

ISSUES CONCERNING SHANGHAI-HONG KONG STOCK CONNECT¹

1. What is the role of Hong Kong Securities Clearing Company Limited (HKSCC) in Shanghai-Hong Kong Stock Connect?

HKSCC provides clearing, settlement and depository services to the securities market in Hong Kong. It is approved as a “recognized clearing house” (RCH) by the Securities and Futures Commission (SFC), Hong Kong’s regulator for the securities market, under section 37(1) of the Securities and Futures Ordinance (SFO). In addition to the provision of clearing services, HKSCC’s role as a central securities depository (CSD) and a securities settlement system (SSS) in the provision of depository, nominee, securities and settlement services is enshrined in its CCASS Rules as approved by the SFC. Apart from the SFC, HKSCC is also accepted as a central clearing counterparty (CCP), SSS and CSD by other international bodies including the IMF.² It has also applied to the European Securities Markets Authority (ESMA) in the EU to be recognized as a “Third Country CCP” under the European Market Infrastructure Regulation (EMIR)³ and has recently updated its application by including features of the Shanghai-Hong Kong Stock Connect.⁴

In relation to SSE Securities, HKSCC performs the following functions:

- (i) it acts as the “participating CCP” vis-à-vis ChinaClear⁵ for the clearing and settlement of all the SSE Securities traded through the Northbound Trading Link (i.e. all the SSE Securities bought and sold by HKSCC Clearing Participants for Hong Kong and overseas investors including UCITS); and
- (ii) post-clearing and settlement, the SSE Securities are registered in the name of HKSCC in ChinaClear’s books and records as the nominee holder for HKSCC Participants and the underlying investors. Similar to Hong Kong listed shares and other types of securities, HKSCC offers nominee services to HKSCC Participants in its role as a CSD.

The above functions are specifically set out and provided for in the CSD and Clearing Link Agreement entered into between ChinaClear and HKSCC prior to the launch of the Stock Connect. HKSCC’s role as the nominee is recognized and confirmed in HKSCC’s own rules and in the rules and regulations of the China Securities Regulatory Commission (CSRC), Shanghai Stock Exchange (SSE) and ChinaClear.

¹ Supplemental Q&A which may be merged with or form part of the existing FAQ by way of update.

² IMF Assessment: <https://www.imf.org/external/pubs/ft/scr/2014/cr14208.pdf>. See Section 4: Overview of Financial Market Infrastructures and Appendix I (Table 3)

³ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

⁴ Hong Kong has already been accepted by ESMA as an equivalent jurisdiction for the purposes of recognizing Hong Kong clearing houses as Third Country CCPs under EMIR.

⁵ Under the CSD and Clearing Link Agreement, ChinaClear acts as the “host CCP” in the Mainland for the clearing and settlement of all SSE Securities traded on SSE, while HKSCC acts as the “participating CCP” through its status as a special clearing participant of ChinaClear. ChinaClear also acts as the “host CSD” in Mainland in relation to the SSE Securities acquired through the Northbound Trading Link.

It is worth noting that HKSCC does not take on the role of and is not appointed by any HKSCC Participant or investor as a typical “custodian”, “sub-custodian” or “safe-keeping agent” in respect of the SSE Securities. As a CCP, CSD and SSS, HKSCC acts and operates as a financial market infrastructure and is regulated by the SFC as such. It is required to comply with CPMI-IOSCO’s Principles for Financial Market Infrastructures (April 2012) (the PFMI Principles) which do not apply to typical custodians or safe-keeping agents. Disclosure of HKSCC’s compliance with the PFMI Principles as a CCP, CSD and SSS is published in the HKEx website.⁶

The following description of the role and functions of a CSD in the PFMI Principles should be helpful in demonstrating that HKSCC acts as a full-fledged CSD:⁷

- “A central securities depository provides securities accounts, central safekeeping services, and asset services, which may include the administration of corporate actions and redemptions, and plays an important role in helping to ensure the integrity of securities issues (that is, ensure that securities are not accidentally or fraudulently created or destroyed or their details changed).” **[NOTE: This is what HKSCC does in relation to Hong Kong listed shares, SSE Securities and other securities held by it as CSD and nominee.]**
- “A CSD can hold securities either in physical form (but immobilized) or in dematerialised form (that is, they exist only as electronic records). **[NOTE: This applies to HKSCC.]** The precise activities of a CSD vary based on jurisdiction and market practices. For example, the activities of a CSD may vary depending on whether it operates in a jurisdiction with a direct or indirect holding arrangement or a combination of both. In a direct holding system, each beneficial or direct owner of the security is known to the CSD or the issuer. In some countries, the use of direct holding systems is required by law. Alternatively, an indirect holding system employs a multi-tiered arrangement for the custody and transfer of ownership of securities (or the transfer of similar interests therein) in which investors are identified only at the level of their custodian or intermediary.” **[NOTE: HKSCC currently uses an indirect holding system as described above. Indeed, “Custodian Participants” constitute one of its categories of participants. These are typical custodians which depositaries of UCITS appoint to safe-keep assets on their behalf.]**
- “A CSD may maintain the definitive record of legal ownership for a security; **[NOTE: HKSCC is not providing such services yet but is moving towards this**

⁶ The SFC published guidelines in August 2013 requiring HKSCC to observe on an ongoing basis the PFMI Principles as applicable to a CCP, SSS operator, and CSD. The following link to HKEX’s website introduces HKSCC as a financial market infrastructure and its disclosure on compliance with the PFMI Principles: <http://www.hkex.com.hk/eng/market/clar/specialtopics/pfmi.htm>. Although the disclosure document does not focus on Stock Connect, it provides information on the following:

- Participants of HKSCC (paragraphs 16 to 18)
- Legal framework that governs HKSCC and its statutory duties (paragraphs 24 to 31)
- Typical functions of HKSCC as CSD (paragraphs 57 to 61).

⁷ Paragraph 1.11 and the related footnotes, PFMI Principles: <http://www.bis.org/cpmi/publ/d101a.pdf>

direction as set out in the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 currently considered by the Hong Kong Legislative Council. When the Bill is enacted and becomes effective (expected to be in 2017/18), HKSCC will, in addition to its role as CCP, CSD and SSS, also act as the “system operator” to maintain the definitive records of legal ownership for Hong Kong listed securities.] *in some cases, however, a separate securities registrar will serve this notary function. In many countries, a CSD also operates a securities settlement system. A securities settlement system enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules.”* **[HKSCC is a securities settlement system under the PFMI Principles and has been assessed as such.]**

Based on the above, HKSCC’s role in Shanghai-Hong Kong Stock Connect is to act as CCP, CSD and SSS, as recognized and regulated by the SFC and as agreed with ChinaClear.

2. Is HKSCC’s capacity in holding the SSE Securities acquired by Hong Kong and overseas investors through Shanghai-Hong Kong Stock Connect inconsistent with its role as CSD?

As mentioned in 1 above and HKSCC’s FAQs for Investors (Q50), HKSCC holds the SSE Securities acquired by Hong Kong and overseas investors as the “nominee holder”.

HKSCC’s role as nominee holder (with its name being registered as the holder of SSE Securities in the books of ChinaClear and accordingly, the register of members of the relevant listed companies (see 4 below)) is consistent with its role as CSD.⁸ In fact, providing nominee services and acting as the nominee holder of the legal interest in Hong Kong listed shares for HKSCC Participants and investors has been HKSCC’s role under the existing regulatory regime.

As nominee, HKSCC performs, among others, the following functions which enable HKSCC Participants and the underlying investors to exercise their rights as beneficial owners of the relevant securities:

- collection or receipt of dividends, interest payments, redemption proceeds, distributions, rights, entitlements and other properties and documents with respect to the securities held by HKSCC;
- distribution or payment to HKSCC Participants of dividends, interest payments, redemption proceeds, distributions, rights, entitlements and other properties and documents received by HKSCC with respect to the securities held by HKSCC;
- the seeking of voting instructions from HKSCC Participants, voting at general meetings or the passing on of voting instructions to the relevant listed companies for voting during general meetings; and

⁸ It is also consistent with PFMI Principles’ description of a CSD’s role under the “indirect holding system”.

- the seeking of instructions from HKSCC Participants with regard to the exercise of rights and entitlements accruing to relevant securities or the participation in other actions, transactions or matters affecting them.⁹

Subject to applicable Mainland China law, these are functions which HKSCC also performs as nominee for HKSCC Participants in relation to all the SSE Securities registered in its name in the books and records maintained by ChinaClear (see 5(i) below).

3. HKSCC’s FAQs for Investors (Q52) states that based on the CSRC Stock Connect Rules, Hong Kong and overseas investors “should be” recognized under the laws and regulations of Mainland China as having beneficial ownership in the SSE Securities. Does the reference to “should be” instead of “will be”, “shall be” or “must be” suggest that HKSCC is not sure about beneficial owners’ interest in the SSE Securities?

No. In HKSCC’s view, it is clear that under Mainland regulations, HKSCC is only the holder of the SSE Securities in name and not in substance. Hence, the ultimate investors who invest in SSE Securities should be regarded as the beneficial owner.

The use of “should be” represents HKSCC’s view and position on the subject as it cannot guarantee that the ultimate investors must universally be accepted by all concerned as beneficial owners in every circumstance given the different factual situations that securities are held for investors through potentially chains of brokers, custodians, trustees and other intermediaries. Further, the reference to “should be” is not meant to suggest that there is any form of discretion that lies with HKSCC for it to decide who the beneficial owner of an SSE Security is. Under the current indirect holding system adopted in Hong Kong, HKSCC is not in a position to identify who is the beneficial owner.

Appropriate amendments will be made to FAQ52 to reflect the above.

4. For an investor who is the beneficial owner of the SSE Securities, how can it be sure that its beneficial holdings or ownership in SSE Securities is based on and can be traced back to legally recognized interest held through HKSCC as the nominee holder under Mainland law?

This question can be answered in two parts by considering:

- (i) the nature of HKSCC’s interest as the holder of SSE Securities as recorded by ChinaClear; and
- (ii) the concept of nominee holder as it is recognized under Mainland law.

With respect to (i), there are clear provisions under existing Mainland law recognizing the interest of a registered holder of shares as recorded by ChinaClear. These provisions are summarised below:

- (a) **Article 30 of CSRC’s Guidance on Listed Company Articles of Association**¹⁰ - This provides that Mainland listed companies shall set up and maintain their register

⁹ See CCASS Rule 1101 : <http://www.hkex.com.hk/eng/rulesreg/clearrules/ccassgr/ccassrule.htm>

of shareholders in accordance with the records provided by the securities registration and settlement institution (i.e. ChinaClear), which serve as sufficient evidence on the shares held by shareholders. This means that the register of shareholders of listed companies should be maintained in accordance with the records or registers of securities holders maintained by ChinaClear.¹¹

- (b) **Section 160 of the Securities Law of the People's Republic of China**¹² – This provides that ChinaClear shall provide the issuer of securities with the register of securities holders and information regarding securities holders; ChinaClear shall confirm the fact that securities holders own or hold the relevant securities based on the result of the clearing and settlement arrangements. In addition, ChinaClear shall ensure that the registers of securities holders and the securities transfer and registration records maintained by it are true, accurate and complete.
- (c) **Article 7 of ChinaClear's Implementing Rules for Registration, Depository and Clearing Services under the Shanghai-Hong Kong Stock Connect Pilot Programme**¹³ – This states that HKSCC, as the nominee holder of the SSE Securities, shall be registered in the register of shareholders maintained by SSE listed companies.
- (d) **Article 5 of ChinaClear's Securities Registration Rules** – This provides that the securities registration records issued by ChinaClear shall be valid evidence of the securities holders' possession or holding of such securities.

¹⁰ Article 30: The company shall, according to the vouchers provided by the securities registration authority, prepare a register of shareholders, which serves as sufficient evidence for the company's shares held by the shareholders. Shareholders shall enjoy rights and bear responsibilities according to the classes of shares held by them; shareholders with the same class of shares shall enjoy equal rights and bear the same obligations. (第三十条 公司依据证券登记机构提供的凭证建立股东名册，股东名册是证明股东持有公司股份的充分证据。股东按其所持有股份的种类享有权利，承担义务；持有同一种类股份的股东，享有同等权利，承担同种义务。) English version link: <http://hk.lexiscn.com/law/law-english-1-2469768.html> Chinese version link: <http://hk.lexiscn.com/law/law-chinese-1-2469444.html>

¹¹ The Mainland operates an uncertificated securities system.

¹² Article 160: A securities registration and clearing institution shall provide the register of securities holders and associated documents to an issuer of securities. A securities registration and clearing institution shall, according to its securities registration and settlement records, confirm that a holder of securities owns the relevant securities and provide the registration documents of relevant securities holders. A securities registration and clearing institution shall guarantee the authenticity, accuracy and completeness of its registers of securities holders and transfer and registration records, and may not conceal, forge, alter or damage any of the aforesaid materials. (第一百六十条 证券登记结算机构应当向证券发行人提供证券持有人名册及其有关资料。证券登记结算机构应当根据证券登记结算的结果，确认证券持有人持有证券的事实，提供证券持有人登记资料。证券登记结算机构应当保证证券持有人名册和登记过户记录真实、准确、完整，不得隐匿、伪造、篡改或者毁损。) English version link: <http://hk.lexiscn.com/law/law-english-1-2441063.html> Chinese version link: http://hk.lexiscn.com/law/content.php?provider_id=1&isEnglish=N&origin_id=2441059&keyword=6K%2BB5Yi45rOV&t_kw=6K%2BB5Yi45rOV&eng=0

¹³ Article 7: The securities acquired by investors through Shanghai Connect and held by HKSCC as nominee shall be deposited in CSDC and registered in the register of shareholders of the relevant companies listed on the Shanghai Stock Exchange ("SSE") in the name of HKSCC. (第七条 香港结算作为名义持有人持有的沪股通投资者买入的证券，以香港结算名义存管在本公司，登记在上海证券交易所（以下简称“上交所”）上市公司的股东名册。）

The above provides sound legally basis confirming that ChinaClear's records (to be reflected in listed companies' register of shareholders) provide conclusive evidence with respect to a person's holding of securities in a listed company. As HKSCC holds the SSE Securities as nominee only and its holdings are recorded in the registers maintained by ChinaClear and listed companies in accordance with the above regulations, the relevant records should serve as good evidence of ownership of SSE Securities at the HKSCC level.

With respect to (ii), HKSCC's FAQs for Investors (Q51 and 52) have already dealt with the ownership position at the beneficial owners' level (see also 3 above). In summary, as nominee holder of SSE Securities, HKSCC does not have any proprietary interest in SSE Securities; such interest rests with the beneficial owners. This is the case whether or not HKSCC is solvent or insolvent.

The combination of (i) and (ii) provides a good basis to show that an investor's beneficial ownership in SSE Securities is based on and can be traced back to legally recognized interest held through HKSCC as nominee under Mainland law.

5. How does an investor, as the beneficial owner of SSE Securities under the nominee structure, assert, exercise and enforce its rights over the SSE Securities?

First and foremost, a distinction should be made between a beneficial owner (i) asserting or exercising its rights over SSE Securities; and (ii) taking legal action or court proceedings to enforce rights over the SSE Securities. These are examined below.

(i) Asserting or exercising rights over SSE Securities

As mentioned in HKSCC's FAQs for Investors (Q53), Article 5 of the *ChinaClear Securities Registration Rules* provides that beneficial owners of SSE Securities shall "exercise their rights" in relation to SSE Securities through the nominee holder. It is HKSCC's understanding that when Mainland China regulations refer to "exercising rights" in relation to SSE Securities, they refer to the dealings between shareholders and the companies covering the following:

- the right to call and participate in shareholders' meetings;
- the right to propose matters for voting at shareholders' meetings;
- the right to exercise voting rights or control over the company through voting at shareholders' meetings;
- the right to subscribe for allocated rights and entitlements; and
- the right to receive dividends and other distributions declared by the company.¹⁴

¹⁴ HKSCC's understanding in this regard is confirmed by *Article 31 of CSRC's Administrative Measures for Margin Financing and Securities Lending Services of Securities Firms*. Article 31 provides as follows: With respect to the securities recorded in the covered securities account of the credit transactions of the clients, the securities firm shall exercise the rights attached to such securities against the issuers thereof in its own name and for the interest of the relevant clients. Before exercising the rights attached to such securities against the issuers thereof, the securities firm shall solicit opinions from the clients and proceed according to their opinions. **The rights against the issuers above mean the rights arising from holding securities such as requesting the convening of the general meeting of securities holders, participating in the general meeting of securities holders, proposal, voting, subscription of allotted shares and requesting the distribution of the earnings from investment.** [Emphasis added] (第三十一条 对客户信用交易担保证券账户记录的证券，由证券公司以自己的名义，为客户的利益，行使对证券发行人的权利。证券

As provided in Chapter 11 of the CCASS Rules (see 2 above) and Section 8 of the CCASS Operational Procedures, HKSCC, as the nominee holder, will (subject to applicable Mainland regulations) assert or exercise the above rights for or on behalf of HKSCC Participants and the underlying beneficial owners of SSE Securities under the Stock-Connect pilot scheme. These cover HKSCC's obligations to distribute company announcements and communications, attend shareholders' meetings and obtain voting instructions and instructions to deal with entitlements, dividends, distributions, and various kinds of corporate actions of listed companies. The obligations are discharged by HKSCC seeking and acting on the instructions of HKSCC Participants which, in turn, seek instructions from their clients or the beneficial owners.¹⁵

Accordingly, the relevant CCASS rules and HKSCC's role are consistent and compliant with *Article 5 of ChinaClear's Securities Registration Rules*.¹⁶

(ii) Taking legal action or court proceedings to enforce rights over the SSE Securities

The rights under (i) should be distinguished from a beneficial owner's ability and voluntary decision to take legal action against an issuer of SSE Securities for whatever reasons.

Similar to CSDs such as Euroclear and Clearstream in the EU or the DTCC in the U.S., it is not the ordinary business of HKSCC to get involved in private disputes by taking actions on behalf of HKSCC Participants or the underlying investors. Further, similar to other professional nominees, HKSCC does not normally exercise independent judgment on whether listed companies have acted properly or whether HKSCC Participants or the underlying investors have a cause of action against a listed company. For these reasons, it is provided in the CCASS Rules and FAQ53 that HKSCC is not obligated to enforce rights against issuers of SSE Securities in any court proceedings in Mainland China.

That said, it is noted that beneficial owners may have good cause to pursue a claim against a listed company and may wish to bring legal action against companies for different reasons. The following observations are relevant:

- (a) Where Mainland China law affords a person a cause of action against a company, its directors or management in its capacity as an investor (as distinct from its capacity as a shareholder whose name appears in the records or registers of ChinaClear or the listed company), it is believed that similar to a Mainland investor, the person (including UCITS) should be able to bring legal

公司行使对证券发行人的权利，应当事先征求客户的意见，并按照其意见办理。前款所称对证券发行人的权利，是指请求召开证券持有人会议、参加证券持有人会议、提案、表决、配售股份的认购、请求分配投资收益等因持有证券而产生的权利。) Chinese version link: <https://hk.lexiscn.com/law/law-chinese-1-1385301.html>

¹⁵ The fact that HKSCC does assist HKSCC Participants and beneficial investors to exercise and assert their rights as shareholders has already been confirmed by paragraph 1 of FAQ53.

¹⁶ Article 5 states, among others, that "securities may be registered under the name of nominee holders if this complies with laws, administrative regulations and CSRC rules. Nominee holders are legally entitled to the relevant rights as securities holders and shall bear corresponding obligations to the relevant beneficial owners. The beneficial owners shall exercise their relevant rights through the nominee holders. When nominee holders exercise the relevant rights as securities holders, they shall consult the beneficial owners and shall not harm the interests of beneficial owners."

action in Mainland China directly against the company without involving HKSCC. In such a situation, as HKSCC is not the investor of SSE Securities, it is not in a position to commence legal action in any event.

- (b) Where a beneficial owner of SSE Securities decides to bring legal action against a listed company, its directors or management to enforce its rights as shareholder (as opposed to an investor) and the relevant cause of action must, under Mainland China law, be taken or initiated by the shareholder whose name appears in the records or registers of ChinaClear or the company, HKSCC would be prepared to provide assistance to the beneficial owner (including UCITS) subject to conditions and after having regard to the public interest, interest of the investing public and its statutory duties under the SFO. The assistance that HKSCC may be able to provide will be determined on a case by case basis and subject to the legal and procedural rules and requirements under Mainland China law, including, for example, consideration of whether the beneficial owner may bring the action directly without HKSCC's involvement or whether it may commence action with HKSCC being joined as a "nominal plaintiff" to facilitate the proceedings. As each case depends on its own facts, it would be unreasonable to expect HKSCC to provide a blanket agreement to commit to taking action for all HKSCC Participants and investors. As HKSCC is only a nominee holder of SSE Securities, the beneficial owner who wishes to take legal action should be responsible for seeking proper legal advice to satisfy itself and HKSCC that a cause of action exists.¹⁷ The beneficial owner should be prepared to conduct the action and take up all costs in relation to the action, including providing HKSCC with indemnities and legal representation in the proceedings. To make the above clear to the market, appropriate amendments to the CCASS Rules and HKSCC's FAQs will be made to reflect the principles mentioned above. The current intention is to amend the rules in the first quarter of 2015. While there is every intention to expedite rule changes subject to the relevant regulatory approval, no firm commitment can be given.
- (c) As mentioned in FAQ53, in the case of (a) and (b) and in order to facilitate any action to be taken by a beneficial owner of SSE Securities, at the request of the beneficial owner and with the consent of the HKSCC Participant who represents it, HKSCC would be prepared to provide certification of the HKSCC Participant's holdings of SSE Securities. This should assist the beneficial owner in establishing evidential proof that it has invested or have beneficial interest in the relevant SSE Securities at the relevant time, when read together with other records or produced by the HKSCC Participants or the other intermediaries acting for the beneficial owner. To this end, HKSCC understands that, pursuant to paragraph 3 of Article 5 of the *ChinaClear*

¹⁷ It should be noted, for example, that under the Mainland Company Law, certain actions that may be taken by shareholders require shareholders to meet the required shareholding thresholds. If the beneficial owner does not have the required level of shareholdings in SSE Securities held through HKSCC, it may not be able to establish a proper cause of action.

Securities Registration Rules, such certification would be recognized by ChinaClear (see 6 below).

- (d) It is worth pointing out that HKSCC has not, to date, been asked to take any legal action against a listed company with respect to the shares or securities that are held by it as CSD or nominee. In practice, it appears that where misfeasance or fraud has been committed by directors or listed companies, the relevant regulators would likely have taken the appropriate action to protect investors.

6. Will the certification of SSE Securities provided by HKSCC be recognized by the Mainland authorities?

Paragraph 3, Article 5 of the ChinaClear Securities Registration Rules states that “any certification on securities holding of the beneficiary owner issued by the nominee holder is the lawful proof that the beneficiary owner holds the relevant securities”. Based on this provision, HKSCC’s certification of HKSCC Participant’s SSE Securities holdings should be recognized by ChinaClear and the CSRC. HKSCC will follow up with ChinaClear and CSRC to confirm this understanding. HKSCC will also follow up with the Mainland authorities to confirm their understanding where the HKSCC Participant in turn holds SSE Securities for the beneficial owner (e.g. UCITS), and the HKSCC Participant has issued certification of the beneficial owner’s holding in the relevant SSE Securities.

7. Will the SSE Securities acquired by Hong Kong and overseas investors through Shanghai-Hong Kong Stock Connect be held on a segregated basis? To what extent are securities held at HKSCC and different levels segregated from the assets of HKSCC and the relevant intermediaries under the Hong Kong regulatory framework?

After the clearance and settlement of a buy transaction on SSE Securities through the Northbound Trading Link, the SSE Securities are held via book entry at different levels as follows:

- (i) **At the ChinaClear level** – In the books and records of ChinaClear, SSE Securities are held in an omnibus stock account in the name of HKSCC and all the shares in this account are held by HKSCC as nominee for HKSCC Participants and their underlying clients. The HKSCC account is separate from the accounts of the other clearing participants of ChinaClear, hence, the SSE Securities are segregated from the assets of other clearing participants of ChinaClear and ChinaClear itself. According to *Article 13 of CSRC’s Several Provisions on the Pilot Programme of Shanghai-Hong Kong Stock Market Connect*, investors are entitled in accordance with the law to the rights and interests in respect of shares purchased through Shanghai-Hong Kong Stock Connect. Furthermore, in the insolvency of ChinaClear, the SSE Securities recorded in HKSCC’s omnibus account will not form part of the assets of ChinaClear and will not be available for distribution to creditors of ChinaClear.
- (ii) **At the HKSCC level** – As all the SSE Securities recorded in HKSCC’s omnibus account with ChinaClear are held by HKSCC as nominee, in the books and records of HKSCC, the full amount of such SSE Securities are allocated to, and

recorded as separate holdings of, the HKSCC Participants that have acquired the relevant number of SSE Securities (as reflected in the clearing and settlement records of HKSCC as the participating CCP under the CSD and Clearing Link Agreement and in accordance with its rules and operational procedures).

HKSCC Participants' holdings in SSE Securities are recorded in their respective stock accounts in the Central Clearing and Settlement System (CCASS) of HKSCC. Each HKSCC Participant's account is separate from the other participants' accounts and the securities held in them are segregated from those held for other participants and from HKSCC's own assets. Proper system processes and operational procedures have been established to ensure the timely and daily reconciliation of HKSCC Participants' holdings of SSE Securities in CCASS with those of HKSCC in ChinaClear.

To enable HKSCC Participants to separately identify and handle their proprietary and clients' securities holdings in CCASS, HKSCC provides multiple stock segregated accounts to HKSCC Participants for holding client securities. HKSCC Participants can, therefore, hold clients' securities in CCASS on an omnibus basis, or if they so wish, through individual stock segregated accounts provided by CCASS. Accordingly, it is possible for HKSCC Participants to segregate each UCITS holdings in SSE Securities through individual stock segregated accounts at the HKSCC level.

As provided for in the rules and operational procedures of HKSCC, SSE Securities are held by HKSCC for the account of its participants. HKSCC does not have a proprietary interest in the securities. Accordingly, as set out in HKSCC's FAQs for Investors (Q55), upon the insolvency of HKSCC, the SSE Securities held by it as nominee will not be regarded as the general assets of HKSCC under Hong Kong and Mainland China law and will not be available to the general creditors of HKSCC. Further, based on the SFC's and Hong Kong Monetary Authority's proposals on establishing an effective resolution regime for financial institutions in Hong Kong, HKSCC, as a financial market infrastructure, will be included in the proposed resolution regime for the protection of HKSCC Participants, investors and other stakeholders. Therefore, should HKSCC become insolvent, it is expected that the interests of participants and the underlying investors will be safeguarded by the relevant regulations upon their becoming effective.

HKSCC is satisfied that the above structure meets the relevant segregation requirements under the PFMI Principles and the sub-account provision referred to in *Article 24 of ChinaClear's Administrative Rules on Securities Accounts* published in August 2014).¹⁸

¹⁸ Article 24: Agencies that are designated by others to hold securities for others in compliance with laws, administrative regulations and relevant provisions of the securities regulatory authorities under the State Council may apply for the opening of securities accounts as a nominee. A nominee shall open subsidiary accounts for each of its securities beneficiary or subordinated nominee (i.e. the next level of nominee). A nominee may ask CSDC to open subsidiary accounts for the securities beneficiaries or subordinated nominees (i.e. the next level of nominee) under its name. A nominee shall comply with, and urge the securities beneficiaries or subordinated nominees under its name to comply with the provisions of laws, administrative regulations, the securities regulatory authorities under the State Council, the securities exchange and CSDC in relation to information disclosure, collection, voting, and others. To perform its

- (iii) **At the HKSCC Participant level** – In the books and records of each HKSCC Participant, the SSE Securities are held for their clients including UCITS. Under Hong Kong law, securities held by intermediaries for clients are held on trust on a fiduciary basis and do not normally form part of the assets of the intermediaries. Also, each client is entitled to agree with its/their intermediaries on how the SSE Securities should be held or segregated from the intermediary's or its other clients' assets.

Separately, the SFO sets out various requirements for the recording of client trades and the safeguarding of client positions and funds by all licensed corporations and registered institutions, including HKSCC Participants (i.e. brokers and banks). For example, under section 3 of the Securities and Futures (Keeping of Records) Rules, a licensed corporation or registered institution is required, among others, to keep, where applicable, such accounting, trading and other records as are sufficient to account for all client assets that it receives or holds, and enable all movements of such client assets to be traced through its accounting systems and stock holding systems; and under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, a licensed corporation or registered institution should keep separate accounts for each client for dealings in securities. Compliance with these requirements is assessed as part of the routine market intermediaries' supervision programme conducted by the SFC.

Hong Kong Exchanges and Clearing Limited

December 2014

duties by law, CSDC has the right to require a nominee to provide information relating the securities or subsidiary accounts held by any securities beneficiary or subordinated nominee under its name, as well as the information relating to any change in the holding. (第二十四条 符合法律、行政法规和国务院证券监督管理机构有关规定，受他人指定并代表他人持有证券的机构，可以申请开立名义持有人证券账户。名义持有人应当分别为每个证券实际权益拥有人或其次一级名义持有人开立明细账户，名义持有人可以委托本公司为其名下的证券实际权益拥有人或次一级名义持有人开立明细账户。名义持有人应当遵守并督促其名下证券实际权益拥有人、次一级名义持有人遵守法律、行政法规、国务院证券监督管理机构、证券交易场所及本公司关于信息披露、征集投票等相关规定。本公司为依法履行职责，有权要求名义持有人提供其名下证券实际权益拥有人、次一级名义持有人、明细账户证券持有及变动情况等有关信息。)