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THE THROUGH TRAIN: STOCK CONNECT'S IMPACT AND FUTURE

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LAUNCH

Shanghai-Hong Kong Stock Connect launched on Monday, November 17, 2014 in an impressive debut. By 2pm the entire allowable quota of trading in the northbound direction (from Hong Kong into Shanghai) was consumed. Southbound trading (from the mainland into the Hong Kong market) was more muted, not surprisingly given the alternative channels for investing abroad Chinese investors have enjoyed for some years. By the end of the trading day southbound trading had used only 17 percent of the allowable maximum. In the days following the launch trading volume in both directions fell off to more sedate levels, well below the daily quotas in either direction. The lower subsequent volumes should not surprise observers given the pent-up demand released on launch day and the reality that any new financial product requires time to gain the attention and acceptance of investors.

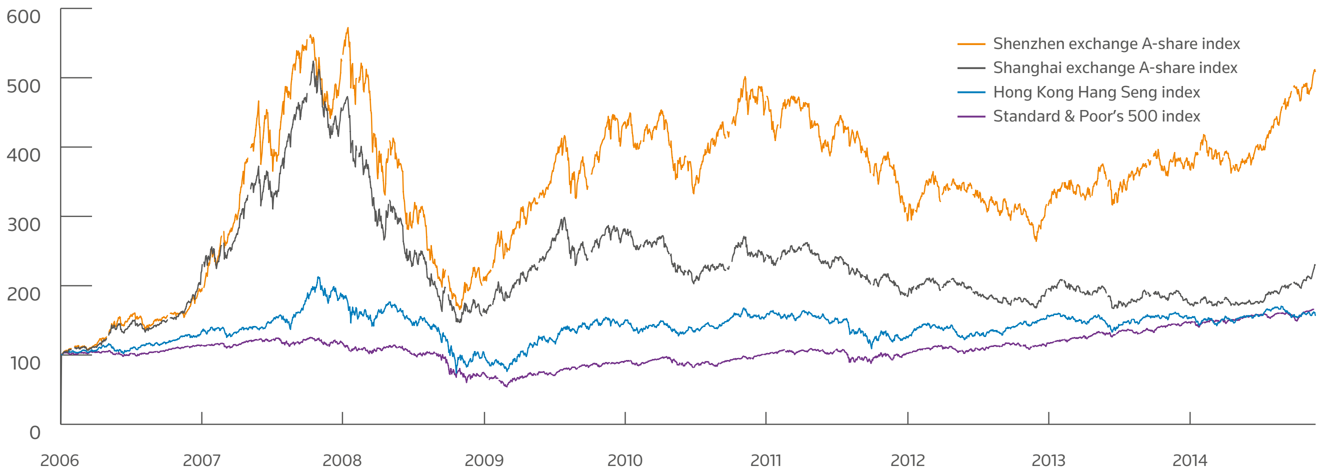
The fact remains that Stock Connect is a transformational development for China's capital markets that will, as it develops and matures, open new volumes of international investment into the Shanghai Stock Exchange (SSE), and lead to increased integration of China's capital markets into the global economy. It gives investors around the world greater access to China's growth trajectory via previously unavailable exposure to a broad range of Chinese equities. It provides another channel for capital from the mainland into the Hong Kong Exchanges and Clearing (HKEx), increasing the internationalization of Chinese outbound institutional and retail investment. Of course as with any new initiative there are challenges, including tax, legal, and operational issues that have prompted some investors to delay their full participation until some of the uncertainties are resolved.

WHERE WE ARE NOW

The backdrop

Shanghai-Hong Kong Stock Connect, though labeled a pilot project, is a major step forward for China's cross-border investment strategy. It arrives at a time when the world's most populous nation is in the middle of significant financial reform that seeks to bring globally accepted governance standards to the country's capital markets and financial institutions. These reforms, announced at China's Third Plenum of the 18th Party Congress in November 2013, include liberalizing the interest rate regime, reforming the country's state-owned banking system, internationalizing China's controlled currency – the renminbi (RMB) – and opening the country's capital markets to more international investment[1]. This last objective is where Shanghai-Hong Kong Stock Connect is targeted.

Although former leader Deng Xiaoping launched China's economic reform trajectory decades ago (in the late 1970s) foreign access to the country's capital markets has always remained under tight control. New access points have only been granted at a gradual pace in line with steady and conservative tweaks to the regulatory framework. Until the launch of Shanghai-Hong Kong Stock Connect, Chinese financial authorities have mostly restricted international investment in the country's stock markets to foreign currency denominated shares – or B-shares – listed in Shanghai and Shenzhen, which have been hampered by low trading volumes and concerns over the quality of listed companies. An alternative channel into China's capital markets is as a participant in China's Qualified Foreign Institutional Investor (QFII) or Renminbi Qualified Foreign Institutional Investor (RQFII) schemes, which provide direct access to the Asian giant's security markets – but only to selected, and government-approved, institutional investors.



Rebased performance of Shanghai Stock Exchange A-share index (SSEA), Shenzhen Stock Exchange A-share index (SZSA), Hong Kong Hang Seng index (HSI) and Standard & Poor's 500 index (SPX) between January 2006 and November 2014.

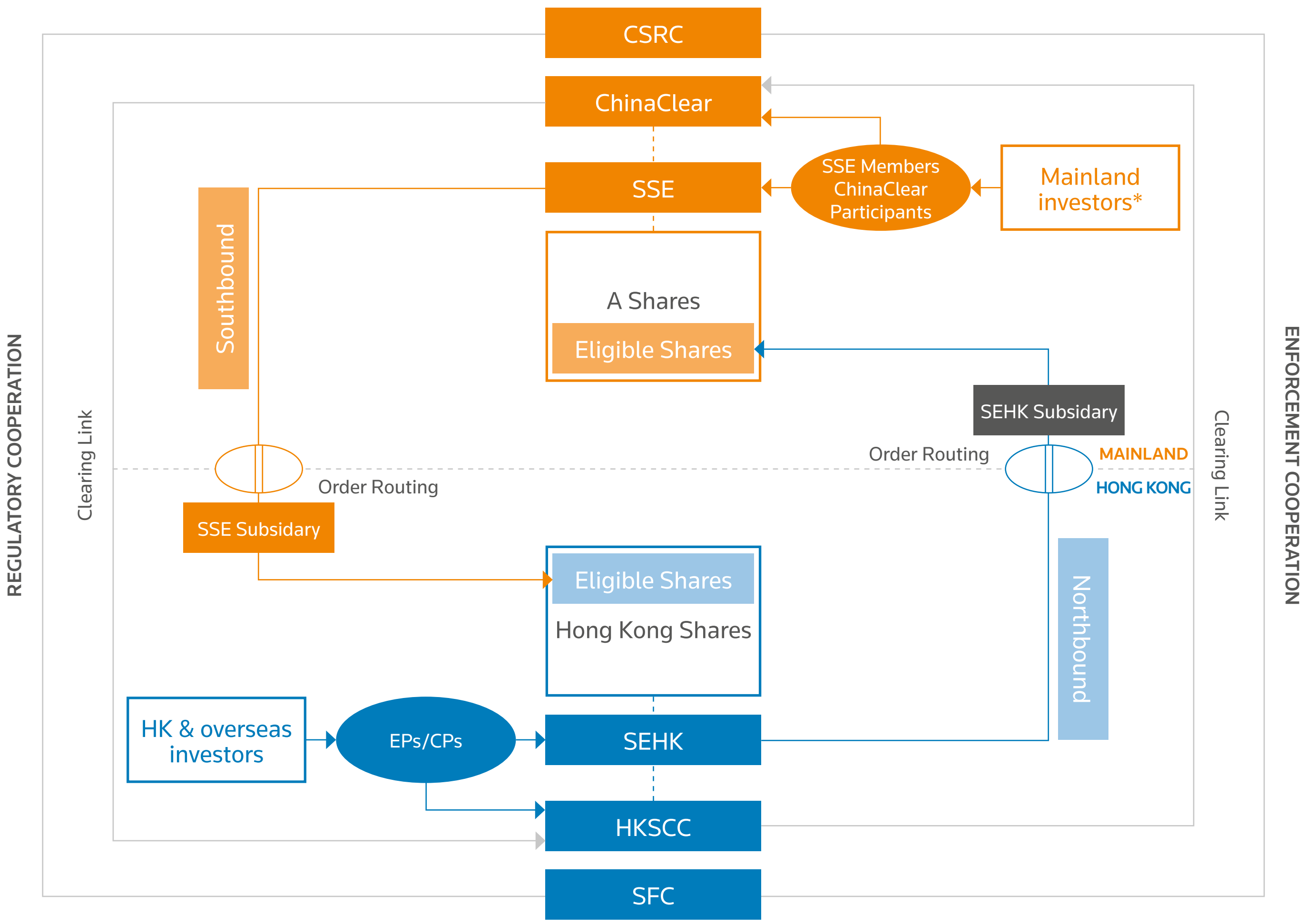
Source: Thomson Reuters

1 Reuters News. November 2013.

Shanghai-Hong Kong Stock Connect: the basics

For the first time, Shanghai-Hong Kong Stock Connect – often referred to as the 'Through Train' – allows investors in Hong Kong and Shanghai to directly buy shares in each other's markets and therefore has the potential to attract significant incremental investment flows in both directions. It grants Hong Kong and international investors access to China A-shares via Hong Kong, which are denominated in China's own currency, the renminbi (also called the yuan). Meanwhile, a greater number of mainland investors will gain access to equities listed on the Stock Exchange of Hong Kong (SEHK), giving them additional diversification and investment opportunities via Hong Kong's more established stock market.

For northbound investors – those outside China trading north into the Shanghai Stock Exchange – access to equities listed in Shanghai is via Hong Kong brokers executing trades through the Stock Exchange of Hong Kong; for southbound investors, Hong Kong listed equities are traded by mainland brokers via the Shanghai Stock Exchange rather than via the broker-to-broker relationships, more typical in cross-border trades. This structure – trading via brokers based in jurisdictions other than the target market and channeling the trades to the foreign exchange through the local exchange – is unique for global markets. Although investors in both jurisdictions will benefit, the northbound channel for foreign investment into Shanghai's equity markets is seen as the more significant development, given the global implications of China's financial reform trajectory and the tight regulations that governed such investment into China previously.



Structure of Stock Connect: order routing and execution.

Source: HKEx[2]

2 https://www.hkex.com.hk/eng/newsconsul/blog/140508blog.htm

Considering its unique structure, Stock Connect is an extraordinary development not only for China's markets but also for financial markets around the world. The Stock Exchange of Hong Kong ranked sixth in the world as of October 2014, with a market capitalization of US$3.3 trillion, whereas the Shanghai Stock Exchange is just a notch below in seventh place, with an estimated US$3 trillion market capitalization. Seen in combination as a single China-focused investment opportunity, the two markets will boast capitalization of US$6.3 trillion, more than some long-established equity market leaders such as those of London and continental Europe.

All Hong Kong and international investors – including retail investors and hedge funds – are eligible to trade Shanghai A-shares via local Hong Kong brokers (A-shares are RMB denominated stocks listed in China; H-shares are Hong Kong dollar (HKD) denominated stocks of Chinese companies listed in Hong Kong; B-shares are US dollar (USD) or HKD denominated stocks listed in China and accessible to foreign investors). These northbound trades are subject to a daily quota of RMB13 billion and an aggregate quota of RMB300 billion. Tradable shares include all constituent stocks of the SSE 180 and 380 indices – made up of the SSE's most broadly representative large-cap stocks and of mid-cap shares with high growth and established earnings records, respectively – and all shares that are dual-listed in Hong Kong. The only exceptions will be shares traded in a currency other than the RMB, stocks that are included on the exchange's 'risk alert board' – generally, shares of companies which are in the midst of scandals or in danger of delisting – and initial public offerings (IPOs)[3].

Qualified mainland investors (the southbound investors) can trade all constituent stocks of the Hang Seng's large-cap and mid-cap indices, plus all dual-listed shares. Exceptions to southbound investment include shares that are not traded in Hong Kong dollars, IPOs and A+H-shares that are listed on any exchange other than the SSE. Only mainland retail investors who hold an aggregate balance of no less than RMB500,000 will be allowed to participate in the program. By contrast, there is no minimum asset requirement for northbound trades. Whether mainland or international in origin, investors in each jurisdiction must follow the rules that govern the operation of each local market.

A historic agreement

The memorandum of understanding (MoU) concluded between the China Securities Regulatory Commission (CSRC) and the Securities and Futures Commission (SFC) of Hong Kong on October 17, 2014 is itself historic. It breaks new ground in the degree to which it brings the two securities regulators into a much closer cooperative relationship. The agreement establishes a basis for cooperation between the two regulators on market surveillance, enforcement and information sharing essential for both. The immediate goal of ensuring adequate access to information to safeguard market integrity is only part of the full import of the MoU. Of deeper significance is the foundation of the relationship created between the two regulators that will likely accelerate the development of China's securities industry and its integration into the global securities market.

Working together

All the parties to the scheme – HKEx, the SSE, their clearing entities, and the two regulators, Hong Kong's Securities and Futures Commission (SFC) and the China Securities Regulatory Commission (CSRC) – have worked intensively with market participants towards resolving remaining characteristics and concerns. Already one of the great successes of the Stock Connect project is that it has brought all these parties together in a cooperative effort to make Stock Connect meet stakeholders' needs. The Chinese authorities have welcomed feedback from industry groups such as ASIFMA and addressed many of the industry's initial concerns in their revised rules issued on September 26, 2014. Similarly HKEx has held many meetings with industry in the months leading up to launch to hear industry feedback and to address concerns. In fact, HKEx has worked to address and resolve concerns to the extent possible via rule changes and a comprehensive set of FAQs[4]. These discussions are continuing post-launch and further developments may follow as the program matures. For example, HKEx has announced that it will work to develop a solution to the pre-delivery requirement (see "Distinctive features") for implementation by mid-2015.

Open to retail

Shanghai-Hong Kong Stock Connect represents the first opportunity available to retail investors outside China to trade Chinese stocks. The combination of retail flow and incremental institutional flow will bring a substantial increase in liquidity to China's stock markets. That said, some financial analysts and market insiders predict the full impact of the program will take months and even years to fully mature, as international investors on the northbound side familiarize themselves with the

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3 HKEx. Shanghai-Hong Kong Stock Connect: Information Book for Investors. 14 October 2014.
4 http://www.hkex.com.hk/eng/csm/chinaConnect.asp?LangCode=en

scheme, its regulatory and operational challenges are addressed, and quotas are expanded to allow large global funds to scale up their allocations. According to official sources, foreign investment under the existing schemes accounted for less than two percent of China's A-share market last year[5]. That percentage will surely rise as Stock Connect gets under way, given that China's share of global GDP was 12.3 percent in 2013[6].

Who's in first?

Among northbound investors in Hong Kong and elsewhere, hedge funds were expected to be among early participants. This has in fact been the case. Regarded as flightier investors by policy makers as the QFII and RQFII programs were being formed, they were largely excluded from these existing channels of access. On the other hand, most institutional investors, including current QFII investors, which are mostly 'long only' in their investment style, are shying away from Stock Connect. They are choosing to stick with the vehicle they already have available – QFIIs – until questions about the scheme's operational and legal issues are resolved to their satisfaction. In addition, QFII investors are likely to use the two alternative channels for different products – their QFII quota for small and midcap equities such as those traded on the Shenzhen Stock Exchange (SZSE), which are not at present accessible via Stock Connect, and use Stock Connect for large caps trade at the SSE. In addition, QFIIs may be used for investments other than equities, such as bonds and ETFs, which are not accessible on Stock Connect.

Market watchers predict A-shares will eventually be added to global indices such as the MSCI's emerging market index, as a maturing Stock Connect leads to standards of access and liquidity that index companies require. Once SSE shares are accepted by such indices, the more cautious institutional investors, especially long-only investors and passive funds, will become active participants in Stock Connect and the scheme will pass an important milestone in its maturation.

Price differences

Given that a number of equities are dual-listed in both Hong Kong and Shanghai, Stock Connect will facilitate a way for investors to profit from price differences between markets as investors buy in the cheaper market and sell in the dearer (A-shares have tended to be cheaper than their H-share counterparts recently). But as a consequence of investors directing their orders to the most attractively priced venue, price differences in dual-listed shares should narrow as the program develops. True arbitrage is not possible in that an investor cannot buy an H-share and sell on Stock Connect, or vice versa. Hence some deviations from parity are likely to continue as long as Stock Connect remains a separate channel into China's equity markets.

Hang Seng China AH Premium Index: A-shares – H-shares.

Source: Thomson Reuters

The Hang Seng AH Premium Index tracks the average price difference of A-shares over H-shares for the largest and most liquid Chinese companies with A-share and H-share listings. While it shows near convergence at launch, significant spreads between individual shares have been observable since launch.

5 Xinhua. July 13, 2013.
6 The World Bank, Data Bank, 2013.

The impact on China's equity markets

International investors have long sought increased exposure and access to the China growth story, which has transformed the world's most populous nation into the world's second largest economy in just over three decades. However, the Chinese government has taken a cautious and gradual approach to financial reforms given the task at hand: to overhaul a still largely state-centered economy and foster an environment conducive to more efficient allocation of capital and broad-based competition.

Chinese leaders recognize that the country must remain committed to financial reform given its aspiration to assume a more influential role in Asia and on the world stage. To attract and retain the capital needed to finance the most vibrant source of growth – the private sector – China's preferred course is to allow market mechanisms more scope to price and allocate capital. Otherwise investor capital will be more costly than it need be, sacrificing potential gains in growth and productivity.

At the same time, mainland retail and institutional investors need more direct access to well-regulated markets such as Hong Kong's: they want to create new avenues for capital seeking returns on China's growth and to diversify their portfolios. In addition, the experience such investors gain in foreign markets will be brought home and ultimately benefit the development of the onshore market. Such access may also provide another alternative to what has long been a favored investment target in China: real estate, which started notching widespread declines in the latter half of 2014 for the first time in recent history. Over the long term, Stock Connect will also raise the SSE's profile and elevate Shanghai's status as a regional financial center[7].

"We welcome greater access to China's capital markets," said Sam Kim, head of the trading and liquidity strategies group for Asia Pacific at BlackRock. "China is an important investment destination for our clients globally, and Stock Connect is an innovative move towards allowing more of our clients access to China. The program will further consolidate the regional positions of Shanghai and Hong Kong as financial centers and promote the internationalization of the RMB and the development of Hong Kong as an offshore RMB business center."

7 Securities and Futures Commission. April 2014.

CHALLENGES

Distinctive features

Differences in settlement systems between the Shanghai market and those of many other exchanges mean that investors selling A-shares in Hong Kong must "pre-deliver" their shares to the brokers on the day prior to the trade itself. This differs from the investment and trading processes of most institutional investors and may create additional counterparty risk between the investors and their brokers. Counterparty risk arises from the fact that money settles on the day after a trade, or "T+1", so investors have a gap of two days between the delivery of their shares and receipt of payment, unless alternative arrangements are made with brokers. This cycle contrasts to the 'delivery versus payment' (DVP) settlement process in many other markets, where transfer of shares and money occur simultaneously. This difference in the Chinese settlement system poses a particular issue for long-only clients, especially those with multiple custodians[8].

Quota challenges are another factor investors need to take into consideration, according to market analysts. Once a daily quota is reached (RMB13 billion for Hong Kong-Shanghai northbound investors, RMB10.5 billion for southbound investors) further buy orders are prohibited; investors are only permitted to sell for the remainder of the trading day. This possibility creates execution risk – the risk that a buy order may not be filled if it arrives just after the quota limit is reached. The existing QFII and RQFII schemes do not have such execution risk. This execution risk gives long-only institutional investors with QFIIs another reason to favor the more familiar channel for the time being. An aggregate quota puts an upper limit for total investment via Stock Connect at RMB300 billion for northbound and RMB250 billion for southbound investments. Both the daily and aggregate quota are likely to be increased as the scheme develops and matures, mitigating or eventually even removing the execution risk.

Another source of execution risk is a limit of 10 percent for foreign ownership of any one stock. If that limit is breached it would likely not be known until the end of the trading day and a forced sale procedure would be implemented to bring the foreign ownership back below 10 percent. The same procedure would be triggered when the aggregate limit of RMB300 billion (northbound) is reached.

Stock Connect investors will also have to adapt to a Chinese prohibition on day trading. Hong Kong and foreign investors buying SSE shares via the program may only sell those shares after the trade has settled, which as we have seen is T+1, the day after the trade[9]. This will require adjustments for funds where investment strategies or algorithms call for the sale of a stock based on price signals, for example.

Shares acquired via Stock Connect are not interchangeable – or 'fungible' – with equities acquired by international investors through other equity trading schemes in China such as QFII. They need to be accounted for and classified separately, requiring some administrative and reporting adaptations for brokers. The structure of Shanghai-Hong Kong Stock Connect is designed in part to allow China to retain control of its capital account during the gradual reform process.

The Stock Connect program may end once China fully liberalizes its capital account, as may other controls such as QFII and RQFII. It is also possible of course that Stock Connect will become so well established that investors would continue to favor it.

Short selling, stock lending, and margin financing

Short selling is not yet possible on Stock Connect. HKEx has announced plans to allow shorting sometime in the first quarter of 2015. However, cost-effective short-selling is only possible when there is a reasonably efficient market for stock borrowing and lending (SBL) and margin financing. At present Chinese rules restrict margin financing and stock lending. Stakeholders – industry, the exchanges, and regulators – should therefore collaborate to develop rules and mechanisms to facilitate SBL and margin financing. Doing so will attract more participants and stimulate more volume.

8 Schroders: Shanghai-Hong Kong 'through train' picks up steam. September 2014.
9 K&L Gates. An Overview of the Shanghai-Hong Kong Stock Connect. October 2014.

Taxation

Uncertainties over taxes initially caused concerns but were resolved prior to launch. After the close of trading on the Friday preceding the launch, the Chinese Ministry of Finance issued circulars announcing that trades through Stock Connect would be exempt from income and business taxes (trades via QFIIs and RQFIIs would also be exempt, to maintain parity). The HKEx rules had put the onus to collect the tax on the brokers, an obligation they might have been unable to fulfill without a client's complete trading history. A 10 percent dividend tax will be withheld at the source and is hence of little concern (in addition, foreign investors may apply for refunds). Though the exemption removes a major hurdle for many investors, tax concerns are not entirely eliminated because they may be imposed at some future time. The challenge of how to collect the taxes would then have to be faced anew.

Beneficial ownership

One additional challenge for some prospective users of Stock Connect concerns beneficial ownership, or the degree of legal certainty and enforceability of rights of northbound investors holding the A-shares acquired via Stock Connect. This is particularly important for some international fund managers.

The northbound shares are held by the Hong Kong exchanges' clearing entity, the Hong Kong Securities Clearing Company (HKSCC), in an omnibus account held at ChinaClear. Chinese regulations recognize that shares held by the HKSCC are held on a nominee basis, meaning that they are not assets of HKSCC but owned by the beneficial investors. However, there is no stated mechanism in the Stock Connect scheme, in existing Chinese law and regulations, or in the rules of the SSE or ChinaClear for recognizing or confirming the identity of the beneficial owners of the A-shares held by HKSCC. There remains some uncertainty as to how owners of the A-shares assert or pursue their claims as shareholders in China.

POTENTIAL FOR FUTURE

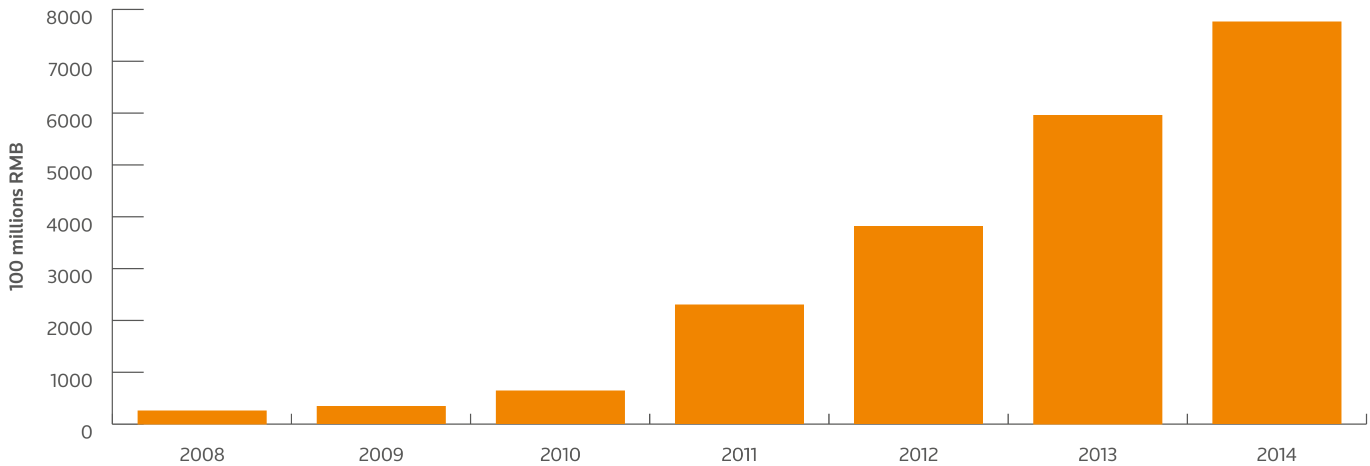
RMB internationalization

Shanghai-Hong Kong Stock Connect will contribute to the gradual internationalization of the renminbi, an important aim of China's financial reform process. Stock Connect gives international investors direct access to A-shares denominated in RMB, resulting in a significant broadening of the currency's use among an investor base beyond China's borders. The scheme is designed to ensure RMB which is used to trade SSE shares via the program cannot be used for other purposes: Stock Connect is sealed from the rest of China's market. When a position acquired through Stock Connect is sold, the RMB is returned to the seller in Hong Kong, thus preventing RMB acquired for Stock Connect purchases from being redeployed for other purposes in China. But certainly global investors will become more interested in, and familiar with, RMB products as a result of Stock Connect, paving the way for further RMB liberalization in the years ahead.

Beyond Dim Sum bonds

Against this backdrop of relaxing controls over the RMB, international investors have sought greater access to a wider-variety of RMB-denominated assets, no doubt largely on expectations of the long-term strengthening of the currency (the RMB weakened early in 2014 then resumed a decade-long rising trend). One of the more popular RMB-denominated asset classes among foreign investors is the offshore RMB-denominated bond – the Dim Sum bond. Offshore issuance of Dim Sum bonds reached a record RMB 350 billion in the half-year ended June 30, 2014, according to Thomson Reuters data, and analysts expect rapid growth to continue at least into 2015[10].

Beyond Dim Sum bonds, RMB internationalization is also accelerating in other areas. For example, acceptance of the RMB around the world for trade settlement is growing due to China's status as the world's largest exporter. As part of the country's reform process, China is determined to expand the use of the RMB beyond traditional regional offshore hubs such as Hong Kong and Singapore to the financial capitals of Europe and elsewhere. Shanghai-Hong Kong Stock Connect represents a big step forward for RMB internationalization. Just as Dim Sum bonds offer a global pool of investors access to RMB fixed-income exposure, Stock Connect broadens that access to equities beyond the constraints of the existing QFII and RQFII schemes.



Ending balance of Dim Sum bonds: Offshore RMB bond issuance between 2008 and 2014.

Source: Thomson Reuters

10 Reuters News. August 2014.

Shenzhen Connect?

Additional programs on the Stock Connect model aimed at connecting the two jurisdictions and further attracting international investors to China's capital markets are surely on drawing boards across China – and in markets elsewhere in Asia, Europe, and the Americas. It is widely expected that China's second stock exchange in the southern city of Shenzhen, which lies just across the border from Hong Kong, will launch a sister program to Shanghai-Hong Kong Stock Connect in approximately a year.

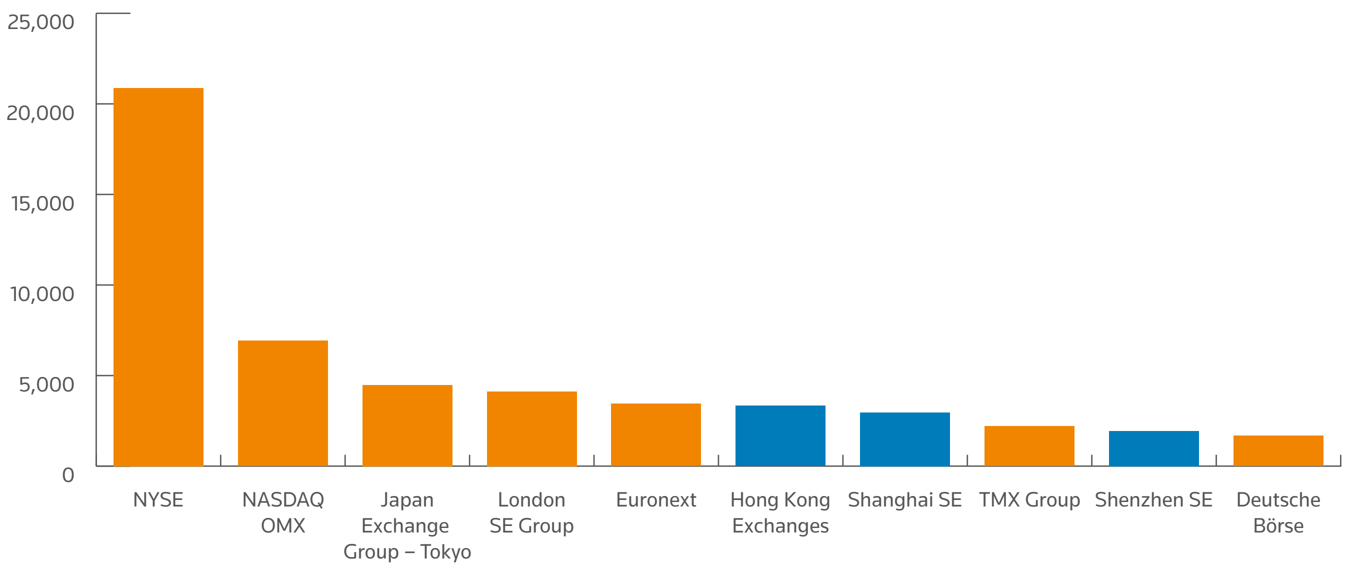
It would be a significant addition. The Shenzhen exchange can arguably be seen as China's growth market – a market for companies in their early stages. In fact, many Shenzhen-listed companies, which include China's leading residential property developer Vanke and traditional medicine producer Tibet Cheezheng, have earned the market's backing as they have consistently outperformed many of the major state-backed enterprises listed in Shanghai. For some investors, the companies listed on Shenzhen's market are a good representation of China's growth trajectory over the long term. Reuters News reports that a foreign fund manager believes foreign investors would be strongly attracted to Shenzhen's market, which tends to feature more technology and consumer names.

Xiao Zhijia, deputy director-general of Shenzhen's Office of Financial Development Services, told Reuters in August 2014: "The Shenzhen government has raised this suggestion to the China Securities Regulatory Commission and the CSRC's opinion is that we can do some research on the Shenzhen-Hong Kong Stock Connect plan."[11]

INDICATOR	SSE	SZSE	HKEx
Number of listed companies	980	1,604	1,729
Market capitalization (USD billion)	2,960.24	1,954.89	3,264.72
Value of share trading (USD billion, monthly average)	343.40	422.83	121.35
Number of trades (monthly average in millions)	101.17	128.38	16.82

Shanghai, Shenzhen and Hong Kong exchanges: key statistics as of October 31, 2014 for year 2014.

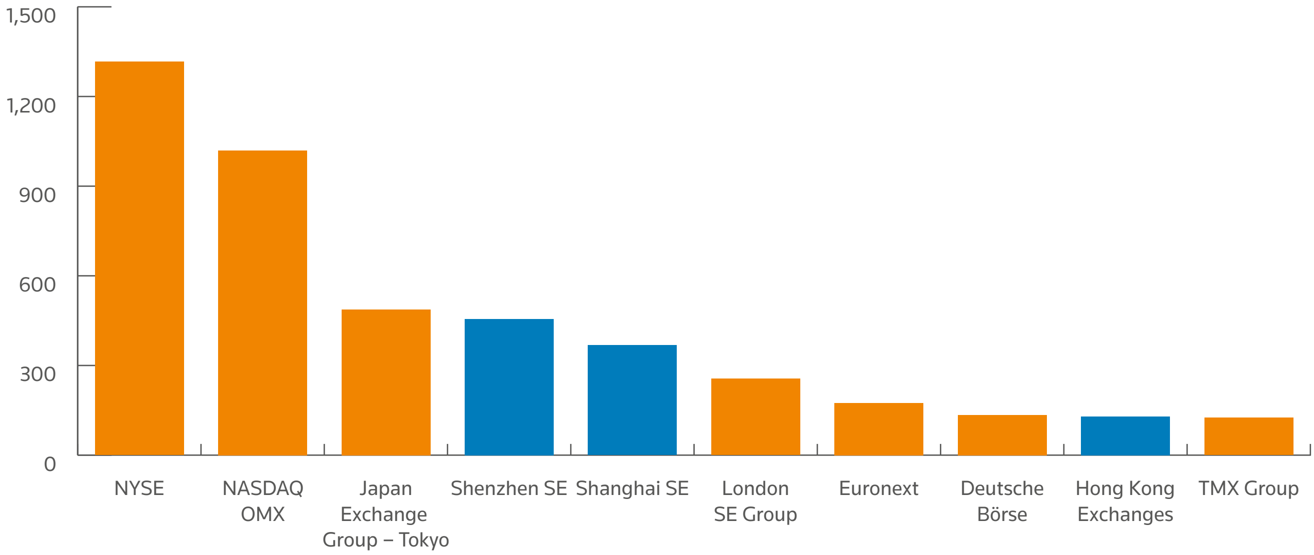
Source: World Federation of Exchanges (WFE)



Market capitalization of world top 10 exchanges (USD billion) as of October 31, 2014.

Source: World Federation of Exchanges (WFE)[12]

11 UPDATE 1 – Shenzhen exchange explores stock pipeline with Hong Kong – official. Reuters News. August 27 2014.
12 http://www.world-exchanges.org/statistics/monthly-query-tool



Turnover value (USD billion, monthly average) as of October 31, 2014.

Source: World Federation of Exchanges (WFE)[13]

Other assets Connect?

Additional asset classes may also be added to the program. Equity products such as exchange-traded funds (ETFs) would seem a logical next step. Futures also seem likely, such as the successful CSI 300 contract traded at the China Financial Futures Exchange (CFFEX), and Hong Kong's Hang Seng Index Futures. China's three commodity futures exchanges also boast some of the most actively traded commodity futures in the world but are at present closed to traders outside China. Those exchanges would surely welcome the additional business that Stock Connect-like schemes would bring.

Bond Connect?

Of course, the other big asset class besides equities is fixed income. A "Bond Connect" could usher greater liquidity into the China bond market and lower funding costs for corporates at a time when the cost of capital is increasing. It could complement the process of interest-rate liberalization, such as the removal of the cap on deposit rates, to allow greater scope for market-based rates.

But structural differences between stock and bond markets mean the Stock Connect template cannot simply be superimposed on the existing bond markets. Bonds are mostly traded bilaterally in the over-the-counter market or through multilateral electronic request-for-quote systems, rather than on exchanges with central limit order books. Bond traders typically rely on indicative quotes that need to be negotiated and confirmed before getting executed. That means investors require relationships with local dealers rather than outside brokers. Creating an exchange-to-exchange connection for bonds would at best link a small proportion of the bond market (those that are exchange-traded, as most of the market is electronic or voice traded). Further, unlike Stock Connect, which has HKEx, the SSE and their respective clearing houses at its center, equivalent institutions for a Bond Connect are not as readily at hand as bonds are not required to be traded on regulated entities. Moreover, the HKD and offshore (CNH) renminbi markets would not be large enough to offset the flow going into the onshore (CNY) renminbi market. Bond market investors are also more diverse, a potential challenge to achieving an industry consensus on the shape such a program should take.

There are potential solutions for all these issues, but alternative models would need to be carefully studied by policymakers and market participants before a Bond Connect could launch successfully.

13 http://www.world-exchanges.org/statistics/monthly-query-tool

Where does the market stand on Stock Connect?

Investors around the world who have taken notice are largely enthusiastic, even if not all are ready yet to take the plunge. Stock Connect will increase liquidity and business in both the connected exchanges, enhance opportunities for investor portfolios on both sides of the border and raise the global profiles of both Shanghai and Hong Kong as financial centers.

The still-developing investor base in China may have contributed to the decision of some of China's high-profile companies – Alibaba being a recent example – to pursue listings beyond China's borders to reach a more diverse investor base. As Stock Connect grows and China's equity market internationalizes, the need to list outside China will diminish.

From the investor perspective, a broad range of international investors will also get easier access to a whole new palette of companies and sectors when seeking more exposure to mainland China – many in high-growth areas such as Chinese medicine and environmental services. For investors with stronger risk appetites, there are also some smaller-cap equities where liquidity premia and underexposure may create opportunities.

A journey

In short, Shanghai-Hong Kong Stock Connect will be of major benefit to China's capital markets. By itself the scheme is a compelling opportunity for regional and global investors seeking returns and portfolio diversification in the world's second-largest economy. As it matures and evolves to embrace additional exchanges and asset classes on both sides of the border, its impact and significance will spread. For the first time in its 25-year history the SSE has to recognize that its customers are now all over the world. It has already reconfigured its marketing efforts accordingly. Henceforth the Shanghai Stock Exchange's strategic outlook must be global, not just local. This outward-looking perspective will magnify the impact of Stock Connect and similar schemes as they are launched and evolve.

Shanghai-Hong Kong Stock Connect is also further evidence that China is unlikely to slow the pace of reforms. On the contrary, as Beijing policy makers confront the challenges of a middle-income economy, greater integration with the global economy and freer access to global capital will be the surest direction forward.

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GLOSSARY OF ABBREVIATIONS

AFME – Association for Financial Markets in Europe

ASIFMA – Asia Securities Industry and Financial Markets Association

CFFEX – China Financial Futures Exchange

ChinaClear – China Securities Depository and Clearing Corporation

CNH – renminbi traded offshore outside China

CNY – renminbi traded onshore in mainland China

CSRC – China Securities Regulatory Commission

DVP – delivery versus payment

ETF – exchange-traded fund

GFMA – Global Financial Markets Association

HKD – Hong Kong dollar

HKEx – Hong Kong Exchanges and Clearing – also known as SEHK – Stock Exchange of Hong Kong

HKSCC – Hong Kong Securities Clearing Company

HSI – Hong Kong Hang Seng Index

IPO – initial public offering – also known as flotation

MoU – memorandum of understanding

QFII – Qualified Foreign Institutional Investor – a program that permits certain licensed international investors to participate in China's stock exchanges

RQFII – offshore renminbi QFII

RMB – renminbi – China's currency (yuan is the unit of account)

SPX – Standard & Poor's 500 Index - also known as S&P 500 Index

SBL – stock borrowing and lending

SEHK – Stock Exchange of Hong Kong – also known as HKEx – Hong Kong Exchanges and Clearing

SFC – Securities and Futures Commission of Hong Kong

SSEA – Shanghai Stock Exchange A-share Index : Reuters Instrument Code

SSE – Shanghai Stock Exchange

SZSA – Shenzhen Stock Exchange A-share Index : Reuters Instrument Code

SZSE – Shenzhen Stock Exchange

TWSE – Taiwan Stock Exchange

USD – United States dollar

WFE – World Federation of Exchanges

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