

Legal Commentary

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A Great Leap Forward in R/QFII Liberalization

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China has the second largest stock and bond markets in the world. By the end of June 2020, foreign investment in China's stock and bond markets amounted to US\$737.5 billion, accounting for 4.5% of China's stock markets and 2.4% of China's bond markets. With U.S. trade and diplomatic relations remaining strained, Chinese regulators have been determined to make continuous efforts to accelerate and deepen the opening-up of the country's financial markets. On 25 September 2020, the China Securities Regulatory Commission (CSRC), the People's Bank of China (PBoC), and the State Administration of Foreign Exchange (SAFE) jointly released the *Measures for Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors* (《合格境外机构投资者和人民币合格境外机构投资者境内证券期货投资管理办法》) (the "**R/QFII Measures**") and CSRC simultaneously published the *Provisions on Issues Concerning the Implementation of the Measures for Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors* (《关于实施〈合格境外机构投资者和人民币合格境外机构投资者境内证券期货投资管理办法〉有关问题的规定》) (the "**CSRC Implementing Provisions**", together with the R/QFII Measures, the "**R/QFII Rules**").¹

The R/QFII Rules will take effect on 1 November 2020. It has been over a year and a half since the regulators issued consultation drafts of the R/QFII Rules to solicit public comments in January 2019. During this period of time, PBoC and SAFE revised rules in May 2020 relating to R/QFIIs' onshore capital management, which removed R/QFII quotas, simplified repatriation processes, and unified the relevant rules applicable to R/QFIIs.

As the market expected, the R/QFII Rules mark a great leap forward in further liberalizing China's capital markets. The key highlights of the R/QFII Rules include further combining the QFII and RQFII programs, lowering eligibility requirements, simplifying application processes, expanding investment scopes, and removing limits on the number of onshore service providers which R/QFIIs may engage (including local custodians and securities/futures brokers).

¹ The full versions of the R/QFII Rules are available at http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202009/t20200925_383649.html (in Chinese) and http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202009/t20200925_383652.html (in English).

Merging QFII and RQFII Programs

QFII and RQFII programs have been subject to separate rules and application procedures. The R/QFII Rules consolidate all QFII and RQFII regulations into one set of unified rules to further harmonize the qualification requirements applicable to R/QFIIs and to mitigate regulatory arbitrage by investors. R/QFIIs are encouraged to use offshore RMB to make domestic investments.

Lowering Eligibility Requirements

There is no longer any track record or AUM requirement for R/QFII applicants. The major requirements include that an applicant must have securities and futures investment experience and not have received significant regulatory punishments in the past three (3) years or since its inception. Compared to the consultation draft, the R/QFII Measures impose a new eligibility requirement: the applicant may not have significant impact on the operation of China's domestic capital markets, which leaves more discretion with CSRC in the application review process.

Simplification of Application Process

The R/QFII application process is further simplified and there are no longer time-consuming notarization or certification requirements; CSRC's review timeline has been shortened from 20 working days to 10 working days.

Expansion of Investment Scope

In addition to the currently permissible asset classes, which mainly include A-shares, bonds, public securities investment funds and stock index futures, R/QFIIs will be allowed to invest in:

1. depositary receipts, bond repos and asset backed securities traded on securities exchanges;
2. shares traded on the National Equities Exchange and Quotations;
3. private investment funds;
4. financial futures listed and traded on the China Financial Futures Exchange;
5. commodity futures traded on futures exchanges approved by CSRC;
6. financial products traded on the China Interbank Bond Market and PBoC-approved derivatives products related to bonds, interest rates, and foreign exchange (under current rules, R/QFIIs are only permitted to invest in fixed-income products traded on the China Interbank Bond Market);
7. foreign exchange derivatives products permitted by SAFE for hedging purposes;
8. options traded on exchanges approved by the State Council or CSRC; and
9. other financial instruments permitted by CSRC.

For investments in private investment funds, the underlying investment of the private investment funds must fall within the permissible investment scope of R/QFIIs.

RQFII will also be allowed to participate in issuance of asset backed securities, margin trading and securities lending on the exchanges, and securities lending to the securities finance company (currently China Securities Finance Corporation Limited).

Engaging Affiliated Investment Advisors

An R/QFII may engage as its investment advisor a controlled or affiliated domestic private investment fund manager. This means an R/QFII may appoint a PFM manager or potentially a QDLP manager within its group as its investment advisor.

Clarifying Securities/Futures Account Structure

The R/QFII account naming requirements are further clarified and asset management R/QFIIs are encouraged to adopt “R/QFII + Client Name” or “R/QFII + Fund” format to specify the underlying investors or products. For omnibus accounts in the name of “R/QFII + Client Assets”, the R/QFII will report relevant information about the underlying investors and their assets in accordance with relevant requirements.

Reporting Offshore Hedging Positions

Under the consultation draft, it was contemplated that R/QFIIs would report to CSRC on a quarterly basis their overseas hedging positions related to the domestic securities/futures investments. Now, the R/QFII Rules merely require reporting upon CSRC’s request based on its regulatory needs.

Enhancing Ongoing Supervision

The R/QFII Rules have also enhanced ongoing supervision on R/QFIIs, including broker account and transaction monitoring, information sharing by exchanges and depositaries, additional information disclosure on offshore hedging positions related to onshore investment, and the “look-through” approach for underlying investors’ compliance with holding limits and disclosure of interest requirements. For example, the CSRC Implementing Provisions specifically require investors that invest in China’s markets via R/QFIIs (i.e. the underlying clients of R/QFIIs) submit through R/QFIIs the information disclosure materials with relevant stock exchanges if the relevant information disclosure obligations are triggered, and R/QFIIs are required to monitor the onshore shareholdings of their underlying clients and urge those clients to strictly perform their information disclosure obligations. The corresponding penalties for violations are also specified.

Outlook

The R/QFII Rules also make some reservations in terms of investment scope expansion. For example, with respect to the financial futures, commodities futures and options available to R/QFIIs, the specific types and trading models are subject to CSRC’s separate approvals based on the relevant exchange’s proposals. Implementing details may also be required as to R/QFIIs’ participation in margin trading and securities lending on the exchanges, securities lending to the securities finance company, etc.

Given the size of China's securities markets and the current low level of foreign participation in those markets, there remains great potential for China to continue its opening-up policies. Beyond R/QFII, we expect more initiatives to be rolled out to serve China's agenda to develop more internationalized capital markets.

Important Announcement

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