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## CONSULTATION CONCLUSIONS ISSUED ON A PAPERLESS SECURITIES MARKET FOR HKEX-LISTED SECURITIES

Joint Consultation Conclusions<sup>1</sup> on proposals for a paperless securities market for Hong Kong were published in April 2020. The original proposals were set out in a Consultation Paper<sup>2</sup> (**Consultation Paper**) issued jointly by the Securities and Futures Commission (**SFC**), the Hong Kong Exchanges and Clearing Limited (**HKEx**) and the Federation of Share Registrars Limited (**FSR**) (together the **regulators**) in January 2019. For a summary of the original consultation paper proposals, please see Charltons' March 2019 newsletter.<sup>3</sup>

Currently, paper documents are required in Hong Kong to evidence and transfer legal title to certain securities, including shares. As a result, most investors use the Central Clearing and Settlement System (**CCASS**) to hold and transfer their listed securities. The listed securities are "immobilised" and held in the name of a single nominee – HKSCC Nominees Limited (**HKSCC-NOMS**). Under the CCASS system, investors hold and transfer only their beneficial interests in securities, rather than legal title.

The proposed model for an uncertificated securities market in Hong Kong (**Revised Model**) will allow investors to hold securities in their own name and without paper documents.

The majority of respondents to the Consultation Paper were generally supportive of the proposed Revised Model.

The regulators will now develop the model further, including the more technical features, and aim to implement the regulatory framework from 2022. This will require amendments to the rules and procedures of The Stock Exchange of Hong Kong Limited (**SEHK**) and Hong Kong Securities Clearing Company Limited (**HKSCC**) and statutory changes. The regulators will continue discussions with stakeholders over the coming months.

The uncertificated securities market aims to offer improved investor choice and protection, and improvements in efficiency and competitiveness. The existing paper-based system has involved financial and time costs for effecting legal title transfers. Under the current system, investors must choose between (i) enhanced shareholder protection and rights by holding securities in paper form in their own name, and (ii) increased convenience by holding securities in CCASS which are registered in the name of HKSCC-NOMS.

The Revised Model will operate under a new system to be introduced to replace CCASS (**HKEX System**). The HKEX System will retain the role of a central nominee and allow investors to hold securities in their own names without paper. The HKEX System and Approved Share Registrars' system will be linked electronically to support transfers into and out of the HKEX System. Although the central nominee structure offers an option for investors who prefer to hold securities in the name of a nominee, the regulating authorities hope

1 Joint Consultation Conclusions on a Revised Operational Model for Implementing an Uncertificated Securities Market in Hong Kong. Available at: [https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/Jan-2019-USM-Joint-Consultation-Conclusions-Paper/Conclusion-Paper/USMCP\\_2020\\_EN.pdf?la=en](https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/Jan-2019-USM-Joint-Consultation-Conclusions-Paper/Conclusion-Paper/USMCP_2020_EN.pdf?la=en).

2 <https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=19CP1>.

3 <https://www.charltonslaw.com/hong-kong-consults-on-paperless-securities-market/>.

that over time, investors will become more familiar with the Uncertificated Securities Market environment, and may be encouraged to hold securities in their own names.

## Revised Model for Hong Kong Uncertificated Securities Market

The Revised Model will retain the current nominee structure so that investors can hold securities through the HKEX System. Securities will be registered in the name of HKSCC-NOMS and investors will hold a beneficial interest only in the securities. The three types of CCASS accounts will continue:

1. CP accounts - accounts holding the securities of multiple investors which are opened and managed by a clearing or custodian participant in CCASS (**CP**);
2. SSA (stock segregated accounts with statement service) - accounts holding the securities of a specific investor which are opened and managed by a custodian participant); and
3. IP accounts - accounts opened and managed by an investor admitted by HKSCC as an investor participant (**IP**) which hold the investor participant's own securities.

Currently, investors can hold securities in their own name, but only in paper form and outside of CCASS. Under the Revised Model, there will also be a new "USS" feature and a new "USI" feature that will allow investors to hold securities in their own name and in uncertificated form.

Investors will have the following options under the Revised Model:

1. to hold uncertificated securities through a CP account, an SSA or an IP account. The securities will be registered in the name of HKSCC-NOMS and investors will have a beneficial interest in, but not legal title to, the securities;
2. to hold uncertificated securities in their own name and manage them directly by communicating directly with the issuer or the issuer's share registrar (**USI feature**); or
3. to hold uncertificated securities in their own name and manage the securities indirectly via a clearing or custodian participant and the HKEX System (**USS feature**).

Investors may also hold securities in certificated form for a limited period of time.

Approved Share Registrars will be responsible for evidencing and effecting transfers of legal title to securities without paper documents. Both USI holders and USS holders will be recorded as the registered owners of uncertificated securities in registers of members.

Both USS and USI holders must be legal persons. A fund that is structured as a corporate entity can be a USS/USI holder. However, if a fund is structured in a non-corporate form (such as a trust), the entity holding the fund's assets (e.g. the trustee) may be the USS/USI holder. Registered holders of securities (including USS holders) may be nominees holding the securities on trust, and are not required to be the ultimate beneficial owner. The Consultation Conclusions clarified that fund issuers (e.g. ETFs) will not be required to offer their shareholders (or unitholders) the option to withdraw their shares or units from CCASS and register them in their own names. The main change from the original proposals is that the USS feature will be available to both retail and institutional investors.

## Uncertificated Securities Market

The principal objection of consultation respondents who opposed the Revised Model was that it does not allow an investor to hold securities in their own name *within* the HKEX System. This means that investors holding securities in their own name (and thus *outside* the HKEX System) who wish to settle trades executed on the SEHK must first move their securities into the HKEX System by transferring them to HKSCC-NOMS, incurring time and monetary costs. On the other hand, investors who choose to hold securities *within* the HKEX System will only hold beneficial title to their securities, and will be subject to complicated procedures for corporate communications and the exercise of voting rights, and will not enjoy all shareholder rights, such as nomination of directors.

The regulators did not consider these concerns to be overly problematic. An electronic interface between the HKEX System and each Approved Share Registrar's system will be introduced under the Revised Model, enabling investors to efficiently move their securities into and out of the HKEX System by transferring them to and from HKSCC-NOMS. Further, investors can hold their securities in their own name, and the regulators do not consider the fact that they are unable to do so within the HKEX System to be a deterrent. Further, some investors may want to hold securities through a nominee

as beneficial owners. Separate to the Uncertificated Securities Market model, the regulators are looking at initiatives to enhance the position of beneficial owners holding securities through the CCASS/HKEX System.

In the Consultation Paper, it was proposed that investors who seek to hold uncertificated securities in their own name would be allowed to do so through a USI or USS. The regulators clarified in the Consultation Conclusions that in using the term “account”, they did not mean that securities would be “held with” or “held in the custody of” a sponsoring custodian participant/Approved Share Registrar, but instead the USS and USI features are two options for the management of uncertificated securities that are held in an investor’s own name. Accordingly, the regulators decided to use the terminology USS/USI “feature” or “service” (instead of USS/USI “account”) to prevent confusion.

The regulators do not regard the Revised Model to affect shareholder-related obligations under the SFO, including Part XV disclosure of interests obligations or SFC approval requirements for substantial shareholders of licensed corporations.

### USS Feature

Investors choosing the USS feature will be able to hold their securities in their name in uncertificated form, and must manage their securities indirectly by communicating with the issuer/Approved Share Registrar via a sponsoring custodian participant and the HKEX System.

In the Consultation Paper, it was proposed that the USS feature would only be available to institutional investors, while the USI feature would be available to all investors. However, in light of responses to the consultation, it is now proposed that all investors will be able to use both the USS and USI features. However, given concerns that intermediaries may find it operationally difficult to offer USS services to retail investors, there is no obligation on intermediaries to offer such services.

Arrangements relating to the USS feature will be documented and governed by: (i) the HKEX System rules which will be binding on HKSCC and HKSCC participants (including sponsoring custodian participants and registrar participants), and (ii) sponsoring agreements to be entered into between the sponsoring custodian participant and each of its USS holders (these agreements will be required to include certain prescribed terms as set out in the HKEX System rules).

Sponsoring custodian participants in acting as intermediaries will be required to perform account opening procedures (such as KYC checks) for all clients, including USS holders. Sponsoring custodian participants will be expected to offer different services to support communications between USS holders and the issuer/its Approved Share Registrar. The sponsoring custodian participants will pass relevant investor details through the HKEX System to the relevant Approved Share Registrar who will then enter the relevant information in the register of members.

Certain processes and communications will be routed via sponsoring custodian participants and the HKEX System:

- transfers of USS holders’ uncertificated securities, even if there is no payment;
- dematerialisation of USS holders’ securities into uncertificated form;
- distributions of entitlements to USS holders, including securities or cash dividends, interest payments, redemption proceeds, rights, bonus securities and other properties;
- submission of USS holders’ instructions regarding corporate action matters, for example rights, entitlements and proxy nominations; and
- submission of potential USS holders’ applications for IPO securities to the Approved Share Registrar and collection and return of the associated monies.

USS holders will receive regular statements of their registered holdings in electronic form from their sponsoring custodian participant via the HKEX System, and an electronic confirmation regarding the successful allotment or transfer of uncertificated securities in their name.

The issuer or its Approved Share Registrar may send certain documents to USS holders directly, such as regular reports, including annual, interim, quarterly and summary reports, and notices and circulars.

The HKEx and Approved Share Registrars must ensure the security, robustness and reliability of their systems and employ business contingency arrangements. These systems, which are vital in the Uncertificated Securities Market environment, will be subject to the SFC’s regulatory oversight.

Cash payments relating to corporate actions (such as dividend payments) will be credited directly into a USI holder's designated bank account. The regulating authorities consulted the market in respect of payment of cash entitlements to USS holders. As most respondents indicated a preference for cash entitlements to be paid to the sponsoring custodian participant on behalf of the USS holder, the regulators are seeking to realise this, e.g. by empowering issuers to verify the authority of the sponsoring custodian participant. Nevertheless, the regulators do not consider it appropriate to require payments to always be made to the sponsoring custodian participant, and instead view this as a decision to be made by USS holders and sponsoring custodian participants.

The Consultation Conclusions further clarified that USS holders' securities entitlements will be credited directly to the holders' entry on the register of members, while communications regarding those holdings will be routed via the sponsoring custodian participant and the HKEX System. There are no advantages to being a USS holder (whose securities will be managed via a sponsoring custodian participant and the HKEX System) in terms of trading securities on the SEHK or clearing and settling securities through the HKEX System.

### USI Feature

Investors choosing the USI feature will be able to hold securities in their own name in uncertificated form and must manage their securities directly. The USI service will be provided by issuers through Approved Share Registrars. An Approved Share Registrar will conduct basic checks to verify each prospective investor's identity and obtain the relevant information (including the investor's identification number, name and address) to be entered into the register of members. Intermediaries will not be allowed to rely on checks conducted by Approved Share Registrars as the process will not be as comprehensive as the KYC checks required to be undertaken by intermediaries. The possibility of permitting an online process for submission of identification of documents (rather than in person) is being explored. Investors may apply for a USI service for all securities handled by the same Approved Share Registrar. The maximum number of joint holders for the USI service will be four. Communications between USI holders and the issuer will be conducted through the Approved Share Registrar, including regular electronic statements of registered holdings and confirmations on successful allotment or transfer of uncertificated securities.

The FSR is looking into developing a Common Platform, a web-based portal across participating Approved Share Registrars, so that all registered securities (which may be handled by more than one Approved Share Registrar) of a USI holder may be managed through a single access point. The platform will provide a point of communication among USI holders, issuers and Approved Share Registrars. USI holders will be able to log-in on a single webpage access point to manage their registered securities holdings (both in certificated and uncertificated form). Sponsoring custodian participants and USS holders will not be able to access the Common Platform. The platform will only handle simple functions (such as managing holders' basic profile and viewing portfolio balances), while more complicated functions (such as transfers of securities and exercise of corporate action rights) will be performed through the applicable Approved Share Registrar's web system. The FSR will provide further details in due course.

### Securities Holders' Unique Identification Number

Currently, issuers do not possess a complete record of all registered securities holders' identification numbers. Under the Revised Model, registered securities holders (and not the beneficial owners who hold securities through intermediaries) will be required to provide a unique identification number to the issuer when the investor applies for the USS/USI feature (and not at the time a transfer or other process is carried out). Securities holders' identification numbers will not be included in the register of members and will not be available for public inspection. These are separate and unrelated to the SFC's Investor ID initiative.

Due to personal data protection and privacy concerns, the regulators intend to implement strict requirements so that identification information may only be used for legitimate purposes and will be protected against theft, unauthorised use and unauthorised transfer. Compliance with applicable data privacy laws will be required.

Unique identification numbers may include Hong Kong Identity Card numbers for Hong Kong residents, most recently issued passport numbers for other individuals, and Hong Kong company registration number or equivalent for companies. Although the regulators are not planning to prescribe the types of identification numbers, they may stipulate an order of priority so that investors must include details of their identification document that is highest on the list. In relation to the problem of passport numbers changing, if an individual does not have a Hong Kong identity card, they may provide details of other national identity documents. In respect of joint holders, each

joint holder will be required to provide its identification number. The regulators will look into options for encouraging registered holders holding securities in certificated form to provide their identification numbers when transferring such securities. The details relating to the provision of unique identification numbers, which will be finalised later, will be outlined in rules or guidelines to be issued by the SFC.

As a result of investors providing unique identification numbers, issuers may consolidate the holdings of registered holders regardless of how they hold the securities (whether in certificated form or in uncertificated form as a USS or USI holder). In response to the question in the Consultation Paper as to whether securities entitlements (such as rights issues, share dividends and bonus shares) should be calculated separately in the case of USS holders with securities managed through multiple custodian participants, most respondents were of the view that these entitlements should be calculated separately, largely due to concerns about fractional entitlements and treating USS and USI holders equally. The regulators stated that they will take this into account in developing the technical and operational aspects of the USS and USI features.

### Hong Kong Regulation of Approved Share Registrars

Share registrars currently do not need SFC approval. The SFC is developing a regulatory framework for approving and regulating share registrars. A major focus of the new regulatory regime will be the integrity, security and adequacy of share registrars' systems and processes, especially IT systems, infrastructure and interface with external parties. The SFC will consider other aspects, including governance, financial resources, internal controls and risk management, as well as risks and liabilities.

When approving and regulating persons as Approved Share Registrars, the SFC intends to take into account the fitness and properness of the share registrar's directors/owners, and the share registrar's financial resources and internal controls. The SFC is examining the potential regulation of registrars' fees.

The SFC considers that empowering investors to remove an Approved Share Registrar is not appropriate as the SFC will regulate them directly. The SFC is proposing to introduce legislative amendments to give it sufficient supervisory, investigatory and regulatory powers, such as the power to impose disciplinary sanctions for breaches by registrars. Sanctions similar to those applicable to licensed corporations under the SFO are being considered.

The regulators view the role of Approved Share Registrars as not overlapping with or replacing the roles of intermediaries, such as banks and brokers – share registrars will continue to act as agents of issuers in maintaining the register of members. Both USI and USS holders will be reflected as registered owners of uncertificated securities in the relevant register of members. Where an investor holds securities both in certificated and in uncertificated form, the register of members will reflect their total holding, showing the respective number in each form. For USS holders, the Approved Share Registrar will also keep a note of its sponsoring custodian participant but may not reflect this in the register of members.

The SFC is examining introducing requirements to deal with concerns about the safety and integrity of registers of members, as well as related liability. The SFC does not propose any changes in relation to the current requirements and practices relating to the inspection of registers of members – the names and addresses of registered holders and the number of registered securities held will be available for inspection.

### Electronic Interface between HKEX System and Approved Share Registrars

A new electronic interface will be established between the HKEX System and each Approved Share Registrar's system and a new "registrar participant" category will be introduced to facilitate electronic communications between HKSCC and Approved Share Registrars. Registrar participants will enable various Uncertificated Securities Market processes, including the transfer of securities between a USS/USI holder and HKSCC-NOMS and between a USS holder and a USI holder. The eligibility criteria and responsibilities of the registrar participant category are still being finalised, but it is likely that only Approved Share Registrars will be eligible to become registrar participants. There is no plan to allow registrar participants to offer trading or clearing and settlement services similar to those presently offered by custodian participants in CCASS.

It is expected that the central regulatory framework for Approved Share Registrars will be outlined in the SFO, and that detailed requirements will be included in subsidiary legislation and/or SFC rules, codes and/or guidelines. The SFC will consult the market in due course.

### Key Processes – IPO Subscriptions

After applying for IPO securities, the securities will be credited directly into an IP account, a CP account, a USI feature or a USS feature. Paper application forms and use of paper cheques and cashier orders will be phased out. The following sets out the key features of the IPO subscription process for USI and USS features:

1. the investor must have the USI/USS service at the time of submitting the application. The Consultation Conclusions clarified that prospective investors will be allowed to apply for the USI service at any time, regardless of whether they own securities at the relevant time. The FSR is considering an express service so that the USI service application process for Hong Kong individuals can be completed within one business day;
2. multiple applications from the same investor will be rejected (as is the current practice);
3. in cases where securities are allotted on the business day prior to the listing date, the share registrar will update the provisional register of members with conditional holdings, which will become unconditional on the listing date;
4. in respect of USI features, the application form and subscription monies must be submitted electronically via the system designated by the issuer, and any refund of subscription monies will be credited directly to the bank account designated by the USI holder; and
5. in respect of USS features, the application form and subscription monies must be submitted through the relevant sponsoring custodian participant and through the new HKEX System, and any refund of subscription monies will be credited directly to the sponsoring custodian participant's designated bank account.

The regulators are exploring a shortened IPO settlement timetable separately in connection with the transition to paperless applications and settlement.

### Key processes – Transfers

#### Transfers of securities within the HKEX System

Transfers between different CP accounts, IP accounts and SSAs in the HKEX System will not result in any change of

legal title and the securities will remain registered in the name of HKSCC-NOMS at all times. The process for transfers will remain largely unchanged. Options for settling the money leg and the process of collecting and paying related stamp duty will also remain the same.

#### Transfers of uncertificated securities to or from HKSCC-NOMS

Deposit and withdrawal of securities into and out of a CP account, IP account or SSA in the HKEX System by a USI or USS holder will result in a change of legal title, and these processes will be effected electronically through the HKEX System and the relevant share registrar system.

USS holders will have the option to transfer securities on a free-of-payment (**FOP**) basis or on a real-time-delivery-versus-payment (**DRVP**) basis, while USI holders will be able to transfer their securities only on an FOP basis.

The sponsoring custodian participant or Approved Share Registrar will need to make declarations as to whether stamp duty is payable and whether it has been paid. However most transfers are expected to not entail a change in beneficial interest and will not therefore require stamp duty collection.

Market participants will be able to choose when to effect their transfers, e.g. on a real-time, same day or next day basis. It is currently anticipated that transfers to/from HKSCC-NOMS will be processed in multiple batches throughout the day, each shortly prior to HKSCC's batch settlement for on-exchange trades. The regulators are also looking into allowing additional flexibilities to deal with system delays or failures.

USS and USI holders' securities must be transferred to HKSCC-NOMS in time for settlement within the T+2 settlement period, which also means that transfers will not need to be effected prior to placing a sell order. The HKEX and FSR are examining the feasibility of designing the process so that USI holders will only send their transfer instructions once, rather than to both the intermediary and Approved Share Registrar.

#### Other transfers of uncertificated securities

Transfers between two USI holders, between two USS holders or between a USI holder and a USS holder will result in a change in legal title and are likely to cause a change in beneficial interest. These transfers are therefore likely to be subject to ad valorem stamp duty. Transfers will be effected electronically and, in the case of USI holders as parties to the transfer, through the relevant share registrar system, or in the

case of a USS holder being a party to the transfer – through both the HKEX System and share registrar system. Both parties will be required to provide details of the transaction (so that the share registrar will be able to match the transfer instructions) and their own identification numbers.

#### Transfers of certificated securities

These transfers will continue to be paper-based until a final deadline for dematerialisation set by the regulators comes into effect.

#### Transfers on half-day trading days

It was proposed in the Consultation Paper that securities settlement and transfers within the HKEX System be made available on all Hong Kong business days and off-exchange trade settlement and transfer services be offered on half-day trading days as well.

Many concerns and issues were raised in the consultation process in respect of transfers on half-trading days, such as that it may cause inconsistent settlement practices and intermediaries may not be able to determine whether client instructions concern on-exchange or off-exchange trades. As a result, the HKEx will reconsider this proposal and seek views from the market.

#### Alternative stamping arrangement for off-exchange transactions

The regulators are working with the Stamp Office to implement alternative, electronic arrangements for stamping off-exchange securities transactions. This will replace the existing paper-based process. Under the new arrangements, share registrars and/or intermediaries would make declarations as to whether ad valorem stamp duty is payable on transactions, and if so, whether it has been paid. The current time limit for stamping of 2 or 30 days after execution of the contract note will continue to apply. The party responsible for making the stamp duty payment will be a matter for agreement between the sponsoring custodian participant and the USS holder. Where a transfer is effected electronically in the Uncertificated Securities Market environment, the current HK\$5 charge payable on instruments of transfer will not be payable.

## Corporate actions

For securities held through a CP account or an IP account, the corporate action processes under the Revised Model will remain substantially unchanged, and all corporate action instructions and entitlements will continue to be routed through the HKEX System.

Separately, the SFC is working with HKEx and FSR to enhance the position of investors whose securities are registered in the name of HKSCC-NOMS (and therefore hold a beneficial interest only), to facilitate and encourage their participation in voting without additional undue costs.

With regard to a USI or USS feature, while they will be treated as equally as possible, the following differences in the routing of instructions and entitlements will remain:

#### (i) Conveying instructions

USI holders will be able to convey their corporate action instructions through the relevant share registrar system, while USS holders will need to route their corporate action instructions via their sponsoring custodian participant and the HKEX System.

#### (ii) Securities entitlements

In cases where corporate actions affect a holder's securities balance:

- a) for USI holders, securities entitlements will be credited to the relevant USI feature (by adjusting the securities balance on the relevant register of members) and the USI holder will be notified by the relevant share registrar of the change by day-end on a payment date;
- b) for USS holders, securities entitlements will be credited to the relevant USS feature (by adjusting the securities balance on the relevant register of members) and the timing and manner of notification will be governed by the client documentation and arrangement between the USS holder and its sponsoring custodian participant.

#### (iii) Voting and proxies

USI and USS holders will have the right to vote and to attend and speak at meetings of the issuer, and will be entitled to appoint proxies. When developing the Revised Model, the regulators will take into account suggestions from consultation respondents regarding: (i) implementing operational rules to regulate USS holders' exercise of rights to attend and vote at meetings, (ii) streamlining voting procedures; and (iii) developing a feature to block shares for voting purposes.

The Consultation Paper also proposed that shareholders who are individuals should be limited to appointing a maximum of two proxies to tackle potential abuses involving appointing large numbers of proxies without a legitimate purpose. The regulators clarified in the Consultation Conclusions that they want to reinstate the position under the old Companies' Ordinance (but only for shareholders who are individuals). Although it was proposed to shorten the deadline for submission of proxy material to one clear business day before the meeting day, the regulators will maintain the current 48-hour deadline.

#### (iv) Takeovers

As it will not be possible for shareholders who hold their shares in uncertificated form to surrender share certificates and signed instruments of transfer upon acceptance of a takeover offer (whether conditional or unconditional), it is proposed that USI and USS holders should consent to earmarking and "locking" their shares until the offer is declared unconditional. This means there cannot be any movement or transfer of such shares, and the shares would remain registered in the name of the relevant USI or USS holder. The consent to "locking" the shares will need to be given at the time of accepting the offer through the relevant share registrar system (for USI holders) or the sponsoring custodian participant and the HKEX System (for USS holders). It is proposed that the transfer of shares to the offeror would not be registered until payment has been made to accepting shareholders.

#### (v) Pledging

To enable pledging in the absence of share certificates and signed instruments of transfer, a "locking arrangement" will be introduced, pursuant to which pledged shares in uncertificated form will be "locked" and administered by the relevant Approved Share Registrar on terms agreed among the pledgor, pledgee and Approved Share Registrar. "Locked" securities will not be reflected in the register of members as being locked. The

FSR anticipates that similar practices to the current ones will be implemented for pledging in the Uncertificated Securities Market environment.

The SFC and FSR will together examine the development of standard provisions to be included in pledging agreements in respect of securities held in uncertificated form. The SFC will look into introducing legislative amendments to support pledging in the Uncertificated Securities Market environment.

#### (vi) Timing issues

The regulators are currently exploring the possibility of aligning the cut-off times for securities registered in the name of USS holders and those in the name of HKSCC-NOMS.

Securities entitlements for all registered holders will be updated at the same time.

### **Fees and costs**

In response to concerns about fees and charges to investors and listed issuers, the regulators stated in the Consultation Conclusions that as technical and operational aspects of the Revised Model are being developed, they currently cannot provide detailed information about fees and costs. They however clarified that:

- a) it is expected that the HKEx and share registrars will bear most of the initial development costs, and that existing processes will be retained (as much as possible), limiting the financial impact on issuers and other market participants;
- b) costs savings from the reduced use of paper should be passed to investors, and investors should not be discouraged from holding securities in their own name or in uncertificated form due to fee structures; and
- c) the regulators aim to keep fees and charges fair, reasonable and conducive to fostering the market's transition to full dematerialisation. The HKEx and FSR are also researching the adoption of a tiered approach and/or establishing caps for certain fees.



#### Phased Approach – Product Scope

The Uncertificated Securities Market will be introduced gradually and in phases. It was proposed that the first focus will be shares, starting with Hong Kong-incorporated companies' shares and then moving on to shares of overseas-incorporated companies. In the Consultation Conclusions, the regulators stated that they will take into consideration respondents' comments that the initial phase should be expanded to cover issuers incorporated in the Cayman Islands, Mainland China and Bermuda. The paper-based system will be maintained for companies incorporated in jurisdictions which restrict or prohibit the holding or transfer of shares without paper documentation.

The next focus of the Uncertificated Securities Market's introduction will be listed funds and "share-like securities" such as rights issues, subscription offers and depositary receipts. It is intended to focus on products issued under Hong Kong law first, and then move on to those issued under overseas laws. Although SFC-authorized listed funds may be included in the Uncertificated Securities Market initiative, such funds with units/shares that are not withdrawable from the HKEX System will not be required to participate in the initiative and/or appoint ASRs. The processes for voluntary corporate actions (such as rights issues) and subscription offers will be similar to currently, although the processes, documents and payments will be electronic. Similar to shares, depositary receipts may be held in physical form (for a short period of time) or uncertificated form (in investors' own names as USS/USI holders or in the name of HKSCC-NOMS).

The regulators clarified that in respect of Stock Connect securities, the Uncertificated Securities Market model will only apply to securities listed on the SEHK, and the model will not impact Mainland investors as they are not allowed to withdraw securities and register them in their own names (and therefore, they will not be able to become USS or USI holders). The Uncertificated Securities Market initiative will not extend to shares in private companies. Other listed products (for example, CBBCs and DWs) will not come within the scope of the new initiative, and will remain in the HKEX System and registered in the name of HKSCC-NOMS.

#### Phased Approach – Timeline to full Dematerialisation

Although it will be necessary to retain a paper option, the ultimate aim is to remove the paper option entirely. The regulators will try to keep the transition period to full dematerialisation as short as possible, taking into consideration the requirements

of and costs to various stakeholders. The timelines for different phases will depend on market readiness, and advance notice will be given for each phase.

It is intended to first require all IPO securities to be issued in uncertificated form only, starting with the shares of Hong Kong companies. A date will be determined after which a specified class of securities can only be issued in uncertificated form, and there will be no option to convert these IPO securities into certificated form after their issuance. It will, however, be possible to offer IPO securities in paperless form prior to that date, and a "pilot" period may be introduced to test the mechanism.

Securities in certificated form will continue to be valid following the final deadline, so that holders of certificated securities will remain the owner of their securities and of any securities entitlements distributed following the final deadline. However, investors must dematerialise their securities before selling or disposing them.

Pre-IPO investors must complete processes to become a USS/USI holder before their securities become tradeable on the SEHK (unless they wish to hold their securities in the HKEX System and transfer them securities to HKSCC-NOMS).

There will be no option to rematerialise securities that are in uncertificated form. The regulators are still working out details of the treatment of unclaimed physical certificates and delisted securities/untradeable securities.

Securities held within the HKEX System and registered in the name of HKSCC-NOMS will be dematerialised early on and in batches, starting with the shares of Hong Kong companies, and a "pilot" batch may be introduced to test the process. This process of dematerialisation will require HKSCC to return any title documents relating to securities to the relevant share registrar for cancellation, and the share registrar to record the uncertificated securities in the relevant register of members. It will not, however, be possible for investors holding stock or securities in the name of HKSCC-NOMS to withdraw them from the HKEX System and hold them in the certificated form after dematerialisation. The regulators will provide advance notice of each dematerialisation stage, taking into consideration the time needed for intermediaries to notify investors and make necessary arrangements in accordance with investor instructions.

For securities held outside the HKEX System, there will continue to be an option of holding securities in paper form, but it will be available for a limited time only. The final deadline will be implemented for Hong Kong companies' shares first. After such deadline:

- i) any transfer of securities held in certificated form will have to incorporate a dematerialisation process;
- ii) any new securities issued to the certificated securities holder will be issued in uncertificated form and credited to a USI account;
- iii) any cash entitlements payable to the certificated holder will need to be paid into their designated bank account or by cheque; and
- iv) any securities entitlements will be reflected in the holder's securities balance on the register of members, such entitlements will no longer be distributed in paper form, and the Approved Share Registrar will generate a "temporary" USI record to reflect the distribution of such entitlements.

The regulators intend to maintain the option of allowing investors to receive corporate notices and dividend cheques in paper, but only for a limited period.

In relation to queries about managing processes across CCASS and the HKEX System, the HKEx explained that functions will be migrated from CCASS to the HKEX System in phases, and that related processes will be migrated simultaneously. Although the two platforms may operate at the same time (but only for a short period), the platforms will be for different functions and processes.

## Encouraging Electronic Communications

Most respondents agreed with the proposal to encourage issuers and registered securities holders to communicate electronically instead of in paper form. In respect of various concerns, the HKEX and FSR will take into account data integrity and security and business continuity planning when developing system enhancements to support issuer-investor communications, and will consider keeping the paper option in certain limited circumstances.

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