

LEGAL UPDATE

China integrates and further liberalizes QFII/RQFII schemes

New Regulations Effective 1 November 2020

On 25 September 2020, China Securities Regulatory Commission (CSRC), People's Bank of China (PBOC) and State Administration of Foreign Exchange (SAFE) released the *Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors* (the "Measures") as a measure of further opening-up of China's capital market. Meanwhile, the CSRC released the *Provisions on Issues Concerning the Implementation of the Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors* (the "Provisions") to facilitate the implementations of the Measures.

Both the Measures and the Provisions will come into effect on 1 November 2020, and will supersede the 2006 QFII measures, 2013 RQFII measures and other previous CSRC related regulations which will all be repealed.

With the Measures and the Provisions coming into effect on 1 November 2020, China's QFII and RQFII schemes introduced since 2006 and 2013 respectively and which have been governed by separate set of rules and regulations will be integrated, and past QFII and RQFII rules and guidelines will be invalidated. The new QFII/RQFII integrated scheme will be further liberalized with eligibility requirements further relaxed and application procedures streamlined, among others. With QFII and RQFII schemes integrated, the Measures encourage investing in domestic securities and futures markets with offshore RMB funds.

Permitted Investments Expanded

Most noteworthy and highly anticipated by the market is the expansion of investment scope under the new QFII/RQFII scheme.

Pursuant to Article 6 of the Provisions, QFIIs and RQFIIs will be allowed to invest in additional types of assets in China's securities and futures market, including: (i) shares of small and medium enterprises traded on the National Equities Exchange and Quotations (NEEQ) market; (ii) private investment funds of a securities or futures institutions or by a private fund manager registered with Asset Management Association of China (provided such private investment fund shall only invest in assets falling into the category of paragraphs 1 and 2 of Article 6 – being stocks, depository receipts, bonds, bond repurchases, asset-backed securities traded or transferred on stock exchange, shares and other types of securities on the NEEQ); (iii) financial futures contracts listed and traded on the China Financial Futures Exchange (CFFEX); (iv) commodity futures contracts listed and traded on futures exchanges approved by the CSRC; (v) options listed and traded on exchanges approved by the State Council or the CSRC, and further, QFII/RQFII may engage in (vi) bond repurchases, (vii) margin trading and securities financing on stock exchanges, and (viii) securities lending to securities finance companies. The above relaxations are on top of existing investment scope of stocks, bonds and warrants traded on the domestic stock exchanges, bonds traded on the domestic interbank bond market, public securities investment funds and stock index futures.

Article 7 of the Provisions stipulates the following investment restrictions: (a) an aggregate of not more than 10% of the total shares of an exchange-listed or a NEEQ-admitted company may be held by a single QFII or RQFII or any other foreign investor; (b) the aggregate shareholding of all QFIIs and RQFIIs and other foreign investors shall not exceed 30% of the total shares of an exchange-listed or a NEEQ-

admitted company. These restrictions, however, will not apply to strategic investment in listed companies by QFIIs and RQFIIs and other foreign investors.

In its new release, the CSRC states its commitment to “market liberalization and [to] accelerate the two-way opening-up of Chinese domestic capital markets at a higher level”. Although not relaxed in this round of liberalisation, the CSRC will consult with PBOC and SAFE regarding QFII/RQFII’s access to financial derivatives contracts and related trading models, which will be gradually relaxed in an orderly manner and to be announced by CSRC upon consent of the PBOC and the SAFE.

Appointing group entity in China as investment advisor

Under the new rules, QFIIs and RQFIIs may appoint a domestic private fund manager or investment fund manager which is either its subsidiary or its group company as its investment advisor. This will clearly enable private fund management enterprises or investment fund management company set up by foreign fund managers in China to act as investment advisor to the parent or group QFII or RQFII licensed managers in investing in China onshore securities and futures markets. Notably, global fund managers establishing and developing onshore capabilities through setting up a fund management entity in China can now offer this on its global China investment products.

Segregated securities and futures accounts for funds and clients

With respect to custody and ownership, Article 5 of the Provisions emphasizes segregation of assets, that a QFII or RQFII shall open separate securities and futures accounts for proprietary funds and client funds respectively (the latter may be funds managed by the QFII/RQFII or investment mandates under segregated discretionary managed accounts for clients of the QFII/RQFII). The account for proprietary funds shall be named in the format of “QFII/RQFII + Proprietary Funds” while the account for client funds is required to be in the format of “QFII/RQFII + Client Name” or “Qualified Investor + Fund Name”. Where it is deemed necessary to name any account as “Qualified Foreign Investor + Client Funds”, QFIIs or RQFIIs are required to report, through the custodian, relevant account information such as names of investors or funds and assets under custody. It is expressly stipulated that the assets in the accounts for client funds will belong to the relevant client or fund and will be segregated from the assets of the QFII or RQFII and the custodian.

Consolidating shareholding and exercise shareholder rights

Foreign managers should note that the Measures clearly require a qualified foreign investor to lawfully aggregate the interests of its shareholdings in a company including shares listed in overseas markets and shares listed in China domestic markets, and comply with relevant disclosures rules (including rules on parties acting in concert). On the other hand, qualified foreign investors may exercise rights as shareholders of domestic securities, by itself or through its custodian, domestic securities company, an independent director or the secretary of the board of directors of an exchange-listed or NEEQ-admitted company, or a foreign investor under its name.

Non-trade transfer for qualification transfer and restructure

Institutions currently holding multiple QFII/RQFII qualifications may also wish to note Article 17 of the Provisions, where it is provided that a qualified foreign investor may file for a non-trade transfer according to rules issued by the securities depository and clearing institution and securities trading venues, to transfer its qualification to another entity under its same control, rearrange its accounts or change managers of its fund products or accounts, to improve investment and operation efficiency or to streamline account structure.

<p>Categories of foreign institutional investors that may be approved</p> <p>Foreign fund management institutions, commercial banks, insurance companies, securities company, futures companies, trust companies, government investment management companies, sovereign funds, pension funds, charity funds, endowment funds, international organisations and other institutions recognized by the CSRC</p>	<p>Permitted investments and financial instruments:</p> <ol style="list-style-type: none"> I. stocks, depository receipts, bonds, bond repurchases and asset-backed securities traded or transferred on stock exchanges; II. shares and other types of securities transferred on the NEEQ; III. products and derivatives on bonds, interest rates and foreign exchange traded on the domestic interbank bond market and approved by PBOC as eligible for qualified foreign investors; IV. publicly offered securities investment funds; V. financial futures contracts listed and traded on the China Financial Futures Exchange (CFFEX); VI. commodity futures contracts listed and traded on futures exchanges approved by the CSRC; VII. options listed and traded on exchanges approved by the State Council or the CSRC; VIII. foreign exchange derivatives for hedging purposes approved by SAFE as eligible for qualified foreign investors; IX. other financial instruments approved by the CSRC; X. participate in subscription for new share issuance, bond issuance, asset-backed securities issuance, follow-on share offerings and rights issue on stock exchanges and NEEQ; XI. engage in margin trading and securities financing on stock exchanges, securities lending to securities finance company; XII. private investment funds of securities or futures institutions or private fund manager registered with Asset Management Association of China, provided such private investment funds invest in assets in I and II. <p>(Note: specific types of financial futures contracts, commodity futures contracts and options contracts, and relevant trading models, shall be proposed by securities and futures venues to the CSRC for approval.)</p>
<p>Eligibility requirements</p> <ul style="list-style-type: none"> • Sound financial conditions and good credit standing with experiences in securities and futures investment • Management personnel in charge of investment in China shall meet relevant professional requirements of home country (if any such requirement) • Sound and effective governance structure, internal control system and compliance management regime, and appoint a compliance officer to oversee compliance of its China investment operations • Not having been subject to any major punishments by regulatory authorities in the most recent 3 years or since establishment (if shorter period) • No situation of causing significant impact to the operation of China domestic capital market 	
<p>Application requirement and timeframe</p> <p>Submit application for eligibility through its appointed custodian, and CSRC shall make a decision within 10 business days of accepting the application</p> <p>(QFII/RQFII may appoint more than one custodian, and in such case of having more than 2 custodians, should appoint one custodian as having principal responsibility to report on the QFII/RQFII on the investment activities and account activities to CSRC, PBOC and SAFE as required, and also handle registration matters)</p>	

Contact

If you would like to know more information about the subjects covered in this publication, please contact the lawyers of our investment funds and regulatory practice or your usual contact at our firm.

Our lawyers have extensive experience advising on cross-market access schemes, fund structures and investment mandates for China onshore and offshore investments, investment management and advisory arrangements and related legal and regulatory issues for funds and asset managers.

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