Investing in China - the RQFII Regime and Irish funds

The revision and extension of China's Renminbi Qualified Foreign Institutional Investor scheme present a significant opportunity for investors to use Irish domiciled funds to gain direct exposure to Chinese mainland securites write A&L Goodbody's ELAINE KEANE and SHANE HICKEY. They look the Irish funds structures suited to investing in Chinese securities through the regime.

The Enhanced RQFII Regime

Initially launched on 16 December 2011, the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme facilitates investment in the mainland Chinese securities markets by investors holding a China Securities Regulatory Commission (CSRC) issued RQFII license, within an allocated State Administration of Foreign Exchange (SAFE) approved RMB investment quota.

The scheme was revised and extended in March 2013 following the joint promulgation by the CSRC, SAFE and the People's Bank of China (PBOC) of the Pilot Measures for Onshore Securities Investment by RMB Qualified Foreign Institutional Investors and the issuance of associated implementing rules (the Pilot Measures).

As discussed below, the revisions introduced by the Pilot Measures, and particularly the ability for RQFIIs to raise RMB funds offshore, present a significant opportunity for RQFIIs to establish and manage Irish domiciled funds that can gain direct exposure to the Chinese mainland securities markets through utilisation of the license holder's RQFII quota.

Separately, the CSRC announced on 12 July 2013 that the RQFII scheme would be extended to Singapore and London in another positive development that will provide further opportunities for overseas investors seeking to gain direct exposure to mainland Chinese markets.

Eligibility for RQFII Licenses

Whereas RQFII licenses were initially only available to Hong Kong subsidiaries of (i) fund management; and (ii) securities companies incorporated in the Chinese mainland, the Pilot Measures have extended the scope of eligible applicants to include the Hong Kong subsidiaries of Chinese commercial banks and insurance companies, as well as financial institutions who maintain their place of registration and principal place of business in Hong Kong.

Significantly, whilst the original RQFII scheme required RMB funds to be raised in Hong Kong, the Pilot Measures allow RMB funds to be raised offshore.

Investment Restrictions

Previously, investments in stocks and equity funds were limited to no more than 20 per cent of an RQFII's funds, with the remaining 80 per cent required to be comprised of fixed income securities. Under the Pilot Measures however RQFII's may now invest freely, subject to their investment quota, in:

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1. Stocks, bonds and warrants tradable / transferrable on stock exchanges;
2. Fixed-income products traded on the interbank bond market;
3. Securities investment funds;
4. Stock index futures; and
5. Other financial instruments permitted by the CSRC.

Investment in the shares of listed companies in mainland China is still however subject to restrictions on foreign ownership, and the percentage ownership an overseas investor may acquire in a listed company is limited to not more than:

- 10 per cent of the total number of shares for any single offshore investor; and
- 30 per cent of the total number of A shares, held in aggregate by all offshore investors.

Remittance and Repatriation of Funds

RQFIIs are required to entrust (i) Chinese mainland securities companies with securities trading, and (ii) a Chinese mainland commercial bank with asset custody. Its mainland custodian must be qualified as a custodian under the separate Qualified Foreign Institutional Investor (QFII) Scheme, and in addition to its asset custody role, is also required to compile and report various statistics to the Chinese authorities.

Remittances are made into mainland China by an RQFII via its appointed onshore custodian, and must be made in RMB. Repatriations of the investment principal and profits out of China can be made in either RMB or foreign currencies.

Significantly, open ended funds enjoy daily liquidity, based on the net of subscription and redemption proceeds. Open ended funds are categorised as funds with variable capital that allow subscription / redemption in accordance with the fund's rules. Funds other than open ended funds are subject to monthly liquidity and to a one year lock up period.

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Utilising Irish Investment Funds

Once the use of Irish domiciled collective investment schemes has been approved by the CSRC as part of their initial RQFII application, the Pilot Measures open up numerous possibilities for asset managers wishing to use such schemes to raise funds offshore.

Lock up and liquidity issues presented a challenge for those wishing to structure UCITS funds under the separate QFII scheme.

The absence of a lock up period for open ended funds, coupled with daily liquidity, make the expanded RQFII scheme very attractive to asset managers who wish to obtain direct exposure to the Chinese mainland markets via a UCITS compliant fund.

Depending on the proposed investment strategy, Irish Alternative Investment Fund Manager Directive (AIFMD) compliant funds structures, such as the retail investor alternative investment fund (RIAIF) or qualifying investor alternative investment fund (QIAIF) may be preferred. Of these, the QIAIF is targeted at sophisticated investors, with a minimum subscription requirement of €100,000 per investor, but is also the most flexible investment structure as many of the restrictions (for example, regarding investment restrictions and leverage) that apply to retail funds are dis-applied in the case of QIAIFs.

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