# Building a Eurasian Capital Market: Understanding the Operating Mechanism and Legal Framework of Shanghai–London Stock Connect

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## Abstract

*This article provides an in-depth analysis of laws and regulations relating to the Shanghai–London Stock Connect (SLSC) which enables investors and public companies in both China and the UK to access each other's capital markets. It introduces the history and latest developments of the SLSC. It considers the SLSC's operating mechanism, including the East Bound and West Bound sub-schemes, and how the pilot scheme is regulated under Chinese and English laws. Moreover, it evaluates potential regulatory challenges posed by the SLSC.*

## Introduction

2019 marked the 70th anniversary of the founding of the People's Republic of China (PRC).[1] Over the past decades, China has witnessed the massive transition of its economy from a left-behind agrarian state to a modern industrialised and service-based nation. It is considered as an economic miracle in the 21st century. Nowadays, China holds the largest banking industry in the world. According to *The Banker*, ICBC, China Construction Bank, Agricultural Bank of China, Bank of China were ranked the four largest global banks by Tier 1 capital as they possess USD 338 billion, USD 287 billion, USD 243 billion and USD 230 billion respectively.[2] Aside from this, the Chinese capital market has seen dramatic growth in recent years. China has two main stock exchanges—Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE)—with a total of 3,500 listed companies.[3] The scale of the Chinese markets is comparable to that of New York Stock Exchange and NASDAQ in the US and Japan's Tokyo Stock Exchange. The SSE was ranked the world's 4th largest stock exchange in terms of total market capitalisation ($4.78 trillion) and the SZSE was ranked the 8th ($3.03 trillion).[4]

At present, China's stock markets have been undergoing a series of radical reforms to remove regulatory red tape, boost capital allocation efficiency, and integrate with the international capital market. For example, recently Chinese regulators have loosened the public listing requirements and started to allow certain foreign-listed companies to issue Chinese depositary receipts (CDRs) to dual-list their shares in mainland China.[5] The pilot CDR project is said to attract Chinese tech giants like Alibaba, Tencent, Xiaomi and *JD.com*, as well as some international corporations such as HSBC to land their shares in Shanghai or Shenzhen.[6] Moreover, the SSE has recently launched the Technology Innovation Board (which is often referred to as the Start Market) to encourage the investments in China's tech industry and help more Chinese businesses to list at home rather than overseas.[7] The Star Market is viewed as the Chinese version of NASDAQ. It has adopted the laissez-faire regulatory approach as the Star Market allows the use of dual-class shares and the short selling of individual stocks, which are prohibited in the main board of SSE.

The SLSC is another regulatory experiment to push forward the internationalisation and marketisation of Chinese capital market. The SLSC is a pilot cross-border listing and trading scheme connecting China's SSE with the UK's London Stock Exchange (LSE).[8] The bilateral arrangement between China and Britain allows eligible companies listed in Shanghai and London to issue depositary receipts to be dual-listed on the other side's stock markets. Evidently, the SLSC offers British investors a rare opportunity to buy the shares of some of the best companies in the world's second largest economy. Vice versa, investors in mainland China will be able to

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1 BBC, "China anniversary: Beijing celebrations mark 70 years of Communist rule" (1 October 2019) available at: *http://www.bbc.co.uk/news/world-asia-china-49808078* [Accessed 6 December 2019].

2 "Top 1000 World Banks 2019" (1 July 2019), *The Banker* available at: *http://www.thebanker.com/Top-1000-World-Banks/Top-1000-World-Banks-2019-The-Banker-International-Press-Release-for-immediate-release* [Accessed 6 December 2019].

3 Lerong Lu and Ningyao Ye, "Chinese Depositary Receipts: What They Are, How They Work and Why This Represents a Golden Opportunity" (2018) 33 *Butterworths Journal of International Banking and Financial Law* 529.

4 Hong Kong Securities and Futures Commission, "Market Capitalisation of the World's Top Stock Exchanges" (June 2019) available at: *http://www.sfc.hk/web/EN/files/SOM/MarketStatistics/2019/a01.pdf* [Accessed 6 December 2019].

5 Ningyao Ye and Lerong Lu, "How to Harness a Unicorn? Demystifying China's Reform of Share Listing Rules and Chinese Depositary Receipts" [2019] I.C.C.L.R. 454, 462.

6 Don Weinland and Emma Dunkley, "HSBC set to become first foreign company to list in China" (18 October 2018), *Financial Times* available at: *http://www.ft.com/content/e9b519b8-d28b-11e8-a9f2-7574db66bcd5* [Accessed 6 December 2019].

7 Hudson Lockett, "Shares on China tech exchange surge in trading debut" (22 July 2019), *Financial Times* available at: *http://www.ft.com/content/6c7dacfc-ac25-11e9-8030-530adfa879c2* [Accessed 6 December 2019].

8 London Stock Exchange Group, "Shanghai–London Stock Connect" available at: *http://www.lseg.com/markets-products-and-services/our-markets/shanghai-london-stock-connect* [Accessed 6 December 2019].

trade the shares of certain London-listed firms. It is clear that the SLSC creates a win-win situation for both China and the UK. The experimental project can promote the international reputation and influence of Chinese markets and helps Chinese-listed companies to adhere to international standards regarding information disclosure and corporate governance. Meanwhile, the SLSC could support London maintaining its prestigious status as the top global financial centre at the time when it is prone to some serious negative impact from Brexit.

Against this backdrop, this article aims to discuss and analyse the operating mechanism of the SLSC and relevant legal and regulatory challenges facing financial lawyers and financial regulators in China and the UK. Following the introduction, this article presents the historical developments of the SLSC. It then examines the operating methods of the SLSC, including East Bound and West Bound sub-schemes, as well as how they are governed by Chinese and English laws. This article will then consider the requirements for London-listed companies to issue CDRs to be traded in Shanghai via the stock connect and will then focus on potential regulatory challenges created by the pilot project. The final section draws a conclusion.

## Shanghai–London Stock Connect: past, present and future

China's economic reform, guided by the reform and open-up policy, has rejuvenated its economy as it experienced average 9.8% of GDP growth from 1978 to 2012.[9] In 2010, China overtook Japan as the second-largest economy in the world, just next to the US.[10] More recently, China launched the Belt and Road Initiative (BRI) in 2013 which is a vast infrastructure programme connecting Eurasia, the Middle East and Africa.[11] As China promised to integrate it further into the global economy, the launch of SLSC has shown its willingness to open its door to western investors and financial institutions. In the past, investors outside China have limited access to Chinese stocks, bonds, derivatives and other financial instruments, as China has made strict laws to limit foreign investors' ability to purchase financial assets in China due to multiple concerns such as the stability of foreign exchange rates and the national economic security. Therefore, the only possible way for foreign investors to buy Chinese equities was to go through the Qualified Foreign Institutional Investor (QFII) Scheme that allows licensed international investors to trade some shares, bonds and other securities listed in Shanghai and Shenzhen.[12] Strict investment quotas have been allocated to around 300 international investors admitted to the QFII Scheme.

Over the past decade, China has been actively experimenting different stock links with markets outside mainland China. For example, the Hong Kong Stock Exchange has built stock connect schemes with both Shanghai and Shenzhen since 2014 to allow international and mainland Chinese investors to trade securities in each other's markets through the trading and clearing facilities of their home exchange.[13] In September 2015, George Osborne, then UK Chancellor of the Exchequer, revealed a landmark feasibility study into the pilot scheme of linking Chinese and British stock exchanges together, when he attended the 7th China–UK Economic and Financial Dialogue[14]:

> "I want to see our stock markets in London and Shanghai formally connected, with UK firms raising funds from Chinese savers, and Chinese firms listing in London",

the Chancellor said when he was in Shanghai.[15] In December 2017, the UK and China reiterated their commitment to defend global free trade when the then Chancellor, Philip Hammond, attended the 9th China–UK Economic and Financial Dialogue in Beijing.[16] He stated:

> "we have agreed to accelerate the final preparations for the London–Shanghai Stock Connect initiative and we have agreed to commence feasibility studies for a UK–China bond connect and for mutual recognition of funds between the two jurisdictions".[17]

Since 2018, both countries have been working on the long-awaited SLSC. The China Securities Regulatory Commission (CSRC) promulgated "Administrative Measures for the Issuance and Trading of Depository Receipts" and "Regulatory Provisions on the Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange" which set out the listing and trading rules for the upcoming SLSC. Meanwhile, the LSE issued the "Consultations on Amendments to Issuance and Information Disclosure Standards" which is regarded as an important stage to prepare for the launch of the SLSC.

In June 2019, Huatai Securities which is one of the largest securities brokers in China became the first Chinese company to board the LSE through the SLSC programme.[18] Huatai raised USD 1.7 billion from selling

[9] Jianhong Zhu, "35 Years, Chinese Economy Keep Rising", *People's Daily*, 21 November 2013, p.4.
[10] Mure Dickie and Jonathan Soble, "China Displaces Japan as Second Biggest Economy", *Financial Times*, 15 February 2011, p.9.
[11] "Italy's plan to join China's Belt and Road Initiative ruffles feathers", *The Economist*, 21 March 2019.
[12] Shanghai Stock Exchange, "What is QFII and RQFII?" available at: *http://english.sse.com.cn/investors/qfii/what/* [Accessed 6 December 2019].
[13] Hong Kong Stock Exchange, "Stock Connect" available at: *http://www.hkex.com.hk/Mutual-Market/Stock-Connect?sc_lang=en* [Accessed 6 December 2019].
[14] BBC, "UK–China stocks link plan unveiled" (22 September 2015) available at: *http://www.bbc.co.uk/news/business-34322446* [Accessed 6 December 2019].
[15] BBC, "UK–China stocks link plan unveiled" (2015).
[16] Reuters, "Britain and China promise to speed up work on London-Shanghai stock connect" (16 December 2017) available at: *http://www.scmp.com/news/china/diplomacy-defence/article/2124601/britain-and-china-promise-speed-work-london-shanghai* [Accessed 6 December 2019].
[17] Reuters, "Britain and China promise to speed up work on London–Shanghai stock connect" (2017).
[18] Sarah Provan, "Huatai Securities to Raise as much as $1.7bn in London Listing" (14 June 2019), *Financial Times* available at: *http://www.ft.com/content/40a6eb48-8e84-11e9-a1c1-51bf8f989972* [Accessed 6 December 2019].

82.5 million global depositary receipts (GDRs), which is around 10% of its outstanding share capital.[19] The listing of Huatai formally kicked off the ground-breaking SLSC initiative. Philip Hammond stated at the SLSC launch event in London that:

> "Stock Connect is a ground breaking initiative, which will deepen our connectivity as we look outwards to new opportunities in Asia … London is a global financial centre like no other, and today's launch is a strong vote of confidence in the UK market."[20]

According to one estimate, over 260 Shanghai-listed companies might be eligible to take part in the SLSC scheme and obtain a second listing in London.[21] Aside from this, HSBC has expressed its interest to become the first UK company to apply for a listing in Shanghai by participating in the East Bound part of the SLSC.[22] Hundreds of public companies in either China or the UK would be potentially qualified to join the SLSC over the next few years, which will benefit relevant parties including issuing companies, banks, brokers, asset managers, shareholders and professional services firms from both countries. According to the LSE, the SLSC project has achieved a number of firsts:

- the first time any foreign companies will be able to list in mainland China and the first time SSE-listed companies will be able to raise capital abroad through instruments fungible with their domestic shares;
- the first time Chinese investors will be able to access international stocks from within China without being subject to domestic capital controls; and
- the first-time international investors will be able to access China A-shares from outside Greater China and through international trading and settlement practices.[23]

## Operating mechanism of Shanghai–London Stock Connect

The SLSC refers to the cross-border listing and trading system that enables SSE or LSE-listed companies to dual-list their shares in the opposite market and raise extra funds through the issuance of either global depository receipts (GDRs) or CDRs. The SLSC has two sub-schemes: East Bound and West Bound. The cross-border conversion of depository receipts remains the key to facilitate the successful operation of the SLSC. In terms of the East Bound scheme, UK-listed companies planning to list shares on the SSE will proceed via the creation and sale of CDRs. Regarding the West Bound scheme, it provides a channel for Chinese A-share companies to tap financing resources in London by issuing and selling GDRs on the LSE. From the legal perspective, depository receipts are very different from ordinary shares, as the issuer needs to entrust an offshore custodian bank who will be the representative of the foreign registered company to claim equity interests.[24] According to CITIC Securities, the prospective market scale of depository receipts amounts to USD 2.9 trillion globally; Goldman Sachs also predicted that the CDR market will possibly reach USD 800 billion in the future.[25]

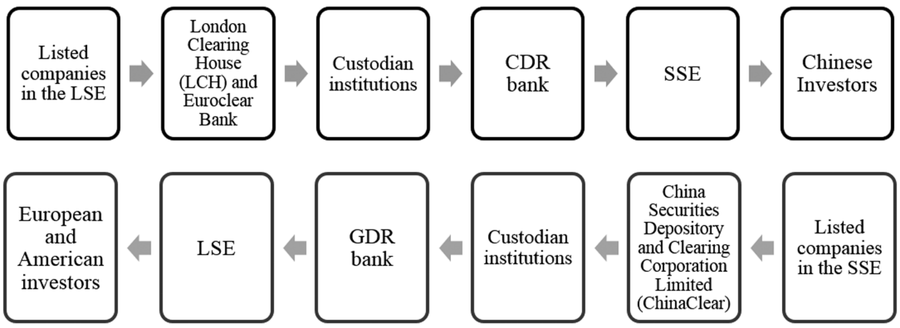


***Figure 1: The East Bound and West Bound sub-schemes under SLSC***[26]

[19] Provan, "Huatai Securities to Raise as much as $1.7bn in London Listing" (14 June 2019).
[20] BBC, "UK to Launch Ground-Breaking China Stock Market Link" (17 June 2019) available at: *http://www.bbc.co.uk/news/business-48658844* [Accessed 6 December 2019].
[21] BBC, "UK to Launch Ground-Breaking China Stock Market Link" (2019).
[22] Don Weinland and Emma Dunkley, "HSBC set to become first foreign company to list in China" (18 October 2018), *Financial Times* available at: *http://www.ft.com/content/e9b519b8-d28b-11e8-a9f2-7574db66bcd5* [Accessed 6 December 2019].
[23] London Stock Exchange Group, "Shanghai–London Stock Connect" available at: *http://www.lseg.com/markets-products-and-services/our-markets/shanghai-london-stock-connect* [Accessed 6 December 2019].
[24] Lu and Ye, "Chinese Depositary Receipts" (2018) 33 *Butterworths Journal of International Banking and Financial Law* 529.
[25] "Opportunities for Prospective CDR Market" (17 March 2018), *China Securities Times* available at: *http://www.stcn.com/2018/0317/14034981.shtml*; "CDRs Are a Foundation for Internationalised A-shares" (8 March 2018), *Sina Finance* available at: *http://finance.sina.com.cn/stock/marketresearch/2018-03-08/doc-ifxpwyhv9413509.shtml* [Both accessed 6 December 2019].
[26] Figure 1 is compiled by the authors.

Under the cross-border conversion mechanism, China Securities Depository and Clearing Corp Ltd (China Clear) is responsible for providing the clearing and settlement service for CDR issuers, whilst London Clearing House and Euroclear Bank offer the clearing service and the settlement respectively.[27] Compared with the freedom to select depository institutions and custodian institutions in the UK, China has set more restrictions over the candidate list of depository institutions and custodian institutions. At present, only China Clear and its subsidiaries, commercial banks and securities brokers approved by the CSRC are allowed to serve the role of depository banks for CDR issuers and custodian institutions for A-share issuers.[28] Regarding depository banks for GDR issuers and custodian institutions for UK-listed companies, they face fewer restrictions and only need to file with the SSE. Both sides have to comply with local laws when listing in the opposite market. GDR issuers are asked to prepare a prospectus in English with the consent of the UK Listing Authority, namely, the Financial Conduct Authority (FCA). In addition, CDR issuers have to run an office in mainland China for the sake of information disclosure and maintaining investor relationship.

Cross-border conversion institutions (designated brokers in the LSE) will mainly comprise securities companies which have obtained a special licence to represent their clients to buy and sell CDRs and GDRs. The SSE will be responsible for issuing and revoking licences of cross-border conversion institutions which are the main market makers for cross-border transactions. LSE member brokers that would like to become GDR cross-border conversion institutions should request a SSE member broker to help it to submit the application with other supporting documents and CDR cross-border conversion institutions will be directly appointed by the SSE and CSRC from a certain group of securities companies. To become GDR cross-border conversion institutions, securities brokers should comply with the following requirements:

- have a full membership of the LSE;
- be qualified as QFII or Renminbi Qualified Foreign Institutional Investor (RQFII), or a subsidiary wholly owned by the QFII or RQFII; and
- comply with the regulatory requirements and rules set by the SSE.[29]

CDR cross-border conversion institutions must adhere to additional requirements made by the SSE and CSRC, including:

- be approved by the SSE;
- be approved and rated by the CSRC;
- have a history of overseas trading;
- be able to carry out market-making services, initial liquidity and bilateral quotation;
- be qualified to be involved in proprietary trading of securities;
- be classified as securities with at least "BBB" rating for a minimum of two years; and
- have been trading in overseas securities for at least three years.[30]

Qualified CDR cross-border conversion institutions can be market makers for single or multiple CDRs, whereas the SSE will designate CDR cross-border conversion institutions as market makers for a CDR issuance with fewer than three market makers, which aims to encourage the active transactions of CDRs as well as curtail opportunist investors in the market. So far, 17 securities companies are qualified as candidates of CDR cross-border conversion institutions and the prospective conversion institutions will be picked from this group.[31]

Unlike normal initial public offerings (IPOs) of A-shares and CDR issuance of innovating companies, the issuance of CDRs under the SLSC programme have a limited financing function since they are totally based on the secondary offering. Therefore, CDR issuers do not have to proceed through the Issuance Appraisal Committee of the CSRC and they just need to submit the applications to the CSRC and wait for the final approval by the CSRC with the SSE's consent. Both stock exchanges have published guidance for eligible companies to issue shares via this programme. For CDR issuers, they must meet the following criteria:

- have a market value of over CNY 20 billion (USD 2.92 billion, based on the closing price of the quoted stock 120 days ago);
- have been listed on the LSE for over three years, with the minimum of one year in the Premium Segment of the Main Market;
- issue at least 50 million shares of CDRs worth over CNY 500 million (USD 73 million); and

[27] CSRC, "Opinions for Developing Creative Domestic IPO and Pilot Project of Chinese Depositary Receipts", Pt 3.
[28] CSRC, "Measures for the Issuance and Trading of Depository Receipts (for Trial Implementation)", art.26.
[29] SSE, "Notice on Issuing the Guidelines for the Cross-Border Conversion of Depositary Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange", art.82.
[30] CSRC, "Administrative Measures for the Issuance and Trading of Depository Receipts (for Trial Implementation)", art.26; SSE, "Notice on Issuing the Guidelines for the Cross-Border Conversion of Depositary Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange", art.5.
[31] The 17 securities companies are: Shenwan Hongyuan, Orient Securities, GuangFa Securities, Huatai Securities, Guotai Junan Securities, China Merchants Securities, Guosen Securities, CITIC Securities, Haitong Securities, Goldman Sachs Gaohua Securities, China International Capital Corporation, Everbright Securities, Caida Securities, China Galaxy Securities, UBS Securities, BOC International and CSC Financial. See "17 Securities Companies Involved in CDR Cross-Border Conversion Test and Are Qualified as Candidates of CDR Cross-Border Conversion Institutions" (18 October 2018), *Shanghai Securities News* available at: *http://news.cnstock.com/news,qy-201810-4284652.htm* [Accessed 6 December 2019].

- obtain the approval from the CSRC in line with the SSE requirements.[32]

Apart from above requirements, the CSRC further sets the additional selection criteria for CDR issuers:

- have a complete and well-operated organisation;
- have the capability of making profits continuously and a sound financial status;
- have no false record in its financial statements over the latest three years and have no other irregularity;
- have legally operated over three years without ownership disputes over major assets;
- have taken no illegal actions in violating the legal rights of investors and public interest;
- have in place a standardised accounting and sound internal control system;
- directors, auditors and senior management should have a good reputation, qualifications and good credit records; and
- follow other rules issued by the CSRC.[33]

Compared with CDR issuance, GDR issuers face simpler rules to be traded on the LSE as they have to satisfy the following criteria:

- have a market value of over CNY 20 billion (USD 2.92 billion);
- be listed on the SSE;
- be approved by the CSRC;
- allot new shares to be listed on the SSE, which will be the underlying securities to be cross-border converted as GDRs to be traded on the LSE;
- comply with the rules of the UKLA and the LSE admission and disclosure standards; and
- comply with the 25% free float requirement for GDR listing.[34]

CDR issuers should submit an application to apply pre-examination, which will be responded to within 30 trading days.[35] After CDR issuers pass the pre-examination, CDR conversion institutions can begin purchasing the LSE stocks and convert them into CDRs. Finally, once CDRs which have been converted from the LSE stocks reach 50 million shares or CNY 500 million, CDR issuers will have to apply to list CDRs in the A-Share market and the SSE will give the decision within five trading days.[36]

At present, the SSE and CSRC have collectively announced thresholds for eligible Chinese individual investors. Individual investors should have over CNY 3 million in cash or securities accounts during the last 20 trading days without bad credit records and criminal records, and all transactions of CDRs and related transactions are settled in renminbi.[37] Institutional investors that wish to take part in CDR transactions should submit an application to apply for a licence to become a CDR cross-border conversion institution in line with relevant provisions set by the CSRC and the SSE.

The price fluctuation of a CDR will be restricted within the maximum allowable 10% on its first trading date in contrast to the maximum allowable 44% for an A-share debut; if the market closure at the SSE lasts for seven calendar days or above, the maximum allowable percentage of rise and fall will be capped at 20%.[38] Considering the different time zone between the UK and China, the "T+1" transaction approach has been adopted, indicating that actual transaction will be settled by next working day and buying and selling cannot occur in the same day. Meanwhile, the trading of CDRs relies on the market maker mechanism, in which CDR buyers should bid for CDRs with no more than 1 million in a single purchase.

With respect to GDRs, GDR issuers are not allowed to buy GDRs they have issued back within 120 days, so as to contain opportunistic GDR issuers which sell at high price and then repurchase at a lower price to make profits.[39] Nevertheless, the initial restrictions on the buy-back was six months but in order to encourage active transactions the restriction has been cut to 120 days.[40] In contrast to GDRs, CDRs have no restrictions on the buy-back. In principle, the issuing price of GDRs should be no less than 90% of the average price in the last 20 trading days.[41] Shareholders, de facto controller, and affiliated companies of GDR issuers are not able to sell GDRs within 36 months of the listing date.[42]

[32] SSE, "Notice on Issuing the Interim Measures for the Listing and Trading of Depositary Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange", art.6.
[33] CSRC, "Measures for the Issuance and Trading of Chinese Depositary Receipts (for Trial Implementation)", art.5.
[34] LSE, *A Guide to Listing on the London Stock Exchange* (November 2010) available at: *https://www.londonstockexchange.com/home/guide-to-listing.pdf* [Accessed 9 December 2019].
[35] SSE, "Notice on Issuing the Interim Measures for the Listing and Trading of Depositary Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange", arts 7–8.
[36] SSE, "Notice on Issuing the Interim Measures for the Listing and Trading of Depositary Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange", art.8.
[37] SSE, "Measures for Trading of Chinese Depositary Receipts under the Shanghai–London Stock Connect (for Trial Implementation)", art.45.
[38] SSE, "Measures for Trading of Chinese Depositary Receipts under the Shanghai–London Stock Connect (for Trial Implementation)", art.52.
[39] CSRC, "Provisions on the Supervision and Administration of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange (for Trial Implementation)", art.32.
[40] "Investors Now Can Participate SLSC" (18 June 2019), *China Stock Times* available at: *http://news.stcn.com/2019/0618/15190546.shtml* [Accessed 6 December 2019].
[41] CSRC, "Provisions on the Supervision and Administration of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange (for Trial Implementation)", art.18.
[42] CSRC, "Provisions on the Supervision and Administration of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange (for Trial Implementation)", art.20.

Besides, there are three major differences between GDRs and CDRs. First, unlike CDRs which are converted from existing shares with no fundraising functions, the SSE-listed companies can be financed via GDRs in the form of issuing new shares. Secondly, in terms of cross-border buy-backs, GDRs cannot be redeemed within 120 days since the listing date, whereas, CDRs do not have any restriction on the redemption date. Thirdly, GDR issuers should comply with the LSE regulations and UK laws, and CDR issuers should be examined by the SSE and be approved by the CSRC. In a nutshell, GDR issuers face relatively easy regulations compared to CDR issuers' procedures to list on the SSE.

Finally, the "Measures for the Issuance and Trading of Chinese Depository Receipts (for Trial Implementation)" seeks to reconcile the conflicts of laws for any UK-listed companies that wish to issue CDRs in Shanghai. First, UK-listed companies should elaborate the principal distinctions between the UK company law and the PRC company law, and relevant influences on issuing CDRs and investor protection in the prospectus.[43] Secondly, companies with variable interest entity and weighted voting rights should remind investors of potential risks and corporate issues in a conspicuous place in the prospectus.[44] An independent chapter regarding investor protection is required in the prospectus. After the CDR listing, the ongoing supervision of CDRs are subject to art.14 of the "Provisions on the Supervision and Administration of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and London Stock Exchange (for Trial Implementation)". Issues not covered in art.14 will be addressed by the "Measures for Ongoing Supervision of Innovative Enterprises Following Listing of Domestically Offered Stocks or Depository Receipts (for Trial Implementation)".

## Potential UK-listed companies to issue Chinese depositary receipts via Shanghai–London Stock Connect

In accordance with the standards set by the SSE and the CSRC, companies included in the FTSE 100 will be eligible for issuing CDRs in China's A-share market.[45] The FTSE 100 companies take up around 81% of the whole market value in the UK, and most of them are international corporations that are more likely to meet the requirements of being CDR issuers.[46] In light of a LSE's report, as of the end of 2018 there were 477 companies listed in the Premium Segment of the Main Market, of which 458 companies have been listed for over three years with at least one year in the Premium Segment.[47] They account for 90.4% of all UK-listed companies that can meet CDR's minimum requirement of listing in the Premium Segment at least one year. Nevertheless, considering the market value, only a quarter of the above-listed companies possess a market capitalisation of over CNY 20 billion (£2.39 billion) that meet the standards of a CDR issuance. As most FTSE 100 companies are renowned international groups and their overseas revenues make up the majority of their total incomes, it might be of interest to them to pursue another listing in overseas capital markets. The LSE has been performing well since 2009 but the SSE has hit a low over the past few years so the SLSC can be a win–win solution for both markets to improve their market value. Under the SLSC, the A-share companies can raise capital from a vast base of international investors. The FSTE 100 companies, if becoming listed on the SSE, could promote the investor confidence and bring high-quality investment objects to the Chinese capital market, thus stimulating the long-term growth of the SSE. By tracking historical data of the FSTE 100, analysts at CITIC Securities and Guotai Junan Securities have singled out some potential CDR issuers (which are displayed in Table 1 below) by the following criteria:

- top 50 in the FTSE 100;
- having experience on issuing depository receipts;
- having built up businesses in China;
- complying with Chinese customer demands for energy, banking service, insurance, biotechnology and pharmacy; and
- complying with A-share investors' preference in investment, such as financial services, energy etc.[48]

**Table 1: The selection of potential CDR issuers in the UK[49]**

| Potential CDR issuers (UK-listed companies) | Industry |
|---|---|
| AstraZeneca | Pharmaceuticals & biotechnology |
| Aviva | Life insurance |
| Barclays | Banks |
| BHP | Mining |
| BP | Oil & gas producers |
| Diageo | Beverages |
| GlaxoSmithKline | Pharmaceuticals & biotechnology |
| HSBC | Banks |

43 CSRC, "Measures for the Issuance and Trading of Chinese Depositary Receipts (for Trial Implementation)", art.17.

44 Variable interest entity (VIE) is an offshore legal business structure adopted by a majority of Chinese high-tech companies, enabling foreign investors to evade Beijing's restriction of foreign ownership in companies in key industries such as the internet, finance and education. See Ye and Lu, "How to Harness a Unicorn?" [2019] I.C.C.L.R. 454, 458.

45 FTSE 100, an index compiled by the FTSE Group which is a subsidiary of the London Stock Exchange Group, is made of the top 100 most valuable UK-listed companies on a basis of their current market values. The index is renewed every quarter to reflect the latest market conditions.

46 LSE, "FTSE 100 Stocks Listed in London" (March 2018) available at: *http://www.londonstockexchange.com/prices-and-markets/stocks/ftse100/2018report.pdf*.

47 LSE, "FTSE 100 Stocks Listed in London" (2018).

48 "The SLSC is Coming Soon and the HSBC Might Be the First" (19 October 2018), *Sohu Finance* available at: *http://www.sohu.com/a/260358450_694776* [Accessed 6 December 2019].

49 "The SLSC is Coming Soon and the HSBC Might Be the First" (2018).

| Potential CDR issuers (UK-listed companies) | Industry |
|---|---|
| InterContinental Hotels Group | Travel & leisure |
| Lloyds Banking Group | Banks |
| Pearson Plc | Media |
| Prudential Plc | Life insurance |
| Rio Tinto Group | Mining |
| Royal Dutch Shell | Oil & gas producers |
| Standard Life | Financial services |
| Unilever | Personal goods |
| WPP Plc | Media |

## Regulatory challenges for Shanghai–London Stock Connect

Considering the significant differences of trading mechanisms, laws, financial regulations, investor sophistication, and culture between China and the UK, it creates multiple challenges for securities regulators in both countries. One main concern has been the time difference between London (Greenwich Mean Time, GMT or British Summer Time, GMT+1) and Shanghai (GMT+8), making it difficult for traders to react to the real-time price changes in another time zone. Mr Charles Li, the Chief Executive of the Hong Kong Stock Exchange, once commented that:

> "London and Shanghai are in different time zones. When the Shanghai stock market opens, London brokers and investors are still sleeping. The connect between the stock markets in Shanghai and London would only be suitable to those investors who do not sleep".[50]

As a response, the SSE has proposed an international sector during London hours to address this problem. Aside from this, there are a few regulatory challenges posed by the innovative cross-border stock connect. First, with the rapid growth of GDR and CDR issuance in the upcoming years, it renders cross-border securities regulation and supervision an urgent task for both the CSRC and FCA. As we know, the two countries have different financial system regulatory approaches. China's financial industry has been dominated by state players as most Chinese banks have been launched or controlled by either the central or local governments.[51] In comparison with China's heavily regulated financial markets, the UK has adopted a more market-oriented approach and it has less stringent rules for financial institutions and financial markets. This may result in the problem of regulatory arbitrage and improper competition arising from the deregulation process. Lax regulation in the UK could create the incentive for parties to favour their domestic UK companies over the counterparties by applying advantageous rules through deregulation. Accordingly, China and the UK have been advised to establish a SLSC joint task force handling regulatory issues to try to unify the applying laws and regulatory approaches.[52] Secondly, we have seen some inconsistencies between two countries' regulatory rules relating to information disclosure. At present, CDR issuers will be individually responsible for information disclosure. According to Ch.4 of the "Administrative Measures for the Issuance and Trading of Depository Receipts (for Trial Implementation)", CDR issuers are obliged to release all information required by the SSE. This could make CDR issuers overburdened with various information disclosure obligations, which may hit the enthusiasm of potential CDR issuers and jeopardise the international competitiveness of the Chinese capital market. The legal arrangements for information disclosure under the American depositary receipt (ADR) can offer a point of reference for the SLSC. For example, in the US, depository institutions as nominal issuers are responsible for the issuance, registration and information disclosure of depository receipts whereas ADR issuers only need to undertake the responsibilities of issuance, registration and information disclosure of underlying securities listed abroad.[53] Thirdly, there are some controversies about whether current regulations in both countries can offer an adequate level of protection for investors who trade cross-border depositary receipts. Owing to the difference in geographical location, language, corporate culture and legal systems, the classic problem of information asymmetry in the stock market would be magnified as it might be difficult for investors to acquire the information they need in order to make informed investment decisions on foreign depository receipts. Considering the long and complex transactional chains relating to GDRs and CDRs, the bankruptcy of any parties in the chain such as overseas listed companies, custodian institutions or depository institutions might result in substantial financial losses for investors who have limited legal remedies. In the absence of effective dispute resolution mechanisms, it would be challenging for investors to pursue litigations as they will have to overcome the difficulties of interpreting laws, collecting evidence and enforcing claims.

## Conclusion

The SLSC is a big step forward for the Chinese capital market to be further and deeply integrated into the global trading system when the PRC celebrated its 70th birthday. The experimental stock connect will boost cross-border investments between the UK and China as it provides

[50] Enoch Yiu, "London-Shanghai stock connect will address time zone difference" (16 November 2016), *South China Morning Post* available at: *http://www.scmp.com/business/companies/article/2046540/london-shanghai-stock-connect-will-address-time-zone-difference* [Accessed 6 December 2019].
[51] Lerong Lu, "Private Banks in China: Origin, Challenges and Regulatory Implications" (2016) 31 *Banking and Finance Law Review* 585.
[52] Daniel Ren, "Shanghai and London stock exchanges take a step closer to setting up trading link" (17 December 2017), *South China Morning Post* available at: *http://www.scmp.com/business/global-economy/article/2124684/shanghai-and-london-stock-exchanges-take-step-closer-setting* [Accessed 6 December 2019].
[53] Securities and Exchange Commission (US), "Accessing the US Capital Markets: A Brief Overview for Foreign Private Issuers" (13 February 2013) available at: *https://www.sec.gov/divisions/corpfin/internatl/foreign-private-issuers-overview.shtml* [Accessed 6 December 2019].

investors and listed companies in both countries with mutual access to each other's stock markets.[54] The closer ties between the Chinese and British capital markets have been welcomed by London which has been trying to defend its prominent status as a leading global financial centre amidst the current Brexit uncertainty. Clearly, China and the UK share the same vision to create a Eurasian capital market in the 21st century. However, market players and financial regulators in both countries have to overcome a series of technical difficulties and regulatory discrepancies to achieve this ambitious goal.

[54] Financial Conduct Authority, "FCA and CSRC announce their support for the Shanghai–London Stock Connect scheme" (17 June 2019) available at: *http://www.fca.org.uk/news/press-releases/fca-and-csrc-announce-their-support-shanghai-london-stock-connect-scheme* [Accessed 6 December 2019].