

## **Shanghai-Hong Kong Stock Connect**

### **FAQ on Latest Progress (26 September 2014)**

#### ***Margin Trading/Stock Borrowing and Lending/Covered Short Selling***

**1. Is margin trading allowed for SSE Securities? (EP-CP FAQ 1.16)**

Subject to conditions, margin trading in SSE Securities may be conducted. Hong Kong and overseas investors cannot participate in the Margin Trading and Securities Lending (融資融券) Programme of SSE via the Shanghai-Hong Kong Stock Connect. However, based on requirements set by SSE, margin trading via the Shanghai-Hong Kong Stock Connect may be conducted within certain parameters to be included in the Rules of the SEHK in due course.

Currently, Mainland investors can only conduct margin trading in certain A shares that the SSE has determined are eligible for margin trading and stock borrowing and lending. Hong Kong and overseas investors conducting margin trading in SSE Securities via the Shanghai-Hong Kong Stock Connect will be subject to a similar restriction. An Eligible SSE Securities List for Margin Trading, the scope of which will be determined by SSE from time to time, will be posted on the HKEx website for reference by the investing public.

According to the relevant rules of SSE, SSE may suspend margin trading activities in specific A shares when the volume of margin trading activities in such A shares exceeds the threshold determined by SSE and resume margin trading activities when the volume drops below a prescribed threshold. When SEHK is notified by SSE that such suspension and resumption involves an SSE Security on the Eligible SSE Securities List for Margin Trading, EPs and investors will be informed through the HKEx website. Margin trading in the relevant SSE Security should be suspended/resumed in Hong Kong accordingly.

**2. Is Stock Borrowing and Lending (SBL) allowed for SSE Securities? (EP-CP FAQ 1.17)**

SBL of SSE Securities will be allowed in the following situations:

- (a) for covered short selling: an investor borrows SSE Securities and sells it on SSE through an EP via Northbound trading; and
- (b) for meeting the pre-trade checking requirement in certain circumstances (such as where an EP's client has been unable to effect a transfer of shares to the EP's clearing account in time to meet the pre-trade checking requirement).

SBL in SSE Securities will be subject to restrictions set by SSE to be incorporated into the Rules of SEHK. These include:

- (a) SBL agreements for covered short selling purpose cannot be longer than one month;
- (b) SBL agreements for pre-trade checking purpose cannot be longer than one day (roll-over not allowed);
- (c) Stock lending will be restricted to certain types of persons to be determined by SSE; and
- (d) SBL activities will be required to be reported to SEHK.

Further details on the requirements relating to SBL will be published in due course.

**3. Is covered short selling of SSE Securities allowed through Northbound trading? (EP-CP FAQ 1.18)**

Covered short selling of SSE Securities through Northbound trading will be allowed subject to a number of requirements set by SSE. These include requirements on:

- (a) the eligibility of SSE Securities that can be short sold;
- (b) flagging of short selling orders by EPs when inputting them into the system;
- (c) the input price of a short selling order must not be lower than the last traded price (and in the absence of the last traded price, the previous closing price), of the relevant SSE Security;
- (d) in respect of each SSE Security, restrictions will be imposed on (i) the total quantity that can be short sold on each trading day, and (ii) for a rolling period;
- (e) reporting of open short positions; and
- (f) according to the relevant rules of SSE, SSE may suspend short selling activities in specific A shares when the volume of short selling activities in such A shares exceeds the threshold determined by SSE and resume short selling activities when the volume drops below a prescribed threshold. When SEHK is notified by SSE that such suspension and resumption involves an SSE Security on the Eligible SSE Securities List for Short Selling, EPs and investors will be informed through the HKEx website, and short selling in the relevant SSE Security should be suspended/resumed in Hong Kong accordingly.

Further details on the above will be published in due course.

Implementation of some of the requirements described above needs system support. Therefore, covered short selling of SSE Securities will unlikely be available at the initial launch of Shanghai-Hong Kong Stock Connect. SEHK will keep the market informed of developments and proposed timing of implementation.

*Non-trade Transfer*

**4. Can SSE Securities be transferred off-exchange? (Updated as of 26 September 2014) (EP-CP FAQ 1.19)**

As stipulated in Article 11 of the CSRC Stock Connect Rules, transfers of SSE Securities should only be conducted on SSE and off-exchange trading is not allowed unless otherwise permitted. To facilitate market players in conducting Northbound trading and the normal course of business operation, the following types of off-exchange or “non-trade” transfer of SSE Securities are allowed (Article 29 of the SSE Stock Connect Pilot Provisions):

- (a) SBL for covered short selling purpose (not more than one month duration);
- (b) SBL for the purpose of satisfying the pre-trade checking requirement (one-day duration which cannot be rolled over);
- (c) transfers between EPs and their clients for the purpose of rectifying error trades;
- (d) post-trade allocation of shares to different funds/sub-funds by fund managers; and
- (e) other situations specified by SSE and ChinaClear.

With respect to (a) and (b), details are set out in Q1.17.

With respect to (c), EPs who perform non-trade transfers of SSE Securities to rectify error trades will be required to submit to SEHK an error trade report together with supporting documents explaining the error made and providing details of the non-trade transfer. SEHK has the power to disallow a particular EP to conduct further non-trade transfers for error trade rectification if SEHK believes that the EP has abused such rectification arrangements. SEHK may provide error trade reports and related information to the SFC and SSE. EPs are cautioned not to misuse this arrangement to effect off-exchange trades or transfers which are otherwise disallowed under the relevant Mainland regulation.

With respect to (e), ChinaClear has stipulated in Article 9 of the ChinaClear Implementing Rules for Registration, Depository and Clearing Services under the Shanghai-Hong Kong Stock Connect Pilot Program that non-trade transfers are allowed in the following situations:

- succession;
- divorce;
- the dissolution, liquidation or winding-up of any company or corporation;
- donation to a charitable foundation;
- assisting in any enforcement in connection with proceedings or action taken by any court, prosecutor or law enforcement agency; and
- any other transfer as may be permitted by SSE.

HKSCC is discussing with ChinaClear and the relevant authorities how to facilitate stamp duty collection (if required) from investors for these non-trade transfers in SSE Securities. Further details will be published on the HKEx website in due course.

### *Dynamic Price Checking*

**5. Are there any measures in place to prevent quota hogging? (EP-CP FAQ 1.12)**

Since the announcement of Shanghai-Hong Kong Stock Connect, SEHK has received market feedback concerning the possibility of mischievous behavior towards the use of the Northbound quota, which may affect the proper running of the programme. In light of this, SEHK will put in place a dynamic price checking for buy orders.

Buy orders with input prices lower than the current best bid (or last traded price in the absence of current best bid, or previous closing price in the absence of both current best bid and last traded price) beyond a prescribed percentage will be rejected by CSC. During Opening Call Auction, the current bid (or previous closing price in the absence of the current bid) will be used for checking. Dynamic price checking will be applied throughout the trading day, from the 5-minute input period before the start of Opening Call Auction until the end of the afternoon Continuous Auction. SEHK intends to set the dynamic price checking at 3% during the initial phase of Shanghai-Hong Kong Stock Connect. The percentage may be adjusted from time to time subject to market conditions.

### *A shares Ownership*

**6. In what capacity does HKSCC hold the SSE Securities acquired by Hong Kong and overseas investors through Shanghai-Hong Kong Stock Connect? (EP-CP FAQ 2.32)**

Hong Kong Securities Clearing Company Limited (“HKSCC”) is the “nominee holder” (名義持有人) of the SSE Securities acquired by Hong Kong and overseas investors through Shanghai-Hong Kong Stock Connect<sup>1</sup>.

**7. Is such concept of “nominee holder” recognised under the laws and regulations of Mainland China? If so, what is the function of a “nominee holder”? (EP-CP FAQ 2.33)**

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<sup>1</sup>See, article 7, *Several Provisions on the Pilot Program of Shanghai-Hong Kong Stock Market Connect, the “CSRC Stock Connect Rules”* 《滬港股票市場交易互聯互通機制試點若干規定》; article 118, *Shanghai Stock Exchange Shanghai-Hong Kong Stock Connect Pilot Programme Provisions, the “SSE Stock Connect Pilot Provisions”* 《上海證券交易所滬港通試點辦法》; and article 6, *ChinaClear’s Implementing Rules for Registration, Depository and Clearing Services under the Shanghai-Hong Kong Stock Connect Pilot Programme, the “ChinaClear Stock Connect Implementing Rules”* 中國證券登記結算有限責任公司《滬港股票市場交易互聯互通機制試點登記、存管、結算業務實施細則》.

The CSRC Stock Connect Rules, as departmental regulations having legal effect in Mainland China, expressly provide for the concept of a “nominee holder”. As mentioned in the response to Question 2.32, the concept is also expressly used in the SSE Stock Connect Pilot Provisions and the ChinaClear Stock Connect Implementing Rules. There are also other laws and regulations in Mainland China which provide that securities can be registered in an account opened in the name of such “nominee holder”<sup>2</sup>. The reference to “nominee holder” in the Settlement Measures expressly recognises the concept of a “beneficial owner” of securities (證券權益擁有人). In addition, pursuant to the Settlement Measures, a nominee holder (being HKSCC in relation to the SSE Securities) is the person who holds securities on behalf of others (being Hong Kong and overseas investors in relation to the SSE Securities)<sup>3</sup>. The rights and obligations of HKSCC as the nominee holder in relation to the SSE Securities acquired by Hong Kong and overseas investors are set out in the amended CCASS Rules and CCASS Operational Procedures (amendments approved by the SFC pending announcement of effective date). Similar to existing provisions on other securities, it is made clear that HKSCC has no proprietary interest in SSE Securities and as a nominee, HKSCC will be responsible for collecting and distributing dividends to its participants (for their own account and/or as agent for their investors), obtaining and consolidating voting instructions from its participants and submitting a combined single voting instruction to the issuer of the relevant SSE Securities<sup>4</sup>.

**8. Who are the beneficial owners of the SSE Securities? (EP-CP FAQ 2.34)**

While HKSCC is the “nominee holder”, it holds the SSE Securities on behalf of Hong Kong and overseas investors who are the beneficial owners of the SSE Securities. The CSRC Stock Connect Rules expressly provide that investors enjoy the rights and benefits of the SSE Securities acquired through Shanghai-Hong Kong Stock Connect<sup>5</sup> in accordance with applicable laws. Therefore, based on such provision, it is the Hong Kong and overseas investors as the ultimate investors (rather than any broker, custodian or intermediary through whom such investors hold the SSE Securities) who should be recognised under the laws and regulations of Mainland China as having beneficial ownership in the SSE Securities. Any broker or intermediary holding SSE Securities for its own account will also be regarded as an investor having beneficial ownership in such SSE Securities.

**9. Being the beneficial owner of the SSE Securities, can a Hong Kong or overseas investor exercise shareholder rights in Mainland China against the issuer of such SSE Securities? (EP-CP FAQ 2.35)**

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<sup>2</sup> Article 18, the Administrative Measures for Registration and Settlement of Securities, the “Settlement Measures” 《證券登記結算管理辦法》.

<sup>3</sup> Article 78, Settlement Measures.

<sup>4</sup> New Rule 824 of the CCASS Rules and Section 8 of the CCASS Operational Procedures, and article 118, the SSE Stock Connect Pilot Provisions.

<sup>5</sup> Article 13, CSRC Stock Connect Rules.

According to the “nominee holder” arrangement, the beneficial owners of the SSE Securities shall exercise their rights in relation to such securities through the nominee holder<sup>6</sup>. The securities account for the SSE Securities acquired by Hong Kong and overseas investors through Shanghai-Hong Kong Stock Connect will be opened in the name of HKSCC as nominee holder with China Securities Depository and Clearing Corporation Limited<sup>7</sup>. Accordingly, Hong Kong and overseas investors are to exercise shareholder rights in relation to the SSE Securities through HKSCC in accordance with the CCASS Rules and CCASS Operational Procedures including receiving dividends through, and giving voting instructions to, HKSCC<sup>8</sup>.

However, it should be noted that, under the CCASS Rules, HKSCC as nominee holder shall have no obligation to take any legal action or court proceeding to enforce any rights on behalf of the investors in respect of the SSE Securities in Mainland China or elsewhere. HKSCC as nominee holder will, upon the request of a participant holding SSE Securities through HKSCC, provide certification of the participant’s holdings of SSE Securities in CCASS.

**10. Who is obligated to make any disclosure in respect of SSE Securities acquired by Hong Kong and overseas investors? (EP-CP FAQ 2.36)**

Pursuant to the laws and regulations of Mainland China, when trading in securities through Shanghai-Hong Kong Stock Connect, Hong Kong investors shall comply with their reporting and disclosure obligations in accordance with applicable laws upon their triggering any relevant disclosure requirements (“Hong Kong investors” here refers to the investors who trade securities through Shanghai-Hong Kong Stock Connect, including both the local investors in Hong Kong and other overseas investors)<sup>9</sup>. Disclosure responsibilities are borne by the person who has “actual control over voting rights of the securities”<sup>10</sup>. Furthermore, this test may be satisfied by considering the single holding of an investor or by aggregating the holding of other parties “acting in concert” with such investor<sup>11</sup>. Accordingly, Hong Kong and overseas investors who will have “actual control over voting rights of the securities” (either individually or acting in concert with others) are responsible for complying with disclosure obligations under the laws and regulations of Mainland China in relation to SSE Securities acquired through Shanghai-Hong Kong Stock Connect.

Broadly speaking, a disclosure is required to be made within 3 days when such holding reaches 5% of the issued shares of an SSE-listed issuer. Thereafter, every increase or decrease in such holding by 5% will also trigger a disclosure to be made within 3 days. Please refer to Q1.45 of EP-CP

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<sup>6</sup> Article 5, *China Securities Depository and Clearing Corporation Limited Securities Registration Rules* 《中國證券登記結算有限責任公司證券登記規則》.

<sup>7</sup> Article 7, *CSRC Stock Connect Rules*.

<sup>8</sup> Article 118, *the SSE Stock Connect Pilot Provisions*.

<sup>9</sup> Article 13, *CSRC Stock Connect Rules*.

<sup>10</sup> Article 12, *the Administrative Measures for Acquisition of Listed Companies* 《上市公司收购管理办法》.

<sup>11</sup> Art. 86, *PRC Securities Law* 《中华人民共和国证券法》.

FAQ for further discussion in relation to disclosure obligations under the laws and regulations of Mainland China.

The disclosure obligation in respect of changes to the interest in SSE Securities does not apply to HKSCC in its capacity as the nominee holder of SSE Securities holding on behalf of Hong Kong and overseas investors<sup>12</sup>.

**11. On the insolvency of HKSCC, will SSE Securities acquired by Hong Kong and overseas investors be regarded as general assets of HKSCC and therefore distributed to HKSCC's creditors? (EP-CP FAQ 2.37)**

As discussed in the response to Question 2.34, HKSCC is only the nominee holder of SSE Securities acquired by Hong Kong and overseas investors, and is not the beneficial owner of such securities. Accordingly, such SSE Securities 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 on its insolvency. Furthermore, as a company incorporated in Hong Kong, any bankruptcy proceedings against HKSCC will be initiated in Hong Kong and any claims against HKSCC will be determined as a matter of Hong Kong law. In that event, ChinaClear and the People's courts will recognize the liquidator of HKSCC, which has been duly appointed pursuant to Hong Kong law, as the rightful entity having the power to deal with SSE Securities in the place of HKSCC.

***Rights Subscription***

**12. Can Hong Kong and overseas investors participate in rights issue / open offer subscription of SSE-listed companies through CCASS Participants? What is the subscription period and subscription instruction input time for rights issue/ open offer in CCASS? (EP-CP FAQ 2.31)**

Yes. Normally, the subscription period for rights issue of SSE-listed companies will be around one week, but it may be as short as one business day only. CCASS Participants may submit instructions via CCASS' existing subscription functions immediately after the second CNS BSR at around 6:00 p.m. to 7:00 p.m. during the subscription period. No excess application will be available in general. HKSCC will debit the rights/ open offer entitlements in respect of which subscription have been made from the relevant stock accounts of the CCASS Participants and the subscription monies on the instruction input day. CCASS Participants may be required to submit written instructions together with proof of payment (in good fund) to HKSCC for cases where the subscription period is as short as one business day.

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<sup>12</sup> Article 115, SSE Stock Connect Pilot Provisions.