

Annex 3-2:

Drafting Notes on the Guidelines for Cross-Border Conversion of Depositary Receipts under the Stock Connect Scheme between Shenzhen Stock Exchange and Overseas Stock Exchanges (Draft Proposal for Public Consultation)

To regulate the cross-border conversion business of depositary receipts (“*depositary receipts*”) under the stock connect scheme between Shenzhen Stock Exchange (the “**SZSE**”) and overseas Exchanges and maintain the smooth operation of the connect mechanism, SZSE formulated the *Guidelines for Cross-Border Conversion of Depositary Receipts under the Stock Connect Scheme between Shenzhen Stock Exchange and Overseas Stock Exchanges* (Draft Proposal for Public Consultation) (“**Cross-border Conversion Guidelines**”), the relevant situation is now explained as follows:

1. Drafting Background

The cross-border conversion mechanism of depositary receipts refers to the mechanism by which depositary receipts and underlying stocks can be converted into each other in a predetermined ratio. The cross-border conversion mechanism, a common practice in the international depositary receipt market, is the main way to realize the interconnection of domestic and overseas markets. The cross-border conversion mechanism can maintain the price linkage between depositary receipts and the underlying stocks, which is conducive to improving the pricing efficiency of the depositary receipts and promoting the healthy development of the market. *Provisions on the Supervision and Administration of Depositary Receipts under the Stock Connect Scheme between Domestic and Overseas Stock Exchanges* (Draft Proposal for Public Consultation) and *Interim Measures for the Listing and Trading of Depositary Receipts under the Stock Connect Scheme between Shanghai/Shenzhen Stock Exchange and Overseas Stock Exchange* (Draft Proposal for Public Consultation) have established the rule basis and institutional framework for the cross-border conversion of depositary receipts. In order to further refine the requirements for cross-border conversion of depositary receipts and standardize the cross-border conversion of depositary receipts, SZSE has formulated the *Cross-border Conversion Guidelines*.

2. Drafting Principles and Ideas

The first is to implement registration system for participants to reduce market costs. In order to improve market efficiency and reduce the cost of participants in cross-border conversion, SZSE implements a registration system for participants in cross-border conversion, and qualified institutions can launch cross-border conversion business once completing the record. Depositaries only need to file with SZSE for the creation and redemption of global depositary receipts (“GDRs”).

The second is to improve pricing efficiency and promote market development. Pricing efficiency is the basis for market function. Improving the efficiency of cross-border conversion is the key to guaranteeing the efficiency of depositary receipt pricing. In order to adapt the supply of depositary receipts to demand and avoid substantial deviations in the price of depositary receipts from the underlying securities, the *Cross-border Conversion Guidelines* determine the creation and redemption with higher efficiency and shorter cycles which can be achieved under current conditions, to ensure the efficiency of cross-border conversion and maintain the smooth operation of the market.

The third is to implement stringent supervision and maintain market stability. The cross-border conversion business involves the overseas securities trading activities of Chinese cross-border conversion institutions and the domestic securities trading activities of overseas cross-border conversion institutions. In order to reduce the market impact of cross-border conversion business and maintain market stability, the *Cross-border Conversion Guidelines* implement strict supervision of cross-border conversion participants, and stipulate the account registration of cross-border conversion entities, custodian information submission and supervision, etc. At the same time, it is clarified that the member entrusted by overseas cross-border conversion institutions and global depository shall have the supervision and administration obligations to ensure the compliance of cross-border conversion business.

3. Main Contents

The Guidelines for Cross-Border Conversion consists of five chapters and forty-three articles. It mainly includes three aspects: the first is the registration administration of cross-border conversion entities, including the registration application and termination of domestic cross-border conversion institutions, overseas cross-border conversion institutions and global depositories; the second is cross-border conversion administration, including the process of cross-border conversion of Chinese depository receipts (“CDRs”) ongoing information submission of cross-border conversion, etc.; the third is the supervision and administration of cross-border conversion, which mainly includes compliance requirements, inspections, self-regulation, etc.

(1) General Provisions. This chapter clarifies the purpose and basis for the *Cross-border Conversion Guidelines*, defines the scope of application, explains the definition of the cross-border conversion business of Chinese Depositary Receipts and Global Depositary Receipts, and stipulates that the cross-border conversion business should be subject to registration administration.

(2) Cross-Border Conversion of CDRs. The cross-border conversion of CDRs includes registration administration and ongoing administration of Chinese cross-border conversion institutions, and the administration of the creation and redemption of CDRs. The first is the registration management of Chinese cross-border conversion institutions. Applicants should meet certain conditions and file application materials to SZSE, and SZSE will file for the record after review and approval. SZSE shall terminate registration in accordance with the application of the Chinese cross-border conversion institutions and the conditions for the termination. The second is the ongoing administration of China's cross-border conversion institutions, including the establishment of initial liquidity, the ongoing reporting of cross-border conversion information. The third is the creation and redemption process of CDRs, including the basic requirements for creation and redemption and error correction mechanisms.

(3) Cross-Border Conversion of GDRs. Including the registration administration of overseas cross-border conversion institutions, the ongoing administration of the cross-border conversion business of global depository receipts, and the registration and ongoing administration of overseas depositories. The registration administration of overseas cross-border conversion institutions includes registration application and termination of overseas cross-border conversion institutions. The administration of cross-border conversion of GDRs includes overseas cross-border conversion institutions entrusting members of SZSE for transaction, members’ supervision responsibilities, and cross-border conversion business accounts filing and ongoing information submission, etc. The registration and ongoing

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administration of global depositaries include application materials for registration, entrusting members of SZSE for transaction, and members' supervision responsibilities, etc.

(4) Self-Regulation. The *Cross-border Conversion Guidelines* clarify that SZSE can conduct on-site and off-site inspections of cross-border conversion institutions, depositaries, and entrusted members, and has the right to conduct relevant self-regulatory measures or disciplinary on cross-border conversion institutions, depositaries, and entrusted members in accordance with relevant rules.

Hereby note.