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Llinks Asset Management Bulletin
December 2019

Introduction of SAFE's Consultation Paper on the Administration of Qualified Foreign Investors

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On 31 January 2019, China Securities Regulatory Committee (the "**CSRC**") issued the *Measures for the Administration of Domestic Securities and Futures Investments by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Consultation Paper)* (the "**CSRC Measures**") and the *Provisions on Issues Concerning the Implementation of the Measures for the Administration of Domestic Securities and Futures Investments by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Consultation Paper)* (the "**CSRC Provisions**"), which show the trend to combine the two regulatory regimes for qualified foreign institutional investors (the "**QFII**") and RMB qualified foreign institutional investors (the "**RQFII**") into one, i.e. the regime of qualified foreign investors (the "**QFI**").

On 10 September 2019, the State Administration of Foreign Exchange (the "**SAFE**") announced that the People's Bank of China (the "**PBOC**") and SAFE, upon approval of the State Council, decided to generally cancel the administration of investment quotas for QFIIs and RQFIIs, and the pilot countries and regions limitation under RQFII regime. SAFE Spokesman said that SAFE would start working on amending relevant regulations and made it clear that no filing or approval would be required for obtaining the investment quota by a QFI.

On 13 December 2019, PBOC and SAFE issued the *Provisions on the Administration of Funds of Qualified Foreign Investors for Domestic*

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Securities Investment (Consultation Paper) (the "**New Regulation**") and started soliciting public comments on the New Regulation. The New Regulation, on top of cancelling investment quota limitation, imposes specific requirements for a QFI to open special cash account(s), conduct inbound and outbound remittance and so on. The New Regulation combines the provisions respectively under QFII regime and RQFII regime, and will act as the replacement of the QFII, RQFII rules issued by SAFE. The following is our summary and comments of the highlights of the New Regulation.

I. Administration on Registration with SAFE

Pursuant to the New Regulation, SAFE conducts registration administration on the funds of a QFI for domestic securities investment.

1. The filing/approval mechanism for investment quota will be cancelled

The current filing/approval mechanism for investment quota can be traced back to year 2016 when the reform of optimizing QFII, RQFII quota management was implemented. Each QFII and RQFII shall calculate its own basic quota as a certain percentage of its asset or the size of its securities assets under management and obtain the investment quota within the basic quota by way of filing with SAFE. Application for an investment quota exceeding the basic quota requires approval by SAFE. Such filing/approval mechanism for investment quota will be annulled with the effectiveness of the New Regulation.

2. A QFI may open special cash accounts and conduct inbound and outbound remittance after completing registration with SAFE

Pursuant to Articles 6 and 7 of the New Regulation, after obtaining the Securities and Futures Business License granted by CSRC, a QFI shall apply to the local bureau of SAFE for special institution code through the PRC custodian, and the PRC custodian shall submit the QFI's information to the Capital Account Information System of SAFE (repeated submission is not required if the information of the same entity has already been submitted, or the special institution code has already been granted to the entity because of other cross-border or foreign exchange business). A QFI shall then handle business registration with SAFE through the PRC custodian.

Repeated registration with SAFE is not required for existing QFIIs and RQFIIs who have conducted relevant registration with SAFE before the implementation of the New Regulation.

3. Registration Materials and Registration Certificate

To conduct registration with SAFE, a QFI is only required to submit: (1) the QFI Registration Form (Attachment One of the New Regulation); and (2) a photocopy of Securities and Futures Business

License granted by CSRC. It is worth noting that, compared with the requisite information for current registration with SAFE by QFIIs and RQFIIs, the information that needs to be filled in the QFI Registration Form has been greatly simplified. SAFE will issue registration certificate after QFI's completion of the registration.

4. A QFI who appoints two or more PRC custodians shall designate one of them as the main reporter

We notice that CSRC Measures also cancel the limitation on the number of PRC custodians (note: under current regulations, a QFII can appoint one PRC custodian only, and an RQFII may appoint at most three PRC custodians). The New Regulation further specifies that a QFI appointing two or more PRC custodians shall designate one of them as the main reporter; if there is only one PRC custodian, such PRC custodian will be deemed as main reporter by default and will be responsible for matters including the registration for the QFI.

II. Administration on Accounts

Pursuant to Article 8 of the New Regulation, a QFI, with the registration certificate issued by SAFE, shall open one or more special accounts with the PRC custodian(s) based on its needs of investment and funds remittance. Specifically:

- If a QFI remits in foreign currencies only, it is required to open foreign exchange account(s) and RMB special deposit account(s) with each corresponding to the foreign exchange account(s);
- If a QFI remits in RMB only, it is only required to open RMB special deposit account(s);
- If a QFI needs to remit in both RMB and foreign currencies, it is required to separately open RMB special deposit account(s) for the remitted funds in RMB, and foreign exchange account(s) for the remitted funds in foreign currencies and RMB special deposit account(s) with each corresponding to the relevant foreign exchange account(s);
- For an existing QFII, if it needs to remit in RMB, it shall separately open RMB special deposit account(s) for the remitted funds in RMB;
- For an existing RQFII, if it needs to remit in foreign currencies, it shall separately open foreign exchange account(s) and RMB special deposit account(s) with each corresponding to the relevant foreign exchange account(s) for the remitted funds in foreign currencies.

For the avoidance of doubt, with the combination of QFII and RQFII regimes, a QFI may remit in foreign currencies and/or Renminbi as needed, but the administration route on foreign exchange and cross-border Renminbi are still independent from each other from the perspective of account management and funds remittance. It is clearly provided in the New Regulation that the currency of funds QFI remits into and out of China shall remain consistent, and cross-currency arbitrage is prohibited.

For example, even for the same open-ended fund, the QFI cannot transfer money between the fund's RMB special deposit account (for remitting in Renminbi) and the fund's RMB special deposit account corresponding to the foreign exchange account (for remitting in foreign currencies).

III. Administration on Funds Remittance

1. Remittance due to overseas subscription and redemption of an open-ended fund

Inbound and outbound remittance can be processed on a daily basis through PRC custodian(s) for an open-ended fund according to the net amount of overseas subscription or redemption, and no relevant document is required to be provided.

2. Remittance of realized accumulated profits out of China

The New Regulation significantly simplifies the materials required to be provided for outbound remittance of profits concerning open-ended fund products, client money, and proprietary money.

Current Regulation	New Regulation
Written application or order of the QFII/RQFII	Written application or order of the QFI
Ad hoc audit report for investment profits issued by PRC certified public accountants	Undertaking letter on tax payment by the QFI
Proof of tax payment or tax filing (if any)	

The New Regulation no longer requires a QFI to provide documents including *ad hoc* audit report for investment profits issued by PRC certified public accountants, tax filing form when repatriating the realized accumulated profits, and an undertaking letter on tax payment should suffice, which will greatly simplifies the formalities for repatriating funds out of China and ensures timely outbound remittance of the realized accumulated profits.

3. Remittance out of China due to liquidation (including liquidation of products)

Compared with current regulations, there is no material change in the New Regulation about the documents required to be provided for repatriation due to liquidation (including liquidation of products). However, the New Regulation adds flexibility in terms of the requirements on the evidencing documents, i.e. tax filing form is not required to be provided when it is otherwise provided by other laws and regulations.

Current Regulation	New Regulation
Written application or order of the QFI	Written application or order of the QFI
Ad hoc audit report for investment proceeds issued by PRC certified public accountants	*Ad hoc* audit report for investment proceeds issued by PRC certified public accountants
Proof of tax payment or tax filing (if any)	Tax filing form (unless not required to be provided under other laws and regulations)

IV. Administration on Risk Management of Derivatives

Pursuant to Article 15 of the New Regulation, a QFI may conduct foreign exchange risk hedging transaction and stock index futures trading for hedging purpose.

1. A QFI may carry out stock index futures trading for hedging purpose

New Regulation aligns with current QFII/RQFII regulations about stock index futures trading. To manage investment risks, a QFI may conduct stock index futures trading for hedging purpose only. There shall be reasonable correlation between the derivative exposure and the investment risk exposure associated with the underlying securities of the derivatives.

2. Exposure to foreign exchange derivatives held by a QFI

According to current regulations, the exposure to foreign exchange derivatives held by a QFI can only be adjusted monthly. A QFI shall adjust the exposure to foreign exchange derivatives within 5 working days after the end of each month based on the RMB asset size corresponding to the domestic securities investment verified by the PRC custodians, to ensure compliance with the principle of real demand transaction.

Article 16 of the New Regulation provides that a QFI shall ensure the exposure to foreign exchange derivatives to comply with the principle of real demand transaction, but deletes the mechanism of monthly adjustment of the exposure to foreign exchange derivatives. That is to say, the adjustment can and should be made on timely basis, while the mechanism of monthly adjustment no longer exists.

V. Supervision and Administration

It is worth noting that, although the process for inbound and outbound remittance has been greatly simplified under the New Regulation, a PRC custodian will still verify the authenticity and compliance of the receipts and payments of funds when handling inbound and outbound remittance for a QFI and shall earnestly perform anti-money laundering and anti-terrorism financing obligations.

PBOC and SAFE may conduct macro-prudential administration according to the national economy and finance situation, supply and demand relationship in foreign exchange market, balance of international receipts and payments, etc.

Remarks

In view of the consultation papers and relevant policies having been issued successively from the beginning to the end of year 2019, we believe that QFII and RQFII regimes are facing a significant reform in the near future. Fundamental breakthroughs will occur on the scope of domestic securities investment, flexibilities of cross-border remittance, enhancement of formalities convenience and so on. Such reform will make QFI regime become very attractive, and well suit for the demand of increasing A-shares' index inclusion factors by the international indices such as MSCI. We also note that certain issues are still subject to further clarification and practice test. For example:

1. According to current regulations, without approval, the investment quota cannot be resold or transferred in any form to any other institution or individual for use. Since PBOC and SAFE are to cancel the QFII and RQFII investment quota and pilot countries and regions limitation under RQFII regime, for certain existing cases of investment quota sharing among the group affiliates (particularly in QFII area), it needs further clarification on whether such facility can continue or whether the institution previously enjoying the facility shall separately apply for a QFI license.

2. Although the New Regulation specifies that it is no longer required to provide documents including *ad hoc* audit report issued by PRC certified public accountants and tax filing form when a QFI remits out of China the realized accumulated profits and an undertaking letter on tax payment should suffice, the operating procedures for a QFI to repatriate realized accumulated profits are still subject to practice test given this may involve the convergence with relevant tax authorities.

3. According to CSRC Measures and CSRC Provisions, besides stock index futures and foreign exchange derivatives, the investable derivatives also include other financial derivatives (e.g. bond futures) traded on China Financial Futures Exchange, commodities futures and options traded on recognized futures exchanges; while according to Article 15 of the New Regulation, a QFI may only conduct foreign exchange risk hedging transaction and stock index futures trading for hedging purpose. Such difference and the possible trend remain to be seen.

SAFE is soliciting public comments on the New Regulation until 13 January 2020. If you have any questions, please do not hesitate contacting us, and we may also help sort out your comments and suggestions on the New Regulation. We will pay continuous attention to the progress of issuance and implementation of the regulations under the QFI regime.

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