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Introduction of New RQFII Implementing Regulations

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On March 6, 2013, the China Securities Regulatory Commission released the *Measures for the Pilot Program of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* (the "**New RQFII Rules**"). Thereafter, the State Administration of Foreign Exchange ("**SAFE**") and the People's Bank of China **(**the "**PBOC**") respectively promulgated their own implementing rules (i.e., *the Circular of the State Administration of Foreign Exchange on Issues Concerning the Pilot Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* (the "**New SAFE Circular**") and *the Circular of the People's Bank of China on the Relevant Issues Regarding the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* (the "**New PBOC Circular**", together with the New SAFE Circular, the "**New Implementing Regulations**"), which specify and clarify relevant issues of the New RQFII Rules.

At the end of 2011, following the promulgation of *the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the "**RQFII Pilot Measures**"), SAFE and the PBOC released *the Circular of the State Administration of Foreign Exchange on the Relevant Issues Regarding the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the "**Old SAFE Circular**") and *the Circular of the People's Bank of China on the Relevant Issues Regarding the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the " **Old PBOC Circular**"), respectively.[1] The following contains an introduction to the New Implementing Rules with a focus on the comparison to the Old SAFE Circular and the Old PBOC Circular.[2]

[1] Introduction of Newly-Issued Rules on the Pilot Program of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors (http://www.hankunlaw.com/backuser/picinfo/20122317218.pdf)

[2] For the avoidance of doubt, the RQFII Pilot Measures, the Old SAFE Circular and the Old PBOC Circular have been superseded by the New RQFII Rules, the New SAFE Circular and the New PBOC Circular.

Introduction of New SAFE Circular

The New SAFE Circular specifies the supervision over investment quotas, application procedures, the inward and outward remittance of capital and the verification mechanism, which are in most parts consistent with the Old SAFE Circular. For example, the rules regarding application materials for investment quotas, the restrictions on the transfer, re-sale and effective use of investment quotas, permitted types of remittance of capital and exchange as well as the receipt and payment of capital under the New SAFE Circular are consistent with the Old SAFE Circular. However, there are certain differences between the New SAFE Circular and the Old SAFE Circular.

1. Combination of Balance Administration and Administration by Amount Incurred

Pursuant to the Old SAFE Circular, SAFE conducts balance administration for investment quotas of all kinds of RQFII products, while the New SAFE Circular conducts a different type of administration for open-ended and non open-ended funds. Under the New SAFE Circular, open-ended funds shall be administered under balance administration and the cumulative net inward remittance of RMB capital by an open-ended fund shall not exceed its approved investment quota. In addition, products and funds other than open-ended funds shall be administrated by the amount incurred, and the cumulative inward remittance of funds shall not exceed the investment quota approved by SAFE.

Furthermore, products and funds other than open-ended funds shall have their investment principal remitted within six (6) months from the date of each investment quota's approval, and without approval no inward remittance beyond the time limit can be made. The lock-up period for the investment principal shall be one (1) year.

2. Differences in Inward and Outward Remittance Procedures

According to the Old SAFE Circular, for open-ended funds, the custodian may complete on its behalf the corresponding formalities for the inward remittance of RMB funds on a daily basis upon the occurrence of net subscriptions in view of the net offset balance of daily subscription or redemption, and complete on its behalf the corresponding formalities for the outward remittance of RMB or purchased foreign exchange funds on a daily basis upon the occurrence of net redemptions. The New SAFE Circular has loosened the inward and outward remittance procedures for open-ended funds. The custodian may complete on its behalf the corresponding procedures of capital remittance in or out or of purchasing foreign exchange and remitting abroad based on subscription or redemption, which gives the custodian more discretion. Moreover, it is worth noting an important advantage of the RQFII regime over the QFII one, i.e., pursuant to the relevant QFII rules, RMB capital of open-ended QFII funds may be remitted inward and outward by the custodian only on a weekly basis as opposed to a daily basis for open-ended RQFII funds.

Furthermore, the New SAFE Circular provides that for funds and products other than open-ended funds, the custodians shall distinguish between the principal and income in the capital remittance. Outward remittance that constitutes return of principal may not be remitted inward again and the investment quota shall be decreased accordingly. In addition, in the case of outward remittance of investment income, audit reports and relevant tax certificates issued by domestic accounting firms are required to be submitted to the custodian.

3. Clarification on Penalties for Violations

Pursuant to the Old SAFE Circular, if the RQFII and its custodian violate any of the requirements of the Circular, SAFE shall take appropriate regulatory measures and impose administrative penalties thereon according to relevant laws and regulations. The New SAFE Circular further clarifies the penalties for different types of violation:

(i) RQFIIs that obtain investment quotas through the transfer or re-sale to make investments shall be ordered to take appropriate remedial actions by the relevant foreign exchange administrative authorities and be subject to a fine of up to 30% of the relevant amount involved in the violation. Where the circumstances of the case are aggravated, a fine of between 30% and 100% of the illegal amount involved shall be imposed on the RQFII concerned. In addition, depending on the gravity of the case, SAFE may revoke the investment quota of the transferring or re-selling RQFII;

(ii) RQFIIs that fail to go through relevant filing formalities for account opening shall be ordered to take appropriate remedial actions by the relevant foreign exchange administrative authorities and be subject to a fine of up to RMB300,000;

(iii) Where a custodian fails to verify the authenticity and compliance of the remittance and exchange as well as the receipt and payment of the capital of the RQFII, the relevant foreign exchange administrative authorities shall order it to take appropriate remedial actions within a specified period of time, confiscate any illegal income, and impose a fine of between RMB200,000 and RMB1,000,000. Where the circumstances of the case are aggravated or no remedial action has been taken within the specified period of time, the foreign exchange administrative authorities shall order the custodian to cease its operation of relevant business.

Introduction of New PBOC Circular

Compared with the Old PBOC Circular, no material modifications have been made under the New PBOC Circular except for the following:

1. Adjustment for Three Categories of Special Deposit Accounts

According to the Old PBOC Circular, RQFIIs may open three categories of special deposit accounts used for capital settlement in inter-bank bond market transactions, exchange bond market transactions, and stock market transactions, respectively. The New PBOC Circular instead provides for the three categories of special deposit accounts opened by RQFIIs to be used for exchange market transactions, inter-bank bond market transactions, and stock index futures margins, respectively. The special deposit accounts used for stock index futures margins shall be opened with a futures margin deposit bank.

2. Adjustment for Income and Expenditure Scope of Special Deposit Accounts

In addition to the scope of special deposit accounts as provided by the Old PBOC Circular, the scope of income under the New PBOC Circular also includes funds remitted from other special deposit accounts. The scope of expenditure under the New PBOC Circular also includes funds remitted to other special deposit accounts.

3. Strengthening of Capital Transfer among Different Accounts

In addition to the prohibition of capital transfers between special deposit accounts and basic deposit accounts as well as the prohibition of drawing from special deposit accounts, the New PBOC Circular also prohibits capital transfers between special deposit accounts and other accounts and capital transfers among different open-ended fund accounts.

4. Removal of Restrictions on Investment Proportion

The New PBOC Circular has removed the restrictions on the proportion of investments in equity and fixed income securities previously imposed by the Old PBOC Circular.

5. Extension of Time Limit for Reporting

According to the Old PBOC Circular, the custody and settlement agency bank shall, within one (1) working day upon occurrence of business, submit the following to the RMB cross-border receipt and payment information management system: information regarding the opening and cancelling of the RMB bank settlement account, information regarding the approved investment quota, capital raised and cross-border transfer of capital by the pilot institution and general information regarding asset allocation of security investment within the territory of China by the pilot institution. The New PBOC Circular extends the time for such reporting to five (5) working days after the occurrence of the relevant event.

In conclusion, the New RQFII Implementing Rules, which were released following a relatively long period of time of implementation of the RQFII pilot program, are more sensitive to the market, and the supervision hereunder is more effective. It can be expected that the New RQFII Implementing Rules will play an important role in the RQFII's further development.

Important Announcement

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