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HK Firms Can Now Offer Securities Investment Consulting Services to the Mainland

TieCheng YANG | Yin GE | Ting ZHENG | Michael KAN

On 29 June 2018, the China Securities Regulatory Commission ("**CSRC**") officially promulgated the *Interim Provisions on the Use of Hong Kong Institution Securities Investment Consulting Services by Institutions Engaged in Securities or Funds Business* (the "**Interim Provisions**")¹, following CSRC's issuance of a consultation draft of the same on 20 April 2018 for public comment². The Interim Provisions officially came into effect on 1 July 2018. It is widely regarded as a favorable measure to further promote common development and mutual cooperation between the capital markets of mainland China and Hong Kong.

How will the Interim Provisions deepen the opening-up and cooperation between the capital markets of mainland China and Hong Kong? This newsletter begins with a background of the Interim Provisions, interprets the key requirements, and analyzes the impact on mainland-based securities firms and fund management companies ("**Mainland Institutions**") and Hong Kong-based institutions ("**HK Institutions**").

I. Background

Since the launch of the Shanghai-Hong Kong Stock Connect on 17 November 2014 and the

¹ 《证券投资基金经营机构使用香港机构证券投资咨询服务暂行规定(正式稿)》 [Interim Provisions on the Use of Hong Kong Institution Securities Investment Consulting Services by Institutions Engaged in Securities or Funds Business (Official Version)] (China Securities Reg. Comm., Announcement [2018] No. 23; effective 1 Jul. 2018), available at: http://www.csrc.gov.cn/pub/zjhpublic/zjh/201806/t20180629_340512.htm (Chinese)

² 《证券投资基金经营机构使用香港机构证券投资咨询服务暂行规定(征求意见稿)》 [Interim Provisions on the Use of Hong Kong Institution Securities Investment Advisory Services by Institutions Engaged in Securities or Funds Business (Draft for Comment)] (China Securities Reg. Comm., issued 20 Apr. 2018, for public comment until 21 May. 2018), available at: http://www.csrc.gov.cn/pub/zjhpublic/zjh/201804/t20180420_337079.htm (Chinese)

launch of the Shenzhen-Hong Kong Stock Connect on 5 December 2016, the two-way trading links between mainland and Hong Kong stock markets have been operating smoothly and have continued to realize breakthroughs. For example, as of 30 March 2018, the total trading volume on the Shanghai-Hong Kong Stock Connect has reached RMB 7.8 trillion (USD 1.2 trillion). Among these figures, the Northbound Shanghai-Hong Kong Stock Connect has a total of 795 stocks traded, with a trading volume of RMB 4.3 trillion (USD 642.5 billion); the Southbound Shanghai-Hong Kong Stock Connect has a total of 385 stocks traded, with a trading volume of RMB 3.5 trillion (USD 533.9 billion)³.

On 11 April 2018, in order to further enhance the two-way trading links between mainland and Hong Kong stock markets, CSRC and the Hong Kong Securities and Futures Commission ("**SFC**") jointly announced that they have agreed to quadruple the daily trading volume quota⁴. Effective 1 May 2018, the daily trading volume quota for each of the Southbound Trading Link (under Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect) was adjusted to RMB 42 billion.

With the increasing willingness of mainland investors to invest in H-shares under the Southbound Trading Link, the scale of trading has surged to new highs. Meanwhile, mainland investors are also facing growing demand for securities research reports and securities investment advisory services on H-shares under the Southbound Trading Link. However, the market research of Mainland Institutions on Hong Kong stock market is currently in its early stages. Compared with the current research capabilities of Mainland Institutions, HK Institutions enjoy a local competitive advantage in securities analysis and research on the Hong Kong stock market, with key strengths in terms of the scale and capabilities of analyst teams as well as the advantage of location proximity. In this regard, the cooperation between Mainland Institutions and HK Institutions will be mutually beneficial and helpful.

On the basis of the continuous development of the two-way trading links between mainland and Hong Kong stock markets, CSRC recently promulgated the Interim Provisions to regulate Mainland Institutions' use of securities consulting services provided by HK Institutions under the Southbound Trading Link, which aims to further deepen the mutual cooperation between the securities and fund industries of mainland China and Hong Kong and to better fulfill investors' needs during cross-border investment.

³ 《深化互联互通机制 沪港通每日额度扩大四倍》 [Deepening the Trading Links between Mainland and Hong Kong and quadruple the daily quota for Shanghai-Hong Kong Stock Connect] (Shanghai Securities Exchange, issued 11 Apr. 2018), *available at*:

www.sse.com.cn/aboutus/mediacenter/hotandd/c/c_20180412_4499566.shtml (Chinese)

⁴ 《中国证券监督管理委员会 香港证券及期货事务监察委员会联合公告》 [Joint Announcement of the China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission] (China Securities Reg. Comm.; issued 11 Apr. 2018 and effective 1 May 2018), *available at*:

http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201804/t20180411_336497.html (Chinese)

II. Two Business Models under the Interim Provisions

The Interim Provisions apply to the use by Mainland Institutions of HK Institutions' securities investment consulting services under the Southbound Trading Link. The Interim Provisions allow for the following two business models:

- i. **H-shares research report business model.** According to the *Guidelines for Institutions Engaged in Securities or Funds Business in Interconnection of Mainland and Hong Kong Stock Markets*⁵ issued by CSRC on 11 October 2016, licensed HK Institutions may issue securities research reports under the Southbound Trading Link under the name of Mainland Institutions. As a further step, the Interim Provisions allow Mainland Institutions or their subsidiaries that issue securities research reports to re-issue the reports of HK Institutions to their mainland clients with the authorization of the HK Institutions. These reports contain investment analysis on eligible H-shares under the Southbound Trading Link.
- ii. **H-shares investment adviser business model.** Mainland Institutions are allowed to appoint HK Institutions to provide investment advisory services for eligible H-shares under the Southbound Trading Link for securities investment funds that Mainland Institutions manage and which participate in the Southbound Trading Link.

For purposes of the Interim Provisions, "eligible H-shares under the Southbound Trading Link" refer to the stocks listed on the Stock Exchange of Hong Kong within the scope of the Southbound Trading Link as provided in the *Several Provisions on the Interconnection Mechanism for Mainland and Hong Kong Stock Markets*⁶.

The following table summarizes the two types of business models that are applicable under the Interim Provisions.

⁵ 《证券基金经营机构参与内地与香港股票市场交易互联互通指引》 [Guidelines for Institutions Engaged in Securities or Funds Business in Interconnection of Mainland and Hong Kong Stock Markets] (China Securities Reg. Comm., Announcement [2016] No. 24; effective 11 Jan. 2016), *available at*:

http://www.csrc.gov.cn/pub/xiamen/xxfw/gfxwj/201611/t20161102_305349.htm (Chinese)

⁶ 《内地与香港股票市场交易互联互通机制若干规定》 [Several Provisions on the Interconnection Mechanism for Mainland and Hong Kong Stock Markets] (China Securities Reg. Comm., Order No. 128; effective 30 Sept. 2016), *available at*:

www.csrc.gov.cn/pub/zjhpublic/G00306201/201609/t20160930_304241.htm (Chinese)

Business model	H-shares research report business model	H-shares investment adviser business model
Applicable service scope	<ul style="list-style-type: none"> Distribution of securities research reports on eligible H-shares under the Southbound Trading Link. 	<ul style="list-style-type: none"> Provision of investment advisory services for eligible H-shares under the Southbound Trading Link invested in by securities investment funds.
Eligible Mainland Institutions	<ul style="list-style-type: none"> Mainland-based securities firms or their subsidiaries that engage in the issuance of securities research reports; (except for firms that have been subject to administrative punishment or major administrative supervision measures in the past three years due to the violation of laws or regulations). 	<ul style="list-style-type: none"> Mainland Institutions which manage securities investment funds investing through the Southbound Trading Link.
Eligible HK Institutions	<ul style="list-style-type: none"> Licensed by SFC to provide advice on securities; Experienced in issuing securities research reports. 	<ul style="list-style-type: none"> Licensed by SFC to provide advice on securities and to conduct asset management; Experienced in asset management.
Key requirements for Mainland Institutions	<ol style="list-style-type: none"> Have a signed agreement with an HK Institution to obtain proper authorization from the HK Institution; Review the qualifications of the HK institution; Submit the agreement and other related materials to the local CSRC office for filing as required; Establish a mechanism for reviewing the H-shares research reports to be re-issued; Notify the HK Institution of relevant laws and regulations on 	<ol style="list-style-type: none"> Sign an agreement with the HK institution appointing the HK institution to provide investment advisory services for eligible H-shares; Conduct due diligence on the HK Institution; Submit the agreement and other related materials to the local CSRC office for filing as required; Submit relevant materials in accordance with laws and regulations, when registering or record-filing a securities

	<p>the issuance of securities research reports in mainland China;</p> <p>(6) State relevant issues in the H-shares research reports as required by the Interim Provisions.</p>	<p>investment fund that will use the H-shares investment advisory services;</p> <p>(5) Truthfully disclose relevant information and risks in fund contracts, prospectuses, and other documents;</p> <p>(6) Maintain records of using the H-shares investment advisory services.</p>
<p>Key requirements for HK Institutions</p>	<p>(1) Ensure that the requirements from SFC are followed during the issuance of H-shares research reports and authorization of the mainland-based securities firms to re-issue such reports;</p> <p>(2) Ensure that the H-shares research reports follow the relevant laws and regulations on the issuance of securities research reports in mainland China;</p> <p>(3) In principle, shall not communicate with clients of the securities firms to discuss the content of the H-shares research report (with very limited exceptions);</p> <p>(4) Undertake to cooperate with supervision and regulation by CSRC and its local offices, and provide relevant business materials and information as required.</p>	<p>(1) Follow relevant laws, regulations and regulatory requirements of mainland China and Hong Kong on securities investment advisory business, and file basic information with the Asset Management Association of China in accordance with its rules;</p> <p>(2) Undertake to cooperate with supervision and regulation by CSRC and its local offices, and provide relevant business materials and information as required.</p>

III. Outlook

The official promulgation and implementation of the Interim Provisions will have a broad and positive impact on mutual cooperation between the capital markets of mainland China and Hong Kong. Mainland Institutions can fully leverage investment advisers' familiarity with the Hong Kong stock market to provide professional advice which will help these institutions to carry out professional investing in H-shares and improve the performance of fund products. Meanwhile, by cooperating with Mainland Institutions, HK Institutions can further expand their client base in mainland China and take advantage of the beneficial two-way opening-up and cooperation between the capital markets of mainland China and Hong Kong.

In addition, we note that, for both the H-shares research report business model and the H-shares investment adviser business model in the Interim Provisions, the applicable service scope is currently limited to eligible H-shares traded on the Stock Exchange of Hong Kong through the Southbound Trading Link as specified in the *Several Provisions on the Interconnection Mechanism for Mainland and Hong Kong Stock Markets*. For now, the scope of the Interim Provisions does not include H-shares outside the scope of the Southbound Trading Link and stocks listed on other overseas exchanges. In this regard, we look forward to the future expansion of the applicable scope for both the H-shares research report business model and the H-shares investment adviser business model. We believe the inclusion of H-shares outside the scope of Southbound Trading Link and stocks listed on other overseas exchanges will facilitate broader cooperation between Mainland Institutions and HK Institutions, which will also benefit mainland investors for their cross-border investments.

● **Important Notice**

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If you have any questions regarding this publication or wish to request a free English translation of the *Interim Provisions on the Use of Hong Kong Institution Securities Investment Consulting Services by Institutions Engaged in Securities or Funds Business*, please contact **Mr. TieCheng YANG (86 10 85164286; iecheng.yang@hankunlaw.com)** or **Ms. Yin GE (86 21 60800966; yin.ge@hankunlaw.com)**.