China Access Schemes: A Closer Look at the Opportunities and Challenges for Foreign Institutional Investors (Part 1)

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How have the Stock Connect and Bond Connect progressed since launch?

China Connect program is a transformative program for global investors to access Chinese capital market, and Hong Kong Exchange started the program with Shanghai Connect in November 2014, followed by Shenzhen Connect in December 2016. And since then, we had significant improvements and enhancements in the programs. We've implemented Special Segregated Accounts, also implemented Real-Time Delivery-versus Payment (DVP). Now global investors have embraced investing in the Chinese A Shares market. At the end of 2017, we are looking at RMB 530 billion assets under custody, that is 162% growth since January 2017. We are constantly averaging well over RMB 11 billion in daily turnover, and we'll continue to look forward to growth and embrace international investors investing in A Shares market.

Bond Connect program has also been a transformative program providing global investors access to the onshore Chinese fixed income market. The program started in July 2017, and at that point in time, foreign holdings stood at RMB 800 billion. At the end of December 2017, the foreign holdings stood at RMB 1.147 trillion, that's 43% growth since the launch of the Bond Connect program.

Global investors have been embraced the program. 247 Bond Connect accounts have been opened, they cover 18 different jurisdictions. 24 market makers onshore provide active quotes for these investors, and 53 custodian banks providing settlement services to these global investors. Also 20 FX settlement banks providing FX conversion services.

What are the key challenges to foreign investors?

There are 2 key challenges that Stock Connect pose to foreign investors. Firstly, there is a time lag between securities and cash settlement. Same day finality is not assured as the cash settlement could be postponed to the following day. This can present overnight counterparty risk. Secondly, the short settlement cycle, and the tight securities and cash funding deadlines may be a challenge for American and European foreign investors without an Asian time-zone presence. Both of these challenges can be resolved by a service provider like BNY Mellon.

Upon launching of the Stock Connect scheme back in November 2014, the challenges around were primarily driven by counterparty risk that were deriving from pre-delivery requirements, the settlement cycle which implies the payment of cash consideration in T+1 as well as questions around beneficial ownership, and the very specific role of the Hong Kong Securities Clearing Company (HKSCC) in the Stock Connect structure.

What are the solutions available to address these challenges?

On one hand, we have this synthetic DVP which is taking away the counterpart risk by basically removing pre-delivery requirements as well as dealing with the settlement cycle. And on the other hand, we have clarification given around the beneficial ownership question by Hong Kong and Chinese authorities. However, one aspect which was yet not ideal with this synthetic DVP is the fact that those managers can only use one single broker, they cannot have multiple-broker approach.

We had to wait a couple of months after the launch of Stock Connect to see a new concept emerging with HKEX introducing the Special Segregated Accounts, which basically allow the managers to appoint up to 20 brokers, which is a clear improvement compared to the first iteration of Stock Connect.

So now, we do have a variety of models – such as the synthetic DVP, the SPSA plus model as well as the SPSA model which are being used by various players and offer different possibilities.

With an understanding of global investors' pain points, BNY Mellon has developed several Special Segregated Accounts, or for short, 'SPSA' service models to improve client experience, address market constraints and risks, and provide clients' seamless solutions.

The SPSA Plus Multi Broker model provides real time irrevocable settlement finality with 3 brokers in Hong Kong and it mitigates counterparty risk.

The SPSA Plus Pershing model is a connected solution providing execution-to-custody service that makes life easier for our clients. The model allows clients to place their Stock Connect orders in their own time zones utilizing Pershing as their broker-dealer, and settlement is based on settlement instructions received directly by BNY Mellon from Pershing. Our clients can ensure timely funding via a range of FX standing instruction services.