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New QFII/RQFII Legislations for Consultation

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When the SAFE announced the expansion of total QFII quota from USD150 billion to USD300 billion on 14 January 2019, market inferred that there might be some moves of the long-awaited QFII, RQFII amended rules. It comes as expected but with an unexpected leap forward.

Highlights

“Measures” refers to the *Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Consultation Paper)* issued by the CSRC on 31 January 2019.

“Provisions” refers to the *Provisions on Issues Concerning the Implementation of the Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Consultation Paper)* issued by the CSRC on 31 January 2019.

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New QFII/RQFII Legislations for Consultation**I. Providing a huge boost to WFOE PFM business****1. Seeding PFM fund products**

According to Paragraph 3 of Article 6 of the *Provisions*, privately-raised securities investment funds of which underlying investments are standardized financial instruments (e.g. stocks, bonds, publicly-offered funds, exchange-traded securities, financial derivatives, commodities futures, options, and foreign exchange derivatives) are newly included to the permissible investment scope of QFIIs/RQFIIs. It is of great significance to WFOE PFMs. Funds sourced from QFIIs/RQFIIs can be utilized as seed money to sponsor the establishment of PFM funds. Particularly, it may release the pressure of meeting the AMAC's requirement to successfully raise money and launch.

the 1st PFM fund within 6 months since the completion of AMAC registration, solve the immediate lack of local distribution resources, and facilitate a WFOE PFM to build up investment track records for its development of PFM business and further for publicly-offered fund management business initiative in China.

Having said that, the mechanism of well handling conflict of interest should be in place as to a QFII/RQFII if the money is sourced from the fund products, client mandates it manages, rather than its proprietary money.

2. Obtaining revenue from providing investment advisory service

Currently, WFOE PFMs are only allowed to provide research support and sharing through intra-group transfer pricing arrangement. According to Paragraph 5 of Article 6 of the *Provisions*, a QFII/RQFII can appoint its affiliated WFOE PFM as the non-discretionary investment advisor for its investment in Chinese securities and futures. As such, a WFOE PFM can get business revenue to reduce its financial pressure, effectively leverage the investment capability of local team and well coordinate group resources.

We understand that WFOE PFM's acting as the investment advisor to the affiliated QFII/RQFII is not subject to the "1+3+3" criteria requirement (i.e. one-year PFM registration status, AMAC membership, three investment management personnel with at least 3-year consecutive securities and/or futures investment experience). From legislative perspective, "1+3+3" is applicable to investment advisory service to privately-raised asset management schemes launched by local financial institutions or their asset management subsidiaries. Paragraph 5 of Article 6 of the *Provisions*, without specific criteria requirements other than the affiliated relationship, can be the legal basis for a WFOE PFM to provide investment advisory service to its affiliated QFII/RQFII.

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On one side, the above business facilities serve for providing better China solutions for global asset management institutions on top of close cooperation and better coordination of resources at the group level, and thus encouraging more foreign asset management institutions to set up WFOE PFMs; on the other side, it enhances the attractiveness to QFIIs/RQFIIs, optimizes the investor structure of Chinese securities market and stimulates vitality of the market.

II. Revising and consolidating QFII Measures, RQFII Measures and their supporting rules

The CSRC creatively merges QFII scheme and RQFII scheme. Going forward, the CSRC's regulation on QFIIs and RQFIIs becomes unified. For example, (1) one application can seek both QFII and RQFII license, except that the home jurisdiction of the applicant has not yet obtained RQFII overall quota; (2) the AUM requirement for a QFII applicant has been removed; (3) types of RQFII holders will be no longer limited to asset management institutions, instead, it extends to the same types of QFII holders, i.e. foreign fund management institutions, commercial banks, insurance companies, securities companies, futures companies, trust companies, government investment management companies and other assets management institutions, as well as other types of institutional investors recognized by the CSRC such as pension funds, charity funds and endowment funds.

We also note that the CSRC has consolidated most of the rules, notices, regulatory approaches it has issued in the past few years for QFIIs/RQFIIs into the *Measures* and the *Provisions*. It really does good to explicitly implement QFII/RQFII rules and help the market get clear understanding about the legal and regulatory requirements.

III. Expanding investment scope

The investment scope of QFIIs/RQFIIs is significantly expanded.

Before	After
(1) Stocks, bonds, warrants traded or transferred on stock exchanges;	(1) Stocks, depository receipts , bonds, bond repurchases , and asset-backed securities traded or transferred on stock exchanges;
(2) Fixed-income products traded on the China Interbank bond market (" CIBM ");	(2) Shares transferred on the National Equities Exchange and Quotations (NEEQ) ;
(3) Publicly-offered securities investment funds;	(3) CIBM-traded products that PBoC allows QFIIs/RQFIIs to invest in;
(4) Stock index futures;	(4) Publicly-offered securities investment funds;
(5) Privately-raised asset management schemes	(5) Financial futures contracts (e.g. stock index futures, bond index futures) listed and traded on the China Financial Futures Exchange (CFFEX);

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managed by securities firms, fund management companies; (6) Other financial instruments as approved by the CSRC. QFIIs/RQFIIs can participate in IPO of stocks, IPO of convertible bonds, private placement of stocks, and right issue of stocks.	(6) Commodity futures contracts listed and traded on futures exchanges approved by the CSRC; (7) Options listed and traded on futures exchanges approved by the State Council or the CSRC; (8) Foreign exchange derivatives that the SAFE allows QFIIs/RQFIIs to trade; (9) Privately-raised asset management schemes managed by asset management institutions such as securities firms, fund management companies; (10) Other financial instruments as approved by the CSRC. QFIIs/RQFIIs can participate in IPO of stocks, IPO of convertible bonds, private placement of stocks, and right issue of stocks on stock exchanges and the NEEQ, and can engage in margin trading and securities lending on stock exchanges. QFIIs/RQFIIs can invest in a privately-raised investment fund whose investment scope conforms to the above. Relevant trading venues will propose specific types of bond repurchases, financial futures, commodity futures, and options and report to the regulatory authority for approval.
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IV. Strengthening the see-through regulation and further clarifying the ownership issue

In Article 5 of the *Provisions*, it further clarifies that the client assets of a QFII/RQFII belong to the client and are segregated from the QFII/RQFII and the PRC custodian. If the securities account is named as “QFII/RQFII + client funds” in general rather than embodying the specific name of the client, the QFII/RQFII must separately open sub-accounts thereunder for each fund and product according to the rules of the securities depository and clearing institution and the futures market monitoring institutions, and verify the identities of end investors of such funds and products on a see-through basis, and quarterly report the information of end investors through the PRC custodian.

V. Relaxing the management of PRC Custodian

The licensing requirement of PRC custodian is removed and only pre-filing towards the CSRC within 5 business days of the first-time signing of a custodian agreement with a QFII/RQFII (i.e. the initiation of PRC custodian business) is required.

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Previously, a QFII can only appoint one PRC custodian, and an RQFII can only appoint no more than three PRC custodians. Such amount limit is removed. In the case of having two or more PRC custodians, the QFII/RQFII must designate one of them as the principal PRC custodian to take charge of license and quota application, reporting, information registration, etc.

The CSRC is soliciting public comments on the *Measures* and the *Provisions* until **2 March 2019**. If you have any comment or suggestion, please do not hesitate to let us know. We are happy to discuss and formulate a comprehensive paper for submission before the deadline.

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