Stock Connect: Integration, Internationalisation and Implementation

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Abstract

Stock Connect is a stock exchange collaboration between China and international bourses such as Hong Kong and London. In contrast to existing literature mostly focusing on economic analysis, this article explores the legal issues in Stock Connect and makes practical contributions by appraising the successes and failures of this scheme.

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Stock Connect: Integration, Internationalisation and Implementation

Stock Connect is a collaboration between China[1] and Hong Kong and London bourses, allowing Chinese and international investors to trade securities in each other's market through the trading and clearing facilities of their home exchange. First launched in 2014 in Shanghai-Hong Kong and then extended to Shenzhen with Hong Kong in 2016, the Stock Connect scheme creates a single Chinese stock market that ranks the second biggest in the world (behind the US) in terms of market capitalisation and daily trading turnover.[2] To further integrate Chinese markets into international financial systems, Shanghai-London Stock Connect (London Connect) was established in June 2019.

Stock Connect is a unique mechanism in China in the light of a number of 'firsts'.[3] It is the first time foreign companies are allowed to effectively list in China, and the first time for Chinese and international investors to invest directly in designated securities listed in each other's market. On the one hand, it is viewed as an important landmark for China's financial liberalisation process. Previously in 2002, institutional investors who obtained a Qualified Foreign Institutional Investor (QFII) or its modified version Renminbi QFII (RQFII) licence were allowed to purchase securities on Chinese stock exchanges. Instead, Stock Connect allows international investors to achieve direct participation in Chinese securities without reliance on such licences. Equally, Chinese investors now have more ready access to overseas markets through Stock Connect.

On the other hand, London recently has lost its crown as the world's top financial centre to New York.[4] The UK market is keen to join force with its Chinese counterpart to maintain its position as a leading global financial centre in the post-Brexit era. The launch of London Connect is expected to provide a boost for the 'Global Britain' narrative, with the UK open and eager to explore new opportunities in Asia.[5]

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[1] For the purpose of this article, the word 'China' refers to mainland China, excluding Hong Kong Special Administrative Region, Macau Special Administrative Region, and Taiwan.

[2] The total equity market capitalisation of China (including Shanghai and Shenzhen) and Hong Kong was US$ 13,414.7 billion in 2019, compared to that of New York Stock Exchange (NYSE) US$ 23,327.8 billion and NASDAQ US$ 10,857 billion. Average daily turnover was calculated from the combined shares turnover value for 2019 using the total number of trading days (365 days). Ranking was based on combined trading value as of the end of 2019. See World Federation of Exchanges (WFE), 'Statistics', available at <https://www.world-exchanges.org/our-work/statistics> accessed 30 May 2020.

[3] London Stock Exchange (LSE), 'Shanghai-London Stock Connect', available at <https://www.lseg.com/markets-products-and-services/our-markets/shanghai-london-stock-connect> accessed 30 May 2020.

[4] London has surrendered its position as the world's top financial centre to New York since 2018 due in part to uncertainty over Brexit. See Caroline Binham, 'London Loses Top Spot as Global Finance Hub' (Financial Times, 27 January 2020), available at <https://www.ft.com/content/06d80468-3e0d-11ea-b232-000f4477fbca> accessed 30 May 2020.

[5] Melanie Wadsworth et al, '"Britain and China's Stock Exchange Deal Creates New Opportunities for UK Firms But It's Far From Ground-breaking," Say Legal Experts' (Thisismoney, 27 June 2019), available at <https://www.thisismoney.co.uk/money/markets/article-7187463/Britain-Chinas-stock-exchange-deal-creates-new-opportunities-far-ground-breaking.html> accessed 30 May 2020.

Despite the frequent feature of Stock Connect in newspapers and exchange reports, this mechanism has not been adequately understood and studied, especially from a legal perspective. Most literature focus on the economic analysis of Stock Connect while very few are on the legal issues arising from such an emerging viable cross-border investment channel.[6] In particular, there have been significant legal and regulatory changes since the launch of Stock Connect in 2014, for instances, the new Chinese Securities Law 2020, the amended Stock Connect Rules and many initiatives in regulatory enforcement between China and other regulators.[7] This article fills in the literature gap by exploring the legal issues in Stock Connect and makes practical contributions by appraising the successes and failures of this scheme.

The structure of this article proceeds as follows. Firstly, an overview of Stock Connect will be provided, which is followed by the uniqueness of this scheme distinguished from other Chinese existing investment channels. The next two parts will analyse the legal issues concerning Stock Connect and explain the reasons of an observation that China-Hong Kong Stock Connect succeeds but Shanghai-London Stock Connect does not progress well. The final part concludes.

1. A Snapshot of Stock Connect

As shown in Table 1, Stock Connect comprises three separate links, namely Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, and Shanghai-London Stock Connect. This section will outline more details to each link and distinguish the differences between them.

Table 1: Stock Connect 'Operational Directions'

Shanghai-Hong Kong Stock Connect (Shanghai Connect)	**Shenzhen-Hong Kong Stock Connect (Shenzhen Connect)**	**Shanghai-London Stock Connect (London Connect)**
Northbound Shanghai Trading Link	Northbound Shenzhen Trading Link	Eastbound Shanghai Business Link
Southbound Hong Kong Trading Link	Southbound Hong Kong Trading Link	Westbound London Business Link

[6] With respect to the economic impacts of China-Hong Kong Stock Connect, for example, Rui Huo and Abudullahi Ahmed, 'Return and Volatility Spillovers Effects: Evaluating the Impact of Shanghai-Hong Kong Stock Connect' (2017) 61 Economic Modelling 260; and Qiyu Wang and Terrence Chong, 'Co-integrated or not? After the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect Schemes' (2018) 163 Economic Letters 167. For the impacts of Shanghai-London Stock Connect, see Kun Yang et al, 'Dependence and Risk Spillovers Between Mainland China and London Stock Markets Before and After the Stock Connect Programs' (2019) 526 Physica A 1.

[7] The first Chinese Securities Law was enacted in 1998 and then amended four times in 2005, 2013, 2014 and 2019. The New Chinese Securities Law came into force on 1 March 2020. For more details with respect to the Stock Connect Rules and the regulatory enforcement, refer to Section 3 of this article.

1.1 Shanghai-Hong Kong Stock Connect (Shanghai Connect) and Shenzhen-Hong Kong Stock Connect (Shenzhen Connect)

On 10 April 2014, the China Securities Regulatory Commission (CSRC) and Hong Kong's Securities and Futures Commission (SFC) made a join announcement regarding the in-principle approval for the establishment of mutual stock market access between China and Hong Kong (also commonly known as 'Through Train' or 'Mutual Market Access').[8]

Subsequently Shanghai Connect was launched on 17 November 2014, followed by Shenzhen Connect on 5 December 2016 by re-using similar programme and design. Shenzhen Connect is a significant addition to this scheme as Shenzhen Stock Exchange (SZSE) is widely regarded as China's growth market – a market for companies in their early stages.[9] By then, a mutual market platform across Shanghai, Shenzhen and Hong Kong was basically formed. However, Shanghai and Shenzhen Connects are currently confined to secondary market trading only and investors are barred from primary market equity such as initial public offering (IPO) on the other side. This has deprived investors of investment opportunities from IPO across the border and has essentially hindered the pooling of liquidity in the mutual market to support its function in fund raising by issuers.[10]

Shanghai Connect is designed as a bi-directional channel connecting China through Hong Kong to the rest of the world. A 'Northbound' link allows non-Chinese investors to buy and sell Chinese stocks via the more accessible Hong Kong Stock Exchange (HKEx). In the reverse, the 'Southbound' link allows Chinese investors to buy and sell international stock through Hong Kong. As far as restrictions are concerned, Stock Connect imposes an aggregate daily net buying quota, but the quotas apply to the exchange as a whole, and not individual investors.[11]

Chinese institutional and individual investors who are qualified to trade connect stocks must satisfy the eligibility criteria (i.e. Individual investors who hold an aggregate balance of not less than RMB 500,000 in their securities and cash accounts). But there is no such requirement for Hong Kong's investors. The rationale is to protect a vulnerable group of market participants by increasing market-entry level as many Chinese individual investors are low or middle incomers without financial and investment knowledge. According to the China Capital Market Investor Protection Report 2018, the number of Chinese individual investors reached

[8] For a brief introduction on Stock Connect, see Shanghai Stock Exchange's website <http://english.sse.com.cn/access/stockconnect/introduction> accessed 20 March 2020.
[9] ASIFMA, 'The Through Train: Stock Connect's Impact and Future' (December 2014), 12, available at <https://www.asifma.org/wp-content/uploads/2018/05/asifma-tr-stock-connect-white-paper.pdf> accessed 30 March 2020.
[10] HKEx, 'Primary Equity Connect- A Breakthrough Opportunity for Mainland-Hong Kong Mutual Market Connectivity and RMB Internationalisation' (August 2017), 1, available at <https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research Papers/2017/CCEO_Rpt(PEC)_201708_e.pdf?la=en> accessed 30 March 2020.
[11] HKEx, 'Stock Connect Another Milestone FAQ' (updated on 31 March 2020), 9-10, available at <https://www.hkex.com.hk/-/media/HKEX-Market/Mutual-Market/Stock-Connect/Getting-Started/Information-Booklet-and-FAQ/FAQ/FAQ_En.pdf> accessed 30 May 2020.

1.46 million in 2018, representing 99.77% of the total investor accounts, most of which under RMB 500,000 in asset value.[12]

Under Shanghai Connect, Shanghai Stock Exchange (SSE)-listed securities that are eligible for trading by Hong Kong and overseas investors include all the constituent stocks of the SSE 180 Index and the SSE 380 Index as well as all A+H dual-listed shares on SSE and HKEx,[13] with the exceptions of shares that are not traded in RMB and shares under risk alert.[14] HKEx eligible securities comprise Hang Seng Composite LargeCap and MidCap Index as well dual-listed shares, covering 95% of the total market capitalisation of the stocks in Hong Kong. By contrast, the eligible shares of Shenzhen Connect not only include the Main Board-listed shares, but also expand to cover SME Board and NASDAQ-style ChiNext market, while the scope of eligible shares for its Southbound link is extended to include the constituents of Hang Seng SmallCap Index above a certain market cap threshold.[15] This highlights the characteristics of Shenzhen Connect as a platform for emerging industries with the distinctive feature of growth.

1.2 Shanghai-London Stock Connect (London Connect)

The scheme to link SSE and the London Stock Exchange (LSE) was originally scheduled to commerce in 2018, but was postponed to 16 June 2019, which the uncertainties created by Brexit was blamed for the delay.[16] On 12 October 2018, the CSRC promulgated the *Provisions on the Supervision and Administration of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange (for trial implementation)*,[17] providing a legal and institutional basis for the connectivity of the two markets and issuance of depositary receipts. Later, the SSE issued eight circulars setting out the guidelines and regulations on the listing and trading of depository receipts.[18] On the other hand, the LSE issued the amended *Admission and Disclosure Standards*, adding the London Connect segment to the Main Market and corresponding issuance and disclosure requirements which

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[12] China Securities Investor Protection Fund Corporation (SIPF), 'China Capital Market Investor Protection Report 2018', 9, available at < http://finance.sipf.com.cn/finance/app/zhuanTi/bps2019/detail1> accessed 30 March 2020.

[13] In China, shares are categorised into different groups. 'A-shares' means any securities issued by companies incorporated in China which are listed and traded on Shanghai or Shenzhen stock exchanges. 'B-shares' are issued by China-based companies and traded in foreign currency for foreign investors. 'H-shares' means any securities issued by companies incorporated in China and listed on the HKEx. 'A+H' is referred to dual listed shares in China and Hong Kong.

[14] SSE, 'Shanghai-Hong Kong Stock Connect: Eligibility', available at <http://english.sse.com.cn/access/stockconnect/eligibility> accessed 30 March 2020.

[15] SZSE, 'SZHK Stock Connect Investor FAQs', available at <http://www.szse.cn/enSzhk/faqs> accessed 30 March 2020.

[16] Tom Hancock et al., 'London-Shanghai Stock Link Hailed as "Groundbreaking"' (Financial Times, 16 June 2019), available at < https://www.ft.com/content/d8db0830-9024-11e9-aea1-2b1d33ac3271> accessed 30 March 2020.

[17] Available at CSRC's website, <http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/201808/P020180831757865678938.pdf> accessed 23 March 2020.

[18] The circulars were issued by the CSRC on 2 November 2018, available at SSE's website, <http://english.sse.com.cn/start/rules/related/slsc> accessed 23 March 2020.

came into effect on 1 October 2018. However, no circulars on the China and UK taxation matters in relation to London Connect have been issued yet.

London Connect is also a two-way mechanism with Westbound and Eastbound business flows. In the Westbound business (listing), eligible SSE-listed companies can issue Global Depositary Receipts (GDRs) and apply for their listing on the Main Market of the LSE. In the Eastbound business, eligible LSE-listed companies can issue Chinese Depositary Receipts (CDRs) and apply for their listing on the Main Board of the SSE. GDRs and CDRs are interchangeable with the underlying shares which they represent, that is LSE Main Market shares or Chinese A-shares.

Notably, it has set thresholds for participants, taking into account of the complexities of London Connect and the protection of Chinese investors' interests and rights.[19] SSE-listed companies issuing GDRs in London must have a minimum market capitalisation of RMB 20 billion (US$ 2.9 billion) and obtain CSRC approval, while LSE-listed companies must meet the same market capitalisation requirement and be approved by the CSRC to participate in CDR trading in Shanghai.[20] But CDRs are not used to raise additional capital and only available to investors with more than RMB 3 milllion (US$ 424,580) in financial assets.

1.3 Differences between Shanghai Connect and London Connect

Despite the connectivity between Shanghai and the exchanges in Hong Kong and London, Shanghai and London Connects differ significantly in several ways.

Firstly, the biggest difference lies in their market operation mechanisms. Under Shanghai Connect, the investors on both sides directly buy and sell stocks in the market on the other side, with the investors crossing border but the products still remaining locally. Meanwhile, under London Connect, depositary receipts converted from the stocks in the opposite market are listed and traded in the local market, with the product crossing the border but the investors still remaining locally.[21]

Secondly, the eligibility criteria for the issuers and investors under London Connect are higher than those of Shanghai Connect. In order to issue CDRs in Shanghai, LSE-listed companies must meet a minimum market capitalisation of RMB 20 billion and have at least three year of listing history with a minimum of one year on the Premium Segment of the Main Market. But there are no such requirements for Hong Kong issuers. In addition, London Connect CDRs are only available to Chinese investors with more than RMB 3 million in financial assets, six times larger than those of Chinese investors under Shanghai Connect (RMB 500,000).

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[19] SSE, 'Q&A on Shanghai-London Stock Connect Mechanism', Q11, available at <https://mondovisione.com/media-and-resources/news/q-and-a-on-shanghai-london-stock-connect-mechanism> accessed 30 March 2020.

[20] The eligibility criteria for Stock Connect participants are available at the LSE's website, 'Listing Through Shanghai-London Stock Connect', available at <https://www.lseg.com/markets-products-and-services/our-markets/shanghai-london-stock-connect/listing-through-shanghai-london-stock-connect> accessed 30 March 2020.

[21] SSE (n 19), Q8.

Thirdly, Shanghai Connect is a secondary market trading scheme through which investors in one market can purchase shares of listed companies in the counterpart's market. But it does not support primary market activities such as IPOs. By contrast, London Connect covers both primary and secondary markets. For the Westbound listing link, SSE listed companies can use newly issued shares for the issue of GDRs to achieve primary market security issuance, but the Eastbound listing link does not allow the LSE-listed companies to conduct direct fund raising in SSE by issuing new shares in the form of CDR for the time being.

Last but not least, they have different scopes of investment. Eligible shares can be traded automatically under Shanghai Connect and Shenzhen Connect. However, those eligible shares do not automatically fall into the trading system of London Connect. Instead, as mentioned previously, the depositary receipts are listed and traded, subject to the voluntary applications of eligible companies and approval of the regulatory bodies in London and Shanghai. Trading and settlement of the depositary receipts are similar to those for stocks.

2. Differences between Stock Connect and Other Existing Chinese Liberalisation Schemes

Prior to Stock Connect, eligible foreign investors investing in Chinese stock market were confined to two parallel investment schemes: the QFII or its modified version RQFII for foreign investors to participate in Chinese markets; and the Qualified Domestic Institutional Investor (QDII) or Renminbi QDII (RQDII) for Chinese domestic investors to invest in securities outside of China.[22] RQFII participants can invest in the same range of investment products as QFIIs and are subject to many of the same restrictions. But a RQFII uses offshore RMB to purchase Chinese securities, while a QFII has to convert their foreign home currency into RMB to invest directly in China's capital markets. The same applies to QDII and RQDII.[23] According to a HKEx's report, foreign holding via QFII and RQFII in Chinese stock market was less than 0.3% of Chinese total negotiable market capitalisation in 2017.[24]

Stock Connect co-exists with these current inbound and outbound investment schemes, and opens up another channel for foreign investors and issuers to access Chinese markets. But their shares are not considered fungible across different schemes. To become a QFII or RQFII, a non-Chinese financial institution must satisfy certain conditions to seek the approval of the CSRC and the State Administration of Foreign Exchange (SAFE). Similarly, only Chinese banks, securities-related institutions and insurance companies may apply for QDII or RQDII status. Compared to them, Stock Connect provides Chinese and international investors with mutual

[22] In 2002, the CSRC and the People's Bank of China (PBOC) jointly issued the *Provisional Measures on Administration of Domestic Securities Investment of Qualified Foreign Institutional Investors*, initiating the pilot QFII scheme, allowing foreign investors to enter China's capital market directly. For more details about QFII and RQFII, see the SZSE's website, 'About QFII', available at <http://www.szse.cn/enqfii/aboutqfii> accessed 30 May 2020.

[23] The RQDII regime was first launched in 2014, but suspended one year later in 2015 owing to the pressure of capital outflow and a disguised investment into foreign currency denominated assets by RQDII. RQDII was resumed by the People's Bank of China in May 2018.

[24] HKEx, 'Primary Equity Connect- A Breakthrough Opportunity for Mainland-Hong Kong Mutual Market Connectivity and RMB Internationalisation' (August 2017), 7, available at <https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research Papers/2017/CCEO_Rpt(PEC)_201708_e.pdf?la=en> accessed 1 April 2020.

access to each other's markets without the need to go through any protracted and formal approval access.

In addition, there are significant differences between them in several ways.[25] Firstly, they have different scopes of eligible investments. Previously only A-shares were covered in Stock Connect, excluding B-shares, exchange-traded funds (ETFs), bonds and other securities. The products then were expanded into ETFs in 2016 and depository receipts in 2019. Conversely, QFII/RQFII and QDII/RQDII have much broader range of investments including stocks, bonds, investment funds and others such as warrants and index futures.

Secondly, the scope of investors in the pre-existing schemes are narrower than those of Stock Connect. The former is limited to institutional investors with eligibility requirements on minimum business experience, capital and assets under management.[26] Particularly, QFII is only available to qualified institutions domiciled in a country in a memorandum of understanding (MoU) with China. Likewise, RQFII is only available to qualified institutions in the approved RQFII jurisdictions. By contrast, trading securities under Stock Connect is open to all Hong Kong and overseas investors including institutional and individual investors, which are free from any approval and eligibility requirements. Even investors located in jurisdictions that do not qualify for QFII or RQFII can have access to A-shares via Stock Connect. The only exception to Stock Connect is that shares listed on ChiNext, a NASDAQ-style subsidiary of the SZSE initially is limited to institutional professional investors only.[27]

Thirdly, QFII or RQFII used to involve an approval process for a certain amount of associated quota, and the holder was responsible for trading within the limits and disclosing all required information. However, their quota limits were recently removed on 7 May 2020 while a registration process is in place to monitor qualified foreign investors to transfer capital into and out of China.[28] It is a gesture to further open Chinese capital markets to the world, despite the criticism that it will make very little difference, because foreign investors have been relying more heavily on other cross-border channels with better arrangement such as Stock Connect to allow easier access to trade in China.[29] By contrast, the aggregate quota of RMB

[25] A detailed summary of the differences between Stock Connect and other two schemes is included in Citibank's report entitled 'Stock Connect Handbook: A Transformational Breakthrough in China Market Access' (July 2016), at 14-21, available at <https://www.citibank.com/mss/about/assets/docs//Stock_Connect_Handbook_Feb2017.pdf> accessed 31 March 2020.

[26] For the summary of the QFII requirements and the relevant regulations, see SZSE's website, 'About QFII', available at <http://www.szse.cn/enqfii/aboutqfii/> accessed 31 March 2020.

[27] HKEx, 'Stock Connect Another Milestone' (31 March 2020), 4, available at <https://www.hkex.com.hk/-/media/HKEX-Market/Mutual-Market/Stock-Connect/Getting-Started/Information-Booklet-and-FAQ/FAQ/FAQ_En.pdf> accessed 31 March 2020.

[28] China had liberalised monetary policies on securities settlements by increasing quotas from US$ 20 billion to US$ 200 billion for QFIIs who purchased in RMB, but later removed all the quota for QFII and RQFII. Qinqin Peng and Denise Jia, 'China Scraps Quota Limits on QFII, RQFII Foreign Investment Systems' (Caixin, 8 May 2020), available at <https://www.caixinglobal.com/2020-05-08/china-scraps-quota-limits-on-qfii-rqfii-foreign-investment-systems-101551248.html> accessed 8 May 2020.

[29] Xie Yu, 'China's Scrapping of QFII and RQFII Caps on Foreign Investment Will Have a Very Limited Effect, Say Analysts' (South China Morning Post, 21 September 2019), available at <https://www.scmp.com/business/banking-finance/article/3029625/chinas-scrapping-qfii-and-rqfii-caps-foreign-investment> accessed 30 May 2019.

300 billion for Shanghai Connect has been abolished since 16 August 2016 and no aggregate quota has been established for Shenzhen Connect. Instead, trading under Stock Connect is subject to a daily quota for the total market level,[30] with no additional approval or separate quota allocation at the investor level.

3. Key Legal Impediments to Stock Connect

Despite the excitement surrounding Stock Connect, many are wary of numerous hurdles to the smooth implementation of this initiative. This section analyses four major legal issues arising from Stock Connect and their contemporary development.

a. Beneficial Ownership

A key issue for investors using Stock Connect is whether investors have any proprietary rights or beneficial ownership in the shares. Under the Stock Connect trading scheme, the SSE-listed shares are held in a separate account controlled by the Hong Kong Securities Clearing Company (HKSCC) on behalf of investors. This raises concerns about the ambiguity of share ownership since the securities were neither HKSCC's assets nor owned by the investors. In other words, foreign investors are concerned about whether they have any proprietary rights to or beneficial ownership of China's shares under Chinese law.

Under Hong Kong's law, it is well established that HKSCC holds the shares or trust for investors and investors thus would undoubtedly have beneficial ownership.[31] Such rights include, among others, the right to call shareholders' meetings, to exercise voting rights, to subscribe for allocated rights and entitlements, and to receive dividends and distributions, which are all substantive rights normally enjoyed by beneficial owners of shares.[32] The remaining question then is whether Chinese law provides comparable provisions for such ownership. Unlike the common law system, China with a civil law system has traditionally not contained equitable ownership and trust concepts.[33] But the notion of 'nominee holder' was first time introduced into the CSRC's Administrative Measures for the Securities Registration and Settlement 2006.[34] This provision establishes the legal basis upon which QFII/RQFII asset managers hold A-shares (as the nominee holder) for their investors (the beneficial owners).

In addition, the Stock Connect Rules specify that HKSCC is the nominee holder of shares purchased by overseas investors and that investors would 'enjoy rights and interests in the

[30] From 1 May 2018, the Northbound daily quota has been increased from RMB 13 billion to 52 billion and the Southbound daily quota has been increased from RMB 10.5 billion to 42 billion for both Shanghai Connect and Shenzhen Connect. See HKEx, 'Stock Connect Another Milestone' (31 March 2020), 9.

[31] General Rules 824 (Charter 8) of the Hong Kong's Central Clearing and Settlement System stipulates that HKSCC as the nominee holder to provide service to the relevant China authority/China clearing house.

[32] Ibid.

[33] Ping Jiang, *Zhongmei Wuquanfa de Xianzhuang yu Fazhan* (The Presence and Development of Sino-US Property Law) (Tsinghua University Press 2003), 20; and Ming Chang, 'Hugangtong Mingyi Chiyou Gupiao Falv Wenti Chutan (Discussion on Beneficial Ownership under Shanghai-Hong Kong Stock Connect)' (2015) Company Law Review 109, 116.

[34] Article 18 of CSRC's Administrative Measures for the Securities Registration and Settlement (re-issued and effective as of 20 November 2009).

shares according to law'.[35] In response to the concerns arising from market participants, CSRC further released an FAQ on beneficial ownership on 15 May 2015 to confirm the recognition of 'nominee holder' and 'beneficial owner' under Chinese law.[36]

One notable challenge lies in determining whether the investors as beneficial owners have any direct enforcement rights against the underlying listed companies at Chinese courts.[37] Chinese law does not prohibit a beneficial owner of shares from suing the company, nor does it expressly provide for the beneficial owner to do so. The reason is that if Chinese law affords rights (beneficial ownership rights in this case) to a party then, as a general rule, the court would empower a party to seek to enforce those rights and thus beneficial owners would be able to bring a lawsuit. Under Stock Connect, the CSRC makes it clear that an investor taking legal action in China must prove himself as beneficial owner which can be certified by the HKSCC as nominee holder in its records.[38] In addition, Article 119 of China's Civil Procedure Law only requires that a claimant have a 'direct interest' in this matter. In a nutshell, 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 Chinese courts.

Further, it remains unclear, in the insolvency of the nominee holder, whether the shares would be bankruptcy assets to its general creditors or investors only; and how Chinese courts would recognise overseas liquidation is dubious as Chinese bankruptcy law does not apply to entities incorporated outside China. Indeed, both Hong Kong and China admit that HKSCC is merely the nominee holder and not the beneficial owner. On that basis, the shares are not part of the bankruptcy assets of HKSCC but remain the assets of investors. Even in the (rather unlikely) insolvency of HKSCC, Chinese courts would also recognise the Hong Kong liquidator of HKSCC, but any liquidation would take place in Hong Kong owing to the narrow scope of Chinese bankruptcy law. Therefore, it appears that investors have beneficial ownership under both Hong Kong and Chinese law.

b. Investor Protection

[35] Articles 7 and 13 of CSRC Stock Connect Pilot Rules (issued and effective as of 13 June 2014); and Articles 115 and 118 of SSE Shanghai-Hong Kong Stock Connect Pilot Programme Provisions (issued and effective as of 26 September 2014).

[36] CSRC, 'FAQ on Beneficial Ownership under SH-HK Stock Connect' (15 May 2015), available at <http://www.csrc.gov.cn/pub/csrc_en/newsfacts/PressConference/201505/t20150515_277108.html> accessed 4 April 2020.

[37] Guangjian Tu, 'Lun "Hugangtong" JIzhi xia Zhengquan Quanyi de Falv Shiyong (Analysis on the Applicable Law of Securities Ownership under Shanghai-Hong Kong Stock Connect' (2016) 5 Guojifa Yanjiu (Chinese Review of International Law) 65, 72-73; and Hui Huang, '"Yiguoliangzhi" Beijing xia de Xianggang yu Neidi Zhengquan Jianguan Hezuojizhi: Lishi Yanbian yu Qianjing Zhanwang (The Prospect and Evolution of Securities Regulatory Cooperation between Hong Kong and Mainland China Under the "One Country, Two Systems" Arrangement)' (2017) 5 Journal of Comparative Law 12, 23-24.

[38] CSRC, 'Q&A regarding Certain Provisions on Stock Connect between Mainland and Hong Kong Stock Markets' (27 October 2016), Q4, available at <http://www.csrc.gov.cn/pub/csrc_en/laws/overRule/PolicyInterpretation/201610/t20161027_305087.html> accessed 5 April 2020, and Also Article 5 of ChinaClear Securities Registration Rules (issued and effective as of 25 July 2006) sets the rule for the nominee holder can certify beneficial ownership in its records.

For cross-border securities transactions to flourish, prudential regulation for investor protection provides the essential foundation for building and maintaining vibrant markets.[39] According to the World Bank's Doing Business Report, China has significantly strengthened shareholder protection, as a result of the issuance of the new Chinese Securities Law, the clarifications on the application of Chinese Company Law and the amended listing rules. Consequently, its ranking in global minority shareholder protection jumped from 98th in 2014 to 28th in 2020, compared to top 7 ranked by both the UK and Hong Kong in 2020.[40]

Although China is catching up with its counterparts to provide comparable protection for investors, the risks associated with investing in Chinese companies have been sparked by the recent Chinese corporate scandals in the US. Two more US-listed Chinese companies, TAL Education Group and video streaming site iQIYI, are under scrutiny for allegedly inflating their financial data, less than a week after Luckin Coffee admitted to a US$ 310 million accounting fraud in April 2020.[41] On the other side of the Atlantic, it is not uncommon for Chinese companies to withdraw from the LSE due to the non-compliance with the exchange rules. As of 2015, roughly 80 companies from China had joined the LSE's AIM (formerly the Alternative Investment Market) in the previous 10 years, but only about 45 remained.[42] In the period of 2014/2015 alone, 13 Chinese companies were delisted.

These cases are reviving a big question for international investors in Chinese firms: should they still trust Chinese companies even if their financial reports look good? As summarised by Chen and others, the emerging Chinese corporate scandals have revealed the existing problems in Chinese financial systems, such as weak corporate governance, the lack of effective accounting and auditing professionals, poor information disclosure and investor protection.[43] But the primary responsibility may fall on the regulators who are still structurally incapable of enforcing the law across borders.[44]

One of the policy considerations for China to push for Connect CDRs is to lure capital from China-born technology giants which are currently listed overseas back into its home market

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[39] OECD, 'Cross-Border Trade in Financial Services: Economic and Regulation', Financial Market Trends, No75 (March 2000), 23-24, available at < http://www.oecd.org/finance/financial-markets/1923208.pdf> accessed 20 April 2020.

[40] World Bank, 'Doing Business Reports' 2014-2020, available at <https://www.doingbusiness.org/en/reports/global-reports/doing-business-2020> accessed 20 April 2020. But The strength of a jurisdiction in protecting shareholders can be interpreted differently depending on the choice of variables in a leximetric study. See Horace Yeung and Flora Huang, 'Shareholder Protection in China from a Numerical Comparative Law Perspective' (2019) 7(1) Chinese Journal of Comparative Law 124.

[41] Yujing Liu, 'Two More US-Listed Chinese Companies Come Under Financial Scrutiny, Less Than a Week After Luckin Coffee's Accounting Fraud', South China Morning Post (8 April 2020), available at <https://www.scmp.com/business/china-business/article/3078934/two-more-us-listed-chinese-companies-come-under-financial> accessed 20 April 2020.

[42] Kate Burgess, 'London Stock Exchange Clamps Down on Aim-Quoted Chinese Companies' (Financial Times, 9 October 2015), available at <https://www.ft.com/content/0eee474a-6e8f-11e5-aca9-d87542bf8673> accessed 20 April 2020.

[43] Catherine Chen et al, 'Corporate Accounting Scandals in China' in Michael John Jones (ed.), *Creative Accounting, Fraud and International Accounting Scandals: Fraud and International Accounting Scandals* (John Wiley & Sons, 2012), 180.

[44] David Cogman and Gordon Orr, 'How They Fell: The Collapse of Chinese Cross-Border Listings' (McKinsey, 1 December 2013), available at <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/how-they-fell-the-collapse-of-chinese-cross-border-listings> accessed 20 April 2020.

to boost the domestic economy.[45] But most Chinese overseas listings which are incorporated in offshore tax havens adopt the Variable Interest Entity (VIE) structure to circumvent China's foreign ownership restrictions, creating complications to investigation and enforcement. Under a VIE structure, foreign investors purchase shares in an offshore entity, typically a shell company domiciled in the Cayman Islands or the British Virgin Island, which owns neither a revenue-generating business operation nor equity in an operating company.[46] The investors derive economic benefits solely from the contractual agreements between the listed entity and the underlying China-domiciled business, but such agreement are hardly enforceable in China due to their technical invalidity under Chinese law.[47]

Although the VIE structure permits both foreign and domestic investors to evade Chinese regulations and reviews, this simultaneously means that the VIE structure hazardously lacks the backing of the relevant authorities which presents a number of legal and regulatory risks.[48] The Securities and Exchange Commission (SEC) has warned the risks of Chinese listings, because the SEC and other authorities often have substantial difficulties in bringing and enforcing actions against such Chinese companies for false disclosures around the nature and quality of financial information, including financial reporting and audits.[49]

Another major risk lying in the existing China-Hong Kong link is that investors may not be protected by safeguards available on both sides. One example is the investor compensation fund. Hong Kong's Investor Compensation Fund (ICF) compensates investors for any pecuniary losses arising from the default of a licensed entity or authorised institution in relation to exchange-traded products in Hong Kong, such as fraud or insolvency.[50] As Southbound trading is conducted by mainland securities brokers that are neither licensed nor regulated with the SFC and Northbound trading securities are not listed in Hong Kong, they are in principle not covered by the ICF.

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[45] Xiangdong Pan et al, 'CDR Faxing Jiaoyi Jizhi ji Xiangguan Peitao Cuoshi (CDR Issuing and Trading Mechanism and Related Supporting Measures)', 3, China Securities Investor Service Centre research report, available at <http://www.isc.com.cn/u/cms/www/201911/01160043imwf.pdf> accessed 20 April 2020.

[46] Guo Li, 'Chinese Style VIEs: Continuing to Sneak under Smog' (2014) 47(3) Cornell International Law Journal 567, 577.

[47] For more than a decade, the Chinese government has largely turned a blind eye to VIEs' legal status. The 2015 Draft Foreign Investment Law prohibited to use VIE structure to operate in sectors of the Chinese economy that were restricted or prohibited to foreign investors. However, this did not make into China's New Foreign Investment Law (effective as at 1 January 2020) due to the controversies over how to regulate the round-trip investment as well as difficulties in exercising ongoing supervision in practice. See Meichen Liu, 'The New Chinese Foreign Investment Law and its Implication on Foreign Investors' (2018) 38 (2) Northwestern Journal of International Law & Business 285; and Ping Xu et al, 'Implementing Regulation for Foreign Investment Law Heralding a New Era of Foreign Investment Regime in China' (King & Wood Mallesons, 8 January 2020), available at <https://www.chinalawinsight.com/2020/01/articles/foreign-investment/implementing-regulation-for-foreign-investment-law-heralding-a-new-era-of-foreign-investment-regime-in-china> accessed 30 May 2020.

[48] Serena Y. Shi, 'Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States' (2014) 37 (4) Fordham International Law Journal 1265, 1303-1306.

[49] SEC, 'Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks, Remedies are Limited' (21 April 2020), available at <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting> accessed 24 May 2020.

[50] The scope and procedure of ICF is available on its website <https://www.hkicc.org.hk/how_claim/main_e.htm> accessed on 20 April 2020.

Similarly, the China Securities Investor Protection Fund (SIPF) only extends to the indemnification of investors with respect of losses arising, 'in case a securities company in China is subjected to compulsory regulatory measures including dissolution, closure, bankruptcy and administrative takeover by CSRC and custodian operation' or 'other functions approved by the State Council'. However, since Northbound trading is carried out through securities brokers in Hong Kong, but not China-based brokers, the SIPF also does not extend to protect defaults experienced on Northbound trading.

But this legal loophole has been addressed by an amendment to Hong Kong's ICF. Since 1 January 2020, Hong Kong's ICF has expanded its coverage to A-shares traded in SSE and SZSE under Stock Connect (Northbound trades of A-shares).[51] The rationale is that transactions under the Northbound link of Stock Connect must be routed through Hong Kong intermediaries, so these transactions should be covered under the regime. But the fund does not cover Southbound trading of Stock Connect. In other words, Hong Kong investors can benefit from compensation under the ICF on Northbound trading while Chinese investors can also exercise their rights under the SIPF on Southbound trading.

c. Home Market Rules v. Extraterritoriality of Chinese Securities Law

A fundamental principle of Stock Connect is that 'home market rules', that is the laws and rules of the home market of the applicable securities, shall apply to investors in such securities.[52] This principle avoids the need to significantly alter home rules and regulations, which could be a very lengthy process. For instance, with respect to purchasing Chinese Connect securities, China is the home market and thus its law applies. Table 2 illustrates different laws applicable to investors in different scenarios. Conversely, Chinese investors trading foreign securities via Stock Connect should refer to predominantly the Hong Kong law and the UK law respectively, subject to the discussion on the extraterritoriality of the Chinese Securities Law below.

Table 2: Applicable Shareholder Protection Laws under Different Routes of Acquisition of Chinese Shares

	Cross-listed Shares in London/Hong Kong	Stock Connect Trading from London	Stock Connect Trading from Hong Kong	Direct Acquisition of A-Shares in China
Company Law	China	China	China	China

[51] Hong Kong SARs, 'Enhancements to Investor Compensation Regime Gazetted' (11 October 2019), press releases, available at <https://www.info.gov.hk/gia/general/201910/11/P2019101100233.htm> accessed 20 April 2020.

[52] For the narrative of the 'home market rules', see LSE, 'Trading Through Shanghai-London Stock Connect', available at <https://www.lseg.com/markets-products-and-services/our-markets/shanghai-london-stock-connect/trading-through-shanghai-london-stock-connect> accessed 30 May 2020; and Credit Lyonnais Securities Asia (CLSA), 'China Connect Services Annex Supplement to Securities Dealing Services: Hong Kong Market Annex' (2018), 17, available at < https://www.clsa.com/wp-content/uploads/2018/05/2-2-China-Connect-May-2018.pdf> accessed 30 May 2020.

Securities Law	UK/HK (+China)*	China (+UK)**	China (+HK)***	China
Listing Rules	UK/HK	China (+UK)**	China	China

Note *: All overseas listing requires approval from the CSRC under the Chinese Securities Law and related provisions.
Note **: As a result of the issuance of GDRs.
Note ***: Trading and clearing participants in Hong Kong are still subject to the Securities and Futures Ordinance (SFO) of Hong Kong.

To implement the 'home market rules', China has made efforts to incorporate Stock Connect into its legal system. For example, Article 2 of the new Chinese Securities Law 2020 defines securities to encompass stocks, bonds, DRs, asset management products, investment fund and other securities with similar nature. DRs as part of Stock Connect products have been embedded into the Securities Law for the first time. The expanded coverage of the Securities Law is to resolve the previous inconsistency between the old Securities Law and the Stock Connect rules.

However, the notion of 'home market rules' has been challenged by the extraterritorial jurisdiction of the Chinese Securities Law 2020, in the context of when the UK/Hong Kong law is to apply. Following the US's lead, the extraterritorial jurisdiction (also called long-arm jurisdiction) is introduced into Article 2 of the Chinese Securities Law 2020. Pursuant to Paragraph 4 of Article 2, it stipulates that:

> 'issuance or trading activities of securities outside the territory of PRC [People's Republic of China] that disrupt the order of the market within the territory of the PRC or damage the legitimate rights and interests of the investors within the territory of the PRC shall be regulated and relevant legal responsibilities shall be pursued in accordance with this Law.'

This indicates that the new law has a scope of extraterritorial jurisdiction, justifying its actions as necessary to protect Chinese investors and the integrity of the Chinese markets. In addition, the issuance or trading behaviour occurred in an exchange or over the counter outside of the territory of China may also trigger the relevant reporting obligations under Article 78. It is intended to capture certain disclosure issues in relation to Stock Connect companies and the holding of a company that is dual listed in China and abroad, for example, A-share and H-share markets, where the holdings should be aggregated as a general principle.

Whereas the extraterritoriality of securities law is now widely accepted, there remains a debate as to the proper scope and justifications for such application.[53] A too narrow approach to extraterritoriality would result in under-regulation whereby countries may lack a sufficient

[53] For general discussion, see Andrew Guzman, 'Choice of Law: New Foundations' (2002) 90 Georgetown Law Journal 883, and also Stephen Choi and Andrew Guzman, 'The Dangerous Extraterritoriality of American Securities Law' (1996) 17 (1) Northwestern Journal of International Law & Business 207. In the context of China, the principles of reasonableness and effects should be taken into account in the application of Securities Law extraterritorially, see Feng Yang, 'Woguo Zhengquanfa Yuwai Shiiyong Zhidu de Goujian (A Framework of the Extraterritoriality of China's Securities Law)' (2016) Fashang Yanjiu (Studies in Law and Business) 166.

basis or motivation for applying their law to a case.[54] By contrast, an overly broad extraterritorial reach of national law may cause jurisdictional conflict with other countries, although such conflict is less acute in the realm of securities law due to the almost universal prohibition of securities fraud.[55] Even the US has characterised the extraterritorial application of its law as exclusively falling within its domestic justification, and has sought to settle conflicts arising from such application. A decision in *Morrison v. National Australia Bank*[56] requires that the fraud-related transactions at issue be conducted in the US to allow a claim for relief in US courts. This new test has revolted the traditional 'conduct and effects' test which was dominant in the US regime before *Morrison*. However, only a few months after *Morrison* in July 2010, the Dodd-Frank Act restored 'conduct and effects' for transnational securities fraud suits, while also directing the SEC to initiate a study on whether and to what extent a private action should be extended beyond *Morrison*'s transactional test.[57]

While the Chinese Securities Law empowers the CSRC to prosecute market frauds extraterritorially, both the CSRC and the Supreme People Court of China remain silent on the interpretation of extraterritoriality. But according to the CSRC's recent press meeting on 27 April 2020, it would not carry out its own investigation on the financial fraud committed by Chinese Nasdaq-listed company Luckin Coffee unless requested otherwise.[58] Two main reasons may contribute to the CSRC for not utilising the Luckin incident to clarify the circumstances for extraterritorial application of the new Securities Law. Firstly, Luckin Coffee was incorporated in the Cayman Islands rather than China-domiciled, and most investment victims are the US investors instead of Chinese investors. Thus, there may be a lack of strong linkage between the fraudulent incident and the distortion of Chinese market order or the damage to the interests of Chinese investors. Secondly, as claimed by the CSRC, it has always held a positive position towards cross-border regulatory collaboration and supported foreign securities regulators in carrying out investigations and penalties for financial frauds by public companies within their own jurisdictions. The CSRC's condemnation on Luckin Coffee should not be over-interpreted as a move to exercise extraterritorial jurisdiction under the Securities Law.[59] In this regard, China seems to adopt a rather cautious approach to extraterritoriality which is motivated by cross-border regulatory collaboration, as opposed to an attempt to invoke the Securities Law for extraterritorial enforcement.

d. Regulatory Enforcement and Cooperation

[54] Genevieve Beyea, 'Transnational Securities Fraud and the Extraterritorial Application of US Securities Laws: Challenges and Opportunities' (2011) 1 Global Business Law Review 139, 154.

[55] Ibid, 167 and also Kelley Morris White, 'Is Extraterritorial Jurisdiction Still Alive- Determining the Scope of US Extraterritorial Jurisdiction in Securities Cases in the Aftermath of Morrison v National Australia Bank' (2011) 37 (4) North Carolina Journal of International Law and Commercial Regulation 1187, 1211.

[56] 130 S. Ct. 2869 (2010).

[57] Joshua Boehm, 'Private Securities Fraud Litigation after Morrison v National Australia Bank: Reconsidering a Reliance-Based Approach to Extraterritoriality' (2012) 53 (1) Harvard International Law Journal 249, 250.

[58] A full response by the CSRC regarding Luckin Coffee is available at Xinhua Net <http://www.xinhuanet.com/2020-04/28/c_1125914475.htm> accessed 21 May 2020.

[59] Qing Xie and Man Wu, 'New Development in Cross-Border Regulatory Collaboration – Observations on CSRC Comments on Luckin Coffee Incident' (Junhe Law Firm Review, 30 April 2020), available at <http://www.junhe.com/legal-updates/1183> accessed 21 May 2020.

Cooperation and information exchange amongst financial regulators is of critical significance for effective oversight in an integrated financial system.[60] Weakness in regulatory cooperation can undermine the efforts of regulatory authorities to ensure that laws are followed and mitigate the safeguard of the legitimate interests of investors.

In addition to the signatories to the International Organisation of Securities Commissions' Multilateral Memorandum of Understanding (MMoU) in 2002 as a multilateral platform, which provides for mutual investigatory and other assistance and exchange of information between international securities regulators, a series of bilateral agreements have been signed between China-Hong Kong and China-UK.

Regulatory cooperation between China and Hong Kong could be traced back to 1993 when the five parties, namely the CSRC, SFC, HKEx, SSE and SZSE, entered a Memorandum of Regulatory Cooperation (MORC) to facilitate mutual assistance and exchange information for the enhancement of investment protection.[61] But this mutual assistance is hardly enforceable due to the absence of non-compliance measures in the memorandum.[62] With the increasing market integration, three MoUs were signed between the CSRC and the SFC to enhance their cooperative arrangements on mutual market access, investigatory assistance and the exchange of information in 2016-2018.[63] This signifies their joint commitment to take effective action against cross-boundary illegal activities and market misconduct to maintain an orderly market and protect investors. In particular, the 2016 MoU established procedures for cross-boundary liaison and cooperation on any contingency or major event that affects mutual trading access.[64]

On the other side, an MoU between the SSE and the LSE was signed in 1994 followed by an agreement with the CSRC in 1996 which allowed Chinese stocks to be listed in London for the first time. Recently, another MoU signed in 2018 between the CSRC and the Financial Conduct Authority (FCA) sets out a framework for co-operation between the two regulators to support Shanghai-London Stock Connect, which aims to protect investors and combat cross-border market abuse and other serious misconduct.[65]

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[60] Financial Stability Board, 'Initiative on Cooperation and Information Exchange' (March 2020), available at <https://www.fsb.org/work-of-the-fsb/implementation-monitoring/initiative-on-cooperation-and-information-exchange> accessed 9 April 2020.

[61] For the development of China-Hong Kong regulatory cooperation, see Flora Huang and Horace Yeung, 'Regulatory Cooperation between Securities Commissions: A Reflection from Hong Kong' (2013) 1 Chinese Journal of Comparative Law 112, 138-140.

[62] Jiangyu Wang, 'Regulatory Competition and Co-operation between Securities Markets in Hong Kong and Mainland China' (2009) 4 Capital Markets Law Journal 383, 390.

[63] SFC, 'Regulatory Collaboration-Mainland China', available at < https://www.sfc.hk/web/EN/about-the-sfc/collaboration/mainland> accessed 6 April 2020.

[64] SFC, 'Joint Announcement of the China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission' (25 November 2016), available at < https://www.sfc.hk/web/EN/news-and-announcements/policy-statements-and-announcements/joint-announcement-of-the-china-securities-regulatory-commission-and-the-hong-kong-sfc.html> accessed 6 April 2020.

[65] FCA, 'FCA and CSR Announce their Support for the Shanghai-London Stock Connect Scheme' (17 June 2019), available at < https://www.fca.org.uk/news/press-releases/fca-and-csrc-announce-their-support-shanghai-london-stock-connect-scheme> accessed 7 April 2020.

While bilateral arrangements, complementing the multilateral platform, are recognised as 'an essential tool in assisting regulators to enforce securities laws globally and locally',[66] it is faced with mounting criticism. All these memoranda constitute more of an expression of a desire to cooperate than a binding agreement.[67] Hence, whether to cooperate or not is largely left to the regulators who should have an incentive to do so to preserve their reputation and credibility.[68] China has long been blamed to reluctantly allow overseas regulators to inspect audit documents relating to Chinese companies due to national security concerns. In a media interview, Jay Clayton, chairman of the SEC, indicated that the regulator's accounting oversight arm, the Public Company Accounting Oversight Board has been unable to access audits of US-listed Chinese companies from the Chinese government for almost a decade.[69] Even in a better-established relationship between China and Hong Kong, China has constituently in the past rejected requests for information by Hong Kong regulators investigating locally listed Chinese companies, particularly in high-profile corporate scandals such as Liu Jinbao, the former chief executive of the Bank of China (Hong Kong), Yang Bin, chairman of Euro-Asia Agricultural Holdings, an orchid grower in north- east China, and Zhou Zhengyi, chairman of Shanghai Land Holdings.[70]

Nevertheless, Stock Connect has changed 'the balance of incentives to cooperate across borders', as addressed by Ashley Alder, CEO of Hong Kong's SFC.[71] The CSRC usually received many requests and required few from other regulators because international companies were not listed in China. But this imbalance has been gradually reversed by Stock Connect to allow trading in Chinese and overseas markets. On 10 March 2017, the CSRC published a decision sanctioning two individuals for the manipulative trading of securities committed through Stock Connect, relying on evidence from the SFC.[72] This was the first ever such sanction for activities committed through Stock Connect. But even if the CSRC or SFC convinces its counterpart to gather evidence on its behalf, additional issues may arise: firstly, will the court recognise the evidence collected by the mutual assistance? Secondly, how should legal liability arising from a wrongful decision based on unsound evidence be allocated to the two regulators?[73] With respect to the first question, the validity of co-collected evidence by the two commissions was affirmed by the Hong Kong Court in *Tang Hanbo v The*

[66] Rita Cunha, 'The IOSCO Multilateral Memorandum of Understanding MMoU: An International Benchmark for Securities Enforcement' (2010) 15 Uniform Law Review 677, 685.
[67] Jiangyu Wang (n 62), 390. And also, for more critics on MoU, see Flora Huang et al., 'Coordinated Efforts to Regulate Overseas Listed Chinese Companies: A Historical Perspective and Recent Developments' (2017) 18(1) Journal of Corporate Law Studies 1, 22.
[68] Janet Austin, 'IOSCO's Multilateral Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information' (2012) 23 Criminal Law Forum 393, 416.
[69] Katanga Johnson, 'US Securities Regulator Warns Investors over Chinese Company Disclosures' (Reuters, 22 April 2020), available at < https://www.reuters.com/article/us-health-coronavirus-sec-china-idUSKCN2242A1> accessed 8 May 2020.
[70] David Donald, *A Financial Centre for Two Empires* (CUP 2014), 252-53.
[71] Chris Wright, 'HK SFC's Alder Says Stock Connect has Improved Balance with Chinese Regulators' (Euromoney, 15 March 2017), available at <https://www.euromoney.com/article/b12khpnfn23blg/hk-sfc39s-alder-says-stock-connect-has-improved-balance-with-chinese-regulators> accessed 8 April 2020.
[72] The CSRC, 'the CSRC's Administrative Sanctioning Decision (Tang Hanbo and Wang Tao)', available at <http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201703/t20170310_313478.htm> accessed 6 April 2020.
[73] Xusheng Yang and Sue Liu, 'Bridging a Vast Gap' (2015) 34 International Financial Law Review 20, 21.

Securities and Futures Commission and another[74]. But unfortunately, the two regulators have yet to decide how to resolve the second issue.

In addition, China's Supreme People's Court and Hong Kong concluded a new '*Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region*' on 18 January 2019 (New Arrangement). Prior to the New Arrangement, the only mechanism for mutual recognition or enforcement of judgments between two jurisdictions was the 2006 Arrangement. The 2006 Arrangement applied only to commercial contracts and placed a number of requirements on those contracts. It also only applied to monetary awards, not to non-monetary orders. But the New Arrangement removes these limitations and broadens its scope to all civil and commercial matters under Chinese and Hong Kong law including Stock Connect, unless expressly excluded.[75] It seeks to establish a bilateral legal mechanism with greater clarity and certainty for recognition and enforcement of judgments in a wider range of civil and commercial matters between the two jurisdictions. Parties seeking to enforce judgments covered by the New Arrangement will not need to re-litigate their cases when seeking to recover assets in Hong Kong or China.

The change of China's incentive to regulatory cooperation is also reflected by the enforcement-related requests between China and Hong Kong in 2010-2018 (see Table 3). Prior to 2014, only a few requests were sent out by the CSRC each year, compared to the high receiving end for requests for investigatory assistance. But after the launch of Stock Connect, the requests made by the CSRC (mainly to the SFC) has jumped to tens. By contrast, the in-and-out requests by the SFC (mainly with the CSRC) were consistent at around 100-160. On the other hand, the UK's FCA received around 1,000 requests from international counterparts while the requests made were not published in 2018/19.[76] And the number of requests communicated between China and the UK was unknown due to the shortage of data.

Table 3: Enforcement-Related Requests for Regulatory Cooperation in China and Hong Kong 2010-2018

	Requests	2010	2011	2012	2013	2014	2015	2016	2017	2018
CSRC	Received	87	75	54	90	97	130	174	184	125
	Made	9	5	3	6	13	30	37	N/A	24
SFC	Received	93	104	112	103	94	92	155	136	113
	Made	74	104	146	113	111	160	112	104	99

Sources: Various Annual Reports of the CSRC and the SFC

[74] [2017] HKCU 2895.
[75] The New Arrangement does not, however, apply to judicial review cases; cases in relation to the succession, administration or distribution of the estate; maritime matters; corporate insolvency and debt restructuring and personal insolvency matters; and judgements on the validity of an arbitration agreement and the setting aside of an arbitral award. The full text is available at <https://www.doj.gov.hk/eng/public/pdf/2019/Doc6_481354e.pdf> accessed 8 May 2020.
[76] FCA, 'Enforcement Annual Performance Report 2018/19' (2019), 20, available at <https://www.fca.org.uk/publication/corporate/annual-report-2018-19-enforcement-performance.pdf> accessed 8 April 2020.

With respect to the enforcement on Stock Connect, the SFC and the CSRC agreed on a reciprocal basis to introduce an investor identification regime, that is the 'see-through' model, to give both regulators a direct and real-time line of sight into Stock Connect cross-market trades at the client level.[77] The see-through model requires the identification of the customers of intermediaries, i.e. the end-investors, for each order and transaction.

The launch of the investor identification regime has caused considerable controversies in China and Hong Kong, giving their different regulatory systems. In contrast to China's direct holding system having a direct oversight of investor trading activities, Hong Kong adopts an indirect nominee system which is common in other developed markets such as the US, the EU and Australia.[78] As securities are held in custody or brokers or custodians which are participants of HKSCC, a subsidiary of HKEx, the SFC normally obtains trading information, by requiring individual brokers to identity clients and trading. While the direct holding system brings concerns to the privacy of investors, the nominee system is criticised to lack transparency on investor identification and make market supervision difficult, albeit the efficiency of securities transfer and cost reduction in securities safekeeping.[79]

The disparities in Chinese and Hong Kong's regulatory and operational models have given rise to difficulties in cross-border market supervision over trading activities under Stock Connect. The SFC's usual practice of obtaining client trading information from brokers has become a strain on its internal resources, and in the meantime, Chinese regulator has 'no meaningful data for surveillance purposes when global investors trade mainland securities through Stock Connect', and similarly for the Hong Kong regulator in identifying investors of Southbound trades.[80] Thus, the investor identification system will bring the Hong Kong regulatory framework more in line with Chinese efforts to increase transparency and improve cross-border market surveillance.

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[77] Followed by the introduction of the investor identification regime for northbound trading in September 2018, the regime for southbound trading was also announced in October 2019. See the SFC's website, available at <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR99> accessed 11 May 2020.

[78] The UK has a mixed holding model with standing register where investors may hold shares directly on the register either in dematerilaised or materialised form or may use an intermediary to hold shares on their behalf. However, the EU and the US are preparing for the implementation of investor identification regimes as parts of the European Market in Financial Instruments Directive II and the US Consolidated Audit Trail plan respectively. Australia has also introduced relevant clauses in its rules since March 2014 to require market participants to provide investor identification data for the purpose of placing buy and sell orders, trading and trade reporting. See the HKSAR Press Release, 'LCQ12: Real-time Investor Identification System for Northbound Cross-boundary Stock Trading' (29 November 2017), available at <https://www.info.gov.hk/gia/general/201711/29/P2017112800785.htm> accessed 12 May 2020.

[79] For a summary on the benefits and drawbacks of the direct holding and indirect nominee systems, see HKEx, 'Securities Holding System and "See-Through" Market Supervision – International Experience' (January 2020), 4-5, available at <https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2020/CCEO_SecHolding_202001_e.pdf?la=en> accessed 12 May 2020.

[80] Keynote speech at the 8th Pan Asian Regulatory Summit by Ashley Alder, CEO of the SFC, 10 October 2017, available at <https://www.sfc.hk/web/EN/files/ER/PDF/Speeches/AIA20171010%20final.pdf> accessed 12 May 2020.

4. Why does China-Hong Kong Stock Connect Succeed while Shanghai-London Stock Connect Fails (Thus Far)?

As of the end of May 2020, there were 321 eligible Southbound stocks and 579 eligible Northbound stocks (for both sell and buy) under Shanghai Connect, representing around 15.2% of stocks on the HKEx Main Board and 35.4% in the number of A-shares listed on the SSE (see Table 4). The average daily Northbound trading value constituted about 10.1% of Chinese A-share market total turnover and the average daily Southbound trading value accounted for 19% of the HKEx Main Board total turnover.[81] The scope of eligible shares for Shenzhen Connect is extended to cover a group of shares on the SME Board and ChiNext market in the SZSE and to include the constituents of small cap shares in the HKEx. So the number of Shenzhen Connect stocks was larger than those under Shanghai Connect, increasing to 476 Southbound and 706 Northbound stocks.

In contrast to the successful growth of China-Hong Kong Stock Connects, London Connect has attracted little interest thus far. As of the end of May 2020, only one Chinese company, Huatai Securities, raised US$ 1.54 billion GDRs in London on 17 June 2019.[82] This is also the first time for international investors with access to China A-shares on an exchange outside Greater China using international trading and settlement mechanism. The initiative of an International Board on the SSE was raised in 2009 to attract foreign companies to raise funds on China's stock market. However, slow progress has been made so far, subject to the convertibility of Chinese currency and the removal of foreign ownership limit in firms providing securities and fund management services.[83]

Following Huatai's step, Shanghai-listed SDIC Power - an alternative energy operator which would have become the second Chinese company issuing GDRs in London, decided to delay its listing based on 'its own financing needs and market situation'.[84] Other companies that were hopeful of expansion and increased investment such as China Pacific were also ordered to halt their plans by the CSRC. On the other side, no UK company has been successfully listed in the SSE via London Connect. HSBC, along with British luxury brand Burberry, were planning to become the first CDRs issuers but to no avail as of now. It was reported that the cross-border link had been suspended in January 2020, likely owing to the China-Britain political tension over the Hong Kong protest, but it was denied by China.[85]

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[81] Stock Connect daily turnover value is available at HKEx, 'Stock Connect', <https://www.hkex.com.hk/Mutual-Market/Stock-Connect?sc_lang=en>, and A-share daily turnover value is available at SSE, 'Market Data', <http://english.sse.com.cn> and SZSE, 'Market Overview', <http://www.szse.cn/English/siteMarketData/marketStatistics/overview/index.html> accessed 3 June 2020.

[82] For the news press, available at LSE's website <https://www.lseg.com/resources/media-centre/press-releases/shanghai-london-stock-connect-welcomes-its-first-issuer-huatai-securities> accessed 25 March 2020.

[83] Daniel Ren, 'China still "Exploring" International Board for Foreign Companies to Raise Funds on Shanghai Stock Exchange' (South China Morning Post, 14 June 2019), available at <https://www.scmp.com/business/companies/article/3014457/china-still-exploring-international-board-foreign-companies> accessed 2 April 2020.

[84] Julie Zhu et al, 'Exclusive: China Halts British Stock Link over Political Tensions – Source' (Reuters, 2 January 2020), available at < https://uk.reuters.com/article/us-china-britain-ipos-exclusive/exclusive-china-halts-british-stock-link-over-political-tensions-sources-idUKKBN1Z108L> accessed 25 March 2020.

[85] Xiaochao Zhang and Andrew Galbraith, 'China Regulator Denies Report of Halt to Shanghai-London Stock Connect Listings' (Reuters, 3 January 2020), available at <https://www.reuters.com/article/us-china-markets-

Some commentaries cast doubts on the growth prospects of London Connect and how much value it can add to the UK markets.[86] London Connect is probably considered more 'incremental than revolutionary' because international investors have already had access to Chinese shares through the existing avenues such as China-Hong Kong Stock Connect and Chinese overseas listings.[87] Moreover, whereas London connect only allows investors to access DRs, the already existing stock connect schemes between China and Hong Kong offer a much wider menu of stock selections. These stocks give investors the chance to invest in all Chinese prominent economic sectors like industrial, financial and utilities sectors. It is in doubt whether international investors will choose to access A-shares through London Connect, which has been criticised for being 'just a watered-down version of Hong Kong's programme' when they can already access them easily through Hong Kong, a free market open to traders worldwide.[88]

Another facet dampening British interest in the Connect is that while Chinese companies may raise new capital by selling GDRs in London, under the current agreement UK-listed companies can only issue CDRs backed by existing shares. It means that they cannot raise additional capital in the SSE due to China's attempt to curb capital outflows and prevent capital inflows of fresh equity from flooding the domestic markets.[89] The restrictions are not only on the CDR issuers but also on the investors. Only a relatively low proportion of Chinese investors with RMB 3 million are allowed to trade in London Connect. Data released by the SSE showed that about 820,000 stock trading account holders in China met the standards for CDR trading, which accounts for merely 2.1% of the total.[90]

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regulator/china-regulator-denies-report-of-halt-to-shanghai-london-stock-connect-listings-idUSKBN1Z20U5> accessed 25 March 2020.

[86] For example, Bloomberg, 'All About the UK-China Plan to Link Stock Markets' (18 June 2019), available at <https://www.bloomberg.com/news/articles/2018-10-10/all-about-the-u-k-china-plan-to-link-stock-markets-quicktake> accessed 25 March 2020.

[87] Julia Fioretti, 'Launch of Shanghai-London Stock Link Stalled amid Doubts on Demand' (Reuters, 20 December 2018), available at <https://uk.reuters.com/article/uk-china-listings-analysis/launch-of-shanghai-london-stock-link-stalled-amid-doubts-on-demand-idUKKCN1OJ00B> accessed 28 May 2020.

[88] Nisha Gopalan, 'London's Shanghai Dream is a Bridge to Nowhere' (Bloomberg, 13 April 2018), available at < https://www.bloomberg.com/opinion/articles/2018-04-13/london-s-shanghai-stock-connect-dream-is-a-bridge-to-nowhere> accessed 1 April 2020.

[89] Samuel Shen and Andrew Galbraith, 'China Constricts Capital Outflows with Eye on Yuan Stability' (Reuters, 11 October 2018), available at < https://www.reuters.com/article/us-china-markets-soft-landing-analysis/china-constricts-capital-outflows-with-eye-on-yuan-stability-idUSKCN1ML1SW> accessed 25 April 2020.

[90] Xiaoyang Li, 'New Connection' (Beijing Review, 24 June 2019), available at <http://www.bjreview.com/Business/201906/t20190624_800171443.html> accessed 25 April 2020.

Table 4: Listed-Securities under Stock Connect in May 2020

	Shenzhen-Hong Kong Stock Connect		Shanghai-Hong Kong Stock Connect		Shanghai-London Stock Connect	
Trading Links	Southbound Hong Kong Trading Link	Northbound Shenzhen Trading Link	Southbound Hong Kong Trading Link	Northbound Shanghai Trading Link	Eastbound Shanghai Business Link	Westbound London Business Link
Number of Securities (as of 31 May 2020)	476	706	321	579	0	1

Sources: the websites of SSE, SZSE, HKEx and LSE.

5. Conclusion

Stock Connect brings together some of the world's largest capital markets. It allows global investors to benefit from China's growth through Hong Kong and London, while foreign companies are able to access Chinese investors directly.

Since the launch of Stock Connect in 2014, numerous legislative and regulatory changes have undergone and continued to take place. The removal of the Stock Connect aggregate quota, the expansion of the eligible stock ranges and the establishment of see-through regulatory mechanism provide investors with more diversified choices while protecting their interests. Moreover, the legal and regulatory gaps between China and other connected markets have been minimised with China's new Securities Law 2020, the amended Stock Connect rules and closer regulatory enforcement. These improvements are mirrored by the affirmation of investors as beneficial owners to enforce their ownership rights by the Stock Connect rules, the expanded scope of the Investor Protection Fund, the CSRC's extraterritorial power to investigate cross-border securities incidents as well as the changes of its willingness to cooperate with the counterparts' regulators. With further development and optimisation, Stock Connect should play an increasingly significant role in the opening-up of Chinese capital markets.

However, while China-Hong Kong Stock Connect gradually shows its importance to international market, London Connect does not progress well owing to the limited participation caused by many restrictions and more appealing investment channels that have already existed. But this situation may be improved with the announcement by the SSE that it would put forward with London Connect in its annual plan for 2020 to strengthen its overseas ties in the wake of the coronavirus crisis.[91] Following the announcement, China

[91] SSE, 'Shanghai Zhengquan Jiaoyisuo Zongjingli Gongzuo Baogao (Jiexuanz)' (SSE Directors' Report (selected) (23 April 2020), available at <http://www.sse.com.cn/aboutus/mediacenter/hotandd/c/c_20200423_5052375.shtml> accessed 20 May 2020.

Pacific Insurance,[92] SDIC Power and China Yangtze Power are moving ahead with their previously suspended London-listing plans.[93]

[92] China Pacific Insurance (CPIC) was listed on the LSE on 17 June 2020 and became the first ever Chinese company listed in Shanghai+Hong Kong+London. See LSE's website <https://www.londonstockexchange.com/discover/news-and-insights/welcome-china-pacific-insurance-group-company-ltd> accessed 18 June 2020.

[93] Abhinav Ramnarayan et al, 'China Urges its Firms to List in London in Renewed Global Push: Sources' (Reuters, 18 May 2020), available at < https://www.reuters.com/article/us-britain-listings-china/china-urges-its-firms-to-list-in-london-in-renewed-global-push-sources-idUSKBN22U1M4> accessed 20 May 2020.