

14 January 2022

Mainland Investors – Northbound Stock Connect

We refer to the China Securities Regulatory Commission's ("CSRC") consultation paper published on 17 December 2021 proposing to amend "Certain Provisions on the Stock Connect between the Mainland and Hong Kong Stock Markets" (CSRC Order No. 128) (the "Northbound Stock Connect Provisions") (the "Consultation Paper").

Specifically, the CSRC wants to prohibit Mainland Chinese Investors from trading A-shares through Northbound Stock Connect. The term "Mainland Chinese Investors" includes: "Chinese citizens who hold identity documents issued in Mainland China and organisations (with or without legal persons status) registered in Mainland China, excluding Chinese citizens who have obtained permanent residence/identity documents abroad".

The Asia Securities Industry and Financial Markets Association ("ASIFMA"), its members and Simmons & Simmons welcome the opportunity to respond to the Consultation Paper.

In summary, ASIFMA, its members and Simmons & Simmons support CSRC's proposal. We have a few clarification questions which we would be grateful if the CSRC could provide us with guidance.

Question One - Level of Due Diligence

We noted in the Consultation Paper that Hong Kong licensed intermediaries and registered institutions (collectively, "Hong Kong brokers") will, from the date of implementation of the rules, not be permitted to open new trading accounts which allow Mainland Chinese Investors to trade A-shares through Stock Connect.

Our members have put forward the below for the purposes of complying with the CSRC's restrictions. We would be grateful if the CSRC could confirm whether the following measures will be considered as sufficient in identifying "Mainland Chinese Investors":

- (i) Hong Kong brokers to identify and verify the nationalities of all customers in accordance with the requirements set out in Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance ("AMLO") and the relevant guidelines issued by the Hong Kong Monetary Authority ("HKMA") and Securities and Futures Commission ("SFC") in this regard; and
- (ii) Given Broker-to-Client Assigned Number ("BCAN") is required to be assigned to all customers trading A-shares through Stock Connect, the above due diligence (including obtaining additional representation, if any) would be performed against the individuals or entities which open trading accounts with the relevant Hong Kong brokers ¹ and consequently to which BCANs are assigned.

¹ We refer to the Northbound Investor ID Model FAQ published by the HKEx (version: 15 October 2018) which recognised that the client entity to be assigned a BCAN is determined by how such client entity's northbound trading account was set up with the particular Hong Kong broker. In Question 11 of the FAQ, it was specifically mentioned that BCAN can be assigned to the fund manager or to the individual funds depending on the account opening arrangement, and market surveillance will be conducted based on such BCANs. Given that the account opening arrangement of each Hong Kong broker varies, the required due diligence to be performed by the Hong Kong brokers for complying with the new requirement should be on the entity that is consistent with the internal account opening arrangement of the relevant Hong Kong brokers. In the case of a Hong Kong broker that treats the fund manager as their Northbound trading client, then due diligence should be performed on this entity to ensure that such entity satisfies the investor eligibility requirement under the Stock Connect rules.

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To expand on (i) above, Schedule 2 to the AMLO sets out, *inter alia*, the customer due diligence requirements which all Hong Kong brokers must comply with. The relevant guidelines issued by the HKMA and the SFC also expand on the requirements under Schedule 2 to the AMLO and set out, *inter alia*, the identification information each Hong Kong broker must obtain from each customer during the account opening process. Each Hong Kong broker is required to update/"refresh" the customer onboarding documents in accordance with the requirements under the applicable HKMA and SFC guidelines.

Through the process of obtaining identification information from each customer, the Hong Kong broker will be aware of whether the customer falls within the definition of "Mainland Chinese Investors". The Hong Kong broker will then restrict the person from trading A-shares through Northbound Stock Connect.

Question Two – "Fake Foreign Capital"

We fully agree with CSRC that there must not be any "fake foreign capital" in Northbound Stock Connect.

With that said, there are a number of PRC fund managers that are very experienced in the market and have the connections within the market. As a result, foreign investors may set up funds which are established outside Mainland China and appoint PRC fund managers to manage their investments including A-shares.

We respectfully submit that in the above scenario, even though the PRC fund managers fall within the proposed definition of "Mainland Chinese Investors", such PRC fund managers in question should be allowed to invest in A-shares through the Stock Connect on behalf of the funds under its management, provided the funds are established outside China.

Additionally, regardless of the position that the CSRC finally decides in regard to this question, we respectfully request the CSRC to be explicit about its position for this kind of scenario so as to ensure there is consistent interpretation among market participants in regard to this scenario.

If you have any queries on this response, please do not hesitate to contact Patrick Pang, Managing Director – Head of Compliance and Tax (+852 2531 6520; ppang@asifma.org).