

Analysis on New Rules on RQFII Investment Quota and Capital Management

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The People's Bank of China ("PBOC") and the State Administration of Foreign Exchange ("SAFE") jointly issued the *Notice on Issues Relevant to Administration of Domestic Securities Investment by Renminbi Qualified Foreign Institutional Investors* (Yinfa [2016] No.227) (the "**New Rules**") on 5 September 2016, which mainly reforms the supervision and administration of the investment quota, the capital account, remittance and repatriation of funds and other such matters of domestic securities investment by Renminbi qualified foreign institutional investors ("**RQFII**").

The New Rules have taken effect since the day of announcement. Rules that were simultaneously abolished (hereinafter referred to as the "**Old Rules**") include:

- Notice by the People's Bank of China regarding the Implementation of the "Pilot Measures for Domestic Securities Investment by Renminbi Qualified Foreign Institutional Investors" (Yinfa [2013] No.105);
- Notice by the State Administration of Foreign Exchange regarding Issues relevant to the Pilot Program of Domestic Securities Investment by Renminbi Qualified Foreign Institutional Investors (Huifa [2013] No.9); and
- Notice by the Capital Account Management Department of the State Administration of Foreign Exchange regarding "Operational Guidance Regarding Administration on Investment Quota of Renminbi Qualified Foreign Institutional Investors (Huizihan [2014] No.2).

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The New Rules have changed the mechanism for obtaining RQFII investment quota, introduced the concept of base quota, exercised consolidated balance control on RQFIIs, and further relaxed the restrictions on the outward and inward remittances on capital. After the announcement of the New Rules, the major regulatory rules relevant to domestic securities investment quota and capital management of both RQFII and qualified foreign institutional investors (“QFII”) are becoming increasingly similar. This article provides an analysis on the relevant content through making comparison between the New Rules and the Old Rules on RQFII and comparing between the regulatory rules of RQFII and QFII.

I. Continuing the Main Reporter System

Same as the Old Rules, an RQFII may appoint no more than three PRC custodians, and shall appoint one PRC custodian as the main reporter. As the duties of the main reporter under the New Rules are relatively simplified, the main reporter shall only be responsible for handling of investment quota filing or application for approval, and registering major information of the RQFII entities. The main reporter no longer has to handle with the adjustment of investment quota or filing for the delay of inward remittance of investment principal, etc.

II. Introducing the “Base Quota” Mechanism and Simplifying the Administration on Approval for Investment Quota

After obtaining the license from the China Securities Regulatory Committee (“CSRC”), an RQFII may obtain investment quota (hereinafter referred to as “**base quota**”) of no more than a certain percentage of its asset scale or the size of securities assets under its management (“**AUM**”) (hereinafter collectively referred to as “**asset size**”) by way of filing. Applications for additional investment quota in excess of the base quota are subject to prior approval of the SAFE.

1. Obtaining Investment Quota within the Base Quota through Filing with the SAFE

Two scenarios for calculation of the base quota:

- (1) If the assets or AUM of an RQFII or its corporate group are mainly located outside the PRC, its base quota shall be: 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);
- (2) If the assets or AUM of an RQFII or its corporate group are mainly located within the PRC, its base quota shall be: RMB 5 billion + asset size in the preceding year $\times$ 80% - obtained QFII quota (converted into RMB for calculation purpose).

Same as QFII base quota mechanism, RQFII base quota is also connected with the RQFII’s asset size.

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Furthermore, the QFII quota obtained shall be taken away. Formula (1) is applicable to wholly foreign-owned RQFIIs, while formula (2) is applicable to RQFIIs owned by Chinese companies (such as offshore subsidiaries of Chinese commercial banks, securities companies, fund management companies, insurance institutions, or private fund management companies). No upper and lower limits are set for the base quota of RQFIIs.

The investment quota of institutions such as foreign sovereign funds, central banks and monetary authorities is not restricted by their asset size. Such institutions may obtain investment quota according to their needs in domestic securities market investment and be subject to filing administration.

An RQFII may, according to its needs, apply for filing of investment quota within its base quota, and shall submit the following documents to its main reporter: (1) a statement of the filing of the application for investment quota together with a Registration Form for Renminbi Qualified Foreign Institutional Investors; (2) the audited balance sheet of the RQFII for the last three years or the preceding one year (or the audited financial report on the securities assets under its management, etc.); and (3) a photocopy of the supporting documents of the RQFII licence issued by the CSRC. The main reporter shall, after having rigorously reviewed the documents and verified the RQFII's base quota, submit the filing applications for investment quota of each RQFII to the SAFE by the 10th day of the month on a consolidated basis. If the filing is accepted and confirmed by the SAFE, it will provide the filing information to the main reporter.

2. Prior Approval by the SAFE for Investment Quota exceeding the Base Quota

- (1) According to Article 6 of the New Rules, where the application of an RQFII for investment quota exceeds its base quota, the RQFII shall submit the following documents to the SAFE through the main reporter: (i) a written application to explain the reasons for increasing its investment quota and how the existing investment quota is utilized; (ii) filing information about the custodian(s) of the RQFII; (iii) audited balance sheets in the last three years or the preceding year (or audited financial report on the securities assets under its management); and (iv) other documents as required by the SAFE.
- (2) According to Article 7 of the New Rules, where an RQFII had already obtained investment quota before the issuance of the New Rules and the RQFII seeks to increase its investment quota, the procedures listed below shall be followed:
 - (i) if the aggregated amount of the existing investment quota and the additional investment quota applied for does not exceed the base quota, the filing procedures as set out in Paragraph 1 above shall apply;
 - (ii) if the aggregated amount of the existing investment quota and the additional investment quota applied for exceeds the base quota, the procedures for seeking approval as set out in this Paragraph 2 shall apply;

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- (iii) where the existing investment quota has exceeded the base quota, the procedures for seeking approval as set out in this Paragraph 2 shall be followed.

RQFIIs shall pay attention to the fact that, the investment quota of an RQFII is still limited by the total quota in the country/ district where the RQFII is located at. Where the total quota of the country/ district has been used up, even though the base quota of an RQFII is larger than its existing investment quota, the RQFII may still not be able to obtain additional investment quota by way of filing or seeking approval.

III. Adopting Quota Management by the Balance of Investment Quota

The quota management by the balance of investment quota is adopted under the New Rules. The investment quota will be granted to each RQFII without distinguishing different types of quota. An RQFII may freely adjust the proportion of utilization among its own capital, open-ended funds and other products (or capital) within the scope of its existing investment quota. The RQFII does not have to apply or file for such adjustments in advance, and would only have to satisfy the requirement that the net asset value of inward remittances on capital shall not exceed the investment quota obtained by way of filing or seeking approval.

IV. Removing the Time Frame Requirement for the Inward Remittance and Shortening the Lock-up Period

Neither the New Rules nor the Old Rules have made restrictions on the time frame for inward remittances of the investment principal of open-ended funds or set up the lock-up period thereon.

The New Rules have removed the requirement that other products (or capital) of the RQFIIs shall remit investment principal within six months from the day the RQFIIs obtain the investment quota approval. The lock-up period for other products (or capital) is shortened from one year to three months. The lock-up period for the investment principal commences from the date when the cumulative investment principal remitted into the PRC by the RQFII reaches an amount equivalent to RMB 100 million. Within the lock-up period, the RQFII shall not remit the investment principal out of the PRC.

An RQFII shall not sell or transfer its investment quota in any form to any other institution or individual for use. Where an RQFII fails to effectively utilize its investment quota within one year from the day of filling or approval of the investment quota, the SAFE may revoke all or part of the unutilized investment quota.

V. Rules on Accounts

1. Account opening

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Rules relevant to the opening of RQFII accounts under the New Rules have not been changed. An RQFII shall, first of all, obtain a License for the Account Opening issued by the PBOC, and then open an RMB basic deposit account in the name of the RQFII itself; afterwards, the RQFII may open, with its custodian(s), special deposit account(s) for settlement of trading in exchanges' securities market and special deposit account(s) for settlement of trading in the inter-bank bond market ("CIBM"), which will be used for investment in the exchange securities market and the CIBM respectively. The RQFII may also, according to business needs, open special deposit account(s) for settlement of stock index futures margins with the futures margin deposit bank for the purpose of taking part in the stock index futures trading.

2. Number and Name of Accounts

The New Rules contain no mandatory rules regulating the number and the names of the abovementioned special deposit accounts, but require RQFIIs to distinguish their own capital from the capital of clients for whom they provide asset management services, and open different accounts, and separate accounts shall be opened for each open-ended fund. Capital shall not be transferred among the three types of accounts.

Regarding clients' capital, the usual practice under the RQFII regime is to open a master account of the RMB special deposit accounts for the type of client money, which does not show the names of the clients, and then open different sub-accounts for different clients' capital under the master account by way of bookkeeping (so that the accounts are marked) with the custodian. At the same time, the China Securities Depository and Clearing Corporation Limited ("CSDCC") requires that the securities account shall correspond to the RMB special deposit account. Our suggestion is that, where the business objective permits, RMB special deposit account shall be opened for each client separately showing the client's identifier and the corresponding securities account shall be opened with the CSDCC. This approach is of vital importance for the independence and effective segregation of the assets of different clients and will facilitate the effective identification of the relevant credit and debt of such client, the avoidance of the assets being commingled or the boundary of liabilities becoming blurred, and may also more effectively prevent the assets from being encumbered by legal actions (such as seizure and freezing of assets) against the RQFII itself or other open-ended funds or other products (or capital).

VI. Cancelling the Foreign Exchange Registration Certificate, Introducing the Special Institution Code

Under the Old Rules, an RQFII shall obtain the Foreign Exchange Registration Certificate for Qualified Foreign Institutional Investors issued by the SAFE ("**Foreign Exchange Registration Certificate**") and major information relevant to the RQFII's entity and the status of investment quota shall be filled in by the custodian. After the relevant cash accounts have been opened with the custodian, the custodian shall record such account information in the Foreign Exchange Registration Certificate promptly and accurately.

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According to the New Rules, an RQFII no longer has to apply for the Foreign Exchange Registration Certificate. The RQFII shall, through the main reporter, apply for the special institution code at the foreign exchange administration authority of the region where the main reporter locates at and complete RQFII's entity information registration within ten (10) working days from the day the RQFII first obtains its investment quota. Where an institution has already obtained a special institution code from other cross-border or foreign exchange receipt or payment businesses, there is no need to apply for the code again.

VII. Facilitating Inward and Outward Remittance of Capital

For Open-ended Funds:

The rules on outward and inward remittances of open-ended funds under the New Rules and the Old Rules remain the same, which means that the RQFII may conduct RMB inward and outward remittance procedures everyday based on the daily difference between the subscribed or redeemed net amount.

For Other Products (or Capital):

Under the Old Rules, the custodian shall conduct outward remittances of RMB capital or outward remittances by purchase each month after the expiry of the lock-up period; and the custodian shall distinguish the principal from the profits among the capital remitted. Principal remitted outwards shall not be remitted inwards again and the investment quota of the RQFII will be reduced accordingly (namely an actually-occurred use of quota mechanism). Where investment profits are remitted outwards, audited reports issued by a PRC accounting firm and relevant tax proof shall be submitted to the custodian.

Under the New Rules, after the expiry of the lock-up period for other products (or capital), the custodian(s) may proceed with outward remittances any time and is no longer restricted to conduct the outward remittance on a monthly basis. The outward remittances of the principal of other products (or capital) will not cause the reduction of the RQFII's investment quota. The materials for proving realized profits outward remittances shall include: written application or instruction provided by the RQFII, the audited report particularly for investment profits issued by a PRC certified accountant, tax clearance certificate or tax filing documents (if applicable), etc.

VIII. Optimizing the Registration of Changes Mechanism

Pursuant to the New Rules, an RQFII shall apply to the SAFE for registration of changes on the following items: (1) changes in material information such as those relating to the name of the RQFII or its custodian(s); (2) changes otherwise prescribed by the PBOC or the SAFE; (3) change of the main reporter, and the new main reporter shall be responsible for completing the registration of change.

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Where an RQFII or its major shareholder or actual controller has been subject to any major regulatory action by any other regulatory authorities (including overseas regulatory authorities), which may have a material impact on the investment operations of the RQFII or may cause relevant business qualifications of the RQFII to be suspended or revoked, the main reporter shall promptly report the same to the PBOC and the SAFE.

IX. Comparison between QFII and RQFII regarding the Regulation on Investment Quota, Capital Management

Key Points		Regulation on QFII	Regulation on RQFII
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; where the investment quota exceeds the base quota, the QFII/RQFII shall make application with the SAFE and seek approval from the SAFE.	
Special Institution Code		The Foreign Exchange Registration Certificate is cancelled. The QFII/RQFII shall, through its custodian/ its main reporter, apply for a special institution code at the foreign exchange administration authority of the region where the custodian/ the main reporter locates at and complete QFII/RQFII's entity information registration.	
PRC Custodian		One	no more than three custodians, and shall appoint one custodian as the main reporter
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)

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Key Points		Regulation on QFII	Regulation on RQFII
Base Quota	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		3 months (without distinguishing among different types of assets), starting from the date on which the cumulative inward remittance of investment principal by the QFII reaches a total of USD20 million	Open-ended funds have no lock-up period 3 months for other products (or capital) starting from the date on which the accumulated investment principal remitted inward reaches RMB 100 million
Restrictions on Capital Outward Remittance		The accumulated net repatriation (principal and profits) shall not exceed 20% of the amount of its total assets within the PRC at the end of the preceding year. The accumulated net repatriation for an open-ended fund shall not exceed 20% of the amount of the total assets under the fund within the PRC at the end of the preceding year.	No upper limit

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