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Shenzhen QDIE Program – An Overview and Comparison with the QDLP Program

Domestic and foreign asset managers have recently developed an increasing interest in the Shenzhen Qualified Domestic Investment Enterprise program. This is because it provides an advanced framework for onshore investors to invest in asset classes overseas which are not otherwise permitted under the Qualified Domestic Institutional Investor (QDII) regime. Compared to other similar regimes in localities such as Shanghai and Tianjin, the Shenzhen-QDIE program sets a lower minimum size requirement on the onshore fund and the amount of subscription per qualified investor. It also allows a broader permissible scope of investment in the overseas market beyond merely the public market. The Shenzhen-QDIE program is seen to provide a new source of capital and investment and is envisaged to promote the asset management industry of the local economy.

Key issues

The Shenzhen QDIE Measures

Regulatory framework

Key features

- **Main participants**
- **Eligibility requirements**
- **Quota administration**
- **Investment scope**

Table comparing with other QDLP programs

The **QDII Regime** was established in around 2006 to enable qualified Chinese financial institutions to invest overseas subject to regulations of the competent regulators. Market participants however viewed the QDII Regime as being overly restrictive. In response to market demand, local governments have launched pilot programs to provide alternative channels for onshore investors to invest in asset classes overseas which are not otherwise permissible under the QDII Regime, such as offshore hedge funds. The Qualified Domestic Limited Partnership program (**QDLP Program**), which was launched in Shanghai in 2013 was the first of such local programs. It is significant as it allowed, for the first time, overseas hedge funds to raise capital directly from Chinese investors to invest in the international capital markets. Prior to the launch of the QDLP Program, domestic Chinese institutions and individuals (**PRC Investors)** could only make offshore portfolio investments with their RMB capital through the restrictive QDII Regime.

Recently, different versions of the QDLP Program have emerged in other cities including Tianjin and Shenzhen. This briefing introduces the program initiated in Shenzhen (**QDIE Program**), which has attracted increasing interests from both domestic and foreign asset managers alike.

Shenzhen – the QDIE Measures

In order to encourage the development of the asset management industry and promote financial reform in Qianhai (which is a special economic zone in Shenzhen), the Shenzhen municipalgovernment issued the *Interim Measures on the Pilot Program of Overseas Investment by Qualified Domestic Investors in Shenzhen* on 8 December 2014 (**QDIE Measures**). Since then, a number of Chinese financial institutions have been approved under the QDIE Program, several of which have already launched fund products.

This briefing examines the QDIE Program from various aspects including the regulatory framework, eligible participants, investment scope and quota administration. It also provides a high-level comparison among the QDIE Program and the QDLP Programs in Shanghai and Tianjin.

Regulatory framework of the Shenzhen QDIE Program

The Shenzhen Financial Services Office (**SFO**), a Shenzhen government agency responsible for financial affairs, is the agency generally in charge of developing the rules of the QDIE Program, coordinating necessary approvals from the Chinese central government, and overseeing the implementation of the QDIE Program.

A "joint committee" that consists of officials from the SFO, the Authority of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (**Qianhai Authority**), as well as the Shenzhen branch of the People's Bank of China and the State Administration of Foreign Exchange (**Shenzhen SAFE**) has been established to facilitate the implementation of the QDIE Program.

The joint committee meets and reviews applications, approvals and program procedures. The SFO and Qianhai Authority are the central coordinators and leaders of the joint committee and are responsible for the overall supervision of the QDIE Program. The other agencies on the joint committee are more focused on the subject areas under their supervisory authority, for example, the Shenzhen SAFE is responsible for granting the QDIE quota.

Key Features of the QDIE Program

Main participants

The QDIE Program allows qualified fund management companies and financial institutions (**QDIE Managers**) to establish and manage onshore investment vehicles (**QDIE Funds**) in making overseas investments. A QDIE Fund may take the form of a company, partnership, or managed account. Only qualified domestic investors that satisfy the eligibility requirements of the QDIE Measures (**Qualified Investors**) may only invest in a QDIE Fund.

Eligibility requirements for QDIE Managers, QDIE Funds and Qualified Investors

Under the QDIE Measures, the QDIE Manager can be either foreign-invested or domestically-funded. The minimum registered capital (or subscribed capital) of a foreign-invested QDIE Manager is US$2 million (or the equivalent amount in other currencies) and that of a domestically-funded QDIE Manager is RMB10 million. The controlling shareholder (or the general partner) of the QDIE Manager or its affiliate must meet certain specified requirements, including having a licence to conduct investment management business, having fund management experience for more than three years, not having been subject to material punishment in the last two years, and satisfying other requirements on professional staff and governance structure. Approved QDIE Managers must also satisfy certain requirements on capital size and the number of investors prescribed by the QDIE Measures.

The minimum size of a QDIE Fund at establishment is RMB30 million (or the equivalent amount in foreign currencies) and capital contribution must be made in cash. The number of investors in a QDIE Fund is limited and this depends on the specific form of the QDIE Fund in issue. For example, under the PRC Partnership Enterprise Law, there must be no more than fifty partners in a limited partnership.

For Qualified Investors, the net asset threshold for each institutional investor is RMB10 million while the financial asset threshold for each individual investor is RMB3 million. Pursuant to the QDIE Measures, financial assets include, but are not limited, to bank deposits, shares, bonds, fund units, wealth management products, trust plans, insurance products, and interests in futures contracts. In addition, the minimum subscription amount per investor in a QDIE Fund is RMB2 million (or the equivalent amount in foreign currencies).

Quota administration

According to the *Basic Situation of the Shenzhen Financial Industry in the Third Quarter of Year 2014* published on the website of the Shenzhen SFO on 13 November 2014, the QDIE Program has secured an initial foreign exchange quota (**QDIE Quota**) of US$1 billion, which may be used by the QDIE Funds to convert their RMB capital into foreign currencies for investment into the global capital market. Based on the observations from the Shanghai QDLP Program, it is likely that the Shenzhen SAFE will also be supportive in granting a QDIE Manager additional QDIE Quota if the originally granted quota is used up and that there is demand for further subscriptions.

Permissible investment scope

Generally speaking, there is no explicit restriction on investment scope under the QDIE Measures. According to a public announcement issued by the Qianhai Authority on 30 January 2015, the QDIE Program allows for a very broad investment scope which covers common and preferred stocks, money market instruments, fixed-income securities, funds, financial derivatives, private equity, debt, hedge funds, real estate, physical assets and other underlying assets approved by the joint committee. Accordingly, the permissible investment scope under the QDIE Program appears to be broader than the QDII Regime and the QDLP Program.

Other requirements for service providers and on information disclosure

Similar to the Shanghai QDLP Program, a QDIE Fund must engage a qualified domestic commercial bank as its custodian to safekeep its onshore assets. It must also engage a qualified administrator to be responsible for the back-office administration of the QDIE Fund. Both custodian and administrator are subject to certain qualification requirements and specific duties as provided under the QDIE Measures.

As for information disclosure, the offering documents of each QDIE Fund must comply with the detailed requirements set out in the QDIE Measures and must contain relevant information relating to the fund manager, custodian and administrator.

A high-level comparison between the Shenzhen-QDIE Program and the Shanghai / Tianjin-QDLP Programs

Key Aspects	Shenzhen-QDIE Program	Shanghai-QDLP Program	Tianjin-QDLP Program
Eligible participants	Qualified fund management companies (either foreign-invested or pure domestically- funded)	Primarily qualified foreign hedge fund managers	Qualified fund management companies (either foreign-invested or pure domestically-funded)
Capital requirements on the onshore manager	Minimum registered capital of US$2 million for foreign-invested manager and RMB10 million for domestically-funded manager	Minimum registered capital of US$2 million	Minimum registered capital of US$2 million
Minimum size of onshore fund	RMB30 million (approximately US$5 million)	RMB 100 million (approximately US$15 million)	RMB 100 million (approximately US$15 million)
Minimum subscription per qualified investor	RMB2 million (approximately US$0.3 million)	RMB5 million (approximately US$0.8 million)	RMB10 million (approximately US$1.5 million)
Permissible investment scope under the local rules	Overseas market in general	Overseas public market	Overseas public market, private equity, real estate or mines, etc.

Conclusion

It is without doubt that the shared similarities of the QDIE and QDLP Programs together signal the trend of more openness and flexibility on China's outbound investment policies. For international asset managers, the QDIE and QDLP Programs provide a new source of investor capital and an entry point into China's private funds industry. For Chinese investors, these programs enable access to new asset classes which are not otherwise available under the QDII Regime and hence help diversify risks. For the local governments, these pilot programs promote the development of the asset management industry and add more vibrant energy into the local economy.

We will monitor the developments closely and prepare follow-up briefings to introduce new policies and pilot programs which may create new and more attractive business and investment opportunities.

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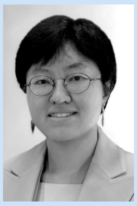

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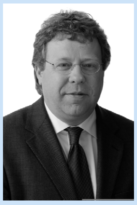

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