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The Legal Risk Management for Stock Connect: A Case Study of Mainland-Hong Kong Stock Connect

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◆ **1 An overview of Mainland-Hong Kong Stock Connect**

◆ **2 The Importance of Legal Risk Management for Cross-border Connect and Related International Standards**

◆ **3 The key points of legal risk prevention mechanism in the research process of Mainland -Hong Kong Stock Connect.**

◆ **4 Suggestions**

◆ 1.1 Operating facts of the Mainland-Hong Kong Stock Connect

The Shanghai-Hong Kong Stock Connect has been operating well for about 4 years since it launched on Nov. 17th 2014.

Trade, securities registration, clearing and settlement, currency exchange and corporate actions all run smoothly.

Total transactions amount of the Connect: up to **7.8 trillion RMB**:

- North-side Shanghai Stock Connect Trade: **4.3 trillion RMB**; **795 stocks**.
- South-side Hong Kong Stock Connect Trade: **3.5 trillion RMB**; **385 stocks**.

(By the end of Mar. 2018)

◆ 1.2 A brief introduction about CSDC and HKSCC collaborative research on Stock Connect

● **Jan. 22rd 2008**, CSDC and HKSCC held a management level meeting at Beijing, building a meeting mechanism on a regular basis and a cross-border collaborative research mechanism.

● **Oct. 2009 – Dec. 2012**, several research projects are completed together:

A comparison table of the differences between stock markets of Mainland and Hong Kong ;

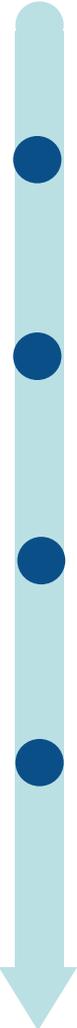
The choice of cross-border trade and settlement mode of Mainland -Hong Kong Stock Connect;

*A discussion about the differences of **security holding mode** between Mainland and Hong Kong and its impacts in case of direct link mode;*

*A discussion about the differences of **trade and settlement mode** between Mainland and Hong Kong and its impacts in case of direct link mode;*

*A discussion about the differences of **corporate actions** between Mainland and Hong Kong and its impacts in case of direct link mode;*

*A discussion about the **risk management** in case of Mainland and Hong Kong direct link mode.*



May 2013, Shanghai-Hong Kong Stock Connect Project work team was built up.

Dec. 2013, related business requirements were confirmed, and the development of the technology system was activated.

Apr. 2014, Shanghai-Hong Kong Stock Connect was launched.

Dec. 2016, Shenzhen-Hong Kong Stock Connect was launched.

2 The Importance of Legal Risk Management for Cross-border Connect and Related International Standards

- ◆ 2.1 Suggestions made by “Recommendations for Securities Settlement System” published by IOSCO and CPSS (Nov. 2001) about **legal application in case of cross-border transactions and settlement.**
- ◆ 2.2 “Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary (Dec. 2002)” passed by the Hague Conference on Private International Law set the principle of **“the place of the relevant intermediary approach”** as join-point for legal application.
- ◆ 2.3 Suggestions made by **“Principle 20: FMI links”** in “Principles for Financial Market Infrastructures (PFMI)” published by IOSCO and CPSS (Apr. 2012) about legal basis requirements for FMI links.

3 The key points of legal risk prevention mechanism in the research process of Mainland -Hong Kong Stock Connect.

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◆ 3.1 Legal framework

A link shall have a well-founded legal basis, in all relevant jurisdictions, that supports its design and provides adequate protection to the FMIs involved in the link, including those relating to rights and interests, collateral arrangements, settlement finality, and netting arrangements.

The terms of the link agreement shall also set out, in cross-jurisdictional contexts, an unambiguous choice of law that will govern each aspect of the link.

◆ 3.2 Application of the law

The application of the law is the core content during conflict of laws.

Securities trading and clearing institutions conduct public functions including supervising the securities market and implementing national financial policy to some extent. Therefore, according to the principle of territorialism, local laws of the stock exchange and settlement institution shall be applicable.

◆ 3.3 Solution to legal disputes

According to the law of the two markets, the dispute solution method can be negotiated by involving parties to be either litigation or arbitration.

◆ 3.4 Jurisdictions of legal disputes

When handling common economic cases involving Hong Kong, the people's courts of mainland shall take the jurisdiction of the court at the place of the defendant's domicile.

While the involving parties of both Mainland and Hong Kong shall negotiate on the jurisdiction, and shall not violate the relevant provisions of the Civil Procedure Law on hierarchical jurisdiction, exclusive jurisdiction and no further agreement on the jurisdiction of the court with the provisions of the arbitration clause.

For example, for the first instance of the civil and administrative cases where CSDC or its subsidiaries involving as the defendant or the third party, mainland designates the local intermediate courts of CSDC and its subsidiaries as the courts that have jurisdiction.

◆ 3.5 Judicial assistance

● 3.5.1 Delivery of judicial documents

The courts of Mainland and Hong Kong may entrust each other to deliver the civil and commercial judicial documents.

● 3.5.2 Recognition and enforcement of arbitration awards

Mainland and Hong Kong have agreed on the conditional mutual recognition and enforcement of arbitration awards.

After negotiations between the Supreme People's Court of China and the Hong Kong government, the courts of Hong Kong agree to enforce the arbitration awards made by Mainland arbitration agency in accordance with the Arbitration Law of the People's Republic of China, and the courts of mainland agree to enforce the arbitration awards made in Hong Kong under the Arbitration Ordinance of the Hong Kong Special Administrative Region.

● 3.5.3 Recognition and enforcement of judgement

Mainland and Hong Kong have agreed on conditional mutual recognition and enforcement of sentences.

For final trials in the civil and commercial cases with written jurisdiction agreement and requirement of payment making, the involving parties may apply recognition and enforcement, either from the people's court of Mainland, or from the court of the Hong Kong Special Administrative Region.

4 Suggestions

- ◆ In order to reach a consensus and consolidate the legal basis of cross border cooperation, the relevant principles mentioned above are strongly recommended for reference.
- ◆ Both parties in cross border cooperation shall give full consideration to the specific situations of their respective markets, and make adaptable adjustments.

Thank you!

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