QFII & RQFII REFRESHER
**QFII & RQFII REFRESHER: CURRENT STATE AND FUTURE DEVELOPMENTS - JANUARY 2020**

**BACKGROUND**

The ‘Qualified Foreign Institutional Investor’ (QFII) scheme was introduced in 2002 to provide qualified foreign institutional investors access to trade on Mainland stock exchanges via issuance of USD quota.

The RMB denominated ‘RMB Qualified Foreign Institutional Investor’ (RQFII) scheme followed in 2011. RQFII quota was initially provided to Hong Kong and subsequently expanded to nineteen other jurisdictions.

**CURRENT USAGE**

Use of the two schemes grew considerably from inception through to 2015. At this point, growth in the QFII scheme plateaued, while the RQFII scheme continued to grow.

Interest in the QFII scheme picked up again in 2019, with seven new QFII licenses issued in the first three quarters of the year, versus three for the same period in 2018.

As at September 2019 (SAFE data):

**QFII**
- 292 licenses
- US $111.4bn quota granted
- US $300bn quota cap*

**RQFII**
- 222 licenses
- RMB 693.3bn quota granted (US $99.4bn)
- RMB 1.99tn quota cap (US $285bn)*

* SAFE has announced the removal of quota restrictions on the QFII and RQFII schemes effective September 2019.

**QFII & RQFII Approved Quota vs Stock Connect Northbound Portfolio**

Source: SAFE, CCASS Sept 2019
KEY DEVELOPMENTS

The schemes were designed to allow certain types of investors’ access to China’s onshore market. This was achieved through setting barriers to entry in terms of qualitative and quantitative requirements, use of quota to limit the scale of investment and controls on capital repatriation. Over time, quota has been increased and some rules have been relaxed as outlined below:

KEY CONSIDERATIONS UNDER THE CURRENT FRAMEWORK

Qualification
Due to qualification requirements, the (R)QFII schemes are not available to:
- Financial institutions (FI)’s with a limited track record;
- FI’s with AUM under threshold (generally US $500m); and
- FI’s whose strategies do not meet with objectives of the schemes.

Set up
Commitment is required in terms of time and resources to:
- Set up onshore brokerage / custodian accounts;
- Obtain the necessary (R)QFII license from the China Securities Regulatory Commission (CSRC); and
- Register with the State Administration of Foreign Exchange (SAFE).

Capital commitment
- Ongoing requirement for pre-trade funding.

Capital repatriation
- A major area of concern for (R)QFII license holders. From June 2018, repatriation of capital and profits was no longer subject to lock-up periods or size limits, however SAFE continues to reserve the right to implement restrictions via macro-prudential supervision.

MAJOR RESTRUCTURE ANNOUNCED IN JANUARY 2019

A comprehensive set of changes to the (R)QFII schemes was proposed via the January 2019 consultation “Measures for the Administration of Domestic Securities and Futures Investment by QFIIs and RQFIIs”.

2002
- QFII launched – quota US $4bn

2005
- QFII quota increased to US $10bn

2006
- Relaxation of QFII rules and qualification requirements

2007
- QFII quota increased to US $30bn

2009
- FX rules relaxed to allow easier capital transfer

2011
- RQFII launched in Hong Kong – quota RMB 20bn

2012
- QFII quota increased to US $80bn
- RMB 80bn RQFII quota granted to the UK

2014
- RQFII quota increased to RMB 270bn for HK

2016
- RMB 250bn RQFII quota granted to the US
- Asset allocation restrictions removed

2017
- RQFII quota increased to RMB 500bn for HK

2018
- RMB 200bn RQFII quota granted to Japan
- Total QFII & RQFII quota increased to US $150bn & RMB 647bn
- Repatriation limits removed / lock-up period removed / FX hedging allowed

2019
- QFII quota doubled to US $200bn
- Announcement of removal of quota restrictions on both schemes
- Plans announced to merge the QFII & RQFII schemes
The proposals look to merge the two schemes into one ‘Qualified Investor’ (QI) program. Notably, the new QI scheme would provide:

- A streamlined application process;
- Increased product scope;
- Margin trading;
- Stock borrowing and lending (SBL); and
- Use of multiple custodians.

A comparison of the current framework and key proposals can be found in the table below.

<table>
<thead>
<tr>
<th>Area</th>
<th>Current state</th>
<th>Proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Framework</td>
<td>Separate QFII &amp; RQFII scheme</td>
<td>Creation of a unified Qualified Investor (QI) scheme</td>
</tr>
<tr>
<td>Application process</td>
<td>Separate QFII and RQFII license obtained from the CSRC then registration with SAFE Up to six months to complete</td>
<td>Single application submitted to the CSRC (decision within 20 days) Registration with SAFE (decision within 20 days)</td>
</tr>
<tr>
<td>Changes to license</td>
<td>Must re-apply in the event of: a change of business name; or an acquisition by, or merger with, other institution(s)</td>
<td>Ability to amend existing license</td>
</tr>
<tr>
<td>AUM requirement</td>
<td>AUM requirement (generally US $500 million)</td>
<td>No AUM requirement</td>
</tr>
<tr>
<td>Qualitative requirements</td>
<td>Financial stability, sound credit status, internal management systems, clean compliance record during the past three years</td>
<td>No change</td>
</tr>
<tr>
<td>Custodian</td>
<td>Limit on the number of custodians QFII limited to one, RQFII limited to three</td>
<td>To be removed</td>
</tr>
<tr>
<td>Investment Scope</td>
<td>Primary and secondary market trading of almost all exchange-listed or traded financial products: - A Shares - Warrants - ETF - Open/Closed-ended funds - Listed fixed income - Issuance bonds - FX derivative - STAR market</td>
<td>Investment scope expanded to also include: - Shares traded NEEQ - Depository receipts - Bond repos - Asset-backed securities - Approved inter-bank bond market products - CFFEX financial futures (for hedging purposes) - Commodity futures - Options - FX derivatives - Margin trading - Securities lending</td>
</tr>
</tbody>
</table>


**COMPLIMENTARY DEVELOPMENTS IN 2019**

Other relevant developments have been introduced to the market via a series of consultations and announcements during 2019, as outlined below.
May: Consultation on transfer of funds and bonds between the (R)QFII and China Interbank Bond Market (CIBM) Direct schemes

Under the proposed changes a Financial Institution (FI) may:
- Transfer CIBM bond holdings between the (R)QFII scheme and CIBM Direct scheme via a non-trade transfer.
- Transfer onshore funds between cash accounts opened under the (R)QFII scheme and CIBM Direct scheme.
- Submit one application for access to CIBM via (R)QFII scheme and the CIBM Direct scheme.

The proposals also provide guidance on regulatory reporting requirements for (R)QFII custodian banks and settlement agent banks with regards to non-trade transfer of bond holdings and onshore fund transfer.

September: Consultation on account structure changes needed to facilitate SBL

The China Securities Depository and Clearing Corporation Limited (CSDC) published a consultation explaining the account structure needed for FI’s to participate in SBL under the merged QI scheme.

The consultation explained the roles and requirements for FI’s, settlement participants and custodians.

September: Announcement of intent to remove QFII & RQFII quota

SAFE announced removal of quota restrictions for both the QFII and RQFII schemes, in order to further expand the opening up of the financial markets. FI’s will still be required to obtain a license from the CSRC and register with SAFE (via onshore custodian) in order to open onshore cash accounts and remit funds.

December: Consultation covering aspects of capital remittance

This consultation explained the new capital framework proposed upon merger of the two schemes and post quota removal.

Key aspects:
- **Registration**: establishes a unified approach to QFII and RQFII capital, including the types of account (Forex / RMB) which needs to be opened and how registration with SAFE should be undertaken.
- **Shortens holding time**: proposes removing the 30 day wait period between capital injection and ability to make investments.
- **Repatriation**: proposes removing a number of documentary requirements. These include the special audit report on investment proceeds and proof of tax payment or tax filing certificate. These requirements will be replaced with an ‘Undertaking Letter of Tax Clearance’.
- **Cross currency arbitrage**: inward remittance and repatriation to be in the same currency. No cross-currency arbitrage allowed.
- **Custodians**: limit on number of custodians removed.
- **Derivatives for hedging only**: reiterates that trading of derivatives is still for hedging purposes only (with a reasonable correlation) although notes that the monthly adjustment is no longer required.

**NEXT STEPS**

While intent to merge the QFII and RQFII schemes was announced via the January 2019 consultation, the merger is yet to come into effect and it is not known when this will happen. In addition to an announcement confirming the merger, further detail will be necessary in order to facilitate a number of the changes proposed, including aspects such as SBL and margin trading.
## APPENDIX – COMPARISON BETWEEN (R)QFII, QI AND STOCK CONNECT

<table>
<thead>
<tr>
<th></th>
<th>(R)QFII</th>
<th>PROPOSED QI SCHEME</th>
<th>STOCK CONNECT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Set up</strong></td>
<td>Application process: Apply to CSRC for license/permit, Register with SAFE</td>
<td>No further changes</td>
<td>None</td>
</tr>
<tr>
<td></td>
<td>Operational set up: Onboard with Mainland broker / custodian, FX &amp; RMB account with custodian &amp; securities account with CSDC</td>
<td>No further changes</td>
<td>SPSA via existing broker / custodian</td>
</tr>
<tr>
<td><strong>Pre trade</strong></td>
<td>Funding: Pre funding required</td>
<td>No further changes</td>
<td>Pre funding not required</td>
</tr>
</tbody>
</table>
| **Scope**     | Eligible products: Primary and secondary market trading of almost all exchange-listed or traded financial products:  
- A-Shares  
- Warrants  
- ETF  
- Open/Closed-ended funds  
- Listed fixed income  
- Issuance bonds  
- Bond collateral repo  
- FX derivative  
- STAR market | Further products to be added per consultation:  
- NEEQ  
- Bond repurchases  
- Private investment funds  
- Financial futures  
- Commodity futures  
- Options | Secondary trading of eligible stocks only                                |
<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Changes</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trading</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock Universe</td>
<td>All listed securities</td>
<td>No further changes</td>
<td>Stock Connect eligible securities, approx. 80% of market</td>
</tr>
<tr>
<td>Trading days</td>
<td>Aligned with Mainland market</td>
<td>No further changes</td>
<td>Subject to HK &amp; Mainland market &amp; banking holidays</td>
</tr>
<tr>
<td>Eligible investors</td>
<td>Foreign investors engaging in specific, limited strategies</td>
<td>Application criteria lowered</td>
<td>All foreign institutional investors</td>
</tr>
<tr>
<td><strong>Broker choice</strong></td>
<td>Maximum of three brokers with buy/sell through same broker</td>
<td>No further changes</td>
<td>Up to 20 different brokers</td>
</tr>
<tr>
<td>Omnibus trading</td>
<td>Not available</td>
<td>No further changes</td>
<td>Will be available via MasterSPSA</td>
</tr>
<tr>
<td>Quota</td>
<td>Removed</td>
<td>No further changes</td>
<td>Market wide quota of RMB 52 bn each for SSE and SZSE, total RMB 104 bn</td>
</tr>
<tr>
<td>Block trading</td>
<td>Available via block crossing window</td>
<td>No further changes</td>
<td>No allowed</td>
</tr>
<tr>
<td>Hedging</td>
<td>Derivative hedging (Mainland listed index futures) and FX hedging possible</td>
<td>No further changes</td>
<td>No derivatives or FX hedging available</td>
</tr>
<tr>
<td><strong>Post Trade</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax</td>
<td>Temporary CGT exemption</td>
<td>-</td>
<td>Temporary CGT exemption</td>
</tr>
<tr>
<td>Currency</td>
<td>Trade CNY, settle CNY via FX or onshore holding</td>
<td>No further changes</td>
<td>Trade CNY, settle CNH or HKD, USD against broker</td>
</tr>
<tr>
<td>(r)DVP settlement</td>
<td>Not available</td>
<td>No further changes</td>
<td>Yes</td>
</tr>
<tr>
<td>Custodian</td>
<td>Limit on the number of custodian's allowed QFII limited to 1</td>
<td>To be removed</td>
<td>No limit</td>
</tr>
<tr>
<td>Legal</td>
<td>Repatriation</td>
<td>Repatriation requirements (like tax certification) potentially eased</td>
<td>No restrictions</td>
</tr>
<tr>
<td>------------</td>
<td>------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>Repatriation theoretically daily, however this does not always align with investor experience</td>
<td></td>
<td>No restrictions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Basic law (UK)</td>
</tr>
<tr>
<td></td>
<td>Legal framework</td>
<td></td>
<td>Fund or fund manager level</td>
</tr>
<tr>
<td></td>
<td>Investor ID</td>
<td></td>
<td>No further changes</td>
</tr>
<tr>
<td></td>
<td>Onshore legal system</td>
<td></td>
<td>No further changes</td>
</tr>
<tr>
<td></td>
<td>Full transparency</td>
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</table>
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