

One Step Forward: Expanding Access to the A-Share Market

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1. Introduction

Mainland China's A-Share market represents the second-largest public equity market in the world and the largest pool of publicly traded stocks by market capitalisation in Asia. As of 31 March 2020, the Shanghai Stock Exchange (“**SSE**”) and the Shenzhen Stock Exchange (“**SZSE**”) are respectively the fourth and seventh largest stock exchanges by market capitalisation in the world, with market capitalisations of USD4.7 trillion (approximately RMB33 trillion) and USD3.3 trillion (approximately RMB23 trillion) respectively.¹

Appendix 2 sets out a summary of the key developments that have driven the A-Share market to become one of the most important equity markets in the world.

The challenge

Developed equity markets worldwide enable investors to invest in a wide range of listed derivatives and structured products. By comparison, the only derivative trading instruments with A-Share underlying available to Mainland retail investors are stock index futures and options, as well as ETF options. The Mainland's equity market has room for further development when compared to other leading international equity markets in this respect.

Appendix 3 sets out an overview of the Mainland's listed derivatives and structured products market and a comparison with other international markets.

Proposals

One way the Mainland might further enhance international investor access to its A-Share market is to expand the range of A-Share-linked derivatives and structured products.

The FSDC has set up a dedicated Working Group comprising leading industry experts to formulate policy recommendations on further developing the A-Share market and Stock Connect.

The Working Group invites the Hong Kong Government and regulators, in coordination with Mainland regulators, to consider providing international investors with easier access to listed structured products over A-Share and Mainland investors with access to A-Share listed structured products and Hong Kong listed structured products.

Capitalised terms which are not defined in the body of this paper have the meaning set out in the glossary in Appendix 1.

¹ Data from the World Federation of Exchanges website as of the end of March 2020.

The Working Group proposes the following expansion of structured products traded on the HKEX in phases:

- (a) **phase 1: introduce Hong Kong listed structured products linked to Stock Connect A-Share or A-Share based indices**; and
- (b) **phase 2:** when the market has accumulated sufficient experience and understanding of Hong Kong listed structured products linked to Stock Connect A-Share, and Mainland regulators have confidence in allowing Mainland investors to participate, **expand the scope of eligible securities for Southbound Stock Connect to include Hong Kong listed structured products linked to a selected list of eligible underlying assets** and gradually permit Mainland investors (starting with eligible investors such as professional investors) to invest in such products.

The introduction of Hong Kong listed structured products linked to Stock Connect A-Share in phase 1 increases the level of A-Share trading by the issuers of such structured products, thereby enhancing the participation by the issuers in the A-Share market (which is currently dominated by retail investors). Once the market has demonstrated sufficient confidence in **phase 1** and Mainland regulators are comfortable to allow eligible Mainland investors to participate, **phase 2** might be implemented by gradually permitting eligible Mainland investors to invest in Hong Kong listed structured products linked to a selected list of eligible underlying assets through Southbound Stock Connect. Mainland regulators may start with certain eligible Mainland investors (such as professional investors) before expanding the investor scope to allow retail investors to participate.

The phased implementation of these proposals enable the Mainland to gradually expand its listed A-Share equity derivatives market in a controlled environment, taking advantage of Hong Kong's well-regulated, liquid and transparent listed structured products market and further utilise the successful Stock Connect platform.

2. Implementation Phases

The proposals can be implemented by phases and with controls and limitations to monitor potential market impact.

The options for Hong Kong and Mainland regulators to consider include:

- (a) Phase 1 - a gradual introduction of Hong Kong listed structured products over Stock Connect A-Share or A-Share based indices, for example:
 - (i) start with one type of Hong Kong listed structured product (e.g. warrants only) that is simple and easily understood by investors; and
 - (ii) start with a shortlist of the most liquid Stock Connect A-Share as the underlying assets; and
- (b) Phase 2 - a gradual expansion of Southbound Stock Connect, to include Hong Kong listed structured products linked to a selected list of eligible underlying assets, then widen the scope of eligible Mainland investors in phases (starting with professional investors before allowing retail investors to participate).

3. Key Benefits of Our Proposals

The proposals will benefit the Mainland and Hong Kong in the following areas:

- (a) facilitate further opening up of financial markets for the Mainland and enable Mainland regulators to gradually expand its listed A-Share equity derivatives market in a safe, stable and risk-controlled environment. This will allow Mainland regulators to accumulate experience for regulating such markets and enable Mainland regulators to gradually expand access to the A-Share market on a controlled basis;
- (b) our proposals, together with the extensive investor education that the HKEX and market participants of Hong Kong listed structured products are already engaged in, will enhance Mainland investors' understanding and knowledge which may support the further development and growth of the Mainland's derivatives market;
- (c) provide Mainland investors with a wide range of structured products traded on the HKEX. Hong Kong's listed structured products market is a highly competitive market with well-regulated issuers that offer competitive pricing and ample liquidity that promotes secondary trading. In addition, Hong Kong's listed structured products are cash-based rather than margin-based, which means less risk because investors never pay more than their initial investment;
- (d) increase Stock Connect trading and usage as follows:
 - (i) increase trading volume of Northbound trading of Stock Connect and drive additional inflows into the A-Share market through structured product issuers' hedging activities in their A-Share positions. It is predicted that issuers' delta hedging activities from A-Share structured products will increase Northbound Stock Connect usage, add liquidity to the Mainland's futures market and attract new investors into the A-Share market.

Based on a Working Group member's data on the scale of Hong Kong's listed structured products market in 2017 to 2019, and assuming (amongst others) that the size of A-Share structured products is the same as Hong Kong's listed structured products, the introduction of A-Share structured products could:

- increase Northbound Stock Connect's projected value by approximately 4.9%;
- add liquidity to the Mainland's futures market by approximately 15.8%; and
- increase the projected investment in the A-Share market by approximately RMB38 billion per year

(detailed calculations are set out in *Appendix 4*);

- (ii) increase Southbound Stock Connect trading by encouraging Mainland investors to invest in A-Share listed structured products through Stock Connect.

Appendix 5 provides an overview of the Stock Connect platform;

- (e) support the strategic direction of the Hong Kong Government and regulators to enhance the competitiveness and product diversity of Hong Kong as an international financial hub, and its continued status as the leading offshore RMB centre. The proposals:
- (i) are in line with the Government's determination to transform Hong Kong into a global hub for private wealth management and a more prominent centre for offshore RMB by promoting more financial integration with the Mainland;
 - (ii) echo the HKEX's vision "Connecting China, Connecting the World" as an attempt to broaden the product suite for Mainland investors; and
 - (iii) are a timely development in view of the recent efforts of Hong Kong and Mainland regulators to foster closer financial cooperation between Hong Kong and the Mainland including:
 - recent support from Fang Xinghai, the CSRC's Vice Chairman, of the launch of A-Share based financial derivatives. At the Caixin Summer Summit 2020 on 22 June 2020, Mr Fang has said the 'time is ripe' for Hong Kong to introduce A-Share derivative products which will benefit the Mainland's capital market and Hong Kong's further development as an international financial centre. Mr Fang also noted the need for international investors to manage investment risks using A-Share derivatives;²
 - the SFC's recent announcement that it is prepared to authorise certain swap-based leveraged and inverse products tracking the Mainland's equity indices structured as exchange traded funds for public offering in Hong Kong;³ and
 - the recent decision by the regulators to implement a cross-boundary Wealth Management Connect pilot scheme, allowing individual residents in the GBA to make cross-boundary investment in wealth management products distributed by banks in the GBA; and

² Regulation Asia, "Time is Ripe' for Hong Kong to Launch A share Derivatives: CSRC" (dated 23 June 2020), available at <https://www.regulationasia.com/-time-is-ripe-for-hong-kong-to-launch-a-share-derivatives-csrc/>

³ SFC's Supplemental Circular on Leveraged and Inverse Products (dated 22 May 2020), available at <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=20EC45>. For more details of the application requirements, please refer to the Frequently Asked Questions on Leveraged and Inverse Products (dated 1 June 2020), available at https://www.sfc.hk/web/files/PCIP/FAQ-PDFS/FAQs%20on%20Leveraged%20and%20Inverse%20Products_20200601.pdf

- (f) take advantage of Hong Kong's highly regulated, diverse and liquid structured products market.

As set out in the FSDC's April 2017 paper on "Optimising Hong Kong's listed structured products Market", the Hong Kong market facilitates risk management and price discovery across a broad range of listed structured products, options and futures. Hong Kong's listed structured products market is well-developed and successful. Hong Kong's listed structured products market provides:

- (i) a clear, organised and transparent regulatory framework;
- (ii) market transparency;
- (iii) quality issuers;
- (iv) standardised documentation and products;
- (v) good liquidity; and
- (vi) simple products that investors understand.

Therefore, Hong Kong's listed structured products market provides a safe, stable and risk-controlled environment for the Mainland to explore the potential of growing its A-Share derivatives product market and allows Mainland regulators to monitor and observe market impact.

Appendix 6 provides an overview of the Hong Kong's listed structured products market.

4. Potential Challenges

In light of the unique trading and settlement system of the A-Share market (as set out in *Appendix 7*), issuers of A-Share structured products may face the following potential challenges:

- (a) in respect of single A-Share underlying – since the A-Share market prohibits same-day trades, issuers of A-Share structured products cannot buy and sell the underlying A-Share so as to match their real time exposure under their issuance of A-Share structured products. As a result, issuers may not be able to offer the same tight bid and offer spread as they currently offer for Hong Kong listed structured products with other underlying stocks; and
- (b) in respect of A-Share based indices – whilst an issuer is able to hedge its position with onshore futures (which trade on a T+0 cycle), there may be potential compliance concerns because:
 - (i) intraday trading is discouraged by Mainland regulators; and
 - (ii) such trades may fall outside brokers' trading quotas and mandates.

However, these challenges are not so significant as to inhibit the development of the Working Group's proposals. These challenges can be addressed if the issuers of A-Share structured products consider the following potential implications:

- (a) at least during the initial phase, A-Share structured products may be quoted at a wider spread by Hong Kong liquidity providers;
- (b) issuance of A-Share structured products is likely to be subject to each issuer's internal trading strategy and inventory of A-Share;
- (c) issuers will leverage A-Share Delivery versus Payment (DvP) settlement mechanism currently implemented in Stock Connect through HKSCC; and
- (d) issuers will need to accumulate A-Shares and manage the issuance size of A-Share structured products relative to its A-Share inventory.

5. Further Information in Appendices

Various supplementary information is included as appendices to this paper.

The appendices are organised as follows:

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Appendix 4	Quantitative Analysis of the Potential Benefit from A-Share Structured Products
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Appendix 6	Overview of the Hong Kong Listed Structured Products Market
Appendix 7	Key Features of the Trading and Settlement System of the A-Share Market

Appendix 1

Glossary

Term	Definition
ADT	Average Daily Turnover
A-Share	RMB-denominated securities of Chinese incorporated companies that trade on either the SSE or the SZSE
A-Share structured products	Hong Kong listed structured products linked to Stock Connect A-Share
B-Share	Foreign currency-denominated securities of Chinese incorporated companies that trade on either the Shanghai or Shenzhen stock exchanges
CBBC	Callable bull/bear contracts
CFFEX	China Financial Futures Exchange
CSDC	China Securities Depository and Clearing Corporation Limited
CSRC	China Securities Regulatory Commission
ETFs	Exchange traded funds
FSDC	Financial Services Development Council
FSDC 2017 Paper	Paper on Optimizing Hong Kong's Listed Structured Products Market published by the FSDC in April 2017
GBA	Greater Bay Area
HKD	Hong Kong Dollar
HKEX	Hong Kong Exchanges and Clearing Limited
HKEX Guide	Guide on Product Review and Approval Process for Listed Structured Products published by the HKEX in July 2018
HKMA	Hong Kong Monetary Authority
HKSCC	The Hong Kong Securities and Clearing Corporation
Hong Kong	Hong Kong Special Administrative Region of the People's Republic of China
Hong Kong listed structured products	Structured products listed on the SEHK
Mainland / China	Hong Kong Special Administrative Region of the People's Republic of China

Term	Definition
Northbound Stock Connect	The trading of SSE Securities or SZSE Securities by Hong Kong and overseas investors through the relevant trading link
QFII	The Qualified Foreign Institutional Investor Scheme
RMB	Renminbi
RQFII	The RMB Qualified Foreign Institutional Investor Scheme
SEHK	The Stock Exchange of Hong Kong Limited
SEHK Securities	Stocks that are eligible for trading through Southbound Stock Connect
SFC	Securities and Futures Commission
Shanghai Connect	A securities trading and clearing links programme developed by SEHK, SSE, HKSCC and CSDC for the establishment of mutual market access between Hong Kong and Shanghai
Shenzhen Connect	A securities trading and clearing links programme developed by SEHK, SZSE, HKSCC and CSDC for the establishment of mutual market access between Hong Kong and Shenzhen
Southbound Stock Connect	The trading of SEHK Securities by Mainland investors through the relevant trading link
SPSA	Special Segregated Account
SSE Listing Rules	Rules Governing the Listing of Stocks on Shanghai Stock Exchange
SSE Trading Rules	Trading Rules of Shanghai Stock Exchange
Stock Connect	A collaboration between the Hong Kong, Shanghai and Shenzhen Stock Exchanges, Stock Connect allows international and Mainland investors to trade securities in each other's markets through the trading and clearing facilities of their home exchange
Stock Connect A-Share	A-Share traded under Stock Connect
SZSE Listing Rules	Rules Governing the Listing of Shares on Shenzhen Stock Exchange
SZSE Trading Rules	Trading Rules of Shenzhen Stock Exchange
USD	United States Dollar

Appendix 2

The Growing Importance of the A-Share Market

1. Introduction

The SSE and SZSE opened in 1990 following which the A-Share market has become one of the world's largest public equity markets. As of 31 March 2020, the A-Share market had the largest pool of publicly traded stocks in Asia by a total market capitalisation of RMB55,025 billion, a total market turnover of RMB559.75 billion, and over 3,700 listed companies.⁴

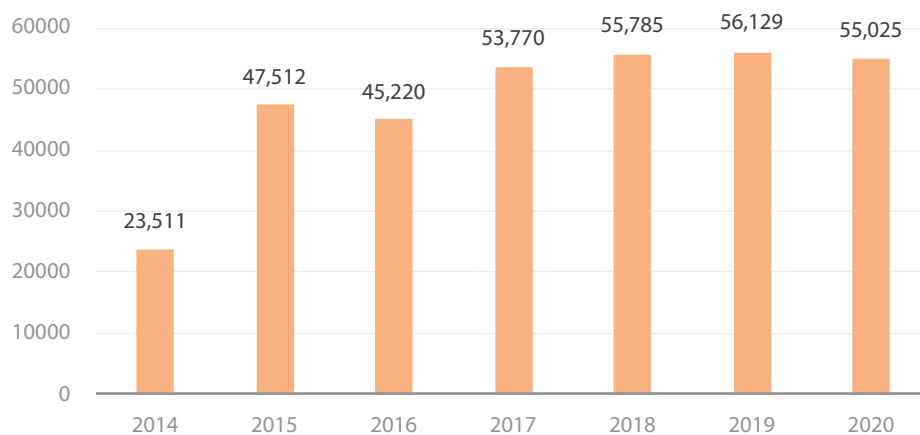
This appendix examines the growing importance of the A-Share Market.

2. Growth of the A-Share market over the years

As illustrated in the chart below, the total market capitalisation of publicly traded stocks on the A-Share market has grown by approximately 134% between 2014 and 2020, from RMB23,511 billion (approximately USD3,366 billion) in 2014 to RMB55,025 billion (approximately USD7,878 billion) in 2020 (as of 31 March respectively).⁵

Total market capitalisation of the A-Share market from 2014 to 2020 (in RMB billion as of 31 March respectively)

Total market capitalisation
(in RMB billion as of 31 March respectively)



Source of data: HKEX

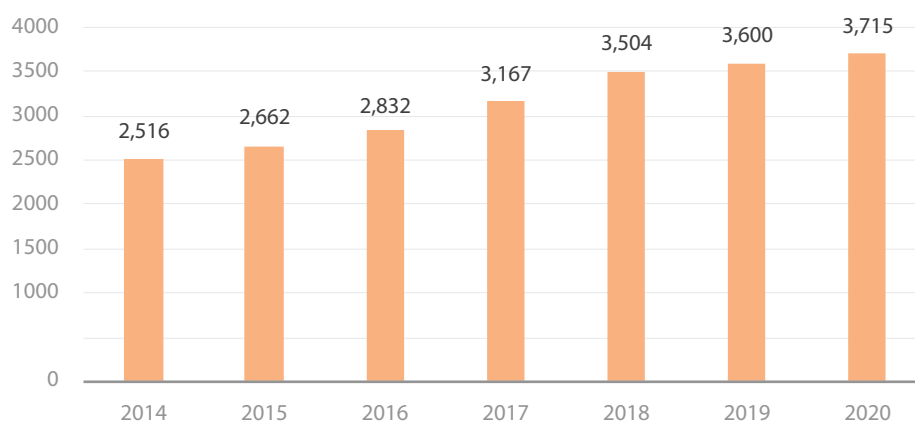
⁴ HKEX, "Hong Kong and Mainland Market Highlights" Data regarding figures on the A-Share market, available at: https://www.hkex.com.hk/Mutual-Market/Stock-Connect/Statistics/Hong-Kong-and-Mainland-Market-Highlights?sc_lang=en#select3=0&select2=8&select1=10

⁵ HKEX, "Hong Kong and Mainland Market Highlights" Data regarding figures on the A-Share market, available at: https://www.hkex.com.hk/Mutual-Market/Stock-Connect/Statistics/Hong-Kong-and-Mainland-Market-Highlights?sc_lang=en#select3=0&select2=8&select1=10

As illustrated in the chart below, the number of A-Share companies listed on the A-Share market has grown by approximately 48% between 2014 and 2020, from 2,516 companies in 2014 to 3,715 companies in 2020 (as of 31 March respectively).⁶

Number of A-Share companies listed on the Mainland stock exchanges from 2014 to 2020 (as of 31 March respectively)

Number of A-Share Listed companies
(as of 31 March)



Source of data: HKEX

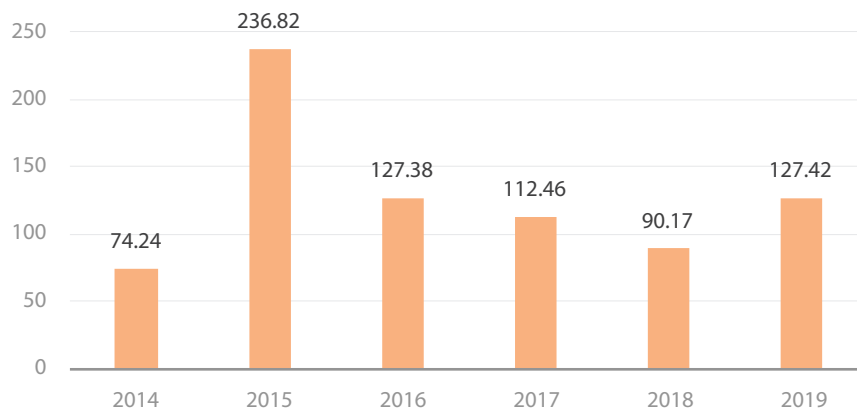
As illustrated in the chart below, the total turnover of the A-Share market has grown by approximately 72% between 2014 and 2019, from RMB74.24 trillion (approximately USD10.6 trillion) in 2014 to RMB127.42 trillion (approximately USD18.19 trillion) in 2019.⁷

⁶ HKEX, "Hong Kong and Mainland Market Highlights" Data regarding figures on the A-Share market, available at: https://www.hkex.com.hk/Mutual-Market/Stock-Connect/Statistics/Hong-Kong-and-Mainland-Market-Highlights?sc_lang=en#select3=0&select2=8&select1=10

⁷ SSE and SZSE's websites, available at www.sse.com.cn and www.szse.cn

Total turnover of the A-Share market from 2014 to 2019 (in RMB trillion)

Total turnover
(in RMB trillion)

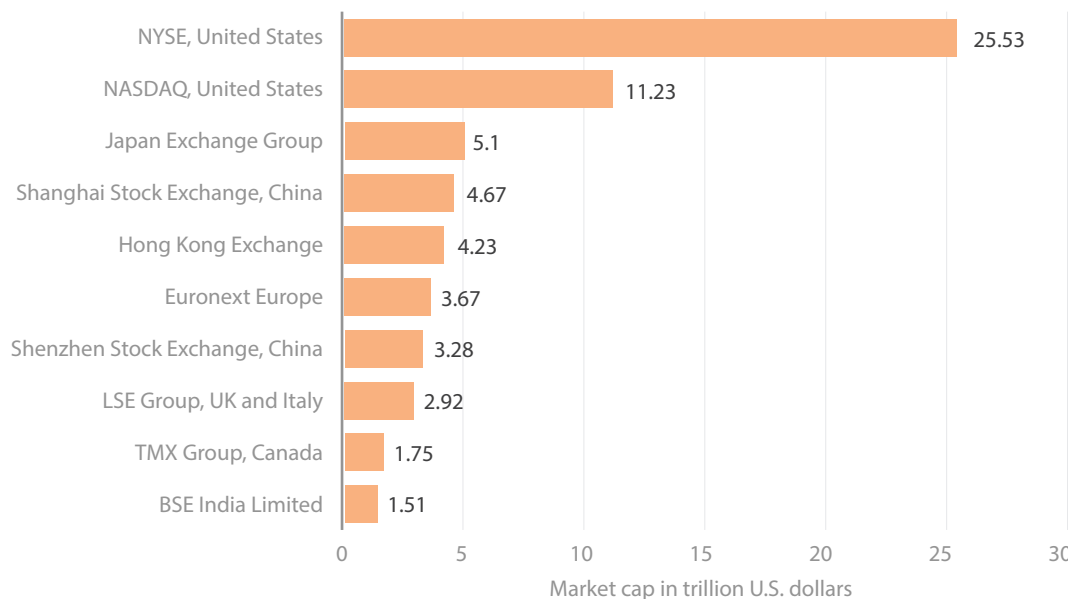


Source of data: SSE and SZSE

3. Comparison to other countries

The A-Share market has seen significant growth in the past decades to become one of the largest and highest performing public equity markets in the world. As illustrated in the chart below, by market capitalisation, as of March 2020, the SSE and SZSE are respectively the fourth and seventh largest stock exchanges by market capitalisation in the world.⁸

Largest stock markets in the world by total market capitalisation (in USD trillion)



Source: Statista, data as of March 2020.

⁸ Data from Statista.

Appendix 3

Overview of the Mainland's Listed Derivatives Market

1. Introduction

This appendix provides an overview of the Mainland's listed derivatives market.

2. Types of listed equity derivatives – international comparison

2.1 Listed structured products offered in other developed equity markets

Developed equity markets worldwide (such as those listed below) provide a wide range of listed structured products. For example:

- (a) the HKEX offers a wide range of listed structured and derivatives products to investors including warrants, CBBCs, futures and/or options over equity index, stock interest rate, currency products and commodity products. These products have been available in the Hong Kong market for over two decades, with the first derivative warrant listed on the HKEX in 1989⁹ and the first single stock options/futures contract in 1995;¹⁰
- (b) Korea Exchange offers numerous listed structured products over stock index, equity and currency etc.;¹¹
- (c) Singapore Exchange offers various derivatives products over equity index, foreign exchange, dividend and commodities (such as metals);¹²
- (d) Japanese stock exchanges¹³ provide trading in options over stock, futures over bonds and options and futures over a range of indices (both Japanese and overseas);¹⁴
- (e) the Börse Stuttgart, which is one of the major exchanges in Europe, offers a wide range of listed structured products including knockout products, warrants and factor certificates, bonus certificates, discount certificates etc.; and¹⁵
- (f) The New York Stock Exchange offers a range of options including equity options, index options, exchange traded product options.¹⁶

⁹ FSDC 2017 Paper, Schedule 2.

¹⁰ HKEX Fact Book 2019, available at https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/HKEX-Fact-Book/HKEX-Fact-Book-2019/FB_2019.pdf?la=en

¹¹ List of Products at Korea Exchange, available at <http://global.krx.co.kr/contents/GLB/02/0201/0201040101/GLB0201040101.jsp>

¹² Overview of derivatives at Singapore Exchange, available at <https://www.sgx.com/derivatives>

¹³ Including Tokyo Stock Exchange, Osaka Exchange and Tokyo Commodity Exchange.

¹⁴ List of Products at Japanese stock exchanges, available at <https://www.jpx.co.jp/english/derivatives/products/list/index.html>

¹⁵ Leverage products and investment products at the Börse Stuttgart, available at <https://www.boerse-stuttgart.de/en/products/leverage-products/> and <https://www.boerse-stuttgart.de/en/products/investment-products/>

¹⁶ List of Products at the New York Stock Exchange, available at <https://www.nyse.com/products>

2.2 Types of listed derivatives in the Mainland

There are only two types of listed derivatives in the Mainland that provide Mainland investors with exposure to A-Share: stock index futures and ETF options.

(a) Stock index futures

The CFFEX has three stock index futures:

- (i) **CSI 300 Index Futures** – the underlying asset is CSI 300 Index, which selects 300 A-Share stocks listed on the SSE or the SZSE;
- (ii) **CSI 500 Index Futures** – the underlying asset is CSI 500 Index, which selects 500 middle and small stocks of good listed on the SSE and the SZSE; and
- (iii) **SSE 50 Index Futures** – the underlying asset is SSE 50 Index, which selects 50 largest stocks listed on the SZSE.

According to the 2019 annual overview report of the CFFEX, there has been a rapid expansion of the Mainland index futures market. The notional trading value of the index futures market in 2019 was RMB54.80 trillion (approximately USD7.85 trillion) (representing a 248.17% increase from 2018).¹⁷

(b) ETF options

Prior to December 2019, the SSE 50 ETF Option was the first and only standardised option traded on the Mainland market, for which the underlying security is the SSE 50 ETF.

On 23 December 2019, the SSE and the SZSE launched the CSI 300 ETF Option.¹⁸ On the same day, trading in the CSI 300 ETF Option also started trading on the CFFEX. The underlying asset of the option contract is the CSI 300 Index which tracks stocks traded on the SSE and the SZSE.

Therefore, the range of derivative trading instruments in the Mainland with A-Share underlying available to retail investors is limited by comparison to those offered in other markets (as summarised in paragraph 2.1). This means investors holding long positions in A-Share have limited access to listed derivatives or structured products with A-Share underlying. Hong Kong listed structured products linked to A-Share will give investors a broader range of investment options compared to the index and ETF based options currently available.

¹⁷ CFFEX, "Data Overview of China Financial Futures Exchange 2019", available at <http://www.cffex.com.cn/sj/yearlymarketReportEng/2019/2019-YearlyMarketReport.pdf>

¹⁸ Shenzhen Stock Exchange's News, "CSI 300 ETF Option Successfully Listed on SZSE Takes Another Significant Step towards a World-Class Stock Exchange" (dated 25 December 2019), available at http://www.szse.cn/enqfii/szseneews/t20191225_572879.html

3. Trading infrastructure

Listed options are traded in the professional market by registered broker-dealers which are members of the SSE or the SZSE, acting as principal or as agents for clients. Some brokers act as market makers and post bids and offers on the SSE or the SZSE in accordance with their rules.

There are no listed equity options for individual shares in the Mainland market. The only form of listed options is the listed equity index option.¹⁹

¹⁹ SSE, Overview of Derivatives, available at <http://english.sse.com.cn/markets/derivatives/overview/>; and SZSE, Options, available at <http://www.szse.cn/market/product/option/index.html>

Appendix 4

Quantitative Analysis of the Potential Benefit from A-Share Structured Products

1. Overview

This appendix sets out Working Group member's quantitative analysis of the potential market impact of our proposals, in particular:

- (a) the projected market impact on the Mainland's onshore cash market arising from A-Share structured products hedging activities;
- (b) the potential impact of A-Share structured products hedging activities to the liquidity of the Mainland's onshore index futures market; and
- (c) the potential contribution of A-Share structured products hedging activities to Stock Connect usage.

2. Methodology

2.1 Methodologies used

The quantitative analysis was prepared using the following methodology:

- (a) Back-testing based on the scale of the Hong Kong listed structured products market in 2017, 2018 and 2019 ("Three Years Historical Data")

Based on the Three Years Historical Data, the Working Group estimated the potential:

- (i) market impact on the Mainland's onshore cash market;
- (ii) market impact on the Mainland's onshore index futures market;
- (iii) contribution to Stock Connect usage; and
- (iv) new fund flow to the A-Share market,

arising from the delta hedging activities by issuers of Hong Kong listed structured products, if the proposals set out in this paper are implemented.

(b) Projections using the 2017, 2018 and 2019 Hong Kong listed structured products market data

The Three Years Historical Data was used to generate certain projections by:

- (i) assigning the weighted average of the Three Years Historical Data for the purposes of projecting the potential impact on the Mainland's onshore cash market and futures market as well as the Northbound Stock Connect: 60% for 2019, 30% for 2018 and 10% for 2017 (since the development of China equity market and Northbound is trending, the 2019 data should be more relevant than previous data in projecting the future development in these markets); and
- (ii) averaging the Three Years Historical Data for the purpose of projecting the new fund flow to A-Share market (given the size of the Hong Kong listed structured products market exhibited mean reversion pattern in the past years depending on market conditions).

2.2 Assumptions

The estimations in this appendix are made on the assumptions that:

- (a) the size of the A-Share structured products is the same as Hong Kong's existing listed structured products; and
- (b) the size of the A-Share structured products is, in comparison to Hong Kong's existing listed structured products, directly proportional to the ratio of cash turnover in the Mainland and Hong Kong. The ratio of Mainland's onshore cash turnover to Hong Kong cash turnover is as follows:²⁰

2017	2018	2019
5.98 : 1	4.04 : 1	6.76 : 1

²⁰ The annual sum of cash turnover in the SSE and the SZSE divided the cash turnover of HKEX.

3. Back-testing of the Three Years Historical Data and conclusions

- (a) The projected market impact on the Mainland's onshore cash market arising from A-Share structured products hedging activities is likely to be very limited. It is calculated from the estimated annual stocks hedging by listed structured products issuers divided by the annual cash turnover in Shanghai Stock Exchange and Shenzhen Stock Exchange.

	2017	2018	2019
Mainland's onshore cash market turnover²¹			
Annual Cash Turnover (RMB billion)	112,463	90,174	127,416
Shanghai Stock Exchange	50,777	40,197	54,384
Shenzhen Stock Exchange	61,686	49,977	73,031
Assuming the size of A-Share structured products is the same as Hong Kong listed structured products			
% of Mainland cash market from estimated delta hedging activities	0.5%	0.6%	0.3%
Assuming the size of A-Share structured products, compared to Hong Kong listed structured products, is directly proportional to the ratio of the Mainland and Hong Kong cash turnover			
% of Mainland cash market from estimated delta hedging activities	3.0%	2.4%	1.9%

²¹ SSE and SZSE's websites, available at www.sse.com.cn and www.szse.cn

- (b) The A-Share structured products hedging activities are projected to contribute to the Stock Connect usage. The potential increase in Northbound usage is calculated from the respective estimated stock hedging activities, depending on whether intra-day buy/sell due to market-making hedging activities is allowed, divided by the Northbound trade value.

	2017	2018	2019
Stock Connect Northbound Trade Value²²			
Daily Northbound Trade Value (RMB million)	9,640	20,410	41,698
Daily Shanghai-HK Stock Connect	5,594	11,626	21,311
Daily Shenzhen-HK Stock Connect	4,046	8,784	20,367
Total Northbound Trade Value (RMB billion)	2,266	4,674	9,757
Total Shanghai-HK Stock Connect	1,315	2,662	4,991
Total Shenzhen-HK Stock Connect	951	2,012	4,766
Assuming the size of A-Share structured products is the same as Hong Kong listed structured products			
Estimated % of northbound trade value (Intra-day buy/sell due to market-making hedging activities is restricted)	14.4%	6.9%	2.3%
Estimated % of northbound trade value (Intra-day buy/sell due to market-making hedging activities is allowed)	25.2%	11.4%	3.7%
Assuming the size of A-Share structured products, compared to Hong Kong listed structured products, is directly proportional to the ratio of the Mainland and Hong Kong cash turnover			
Estimated % of northbound trade value (day-end hedging)	86.2%	27.8%	15.3%
Estimated % of northbound trade value (Intra-day buy/sell allowed)	150.7%	46.1%	25.3%

²² HKEX Factbook, available at https://www.hkex.com.hk/Market-Data/Statistics/Consolidated-Reports/HKEX-Fact-Book?sc_lang=en

- (c) The A-Share structured products hedging activities are projected to add liquidity to the Mainland's onshore index futures market (which is mostly dominated by institutions and professional investors). It is calculated from the estimated annual index futures hedging by listed structured products issuers divided by the annual index futures turnover of CSI 300, CSI 500 and SSE50.

	2017	2018	2019
Mainland's onshore index futures turnover²³			
Annual Futures Turnover (RMB billion)	10,507	15,740	54,804
CSI300 Index Futures	4,509	7,828	26,707
CSI500 Index Futures	4,097	4,388	19,879
SSE50 Index Futures	1,900	3,524	8,218
Assuming the size of A-Share structured products is the same as Hong Kong listed structured products			
% of Mainland index futures market from estimated delta hedging activities	32.1%	29.5%	6.2%
Assuming the size of A-Share structured products, compared to Hong Kong listed structured products, is directly proportional to the ratio of the Mainland and Hong Kong cash turnover			
% of Mainland index futures market from estimated delta hedging activities	191.9%	119.3%	41.7%

- (d) The A-Share structured products hedging activities are projected to add significant net new fund flow to the A-Share market. It is derived from the outstanding delta of listed structured products at year-end.

	2017	2018	2019
Assuming the size of A-Share structured products is the same as Hong Kong listed structured products			
Net new fund flow at year-end (RMB billion)	89	4	20
Assuming the size of A-Share structured products, compared to Hong Kong listed structured products, is directly proportional to the ratio of the Mainland and Hong Kong cash turnover			
Net new fund flow at year-end (RMB billion)	533	17	133

²³ CFFEX's website, available at www.cffex.com.cn

4. Projections

Based on the Three Years Historical Data and methodologies set out in paragraph 2.1, assuming the size of the A-Share structured products is the same as Hong Kong's existing listed structured products, the introduction of A-Share structured products could:

- (a) increase Northbound Stock Connect's projected value by approximately 4.9%;
- (b) add liquidity to the Mainland's futures market by approximately 15.8%; and
- (c) increase the projected investment in the A-Share market by approximately RMB38 billion per year.

	2017	2018	2019	Projection
Weighting	10%	30%	60%	
Estimated % of northbound trade value (Intra-day buy/sell due to market-making hedging activities is restricted)	14.4%	6.9%	2.3%	4.9% (weighted average)
Estimated % of Mainland index futures market from delta hedging activities	32.1%	29.5%	6.2%	15.8% (weighted average)
Net new fund flow at year-end (RMB billion)	89	4	20	38 (average)

Appendix 5

Overview of Stock Connect

1. Introduction

This appendix provides an overview of the Stock Connect programme and examines how the programme has contributed to the continuing development of the A-Share market.

The Working Group's proposals will utilise the now well-established Stock Connect links.

2. Overview and recap

The Stock Connect programme was launched in 2014 with the aim to further open up the Mainland's capital markets. Stock Connect allows any investor in the world, institutional or retail, to access A-Share by providing a direct link between exchanges in Hong Kong and in the Mainland. The link enables brokers who are members of the HKEX to execute orders through a link to the SSE or the SZSE, rather than to make orders through broker members of the SSE and the SZSE.

The programme commenced in November 2014, representing the first mutual market access between the SSE and the SEHK. A similar link between the SEHK and the SZSE was added in December 2016.

The Mainland's capital control regime requires that foreign investors may only invest directly in A-Share through specific approved channels and/or an approved quota system. Stock Connect enables capital flows in and out of the Mainland through an open and liquid market platform of the SEHK to facilitate foreign investor access to A-Share.

As of 31 March 2020, the total cumulative Northbound trading turnover on Stock Connect was RMB23,631 billion (approximately USD3,383 billion), bringing net capital inflows of RMB975 billion (approximately USD140 billion) into the A-Share market. Meanwhile, the total cumulative Southbound trading turnover was HKD10,425 billion (approximately USD1,345 billion), bringing net capital inflows of HKD1,287 billion (approximately USD166 billion) into the Hong Kong market. The net cross-border capital flow (i.e. the difference) is approximately HKD206 billion (approximately USD26 billion).²⁴

According to HKEX's data, as at the end of March 2020, offshore investors held RMB1,298 billion²⁵ worth A-Share stocks, representing 2.9% of the eligible stocks' free float market capitalisation under Shanghai-Hong Kong Connect and 2.9% of that under Shenzhen-Hong Kong Connect. Likewise, Southbound Stock Connect shareholding grew to RMB1,101 billion (approximately USD157 billion), making up 4.5% of the market capitalisation of eligible stocks.²⁶

²⁴ HKEX figures

²⁵ HKEX figures, available at <https://www.hkexgroup.com/-/media/HKEX-Group-Site/Ir/IR-Pack/2020Q1/20200520-IR-Pack,-d-,new,-d-,w.pdf>;

²⁶ HKEX figures

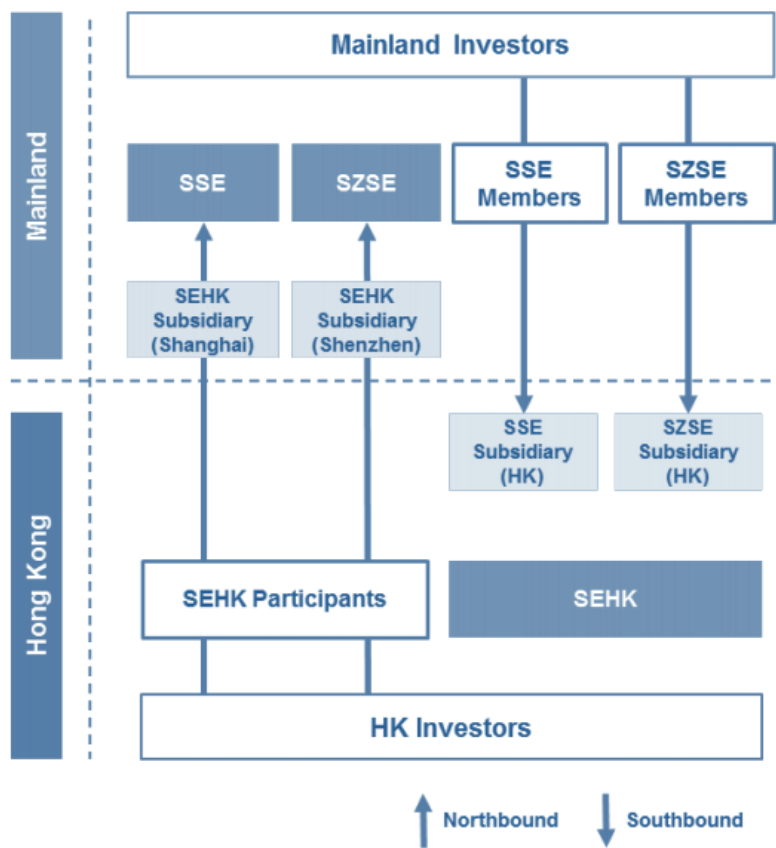
3. Order flow

The Stock Connect operates under a closed-loop two-way capital flow mechanism, involving Northbound and Southbound trading of Stock Connect.

- (a) With Northbound Stock Connect, eligible investors outside the Mainland, through their Hong Kong brokers and a securities trading service company established by the SEHK, place orders to trade eligible shares listed on the SSE or the SZSE.
- (b) With Southbound Stock Connect, eligible Mainland investors, through the Mainland securities firms and securities trading service companies established by the SSE and the SZSE, respectively, place orders to trade eligible shares listed on the SEHK.

The cross-boundary flow of funds is in a closed-loop system under the clearing link arrangement. That ensures funds to buy and sell shares cannot be used for investment in other asset classes and that relevant investors remain subject to the Mainland’s capital flow management.

The diagram below illustrates the order flow process under the Stock Connect programmes.



Source: HKEX

4. Investor eligibility

Hong Kong and overseas investors may trade in a list of eligible Stock Connect A-Share through Shanghai Connect and Shenzhen Connect.

Only the Mainland institutional investors and individual investors who satisfy the eligibility criteria (i.e. individual investors who hold an aggregate balance of not less than RMB500,000 in their securities and cash accounts) are accepted to trade SEHK Securities through Southbound Stock Connect.

5. Eligible securities

Hong Kong and overseas investors may trade in a list of eligible Stock Connect A-Share through Shanghai Connect and Shenzhen Connect.

Only the Mainland institutional investors and individual investors who satisfy the eligibility criteria (i.e. individual investors who hold an aggregate balance of not less than RMB500,000 in their securities and cash accounts) are accepted to trade SEHK Securities through Southbound Stock Connect.

5.1 Northbound Stock Connect

Currently, only designated A-Share are included in Shanghai Connect and Shenzhen Connect. Other product types such as B-Share, ETFs, bonds and other securities are not included in the Northbound Stock Connect eligible list of stocks.

5.2 Southbound Stock Connect

Among the different types of SEHK-listed securities, only designated equities listed on the main board of the HKEX are included in Shanghai Connect and Shenzhen Connect. Other products such as stocks listed on GEM, Nasdaq Pilot Programme stocks, ETFs, Real Estate Investment Trusts (REITs), structured products, bonds and other securities are not included.

6. Success of Stock Connect

The average utilisation of the Stock Connect in terms of the average daily net buy value for Northbound Stock Connect and Southbound Stock Connect has increased from 2018 to 2019 by approximately 117% and by 322% respectively.²⁷ As of 31 March 2020, the total cumulative trading turnover for Northbound Stock Connect and Southbound Stock Connect (buy and sell) are RMB23,613 billion and HKD10,425 billion.²⁸

As illustrated in the chart below, the Stock Connect has been a huge success in terms of the following aspects:

- (a) the total average daily trading volume of Stock Connect increased from HKD7.9 billion in the first quarter of 2015 to HKD89.2 billion in the first quarter of 2020;
- (b) the total investment portfolio value held in Stock Connect through HKSCC is RMB1.687 trillion²⁹ representing 61.8% growth year-over-year; and
- (c) accelerated international investor accounts opening and investment around A-Share inclusion by MSCI and FTSE Russell Index into its respective emerging market investment products tracked by global investors.

²⁷ HKEX figures

²⁸ HKEX figures

²⁹ HKEX figures as of 30 June 2020

Illustration of the enhancements in Stock Connect since 2015

APR 2015	MAY 2015	APR 2016	AUG 2016	DEC 2016	NOV 2017	MAY 2018	AUG 20/ SEP 26 2018	1 st Half 2020	2020 onwards
SPECIAL SEGREGATED ACCOUNTS INTRODUCED	CSRC BENEFICIAL OWNERSHIP CLARIFIED	DELIVERY-VERSUS-PAYMENTS (DVP) SETTLEMENT INTRODUCED¹	AGGREGATE QUOTA ABOLISHED	SHENZHEN CONNECT COMMENCES	INTRODUCTION OF REAL-TIME DVP (RDVP)²	DAILY QUOTA EXPANSION⁴ (RDVP)	SSE CLOSING CALL AUCTION⁶ INVESTOR 10 MODEL⁵	MASTER SPISA SERVICE INTRODUCED	IN PROGRESS
Multi-broker execution solution Pre-trade checking solution	CSRC FAQ HKCSS rules amended	Same day settlement finality on T+0 basis 100% growth of SPISA accounts since launch	Aggregate quota abolished Update on beneficial ownership (Oct 27) ² SEHK and HKSCC rule amendments (Oct 24) Tax clarification announcement	Builds on solid foundation of Shanghai-Hong Kong Stock Connect At launch, 100 small cap stocks listed in HK available	Real-time settlement finality on T+0 basis in RMB, HKD and USD New 4.45pm Batch Settlement Run	4x daily quota expansion on each trading link (NB+SB) commencing May 1st 2018 Revised NB SZ and SH daily Quota: RMB 52 billion each Revised SB SZ and SH Daily Quota: RMB 42 billion each	SSE launched Closing Auction on August 20th BCAN launches on Sept 26th Enable more efficient market close trading and improve HK-Mainland cross-border market surveillance	Enhanced best execution for average pricing for asset managers	Holiday trading Securities lending DLT solution for T+0/T+1 settlement Block trading Short Selling Enhancement

¹ Source: 26 Jan 2016 HKEX Circular http://www.hkex.com.hk/eng/market/partcir/hksc/2016/Documents/CE_020_2016.pdf

² Source: CSRC Updated 27 October 2016, http://www.csrc.gov.cn/pub/csrc_en/laws/overRule/PolicyInterpretation/201610/t20161027_305087.html

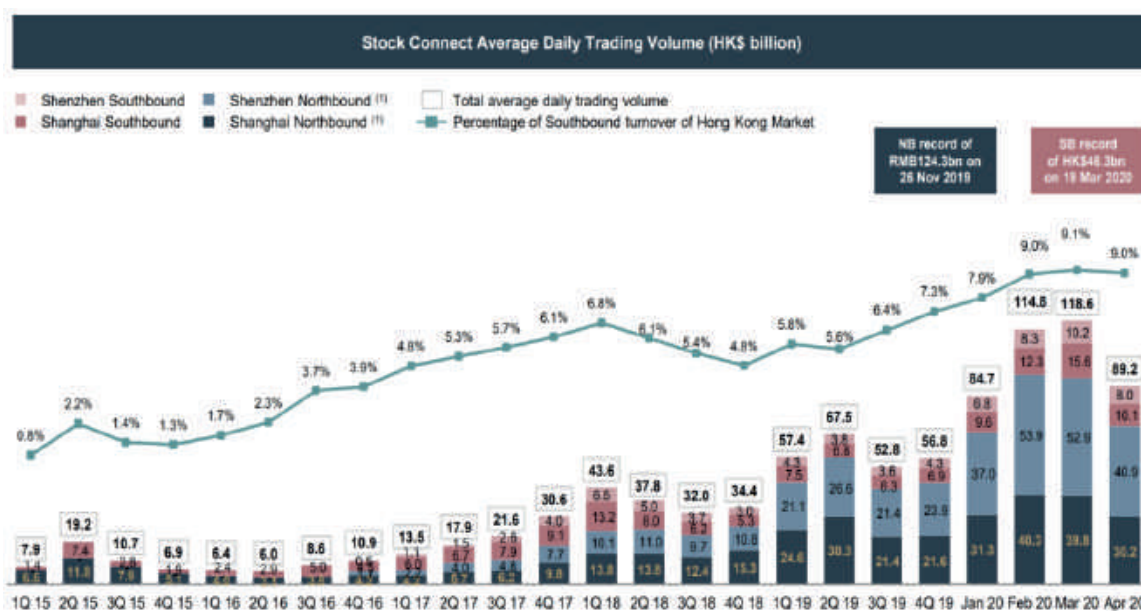
³ Source: 7 July 2017 HKEX Circular https://www.hkex.com.hk/eng/market/partcir/hksc/2017/Documents/ce_015_2017.pdf

⁴ Source: 30 Nov 2017 HKEX Circular <http://www.hkex.com.hk/-/media/HKEX-Market/Services/Circulars-and-Notices/Participant-and-Members-Circulars/SEHK/2017/CT09717E.pdf>

⁵ Source: 11 Apr 2018 <http://www.hkex.com.hk/-/media/hkex-market/services/circulars-and-notice/participant-and-members-circulars/sehk/2018/ct03818b.pdf?a=en>

⁶ Source: 8 Aug 2018 SSE (Simplified Chinese Only) http://www.sse.com.cn/aboutus/mediacenter/hotandd/c/c_20180806_4607055.shtml

Illustration of the trading trends in Stock Connect since 2015



Source: HKEX, data as of April 2020.

Appendix 6

Overview of the Hong Kong Listed Structured Products Market

1. Introduction

This appendix examines the key contributors to the success of the Hong Kong listed structured products market, the market's current profile and the eligibility of A-Share as an underlying to such products.

These contributors are critical to the assessment as to whether:

- (a) A-Share structured products are eligible for listing on the SEHK; and
- (b) Hong Kong listed structured products are suitable for investment by the Mainland investors.

2. Review of the Hong Kong listed structured products market in 2017 – a recap of the FSDC 2017 Paper

The FSDC published a paper in 2017 with a view to:

- (a) undertake a comprehensive review of the existing Hong Kong listed structured products market, including the regulatory framework, product types and market operations;
- (b) compare the Hong Kong listed structured products market with other global markets, in particular, European markets to identify key differences; and
- (c) propose recommendations to optimise the Hong Kong listed structured products market and ensure Hong Kong maintains its competitiveness as a world-leading market.

Since the FSDC 2017 Paper, the Hong Kong listed structured products market has seen various regulatory developments such as:

- (a) the publication of the HKEX Guide by the HKEX in July 2018 – the HKEX Guide addresses the recommendations of the FSDC in its FSDC 2017 Paper by:
 - (i) providing guidance to structured products issuers on the approval process for the listing of new structured products; and
 - (ii) providing clarity on the HKEX's product review and approval process such that new structured products can be introduced to the market more efficiently and within a clear time frame; and
- (b) the launch of a new type of Hong Kong listed structured product called "inline warrants" in July 2019 – inline warrants are a type of structured product that entitles the investors to receive a pre-determined fixed payment at expiry.

3. Success contributors to Hong Kong's listed structured products market

3.1 Success contributor 1 – clear, organised and transparent regulatory framework

The Hong Kong listed structured products market is governed by a clear and well-organised regulatory framework. The framework ensures that investors and market players are provided with detailed and structured guidance in relation to all aspects of the products including:

- (a) the eligibility criteria for the underlying assets;
- (b) the eligibility criteria for issuers and guarantors;
- (c) obligations of issuers and guarantors;
- (d) requirements in relation to the product terms and conditions;
- (e) documentation and information requirements; and
- (f) listing procedures.

3.2 Success contributor 2 – market transparency

The Hong Kong listed structured products market offers market transparency to investors. Investors are provided with easy access to comprehensive information relating to the products including:

- (a) the product's listing documents which set out important information relating to the product such as the key terms, information relating to the issuer, key features of the product, key risks, fees and charges etc.;
- (b) programme documents which set out the product's standard terms and conditions;
- (c) other investor educational materials;
- (d) information relating to the underlying assets; and
- (e) factors affecting issuer's pricing of warrants.

All of the above information is readily available to investors through the HKEX's website and each issuer's own website.

3.3 Success contributor 3 – quality issuers comprising international and domestic household names

A financial institution must meet extensive regulatory criteria to qualify as an eligible issuer of Hong Kong listed structured products. The key eligibility criteria include:

- (a) the issuer must have a net asset value of at least HKD2 billion; and
- (b) either:
 - (i) have a credit rating falling within the top 3 investment grades; or
 - (ii) be an entity regulated by the SFC, the HKMA or other recognised overseas regulators.

3.4 Success contributor 4 – accessibility and standardisation

The products and documentation are substantially standardised – this ensures that the product terms are largely consistent. As a result, Hong Kong listed structured products are easily accessible by investors. Investors (including retail investors) can have a good understanding of the product's structures and key terms.

3.5 Success contributor 5 – liquidity

Market players are able to provide strong level of liquidity driven by commitments by issuers and market competition, as well as a clear regulatory regime for issuers' liquidity obligations.

3.6 Success contributor 6 – simple product with limited product range

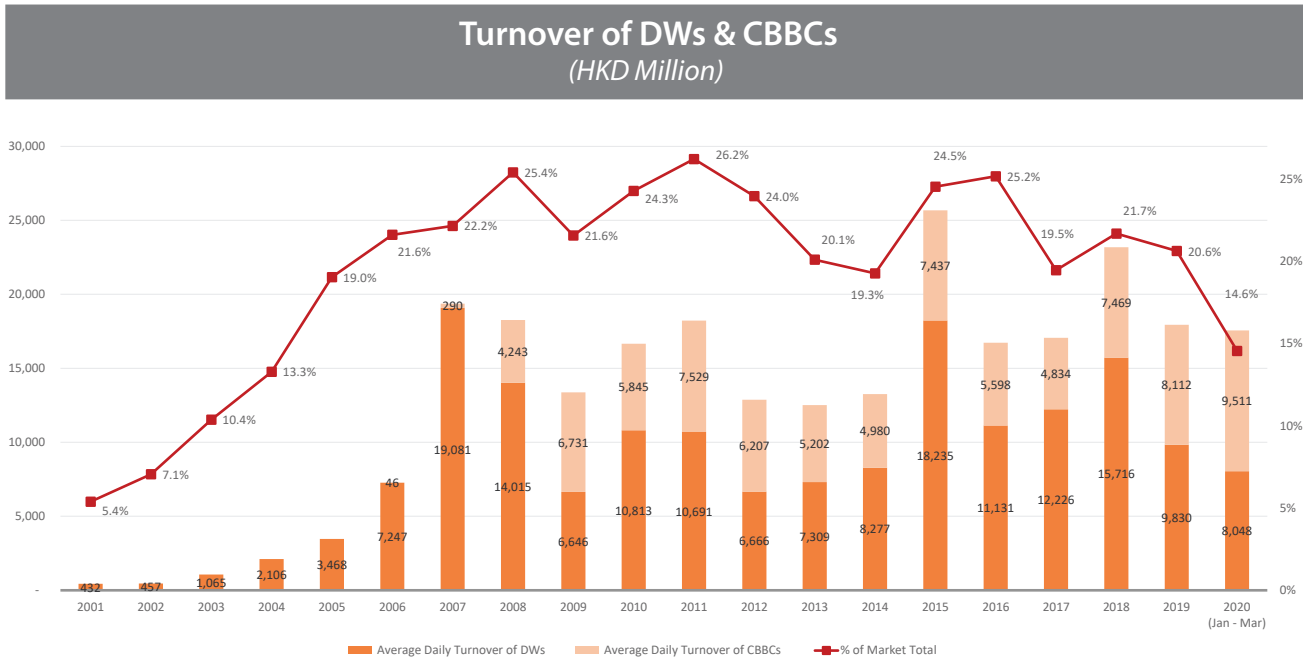
The product range comprises a few product types, all of which have relatively simple structures. This again ensures that investors have a good understanding of the available products.

4. Current market profile

The following data supports our view that inclusion of Hong Kong's listed structured products as eligible securities for Southbound Stock Connect will increase trading volumes in Southbound Stock Connect and therefore benefit the HKEX.

As illustrated in the chart below, there has been significant growth in the trading volume and nominal market value of warrants and CBBCs on the SEHK since 2002, with an increasing turnover for both products .

Illustration of turnover of DWs & CBCs from 2001 to 2020

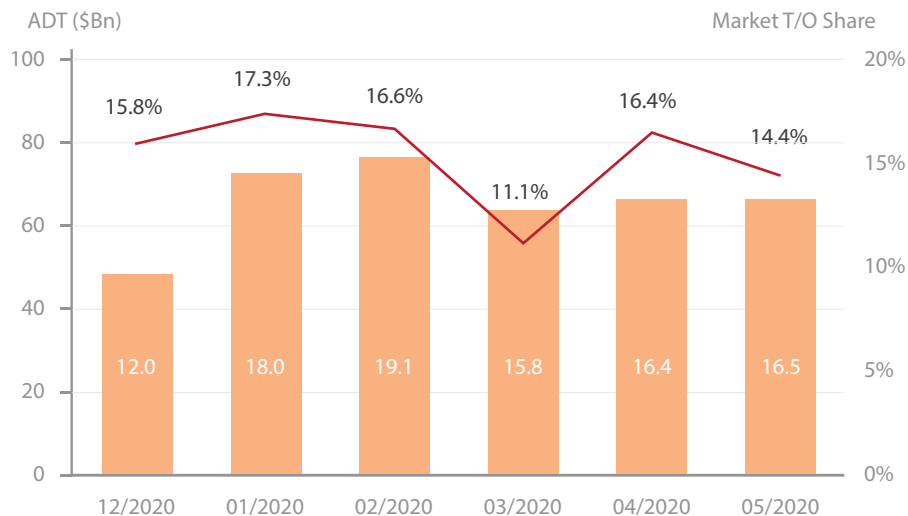


Source: HKEX

As illustrated in the chart below, the ADT of Hong Kong listed structured products traded on the HKEX consistently account for 11% to 17% of market turnover share (taking the data between December 2019 and May 2020).

Illustration of market turnover and average daily turnover of Hong Kong listed structured products versus the cash market

Market Turnover Share & Average Daily (ADT)



Source: HKEX

5. Eligibility of the Stock Connect A-Share as underlying assets

5.1 Regulatory requirements

Chapter 15A of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited allows Hong Kong listed structured products to be linked to “a security, index, currency, commodity or other asset”, or a combination of such assets.

This section examines Chapter 15A in order to determine the eligibility of A-Share as an asset to link to Hong Kong listed structured products.

Foreign stock underlying

Chapter 15A provides that where the structured product relates to a single class of shares which is listed on or dealt in another regulated, regularly operating, open stock market recognised for this purpose by SEHK, SEHK will consider the following non-exhaustive list of factors in determining the suitability of the structured product:

- (a) whether the market is regulated on a fair and orderly basis by a body of laws, regulations or rules which are enforced by government or a body having governmental authority, particularly its trading regulations including timely price and volume dissemination;
- (b) whether the market has adequate and pre-determined trading hours and days the suspension of which is provided for only by the laws, regulations or rules regulating it;
- (c) whether the jurisdiction in which the market is situated restricts foreign investors in the trading of securities listed on or dealt in that market or the remittance of any proceeds from a disposal through, e.g., foreign exchange controls or foreign ownership restrictions;
- (d) the quality of the reporting requirements such as the timely reporting of adequate financial information and the price and volume of transactions whether on or off exchange, timely dissemination of inside information and the availability of the foregoing to investors in Hong Kong;
- (e) the availability of price information in Hong Kong particularly on a real-time basis; and
- (f) the arrangements by the issuer for requesting suspension of trading in the structured products whenever trading in the underlying securities or assets are suspended in the market on which such securities or assets are listed or dealt in.

Listing of any structured product linked to A-Share, which is considered a new underlying asset, is subject to prior approval by the HKEX in consultation with the SFC.

5.2 Current underlying assets linked to warrants and CBBCs

The types of underlying assets over which derivative warrants have been issued (that is, to which the return is linked) include:

- (a) Hong Kong-listed stocks;
- (b) Hong Kong-related stock indices (such as Hang Seng Index and Hang Seng China Enterprises Index);
- (c) foreign stocks (such as Google Inc.);
- (d) foreign stock indices (such as Nikkei 225 Stock Average Index);
- (e) currency pairs (such as British Pound Sterling / USD); and
- (f) commodities (such as oil futures contracts, gold, platinum and silver).

5.3 Eligibility of A-Share as an underlying asset

The Working Group believes that A-Share are eligible underlying assets taking into account the factors set out in Chapter 15A as follows:

(i) whether the market is regulated on a fair and orderly basis by a body of laws, regulations or rules which are enforced by government or a body having governmental authority, particularly its trading regulations including timely price and volume dissemination

Regulated trading market –

The A-Share market is regulated by the Law of the People's Republic of China on Securities (No. 43, Order of the President of the People's Republic of China), the administrative regulations of the State Council, the administrative rules of the regulatory departments, judicial interpretation of the Supreme Court and the rules of the relevant exchanges, including the SSE Listing Rules, SSE Trading Rules³⁰, SZSE Listing Rules and SZSE Trading Rules.³¹

According to the "home market principle", trading A-Share through Stock Connect is subject to, and based on, the existing rules and regulations and operational models governing trading and clearing in the relevant market.

The listing rules and trading rules of the SSE and SZSE contain provisions in relation to the operation of the trading market and securities trading on the market, and the requirements on information disclosure etc.

³⁰ Rules of the Shanghai Stock Exchange, available at <http://english.sse.com.cn/start/rules/sse/public/>

³¹ Rules of the Shenzhen Stock Exchange, available at <http://www.szse.cn/English/rules/siteRule/>

(ii) whether the market has adequate and pre-determined trading hours and days the suspension of which is provided for only by the laws, regulations or rules regulating it

Adequate and pre-determined trading hours and days with suspension mechanisms³² –

Investors are required to follow the trading hours of the SSE and the SZSE to trade A-Share on the SSE or the SZSE. The SSE and the SZSE have the same trading hours as follows:

- an opening call auction session from 9:15 a.m. to 9:25 a.m.;
- two continuous auction sessions from 9:30 a.m. to 11:30 a.m. and 1:00 p.m. to 2:57 p.m.; and
- one closing call auction session from 2:57 p.m. to 3:00 p.m.

Northbound orders are accepted by the SEHK five minutes before the opening of each trading session. Therefore, northbound orders can be input from 9:10 a.m. to 11:30 a.m. and from 12:55 p.m. to 3:00 p.m. The SSE and the SZSE will only process the orders during their trading hours.

Section 2 under Chapter IV of the SSE Trading rules and section 3 under Chapter IV of the SZSE Trading Rules provide for the mechanisms in case of trade suspension on the SSE or the SZSE.

(iii) whether the jurisdiction in which the market is situated restricts foreign investors in the trading of securities listed or dealt in on that market or the remittance of any proceeds from a disposal through, e.g., foreign exchange controls or foreign ownership restrictions

Foreign shareholding restriction³³ –

PRC rules provide the shareholding of a single foreign investor in a listed A-Share (regardless of the channels through which shares are held, including QFII, RQFII and Shanghai and Shenzhen Connect) must not exceed 10% of the relevant company's total issued shares, and the shareholding of all foreign investors in the A-Share of a listed company must not exceed 30% of its total issued shares.

A-Share purchased through Shanghai Connect and Shenzhen Connect are considered in totality with those purchased under QFII and RQFII, and subject to the same foreign shareholding restriction.

³² Section 4 (Trading Hours) under Chapter II of the SSE Trading Rules and SZSE Trading Rules; FAQ 1.28, "Stock Connect Another Milestone – FAQ" published by the Exchange, a copy of which is available at: https://www.hkex.com.hk/-/media/HKEX-Market/Mutual-Market/Stock-Connect/Getting-Started/Information-Booklet-and-FAQ/FAQ/FAQ_En.pdf

³³ HKEX's FAQ 1.49, "Stock Connect Another Milestone – FAQ", available at https://www.hkex.com.hk/-/media/HKEX-Market/Mutual-Market/Stock-Connect/Getting-Started/Information-Booklet-and-FAQ/FAQ/FAQ_En.pdf

(iv) the quality of the reporting requirements such as the timely reporting of adequate financial information and the price and volume of transactions whether on or off exchange, timely dissemination of inside information and the availability of the foregoing to investors in Hong Kong

Information disclosure –

The information disclosure obligations of a company listed on the SSE or the SZSE are set out under Chapter II of the SSE Listing Rules and the SZSE Listing Rules. In particular:

- a listed company and its directors, supervisors and senior officers with disclosure obligations must ensure that information is disclosed in a timely and fair manner, and that the information disclosed is truthful, accurate and complete and contains no misrepresentations, misleading statements or material omissions;
- all the material events that are likely to have significant impact on the prices of its stocks and derivatives must be disclosed;
- forward-looking information and other information in relation to the future operations and financial condition of the company must be disclosed reasonably, cautiously and objectively; and
- where the information to be disclosed by a listed company involves uncertainty, is a temporary business secret, or falls within other circumstances as recognized by the SEHK, and as a consequence, a timely disclosure thereof is detrimental to the interests of the listed company or would mislead investors, and subject to certain conditions, the listed company must also apply to the SEHK for disclosure following the requirements set out under the rules and obtain the approval of the SEHK

The information must be disclosed in the forms such as periodic reports and announcements, which are to be available on the website of the SSE and the SZSE and are accessible by the public, including investors in Hong Kong.³⁴

(v) the availability of price information in Hong Kong particularly on a real-time basis

Real-time price information available via the SSE/SZSE websites

Section 5.1 of each of the SSE Trading Rules³⁵ and SZSE Trading Rules³⁶ provide that the SSE and the SZSE will disseminate real-time quotations, indices, public information and other trading information in respect of securities trading on each trading day.

Real-time price information is available on the website of the SSE and the SZSE and are accessible by the public, including investors in Hong Kong.³⁷

³⁴ The listed company announcements can be found on the following webpage of SSE: <http://english.sse.com.cn/markets/equities/announcements/>

³⁵ A copy of the SSE Trading Rules is available at: <http://english.sse.com.cn/start/rules/sse/trading/c/4962524.pdf>

³⁶ A copy of the SZSE Trading Rules is available at: <http://www.szse.cn/English/rules/siteRule/P020181124401737559498.pdf>

³⁷ Real-time price information can be found on the following webpage of SSE: <http://english.sse.com.cn/>; and the following webpage of the SZSE: <http://www.szse.cn/English/home/index.html>

(vi) the arrangements by the issuer for requesting suspension of trading in the structured products whenever trading in the underlying securities or assets are suspended in the market on which such securities or assets are listed or dealt in

Similar to the existing arrangement for local stock underlying, the Working Group expects the HKEX will impose a suspension obligation on A-Share structured products whenever trading in the underlying A-Share are suspended.

6. T+2 settlement cycle and permissible day trading of listed structured products

Hong Kong listed structured products are traded on a T+2 settlement cycle in Hong Kong (that is, an order executed on a trading day, T, will be delivered to the buyer's stock account on T+2).

An investor in Hong Kong who has a right to acquire a stock is able to immediately sell the equivalent number of stocks on the same day. That is, on T day, an investor who has executed an order to buy Hong Kong listed structured products is able to immediately sell that product on T day. This differs from the Mainland trading on A-Share described in Appendix 7.

Appendix 7

Key Features of the Trading and Settlement System of the A-Share Market

1. Introduction

This appendix summarises the unique features of the trading and settlement system of the A-Share market.

2. Key features

- (a) **the settlement system for shares traded on the A-Share market operates on a “T+1” model** – a trade over an A-Share executed on a trading day (being “T” day) will be settled on the next trading day (ie T+1). This means the A-Share is delivered and accredited to the buyer’s broker account, and the settlement funds are credited to the seller’s account, on T+1.

Illustration of the Mainland’s “T+1” settlement model

If an investor purchases 100 shares of a company for RMB1,000, the 100 shares may immediately appear in the investor's stock account and the RMB1,000 is deducted from his cash account. In reality, the 100 shares have not yet entered his stock account (this will happen during the evening of the day they were traded, so on T+0). Similarly, the payment of RMB1,000 has not yet been credited to the seller's account (this will occur on or before 4pm on T+1). The investor can see the result of the transaction immediately because brokers often provide account services (that may not match actual clearing).

Conversely, if an investor originally held 100 shares, and is paid RMB1,000 on sale, the investor can use the RMB1,000 to buy other shares on the same day, but he cannot withdraw this amount. In other words, the RMB1,000 can only be used for re-investment but withdrawal from the account is not allowed (on or after 4pm on T+1).

- (a) pre-trade checking – all A-Share trades must comply with the pre-trade checking of the “funds and shares” requirement. This means an investor may only give a buy order (or a sell order) when the trader has in its broker account a cash amount at least equal to the purchase price (or a number of shares at least equal to the number of shares sold in the case of a sell order) on the day prior to the trade date;
- (b) no same-day trading – an investor can only make a sale order for A-Share that are accredited to its stock account in the Mainland. As a result of the “T+1” settlement model described above, same day trading is prohibited. In other words, an investor cannot buy A-Share and then sell the same A-Share within the same day;

- (d) off-exchange trades – as a general rule, A-Share can only be transferred on exchange. Off-exchange trading³⁸ is only permitted in limited circumstances such as:
- (i) stock borrowing and lending for the purposes of covered short selling with a loan arrangement of one month or less³⁹;
 - (ii) stock borrowing and lending for the purpose of satisfying the pre-trade checking requirement³⁹;
 - (iii) transfers between exchange participants and their clients for the purpose of rectifying error trades on condition that an error trade report and supporting documents are submitted; and
 - (iv) post-trade allocation of shares to different funds/sub-funds by fund managers; and
- (e) general prohibition on short selling – as a general rule, (naked) short selling of A-Share is prohibited; covered short-selling of Stock Connect A-Share is only permitted in limited circumstances.⁴⁰

3. Implication

The consequence of these trading and settlement features is that issuers of A-Share structured products might be unable to match on a daily basis their risk under A-Share structured products with their holding of A-Share. This means the liquidity bid and ask spread quoted for A-Share structured products is likely to be wider than that quoted for other Hong Kong listed structured products.

³⁸ It should be noted that since only transfers involving a change in beneficial ownership are considered as off-exchange transfers under the SSE Rules, security arrangements that involve no transfer of shares from one securities account to another, for example, charge or assignment by way of security with the custodian bank or broker as a charge, would not contravene the rule against non-trade transfers.

³⁹ Stock borrowing and lending of Stock Connect securities is only allowed in certain situations prescribed by the HKEX and are subject to restrictions set by the SSE or SZSE. Under the relevant rules, only certain types of Stock Connect securities and investors can participate in stock borrowing and lending.

⁴⁰ For example, only eligible Stock Connect A-Share can be short sold, short-selling orders must be submitted in multiples of 100 shares, short selling orders are subject to certain price restrictions etc.



About the FSDC

The FSDC was established in 2013 by the Hong Kong Special Administrative Region Government as a high-level, cross-sectoral advisory body to engage the industry in formulating proposals to promote the further development of the financial services industry of Hong Kong and to map out the strategic direction for the development.

The FSDC has been incorporated as a company limited by guarantee with effect from September 2018 to allow it to better discharge its functions through research, market promotion and human capital development with more flexibility.

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