.

#### ***HKEx's Response***

- We agree with the comments and will pass them to the Federation of Share Registrars and the SFC for their consideration. Insofar as the CCASS dematerialisation programme is concerned, detailed reconciliation of shareholdings in the CCASS Depository will be conducted.

#### **Rematerialisation**

#### ***15. Respondents' Comments***

- Some respondents considered rematerialisation unnecessary and contrary to the objectives of the scripless initiative. A respondent even urged regulators to re-consider the necessity of rematerialisation after implementation of a scripless securities market.
- Some respondents felt that rematerialisation should be subject to a higher cost. However, one respondent held the opposite view and recommended that investors should be able to opt for some form of physical certificates and the level of rematerialisation fees should not be prohibitive.

## *HKEx's Response*

- We see merits in the arguments in favour of and against the rematerialisation option. In order to gain more investor support for the scripless initiative, it is preferable to provide the rematerialisation option to the market at the beginning. However, it should also be noted that running a scripless securities market while maintaining a scrip option results in higher costs for the market. In the light of this, we advocated a user-pays principle, for fairness.

## **Service to Shareholders**

### *16. Respondents' Comments*

- A respondent commented that the split of corporate actions between HKSCC and share registrars seemed unnecessarily costly and complex and would make the vital reconciliation processes undertaken in such transactions very difficult if not impossible. It would also deny the intermediaries the benefit of effectively automating corporate action distribution to their clients (which would otherwise occur automatically through the CCASS Sponsored Account arrangements).
- On the other hand, a respondent welcomed the proposal if HKEx could provide the same service to the standards to which share registrars currently perform without increasing the costs of corporate action for holders on the CCASS Register.
- Another respondent preferred a single point of contact either at HKSCC or at the share registrar (for both timely receipt of corporate event information and issue of responses for company events).
- Furthermore, a respondent said registered shareholders should be able to choose whether HKSCC or the share registrar provides corporate action processing services.

## *HKEx's Response*

- Under the Issuer Register Model, CCASS will continue to operate on a nominee basis and all shares deposited into the CCASS Depository will continue to be registered on the ROM in the name of HKSCC Nominees. HKSCC Nominees, as the registered shareholder, will continue to perform corporate actions for CCASS Participants (including IPs) in relation to their shares deposited into the CCASS Depository. The comments made with reference to the Split Register Model are therefore no longer relevant.

## **Shareholder Reference Number (“SRN”)**

### *17. Respondents' Comments*

- There was comment that when an investor wanted to sell only part of his or her holdings, the disclosure of the SRN to an intermediary could increase the possible risk of misappropriation.
- Some respondents were concerned about the lack of safeguards to prevent an investor from giving sell orders for the same lot of shares to different brokers. They also said the SRN could also create complications in transfer instructions involving different share registrars.
- A respondent commented that the proposal would cause inconvenience to investors in managing multiple SRNs when they held shares in several companies. In connection with this, a respondent suggested that investors should be allowed to change their SRNs.
- Another respondent claimed that the SRN proposal would pose additional practical problems. For example, if the SRN would only be given at settlement day (T+2) and if an investor wanted to buy stock with one broker and sell with a different broker on the same day, there would be no SRN available to give to the selling broker.
- Some respondents were concerned about additional liabilities and obligations of brokers. Brokers would have to ensure their staff did not misuse SRNs and misappropriate clients' shares.
- A respondent commented that it would be too demanding for the general public to understand the SRN concept, keep the SRN safe and use the SRN for settlement.

- A respondent suggested the use of an optional Personal Identification Number (“PIN”) and a replacement SRN for partial sales. However, an optional PIN might create issues for brokers who worried that their capacity to settle trades might be prejudiced.
- It was also proposed that the SRNs be encrypted so that SRNs would not need to be disclosed to a third party. Other recommendations included affirmation from investors before transferring their shares to their intermediaries, control procedures for the share registrars and inclusion of investor’s Hong Kong ID card number in the SRN.
- Furthermore, a respondent recommended that choices be given to investors to either collect the SRN or to have the SRN mailed to them. If the SRNs had to be delivered by mail, share registrars should be required to use small plain envelopes which were free of markings identifying the mail as including the SRN and did not protrude from mail boxes.

### ***HKEx’s response***

- We fully recognise the market’s concerns about the security and user-friendliness of the SRN. While the SRN should not be a major concern during the initial phase of implementation of the Issuer Register Model, it is likely to be relevant when electronic transfers of uncertificated shares become an option in the further development of the scripless initiative. We understand that the Federation of Share Registrars is reviewing the SRN proposal and considering alternatives to address market concerns. We will pass market comments to the Federation of Share Registrars for its consideration. We believe market comments will be fully taken into account before such a measure is finalised.

## **Cost Implications for Market Participants**

### ***18. Respondents’ Comments***

- There were comments that HKSCC, share registrars and market participants would have to review and revise their current operating systems and the related costs on system enhancements would be a great concern to market participants.
- Respondents commented that the new system would bring in additional operating cost for brokers as their systems would need enhancement and that costs would be passed to others for the electronic custody of investors’ shares.

- Other respondents raised concerns over the costs of dematerialisation and rematerialisation. A respondent was concerned that there was no reason for listed companies themselves to absorb the cost of the dematerialisation/rematerialisation requests of shareholders since these were choices of individual shareholders.
- A respondent commented that costs might be a concern to issuers as share registrars might rationalise their fee structure due to the scripless initiative. Fees currently paid by issuers to share registrars might also increase due to the increase in the size of the ROM.
- A respondent thought that if investors and issuers had to share the costs of development and operations, the costs would be similar to a public utility and future tariffs should be approved before any development began. Moreover the daily copying of the CCASS Register to the respective share registrars electronically was likely to increase registrar costs. If allocation of costs would be based on the user-pays principle, investors would be required to bear the costs irrespective of whether or not they requested a transfer.
- Another respondent recommended that the benefits of cost reduction through scripless trading should be passed on to investors to gain their acceptance of uncertificated shareholdings. A respondent said costs should not be disproportionate to benefits and that the future system should also maintain the existing shareholders' choices at low costs. Another recommendation was that regulators should ensure that intermediaries charge reasonable costs.
- A few respondents were concerned about the cost distribution under the scripless model. Moreover, a respondent noted that the scripless market should be more efficient and that cost savings should be passed on to participants in an equitable manner.
- There were suggestions that there should be a review of CCASS fees and the proposed CCASS fees in a scripless securities market should be tabled as a matter of urgency.
- There were also comments that share registrars should put forward the tariffs they would charge. It was commented that the different cost structures under HKSCC and the share registrars might create operational inefficiency as a result of frequent inter-register transfers.

### *HKEx's Response*

- We fully appreciate the market's concerns about the cost implications of implementing the scripless initiative. We believe a progressive approach on implementation will help manage the cost impact effectively. Through this approach, we expect the up-front capital investment required of market intermediaries should be minimal.
- With the gradual dematerialisation of shares in the CCASS Depository, we expect review of certain CCASS fees would be necessary. Any amendments to CCASS fees will be subject to approval by the SFC as required under the Securities and Futures Ordinance. Dematerialisation and rematerialisation of shares may be subject to fees to be determined by the share registrars in consultation with the SFC. Overall, we hope that market efficiency will increase and costs will be lower, ultimately bringing the benefits to the investing public.
- Fees charged by share registrars for their services to issuers are commercial matters between those parties and are outside the jurisdiction of HKEx/HSKCC. However, one of our reasons for choosing the Split Register Model and the current revised model is to preserve competition in the share registration market. So long as that market remains competitive, market forces should be able to regulate costs and charges effectively. Everything being equal, it is for the market to decide whether an increase in fees due to an increase in the number of registered shareholders is a fair price to pay for better corporate governance.