



Hong Kong

August 2016

## SHENZHEN-HONG KONG STOCK CONNECT GETS GREEN LIGHT

### Introduction

On 16 August 2016, the China Securities Regulatory Commission (**CSRC**) and the Securities and Futures Commission (**SFC**) published a joint announcement (the **Announcement**)<sup>1</sup> approving, in principle, the establishment of the Shenzhen-Hong Kong Stock Connect scheme.

Shenzhen-Hong Kong Stock Connect will establish mutual stock market access between Shenzhen and Hong Kong, making it the second cross-border trading scheme between the Mainland and Hong Kong. Shanghai-Hong Kong Stock Connect was launched in November 2014, and provides the basis for the launch of the new Shenzhen-Hong Kong link. For more information on Shanghai-Hong Kong Stock Connect, please see our dedicated page<sup>2</sup> on the issue.

Initially intended to come into effect at the end of 2015, the Shenzhen-Hong Kong trading link was delayed following last year's market crash in China. Although the launch date has not yet been announced, it is expected to occur before the year-end.

The new link will broaden considerably the range of Chinese companies available to Hong Kong and international investors. While the Shanghai Stock Exchange (**SSE**) is dominated by large state-owned enterprises and major banks, the Shenzhen market features many smaller, younger and privately-owned companies with greater growth potential.

SZSE was the world's seventh-largest stock market as of 31 July 2016, with a market capitalisation of US\$3.16 trillion, trailing the Shanghai market which is ranked third with a market capitalisation of HK\$3.87 trillion.<sup>3</sup>

SZSE's ChiNext market, in particular, offers access to the Mainland's growing technology sector. The ChiNext market is an independent market offering a new capital platform tailor-made for the needs of enterprises engaged in independent innovation and other growth venture enterprises.<sup>4</sup> As of August 2016, nearly one-fifth of the companies listed on the SZSE are technology companies. In contrast, tech stocks only make up approximately 4% of the Shanghai market.<sup>5</sup>

Interest in SZSE may result in a greater response to Shenzhen-Hong Kong Stock Connect than was the case for the Shanghai-Hong Kong link. On 17 May 2016, SZSE's Small and Medium Enterprise board (**SME**) climbed ahead of the SSE and became China's leader in turnover rankings. The two exchanges have since vied for the top position.<sup>6</sup>

### Operation of Shenzhen-Hong Kong Stock Connect

Shenzhen-Hong Kong Stock Connect will introduce a Northbound Shenzhen Trading Link (**Northbound Link**) and a Southbound Hong Kong Trading Link (**Southbound**

1 <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=16PR80>

2 <http://www.charltonslaw.com/hong-kong-law/shanghai-hong-kong-stock-connect/>

3 July 2016 Report at <https://www.world-exchanges.org/home/index.php/statistics/monthly-reports>

4 <http://www.szse.cn/main/en/ChiNext/aboutchinext/>

5 <http://www.wsj.com/articles/5-things-on-the-shenzhen-hong-kong-stock-connect-plan-1471346243>

6 <http://www.bloomberg.com/news/articles/2016-06-27/tiny-stocks-trade-like-giants-on-china-s-new-king-of-exchanges>

**Link**), which will complement the existing Northbound and Southbound Trading Links under Shanghai-Hong Kong Stock Connect.

The principal arrangements for the link are made largely by reference to those for Shanghai-Hong Kong Stock Connect. The new link will also follow existing laws and regulations and operation models governing trading and clearing in the two markets.

A key difference between the Shenzhen and Shanghai trading links is that there will be no aggregate quota for the Shenzhen-Hong Kong scheme. The aggregate quota under Shanghai-Hong Kong Stock Connect was also abolished with effect from 16 August 2016. Daily quotas will apply as for the Shanghai link as detailed below.

## Northbound Trading

### *Eligible Shares*

880 stocks will be eligible for Northbound trading including:

- the constituent stocks of the SZSE Component Index and SZSE Small/Mid Cap Innovation Index which have a market capitalisation of at least RMB 6 billion; and
- all A shares of SZSE-listed companies which have H shares listed on the SEHK,

except for shares under “risk alert” or subject to delisting arrangements.

SZSE will separately announce detailed formulas and methods for calculating market capitalisation.

### *Eligible Investors*

Trading in shares listed on SZSE’s ChiNext Board Market will only be open to institutional professional investors (as defined by Hong Kong’s rules and regulations) until related regulatory issues are resolved.

There is no restriction on the types of investors who can invest in other shares eligible for trading under the Northbound link.

### *Daily Investment Quota*

Trading will be in RMB, and there will be a daily quota of RMB 13 million for Northbound trading.

### *Order-routing*

A new wholly-owned subsidiary of SEHK (the **New SEHK Subsidiary**) will carry out the routing of orders from Exchange Participants to SZSE. Authorisation will be sought by the New SEHK Subsidiary from CSRC regarding its activities and also for admission as a special trading participant of SZSE. Authorisation will be sought from the SFC for the New SEHK Subsidiary to be an automated trading services provider.

### *Clearing and other Services*

ChinaClear will provide clearing and settlement services as the host central counterparty in the Mainland for the clearing and settlement of A share trades. HKSCC will also provide clearing and settlement services by virtue of its participation with China Clear.

HKSCC will act as nominee holder for Hong Kong and international investors holding SZSE A Shares under an omnibus account maintained with ChinaClear,

Risk Management measures for clearing and settlement of trades will be the same as for trades executed under the Northbound Shanghai trading link, except that a Mainland Security Deposit rate of 18.5% will apply. The rate is consistent with ChinaClear’s requirements on the clearing and settlement of trades executed on SZSE.

## Southbound Trading

### *Eligible Shares*

417 Hong Kong-listed shares will be eligible for trading through the Southbound link including

- the constituent stocks of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index;
- any constituent stock of the Hang Seng Composite SmallCap Index which has a market capitalisation of HK\$5 billion or above; and
- all SEHK-listed shares of companies which have issued both A shares and H shares.

SEHK will announce separately the detailed formulas and methods for calculating market capitalisation.

## **Eligible Investors**

Eligible investors will include all Mainland institutional investors and individual investors who hold an aggregate balance of not less than RMB 500,000 in their securities and cash accounts.

## **Daily Investment Quota**

The daily trading quota for Southbound trading will be RMB10.5 billion.

## **Order-routing**

SZSE will establish a new subsidiary in Hong Kong to carry out the routing of orders from its participants to the SEHK. Authorisation will be sought from CSRC regarding its activities and it will apply for admission as a special trading participant of SEHK. Authorisation will also be sought from the SFC for the new SZSE subsidiary to be an automated trading services provider.

## **Clearing and other Services**

HKSCC will provide clearing and settlement services as the host central counterparty in Hong Kong for trades executed on SEHK. ChinaClear will hold SEHK-listed shares under an omnibus account maintained with HKSCC as nominee holder for Mainland investors. The omnibus account will be separate from ChinaClear's existing omnibus account for Shanghai-Hong Kong Stock Connect.

The Risk Management measures for clearing and settlement of trades will be the same as those for trades executed under the Southbound link of Shanghai-Hong Kong Stock Connect.

## **Exchange-traded funds (ETFs)**

CSRC and SFC have agreed to include ETFs as eligible securities to broaden the range of investment available for trading and increase the investment opportunities for domestic and overseas investors. A launch date will be announced separately after Shenzhen-Hong Kong Stock Connect has been in operation for a while provided that relevant conditions are satisfied.

## **Additional Information**

CSRC and SFC also refer in the Announcement to the joint announcement on Shanghai-Hong Kong Stock Connect dated 10 April 2014<sup>7</sup> for other issues concerning Shenzhen-Hong Kong Stock Connect which are not addressed in the Announcement.

## **Implementation Timetable**

The exact implementation date of Shenzhen-Hong Kong Stock Connect has not yet been announced. It is estimated that the official launch could take place within 4 months of the announcement date (i.e. by 16<sup>th</sup> December) after completion of investor education, implementation of market readiness measures and necessary rule amendments.<sup>8</sup>

## **Seminars for Exchange Participants**

Seminars for business and operations staff of Exchange Participants will be held on August 25<sup>th</sup>, 26<sup>th</sup>, 29<sup>th</sup> and 31<sup>st</sup> and on September 5<sup>th</sup> 2016. To enroll for these seminars, Exchange Participants should complete and return the Contact Person Registration List and Enrolment Form to SEHK by August 23<sup>rd</sup>.<sup>9</sup>

The regulatory bodies will publish separate circulars to provide additional information on market rehearsal and/or technical tests in due course.<sup>10</sup>

7 "Joint Announcement of the China Securities Regulatory Commission and Securities and Futures Commission". 10th April 2014. <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR41>

8 HKEx. "Circular: Establishment of Shenzhen-Hong Kong Stock Connect and Abolition of Aggregate Quota for Shanghai-Hong Kong Stock Connect". 16th August 2016. <http://www.hkex.com.hk/eng/market/partcir/sehk/2016/Documents/CT04316E.pdf>

9 Ibid, page 4. The Contact Person Registration List and Enrolment Form is available at <http://www.hkex.com.hk/eng/market/partcir/sehk/2016/Documents/CT04316E.pdf>.

10 [http://www.hkex.com.hk/eng/market/partcir/hksc/2016/Documents/ce\\_199\\_2016.pdf](http://www.hkex.com.hk/eng/market/partcir/hksc/2016/Documents/ce_199_2016.pdf)

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**Hong Kong Office**

Dominion Centre

12th Floor

43-59 Queen's Road East

Hong Kong

**Tel:** + (852) 2905 7888

**Fax:** + (852) 2854 9596

[www.charltonslaw.com](http://www.charltonslaw.com)