CLIFFORD
CHANCE

Briefing note

22 March 2013

Renminbi Qualified Foreign Institutional Investor Scheme Scaled Up

The Renminbi Qualified Foreign Institutional Investor (**RQFII**) scheme was launched in China on 16 December 2011 when the China Securities Regulatory Commission (**CSRC**), the People's Bank of China (**PBoC**), and the State Administration of Foreign Exchange (**SAFE**) jointly promulgated the *Pilot Measures for Onshore Securities Investment by Fund Management Companies and Securities Companies that Qualify as RMB Qualified Foreign Institutional Investors* (**2011 Measures**). As a result, Hong Kong witnessed a rapid growth of RQFII products in 2012. Various bond-type funds and four exchange-traded fund products (**ETF**) drew increased investment from investors in Hong Kong. Through the RQFII scheme, an RQFII ETF seeks to track the performance of an A-share index by investing directly in the constituent A-shares of this index. The Chinese government subsequently increased the permissible aggregate quota for RQFII to RMB270 billion. As of 31 January 2013, SAFE has granted a quota of RMB70 billion in aggregate to RQFII licence holders.

The launch of RQFII funds and ETFs has broadened the range of RMB investment products in Hong Kong. As more and more Hong Kong investors become interested in RQFII products, the Hong Kong Securities and Futures Commission (**SFC**) published a list of frequently asked questions (FAQs) on its website to help investors understand the key features and the risks related to RQFII funds and ETFs.

Based on the positive results from implementing the 2011 Measures, CSRC, PBoC and SAFE, among other initiatives, decided to further expand the scope of eligible participants in the RQFII scheme and remove restrictions on RQFII's investment portfolio. On 1 March 2013, the three regulators jointly issued the *Pilot Measures for Onshore Securities Investment by RMB Qualified Foreign Institutional Investors* (**RQFII Pilot Measures**) to replace the 2011 Measures. On the same day, CSRC also issued its implementing rules to the RQFII Pilot Measures (**CSRC Implementing Rules**). On 11 March 2013, SAFE promulgated new implementing rules (**SAFE Implementing Rules**) to replace its rules previously issued in 2011.

Key issues

- An overview of the amended RQFII scheme
- Eligibility requirements
- Investment scope
- Control on remittance and repatriation of funds
- Account Structure
- Choice between RQFII and QFII schemes

On 10 March 2013, PBoC allowed qualified foreign institutional investors (**QFIIs**) to invest in the inter-bank bond market that was already accessible by RQFIIs since the launch of the RQFII scheme, and SAFE has also further clarified the applicable remittance and repatriation rules through the SAFE Implementing Rules, both with a view to eventually integrate the two schemes. The key differences between QFII scheme and RQFII scheme, which may be crucial for some investors, are discussed below.

An overview of the amended RQFII scheme

The RQFII Pilot Measures apply to qualified foreign institutional investors (**Qualified Investors**) who raise RMB funds outside China for investment in the securities market in Mainland China. Upon obtaining an RQFII licence from CSRC and an investment quota from SAFE, a Qualified Investor can invest in the securities market of Mainland China within the approved RMB investment quota. Similar to the QFII scheme, an approved Qualified Investor must engage a qualified onshore commercial bank as its custodian and onshore securities companies as its brokers for securities trading. Pursuant to the CSRC Implementing Rules, up to three brokers may be appointed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange respectively.

Originally, only the Hong Kong subsidiaries of fund management companies and securities companies incorporated in Mainland China were eligible to apply for RQFII licence under the 2011 Measures. With the promulgation of the RQFII Pilot Measures, the Hong Kong subsidiaries of commercial banks and insurance companies incorporated in Mainland China as well as financial institutions with both place of incorporation and main place of business in Hong Kong are now also eligible to apply for RQFII licence.

CSRC, PBoC and SAFE jointly regulate the RQFII scheme. Their respective duties and authorities are summarised below:

CSRC
- reviews and verifies applicants' eligibility and issues RQFII licences
- regulates onshore securities investment by Qualified Investors

PBoC
- regulates onshore RMB accounts opened by Qualified Investors
- regulates investment by Qualified Investors in the inter-bank bond market
- monitors and regulates the remittance and repatriation of RMB funds jointly with SAFE

SAFE
- allocates and regulates the use of the RQFII investment quota
- monitors and regulates the remittance and repatriation of RMB funds jointly with PBoC

Eligibility requirements

A Qualified Investor wishing to apply for an RQFII licence must now satisfy the following requirements:

(i) it must have obtained a Type 9 (asset management) licence from SFC and conducted asset management business;

(ii) it is in stable financial condition and has a good credit standing;

(iii) it has an effective corporate governance and internal control system, and its relevant professionals satisfy the relevant eligibility requirements applicable under local law;

(iv) it has not been imposed any material penalty by the relevant local regulator since its establishment (if it has a track record period of less than three years)or in the last three years; and

(v) it satisfies other requirements of CSRC in accordance with the principle of prudential regulation.

After reviewing a complete set of application documents submitted by the Qualified Investor, CSRC will determine, within sixty (60) days, whether the applicant satisfies the above eligibility requirements and either approve or decline the application accordingly.

Investment scope

RQFII can invest in (i) shares, bonds and warrants listed on stock exchanges (currently the Shanghai Stock Exchange and the Shenzhen Stock Exchange), (ii) fixed-income products traded in the inter-bank bond market; (iii) securities investment funds; (iv) stock index futures; and (v) other financial instruments approved by CSRC. RQFII can also subscribe for equities in an IPO, convertible bonds, as well as a rights issue and allotment of shares.

Originally PBoC explicitly provided in its implementing rules that no more than 20% of the RQFIIs funds may be invested in shares or share-type securities investment funds, and that no less than 80% of the funds must be invested in fixed-income products including various kinds of bonds and fixed-income type of securities investment funds. In reality, regulators have approved ETF funds launched through the RQFII scheme to be exempted from the above balanced portfolio requirement. Upon promulgating the RQFII Pilot Measures, regulators have officially announced that the above restrictions under PBoC rules will be lifted.

The CSRC Implementing Rules have clarified that the following investment restrictions will now apply to the RQFII scheme:

(i) any single Qualified Investor cannot hold more than 10% of any listed company's total share capital; and

(ii) all offshore investors cannot, in aggregate, hold A-shares of any listed company which exceed 30% of the company's total share capital.

The RQFII scheme is different from the QFII scheme in that a QFII needs to apply for both an approval and a quota (which is different from SAFE QFII quota) from PBoC for its investment in the inter-bank bond market. However, an RQFII only needs to obtain PBoC approval to trade in the inter-bank bond market. This means that an RQFII with PBoC approval can utilise its entire quota in the inter-bank bond market as long as this plan is disclosed to PBoC. The inter-bank bond market is regulated by PBoC. It differs from the exchange-traded bond market and is based on a quotation inquiry mechanism with certain financial institutions acting as market makers

Control on remittance and repatriation of funds

Upon receiving the RQFII licence from CSRC, a Qualified Investor must apply to SAFE for an investment quota within one year. SAFE will determine whether to grant the applied quota within sixty (60) days. If a Qualified Investor fails to apply to SAFE within one year after obtaining the RQFII licence, the RQFII licence must be returned to CSRC. After obtaining the investment quota approved by SAFE, a Qualified Investor must remit the investment principal within six months, or if it manages an open-ended fund, substantially utilise its investment quota within one year. Otherwise SAFE has the authority to reduce or even cancel the approved quota. Unless a Qualified Investor manages an open-ended fund, the investment principal is subject to a one-year lock-up period.

Each Qualified Investor can remit RMB funds into Mainland China within its investment quota. The SAFE quota is calculated on the outstanding balance for open-ended funds. This means that an open-ended fund can repatriate investment principal without reducing its quota, but should ensure that the net amount of investment principal remitted into China is within its quota. However, the SAFE quota is not recyclable for other funds or investment vehicles. This is similar to the treatment for "open-ended China funds" / "other funds and investors" under the QFII scheme.

While RMB can now generally be raised by a Qualified Investor outside China under the RQFII Pilot Measures, previously it was only allowed to be raised in Hong Kong under the repealed 2011 Measures. Considering the development of the RMB market outside China and Hong Kong, this change will be welcomed by a broader range of RMB investors. Currently, only Hong Kong funds authorised by SFC have taken advantage of the RQFII scheme. It is expected that non-Hong Kong RMB investors will soon be able to invest in China's securities market through non-Hong Kong domiciled investment vehicles managed by Qualified Investors.

A Qualified Investor must remit RMB funds through its onshore custodian, which must be a qualified custodian under the QFII scheme and a qualified settlement agent for the inter-bank bond market. The custodian is also obliged under the RQFII Pilot Measures to supervise the onshore investment made by the Qualified Investor by attending to certain reporting requirements with relevant PRC regulators. The Qualified Investor must also make certain reportings, through its custodian, to the RMB Cross-border Payment and Receipt Information Management System of PBoC.

Although RMB is required to be remitted into Mainland China for investment, a Qualified Investor can repatriate the investment principal and profits in either RMB or foreign currencies. If a Qualified Investor launches an open-ended fund, it can remit or repatriate funds according to the net subscription or redemption amount on a daily basis. Otherwise, a Qualified Investor can only enjoy monthly liquidity.

Account structure

Consistent with PRC local entities, a Qualified Investor must open a RMB basic deposit account to act as its "identity certificate" in China's funds clearing system. A Qualified Investor may open RMB special deposit accounts (**Special Accounts**) with its custodian bank to make onshore investment. Currently three kinds of Special Accounts are available, namely, Special Accounts for inter-bank bond market, Special Accounts for exchange-traded bonds, and Special Accounts for exchange-traded shares. Funds remitted under the RQFII scheme can be freely transferred by a Qualified Investor among these three kinds of Special Accounts, but cannot be remitted into or from the RMB basic deposit account.

A Qualified Investor must open separate Special Accounts for open-ended funds it manages. It can also open multiple securities account with the securities depository and settlement institution through its custodian, each of which should correspond to a Special Account. The RQFII Pilot Measures do not address or clarify the ownership of the securities invested through an RQFII. However, this was addressed in the QFII scheme for "open-ended China funds" as being "QFII-fund" securities accounts

Choice between RQFII and QFII schemes

Although there are some similarities between the RQFII scheme and the QFII scheme, the two schemes are different in certain respects (such as eligible institutions, currency of funds, quota, investment scope, remittance deadline and amount, lock-up period, repatriation, custodian and account structures). We set out a high-level comparison between the RQFII scheme and the QFII scheme in the Annex for easy reference. With the development of the RQFII scheme, institutional investors and asset managers begin to seriously examine these differences in order to select a product that is most suitable or advantageous to them.

It awaits to be seen who CSRC will approve as RQFIIs after the promulgation of the RQFII Pilot Measures. This will have important significance on Hong Kong assets managers, for example, would such approvals extend to smaller Hong Kong-based financial institutions that cannot satisfy the high asset under management requirement under the QFII scheme, and private equity fund managers who just begin to receive QFII licences as well as alternative investments managers who still find it difficult to obtain the QFII licences?

Conclusion

The RQFII scheme provides additional investment channels for offshore RMB in Hong Kong and in other markets. It will improve the attractiveness of offshore RMB to the investing public, and is a key step to further opening up Mainland China's capital markets in the long run. With the continued expansion of the offshore RMB markets, there is an increasing need to direct offshore RMB back into the capital market in Mainland China. Coupled with the need to promoting RMB internationalisation, the RQFII scheme will likely be scaled up to facilitate the investment of offshore RMB funds in the securities market in Mainland China.

Contacts

Yang TieCheng
Partner
E: tiecheng.yang@cliffordchance.com

Ying White
Partner
E: ying.white@cliffordchance.com

Ge Yin
Senior Associate
E: yin.ge@cliffordchance.com

Mark Shipman
Partner
E: mark.shipman@cliffordchance.com

Matthias Feldmann
Partner
E: matthias.feldmann@cliffordchance.com

Teresa Leung
Consultant
E: teresa.leung@cliffordchance.com

ANNEX

High Level Comparison between the QFII Scheme and the RQFII Scheme

No.	Issues	QFII scheme	RQFII Scheme
1.	Eligible institutions	Non-PRC institutional investors and asset managers that satisfy certain eligibility requirements, in particular, the requirement on track record period, capital adequacy and securities asset under management (**AUM**) as follows: • asset managers – at least two years of experience in asset management business and with AUM of no less than USD500 million in the previous fiscal year; • insurance companies – at least two years of track record and with AUM of no less than USD500 million in the previous fiscal year; • securities companies – at least five years of experience in securities business, with net capital of no less than USD500 million, and with AUM of no less than USD5 billion in the previous fiscal year; • commercial banks – at least ten years of experience in banking business, with first-tier capital of no less than USD300 million and with AUM of no less than USD5 billion in the previous fiscal year; and • other institutional investors – two years of track record and with AUM or securities holding of USD500 million in the previous fiscal year.	See section on "Eligibility requirements" above. There is no specific requirement on track record period, capital adequacy and AUM.
2.	Currency of funds to be remitted into and outside China	Freely exchangeable foreign currencies as approved by SAFE.	RMB (repatriation can be in a freely exchangeable foreign currency)
3.	Maximum quota per applicant	USD1 billion (except for sovereign funds, central banks and monetary authorities)	No restriction

No.	Issues	QFII scheme	RQFII Scheme
4.	Investment scope	Scope of permissible investments: • Shares, bonds and warrants listed or transferred on stock exchange; • Fixed-income products traded in the inter-bank bond market; • Securities investment funds; • Stock index futures; and • Other financial instruments permitted by CSRC.	Same scope as QFII. However, there are currently no operating rules for RQFIIs to trade stock index futures yet.
5.	Deadline and requirement on minimum amount of investment principal to be remitted	• The investment principal must be remitted within six months after obtaining the quota from SAFE (an extension from SAFE can be applied and obtained only under exceptional cases). • The minimum amount is USD20 million.	• Except for open-ended funds, the investment principal must be remitted within six months after obtaining the quota from SAFE. • The quota must be "effectively utilised" within one year after being granted by SAFE. • No minimum amount is specified.
6.	Lock-up period	• Three months for pension funds, insurance funds, mutual funds, charity funds, endowment funds, governmental agencies, monetary authorities, and open-ended China funds. • One year for other QFIIs.	One year, except for open-ended funds.
7.	Repatriation of funds	• Weekly liquidity for open-ended China funds based on net subscription or redemption. • Monthly liquidity for other QFIIs. There is a monthly repatriation cap, being 20% of the total onshore assets of a QFII or fund (in case of open-ended China funds) by the end of the preceding year.	• Daily liquidity for open-ended funds based on net subscription or redemption. • Monthly liquidity for other RQFIIs.
8.	Repatriating investment principal	• SAFE approval is required (except for open-ended China funds). • Investment quota will be reduced accordingly (except for open-ended China funds).	• No SAFE approval is required. • Investment quota will be reduced accordingly (except for open-ended funds).
9.	PRC custodian	Onshore banks which are approved by the China Banking Regulatory Commission and CSRC to conduct custody business for QFIIs.	Onshore banks that qualify both as QFII custodians and settlement agents at the inter-bank bond market

No.	Issues	QFII scheme	RQFII Scheme
10.	Foreign exchange accounts	• One foreign exchange account can be opened for each open-ended China fund launched by a QFII. • Otherwise, up to two foreign exchange accounts can be opened by a QFII: one for proprietary assets and one for client assets.	Not applicable
11.	Special RMB accounts	• A QFII can open special RMB account(s) for each open-ended China fund. • Two kinds of special RMB accounts are available, one for transactions at the securities market and another for stock index futures trading. • A QFII can only open up to six special RMB accounts for securities trading in the name of "QFII-client name" for its asset management clients. Each special RMB account corresponds to a securities account.	• RQFII must open separate special RMB account(s) for each open-ended fund. • Three kinds of special RMB accounts are available, one for settlement at the inter-bank bond market, one for exchange-traded bonds and the other for exchange-traded equities. • There is no restriction on the maximum number of special RMB accounts that can be opened, but the approval of PBoC is required for account opening. Each special RMB account corresponds to a securities account.

This briefing is designed to provide a general commentary on aspects of the subject matter covered. It does not purport to be comprehensive and it does not constitute legal advice. We expressly disclaim any liability in respect of the consequences resulting from acting or refraining from acting on the basis of any matter contained in this publication. All rights reserved.

The above is based on our experience as international counsel representing clients in their business activities in China. As is the case for all international law firms licensed in China, we are authorized to provide information concerning the effect of the Chinese legal environment, however, we are not permitted to engage in Chinese legal affairs in the capacity of a domestic law firm. Should the services of such a firm be required, we would be glad to recommend one.

www.cliffordchance.com

Clifford Chance, 28th Floor, Jardine House, One Connaught Place, Hong Kong

© Clifford Chance 2013

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh* ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh.