

China A-Shares

Introduction

Historically, foreign access to stocks listed on China's mainland exchanges, China A-shares, was via a license and quota system which makes acquiring them very difficult and impractical for index inclusion. The launch of Shanghai–Hong Kong Stock Connect in 2014 and Shenzhen–Hong Kong Stock Connect in 2016 has allowed foreigners to purchase China A-shares in a less restrictive manner, opening up the A-shares market to foreign investment. The establishment of these investment channels has added approximately 1,400 China A-share stocks to investors' opportunity set.

Current Practice on China Equity Share Classes

Several types of share classes of Chinese equities are available for investors. Some of the share classes are eligible for our indices, while others are not. Our policy on each share class is as follows:

Currently Eligible for Inclusion:

- H-Shares: Stocks from companies incorporated in mainland China, but traded on the Stock Exchange of Hong Kong in Hong Kong dollars.
- Red-Chip: Stocks from Chinese companies incorporated outside mainland China and traded on the Stock Exchange of Hong Kong. These companies are substantially owned by mainland China state entities.
- P-Chip: Stocks from Chinese companies incorporated outside mainland China and traded on the Stock Exchange of Hong Kong. These companies are substantially owned by private sector entities.
- S-Shares: Stocks from Chinese companies incorporated outside mainland China, but traded on the Singapore Stock Exchange.
- N-Shares: Stocks from Chinese companies incorporated outside mainland China, but traded on the NYSE, Nasdaq, or NYSE MKT.
- L-Shares: Stocks from Chinese companies incorporated outside mainland China, but traded on the London Stock Exchange.

Currently Ineligible for Inclusion:

- A-Shares: Stocks from companies incorporated in mainland China and traded on the Shanghai and Shenzhen stock exchanges.
- B-Shares: Stocks from companies incorporated in mainland China and traded on the Shanghai and Shenzhen stock exchanges in US dollars or Hong Kong dollars.

Evaluation of RAFI Weight in China A-Shares

The inclusion of China A-shares in the eligible universe results in a noticeable increase in Chinese equities as a percentage of the overall universe. An examination of the 2017 RAFI Global Equity Universe (GEU) shows that free-float-adjusted Chinese equities constituted 2.8% when China A-shares are excluded. When China A-shares are included in the analysis, free-float-adjusted Chinese equities (both A-shares and off-shore) constituted 6.1% of the universe. Adding China A-shares to the eligible universe resulted in the A-shares composing 38.5% of all Chinese equities in the GEU, (when accounting for dual listings).

Examining the RAFI Emerging Markets Index, free-float-adjusted Chinese equities composed 24.1% of the RAFI Emerging Markets Index at the 2017 reconstitution (excluding China A-shares). When including A-shares, Chinese equities composed a much more substantial weight in the overall index, with a 38.3% allocation.

Current Position on China A-Shares

The inclusion of China A-shares in the GEU would have a significant impact to the allocation of Chinese equities in RAFI Indices™. Currently, RAFI Indices does not plan to make China A-shares eligible for inclusion in the GEU for the 2019 reconstitution due to our concerns regarding accessibility and implementation of China A-shares.

Accessibility:

- Through the Stock Connect program, quotas are in place that can impact not only liquidity, but also trade execution, should the quota be reached. Further research is required on how the quota system would affect the liquidity of China A-shares.
- Foreign ownership limits will impact the level of A-shares that can be included in the index. Individual foreign ownership is currently limited at 10%, with total foreign investment not to exceed 30% of a security.



Implementation:

- Local account set up is needed to facilitate same-day trade settlement, for which purchases are subject to pre-funding and repatriation of currency is not immediate.
- Under the Stock Connect program, trading suspensions for securities are common, often without an indication of the reason for the suspension or a timeline for the expected length of the suspension.

RAFI Indices will continue to monitor the development of the Stock Connect program and the China A-shares market and to seek consultation from clients to determine when inclusion of A-shares would be appropriate.

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