

Capital Markets Connectivity: Opportunities and Challenges

— Developments in China



August 2019

Contents

Brief Introduction of the Connectivity Programs

Opportunities and Challenges

Outlook for Deepening Connectivity among Capital Markets

Background

- China boasts the world's **second largest** capital market, which is also the **largest** emerging market.

| Stock Market | | Bond Market | |
|---------------|------------------------------------|----------------------|--------------------------------|
| Listed Stocks | Total Market Cap (trillion RMB) | Outstanding Bonds | Total Amount (trillion RMB) |
| 3665 | 53.63 | 45797 | 92.01 |

- China has not realized full capital account convertibility of currency, which impedes cross-border investment and financing through securities.
- Since stock market connectivity was first brought up in 2012, multiple connectivity programs have been introduced in China's capital market, with the aim to meet domestic investors' needs for risk diversification and global asset allocation, and to attract foreign participation.

Figures are dated to July 31st, 2019.

1. Mainland-Hong Kong Stock Connect

- Mainland-Hong Kong Stock Connect, namely the connectivity program between Mainland stock market and Hong Kong stock market, connects the two markets by order routing.
- It includes four parts: Northbound business and Southbound business under Shanghai-Hong Kong Stock Connect, and Northbound business and Southbound business under Shenzhen-Hong Kong Stock Connect

Operational Mechanism



Features

- Order routing via connecting trading
- Clearing and Settlement via connecting clearing houses
- Stock trading runs in a closed circuit
- Adjustable quota to ensure stable operation
- Clearing house acts as the nominal shareholder

Order routing means that the stock exchange accepts orders from local investors and then transfer them to the other exchange.

Trading

The launch of Mainland-Hong Kong Stock Connect accelerates the development of capital markets on both sides.

| | Shanghai-Hong Kong Stock Connect | | Shenzhen-Hong Kong Stock Connect | |
|---|----------------------------------|------------|----------------------------------|------------|
| | Northbound | Southbound | Northbound | Southbound |
| Eligible stocks | 580 | 326 | 682 | 481 |
| Daily turnover (100 million RMB) | 85.59 | 47.9 | 91.56 | 29.22 |
| Net Capital Flow (100 million RMB) | 4288 | 5638 | 3213 | 1970 |
| Net Capital Flow after Netting (100 million RMB) | 1350 to the south | | 1243 to the north | |

Up to July 31st, 2019. For both Connect programs,
the daily trading quota of northbound trading is RMB 52 billion;
the daily trading quota of southbound trading is RMB 42 billion.

2. Mutual Recognition of Funds (MRF)

- The Mainland-Hong Kong Mutual Recognition of Funds: the MRF scheme allows funds registered and regulated on each side to be publicly offered to residents in the other's market.

History

July 2015

Mutual Recognition of Funds was officially launched.

December 2015

The first southbound fund was distributed.

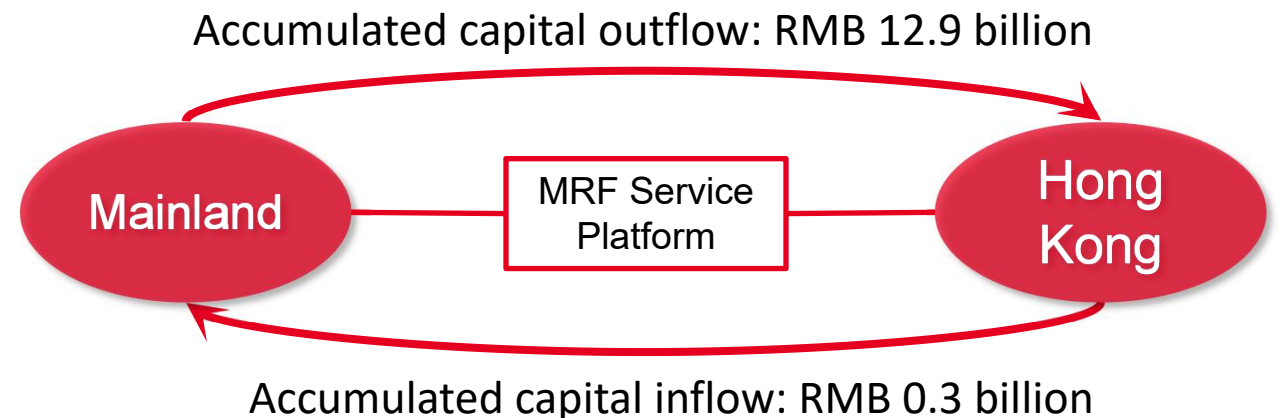
January 2016

The first northbound fund was distributed.

Northbound: Hong Kong fund products distributed in the Mainland;

Southbound: Mainland fund products distributed in Hong Kong.

Operational Mechanism



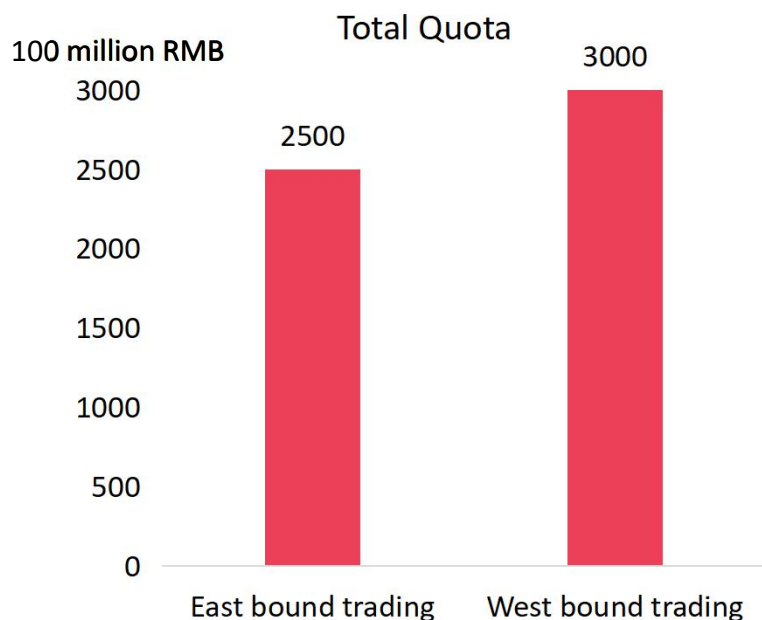
Data as of June, 2019.

The MRF Service Platform is connected with Central Moneymarkets Unit (CMU) of Hong Kong Monetary Authority. Such arrangement provides a single entry point for industry players and realizes functions such as cross-border data exchange of fund sales, secondary registration and depository, and payment of funds, so as to eliminate the differences in fund operation on the two sides and lower business costs of participants.

3. Shanghai-London Stock Connect

- On June 17, 2019, the CSRC and the UK FCA released the *Joint Announcement*, which marks that the Stock Connect was officially launched. This regime builds connectivity by allowing listed companies on each exchange to list depository recipients (DRs) on the other exchange.

Quota Management



Operational Mechanism



For the first month after the listing of Huatai GDR, average daily turnover is 26.78 million US dollar.

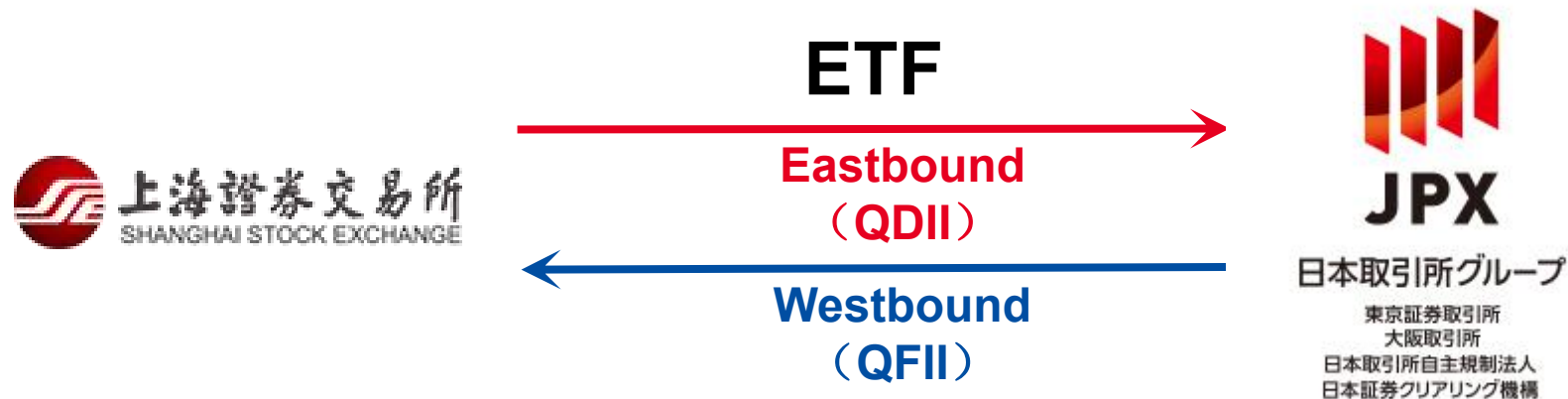
Eastbound trading: Qualified listed companies on LSE issue China depository receipts (CDR) and trade on the main board of SSE.

Westbound trading: Qualified listed companies on SSE issue global depository receipts (GDR) abroad and trade on the main board of LSE.

4. China-Japan ETF Connectivity Scheme

- On June 25, 2019, China-Japan ETF Connectivity Scheme was officially launched. The scheme uses existing QFII and QDII schemes to achieve connectivity.

Operational Mechanism

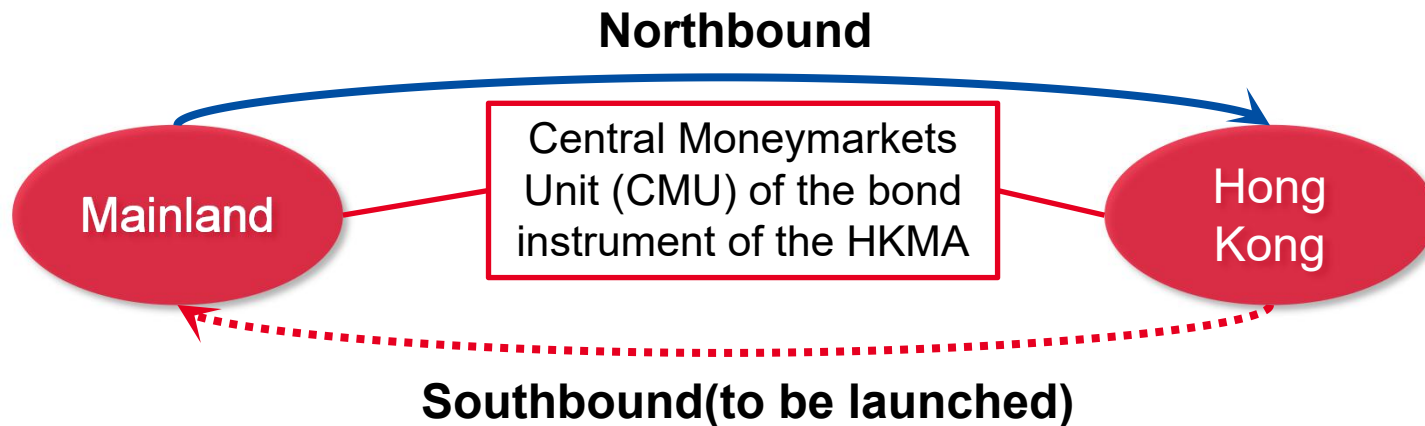


Eastbound ETFs: set up by Chinese fund managers in China and trade on SSE, and invest more than 90% of fund assets in individual ETF in Japan as QDII, tracking the Nikkei 225, TOPIX indices.

5. Bond Connect

- The Bond Connect is similar to Stock Connect. Through connecting market infrastructure of bond markets in the mainland and Hong Kong, this mechanism arrangement enables investors to invest in each other's bond market. On July 3, 2017, the Bond Connect was formally piloted, and currently only the northbound connect link is in operation.

Operational Mechanism



Northbound trading means investors from Hong Kong and abroad can invest in the Chinese inter-bank bond market. The development of the Bond Connect has greatly enhanced the internationalization of the Chinese inter-bank bond market.

- By the end of July 2019, Bond Connect has attracted 1,134 foreign investors from 30 countries and regions, among which US and Hong Kong investors account for 32% and 25% respectively.
- Trading volume of the secondary market under Bond Connect totaled RMB 201 billion in July 2019, and net purchase by foreign investors stood at RMB 52.7 billion.

Main features of the connectivity programs

pilot before wider scale application

Area: Hong Kong → Japan, London

Products: Stock → Bond, ETF

respect differences to facilitate operation

- Connecting the back-end infrastructure without changing trading habits at the front-end.

internationally recognized outcomes

- China A-shares was successively included in international flagship indices including MSCI and FTSE Russell. By the end of July this year, a total of RMB 750 billion has flowed into China under Shanghai and Shenzhen Stock Connects.

Contents

Brief Introduction of the Connectivity Programs

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Outlook for Deepening Connectivity among Capital Markets

Opportunities

1

Greater economic cooperation in Asia.

Asia's economy grew by 5.5% in 2018, nearly 2 percentage points higher than the global average.

2

Enhanced cooperation between capital markets under the Belt and Road Initiative.

China has established Shanghai International Center for Communication and Cooperation between Exchanges, supported domestic exchanges, registration and settlement institutions to participate in Belt and Road capital markets.

3

Broader equity cooperation among exchanges.

Established China Europe International Exchange. Exchanges in the Mainland became strategic shareholders in both Pakistan Stock Exchange and Dhaka Stock Exchange of Bangladesh and invested in the establishment of Astana International Exchange of Kazakhstan.

4

Strengthened cross-border regulatory cooperation.

China has signed MoU or cooperation arrangements on regulation of securities and futures with more than 20 Asian jurisdictions.

Challenges

1

Risks arising from unstable international political and economic environment.

Risks in capital markets are extremely prone to be transmitted across regions, and thus capital market connectivity may incur risks.

2

Cross-regional institutional differences put regulatory adaptability to the test.

Countries and regions differ greatly in systems and practices concerning laws, cultures, and transactions in capital markets.

Contents

Brief Introduction of the Connectivity Programs

Opportunities and Challenges faced by Connectivity

Outlook for Deepening Connectivity among Capital Markets

Future Outlook



Expanding the geographical scope of capital market connectivity

Expand those connectivity programs to more countries and regions, and connect with more exchanges, and clearing and settlement institutions.



Extending the business scope of capital market connectivity

Explore ways to further enrich trading categories, steadily expand scope of financial products in the connects, actively enhance the Belt and Road international cooperation, and strive to promote the Belt and Road financing. The southbound trading of Bond Connect will be introduced in due course.



Strengthening regulatory cooperation on capital market connectivity

Strengthen communication with capital market regulators of Asian countries, enhance regulatory cooperation, and improve effectiveness of cross-border supervision.

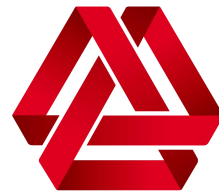
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