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CSRC Proposes Relaxing Qualified Foreign Institutional Investor (QFII) Conditions

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On June 20, 2012, the China Securities Regulatory Commission (CSRC) announced that it had started public consultation on a series of proposed rule changes that will lower some of the thresholds and otherwise relax some conditions for non-Chinese investors to obtain a license to be a qualified foreign institutional investor ("QFII").[1] Under Chinese securities regulations and capital controls, non-Chinese firms and persons cannot invest directly in the Chinese securities markets – most notably the primary equity markets, those for China A Shares in Shanghai and Shenzhen – unless they have a QFII license. A QFII also must obtain a quota to purchase Renminbi from the State Administration of Foreign Exchange (SAFE) before it can invest in Chinese securities. The application process to obtain the license and quota is lengthy, detailed and involved, and the CSRC and SAFE administer the process in accordance with the policy objectives of the Chinese government. The proposed rules appear to be a manifestation of recent moves by the Chinese regulators to attract more foreign capital to the Chinese securities markets.

The proposed changes have completed the public consultation stage, and if they are adopted, several aspects of the QFII rules would be affected. These are summarized below:

First, the CSRC proposed lowering two key thresholds for QFII applicants:

- One of the requirements for a QFII applicant is that it must have five years of experience in asset management. The revised rule would lower this requirement from five years to two years. The proposed change would apply to applicants in certain industries, including asset management firms, insurance companies, and pension and sovereign funds.
- The assets-under-management requirement for a QFII applicant is US$5 billion or more. This threshold would be lowered to US$500 million. This proposed change also would apply to asset management firms, insurance companies, and pension and sovereign funds.

In addition, the CSRC proposed relaxing some of the operational requirements for QFIIs in making and managing investments, which are designed to enhance QFIIs' operational flexibility:

- The proposed rules would allow QFIIs to open separate securities accounts for self-owned assets and managed assets for clients; current rules restrict separate securities accounts.
- The proposed rules also would allow QFIIs to have three brokers in each stock market. Although under current rules QFIIs are allowed to use three brokers in each stock market, these rules have never been implemented.

[1] *Notice on Relevant Issues Regarding Implementation of the QFII Rules.* [http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201206/t20120620_211650.htm]

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The proposed rules would expand the scope of investment opportunities available to QFIIs:

- QFIIs are currently permitted to invest in the A Share markets and in stock index futures. The proposed rules would also allow QFIIs to invest in the interbank bond market.

The proposal would relax existing shareholding ownership limits:

- QFIIs in the aggregate are currently not permitted to own more than 20% of the shares of a Chinese company; under the proposed rules, this cap would be increased to 30%.

Finally, the proposal would take a first step in accelerating the lengthy approval process:

- Applicants would be permitted to file their applications electronically, simplifying the application process.

Conclusion:

As we note above, these proposed changes have completed the public consultation stage, and if adopted, they would represent incremental changes to the otherwise restrictive QFII regime. Nonetheless, they continue the recent initiatives by the Chinese regulators that are designed to encourage non-Chinese investment in the Chinese securities markets, a trend that could well continue given current conditions in the Chinese markets and economy. Please contact the authors or your K&L Gates lawyer if you have any questions about these changes or about the QFII program more generally.

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