



16<sup>th</sup> July 2015

## Shanghai-Hong Kong Stock Connect-Update

The Shanghai-Hong Kong Stock Connect programme (“**Stock Connect**”) is a joint collaboration between the Hong Kong Stock Exchange and Clearing Limited and the Shanghai Stock Exchange. Stock Connect involves two central securities depositories - Hong Kong Securities Clearing Company Limited (“**HKSCC**”) and China Securities Depository & Clearing Corporation Limited (“**China Clear**”). Stock Connect launched on 17<sup>th</sup> November 2014.

You will be aware from previous related publications from Dillon Eustace that the Central Bank of Ireland (the “**Central Bank**”) has been engaging with a representative group of Irish depositories regarding certain concerns that they had and clarifications that they required on the operation of Stock Connect and the ability of Irish authorized investment funds (UCITs and AIFs) to acquire shares through Stock Connect.

The Central Bank has done this in a considered manner focusing in particular on the ability of depositories to provide for the safe-keeping of assets acquired pursuant to Stock Connect in a way that complies with the UCITS and AIFM Regulations, paying particular attention to provisions relating to safe-keeping of assets, beneficial ownership, segregation and reconciliation arrangements and monitoring of sub-custodians.

The Central Bank has now responded in the 6<sup>th</sup> Edition of *UCITS Questions and Answers (Ref: ID1015)* and the 14<sup>th</sup> Edition *AIFMD Questions and Answers (Ref: 1094)* both of which issued on the 15<sup>th</sup> July, 2015 with their considerations around Irish authorized funds

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seeking to acquire Chinese shares through Stock Connect. We have summarized their response below.

### ***Central Bank position***

The Central Bank would require that before an Irish authorized fund initially acquires Chinese shares through Stock Connect, its Irish depository would need to satisfy itself that the manner in which the shares were to be held allowed that Irish depository to meet its legal obligation under the relevant fund regulations and any other conditions imposed by the Central Bank.

If an Irish authorized fund proposes to acquire Chinese shares through Stock Connect, in order to meet the legal obligations on a depository, the Irish depository of the investment fund, or an entity within its custodial network must ensure that it retains control over the shares at all times. The relevant legislation does not provide for the Central Bank to recognise eligible clearing structures. This obligation is to ensure that control will rest in the first instance with the Irish depositories.

During discussions with Irish fund industry participants and engagement with the relevant Stock Connect authorities, the Central Bank have maintained that the legal obligations of an Irish depository cannot be met without at least being a participant in HKSCC. The Central Bank have also stated that in all cases, at the present time, arrangements where the broker of the Irish fund is a participant of HKSCC but not an entity within the Irish depository's custodial network, will not satisfy the provisions of the relevant legislation.

Accordingly in order for Irish funds to avail of Stock Connect, Irish depositories will need to consider both the terms on which they or a sub-custodian could become participants in HKSCC and the arrangements in place from time to time between HKSCC and China Clear and the applicable law.

At present there are a number of options in terms of level of participation within HKSCC, namely General Clearing Participant, Direct Clearing Participant or Custodian Participant. As the terms of participation may vary over time and as the appropriate level of participation will, to some extent, depend on the scale of envisaged activity and as the legal obligation applies directly upon the depository, the Central Bank is not in a position to designate the appropriate level of participation. Accordingly it will be incumbent on the Irish depository, or a member of its custodial network, to identify one or more levels of participation, if any, which would be in line with its legal obligations as a depository. Finally, the Irish depository must review and keep under review the Stock Connect infrastructure arrangements to ensure that its legal obligations can be met as is the case with reliance on all such systems globally.

At Dillon Eustace we are assisting clients with submissions to the Central Bank and we would be delighted to speak with investment managers who are considering participating in Stock Connect to

provide further insight and assistance. Investment managers have welcomed the Central Bank response and have already started to work with their Irish depositaries to progress applications with the assurance provided by the Central Bank's analysis and review. It is expected that other regulators in Europe will have similar responses once they have reviewed in the detail which the Central Bank reviewed. Leading depositaries in the Irish market have already indicated that they feel ready to meet the requirements and can assist their fund clients, who may have avoided the recent downturn in Chinese stocks, to avail of any rally for the benefit of their investors.

Our previous briefings on Stock Connect can be found at the following links:

[Shanghai-Hong Kong Stock Connect-Update](#)

[Shanghai-Hong Kong Cross Border Share Trading Plan,](#)

[Shanghai-Hong Kong Stock Connect-The Train Steams Ahead](#)

[Shanghai-Hong Kong Stock Connect-Launch Date Announced](#)

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