

For discussion on
9 June 2014

Legislative Council Panel on Financial Affairs

Establishment of Shanghai-Hong Kong Stock Connect

Purpose

This paper briefs Members on the establishment of Shanghai-Hong Kong Stock Connect.

Background

2. On 10 April 2014, Premier Li Keqiang announced the establishment of mutual access between Hong Kong and Shanghai stock markets, with a view to further promoting the two-way opening up of the capital markets of the two sides. On the same day, the China Securities Regulatory Commission (CSRC) and the Securities and Futures Commission (SFC) of Hong Kong announced in a joint statement that they had approved, in principle, the development of a pilot programme (Shanghai-Hong Kong Stock Connect) for establishing mutual stock market access between Shanghai and Hong Kong.

Significance of Shanghai-Hong Kong Stock Connect

3. Shanghai-Hong Kong Stock Connect will not only help strengthen the two securities markets, but will also have long-term and strategic significance. This is a mutually beneficial development. For the Mainland, Shanghai-Hong Kong Stock Connect will help increase the participation of overseas investors, in particular institutional investors, in the Shanghai securities market, which will promote the further development of the market in a step-by-step manner, enable Mainland investors to invest in overseas markets in an orderly way, and enhance the opening up of the Mainland's capital markets. For Hong Kong, Shanghai-Hong Kong Stock Connect will strengthen the strategic co-operation and interaction between the Hong Kong and the Mainland capital markets, provide an additional channel for the two-way Renminbi (RMB) funds flows between the onshore and offshore markets, and thereby further increase the liquidity of the offshore RMB market in Hong Kong, whilst reinforcing and enhancing Hong Kong's position as a

premier international financial centre and offshore RMB business centre through this process.

4. The development of Hong Kong as an offshore RMB business centre has made significant progress over the past few years. The relevant financial platforms are increasingly comprehensive and are ready to capture the opportunities offered by mutual access between the Hong Kong and Shanghai stock markets. As the two-way opening-up of the Mainland capital markets and the internationalisation of RMB proceed further, Hong Kong will continue to play a unique and indispensable role in the process.

Key Features of Shanghai-Hong Kong Stock Connect

Applicable Rules

5. Under Shanghai-Hong Kong Stock Connect, trading and clearing arrangements will be subject to the regulations and operational rules of the market where trading and clearing take place. Listed companies will continue to be subject to the listing and other rules and regulations of the markets where they are listed.

Trading

6. The two exchanges will each establish a subsidiary in the other market to receive orders from their respective participants to trade eligible shares under Shanghai-Hong Kong Stock Connect and route them onto the trading platforms of the other exchange for execution.

Clearing and Settlement

7. The Hong Kong Securities Clearing Company (HKSCC) and China Securities Depository and Clearing Corporation (ChinaClear) will become a participant of each other to provide settlement and clearing services for cross-boundary trading through Shanghai-Hong Kong Stock Connect within a closed loop subject to comprehensive risk management measures. With such arrangements, Shanghai-Hong Kong Stock Connect ensures the money that flows into its system can only be used for trading eligible A shares or Hong Kong shares. Upon the sale of these shares, the funds so obtained will flow back to their originating market through the respective clearing system and cannot remain in the other market or be used to buy other asset classes therein.

Eligible Shares and Investors

8. Initially, under Shanghai-Hong Kong Stock Connect, all Mainland institutional investors and eligible individual investors (i.e. individuals who hold an aggregate balance of not less than RMB500,000 in their securities and cash accounts) will be able to trade eligible shares listed on the Stock Exchange of Hong Kong (SEHK) (i.e. all the constituents of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index, and shares of all companies listed on both SSE and SEHK which have issued both A shares and H shares) through the Shanghai Stock Exchange (SSE) and its members. At the same time, all Hong Kong and overseas institutional and individual investors will be able to trade eligible shares listed on SSE (i.e. all the constituents of the SSE 180 Index and SSE 380 Index, and shares of all SSE-listed companies which have issued both A shares and H shares) through SEHK and its Exchange Participants. The aforesaid scope of eligible shares may be adjusted in light of operation of the pilot programme.

Quota

9. Since Shanghai-Hong Kong Stock Connect is a pilot programme, it will be implemented in a progressive manner with proper risk control, and cross-border investment will be subject to quotas. The buying of the aforesaid SEHK shares by Mainland investors will be capped at an aggregate net quota of RMB250 billion and a daily net quota of RMB10.5 billion. The buying of the aforesaid SSE shares by Hong Kong and overseas investors will be capped at an aggregate net quota of RMB300 billion and a daily net quota of RMB13 billion. The aforesaid quotas may be adjusted in light of operation of the pilot programme.

Cross-boundary Enforcement Cooperation

10. The regulatory authorities of the two sides will take all necessary measures to establish, in the interests of investor protection, an effective regime under Shanghai-Hong Kong Stock Connect to respond to all misconduct in either or both markets on a timely basis. CSRC and SFC will upgrade the current bilateral agreement to strengthen enforcement cooperation in respect of mainly the following areas -

- (a) referral and information exchange mechanisms concerning improper activities;

- (b) investigatory cooperation in relation to cross boundary illegal activities including disclosure of false or misleading information, insider dealing and market manipulation;
- (c) bilateral enforcement exchange and training; and
- (d) enhancement of general standards of cross-boundary enforcement cooperation.

Preparatory Work and Market Communication

11. The government and regulatory authorities of the two sides, together with SSE, SEHK, ChinaClear and HKSCC, have been working closely together on the development of Shanghai-Hong Kong Stock Connect, and have set up working groups to follow up relevant work. SSE, SEHK, ChinaClear and HKSCC will collaborate with one another to develop the operational and other components of Shanghai-Hong Kong Stock Connect prior to launch. Launch of Shanghai-Hong Kong Stock Connect will only take place once relevant trading and clearing rules and systems have been finalized, all regulatory approvals have been granted, market participants have had sufficient opportunity to configure and adapt their operational and technical systems. All necessary investor education programmes must also be in place.

12. SSE, SEHK, ChinaClear and HKSCC will, during the development of Shanghai-Hong Kong Stock Connect, and prior to launch, liaise with market participants in relation to all rules, systems and technical requirements relevant to their operations. SEHK and HKSCC have published circulars and related materials to their respective participants, and conducted the first round of 14 briefing sessions for exchange and clearing participants as well as system and information vendors in May 2014. Nearly 2,000 industry practitioners attended. The second and third rounds of briefings are scheduled for June/July 2014 and August 2014 respectively. Further, the Hong Kong Exchanges and Clearing Limited (HKEx) has set up a dedicated webpage, email addresses and hotlines on Shanghai-Hong Kong Stock Connect to disseminate information and handle enquiries. In parallel, HKEx is also working closely with the Investor Education Centre to put together an investor education programme for both institutional and retail investors, and also with SSE to educate Mainland investors about the Hong Kong securities market and vice versa.

13. As announced on 10 April 2014, to launch Shanghai-Hong Kong Stock Connect, the preparatory work will take approximately six months. SEHK and HKSCC plan to conduct the market rehearsal in September 2014.

**Financial Services and the Treasury Bureau
May 2014**