

## **Press Release**

### **LCQ16: Shanghai-Hong Kong Stock Connect**

Wednesday, December 10, 2014

Following is a question by the Hon Sin Chung-kai and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (December 10):

Question:

Under the Shanghai-Hong Kong Stock Connect (S-HK SC) implemented since the 17th of last month, Hong Kong and mainland investors may engage in cross-boundary trading of stocks of designated types of companies listed on the Shanghai Stock Exchange and the Stock Exchange of Hong Kong respectively. S-HK SC involves cross-boundary trading, but there are differences between Hong Kong and the Mainland in terms of the regimes, the legal systems and the law enforcement approaches, etc., for regulation of securities markets. In this connection, will the Government inform this Council:

(1) whether it has plans to assist the mainland authorities in further enhancing the regulation of matters relating to disclosure of information by companies listed on the Mainland; if so, of the details; if not, the reasons for that;

(2) whether the existing legislation of the two places has empowered the regulatory authorities concerned to take law enforcement actions against cross-boundary illegal activities/irregularities in relation to stock trading (e.g. insider dealings); if so, of the details; if not, when the authorities will amend the legislation concerned;

(3) how the regulatory authorities of the two places will cooperate in taking law enforcement actions to combat cross-boundary illegal activities/irregularities in relation to stock trading (e.g. insider dealings); how the authorities decide whether the laws of Hong Kong or those of the Mainland should be applicable;

(4) given that at the meeting of the Panel on Financial Affairs of this Council held in June this year, the representative of the Securities and Futures Commission advised that the relevant authorities of the two places were studying the issue of whether the involvement of Hong Kong investors in

market misconduct (e.g. market manipulations and insider dealings) in trading Shanghai stocks under S-HK SC would constitute a breach of the laws of Hong Kong, whether it knows the outcome of the study; if the study outcome is in the affirmative, of the details; if the study outcome is in the negative, the justifications for that;

(5) whether any mechanism is currently in place under which compensation may be claimed by investors of the two places who have engaged in cross-boundary stock trading and suffered financial losses because of the defaults of licensed intermediaries or authorised financial institutions; if so, of the details; if not, whether the authorities will review and amend the relevant legislation, so as to protect the lawful interests of cross-boundary investors;

(6) whether it has assessed if the nominee and trust arrangements under S-HK SC meet the requirements set by relevant international regulatory authorities (e.g. Luxembourg's Commission de Surveillance du Secteur Financier) on the safe custody of assets managed by mutual funds for retail investors; if the assessment outcome is in the affirmative, of the details; if the assessment outcome is in the negative, the reasons for that; and

(7) whether it has assessed the circumstances under which cross-boundary stock trading under S-HK SC will be suspended, and whether such circumstances include situations where the trading and clearing systems are under attack or there is error trade due to system errors; if it has, of the criteria for deciding to suspend trading; if not, the reasons for that?

Reply:

President,

(1) Hong Kong listed companies have to comply with the listing rules of the Stock Exchange of Hong Kong (SEHK). Similar to Hong Kong listed companies, companies listed on the Shanghai Stock Exchange (SSE) are required to disclose all material information that is likely to have a significant impact on their share prices under the SSE rules. Further, in light of the Shanghai-Hong Kong Stock Connect (Stock Connect), the SEHK and the SSE have agreed to require simultaneous trading suspension of companies with A and H shares listed in the two markets if the company has any unpublished

inside or material information or where there is a false market concern.

The SSE has also published a notice to require SSE listed companies to improve their information disclosure and communication with investors after the launch of Stock Connect. This includes requirements for listed companies to (i) disseminate material information to Mainland and non-Mainland investors at the same time on an equitable basis; (ii) monitor media news relating to them in the Mainland and elsewhere and ensure that their disclosures are timely, true, accurate, complete, and fair; and (iii) establish investors' communication policy with due regard to the specific circumstances of investors outside the Mainland.

(2) In terms of the existing legal framework dealing with cross-boundary misconduct, sections 186 and 378 of the Securities and Futures Ordinance (SFO) empower the Securities and Futures Commission (SFC) to provide investigatory assistance to and share information with securities regulators outside Hong Kong (including the China Securities Regulatory Commission (CSRC)). In fact, the SFC and the CSRC have a good enforcement co-operation relationship for more than 10 years.

To further strengthen the existing cooperation framework for the purposes of Stock Connect, the SFC and the CSRC on October 17, 2014 entered into a Memorandum of Understanding (MoU) on strengthening cross-boundary regulatory and enforcement co-operation.

(3) The MOU provides that the SFC and the CSRC will:

- \* provide for the sharing of information and data of risks and alerts about potential or suspected wrongdoing in either the Hong Kong or Shanghai stock market under Stock Connect;
- \* establish a commitment and a process for joint investigations;
- \* ensure complementary enforcement action can be taken where there is wrongdoing in both jurisdictions; and
- \* make sure enforcement actions in both jurisdictions operate to protect the investing public of both the Mainland and Hong Kong, including actions that

may be necessary to provide financial redress to affected investors.

Whether Mainland laws or Hong Kong laws apply in a particular case will depend on the factual circumstances. For enforcement actions taken by the SFC in Hong Kong, Hong Kong laws will apply, and vice versa.

(4) Sections 274 (false trading) and 295 (offence of false trading) of the SFO cover false trading in securities of any relevant market outside Hong Kong or by means of authorised automated trading services. As such, a Hong Kong investor may commit the aforesaid market misconduct/offence of false trading by manipulating SSE securities through Stock Connect.

For insider dealing in SSE securities, even though the insider dealing provisions under Parts XIII and XIV of the SFO do not expressly cover non-Hong Kong stocks, the fraudulent nature of the insider dealer's conduct may amount to a contravention of section 300 (offence involving fraudulent or deceptive devices, etc) of the SFO.

(5) The SFC and the SEHK have informed the investing public that any Northbound or Southbound trading under Stock Connect will not be covered by Hong Kong's Investor Compensation Fund.

(6) Before the launch of Stock Connect, the SFC and the Hong Kong Exchanges and Clearing Limited (HKEx) discussed various issues with the industry, including the nominee arrangement for securities traded on the SSE. The HKEx issued a set of frequently asked questions (FAQ) to provide information to clarify the issues raised by the industry. In relation to the nominee arrangement, the FAQ explains that (i) the concept of "nominee holder" is recognised under the Mainland laws and regulations; (ii) while the Hong Kong Securities Clearing Company Limited (HKSCC) is the nominee holder of securities traded on the SSE on behalf of Hong Kong and overseas investors, the relevant rules issued by the CSRC provide that the investors enjoy the rights and benefits of the securities; and (iii) Hong Kong and overseas investors can exercise shareholder rights, including receiving dividends and giving voting instructions through the HKSCC. Details of the FAQ are available on HKEx's website.

We understand that the Luxembourg Securities Financial Supervisory

Commission has approved an investment fund registered in Luxembourg to participate in Stock Connect.

(7) The SEHK and the SSE as well as their clearing houses have established contingency measures to deal with various scenarios to minimise disruption to the normal operation of Stock Connect. The scenarios include natural disasters and system problems such as malfunctions of the trading and clearing systems. The contingency measures are intended to maintain the normal operation of Stock Connect as far as possible. However, in an unlikely situation where the markets cannot continue to be operated in a fair, orderly and transparent manner, the exchanges and clearing houses will discuss with the regulatory authorities to consider whether corresponding actions are required, including temporary suspension of Stock Connect. Specific details can be found in relevant rules of the HKEx and the HKSCC and the circulars issued to participants at the time.

Ends