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Update on Recent Rule Changes to the RQFII and QFII Schemes

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TO: ICI GLOBAL ASIA-PACIFIC CHAPTER No. 5-16
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 64-16
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 43-16
INTERNATIONAL COMMITTEE No. 50-16
INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 25-16 RE: UPDATE ON RECENT RULE CHANGES TO THE RQFII AND QFII SCHEMES

On 5 September 2016, the People's Bank of China (PBOC) and the China's State Administration of Foreign Exchange (SAFE) jointly announced several major changes to relax the rules governing the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme. These changes aim to further harmonize the policies for RQFII and QFII (Qualified Foreign Institutional Investor) schemes and provide better liquidity for funds invested into China, by streamlining the quota application process and reducing the lockup period of funds The changes to the RQFII rules, together with the relaxation changes to the QFII scheme announced earlier in February 2016, are the latest steps by the Chinese government to promote foreign investors participation into the China financial market.

In this memo, we will summarize the key differences and similarities in the rules and regulations governing the RQFII and QFII schemes and highlight the implications of these changes for foreign investors.

Background

The RQFII scheme was set up in 2011 to allow financial institutions to use offshore renminbi to buy securities in mainland China, including stocks, bonds and money market investments. At end of August 2016, the RQFII scheme had been extended to 17 countries and regions. A total of RMB 510.33 billion (US $76.4 billion) in total RQFII quotas has been awarded by SAFE to 170 license holders across 10 markets.[1]

The QFII scheme was first launched in 2002, to allow licensed foreign investors to buy and sell RMB-denominated “A” shares. Since then, there have been many changes to the QFII regime; including lowering the entry barriers for foreign institutions to qualify for the QFII regime, expanding the investment scope, and further relaxing quota administration and foreign exchange control. The latest changes to the QFII rules were announced in early

February 2016. As of 23 February 2016, 279 foreign institutions were approved as QFIIs, holding an aggregate QFII investment quota of US$80.8 billion.

The table below compares the key features between the RQFII and QFII schemes after the new changes:

RQFII [i
(new changes effective 5 September 2016)

QFII [ii
(new changes effective 5 February 2016)

Eligible Investors

- Institutional investors based in selected eligible locations
- Institutional investors that meet certain operation and AUM requirements

Investment Quotas

Neither RQFII or QFII license holders need to seek individual approval from SAFE for investment quotas under the following conditions:

- All RQFII license holders will receive an initial “base quota”, which is no greater than a certain proportion of the firm’s assets under management (AUM), after a simple registration with SAFE.
- If the majority of an institution’s AUM is *offshore*, such as foreign asset manager, then its base quota would be *US $100 million, plus 0.2% of its recent three-year average AUM, minus any quota under the QFII scheme it may have.*
- If the majority of an institution’s AUM is *onshore*, such as the overseas units of mainland fund houses, then the base quota would be *RMB $5 billion (US $750 million), plus 80% of its AUM in the previous year, minus any QFII quota*.

- All QFII license holders will be awarded an initial ”base quota”, which will be calculated based on the existing onshore or offshore AUM of a QFII or its group.
- The range of basic quota is *US $20 million to US $5 billion*. If the quota applied for is within the basic quota range, a firm can simply register its request with SAFE.

SAFE approval is required under the following condition:

- Quota being applied for exceeds the initial “base quota”
- Quota being applied for exceeds US $5 billion.

Note: sovereign wealth funds, central banks, and monetary authorities are not subject to the quota restriction.

RQFII
(new changes effective 5 September 2016)

QFII

(new changes effective 5 February 2016)

Open-Ended Funds

Others

Open-Ended Funds

Others

Lock-up Period

- No lock-up period
- Reduced from one year to **three months**, starting the date the funds remitted onshore reach RMB 100 million (US $14.98 million).
- Reduced from one year to **three months**, and commences on the day the accumulative remitted amount reaches US $20 million
- 1 year for all other funds

Capital Repatriation (after the expiry of the lock-up period)

- Daily basis
- Changed from monthly to **daily basis**
- Changed from weekly to **daily basis** provided that the monthly aggregate repatriation does not exceed 20% of its total onshore investment at the end of the preceding year
- Daily basis, provided that the total monthly repatriation (including capital and profit) does not exceed 20% of its total onshore investment at the end of the preceding year.

Deadline for Investment Proceeds to be Remitted

No deadline. However, any investment quota that is not used within one year of the relevant filing or approval may be revoked by the SAFE at its discretion.

Transfer or Selling of Quota

Not allowed. Both RQFIIs and QFIIs are strictly prohibited from transferring or selling any quota to other institutions or individuals.

Implications on foreign fund managers

The new changes to the RQFII scheme announced on 5 September will bring further alignment between the rules governing the RQFII and QFII schemes. These relaxation measures will streamline the quota approval process and ease the capital repatriation process associated with foreign investment into China. However, despite these changes, there are still certain issues associated with the RQFII and QFII schemes that investors should be aware of when investing in the Chinese market.

Firstly, under the current RQFII scheme, the country quota limit is still in place. For example, the existing RMB 270 billion (US $ 40 billion) RQFII quota for Hong Kong has been used up. As a result, even if a Hong Kong RQFII manager is eligible for more quota under the new rules, the asset manager cannot apply for more quota. It would have to find other ways to access additional quota. For global fund managers, one way to obtain additional quota is to use the quota of the fund's other domiciles that have been awarded RQFII quota, such as London, Luxembourg or Singapore. These regions have large RQFII quota that is still unused.

Secondly, the existing method used to calculate the base quota for AUM differs between a Chinese fund managers' offshore businesses and those of a foreign fund managers. For example, an offshore business of a Chinese fund manager can only use the AUM of its Hong Kong branch, and not the AUM of the Mainland parent, to calculate the base quota. A foreign fund manager, on the other hand, can use the group AUM to calculate its quota. If the Chinese managers were able use the AUM of their parent's assets to calculate the base quota, the difference between the quota granted to the Chinese and foreign fund managers would be very significant.

ICI Global welcomes the rule changes to the RQFII and QFII schemes. These changes give a positive signal that the Chinese government is continually making efforts to ease foreign investors' access into the China financial market. ICI Global will continue to follow the developments of the RQFII and QFII schemes and will keep our members informed of any changes to the schemes.

Please contact Qiumei Yang, CEO, ICI Global Asia Pacific at qiumei.yang@iciglobal.org or + 8522-168-0881.

Susan Olson
Chief Counsel - ICI Global

endnotes

[1] http://www.asianinvestor.net/News/429363,beijing-unveils-reforms-to-rqfii-quota-system.aspx

[i] The detailed RQFII rules (in Chinese version only) are available in the SAFE website below:

http://www.safe.gov.cn/wps/portal/!ut/p/c5/04_SB8K8xLLM9MSSzPy8xBz9CP0os3gPZxdnX293QwML7zALA09P02Bnr1BvI2c_E_1wkA6zeGd3Rw8Tcx8DAwsTdwMDTxMnfz8P50BDA09jiLwBDuBooO_nkZ-bql-QnZ3m6KioCACk6Xh-/dl3/d3/L2dJQSEvUUt3QS9ZQnZ3LzZfSENEQ01LRzEwODRJQzBJSUpRRUpKSDEySTI!/?WCM_GLOBAL_CONTEXT=/wps/wcm/connect/safe_web_store/safe_web/zcfg/zbxmwhgl/jwrzyyjzjgl/node_zcfg_zbxm_kjzwtz_store/066884804e1f9eb59398f3cdfa8ffa68

[ii] The detailed QFII rules (in Chinese version only) are available in the SAFE website below: http://www.safe.gov.cn/resources/wcmpages/wps/wcm/connect/safe_web_store/safe_web/zcfg/zbxmwhgl/jwrzyyjzjgl/node_zcfg_zbxm_kjzwtz_store/fd4a9a804b8ed99bbfb2ff196274af30/