Eight questions about depositary receipts under Stock Connect

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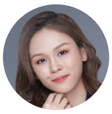

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From Shanghai-London Stock Connect to DRs under Stock Connect: Further opening-up of capital market

In December 2021, China Securities Regulatory Commission (CSRC) revised and improved the Shanghai-London Stock Connect program, and upgraded it into a broader mechanism based on depositary receipts (DRs) under the Stock Connect scheme between domestic and overseas stock exchanges (referred to as "DRs under Stock Connect"). On March 25, 2022, Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) released supporting business rules related to DRs under Stock Connect. The improvement of the DRs under Stock Connect mechanism indicates a further step in the internationalization of China's capital market. In this report, we answer some questions on DRs under Stock Connect that investors are interested in.

Question 1: What is the DRs under Stock Connect mechanism? A depositary receipt (DR) refers to a certificate issued by a depositary bank, representing underlying shares in a foreign company and traded on a local stock exchange. Each DR represents a certain number of underlying shares issued by a foreign company. At present, the DRs under Stock Connect mechanism consists of businesses in two directions: The Global Depositary Receipt (GDR) business that allows qualified companies listed on SSE and SZSE to issue GDRs on overseas exchanges (referred to as the "GDR business"), and the Chinese Depositary Receipt (CDR) business that allows qualified overseas securities issuers to issue CDRs on SSE and SZSE (referred to as the "CDR business").

Question 2: Why is it necessary to establish the DRs under Stock Connect mechanism? DRs not only help global investors invest in foreign enterprises across markets, but also help provide diversified financing channels for enterprises and improve their international reputation. There are some barriers (e.g., barriers around cross-border fund flows, language, time differences, and foreign exchange rate fluctuations) between China's capital market and overseas capital markets, especially those within the scope of existing mechanisms. We think DRs under Stock Connect could effectively address the above issues.

Question 3: What differences are there between the new Stock Connect and existing programs? At present, DRs under Stock Connect and the Stock Connect programs between stock markets in the Chinese mainland and Hong Kong SAR (referred to as "Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs") are important channels for China's capital market to open up to the world. There are some major differences between the DRs under Stock Connect mechanism and Shanghai-/Shenzhen-Hong Kong Stock Connect programs. **Regional difference:** The Shanghai-/Shenzhen-Hong Kong Stock Connect programs mainly rely on the Hong Kong stock market, with its high degree of internationalization, to facilitate internationalization of the A-share market. DRs under Stock Connect are mainly connected to the securities exchanges in the UK, Germany, and Switzerland. **Different markets:** The Shanghai-/Shenzhen-Hong Kong Stock Connect programs do not involve securities issuance in the primary market and securities issuers in the programs still issue securities on local exchanges. Shanghai-/Shenzhen-Hong Kong Stock Connect programs are arrangements based on trading mechanisms in the secondary market. The DRs under Stock Connect mechanism involves securities issuance in the primary market, and DRs are issued across borders after the issuance of underlying securities. **Fund flows:** Shanghai-/Shenzhen-Hong Kong Stock Connect programs allow investors in the secondary market to trade securities listed on domestic (overseas) exchanges through overseas (domestic) exchanges. Northbound fund flows and southbound fund flows of the Shanghai-/Shenzhen-Hong Kong Stock Connect programs have become important indicators for investors to monitor inflows of foreign capital and domestic capital flows to the Hong Kong stock market. Based on arrangements for DRs under Stock Connect, trading of DRs in the secondary market is completed in local markets through qualified custodian institutions and intermediaries, and only the conversion of DRs will involve cross-border transactions.

Question 4: What are the main institutional arrangements for DRs under Stock Connect? CDR business: First, for the issuance of CDRs in the primary market, interim measures of SSE and SZSE stipulate that an overseas issuer of CDRs should have an average market cap of no less than Rmb20bn before the issuance, the number of CDRs to be issued by the issuer should be no less than 50mn units (representing no less than Rmb500mn of corresponding underlying shares at market value), and the issuer's stock must have been listed on overseas exchanges for at least 3 years. In addition, CDR issuers are allowed to use newly issued shares as the underlying securities and adopt a market-based inquiry mechanism to determine the offering price. In principle, funds raised by CDRs should be used to fund the main businesses of issuers, and issuers can remit the funds abroad or retain the funds for domestic use, based on the purpose of funds to be raised. Second, as for trading in the secondary market, interim measures of SSE and SZSE state that CDR trading adopts a hybrid trading mechanism combining auction trading and market-making trading with daily price limit for CDR trading set at 10%. If the stock exchange is closed for seven calendar days or more, the daily price limit for CDR trading on the first trading day after the stock exchange reopens will be set at 20%. Individual investors who intend to trade CDRs must meet a number of requirements imposed by securities exchanges (e.g., owning assets of no less than Rmb0.5mn and trading securities for at least 24 months). **GDR business:** SSE- and SZSE-listed companies with a market cap of more than Rmb20bn are allowed to issue GDRs, and they need to meet the listing requirements of corresponding exchanges overseas. The relevant rules are summarized in the report.

Question 5: What progress has been made in DRs under the Stock Connect program? Four companies have successfully issued GDRs and the CDR business is in progress. Since the launch of the Shanghai-London Stock Connect, four companies listed on the SSE (e.g., Huatai Securities) have successfully issued GDRs on the London Stock Exchange (LSE), and several listed Chinese companies (e.g., Sany Heavy Industry and Gotion High-tech) have announced plans to issue GDRs through the DRs under Stock Connect mechanism. As specific supporting rules were not introduced for the CDR business in the past, no qualified overseas companies have tapped the A-share market through CDRs. However, given Ninebot's successful CDR issuance and the improvement of related mechanisms and rules, we think the CDR business is likely to progress at a faster pace.

Question 6: What are the characteristics of the three markets related to DRs under Stock Connect? At present, overseas securities exchanges that meet the requirements of the DRs under Stock Connect mechanism are securities exchanges in the UK, Germany, and Switzerland, and these three countries are important economic and financial centers in Europe. Total market cap of major stock exchanges in the three countries accounts for 7% of the global total, and total GDP of the three countries accounts for 8.7% of the global total.

Question 7: What is the significance of the DRs under Stock Connect mechanism? China has made some achievements in the opening-up of the country's capital market, and encourages domestic enterprises to tap overseas capital markets and overseas investors to invest in the country in diverse ways. We believe that the significance of the DRs under Stock Connect mechanism is reflected in the following aspects. First, Chinese enterprises have issued more than 600 DR products in overseas markets. Many Chinese enterprises have chosen to directly list shares in overseas capital markets, but the number of overseas enterprises that list shares in China's capital market is relatively small. Experience from overseas markets shows that some major capital markets (such as the US capital market) not only have a relatively high proportion of overseas investors, but also have a relatively high proportion of listed overseas companies. We believe that the DRs under Stock Connect mechanism will be an important effort to gradually attract overseas enterprises to China's capital market (not just "red chip" companies). Second, adjustments to relevant rules related to DRs under Stock Connect, such as allowing overseas issuers to raise capital in the domestic market through CDR issuance, could help to solve or ease various problems (e.g., CDR issuers were unable to raise capital through CDR issuance in the past), making China's capital market more attractive to global enterprises. Third, arrangements for the issuance of GDRs could help to expand the international financing channels of domestic listed companies, promote the internationalization of Chinese listed companies, and improve the international reputation and influence of Chinese listed companies.

Question 8: The outlook for DRs under Stock Connect mechanism, what merits attention? We suggest paying attention to possible progress in the following areas. First, with improved rules for the CDR business, qualified overseas companies may tap the A-share market through the DRs under Stock Connect mechanism. As yet, there are no overseas enterprises in the A-share market. In the future, the improvement of the CDR business may attract great attention in the market. Second, the GDR business may further improve domestic listed companies' willingness to issue GDRs in overseas markets amid accelerated progress of the DRs under Stock Connect mechanism. Third, as the Shanghai-London Stock Connect evolves to the DRs under Stock Connect mechanism, the mechanism may have room for further expansion in the future (e.g., expansion of the scope of overseas markets and market access requirements for enterprises).

Overall, we believe that DRs under Stock Connect will further promote the internationalization of China's capital market and facilitate the country's two-way opening-up from the perspective of capital market. Over the long run, we believe that efforts to promote the internationalization of China's capital market (e.g., efforts to develop DRs under Stock Connect) will be of important significance for China's closer connection to the world and the world's better understanding of China amid a complex international environment and profound changes in the world.

- Strategy | Unified domestic market to facilitate high-quality development of China's economy (2022.04.15)
- Strategy | More policy support needed amid growth pressure and overseas tightening (2022.04.11)
- Strategy | Stabilization policies to continue to gain momentum (2022.04.11)
- Strategy | Foreign inflows return to both A/H-shares, but northbound sees outflows (2022.04.09)

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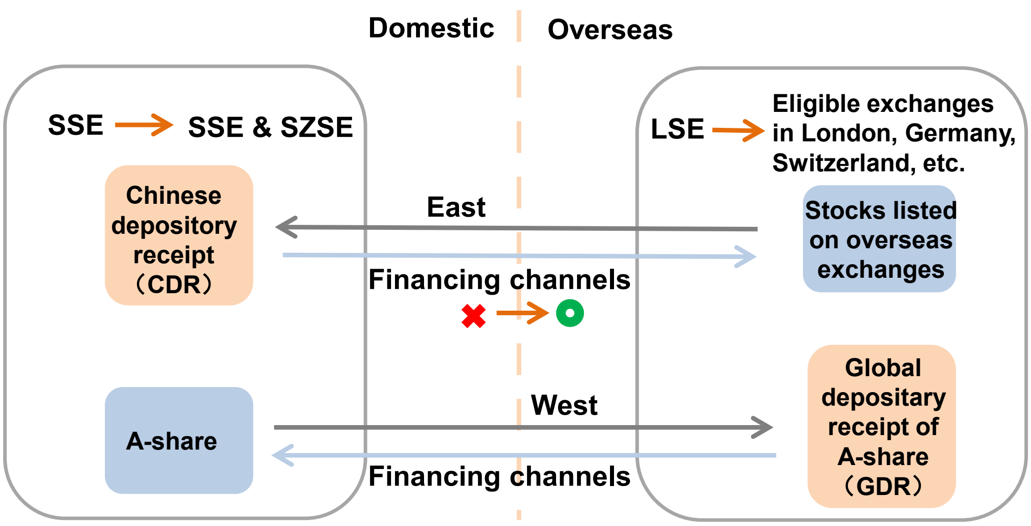
Question 1: What is the DRs under Stock Connect mechanism?

Shanghai-London Stock Connect, the predecessor of DRs under Stock Connect, was established in 2018 and the program consists of businesses in two directions. The Shanghai-London Stock Connect was established in 2018 and launched in 2019. Starting from DRs, the Shanghai-London Stock Connect consists of businesses in two directions: Qualified listed companies on the LSE listing CDRs on SSE Main Board, and qualified A-share listed companies on the SSE issuing and listing GDRs on the LSE. In the early stages of the Shanghai-London Stock Connect, CDR issuers were only allowed to list CDRs on the SSE, but not allowed to raise capital in China's domestic capital market.

CSRC expanded the Shanghai-London Stock Connect program in December 2021. CSRC revised *Provisions on the Supervision and Administration of Depositary Receipts under the Stock Connect between Shanghai Stock Exchange and London Stock Exchange (for trial implementation)*, and changed the name of the policy document into *Provisions on the Supervision and Administration of Depositary Receipts under the Stock Connect Scheme between Domestic and Overseas Stock Exchanges,* so as to revise and improve the Shanghai-London Stock Connect program. On February 11, 2022, CSRC released *Provisions on the Supervision and Administration of Depositary Receipts under the Stock Connect Scheme between Domestic and Overseas Stock Exchanges*. On March 25, SSE and SZSE respectively released *Interim Measures for the Listing and Trading of Depositary Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and Overseas Stock Exchanges* and *Interim Measures for the Listing and Trading of Depositary Receipts under the Stock Connect Scheme between Shenzhen Stock Exchange and Overseas Stock Exchanges* to further improve relevant rules for DRs under Stock Connect.

Figure 1: Comparison of arrangements for Shanghai-London Stock Connect and DRs under Stock Connect



Note: Orange arrows indicate rule changes
Source: SSE, CICC Research

Figure 2: Summary of CSRC's drafts for new rules on Shanghai–London Stock Connect and DRs under Stock Connect

Decision on amending the several provisions on the interconnection mechanism for stock market transactions in the mainland and Hong Kong SAR (Draft for Comment)	
Amendment to article 13, paragraph 1	Clarify that investors in Shanghai and Shenzhen Stock Connect do not include mainland investors
Transition rules	Investors can continue to trade within 1 year, and only be allowed to sell after 1 year
Regulations on the supervision of the depository receipt business for the interconnection of domestic and overseas stock exchanges (Draft for comment)	
Expand the scope of application	Domestically, eligible listed companies on the Shenzhen Stock Exchange will be included. Overseas, the company's listing scope will be expanded to major European markets such as Switzerland and Germany, taking into account factors such as the degree of development of overseas markets, investor protection, and regulatory levels.
Arrangements for financing CDRs	The first is to introduce financing CDRs, allowing overseas issuers to raise funds in China by issuing CDRs. The second is to establish a market-based inquiry mechanism on the basis of the issuance and underwriting rules of the main board market and with reference to the registration-based sector. The third is to clarify that the raised funds should be used for the main business in principle, and should comply with relevant regulations on foreign investment and foreign exchange management in China.
Adjustment of financial information and the disclosure of internal control requirements	First, it is clarified that if an overseas issuer adopts equivalent accounting standards, there is no need to additionally disclose the differences between the accounting standards he used and the Chinese accounting standards for business enterprises and the adjustment information of the differences adjusted according to the Chinese accounting standards for business enterprises. Financial data prepared according to the equivalent accounting standards can be used to calculate financial indicators. If other accounting standards are adopted, the important differences between the accounting standards it used and the Chinese accounting standards for business enterprises and the adjustment information of the differences according to the Chinese accounting standards for business enterprises should be additionally disclosed. The second is to allow accounting firms to issue assurance opinions on the internal control of overseas issuers in accordance with the rules of overseas listing places.

Source: CSRC, CICC Research

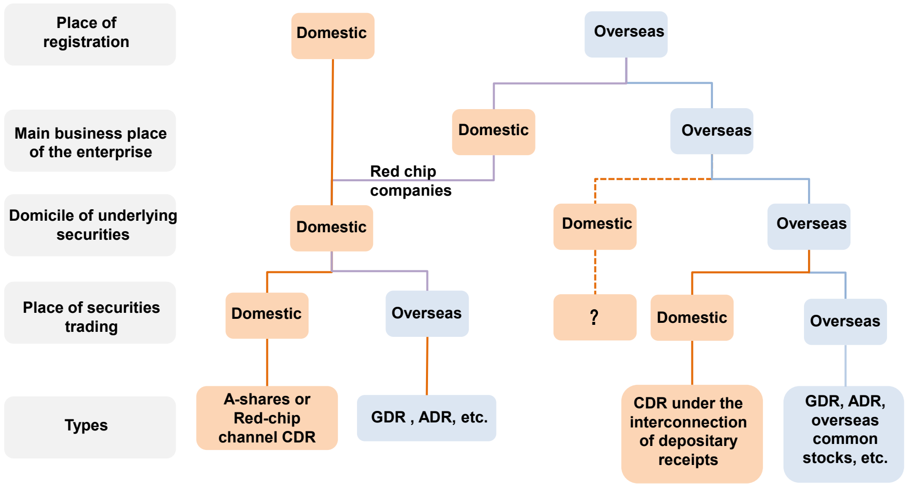
Question 2: Why is it necessary to establish DRs under Stock Connect mechanism?

Cross-border securities investments are typically plagued by some barriers. Although the development of information technology and increasingly frequent global capital flows have made cross-border securities investment increasingly convenient, cross-border securities trading is plagued by constraints and barriers. **Time differences in trading:** There are differences between the opening hours of exchanges. The prices of securities change frequently in the secondary market, making differences in trading hours one of the leading barriers for overseas investors. **Foreign exchange rate fluctuations:** Investors' global asset allocation is not only affected by investment gains or losses from changes in securities prices but also the impact of foreign exchange rates. **Cross-border fund flows:** In addition to foreign exchange gains and losses, procedures and fees related to cross-border fund flows are barriers to cross-border securities investment. **Language and information barriers:** In the process of cross-border investment, operating systems and information disclosures are usually provided in local language, creating a barrier for foreign investors. **Different regulatory mechanisms:** Securities across borders differ in information disclosures, accounting standards, and regulatory environment, and there may be barriers to cross-border investors' understanding of regulatory mechanisms.

In this context, DRs have become an important, and convenient, tool to facilitate companies' cross-border listings and financing. As a financial instrument, DRs originated in the US in the 1920s. In order to help US investors trade shares of UK department store company Selfridges, J.P. Morgan pioneered the concept of American Depositary Receipts (ADR), sending shares of the UK company to a designated bank through ADR arrangements, and thus enabling US investors to trade the shares conveniently in the US domestic market. The existence of DRs enables investors to easily trade securities issued by overseas enterprises in the local market, thus avoiding the above-mentioned barriers (e.g., barriers related to cross-border fund flows, language, time difference in trading, and foreign exchange rate fluctuations) to a certain extent.

As an important financial instrument in the Shanghai-London Stock Connect program and the DRs under Stock Connect mechanism, DRs could facilitate cross-border securities trading. DRs can not only help global investors invest in foreign enterprises across markets, but also help to provide diversified financing channels for enterprises and improve their international reputation. Below we summarize some securities issuance channels in the Chinese market, including issuers and trading locations.

Figure 3: Securities issuance channels in the Chinese market



Note: The "?" symbol indicates that a name for type of securities has not been given

Source: CICC Research

Question 3: What differences are there between the new Stock Connect and existing programs?

At present, both DRs under Stock Connect and Shanghai-/Shenzhen-Hong Kong Stock Connect programs are important channels for China's capital market to open up to the world. There are some major differences between the DRs under Stock Connect mechanism and Shanghai-/Shenzhen-Hong Kong Stock Connect programs:

- **Regional differences.** The Shanghai-/Shenzhen-Hong Kong Stock Connect programs mainly rely on the Hong Kong stock market, with its high degree of internationalization, to facilitate the internationalization of the A-share market. However, DRs under Stock Connect are mainly connected to the securities exchanges in the UK, Germany, and Switzerland.
- **Securities issuance in the primary market.** Shanghai-/Shenzhen-Hong Kong Stock Connect programs do not involve securities issuance in the primary market and securities issuers in the programs still issue securities on local exchanges. Shanghai-/Shenzhen-Hong Kong Stock Connect programs are arrangements based on trading mechanisms in the secondary market. DRs under Stock Connect involve securities issuance in the primary market, and DRs are issued across borders after the issuance of underlying securities.
- **Fund flows.** Shanghai-/Shenzhen-Hong Kong Stock Connect programs allow investors in the secondary market to trade securities listed on domestic (overseas) exchanges through overseas (domestic) exchanges. Northbound fund flows and southbound fund flows of the Shanghai-/Shenzhen-Hong Kong Stock Connect programs have become important indicators for investors to monitor inflows of foreign capital and domestic capital flows to the Hong Kong stock market. Based on arrangements for DRs under Stock Connect, trading of DRs in the secondary market is completed in local markets through qualified custodian institutions and intermediaries, and only the conversion of DRs involves cross-border transactions.

Question 4: What are the institutional arrangements for DRs under Stock Connect?

The DRs under Stock Connect mechanism mainly consists of businesses in two directions: The **CDR business** that allows qualified overseas securities issuers to issue CDRs on SSE and SZSE, and the **GDR business** that allows qualified companies listed on SSE and SZSE to issue GDRs on overseas exchanges.

DRs under Stock Connect: The CDR business

The CDR business mainly involves the issuance of CDRs

The basic institutional framework for the issuance of CDRs was roughly established in 2018. In June 2018, CSRC released rules related to the issuance of DRs, such as administrative measures for the issuance and trading of depositary receipts (for trial implementation), implementing measures for the supervision of domestic offering, and listing of stocks or depositary receipts by pilot innovative enterprises. SSE and SZSE also released relevant trading rules for DRs. The basic institutional framework for CDRs was roughly established.

Issuing CDRs through the DRs under Stock Connect mechanism. In the framework of DRs under Stock Connect, qualified companies listed on qualified overseas exchanges (currently including exchanges in the UK, Germany, and Switzerland) are allowed to issue CDRs in China. At present, interim measures of SSE and SZSE stipulate that an overseas issuer of CDRs should have an average market cap of no less than Rmb20bn before the issuance, the number of CDRs to be issued by the issuer should be no less than 50mn units (representing no less than Rmb500mn of corresponding underlying shares at market value), and the issuer's stock must have been listed on overseas exchanges for at least 3 years. In addition, based on CSRC's regulations, CDR issuers are allowed to use newly issued shares as the underlying securities and adopt a market-based inquiry mechanism to determine the offering price. In principle, funds raised by CDRs should be used to fund the main businesses of issuers, and issuers can remit the funds abroad or retain the funds for domestic use based on the purpose of funds to be raised.

Capital-raising CDRs to further expand the DRs under Stock Connect mechanism's presence in the primary market. In the early days of the Shanghai-London Stock Connect, the issuance of CDRs was limited to non-capital-raising CDRs, and investors in the A-share market were unable to participate in capital-raising of overseas enterprises through the arrangements of the Shanghai-London Stock Connect. After revisions to relevant rules, overseas companies are able to issue capital-raising CDRs and adopt a market-based inquiry mechanism for the pricing of CDRs, which could further enhance the two-way internationalization of the A-share market.

CDR trading in the secondary market: Interim measures of SSE and SZSE state that CDR trading adopts a hybrid trading mechanism combining auction trading and market-making trading with daily price limit for CDR trading set at 10%. If the stock exchange is closed for seven calendar days or more, the daily price limit for CDR trading on the first trading day after the stock exchange reopens will be set at 20%.

Recent rule revisions to make DRs under Stock Connect arrangements applicable to a wider range of securities exchanges and lower barriers for individual investors. The *Provisions on the Supervision and Administration of Depositary Receipts under the Stock Connect Scheme between Domestic and Overseas Stock Exchanges* released by CSRC have expanded the scope of the Shanghai-London Stock Connect program, transforming the program from a special arrangement for trading between SSE and LSE into a DR trading mechanism-based framework for domestic and overseas exchanges. Based on trading rules released by SSE and SZSE, the two exchanges plan to lower investor suitability requirements for individual investors participating in the CDR business from owning assets of no less than Rmb3mn in the securities account and funds account to owning assets of no less than Rmb0.5mn in the securities account and funds account and trading securities for at least 24 months.

Figure 4: Major contents of *Opinions on Launching the Pilot Program of Domestic Offering of Stocks or Depositary Receipts by Innovative Enterprises* (2018)

Opinions on the Pilot of Domestic Share or Depositary Receipt Issuance by Innovative Companies	
Object and selection mechanism	1. Innovative companies of considerable scale that comply with national development strategy, have core competencies and high market recognition, and are involved with high-tech and strategic emerging industries like internet, big data, etc. 2. Meet the following criteria: a) Listed red-chip companies whose market cap is no less than Rmb200bn b) Private innovative enterprises including red-chip enterprises and domestically-registered enterprises) whose latest revenue is no less than Rmb3bn, with a valuation no less than Rmb20bn, or private companies with high sales growth, state-of-the-art technology, and leading position in the industry 3. CSRC will form a committee on the selection of companies that meet the aforementioned criteria
Issuance conditions and audit mechanism of pilot enterprises	1. Allow pilot red-chip enterprises to issue CDRs via required procedures 2. Pilot red-chip enterprises that meet current IPO requirements may apply for listing in domestic market 3. Resolve obstacles for pilot enterprises to go public due to short-term profitability
Information disclosure and regulation	Subject to security law
Investors protection	The controlling shareholders, board directors, and senior management of a pilot enterprise that has not made profits shall not decrease their stock holdings of the company before it reports profits

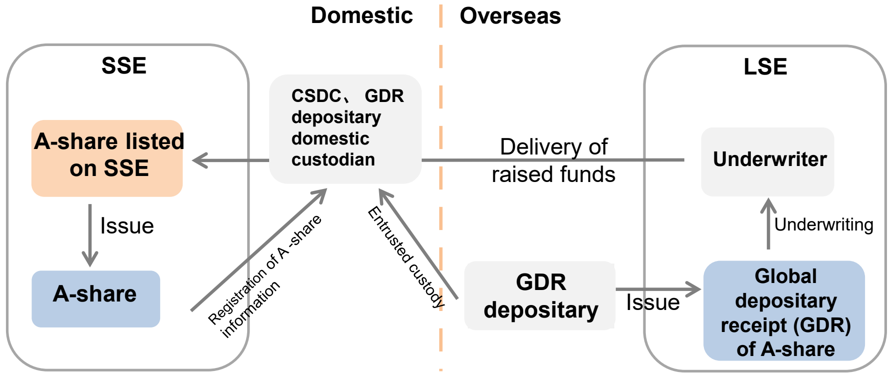
Source: CSRC, CICC Research

DRs under Stock Connect: GDR issuance and trading

The GDR business mainly involves the issuance and trading of GDRs. Some companies have already issued GDRs through the Shanghai-London Stock Connect, while specific GDR issuance rules of qualified German and Swiss securities exchanges for the DRs under Stock Connect mechanism still need to be improved and we need to pay close attention to future arrangements of domestic and overseas exchanges.

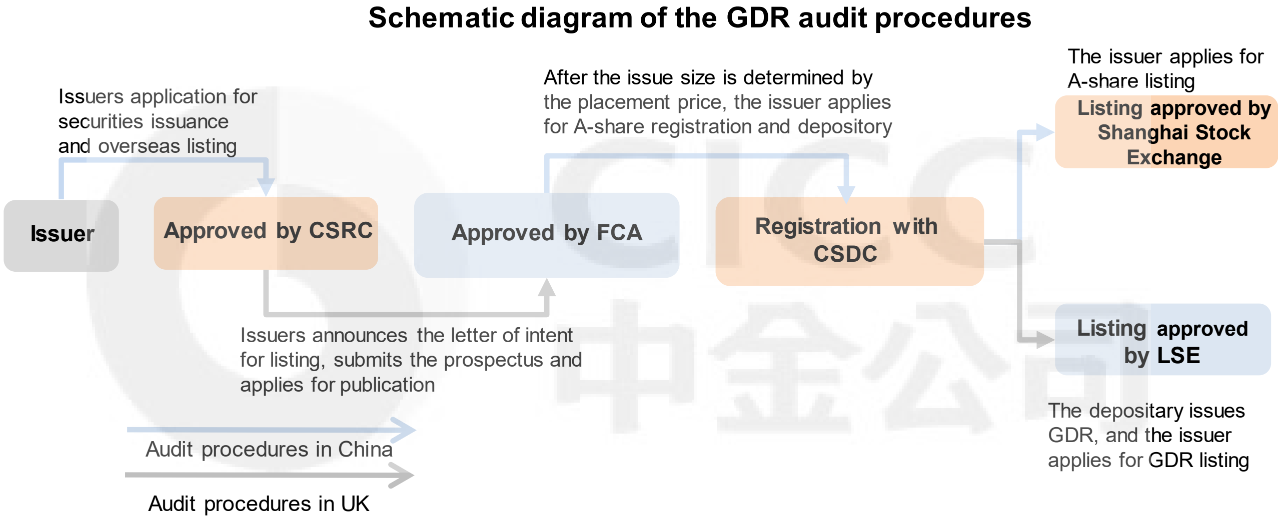
In the following charts, we have summarized information about structure and processes of GDR issuance and listings, cross-border conversion of GDRs, and existing rules for CDR and GDR issuance and trading for investors.

Figure 5: GDR issuance via the Shanghai-London Stock Connect program



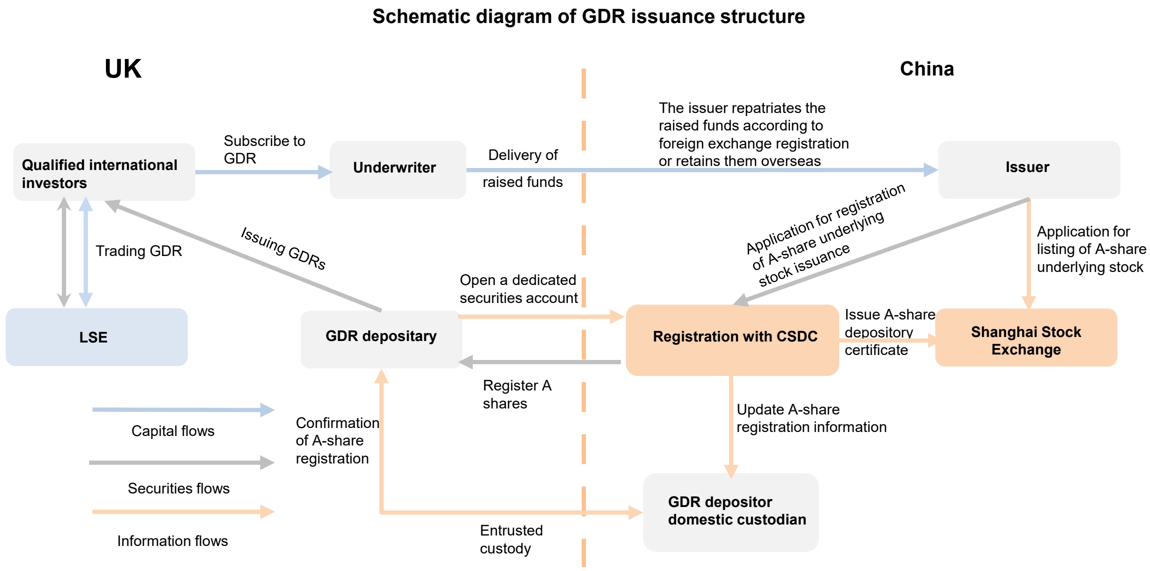
Source: SSE, CICC Research

Figure 6: Processes of GDR issuance and listing approval



Source: SSE, King & Wood Mallesons, CICC Research

Figure 7: Cross-border conversion of GDRs



Source: SSE, King & Wood Mallesons, CICC Research

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Figure 8: Overview of rules for the issuance and trading of GDRs and CDRs

	UK (GDR)	Switzerland (GDR)	Germany (GDR; general market used as an example)	China (CDR)
Primary market issuance				
Applicable subject	Listed companies on the Shanghai Stock Exchange or Shenzhen Stock Exchange; comply with securities law and regulations of the China Securities Regulatory Commission (CSRC) and the stock exchange regarding the issuance of securities; market cap cannot be less than Rmb20bn.			Listed companies on overseas stock exchanges within the scope of the CSRC.
Requirements of market cap and equity		Regulated by Swiss Banking Act or Financial Institutions Act.		The average market cap of the overseas issuer based on the closing price of the underlying stock in the 120 trading days prior to the issuance application date cannot be less than Rmb20bn.
	The registered capital is not less than GBP0.7mn; total share capital is not less than GBP25mn.	At the time of issuance, the issuer's equity interest must be at least CHF25mn.	The company has at least 30 shareholders; according to the corresponding financial criteria, the minimum share capital is EUR1.25mn.	After the number of depositary receipts meets the main board listing conditions stipulated by the domestic stock exchange, the issuer may apply to the domestic stock exchange to list its depositary receipts for trading.
Accounting standards	International financial reporting standards (IFRS), or equivalent accounting standards in the third country; Chinese generally accepted accounting standards (GAAP) have been regarded as equivalent national standards.			If the Chinese accounting standards for business enterprises or equivalent accounting standards are not used, the corresponding information should be additionally disclosed.
	All audited financial statements for the past three years, or since establishment.	Have at least three years of preparing financial statements in accordance with the reporting standards required for listing; have appointed an independent auditor in compliance with Swiss law.	All audited financial statements for the past three years, or since establishment.	
Duration	Continuous operation for more than three years.	Continuous operation for more than three years.	Continuous operation for more than three years.	A minimum three years' listing on an overseas stock exchange as well as other listing conditions agreed upon by the CSRC and the overseas securities regulator, according to the market stratification of the overseas underlying stock market.
Issuance ratio	Free float of at least 25% of the European Economic Area (EEA) GDR (not the underlying stock).	GDR must have at least 20% free float.	Free float of at least 25% of the EEA GDR (not the underlying stock).	
total issuance	The aggregate market cap of all GDRs to be listed exceeds GBP700,000.	The expected free float market cap of GDRs is at least CHF25mn.	Circulation of at least EUR1.25mn.	The number of CDRs applying for listing is not less than 50mn and the corresponding underlying stock market value is not less than Rmb0.5bn.
Pricing	If a domestic listed company issues depositary receipts overseas with its newly issued stocks as underlying securities, the issue price should not be lower than 90% of the average closing price of the underlying stocks in the 20 trading days prior to the pricing benchmark date after proportional conversion.			In the initial public offering of depositary receipts, the issue price should be determined through price inquiry.
Transactions in the secondary market				
Transaction hours	9:00 a.m. to 4:30 p.m. local time	9:00 a.m. to 5:30 p.m. local time	9:00 a.m. to 5:30 p.m. local time	Beijing time 9:00 to 15:00
Cross-border transactions	Depository receipts issued by domestic listed companies for initial public offering abroad should not be redeemed or cancelled within 120 days from the date of listing. The number of shares of depositary receipts issued and listed overseas by domestic listed companies for the duration cannot exceed the upper limit of the number approved by the CSRC. It can only be conducted through the cross-border conversion institution designated by the Shanghai Stock Exchange.			
Investor entry threshold				The daily assets in the securities account and capital account in the 20 trading days prior to the opening of the application authority cannot be less than Rmb0.5mn; required participation in securities trading for more than 24 months.

Source: CSRC, SSE, SZSE, LSE, SIX Swiss Exchange, Deutsche Börse, CICC Research

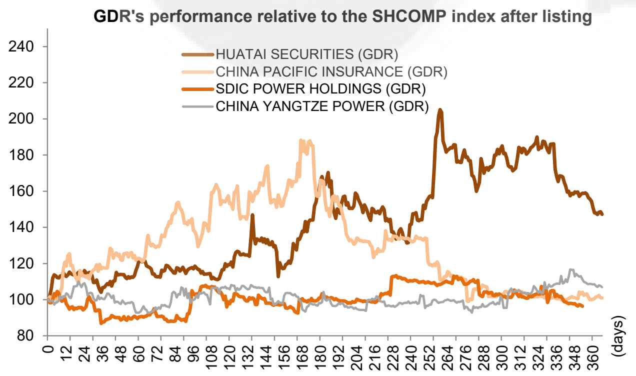
Question 5: What progress has been made in DRs under the Stock Connect program?

Since the launch of the Shanghai-London Stock Connect, four companies have successfully issued GDRs. No CDRs have been issued successfully yet, but the business is in progress.

GDR business: As at end-2021, four companies listed on the SSE (Huatai Securities, CPIC, SDIC Power, and China Yangtze Power) have successfully issued GDRs on the LSE through the Shanghai-London Stock Connect, raising US$3.7bn. These companies issued GDRs at a discount of about 14.1% on average to their A-shares. In terms of performance in the secondary market, the four companies' GDRs outperformed the broader market in the UK. After CSRC released rules on DRs under Stock Connect, several listed Chinese companies (e.g., Ningbo Shanshan, Gotion High-tech, Lepu Medical, and Sany Heavy Industry) have announced plans to issue GDRs on overseas securities exchanges (e.g., securities exchange in Switzerland).

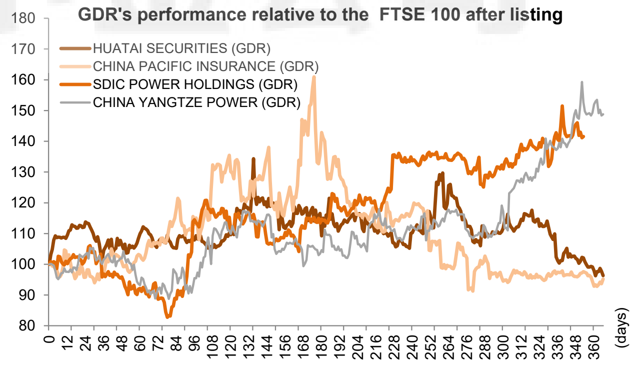
CDR business: As specific supporting rules were not previously introduced for the CDR business, no qualified overseas companies have tapped the A-share market through CDRs. However, given Ninebot's successful CDR issuance and the improvement of related mechanisms and rules, we think the CDR business is likely to grow at a faster pace.

Figure 9: The four GDRs' performance relative to that of Shanghai Composite Index



Source: FactSet, CICC Research

Figure 10: The four GDRs' performance relative to that of FTSE 100 Index



Source: FactSet, CICC Research

Question 6: What are the characteristics of the three markets related to DRs under Stock Connect?

At present, overseas securities exchanges that meet the requirements of the DRs under Stock Connect mechanism are securities exchanges in the UK, Germany, and Switzerland, and these three countries are important economic and financial centers in Europe.

The UK is the world's fifth largest economy with developed financial and service industries. The market value of bonds, overseas creditor rights of banks, stock market, and service trade in the country as a percentage of global total have all exceeded its GDP's share in global GDP. Founded in 1698, the LSE is one of the oldest securities exchanges in the world, and the securities exchange mainly consists of four sub-markets: The main market, the alternative investment market, the professional securities market, and the international securities market. Banking, insurance, energy, pharmaceuticals, and raw materials are representative industries in the UK.

In the **German** securities market, the Frankfurt Stock Exchange plays a dominant role, supplemented by securities exchanges in cities such as Stuttgart, Berlin, Bremen, Hamburg, Hanover, Munich, and Dusseldorf.

Switzerland is one of the oldest financial centers in Europe. SIX Swiss Exchange is the main securities exchange in the country, supplemented by the BX Swiss. SIX Swiss Exchange is the third largest securities exchange in Europe and the world's first securities exchange with fully automated trading, clearing, and settlement systems.

Question 7: What is the significance of the DRs under Stock Connect mechanism?

China has made several achievements in the opening-up of the country's capital market, and China encourages domestic enterprises to tap overseas capital markets and overseas investors to invest in the country in diverse ways. For China's domestic capital market, it is relatively common to encourage domestic securities issuers to tap overseas capital markets and to attract overseas investors to the domestic capital market. Chinese enterprises have issued more than 600 DR products in overseas markets, and many Chinese enterprises have chosen to directly list shares in overseas capital markets. We believe China's economy is developing rapidly with structures constantly optimized and the competitiveness of industries improving, and Chinese assets are also becoming increasingly attractive across the world. The regulations on the management of domestic enterprises' issuance and listing of overseas securities released by the State Council may gradually regulate Chinese enterprises' issuance of securities in overseas markets. While tapping overseas capital markets, we believe Chinese enterprises could also enhance their influence and brand image among investors, and more and more international investors are investing in Chinese assets, according to Bloomberg. Overseas investors' holdings still account for a relatively small share in the market cap of stocks in China's capital market compared with that in other capital markets in the world, and the share of China's capital market in MSCI's global index is relatively small compared with the size of the country's capital market and real economy. However, overseas investors are still rapidly increasing allocation to China's capital market. DRs under Stock Connect could further improve Chinese enterprises' capabilities in raising capital and issuing securities in the global market, and companies listed on SSE and SZSE could issue GDRs on overseas exchanges via DRs under Stock Connect mechanism.

However, there are limited channels for overseas securities issuers to tap China's domestic capital market and for domestic investors to invest abroad. Experience from overseas shows some major capital markets (such as the US capital market) not only have a relatively high proportion of overseas investors, but also have a relatively high proportion of listed overseas companies. In fact, specific rules for issuance by overseas issuers and listings of securities in the A-share market still need to be improved, while channels for listings of "red chip" companies are increasingly working smoothly.

We believe that DRs under Stock Connect will be an important channel for further internationalization of China's capital market.

- **Attracting overseas securities issuers to China's domestic capital market:** We believe the DRs under Stock Connect mechanism will be an important effort to gradually attract overseas securities issuers to China's capital market (not just "red chip" companies). Through the DRs under Stock Connect mechanism, China's capital market is likely to open its door to overseas securities issuers. For qualified securities issuers in major European markets such as the UK, Switzerland, and Germany, this mechanism allows overseas issuers to raise capital in China's capital market through the issuance of CDRs.

- **Encouraging domestic investors to invest in overseas capital markets:** DRs under Stock Connect could facilitate domestic investors' investment in overseas markets. There are various barriers and thresholds for domestic investors to invest in overseas markets. As residents are increasing asset allocation to financial assets, their demand for globalized and diversified asset allocation is also growing. Similar to the Shanghai-/Shenzhen-Hong Kong Stock Connect programs, the establishment of DRs under Stock Connect makes it convenient for investors to invest abroad "on their doorstep".
- **Further encouraging domestic securities issuers to tap overseas capital markets and attracting overseas investors to China's capital market:** As the DRs under Stock Connect mechanism gradually matures, we believe that China's capital market and other capital markets in the world will be connected more closely. Efforts to attract overseas securities issuers to China's capital market could encourage more overseas investors to understand and participate in China's capital market. As China's capital market becomes increasingly mature, it will be easier for Chinese securities issuers to gain recognition in overseas markets.

At present, overseas investors can invest in China's equity assets in the capital market through several major channels: Shanghai-/Shenzhen-Hong Kong Stock Connect programs (northbound trading), the Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor (RQFII) programs, Bond Connect (northbound trading), and DRs under Stock Connect (GDRs). Chinese investors can invest in overseas equity assets through several major channels: Shanghai-/Shenzhen-Hong Kong Stock Connect programs (southbound trading), the Qualified Domestic Institutional Investor (QDII) program, and DRs under Stock Connect (CDRs). We have summarized information about institutional requirements (e.g., requirements on quotas and qualifications) and scope of investments related to these channels.

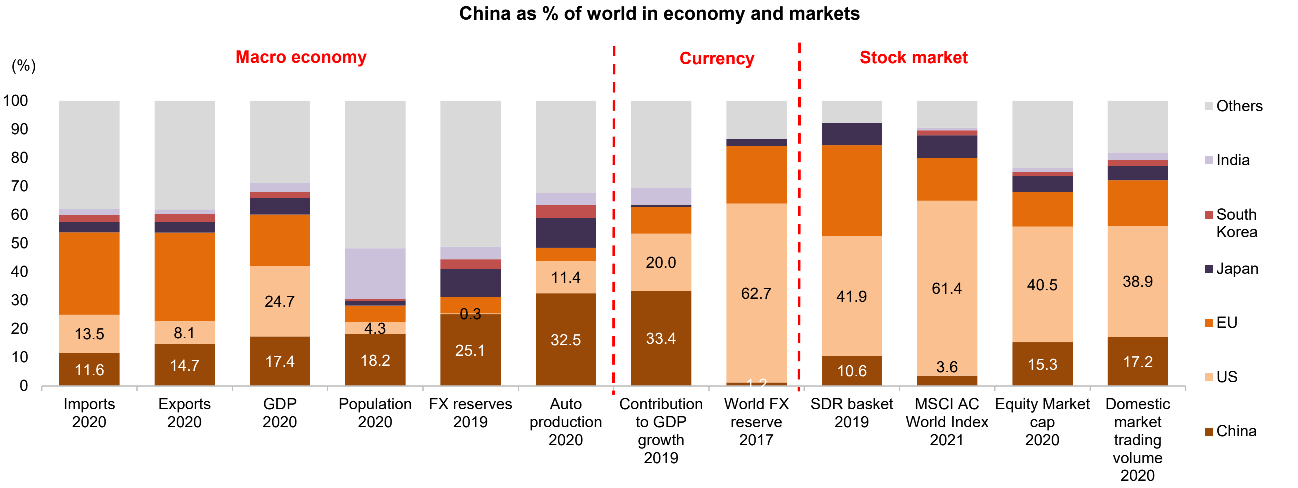
Figure 11: Channels for international investments in China's capital market

Major aspects		Stock		
		QFII/RQFII	Stock Connect (Northbound)	Stock Connect (Southbound)
Preparation	**Qualification**	Institutional investors recognized by CSRC; required financial stability, good credit standing, securities and futures investment experience, a sound and effective governance structure, internal control and compliance management system, and no major penalties from regulatory agencies in the past 3 years or since its establishment.	All investors that trade in HK Exchange can participate in Stock Connect (ChiNext is only available for institutional investors)	**Institutional investors** participating in southbound trading shall comply with laws, administrative regulations, departmental rules, regulatory documents and business rules; **Individual investors** participating in southbound trading shall at least meet the following conditions: the total assets of the securities account and capital account shall not be less than Rmb0.5mn; there is no serious bad integrity record
	Investment Quota	No investment limit	No limitation on total quota.Daily quota is Rmb52bn for SH-HK and SZ-HK Connect	No limitation on total quota.Daily quota is Rmb42bn for SH-HK and SZ-HK Connect
	Transaction Currencies	Allowing qualified investors to independently choose the currency	RMB	Southbound trading is quoted in Hong Kong dollars, and investors are settled in RMB
	Approval Procedures	After obtaining the securities and futures business license from CSRC, a qualified investor shall entrust the main reporter to submit relevant materials and apply to SAFE for business registration	Investors will likely entrust members/participants (securities companies) of the Stock Exchange and the United Property and Share Rights Exchange to execute entrusted orders to the counterpart's exchange	Individual investors and institutional investors open accounts through securities companies
Investment	**Investment Scope**	All products traded on Exchanges: Common stocks, preferred stocks, bonds, funds, index futures, assets-backed securities, new share issuances, bond issuances, private placements and share allotments	Select stocks traded on Exchanges: **Shanghai:** Constituents in the SSE 180 and SSE 380, and A/H-share dual listed stocks. No *ST stocks and B-shares; **Shenzhen:** Constituents of SZSE Component Index and SZSE Small/Mid Cap Innovation Index with market cap no less than Rmb6bn and A/H dual-listed stocks. No *ST stocks and B-shares	Select stocks traded on the exchange: **SSE:** constituent stocks of the Hang Seng Composite Large-Cap Index; constituent stocks of the Hang Seng Composite Mid-Cap Index; H shares of A+H-share listed companies; **SZSE:** Hang Seng Composite Large-Cap Index Constituent Stocks; Hang Seng Composite Mid-Cap Index Constituent Stocks; Hang Seng Composite Small-Cap Index Constituent Stocks, and the constituent stocks are regularly adjusted and reviewed; H shares of A+H-share listed companies listed on the Stock Exchange
	Limitations on Shareholding Ratio	A single investor's shareholding ratio should not exceed 10% of the listed company's total shares. All investors' shareholdings should not exceed 30% of the listed company's total shares (no limitation on strategic investors' shareholding ratio)	Refer to regulations for QFIIs. There is no regulation on a single investors' shareholding ratio in the Hong Kong SAR's existing laws	No limitation
	Margin Trading and Security Lending	Not allowed temporarily, allowed in the revised draft	Allowed within certain restrictions	Not allowed yet
	Trading Days	All A-shares trading days	Only the dual trading days, trading suspended whenever either market is dosed	Only the dual trading days, trading suspended whenever either market is dosed
Management	**Management of Funds**	Foreign institutional investors only need to sign a tax payment commitment letter to remit the investment principal and income; foreign institutional investors can appoint multiple domestic custodians, but should designate one custodian as the main reporter	Funds are under closed management: Funds from selling securities must return along the same path and cannot stay in the local market	Southbound Trading implements a third-party depository system for client transaction settlement funds, which shall be implemented in accordance with relevant regulations on A-share transactions
	Tax	Temporarily exempted from income and value-added taxes; only need to pay a dividend tax at 10% and stamp duties at 0.1%	Temporarily exempted from income and value-added taxes; only need to pay a dividend tax at 10% and stamp duties at 0.1%	Temporarily exempted from income and value-added taxes; only need to pay a dividend tax at 20% and stamp duties at 0.1%

Major aspects		Bond		Mutual Fund Connect
		Bond Connect (Northbound)	CIBM Direct	
Preparation	**Qualification**	Including overseas central banks or monetary authorities, sovereign wealth funds, international financial organizations; qualified foreign institutional investors (QFII), renminbi qualified foreign institutional investors RQFII; overseas legally registered commercial banks, insurance companies, securities companies, and fund management companies And other asset management institutions and other financial institutions	Foreign institutional investors, qualified foreign investors and RMB qualified foreign investors who have opened bond accounts in the inter-bank bond market	Public investors (including companies and individuals)
	Investment Quota	No investment limit	No investment limit	The investment quota for mutual recognition of the Mainland and Hong Kong public funds is Rmb300bn each. The use and distribution of investment quota will be implemented in accordance with the relevant regulations of the State Administration of Foreign Exchange
	Transaction Currencies	RMB or Foreign Currency	RMB	RMB, Hong Kong Dollar
	Approval Procedures	Eligible foreign investors can directly or entrust an institution recognized by PBOC as the agency filing agency to apply for filing with the Shanghai Headquarters of PBOC	Before trading, foreign institutional investors need to submit a letter of commitment to the trading center, and submit an application form for opening trading services to the trading center through the settlement agent	CSRC will review the Hong Kong Mutual Recognition Fund registration application and make a decision. The opinion of the Hong Kong Securities Regulatory Commission may be sought during the review process.
Investment	**Investment Scope**	All types of securities that can be traded in the inter-bank bond market	All types of securities that can be traded in the inter-bank bond market	**Mainland Fund:** the fund shall be established for over 1 year; its asset size shall be over Rmb200 mn or equivalent foreign currency; its main investment direction shall not be the Hong Kong market; and sales in Hong Kong as % of total assets shall not be higher than 50% **HK Fund:** the fund shall be established for over 1 year; its asset size shall be over Rmb200 mn or equivalent foreign currency; its main investment direction shall not be the mainland market; and sales in mainland as % of total assets shall not be higher than 50%
	Trading Days	Applicable to the trading days and trading hours of the mainland inter-bank bond market	Applicable to the trading days and trading hours of the mainland inter-bank bond market	Only when the working days in the Mainland and Hong Kong are the same, the cross-border sales of mutual fund units can only be open for purchase and redemption
Management	**Management of Funds**	"Bond Connect" adopts a multi-level custody approach. Domestic custodians (including Shanghai Clearing Exchange and China Debt) are primary custody, CMU is secondary custody, and CMU opens a nominal holder account with the domestic custodian; "Bond Connect (Northbound)" foreign investors will use the RMB cross-border payment system (CIPS) to settle cross-border bond transactions. Foreign investors can use their own accumulated, raised and self-converted RMB funds to invest in the offshore market	Foreign investors who enter the market directly adopt the first-level custody method, that is, directly open an account in China Bond or Shanghai Clearing House	In the fund purchase and redemption link of funds in the two places, fund managers are required to set up special fund accounts, not limited to RMB or foreign exchange accounts, and cross-border issuance and sales of mutually recognized funds are encouraged to be priced in RMB, and RMB is used for cross-border receipts and payments
	Tax	Temporary exemption of corporate income tax and value-added tax	Temporary exemption of corporate income tax and value-added tax	Temporary exemption from income tax, only 10% dividend tax is paid, no stamp duty is temporarily levied

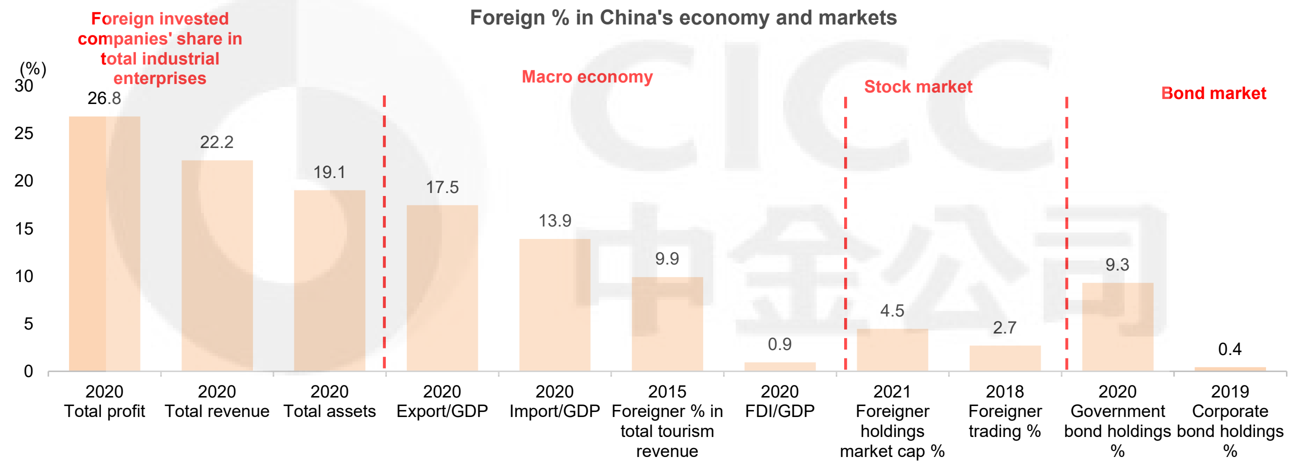
Source: CSRC, SSE, SZSE, CICC Research

Figure 12: China's participation in global real economy and capital market



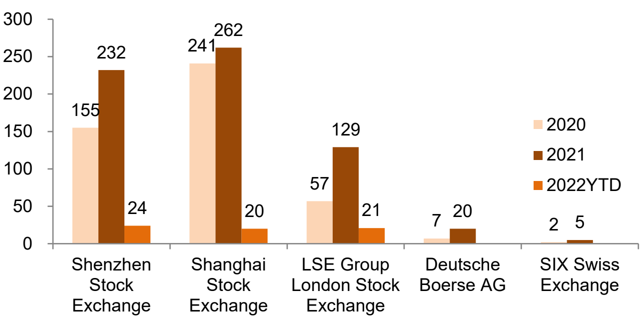
Source: CSRC, CICC Research

Figure 13: Foreign capital's participation in China's real economy and capital market



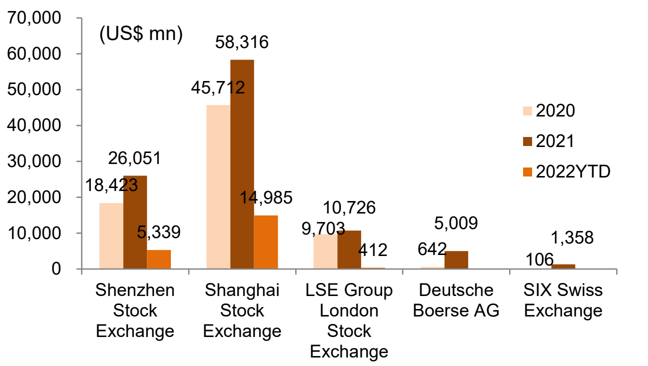
Source: Wind Info, NBS, SSE, PBoC, CICC Research

Figure 14: Number of IPOs on select exchanges in China, UK, Germany and Switzerland



Source: World Federation of Exchanges, Wind Info, CICC Research

Figure 15: Funds raised by IPOs at select exchanges



Source: World Federation of Exchanges, Wind Info, CICC Research

Question 8: The outlook for DRs under Stock Connect mechanism, what merits attention?

We suggest paying attention to possible progress in the following areas.

- First, with improvement in rules for the CDR business, qualified overseas companies may tap the A-share market through the DRs under Stock Connect mechanism. At present, there is no overseas enterprise in the A-share market. In the future, the improvement of the CDR business may attract greater attention from the market.
- Second, the GDR business may further improve domestic listed companies' willingness to issue GDRs in overseas markets amid accelerated progress of the DRs under Stock Connect mechanism.
- Third, as the Shanghai-London Stock Connect is evolving into to the DRs under Stock Connect mechanism, the mechanism may have room for further expansion in the future (e.g., expansion of the scope of overseas markets and market access requirements for enterprises).

Overall, we believe that DRs under Stock Connect will further promote the internationalization of China's capital market and facilitate the country's two-way opening-up from the perspective of capital market. Over the long run, we believe that efforts to promote the internationalization of China's capital market (e.g., efforts to develop DRs under Stock Connect) will be of important significance for China's closer connection to the world and the world's better understanding of China amid a complex international environment and profound changes in the world.

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