mcmillan Securities Bulletin
November 2014

Shanghai-Hong Kong Stock Connect

Introduction

There has been much media coverage on the new Shanghai-Hong Kong Stock Connect scheme, known as the "through train" in colloquial Chinese, that will enable investors in Hong Kong and on Mainland China to cross-trade eligible listed shares as a means to strengthen the connection between the two cities' exchanges.

Presently, individual investors from Hong Kong and overseas can only participate indirectly in Mainland China's securities markets through certain investment products such as the Qualified Foreign Institutional Investor funds, or Renminbi Qualified Foreign Institutional Investor funds.

The official launch date was on November 17, 2014. The Shanghai-Hong Kong Stock Connect now allows Hong Kong and overseas individual investors to directly trade eligible Shanghai-listed A-shares. Under this scheme, Mainland Chinese investors (including retail investors who hold an aggregate balance of not less than RMB500,000 in their securities and cash accounts) will reciprocally be able to directly trade eligible Hong Kong Stock Exchange ("**SEHK**") listed shares.

Most of the attention has been on how it is now easier for Hong Kong and foreign investors to trade the 568 companies currently listed on the Shanghai Stock Exchange ("**SSE**"). The prospect of this new investment has been credited for the Shanghai Composite Index's 14% advance so far this year[1]. For Mainland Chinese investors, there are 268 eligible companies listed on the SEHK. In contrast, the Hang Seng Index has only gained about 3% year-to-date. This relatively small movement may be due to the fact that many Mainland Chinese investors have already set up Hong Kong brokerage accounts for some time now.

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[1] "Opinion: Who gains most from Hong Kong-Shanghai through train?", MarketWatch, November, 9, 2014.

Overview of the Shanghai-Hong Kong Stock Connect Scheme

- Investment Quota
  - The so-called "Northbound Trading" (i.e. trading of A-shares by Hong Kong and overseas investors) and "Southbound Trading" (i.e. trading of Hong Kong shares by Mainland Chinese investors) are each subject to different aggregate and daily quotas:

	Northbound	Southbound
Aggregate quotas	RMB300 billion	RMB250 billion
Daily quotas	RMB13 billion	RMB10.5 billion

- Eligible Securities
  - In the initial phase, the Shanghai-Hong Kong Stock Connect is applicable only to shares under the following scope:

	Northbound	Southbound
Index Constituents	SSE 180 Index and SSE 380 Index	Hang Seng Composite Large-Cap Index and Hang Seng Composite Mid-Cap Index
A/H Shares	SSE-listed shares which are also SEHK-listed	H-shares which are also SSE-listed
Excluding	All SSE-listed shares which are not traded in RMB or which are under risk alert	All SEHK-listed shares which are not traded in HKD; H-shares which have corresponding A-shares listed but not SSE-listed; H-shares which have corresponding SSE-listed shares placed under risk alert

- Applicable trading, clearing and listing rules
  - Trading and clearing arrangements will be subject to the regulations and operational rules of the local market where trading and clearing take place. Listed companies will continue to be subject only to the listing and other rules and regulations of the markets where they are listed. The Shanghai-Hong Kong Stock Connect scheme will only operate on days which is a trading day for both SSE and SEHK, and where the clearing arrangements are in order.

Potential Opportunities for Canadian Companies & Investors

For Canadian companies and investors, Hong Kong continues to be a listing destination and may become more appealing with the potential of having more Mainland Chinese investors gaining access over time. In addition, Hong Kong offers a number of existing advantages which are well-known, including:

- The Hong Kong dollar is freely convertible;
- Hong Kong has a long-established system of rule of law and business transparency; and
- The Canada–Hong Kong Tax Treaty has certain advantages over the Canada-China Tax Treaty, including a lower withholding rate on dividends.

The fact that both SEHK and SSE will retain separate regulatory and trading regimes should also work in Hong Kong's favor as a listing destination. For example, Hong Kong does not have restrictions on intraday trading nor does it have a capital-gains tax. SSE-listed companies are also known to lack transparency and the SSE continues to improve accounting standards and corporate governance, and insider trading remains a concern.

Given this development, Hong Kong has the opportunity to become a global hub for secondary listings for companies with connecting factors to Asia. Among those that have been reported to consider taking advantage are:

- Manulife Financial (TSX: MFC; NYSE: MFC; SEHK: 945) has been inter-listed in Hong Kong since 1999. President and CEO Donald Guloien recently stated that the financial services company is keen to increase exposure to the Mainland share market under the "through train" scheme that will link the Hong Kong and Shanghai exchanges, enabling the company to introduce more yuan insurance and investment products[2].
- Eldorado Gold Corp. (TSX: ELD; NYSE:EGO), based in Vancouver, is the largest foreign producer of gold in China. Eldorado Gold has recently engaged a global investment bank to lead a proposed initial public offering of its Chinese business units on the SEHK sometime next year.[3]

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[2] "Manulife to boost China exposure through stock connect scheme", South China Morning Post, October 4, 2014.

[3] "Eldorado Gold said to weigh $1.5 billion sale of China mines", Bloomberg News, November 5, 2014.

How McMillan Can Help

McMillan LLP is a leading international business law firm committed to client service and professional excellence for over 100 years. With recognized expertise and acknowledged leadership in major business sectors, McMillan provides definitive Canadian legal advice to businesses, financial institutions, governments and private individuals in China, Canada, the United States and internationally.

As Canada's only full-service law firm with an office in Hong Kong, McMillan has the knowledge and skills to provide cross-cultural transactional advice and services to China-based clients seeking financing or investing in Canada. Our legal professionals have many years experience advising on China in-bound and out-bound transactions across a variety of industries including capital markets, mining, oil & gas and other natural resources.

McMillan has strong relationships with the SEHK and major global investment banks in the region. McMillan recently acted as Canadian counsel to Citigroup Global Markets Limited and Bank of China International Asia Limited as underwriters in the inter-listing by China Gold International Resources Corp. Ltd. (TSX:CGG; SEHK:2099), the overseas financing platform of China National Gold Group Corp. The initial public offering successfully raised US$309 million for China Gold.

For more information, please visit our website at mcmillan.ca, or contact:

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a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.