

**MEMO# 31633**

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# Changes Proposed to QFII and RQFII Legislations

[31633]

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ICI Global Pacific Chapter

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International/Global

Investment Advisers RE: Changes Proposed to QFII and RQFII Legislations

On 31 January 2019, the China Securities Regulatory Commission (CSRC) released the *Draft Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors (QFII) and RMB Qualified Foreign Institutional Investors (RQFII)* and the *Draft 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* (collectively, the **FI Measures**[\[1\]](#)). The FI Measures will remove some of the existing hurdles and generally usher in an easier regulatory landscape for QFII and RQFII. Foreign asset managers should find it easier to access China's capital market.

This memo highlights the changes that we believe are significant for foreign asset managers who are considering opportunities in the China capital market. Notably, these include the proposal to merge the QFII and RQFII schemes and expand their investment scope, and introduce changes that will make it easier for foreign managers to raise capital for their Wholly Foreign-Owned Enterprise (WFOE) Private Funds Management (PFM) business in China.

## Background of the QFII and RQFII schemes

The QFII and RQFII schemes, introduced in 2002 and 2011 respectively, allow overseas institutional investors, banks, and asset managers to make capital account investments in China and trade Chinese domestic securities. Over the years, the CSRC has made continuous modifications to the QFII and RQFII schemes (such as expanding the investment scope, reducing the lockup period of funds, and relaxing the quota administration and foreign exchange control) to make the schemes more accessible to foreign institutional investors. According to CSRC data, as of end 2018, of the US \$300 billion QFII quotas available for allocation, US \$101.1 billion was allocated to a total of 309 foreign institutions. For RQFII, the scheme has been granted to 19 jurisdictions with an aggregate quota of RMB 1.94 trillion (US \$290 billion).

## **Unifying the QFII and RQFII schemes into one legal regime**

After the launch of the Shanghai-Hong Kong Stock Connect (in 2014), the Shenzhen-Hong Kong Stock Connect (in 2016), the revised China Interbank Bank Market (CIBM) scheme (in 2016), and the Bond Connect (in 2017), which give foreign investors direct access to the Chinese domestic securities market, the QFII and RQFII schemes have lost their attraction to foreign investors. The QFII and RQFII schemes involve complicated approval/vetting processes, and difficult restrictions on quotas, investment scopes, tie-up periods, and repatriation of profits. The FI Measures are a policy response from the authorities—the purpose likely is to give new life to these two schemes so that they can provide efficient alternative channels towards a wider opening of China's capital account.

## **Proposed Changes**

### **1. Establishing One Common Application; One Common Rule Book**

Currently, the QFII and RQFII schemes are governed by separate rules and application procedures. In the FI Measures, the CSRC proposed to consolidate the QFII and RQFII schemes into one regime. Foreign institutions will only need to make a one-time application for both a QFII and RQFII license (with the exception where the home jurisdiction of the applicant has not yet been granted an RQFII quota by China). The current requirement that an applicant must meet a certain AUM threshold will be removed. A broader range of financial institutions and investors including, for instance pension and charity funds, will be eligible for QFII/RQFII licenses. Those QFII quota holders in a jurisdiction which has been given a RQFII quota (currently there are 19 such jurisdictions) will be able to make investments in the Chinese capital market using offshore RMBs or foreign currencies. However, where an RQFII quota has not been given to the jurisdiction in question, the QFII quota holder will be restricted to investing only in foreign currencies.

### **2. Expanding Investment Scope**

The FI Measures will expand the investment scope of the combined QFII and RQFII regime. The table below summarizes the expanded investment scope for QFII and RQFII<sup>[2]</sup>:

#### **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 QFII/RQFIIs to invest in;
- (4) Stock index futures;
- (4) Publicly offered securities investment funds;

(5) Privately raised asset management schemes managed by securities firms, fund management companies;

(5) Financial futures contracts (e.g. stock index futures, bond index futures) listed and traded on the China Financial Futures Exchange (CFFEX);

(6) Other financial instruments as approved by the CSRC.

(6) Commodity futures contracts listed and traded on futures exchanges approved by the CSRC;

QFII/RQFII can participate in IPO of stocks, IPO of convertible bonds, private placement of stocks, and right issue of stocks.

(7) Options listed and traded on futures exchanges approved by State Council or the CSRC;

(8) Foreign exchange derivatives that the SAFE allows QFII/RQFII 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.

QFII/RQFII 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.

QFII/RQFII can invest in a privately raised investment fund whose investment scope conforms to the above.

### **3. Relaxing restrictions on PRC Custodians**

The licensing requirement of a PRC custodian is removed. Currently, a QFII can appoint only one PRC custodian, and an RQFII can appoint no more than three custodians. These limits are removed under the FI Measures.

### **4. Strengthening Beneficial Ownership Clarification**

The FI Measures mandate that beneficial ownership of assets in QFII/RQFII securities accounts must be identified clearly. The identities of beneficial owners (end investors) must be verified on a see-through basis.

### **5. Easing requirements on WFOE Private Funds Management (PFM) business**

Currently, the Asset Management Association of China (AMAC), who grants PFM licenses to WFOEs, requires a WFOE to launch its first private fund within six months after registering as a PFM in China. Under the FI Measures, QFII/RQFII may invest in private securities investment funds. Thus, a WFOE PFM may use funds sourced from QFII/RQFII to seed its PFM funds in China, easing the pressure of meeting AMAC's requirement to raise capital and launch the first fund within a short and rigid timeframe.

The FI Measures also provide that a QFII/RQFII can appoint its affiliated WFOE PFM as the

investment advisor for its investments in Chinese securities and futures. This could give a WFOE PFM an additional source of business revenue and allow the QFII/RQFII to leverage the investment capability of the local PFM affiliate.

## **Conclusion**

The FI Measures will harmonize the QFII and RQFII regimes, widen the investment scope of QFII and RQFII, and make it easier for foreign investors to trade in the China's capital market.

Irene Leung  
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## **endnotes**

[1] The FI Measures and CSRC Press Release (available in Chinese) are available at: [http://www.csrc.gov.cn/pub/zjhpublic/zjh/201901/t20190131\\_350601.htm](http://www.csrc.gov.cn/pub/zjhpublic/zjh/201901/t20190131_350601.htm) and [http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201901/t20190131\\_350598.html](http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201901/t20190131_350598.html)

[2] Source: LLinks Client Alert (1 February 2019).

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