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SAFE relaxes quota control and capital mobility restrictions for QFIIs

SAFE has published the revised *Foreign Exchange Administrative Rules on the Domestic Securities Investment by Qualified Foreign Institutional Investors* (Revised Rules) which took effect on 3 February 2016. The Revised Rules have further relaxed quota administration and foreign exchange control for QFIIs in an effort to encourage more foreign investments in the PRC securities market.

The timing of the issuance of the Revised Rules is interesting. Considering SAFE's role in balancing international receipts and payments, many believe that the Revised Rules are indicative of the PRC regulator's desire to "hedge" the recent pressure arising from funds outflow and decreasing foreign exchange reserves.

Relaxed quota control

The most note-worthy development of the Revised Rules is related to QFII quota administration. Under the previous regulatory regime, each QFII had to apply to SAFE for an investment quota before making any investments in China. This was after obtaining a license from the China Securities Regulatory Commission. However, under the Revised Rules, a QFII only needs to go through a filing process with SAFE if the quota being applied for is within a certain percentage of its asset value or AUM but no more than US$5 billion (Basic Quota) – in other words, SAFE's approval is only required when the quota being applied for exceeds the Basic Quota. This reform will add greater transparency in the quota application process.

For certain types of QFIIs such as sovereign wealth funds, central banks and monetary authorities, the asset percentage based Basic Quota will not apply and they may apply a quota up to US$5 billion through filing process. The above will also apply to existing QFIIs seeking to increase their quota.

In addition the Revised Rules state that QFIIs' quota will be monitored based on net capital inflows meaning repatriation of investment principal will no longer lead to a reduction in a QFII's quota.

Other key developments

Other than the above, the Revised Rules have also removed some of the barriers to remittance and repatriation of funds providing for better liquidity:

- The previous 6-month fund injection timeline has been removed but a QFII will need to use its quota within one year of the filing or approval.
- QFIIs may make fund remittance and repatriation on a daily basis based on the net subscription or redemption of their open-ended funds.
- The applicable lock-up period for principal repatriation has been shortened from 1 year to 3 months for non-open-ended funds.

Unchanged restrictions

It is worth noting that some key restrictions remain unchanged. For example, QFIIs are still strictly prohibited from transferring or selling any quota to other institutions or individuals.

Conclusion

The Revised Rules mean there is greater alignment between SAFE's policies for QFIIs and RQFIIs while its treatment of open-ended funds and other types of products is more equalized.

In our view, the issuance of the Revised Rules is also a response to the international community's criticism of the QFII regime – most notably MSCI's decision to not include A-shares in its Emerging Markets Index because of the QFII regime's quota allocation process and capital mobility restrictions. The Revised Rules are clearly aimed at addressing such criticism.

We are preparing an English translation of the Revised Rules and are happy to share them upon request.

Authors and China Contacts

Yang Tiecheng
Partner
T:86 10 65352265
Email: tiecheng.yang@cliffordchance.com

Ge Yin
Counsel
T: 86 21 23207202
Email: yin.ge@cliffordchance.com

Hong Kong Contacts

Mark Shipman
Partner
T: 852 2825 8992
Email: mark.shipman@cliffordchance.com

Francis Edwards
Partner
T: 852 2826 3453
Email: francis.edwards@cliffordchance.com