



Q&A from Matthews Asia

April 2014

Establishment of Mutual Market Access Between China and Hong Kong Stock Markets

In a recent landmark announcement by the securities regulators in China and Hong Kong, approval has been given for the establishment of a mutual market access scheme between the stock markets of Shanghai and Hong Kong.

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What is the mutual market access scheme?

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In the recent announcement, the China Securities Regulatory Commission (CSRC) and Hong Kong's Securities and Futures Commission (SFC) have approved, in principle, the development of a pilot program called the "Shanghai-Hong Kong Stock Connect" that will be used to establish mutual stock market access between mainland China and Hong Kong.

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What will this pilot program enable investors to do?

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This program provides an opportunity for Hong Kong and mainland Chinese investors to access each other's equity markets—the Hong Kong and Shanghai stock markets.

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How will this program work in practice?

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The program calls for the creation of a Northbound Trading Link for Hong Kong investors and a Southbound Trading Link for mainland Chinese investors.

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What will the Southbound Trading Link provide investors in mainland China?

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The Southbound Trading Link will provide investors in mainland China with access to all the constituents of the Hang Seng Composite LargeCap Index, the Hang Seng Composite MidCap Index and shares of companies listed on both the Shanghai and Hong Kong stock exchanges.

Q

What will the Northbound Trading Link provide investors in Hong Kong?

A

The Northbound Trading Link will provide investors in Hong Kong with access to all the constituents of the SSE 180 Index and SSE 380 Index, and shares of all SSE-listed companies which have issued both A shares and H shares.

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Will investors be able to gain access to stocks outside of these indexes?

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No. While the list of constituents may be adjusted following the launch of the pilot program, investors will not be able to access stocks outside of these proposed indexes.

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Will there be any restrictions placed on these markets?

A

Yes. While the intention is to provide investors in Hong Kong and mainland China with access to these markets, there will be an overall restriction placed in the form of a cross-border investment quota and daily limits. The Northbound Trading Link will be limited to an aggregate quota of RMB300 billion (US\$48.4 billion) and a daily quota of RMB13 billion (US\$2.1 billion), and the Southbound Trading Link will be limited to an aggregate quota of RMB250 billion (US\$40.3 billion) and a daily quota of RMB10.5 billion (US\$1.7 billion). The two regulators will establish new securities trading companies in order to monitor and control daily investment flows. Additionally, the regulators have stated that these quotas may be adjusted in the future.



Q Who will be eligible for the Shanghai-Hong Kong Stock Connect program?

A The Northbound Trading Link will be open to all Hong Kong and overseas investors including institutional and individual investors. With regards to the Southbound Trading Link, the SFC will require mainland investors to be limited to institutional investors and individual investors who hold an aggregate balance of not less than RMB500,000 (US\$80,645) in their securities and cash accounts.

Q When will this pilot program begin?

A The regulators are currently drafting further details of the scheme. It is expected to commence in approximately six months.

Q What does this mean for the development of China's equity markets?

A This represents a landmark agreement between the Hong Kong and Chinese securities regulators. At Matthew Asia, we also view this as an important milestone in the development of fully open capital markets in China. We also see this as a further move to establish Shanghai as a financial center in mainland China. We also believe the quality of investor in China will also improve, with more institutional and sophisticated investors coming into the market.

We believe the approach taken is consistent with other important policy announcements made by the Chinese government in so far as they typically take a step-by-step approach. We, therefore, anticipate this to represent the first step along the path to a further opening of the capital markets in mainland China, such as the Shanghai A-share market. In addition, we view this announcement as an opportunity to further internationalize the renminbi, China's currency.

Q Is this scheme different to the current cross-border investment schemes?

A Yes. Currently only international institutions can buy Chinese stocks or bonds through schemes called the Qualified Foreign Institutional Investor (QFII) program and the Renminbi Qualified Foreign Institutional Investor (RQFII) program. In addition, mainland Chinese investors can invest in foreign stocks and bonds through the Qualified Domestic Institutional Investor program (QDII). However, these programs are focused on institutional investment and both foreign and Chinese companies must receive a specific licenses to participate.

While there are likely to be further details of the Shanghai-Hong Kong Stock Connect program released in due course, the Northbound Trading Link will be open to all Hong Kong and overseas investors including institutional and individual investors. With regards to the Southbound Trading Link, the SFC will require mainland investors to be limited to institutional investors and individual investors who hold an aggregate balance of not less than RMB500,000 (US\$80,645) in their securities and cash accounts.

Q How do you see the announcement impacting Matthews Asia?

A The specific details of the pilot program are still under discussion by the two regulators and we continue to monitor developments as and when they are announced.

We expect the initial impact of this pilot program will be a narrowing in the valuation gaps between dual-listed "A" and "H" share companies now that investors will have access to both markets. Also, high-quality companies that are only listed in Hong Kong may benefit from mainland Chinese investors seeking to invest in Hong Kong. We view this cross-border scheme positively as it further opens up a significant Chinese equity universe to potential investors, and more importantly, it is a step forward towards the government's long-term goal of capital market liberalization.

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