Client Alert

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China - Securities Law

New SAFE Rules Clarify QFII Account Management

At the end of 2012, the State Administration of Foreign Exchange ("**SAFE**") issued the *Revised Foreign Exchange Rules for Securities Investment*, clarifying account management for qualified foreign institutional investors ("**QFII**"). The new rules make several amendments to the previous 2009 SAFE rules, including increasing the types of RMB accounts available to QFIIs, relaxing restrictions on fund repatriation, and eliminating the maximum quota for sovereign wealth funds, central banks and currency administration authorities.

BACKGROUND

The QFII program, introduced in 2002, underwent a second quota expansion last year and several further modifications. With the issuance of the China Securities Regulatory Commission's *Provisions for Implementing the Administrative Measures for Domestic Securities Investment by QFIIs* on 27 July 2012, QFII management restrictions were relaxed, eligibility requirements lowered, and the investment scope broadened[1].

However, SAFE last issued foreign exchange regulations in 2009 ("**2009 Rules**")[2], leaving many QFIIs to question the permitted types of fund accounts from a foreign exchange perspective and how to manage them. To clarify how to manage QFII accounts and ease fund repatriation, SAFE promulgated the *Revised Foreign Exchange Rules for Securities Investment in the PRC by QFIIs*[3] in December 2012 (the "**Revised Rules**").

[1] For more details regarding CSRC rules, please refer to our Client Alert from August 2012.
[2] *Provisions for Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors* (合格境外机构投资者境内证券投资外汇管理规定) (SAFE Announcement [2009] No. 1), issued by SAFE on 29 September 2009 and effective from the same day
[3] *Revised Foreign Exchange Rules for Securities Investment in the PRC by QFIIs* (关于修改《合格境外机构投资者境内证券投资外汇管理规定》的公告) (SAFE Announcement [2012] No. 2), issued 7 December 2012 and effective from the same day

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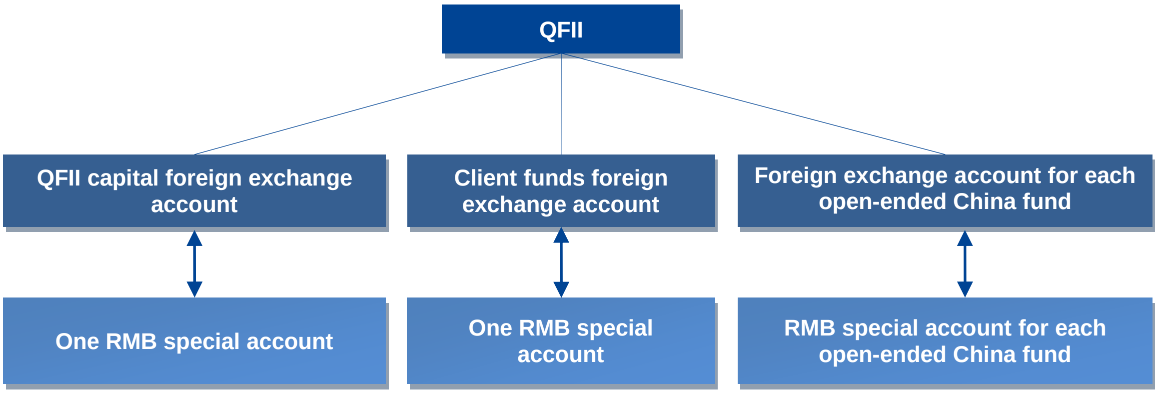
KEY FEATURES OF REVISED RULES

QFII Accounts

Under the 2009 Rules, QFIIs may open up to three foreign exchange accounts, namely an account for:

- The QFII's capital funds;
- The QFII's clients' funds; and
- Open-ended China funds.

The 2009 Rules linked each foreign exchange account to one RMB special account[4]. The following diagram illustrates the relationship between a QFII's foreign exchange accounts and RMB special accounts under the 2009 Rules:



While the 2009 Rules regulated the RMB special account regime, the Revised Rules introduce three new types of RMB accounts: one RMB basic deposit account and two types of RMB special deposit accounts.

RMB basic deposit accounts

The RMB basic deposit account is to be opened with a commercial bank in China. Generally speaking, the RMB basic deposit account should function as a "basic savings account" for foreign institutions[5] and cannot be used for securities trading. However, exactly how the RMB basic deposit account will serve QFIIs' RMB settlement network remains to be seen.

RMB special deposit accounts

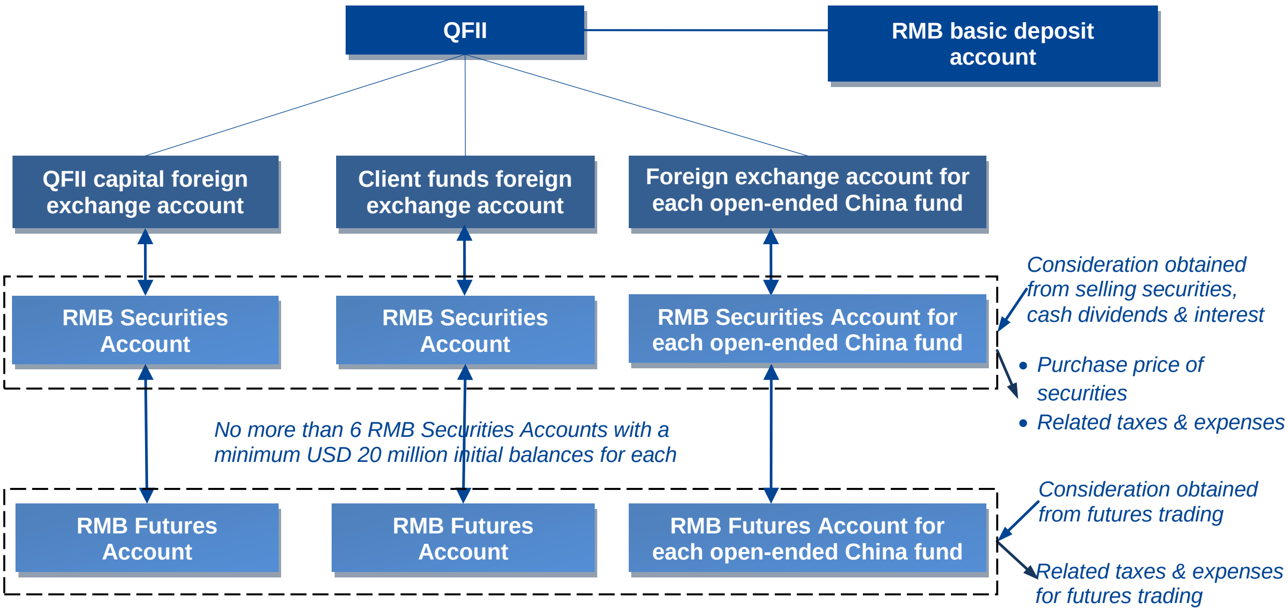
There are two types of RMB special deposit accounts:

- The RMB special deposit account for securities trading ("**RMB Securities Account**") is to be opened with a PRC custodian bank. QFIIs can open up to six RMB Securities Accounts to hold the funds of clients under their management, with a minimum initial balance of USD 20 million for each.
- The RMB special deposit account for futures trading ("**RMB Futures Account**") is linked to an RMB Securities Account; thus it cannot be opened if no RMB Securities Account has been opened. In addition, RMB Futures Accounts must be opened with the same bank where the futures margin is deposited (any one of five state-owned banks[6]). If its PRC custodian bank is the same as the futures margin custodian

[4] According to the 2009 Rules, a QFII may open two RMB special accounts corresponding to the foreign exchange accounts for its capital funds and client funds. A QFII establishing an open-ended China fund can also open an RMB special account for each fund.
[5] Detailed rules for the "basic savings account" for other foreign institutions are contained in the *Notice on Opening and Using RMB Bank Settlement Accounts for Foreign Institutions* (境外机构人民币银行结算账户开立和使用有关问题的通知) (Yin Fa [2012] No. 183), issued by the People's Bank of China on 26 July 2012 and effective from the same day.
[6] So far, only five state banks can be custodian banks for futures margins: the Industrial and Commercial Bank of China, Bank of Communication, China Construction Bank, Bank of China, and Agricultural Bank of China.

bank, a QFII can use its RMB Securities Account or RMB special account (opened under the 2009 Rules) as its RMB Futures Account without having to set up a separate RMB Futures Account.

The following diagram shows the relationship between a QFII's foreign exchange and RMB accounts and how funds flow between them under the Revised Rules:



So far, existing QFIIs are not required to open these new accounts; instead, they have the option of implementing the Revised Rules through the following methods:

- Close their existing RMB special accounts (opened under 2009 Rules) and apply to open an RMB basic deposit account, RMB Securities Account and/or RMB Futures Account corresponding to its foreign exchange accounts. QFIIs may transfer their current funds to their new accounts once they are set up; or
- Apply to transfer only their current RMB special account for client funds to up to six RMB Securities Accounts before 6 May 2013 and keep their other existing RMB special accounts. Once approved, they must transfer the balance within three months. However, there are no detailed criteria for obtaining approval to open the RMB Securities Account.

Fund Repatriation

The Revised Rules set forth the basic rules for QFIIs to repatriate funds overseas from China. QFIIs may only repatriate funds after the lock-up period has expired[7]. The maximum amount that a QFII may repatriate out of China per month cannot exceed 20% of its total onshore assets at the end of the previous year. The Revised Rules do relax other repatriation restrictions, especially for open-ended Chinese funds. The table below compares repatriation regimes under the 2009 Rules and Revised Rules:

[7] Articles 16 and 17 of the 2009 Rules

	Open-Ended China Funds		Other QFIIs	
	Revised SAFE Rules	**2009 Rules**	**Revised SAFE Rules**	**2009 Rules**
Frequency of repatriation	Funds may be repatriated into/out of China weekly according to the subscription/redemption amount.	Monthly	Monthly	Yearly[8]
Approval	The custodian bank may decide by itself; no SAFE approval needed for repatriation.	SAFE approval required for repatriation of more than USD 50 million.	SAFE approval required for repatriation of principal; not required for repatriation of earnings.	SAFE approval required for any repatriation of funds
Restrictions	Maximum amount repatriated out of China per month cannot exceed 20% of the QFII's total onshore assets as of the end of the previous year.	N/A	Maximum amount repatriated out of China per month cannot exceed 20% of the QFII's total onshore assets as of the end of the previous year.	N/A

Quota Expansion

Under the Revised Rules, a QFII that is a sovereign wealth fund, central bank or currency administration authority is no longer subject to the quota restriction of USD 1 billion.

Greater flexibility in QFII account management but uncertainties remain

The Revised Rules allow QFIIs to open an RMB basic deposit account and two new types of RMB special deposit accounts, including up to six RMB Securities Accounts, to house their clients' funds. However, such new accounts are not mandatory, so QFIIs may assess how best to manage their accounts according to their actual needs.

The Revised Rules also provide for an RMB special deposit account for a QFII's potential cash flow from futures trading. Before the Revised Rules, it was very difficult in practice for QFIIs to open an account with futures margin custodian banks to conduct futures trading because rules for opening and managing such accounts were lacking. The Revised Rules now provide for a specific RMB Futures Account available for futures trading, though concrete operational guidance is still needed.

GLN will closely follow any further developments related to the QFII scheme. Meanwhile please contact us should you have any questions regarding the QFII program or other securities laws in China.

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[8] According to the *Answers to Technical Questions regarding the Provisions for Foreign Exchange Administration of Domestic Securities Investment by QFIIs and Overseas Securities Investment by Fund Management Companies and Securities Companies* (关于《合格境外机构投资者境内证券投资外汇管理规定》及《国家外汇管理局关于基金管理公司和证券公司境外证券投资外汇管理有关问题的通知》有关技术性问题的解答) published by SAFE on 26 August 2011

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