



Llinks Asset Management Bulletin
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Significant Reform of QFII and RQFII to Further Open up the Chinese Market

By Sandra Lu | Lily Luo | Olivia Hou

On 12 June 2018, the State Administration of Foreign Exchange (“SAFE”) announced the *Rules on Foreign Exchange Administration of the Domestic Securities Investments by Qualified Foreign Institutional Investors* (SAFE Announcement [2018] No.1) (“**QFII New Rules**”). On the same day, the People’s Bank of China (“PBOC”) and the SAFE jointly announced the *Notice on Issues Relevant to Administration of the Domestic Securities Investments by Renminbi Qualified Foreign Institutional Investors* (Yinfa [2018] No.157) (“**RQFII New Rules**”). The new rules came into effect on 12 June 2018 and respectively replace the old rules bearing the same names and announced in year 2016.

I. Main Content of Reform

The new rules cancel the 20% limit on outward remittance of QFII, cancel the requirement of lock-up period on repatriation of investment principal for QFII and RQFII, and allow QFII and RQFII to utilize foreign exchange (“FX”) derivatives to hedge FX risk associated with domestic securities investment.

Till now, other restrictive policies on QFII and RQFII have been substantially removed except the macro-prudential administration remaining on QFII and RQFII investment quotas. Administration on QFII and RQFII regimes on the aspects like investment quota, capital management has almost been unified.

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Items		Regulation on QFII	Regulation on RQFII
Special Institution Code		The PRC custodian of a QFII / the main PRC custodian of an RQFII shall apply through the local branch of the SAFE where the PRC custodian / the main PRC custodian locates and complete the QFII / RQFII's entity information registration. QFII / RQFII who had obtained the special institutional code through handling other cross-border or FX business do not need to apply again.	
PRC Custodian		One	No more than three PRC custodians, and one of them shall be appointed as the main PRC custodian
Quota Management		Balance control: the accumulated net capital remitted inward shall not exceed the investment quota obtained by way of filing or approval.	
Obtainment of Investment Quota		Filing + Approval: investment quota within the base quota is obtained by way of filing; as to the investment quota which exceeds the base quota, the QFII/RQFII shall make application with the SAFE and seek approval from the SAFE.	
Base Quota	Where the assets (or the assets under the management) of the QFII/RQFII or its corporate group are mainly outside the PRC	USD 100 million+ average asset size in the last three years $\times 0.2\%$ - obtained RQFII quota (converted into US Dollars for calculation purpose)	USD 100 million (or its equivalent) + average asset size in the last three years $\times 0.2\%$ - obtained QFII quota (converted into RMB for calculation purpose)
	Where the assets (or the assets under the management) of the QFII/RQFII or its corporate group are mainly within the PRC	RMB 5 billion (or its equivalent) + asset size in the preceding year $\times 80\%$ - obtained RQFII quota (converted into US Dollars for calculation purpose)	RMB 5 billion + asset size in the preceding year $\times 80\%$ - obtained QFII quota (converted into RMB for calculation purpose)
	Upper and lower limits	Not exceeding USD 5 billion (including institutions such as foreign sovereign funds, central banks and monetary authorities); and no less than USD 20 million	No upper and lower limits
Lock-up Period	No lock-up period		
Restrictions on Capital Outward Remittance	No restriction		

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II. Adding the Flexibility of Administration on Investment Quota

Article 10 of the QFII New Rules and Article 8 of the RQFII New Rules are added with the wordings of “without approval” respectively. On the one hand, it reasserted that QFII and RQFII shall not sell or transfer its investment quota in any form to any other institution or individual for use. On the other hand, it added a flexible mechanism, which allows possible arrangement of reallocating quota among different institutions, given that it has obtained the prior approval from the relevant authorities. Detailed applicable situation, conditions for application and procedures are subject to further explanation from the relevant authorities and practical experience.

III. Newly Added Provisions about FX Risk Management

According to the new rules, QFII and RQFII can utilize FX derivatives instruments in Mainland China. Detailed requirements are as followed:

1. The FX derivatives business of QFII and RQFII must be conducted through the PRC custodian who has the qualification of handling business of RMB/FX derivatives on behalf of clients or a domestic financial institution with the aforesaid qualification, and such institution shall fulfill the responsibility of reporting statistical data on FX settlement;
2. The current rules and regulations of administration on FX derivatives in China with regard to the types of derivative products and their settlement shall be complied with when developing the FX derivatives business;
3. QFII and RQFII shall comply with the principle of real demand transaction which is restricted to hedging the risk exposure of FX incurred by domestic securities investment only. There must be a proper correlation between the exposure to FX derivatives and FX risk exposure associated with domestic securities investments which transaction is based. Exposure to FX derivatives held by QFII / RQFII cannot exceed the scale of assets denominated in RMB (excluding RMB deposits in a RMB special deposit account) relative to domestic securities investments in the last month as verified and monitored by the PRC custodian; and
4. Exposure to FX derivatives can be adjusted monthly, which shall be made within five working days since the end of preceding month and shall comply with the principle of real demand transaction.

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IV. Adjusting Types of RMB Special Deposit Accounts

Before the promulgation of the new rules, QFII and RQFII can open a RMB special deposit account for investing in stock index futures. Such account shall be marked with “futures trade”. After the promulgation of the new rules, in order to meet the need of utilizing FX derivatives by QFII and RQFII, such type of RMB special deposit account shall be adjusted from “special deposit account <futures trade>” to “special deposit account <derivatives transaction>”.

V. Clarifying Procedures of Capital Outward Remittance and Account Closure upon Winding Up

When QFII/RQFII is wound up (including winding up of the products), the PRC custodian can handle relevant procedures of capital outward remittance and procedures of account closure for QFII / RQFII based on (1) QFII/RQFII's written application or instruction; (2) the audited report particularly for investment profits issued by a PRC certified accountant; and (3) tax clearance certificate or tax filing documents, etc.

The reform of QFII and RQFII follows the trend of steadily facilitating the capital account convertibility and expanding the two-way opening up of financial industry. It enhances the attractiveness of QFII and RQFII regimes to foreign investors. This would effectively lead to more inflow of international investments in China's A-share market and such impact would be far-reaching.

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