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Development and Enhancement of Stock Connect Between the Mainland and Hong Kong

By Sandra Lu and Lily Luo

Since 30 September 2016, the People's Bank of China, China Securities Regulatory Commission, Shanghai Stock Exchange, Shenzhen Stock Exchange and China Securities Depository and Clearing Corporation Limited have issued principle regulations and relevant rules with respect to mutual stock market access between the Mainland and Hong Kong ("**Stock Connect**") respectively. The pilot program of mutual stock market access between Shanghai and Hong Kong ("**Shanghai-Hong Kong Stock Connect**") has been implemented for over two years. Based on thorough cooperation among regulators, stock exchanges and depositary and clearing companies in each market, the trading under mutual stock market access between Shenzhen and Hong Kong ("**Shenzhen-Hong Kong Stock Connect**") commenced on 5 December 2016. Through the comparison between Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, the analysis of optimization of Stock Connect, the overview of updates for Shanghai-Hong Kong Stock Connect as well as the in-depth discussion on principle arrangements for Shenzhen-Hong Kong Stock Connect, this Article aims to illustrate the development and enhancement of Stock Connect.

Up till now, principle policies and rules applicable to Stock Connect comprise:

Joint Announcements

- On 10 April 2014, Joint Announcement of China Securities Regulatory Commission and Hong Kong Securities and Futures Commission in respect of Shanghai-Hong Kong Stock Connect ("**Joint Announcement on Shanghai-Hong Kong Stock Connect**")

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- On 16 August 2016, Joint Announcement of China Securities Regulatory Commission and Hong Kong Securities and Futures Commission in respect of Shenzhen-Hong Kong Stock Connect ("**Joint Announcement on Shenzhen-Hong Kong Stock Connect**")

- On 25 November 2016, Joint Announcement of China Securities Regulatory Commission and Hong Kong Securities and Futures Commission in respect of the launch of Shenzhen-Hong Kong Stock Connect ("**Joint Announcement on Launch of Shenzhen-Hong Kong Stock Connect**")

The People's Bank of China

- *Notice on Certain Issues Regarding Stock Connect Between the Mainland and Hong Kong by the People's Bank of China and China Securities Regulatory Commission* (《中国人民银行 中国证券监督管理委员会关于内地与香港股票市场交易互联互通机制有关问题的通知》)

China Securities Regulatory Commission ("CSRC")

- *Certain Provisions on Stock Connect Between the Mainland and Hong Kong Stock Markets* (《内地与香港股票市场交易互联互通机制若干规定》, "**Provisions on Stock Connect**")

- *Q&A Regarding Certain Provisions on Stock Connect Between the Mainland and Hong Kong Stock Markets* (中国证监会就《内地与香港股票市场交易互联互通机制若干规定》相关事宜答记者问, "**CSRC's Q&A**")

- *Guidance on Participating in the Stock Connect Between the Mainland and Hong Kong Stock Markets by Securities and Fund Management Institutions* (《证券基金经营机构参与内地与香港股票市场交易互联互通指引》)

- *Provisions on the Recordation of the Placement of Shares to Existing Mainland Shareholders by Hong Kong-Listed Companies under the Southbound Trading Links* (《关于港股通下香港上市公司向境内原股东配售股份的备案规定》)

Ministry of Finance, State Administration of Taxation and CSRC

- *Notice on Relevant Taxation Policies Concerning the Pilot Program of Mutual Stock Market Access Between Shanghai and Hong Kong* (《关于沪港股票市场交易互联互通机制试点有关税收政策的通知》)

- *Notice on Relevant Taxation Policies Concerning the Pilot Program of Mutual Stock Market Access Between Shenzhen and Hong Kong* (《关于深港股票市场交易互联互通机制试点有关税收政策的通知》)

China Securities Depository and Clearing Corporation Limited ("ChinaClear")

- *Implementation Rules for Registration, Depository and Clearing Services under Stock Connect Between the Mainland and Hong Kong Stock Markets* (《内地与香港股票市场交易互联互通机制登记、存管、结算业务实施细则》, "**ChinaClear's Implementation Rules under Stock Connect**")

- *ChinaClear's Q&A Regarding Implementation Rules for Registration, Depository and Clearing Services under Stock Connect Between the Mainland and Hong Kong Stock Markets* (中国结算就《内地与香港股票市场交易互联互通机制登记、存管、结算业务实施细则》答记者问)

- *Business Guidance on Depository and Clearing Services for the Southbound Hong Kong Trading Link by ChinaClear's Shanghai Branch* (merely applicable to Shanghai-Hong Kong Stock Connect) (《中国结算上海分公司港股通存管结算业务指南》)

- *Business Guidance on Depository and Clearing Services for the Southbound Hong Kong Trading Link by ChinaClear's Shenzhen Branch* (merely applicable to Shenzhen-Hong Kong Stock Connect) (《中国结算深圳分公司港股通存管结算业务指南》)

Shanghai Stock Exchange ("SSE")

- *Trading Rules of Shanghai Stock Exchange* (《上海证券交易所交易规则》)

- *Measures of Shanghai Stock Exchange for the Implementation of Shanghai-Hong Kong Stock Connect Program* (《上海证券交易所沪港通业务实施办法》, "**Measures for Implementation of Shanghai-Hong Kong Stock Connect**")

- *Guidelines on the Management of Investor Suitability for the Southbound Hong Kong Trading Link by Shanghai Stock Exchange* (《上海证券交易所港股通投资者适当性管理指引》)

- *Mandatory Provisions for Client Agreements for the Southbound Hong Kong Trading Link by Shanghai Stock Exchange* (《上海证券交易所港股通委托协议必备条款》)

- *Mandatory Provisions for Risk Disclosure Statements for the Southbound Hong Kong Trading Link by Shanghai Stock Exchange* (《上海证券交易所港股通交易风险揭示书必备条款》)

- *Notice on Enforcing Information Disclosure of Listed Companies in Shanghai Stock Exchange and Other Relevant Issues under Shanghai-Hong Kong Stock Connect* (《关于加强沪港通业务中上海证券交易所上市公司信息披露工作及相关事项的通知》)

- *Detailed Implementation Rules on Online Voting at Shareholders' General Meetings of SSE-Listed Companies* (《上海证券交易所上市公司股东大会网络投票实施细则》)

- *Guidelines on the Implementation of HKSCC Participation in Online Voting of Listed Companies under the Northbound Shanghai Trading Link* (《香港中央结算有限公司参与沪股通上市公司网络投票实施指引》)

Shenzhen Stock Exchange ("SZSE")

- *Trading Rules of Shenzhen Stock Exchange* (《深圳证券交易所交易规则》)

- *Measures of Shenzhen Stock Exchange for the Implementation of Shenzhen-Hong Kong Stock Connect Program* (《深圳证券交易所深港通业务实施办法》, "**Measures for Implementation of Shenzhen-Hong Kong Stock Connect**")

- *Guidelines on the Management of Investor Suitability for the Southbound Hong Kong Trading Link by Shenzhen Stock Exchange* (《深圳证券交易所港股通投资者适当性管理指引》)

- *Mandatory Provisions for Client Agreements for the Southbound Hong Kong Trading Link by Shenzhen Stock Exchange* (《深圳证券交易所港股通委托协议必备条款》)

- *Mandatory Provisions for Risk Disclosure Statements for the Southbound Hong Kong Trading Link by Shenzhen Stock Exchange* (《深圳证券交易所港股通交易风险揭示书必备条款》)

- *Circular on Information Disclosure of Listed Companies and Relevant Issues under Shenzhen-Hong Kong Stock Connect* (《关于深港通业务中上市公司信息披露及相关事项的通知》)

- *Detailed Implementation Rules on Online Voting at Shareholders' General Meetings of SZSE-Listed Companies* (《深圳证券交易所上市公司股东大会网络投票实施细则》)

- *Guidelines on the Implementation of HKSCC Participation in Online Voting of Listed Companies under the Northbound Shenzhen Trading Link* (《香港中央结算有限公司参与深股通上市公司网络投票实施指引》)

I. Major Differences Between Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect

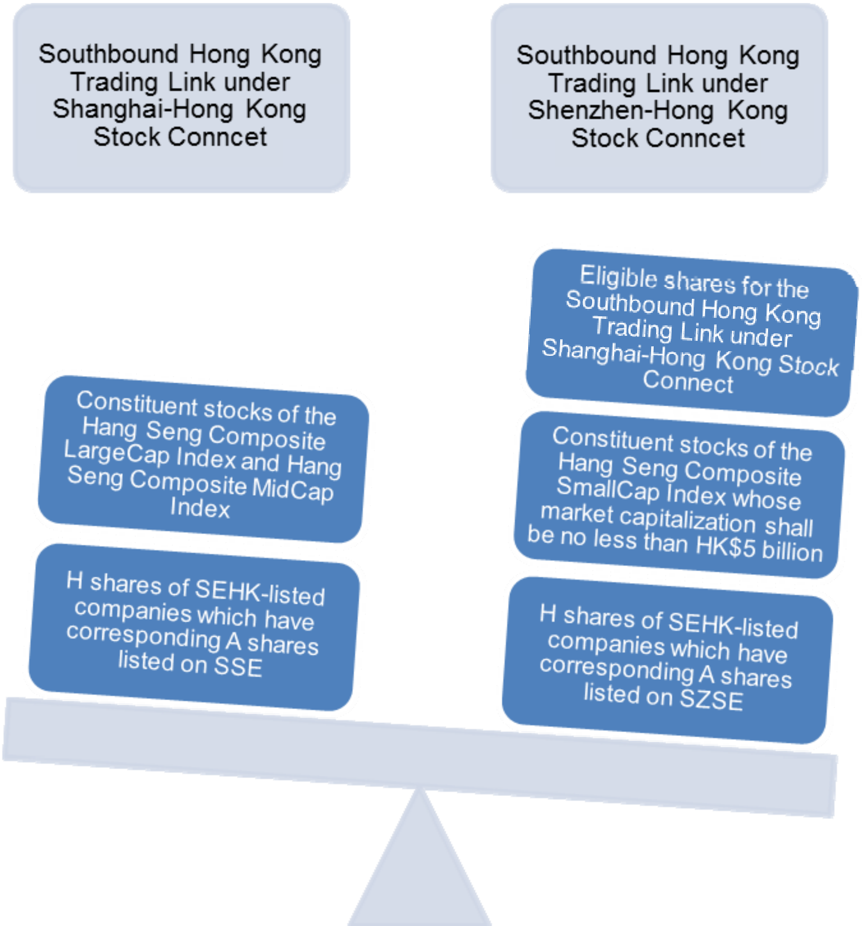
As stated in *Joint Announcement on Shenzhen-Hong Kong Stock Connect*, the principal arrangements for Shenzhen-Hong Kong Stock Connect are designed by reference to those for Shanghai-Hong Kong Stock Connect, following the existing laws and regulations and operational models governing trading and clearing in each market. Nevertheless, differences still exist in terms of the other arrangements, which primarily include the difference of eligible shares and differences resulting from the distinctions between the trading rules of SSE and SZSE per se.

1. Eligible Shares

Under Shenzhen-Hong Kong Stock Connect, eligible shares for the Northbound Shenzhen Trading Link include any constituent stock of the SZSE Component Index and SZSE Small/Mid Cap Innovation Index which has a market capitalization of RMB6 billion or above, and all SZSE-listed shares of companies which have issued both A shares and H shares. It should be noted that at the initial stage of the Northbound Shenzhen Trading Link, investors eligible to trade shares that are listed on the ChiNext Board of SZSE under the Northbound Shenzhen Trading Link will be limited to institutional professional investors as defined in the relevant Hong Kong rules and regulations. Subject to the resolution of related regulatory issues, other investors may subsequently be allowed to trade such shares. The Stock Exchange of Hong Kong Limited ("**SEHK**") has issued the risk disclosure of ChiNext Board of SZSE. As required by SEHK, investors trading shares on the ChiNext Board of SZSE shall read carefully the risk disclosure and refer to the standard Risk Disclosure Statement proposed by Securities Association of China.

In addition to the scope of eligible shares for the Southbound Hong Kong Trading Link under Shanghai-Hong Kong Stock Connect, the Shenzhen-Hong Kong Stock Connect expands to include constituent stocks of the Hang Seng Composite SmallCap Index whose market capitalization shall be no less than HK$5 billion, and all the H shares of companies listed on SEHK which have A shares simultaneously listed on SZSE. Therefore, "SEHK-listed H shares of A+H companies that are dual-listed in the Mainland and Hong Kong" which fall within the scope of eligible shares for the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect refer to (i) all the H shares of SEHK-listed companies which have corresponding A shares listed on SSE, and (ii) all the H shares of SEHK-listed companies which have corresponding A shares listed on SZSE.

As illustrated in the graph below, please see the eligible shares for the Southbound Hong Kong Trading Links under Stock Connect.



2. Differences Resulting from Distinctions Between Trading Rules of SSE and SZSE per se

A. Closing Call Auction Session in SZSE

Pursuant to *Trading Rules of Shenzhen Stock Exchange*, SZSE trading session distinguishes closing call auction sessions from continuous auction sessions. As such, it is specified in the section regarding quota control under the Northbound Shenzhen Trading Link of *Measures for Implementation of Shenzhen-Hong Kong Stock Connect* that where the daily quota is used up during the continuous auction session or closing call auction session, no further buy orders will be accepted by the securities trading service company incorporated in Shenzhen by SEHK, and the acceptance of buy orders will not resume for the remainder of the day. On each trading day in SZSE, 13:00 to 14:57 is the continuous auction session and 14:57 to 15:00 is the closing call auction session. However, 13:00 to 15:00 is the continuous auction session in SSE and no closing call auction session has been set up in SSE. Thus, it is specified in *Measures for Implementation of Shanghai-Hong Kong Stock Connect* that where the daily quota is used up during the continuous auction session, no further buy orders will be accepted by the securities trading service company incorporated in Shanghai by SEHK, and the acceptance of buy orders will not resume for the remainder of the day.

B. Designated Trading in SSE and Transfer of Custody in SZSE

Subject to the provisions of *Trading Rules of Shanghai Stock Exchange*, SSE implements a uniform designated trading system under which an investor who trades securities on SSE must designate a securities company in advance as its agent and participate in trading through the designated agent. To change designation, an investor shall file a cancellation application with the designated agent, who shall submit an instruction of cancellation accordingly. Once the original designated trading is cancelled, another securities company may be designated for re-application for designated trading. Under the rules for the Southbound Hong Kong Trading Link under Shanghai-Hong Kong Stock Connect, a uniform designated trading system is also applicable, and investors are also allowed to change designation. In the case of designation change, investors can execute trading from the next trading day under the Southbound Hong Kong Trading Link. However, where there exists an outstanding business for certain securities accounts, the designated securities company in the Shanghai-Hong Kong Stock Connect shall restrict such cancellation.

Under *Trading Rules of Shenzhen Stock Exchange*, transfer of custody is allowed, that is, investors can purchase securities at different securities brokerage branches of one or more securities companies using one single securities account. Investors may resell securities via the trading unit through which they have purchased such securities. They may also give an instruction to such trading unit for transferring the custody of their securities to another trading unit and, upon completion of the transfer, resell the securities through the new trading unit. Under the rules for the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect, the transfer of custody is also applicable of which relevant issues shall be addressed by reference to *Business Guidance on Depository and Clearing Services for the Southbound Hong Kong Trading Link by ChinaClear's Shenzhen Branch*.

II. Optimization of Stock Connect

Stock Connect basically follows the principle arrangements of Shanghai-Hong Kong Stock Connect, based on which certain optimization and development are made to relevant rules.

Implication of *Joint Announcement on Shenzhen-Hong Kong Stock Connect*

1. There is no aggregate quota for Stock Connect, notwithstanding that the daily quota limitation still needs to be complied with. The daily quota of RMB13 billion is respectively set for the Northbound Shanghai Trading Link and the Northbound Shenzhen Trading Link, and the daily quota of RMB10.5 billion is respectively set for the Southbound Hong Kong Trading Links under Shenzhen-Hong Kong Stock Connect and Shanghai-Hong Kong Stock Connect. The daily quota for each Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect and Shanghai-Hong Kong Stock Connect is separately controlled by SSE and SZSE and neither mutually affected nor transferred.

2. CSRC and Hong Kong Securities and Futures Commission ("**SFC**") have reached a consensus to include exchange-traded funds (ETFs) as eligible shares under the mutual market access scheme. Since the inclusion of ETFs will involve system modification and upgrades among three stock exchanges and relevant securities registration and clearing organizations, which takes a lot of time to prepare, it will be launched upon the satisfaction of relevant conditions.

3. To facilitate and meet the need of Mainland and Hong Kong investors to manage price risks in one another's stock markets, CSRC and SFC have agreed, in principle, to jointly study and introduce other financial products.

Enhancement of Stock Connect by CSRC

1. *Provisions on Stock Connect* has left room for the further improvement of currency exchange mechanism. In the pilot stage of Shanghai-Hong Kong Stock Connect, investors trading shares under Shanghai-Hong Kong Stock Connect were required to settle the trades with securities companies and brokers in RMB. However, it is now further stipulated in *Provisions on Stock Connect* that using other currencies for settlement shall abide by regulations of the People's Bank of China. Hence, other currencies will be accepted in the settlement under Stock Connect after the People's Bank of China clarifies relevant currency exchange mechanism.

2. It has been set forth in *Provisions on Stock Connect* that investor suitability shall be governed by the regulations of the home jurisdiction where the designated securities companies or brokers are located, i.e. an investor shall comply with investor suitability regulations and operational rules in Hong Kong other than those in the Mainland if he designates a Hong Kong broker for trading eligible shares under the Northbound Shenzhen Trading Link.

3. In *CSRC's Q&A*, CSRC has consolidated all existing elaborations on disclosure of information relating to changes in equity and FAQs on ownership under Shanghai-Hong Kong Stock Connect, and expanded the application to Shenzhen-Hong Kong Stock Connect. *CSRC's Q&A* states and reiterates (i) a nominee holding structure is adopted under Stock Connect, that is, shares acquired by overseas

investors shall be registered in the name of Hong Kong Securities Clearing Company Limited ("**HKSCC**"). Overseas investors as beneficial owners shall exercise shareholders' rights via HKSCC. Moreover, as long as an overseas investor can provide evidential proof of its beneficial ownership and direct stakeholdership, the investor may take legal actions in its own name in Mainland courts; (ii) where an overseas investor holds up to 5% shares of a Mainland listed company, such investor shall perform reporting and information disclosure obligations; and (iii) equities held by an overseas investor and other persons acting in concert with such investor in a listed company shall be aggregated.

4. *Guidance on Participating in the Stock Connect Between the Mainland and Hong Kong Stock Markets by Securities and Fund Management Institutions* issued by CSRC on 14 October 2016 consolidates all existing regulatory approaches governing the participation of securities companies and publicly-raised fund managers in Shanghai-Hong Kong Stock Connect. Generally it keeps consistency with the regulatory requirements for securities and fund management institutions participating in the Southbound Trading Hong Kong Link under Shanghai-Hong Kong Stock Connect, and meanwhile expands the application to the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect. Furthermore, it explicitly stipulates that segregated account management business of retail fund management institutions, subsidiaries of securities companies and subsidiaries of retail fund management institutions which engage in private investment fund management business shall also comply with the provisions of such Guidance. Moreover, the Guidance makes it clear that in the case where the proposed investment scope for Hong Kong stocks differs from that agreed in the fund contract, (e.g. if the fund contract merely agrees to invest in the eligible shares for the Southbound Hong Kong Trading Link under Shanghai-Hong Kong Stock Connect, while the fund intends to expand the investment scope to the eligible shares for the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect), the fund manager needs to convene a unitholders' general meeting and amend the fund contract accordingly.

Enhancements and Amendments to Clearing Rules for Stock Connect by ChinaClear

ChinaClear's Implementation Rules under Stock Connect is concurrently applicable to Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, which does not, in principle, differ from the arrangements of registration, depositary, clearing and other services subject to *Implementing Rules on Registration, Depository and Clearing Services under the Shanghai-Hong Kong Stock Connect Pilot Program.* The main amendments include:

1. It clarifies that nominee services provided by ChinaClear shall also relate to subscriptions for scrip shares, rights issues and open offers within the prescribed limit and also sets forth the processing approaches for relevant services. The service arrangement relating to subscription for scrip shares by ChinaClear is consistent with the current service arrangement relating to bonus shares, that is,

according to the time of receipt of shares from HKSCC. ChinaClear will process the shares on the same day or the next day as of the receipt of shares, and such shares will be available for trading on the next trading day of the Southbound Hong Kong Trading Links after the processing day. The first day on which investors under the Southbound Hong Kong Trading Links may sell the shares is one trading day under the Southbound Hong Kong Trading Links later than investors in Hong Kong market. Based on the time of receipt of shares from rights issue and open offers in HKSCC, ChinaClear will process the shares on the same day as of the receipt of shares, and such shares will be available for trading on the next trading day under the Southbound Hong Kong Trading Links.

2. The arrangement after the delisting of eligible shares is added, that is, where the eligible shares are delisted due to takeover or other reasons, ChinaClear can continue to provide nominee services to investors under the Southbound Hong Kong Trading Links by reference to relevant requirements of CSRC and the agreements between ChinaClear and HKSCC.

3. It supplements that where ChinaClear is unable to carry out business for the Southbound Hong Kong Trading Links due to natural disasters or other causes, the clearing and settlement arrangement with HKSCC follows the agreements between ChinaClear and HKSCC, whereas the clearing and settlement arrangement between the Mainland clearing participants will be processed by reference to the clearing and settlement arrangement for A shares.

III. Updates for Shanghai-Hong Kong Stock Connect

Rules on Shanghai-Hong Kong Stock Connect issued by SSE have been updated according to *Joint Announcement on Shenzhen-Hong Kong Stock Connect* and *Provisions on Stock Connect*, including but without limitation, the removal of contents relating to aggregate quota and the clarification that provisions on the settlement currency issued by relevant regulators shall prevail if such provisions are required otherwise. Meanwhile, clarification has been made with respect to certain provisions, including but not limited to (i) shares suspended from listing on SSE are excluded from shares for the Northbound Shanghai Trading Link, and their corresponding H shares are excluded from the eligible shares for the Southbound Hong Kong Trading Link; and (ii) where the daily quota for the Southbound Hong Kong Trading Link is used up during the pre-opening session in SEHK and SSE Securities Trading Service Company suspends the acceptance of any further buy orders, SSE Securities Trading Service Company will resume the acceptance of buy orders after the commencement of continuous trading session in SEHK. Only if the daily quota balance resumes to a positive level due to the cancellation of buy orders, the rejection by SZSE or the execution of sell orders.

Further, *Mandatory Provisions for Client Agreements for the Southbound Hong Kong Trading Link by Shanghai Stock Exchange* sets forth that investors participating in Shanghai-Hong Kong Stock Connect may appoint securities companies merely to trade eligible shares through the Southbound Hong Kong Trading Link under Shanghai-Hong Kong Stock Connect. Securities acquired through the Southbound Hong Kong Trading Link under Shanghai-Hong Kong Stock Connect cannot be sold through the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect for now. *Mandatory Provisions for Risk Disclosure Statements for the Southbound Hong Kong Trading Link by Shanghai Stock Exchange* also makes relevant amendments so as to intensify risk disclosure.

IV. Principle Arrangements for Shenzhen-Hong Kong Stock Connect

Fundamental operation of Shenzhen-Hong Kong Stock Connect is consistent with that of Shanghai-Hong Kong Stock Connect. The Northbound Shenzhen Trading Link means that investors appoint Hong Kong brokers to trade eligible shares under Shenzhen-Hong Kong Stock Connect listed on SZSE by routing orders to SZSE via a securities trading service company incorporated by SEHK in Shenzhen ("**SEHK Securities Trading Services Company**"). The Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock connect means that investors appoint Mainland securities companies to trade eligible shares under Shenzhen-Hong Kong Stock Connect listed on SEHK by routing orders to SEHK via a securities trading service company incorporated by SZSE in Hong Kong ("**SZSE Securities Trading Services Company**").

The Scope of Eligible Shares for Shenzhen-Hong Kong Stock Connect

	Northbound Shenzhen Trading Link	Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect
Including	(1) Constituent stocks of the SZSE Component Index and SZSE Small/Mid Cap Innovation Index which have an average daily market capitalization of at least RMB6 billion in the 6 months prior to the deadline for periodic review of the relevant index; or, if the constituent stock has been listed within the 6 months prior to the periodic review of the relevant index, its average daily market capitalization in the period since it was listed shall be no less than RMB6 billion; and	(1) Constituent stocks of the Hang Seng Composite LargeCap Index (2) Constituent stocks of the Hang Seng Composite MidCap Index (3) Constituent stocks of the Hang Seng Composite SmallCap Index which have an average month-end market capitalization of not less than HK$5 billion in the 12 months prior to the deadline for periodic review; or, if the constituent stock has been listed within the 12 months prior to the periodic review of the relevant index, its

	(2) SZSE-listed A shares of A+H companies that are dual-listed on SZSE and SEHK	average month-end market capitalization in the period since it was listed shall be no less than HK$5 billion; and (4) SEHK-listed H shares of A+H companies that are dual-listed in the Mainland and Hong Kong
Excluding	(1) SZSE-listed shares put under risk alert (2) SZSE-listed shares suspended from listing (3) SZSE-listed shares in the pre-delisting period (4) SZSE-listed shares quoted and traded in foreign currencies (namely B shares) (5) Specific circumstances otherwise determined by SZSE	(1) H shares of A+H companies with corresponding SZSE-listed A shares put under risk alert, suspended from listing or in the pre-delisting period. (2) H shares of A+H companies with corresponding A shares traded on the Risk Alert Board of SSE or suspended from listing. (3) SEHK-listed shares that are not quoted and traded in Hong Kong dollars (HK$) (4) Special circumstances otherwise determined by SZSE

*Table source: *Interpretation on Measures of Shenzhen Stock Exchange for the Implementation of Shenzhen-Hong Kong Stock Connect Program.*
URL: http://www.szse.cn/main/szhk/tzzjy/ggttzzjy/zlwz/39761785.shtml

Market Capitalization as a Screening Criterion for Eligible Shares under Shenzhen-Hong Kong Stock Connect

Market capitalization has been introduced as a screening criterion for eligible shares under Shenzhen-Hong Kong Stock Connect. SZSE has delivered explanation regarding the screening criterion in *Interpretation on Measures of Shenzhen Stock Exchange for the Implementation of Shenzhen-Hong Kong Stock Connect Program*, that is, the review period and calculation method are consistent with the periodic adjustment of constituents of relevant indices. As such, the market capitalization of eligible shares for the Northbound

Shenzhen Trading Link shall be calculated and adjusted with reference to *Compilation Scheme for SZSE Component Index Series* (《深证成份指数系列编制方案》) and *Compilation Scheme for Small/Mid Cap Innovation Index* (《中小创新指数编制方案》), and the market capitalization shall be calculated using the average daily market capitalization in the 6 months prior to the deadline for periodic review of the relevant indices.

As one of the eligible shares for the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect, constituent stocks of Hang Seng Composite SmallCap Index shall be calculated and adjusted with reference to *Index Methodology for Managing the Hang Seng Composite Index Series*, and the market capitalization shall be calculated using average month-end market capitalization of SEHK-listed shares in the 12 months prior to the deadline for periodic review of the index.

Pertinent criterion of market capitalization merely applies at the periodic adjustment of constituent stocks of relevant indices, with relevant shares included under or excluded from Shenzhen-Hong Kong Stock Connect on the date of the periodic adjustment.

Rules on Inclusion and Exclusion as Eligible Shares under Shenzhen-Hong Kong Stock Connect

For the eligible shares under the Northbound Shenzhen Trading Link and the Southbound Hong Kong Trading Link, as a result of constituent stocks adjustment implemented by relevant indices or other factors, certain stocks that meet the criterion of eligible shares for the Northbound Shenzhen Trading Link (or the Southbound Hong Kong Trading Link) will be accepted as eligible shares, whereas stocks which are no longer eligible will be removed from eligible shares.

Under Shenzhen-Hong Kong Stock Connect, market capitalization screening does not apply to A shares and H shares of A+H companies, and rules on the acceptance of such shares are listed as following.

1. In the case where an SEHK-listed company (as H shares) seeks listing on SZSE (as A shares), or an SZSE-listed company (as A shares) seeks listing on SEHK (as H shares), or a company seeks listing on both SZSE (as A shares) and SEHK (as H shares) on the same trading day, the relevant A shares will be accepted as eligible shares for the Northbound Shenzhen Trading Link after the A shares have been listed on SZSE for 10 trading days and the corresponding H shares have passed the price stabilization period;

2. In the case where an SZSE/SSE-listed company (as A shares) seeks listing on SEHK (as H shares), or an SEHK-listed company (as H shares) seeks listing on SZSE/SSE (as A shares), or a company seeks listing on both SZSE/SSE (as A shares) and SEHK (as H shares) on the same trading day, the relevant H shares will be accepted as eligible shares for the Southbound Hong Kong Trading Link after the H shares' price stabilization period has expired and the corresponding A shares have been listed on SZSE/SSE for 10 trading days.

Investors are able to sell stocks removed from eligible shares under the Northbound Shenzhen Trading Link (or the Southbound Hong Kong Trading Link), notwithstanding that investors are not able to buy them. The effective time of inclusion or exclusion as eligible shares under the Northbound Shenzhen Trading Link or the Southbound Hong Kong Trading Link shall be respectively subject to the timeline disseminated by SEHK Securities Trading Service Company or SZSE Securities Trading Service Company.

Quota Calculation

	Northbound Shenzhen Trading Link	Southbound Hong Kong Trading Link
Daily Quota	RMB13 Billion	RMB10.5 Billion

Daily quota balance is calculated as follows: Daily Quota Balance for the Northbound Shenzhen Trading Link (or the Southbound Hong Kong Trading Link) = Daily Quota - Buy Orders + Sell Trades + Buy Orders Cancelled or Rejected by SZSE (or SEHK) + Difference between the execution price and bid price of buy orders. As the approach for quota calculation, orders, turnover and others parameters in trading session will be applied as calculation basis for quota control purposes. Detailed measures in respect of quota control are set forth as below.

1. As for the Northbound Shenzhen Trading Link, where the Northbound Daily Quota Balance is used up during the opening call auction session of SZSE, SEHK Securities Trading Service Company will suspend the acceptance of any further buy orders, notwithstanding that it still accepts sell orders. Subsequently, before the commencement of the continuous auction session, where the Northbound Daily Quota Balance resumes to a positive level due to the cancellation of buy orders, rejection by SZSE or execution of sell orders, SEHK Securities Trading Service Company will resume the acceptance of further buy orders. Where Northbound Daily Quota Balance is used up during the continuous auction session or the closing call auction session, SEHK Securities Trading Service Company will cease to accept any further buy orders for the remainder of the day, notwithstanding that it still accepts sell orders. In the case where buy orders cease to be accepted during the continuous auction session or the closing call auction session, the acceptance of buy orders will not resume for the remainder of the day, unless it is otherwise required by SZSE.

2. As for the Southbound Hong Kong Trading Link, where the Southbound Daily Quota Balance is used up during the pre-opening session of SEHK, SZSE Securities Trading Service Company will suspend the acceptance of any further buy orders and will not resume the acceptance before the end of such session, notwithstanding that it still accepts sell orders. Where the Southbound Daily Quota Balance resumes to a positive level due to the cancellation of buy orders, rejection by SEHK or execution of sell orders, SZSE Securities Trading Service Company will resume the acceptance of further buy orders upon the commencement of the continuous trading session of SEHK. Where Southbound

Daily Quota Balance is used up during the continuous trading session or the closing auction session of SEHK, SZSE Securities Trading Service Company will cease to accept any further buy orders for the remainder of the day, notwithstanding that it still accepts sell orders. In the case where buy orders cease to be accepted during the continuous trading session or the closing auction session of SEHK, the acceptance of buy orders will not resume for the remainder of the day, unless it is otherwise required by SZSE.

Taxation Policies

Taxation policies for Shenzhen-Hong Kong Stock Connect are basically identical to those for Shanghai-Hong Kong Stock Connect, namely, there is no material difference between them. The *Notice on Relevant Taxation Policies Concerning the Pilot Program of Mutual Stock Market Access Between Shenzhen and Hong Kong* clarifies issues about stamp duties for securities (stocks) transactions generated from covered short selling of stocks by Hong Kong investors participating in the Northbound Shanghai Trading Link and the Northbound Shenzhen Trading Link, i.e. stamp duties for securities (stocks) transactions are temporarily exempted for stock borrowing and returning involved therein.

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