Foreign Institutional Investment in China

An Asset Management Perspective

March 2019

ASIFMA is an independent, regional trade association with over 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side including banks, asset managers, accounting and law firms, and market infrastructure service providers. Together, **we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia.** ASIFMA advocates stable, innovative and competitive Asian capital markets that are necessary to support the region's economic growth. We **drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice.** Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the U.S. and AFME in Europe, ASIFMA also provides insights on **global best practices and standards to benefit the region.**

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ASIFMA would like to extend its gratitude to all of the individuals and member firms who contributed to the preparation of this Paper

A. Introduction

In March 2017 **ASIFMA** published a paper titled China's Capital Markets *Navigating the Road Ahead* (the "**2017 Paper**")[1] which was widely read and commended by industry participants and regulators alike for its detailed coverage and analysis of China's capital markets and its development. The 2017 Paper covered the opening of the equities, fixed income, foreign exchange, derivatives and repo markets to foreign institutional investors ("**FIIs**"), new access channels such as Stock Connect, CIBM Direct and Bond Connect, and enhancements suggested to be made to the Chinese domestic market infrastructure.

The 2017 Paper was supplemented in March 2018[2] to reflect the many changes that occurred in just twelve months. Another updated version of the 2017 Paper will be published later this year. In the meantime, ASIFMA's Asset Management Group ("**AAMG**"), which comprises some of the world's largest investment managers, is issuing this Paper to highlight a number of challenges foreign investment managers face when investing and/or operating in China and to suggest improvements that would attract more foreign institutional investment into China's capital markets.

Aim of this Paper

AAMG, which was established in 2014 as a separate division of ASIFMA to represent investment managers in Asia, decided to publish this Paper to help improve foreign investment managers' understanding of the China market and to help Chinese policymakers and regulators understand the commercial, operational and legal challenges they face when investing and/or operating in China.

Tremendous progress has already been made to open and broaden China's capital markets. AAMG hopes that the issues and concerns of FIIs identified in this Paper can receive the relevant level of attention across different regulators and get addressed in ways that would facilitate further investment in China, whether through investments into China A shares and bonds, or through managing funds in China or providing investment management and/or advisory services in China.

Organisation of this Paper

This Paper is organized with an Executive Summary followed by a summary of the developments and progress made in the China capital markets since 2017 and details of the main concerns, issues and challenges faced by foreign investment managers when they (i) invest in China's equities and debt markets through the various access channels, (ii) operate in China, and (iii) raise funds in China for investment offshore.

The issues and challenges mentioned in this Paper are by no means exhaustive. It is our hope that this Paper will lead to more active engagement with foreign investment managers and policymakers through associations such as ASIFMA so that we can all work towards the deepening and broadening of China's capital markets which is a core mission of our association.

Finally, for ease of distinction between onshore and offshore, references to "China" and "Mainland" in this Paper refer to the onshore markets and do not include Hong Kong.

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[1] China's Capital Markets: Navigating the Road Ahead. ASIFMA. March 2017. https://www.asifma.org/wp-content/uploads/2018/07/china-capital-markets-final-english-version.pdf

[2] China's Capital Markets Continuing to Navigate the Road Ahead. ASIFMA. March 2018. https://www.asifma.org/wp-content/uploads/2018/06/chinas-capital-markets-continuing-to-navigate-the-road-ahead.pdf

B. Executive Summary

Below is a summary of our recommendations on policies, regulations and actions that would make it easier and more attractive for FIIs, especially foreign investment managers, to invest in China's capital markets and to set up operations in China.

Foremost among them are (a) certainty and clarity in policies, rules and regulations, especially in regards to repatriation, tax treatment and level playing field, through publication and not verbal communication (e.g. "window guidance"), (b) simplification, alignment and eventual convergence of the different access channels to the most flexible one, (c) harmonization of trading and settlement processes for debt and equities with international standards, and (d) unified rules for the asset management industry in China, across different asset management entities and between foreign and domestic owned entities.

General principles

Certainty in policies and regulations is foremost among what FIIs want to see from China as they have the option to invest in many other markets around the world and also a duty to manage risk and minimize cost to their stakeholders such as underlying investors and clients.

Foreign investors would like greater **transparency, clarity and consistency** in China's policy and regulations across securities trading and the entire asset and wealth management industry and among different regulators and authorities. They want to see the frequent practice of "window guidance" replaced with written circulars that are publicly available to all.

FIIs also want to see more **engagement with the investment community**, both domestic and foreign, by Chinese regulators while policies and regulations are being formulated and developed. In addition, providing **sufficient notice and time** for the industry to comment on proposed rules and regulations can smooth the implementation of regulations and minimize the need for further clarifications and/or amendments. Well thought through policies, rules and regulations that take into account industry practices and global regulations and international standards would go a long way to attracting foreign investors to China's capital markets.

Unrestricted and prompt repatriation is another important consideration in FIIs' decision to invest in any market, particularly for those investment managers who manage retail funds and client mandates that must be able to promptly meet unitholders' redemptions and client withdrawals. The 20% cap on monthly repatriations by Qualified Foreign Institutional Investors ("**QFIIs**") had always been an issue with FIIs until its removal in June 2018. And, it was only after the introduction of the Mainland-Hong Kong Stock Connect ("**Stock Connect**") which has no restrictions on outbound remittances or repatriations that MSCI decided to include China A shares in its global indices. We would like to ask for simplification of the tax clearing process for repatriation of proceeds by QFIIs and Renminbi Qualified Foreign Institutional Investors ("**RQFIIs**") and for the authorities to refrain from giving window guidance on the amount and timing of repatriation under all access channels.

FIIs, particularly investment managers, need **certainty on tax treatment** as it affects not only their decision to invest in China but also whether or not to set up operations in China. While FIIs welcome recent announcements of tax exemptions for foreign investors, there are still many questions that remain unanswered and clarification by the State Administration of Tax (“**SAT**”) would be appreciated.

Access channels

Foreign investors are often confused by the multitude of channels or schemes to access China’s equities or debt markets, each with slightly different conditions or requirements. While we understand that China is gradually opening its markets through these channels, foreign investors welcome the **simplification and alignment of rules and regulations of the different access schemes** to the most flexible one and the eventual merger of all the schemes. Foreign investors would also like to be able to consolidate their positions in one scheme and to transfer easily from one scheme to another to reduce duplication, minimize operational risks, achieve cost efficiencies and optimize returns for investors.

Simplification of qualification and quota requirements for an access scheme, such as granting qualification and quota at the group or parent company level that can be used by any member of the group, looking at the assets under management (“**AUM**”) of the whole group instead of an individual entity for certain eligibility purposes and replacing the approval process with a registration process, would all be welcomed by FIIs. **Fungibility or removal of quotas** entirely would make access easier for foreign investors and bring more inflows into China’s capital markets.

FIIs look forward to further **expansion of the investment scope and permissible activities** under all the different schemes. FIIs applaud and welcome the proposed expansion of the investment scope of QFII/RQFIIs and look forward to the same for the other access schemes.

Investment efficiency

China’s trading and settlement system, while arguably more advanced by comparison than many developed countries/jurisdictions, is unique and poses a lot of challenges for foreign investors because they need to adapt or work around their global trading practices in order to trade in China. **Harmonization of China’s trading and settlement processes** for equities and debt and across the different access schemes and as much as possible with international standards would facilitate greater foreign investment in China’s capital markets.

Permitting FIIs to **use multiple counterparties**, such as brokers, foreign exchange (“**FX**”) settlement banks and custodians, across equity, debt and FX investment or trading would assure those who are subject to best execution obligations (typically foreign investment managers) that they can meet those obligations.

Access to onshore hedging instruments is another important consideration for foreign investors. On the equities side, FIIs participating in Stock Connect would like to be able to trade index futures, which are allowed to QFIIs/RQFIIs. On the debt side, FIIs would like access to bond futures. For those FIIs participating in the Mainland-Hong Kong Bond Connect (“**Bond Connect**”), they would like to be able to engage in bond repos, bond borrowing and lending, bond forwards, interest rate swaps and forward rate agreements that FIIs investing through direct access to the China Interbank Bond Market (“**CIBM Direct**”) are able to do. All the instruments mentioned above are important hedging and risk management tools for FIIs.

Equities

For equities investing, many markets around the world have been converging to a **delivery against payment** ("**DvP**") **settlement cycle** of two days ("**T+2**") after the trade date ("**T**") which allows investors globally to simplify and standardize their operational processes and easily shift investments from one market to another. China's alignment of its current equities settlement cycle (T for shares and one day after the trade date ("**T+1**") for cash) with this global trend would attract more foreign investors to China's markets.

We understand that China's move to a T+2 settlement cycle for equities may take some time. Therefore, in the short term, moving to T+1 DvP for onshore equities trading would greatly help those FIIs or their custodians. It would also be helpful to implement a workable **securities borrowing and lending** ("**SBL**") regime (with not only brokers but their affiliates, asset owners and their lending agents being allowed to engage in SBL) that would help tie FIIs over the current tight settlement timeframe and minimize the possibility of failed settlement.

For global investment managers who manage a large number of funds and/or client mandates, the ability to do **omnibus trading**, i.e. place a single order on behalf of multiple funds and/or client accounts, is important because it is more efficient from both a time and cost perspective. More important, they can ensure that their underlying funds and/or clients are all getting the same average price as most of them are required by law in their respective jurisdictions to treat all their clients fairly.

In addition to the foregoing, adopting international standards with respect to **block trading**, **short selling**, **margin financing**, **derivatives documentation**, **disclosure of interest** and **short swing profits** are some of the other areas that FIIs would like to see China move towards for equities investment and trading.

Last but not least, it is important that the **acting in concert** rules for purposes of shareholding disclosure, short swing profit rule and foreign ownership limit not be applied to investment managers. Otherwise, the threshold triggering these requirements will easily be reached, unfairly impacting the underlying funds and clients which have no connection with each other but for the fact that they are managed by the same investment manager.

Debt

To invest in the China bond markets, FIIs can either convert FX into onshore RMB ("**CNY**") or use offshore RMB ("**CNH**"). **Access to CNY** through FIIs' global custodians is preferred due to basis risk arising from using CNH and the ability to access more stable rates from the greater liquidity of CNY. As of January 2019, there are only 22 FX settlement agent banks approved under the Bond Connect[3] and they do not include some of the global custodians used by many global fund managers. Expanding the list of approved FX settlement agent banks to include more of the global custodians and/or their affiliates would be helpful. The ability of FIIs to use multiple FX settlement banks is also important for foreign investment managers who have to meet best execution obligations.

[3] Source: CFETS. Under section "RMB/FX Market Members", Bond Connect' Hong Kong SAR Settlement Banks. http://www.chinamoney.com.cn/english/mdtmmbfmm/

Ultimately, FIIs would like to see a **convergence of the CNY and CNH markets** as the current requirements to track purchases funded through CNY versus CNH under the Bond Connect (especially since there is no standard coding distinguishing the two) and rules on maintaining the ratio of FX to RMB on inflows and outflows under the CIBM Direct and Bond Connect create a lot of operational challenges for FIIs, their custodians and FX settlement banks.

The **billing of bond trading fees** under Bond Connect is currently a major issue for many foreign investment managers. Although Bond Connect is designed to connect China's bond trading and settlement platforms with those used globally by FIIs, there are still a lot of differences between how bonds are traded globally and how they are traded in China. For example, the global norm is that the relevant fees and charges are built into the bond price rather than charged to the investment managers. Under Bond Connect, the fees and charges are billed to the trading platform which then passes those costs to the investment manager on a monthly basis. This means that investment managers will have to spend time and resources to explain and allocate those costs to their funds and/or clients which are not used to paying such fees and charges separately.

FIIs would like, in the short term, to see the fees and charges under Bond Connect charged, on a trade-by-trade basis, to the custodian for the underlying fund or client account. In the long run, they would like to see the fees and charges related to bond trading in China built into the bond price.

Clarification of tax exemptions on interest income derived by FIIs on onshore China bonds prior to 7 November 2018 is also urgently needed. If these taxes apply to FIIs before this date, it would be difficult if not impossible for FIIs to pay or collect such taxes given the lack of an effective withholding mechanism and the difficulty with retroactive collection of such taxes from the underlying funds and clients.

Improving **liquidity of China's bond market**, in the long run, will help to attract more foreign investors into this market. Allowing a more diverse group of investors with different investment strategies and horizons into China's bond markets, promoting the growth of the repo market by allowing outright repos and not just pledged repos, reducing the number of new bond issuances, allowing more re-tapping by existing bonds and introducing buy-back mechanisms and exchange programs are some of the ways to improve liquidity in the bond market.

Operating in China

Foreign investors often feel that they are treated differently from domestic investors or players and would like to see a **level playing field in China**. For example, while a wholly foreign-owned ("**WFOE**") private fund management company ("**PFM**") is not allowed to launch funds with an overseas exposure (e.g. invest through the southbound link of Stock Connect), domestic owned PFMs are not subject to the same restriction. Instead of the same rules being applied equally to foreign and domestic owned entities, foreign invested firms operating in China are often told verbally (i.e. window guidance) that they are not allowed to do something that domestic owned firms are allowed to do. It is very important for the rules to be clearly written and applied equally to both foreign and domestic owned firms.

The multitude of asset and wealth management entities in China and what each of them are allowed or not allowed to do is most confusing not only for the asset management industry as a whole but also for the end investors of their products. Requiring foreign investment managers to set up separate entities to engage in different asset management businesses or activities is costly and not an efficient use of resources. Foreign investment managers would like to be able to set up in China a **single entity with multiple licenses** for different lines of business that they can acquire over time so as to achieve economies of scale, reduce duplication of personnel, minimize compliance costs and enhance operational efficiencies. As this is the model for securities companies in China, we see no reason why China should not move towards the single entity multiple licences model for the asset management industry.

Having **unified rules over the asset management industry**, ideally based on the type of products and activities involved and not on the type of entity, would reduce the current complexity and confusion over which asset management regulations apply and improve the fragmented nature of the asset management industry in China. In the short term, clarification of the questions and inconsistencies in regulations that have arisen would be helpful.

Localization requirements on personnel, track record and systems prevent foreign firms from **leveraging group resources**. Allowing them to bring in global investment expertise, operational efficiencies, and best practices and standards on compliance and internal processes will help to **internationalize China's markets** and better prepare Chinese investment management companies that plan to expand their business globally.

Chinese regulations on cross-border data flows should take into account foreign investors' need for **connectivity with global trading and operating platforms,** and data privacy and cybersecurity concerns should be balanced against the efficiency of operating models that are built on the basis of seamless data flows.

Private fund management

Many foreign investment managers are taking advantage of the ability to set up PFM WFOEs to enter China's securities investment funds market. As start-ups with no track record in a new market, many of these PFM WFOEs face the immediate challenge of finding investors for their funds and generating enough revenue to sustain their business in the long run.

Allowing QFII/RQFIIs to invest in the funds of PFM WFOEs as set out in CSRC's consultation drafts of the new regulations on QFIIs and RQFIIs issued on 31 January 2019 (the "**Proposed New QFII/RQFII Measures**")[4] is a much-appreciated solution to the seeding problem. Permitting long-term funds, such as insurance funds, social security funds, pension funds and enterprise annuities, to invest in private securities investment funds would greatly **expand the investor base for PFM WFOEs.**

The recently issued *Guiding Opinions regulating Financial Institutions' Asset Management Businesses*[5] *by People's Bank of China ("**PBOC**") , China Securities Regulatory Commission ("**CSRC**") , China Banking and Insurance Regulatory Commission ("**CBIRC**") and State Administration of Foreign Exchange ("**SAFE**") on 27 April 2018* (the "**Guiding Opinions**") and the implementation measures issued by the

[4] Proposed new QFII/RQFII Measures. Article 6 of the Provisions on Issues Concerning the Implementation of the Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Consultation Paper). http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/201901/t20190131_350613.html

[5] Guiding Opinions regulating Financial Institutions' Asset Management Businesses. PBOC, CSRC, CBIRC and SAFE. 27 April 2018. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3529600/index.html

various regulators thereafter have effectively made it difficult if not impossible for PFM WFOEs to access the savings pool in the commercial banks. **Removing restrictions on investments in PFM products** by wealth management products ("**WMPs**") of commercial banks and their wealth management subsidiaries ("**Bank WM Subsidiaries**") and asset management products ("**AMPs**") of securities companies, FMCs, futures companies and their subsidiaries (collectively "**Securities and futures operators**") is critical as PFM WFOEs rely heavily on commercial banks and securities and futures operators to distribute their products.

We welcome the CSRC's proposal under the Proposed New QFII/RQFII Measures to allow PFM WFOEs to **provide investment advisory services** to their QFII/RQFII affiliate. PFM WFOEs would like this to be extended to non-affiliated QFII/RQFIIs as well as domestic institutional investors (and not just WMPs, AMPs and private funds) in the not too distant future.

Public fund management

For many global investment managers, the establishment of a PFM WFOE is just the beginning of their entry into the China market where at some point they may wish to set up a public fund management company ("**FMC**") to launch retail funds in China. Clarification of the rules for the **transition from PFM to FMC** is something that many foreign investment managers look forward to.

As the foreign ownership limit in FMCs has been increased to 51% and will be removed entirely in 2021[6], foreign investors would like to have a clear roadmap on the **transition to majority and wholly owned** interests in an FMC.

Fundraising in China for overseas investment

The Qualified Domestic Institutional Investor ("**QDII**")**, Qualified Domestic Limited Partnership ("QDLP") and Qualified Domestic Institutional Enterprise ('QDIE**") schemes provide an effective channel for Chinese investors, both retail and institutional, to access overseas markets and diversify their investments and risks. They have also provided a good platform for QDII, QDLP and QDIE quota owners to become familiar with offshore investing and for foreign investment managers to build up their brand and reputation in China.

Foreign investment managers would like greater transparency on the **approval requirements for QDLP and QDIE managers** by the Shanghai and Shenzhen authorities. And although SAFE announced on 24 April 2018 that the QDLP and QDIE quotas have been increased to USD 5 billion each[7], FIIs would like greater transparency on the **granting of such quota**. Publishing a schedule on the future **release of quota** will help existing QDLP/QDIE managers better plan their product launches and cooperation with QDII quota holders.

The Mainland-Hong Kong Mutual Recognition of Funds ("**MRF")** scheme is another effective channel for retail investors in China to access overseas markets and diversify their investments and risks. Many in the overseas fund industry are disappointed by the disproportionately low number (17 as of end of

[6] PBOC Governor Yi Gang's announcement on 11 April 2018. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3517821/index.html
[7] SAFE announcement on increasing QDLP and QDIE quotas. 24 April 2018. http://www.safe.gov.cn/safe/2018/0424/8875.html

2018[8]) of Hong Kong funds approved by the CSRC to the much higher number (50 as of end of 2018[9]) of Mainland funds approved by the Hong Kong Securities & Futures Commission ("**SFC**") since the launch of the MRF in May 2015. While China's concern with capital outflows over the past few years may have contributed to the small number of northbound funds approved by the CSRC, we believe **two-way capital flows is beneficial** to China and its investors.

While we understand the reciprocal nature of the MRF scheme, such as requiring at least 50% of the assets of a fund to be raised in its home jurisdiction[10], the undeniable fact is that the Mainland market is so much larger than Hong Kong's and it would be almost impossible for Hong Kong domiciled funds to increase their AUM in Hong Kong to match the potential in the Mainland.

Unless there is a **relaxation of the 50% home jurisdiction AUM rule** for northbound funds, not many foreign investment managers will set up funds in Hong Kong to take advantage of the MRF. This would also limit the opportunity for Mainland investors to benefit from diversification of their investments overseas.

[8] Source: CSRC. http://www.csrc.gov.cn/pub/zjhpublic/
[9] Source: SFC. https://www.sfc.hk/productlistWeb/searchProduct/UTMF.do
[10] Interim Provisions on Administration of Recognized Hong Kong Funds. CSRC. 14 May 2015. http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201505/P020150522552573901196.pdf

C. Progress since 2017

Since the publication of the 2017 Paper, China has further opened up its capital markets, implementing many of the suggestions made in that paper. Below are some of the progress made that are welcomed by FIIs.

Lifting of foreign ownership limits

In November 2017 the State Council announced that foreign ownership limits for banks and financial asset management companies would be removed and that the foreign ownership limit for securities companies, fund management companies and futures companies would be increased to 51% and removed entirely after three years[11]. In April 2018, PBOC confirmed that foregoing also applies to life insurance companies[12].

Before 2018, Hang Seng Qianhai Fund Management Company ("**HSQH FMC**") was the only majority foreign-owned (70%) fund management joint venture ("**JV**") in China as it was established in 2016 under the Mainland and Hong Kong Closer Economic Partnership Arrangement ("**CEPA**") which provides for majority ownership of fund management companies by Hong Kong entities. In April 2018, the CSRC confirmed that foreign investors (from jurisdictions beyond Hong Kong) could apply for 51% ownership of fund management companies in China[13]. It has been reported in the press that several foreign asset managers are currently trying to increase their stake in their existing fund management JV or are in the process of establishing a majority-owned fund management JV.

Even before the State Council's announcement in November 2017, wholly foreign-owned private investment management entities have been allowed to be established and registered with the Asset Management Association of China ("**AMAC**")[14]. The number of PFM WFOEs registered with AMAC have increased from only one in January 2017 to 16 as of the end of 2018; 14 of these PFM WFOEs issued 25 private funds as of the end of 2018[15].

Increase in investment quotas

In July 2017 the quota for RQFIIs based in Hong Kong was increased from RMB 270 billion to RMB 500 billion[16]. In January 2019, the total quota for QFIIs was doubled from USD 150 billion to USD 300 billion[17].

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[11] State Council announcement. 10 November 2017. http://appbriefing.scio.gov.cn/data/gxbimg/gxbwap/2017/11/10/cms_2433509307089920.html

[12] PBOC Governor Yi Gang's announcement on 11 April 2018. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3517821/index.html

[13] Q&A by CSRC spokesperson on Administrative Measures for Foreign-Invested Securities Companies, 28 April 2018. http://www.csrc.gov.cn/pub/csrc_en/newsfacts/PressConference/201804/t20180429_337512.html

[14] Q&A No. 10 on the Relevant Questions Regarding the Registration and Filing of Private Funds. AMAC. 30 June 2016. http://www.amac.org.cn/xhdt/zxdt/390744.shtml

[15] Source: AMAC. http://gs.amac.org.cn/amac-infodisc/res/pof/manager/index.html

[16] PBOC announcement on increasing Hong Kong's RQFII quota to RMB 500 billion. 4 July 2017. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3338499/index.html

[17] SAFE announcement on doubling total QFII quota to USD 300 billion. 14 January 2019. http://www.safe.gov.cn/safe/2019/0114/11177.html

In 2018, after a three-year hiatus, the approval process for QDLPs in Shanghai restarted with 15 QDLPs registering with AMAC that year alone[18]. In April 2018, SAFE increased the quota for QDLPs and QDIEs in Shenzhen to USD 5 billion each[19] from USD 2 billion for QDLPs and USD 2.5 billion for QDIEs set a few years ago.

In May 2018, CSRC also quadrupled the daily quota for both the northbound (from RMB 13 billion to RMB 52 billion) and southbound (from RMB 10.5 billion to RMB 42 billion) Stock Connect[20] in anticipation of MSCI's A share inclusion into its indices in May and August 2018.

Removal of restrictions and increase in investment scope

In June 2018, the 20% monthly cap on repatriations by QFIIs and the three-month lock up period for QFIIs and RQFIIs were removed and QFIIs/RQFIIs were also allowed to engage in foreign exchange derivatives transactions with its onshore QFII custodian and other onshore financial institutions for hedging its FX risk[21].

As recently as 31 January 2019, CSRC issued the Proposed New QFII/RQFII Measures which propose, among other things, to consolidate the QFII and RQFII regulations into one set of unified rules, align the qualification requirements applicable to QFIIs and RQFIIs, and expand their investment scope to include shares traded on the New Third Board, i.e. National Equities Exchange and Quotations System Co. Ltd. ("**NEEQ**"), bond repos, private investment funds, financial futures listed and traded on the China Financial Futures Exchange ("**CFFEX**"), commodity futures traded on futures exchanges approved by CSRC, and options traded on futures exchanges approved by the State Council or CSRC. The proposed amendments in the consultation drafts are most welcomed by FIIs and ASIFMA, in particular, is especially grateful and appreciative because we have been suggesting these changes to the CSRC for a while.

Opening of the CIBM

FIIs are excited by the opening to them of the China interbank bond market ("**CIBM**") which is where government and policy bank bonds, making up about 38%[22] in terms of value of all outstanding bonds in China, are traded. They are able to invest in the CIBM from onshore through the CIBM Direct since 2016 and from offshore through the Bond Connect launched in 2017.

[18] Source: AMAC. http://gs.amac.org.cn/amac-infodisc/res/pof/manager/index.html
[19] SAFE announcement on increasing QDLP and QDIE quotas. 24 April 2018. http://www.safe.gov.cn/safe/2018/0424/8875.html
[20] CSRC and SFC joint announcement on quadrupling Stock Connect daily quota. 11 April 2018. http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201804/t20180411_336497.html
[21] Regulations on Foreign Exchange Administration for Domestic Securities Investments by Qualified Foreign Institutional Investors. SAFE. 12 June 2018. http://www.safe.gov.cn/safe/2018/0612/9320.html
Circular of the People's Bank of China and the State Administration of Foreign Exchange on the Management of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors. PBOC and SAFE. 12 June 2018. http://www.safe.gov.cn/safe/2018/0612/9321.html
[22] Source: PBOC. http://www.pbc.gov.cn/eportal/fileDir/defaultCurSite/resource/cms/2019/01/2019011618374478932.htm

Market infrastructure improvements

Real time DvP settlement, which is critical for many FIIs, particularly public/retail funds and their investment managers and custodians, was finally introduced for northbound Stock Connect in November 2017[23]. This allows FIIs to trade with multiple brokers instead of trading only with the broker that is partnered with the custodian of their funds/clients, usually part of the same group (i.e. the integrated model). Prior to having real time DvP, the broker often has to advance to its FII client cash which settles on T+1 while shares settle on T.

In August 2018, DvP settlement also became available for not only bonds (mostly corporate bonds) settling through Shanghai Clearing House ("**SCH**") but also bonds (mostly government and policy bank bonds) settling through China Central Depositary & Clearing Co., Ltd. ("**CCDC**") under Bond Connect[24]. In September 2018, northbound investor ID for Stock Connect was introduced[25] with the flexibility of having the investor ID established at either the fund manager or fund level, an option which is important for investment managers that manage a large number of funds and/or client mandates as they can place a single order for all the funds/client mandates that they manage as opposed to multiple orders which will take time to execute and more important, will not guarantee that each of their funds/client mandates (to which they owe a duty to treat equally and fairly) get the same price.

On the CIBM side, FIIs were happy to learn in November 2018 that Bloomberg would be added as a second trading platform for Bond Connect[26], which could lead to more competition, lower trading cost and increased trading efficiencies. FIIs also welcome the introduction in August 2018 of block trade allocations under the Bond Connect[27] as well as the introduction in October 2018 of tri-party repos[28].

Increase in capital inflows

MSCI started its inclusion of A shares into its emerging market indices in 2018. Foreign investors' net buying of A shares via northbound Stock Connect in 2018 rose almost 50% to a record USD 44.7 billion, close to USD 15 billion more than in 2017[29]. The Hong Kong Stock Exchange ("**HKEx**") reported a large increase in the number of Special Purpose Segregated Accounts ("**SPSAs**") being opened on behalf of FIIs for northbound Stock Connect. Figure 1 below indicates that more FIIs are preparing to enter the China equities markets.

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[23] Launch of RDP Money Settlement and other CCASS Service Enhancements for China Connect Markets on 20 November 2017. HKEx. 6 November 2017. https://www.hkex.com.hk/-/media/HKEX-Market/Services/Circulars-and-Notices/Participant-and-Members-Circulars/HKSCC/2017/CE_SET019_2017.pdf?la=en

[24] Bond Connect Fully Implements RDVP. BCCL. 27 August 2018. http://www.chinabondconnect.com/documents/NewsRelease2018-08-27EN-DVP.pdf

[25] Launch of investor identification for northbound trading under Stock Connect. SFC. 24 August 2018. https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR99

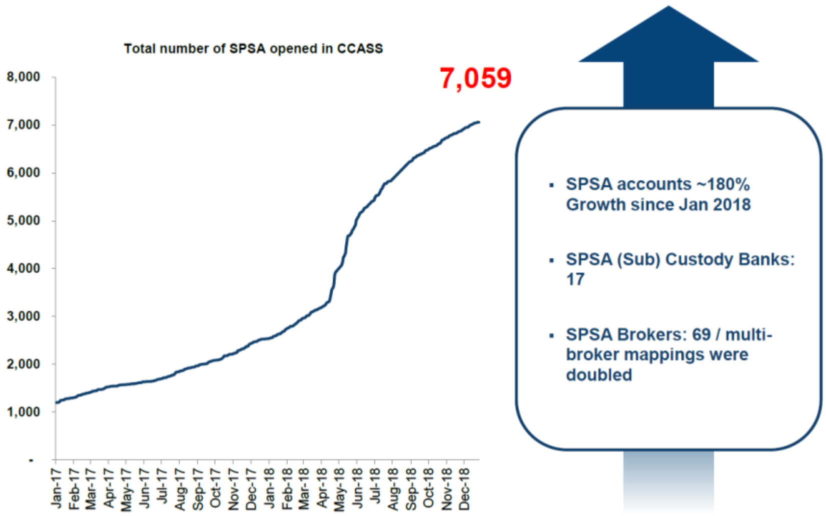
[26] Bond Connect Launches Bloomberg Access. BCCL. 17 January 2019. http://www.chinabondconnect.com/documents/BCCLNews2019-1-17EN.pdf

[27] Bond Connect Launches Block Trade Allocations. BCCL. 31 August 2018. http://www.chinabondconnect.com/documents/News2018-08-30EN-Allocation.pdf

[28] CIBM Launches Tri-party repos Transactions. PBOC. 16 October 2018. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3645588/index.html

[29] Source: HKEx https://www.hkex.com.hk/Mutual-Market/Stock-Connect/Statistics/Historical-Monthly?sc_lang=en#select1=1&select2=2

Figure 1: Special Purpose Segregated Accounts (SPSA)



Source: HKEx

Given the below announcements made by three of the world's leading index providers, we would expect to see a significant increase in capital flows into China's equity markets over the year ahead:

- FTSE Russell's announcement on 26 September 2018 that it will include China A shares in its FTSE Global Equity Index Series in three tranches starting from June 2019 through March 2020;

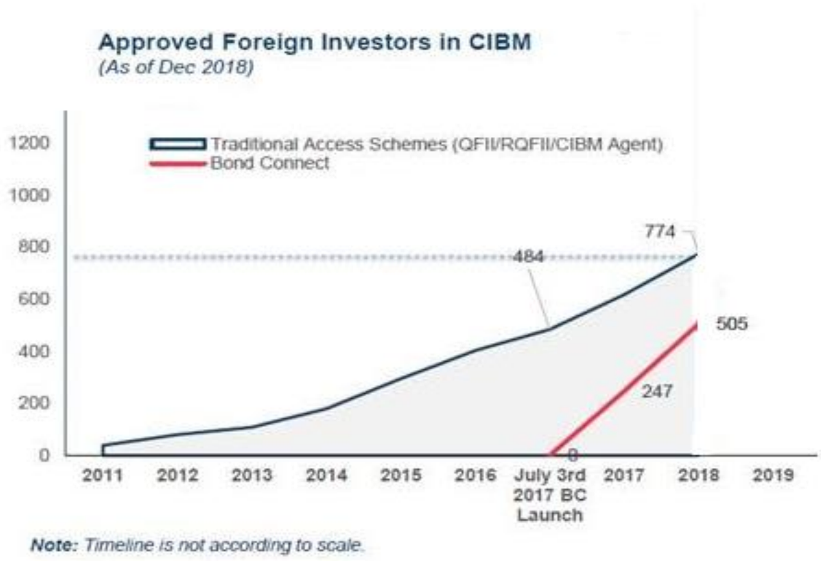
- S&P Dow Jones Indices' announcement on 5 December 2018 that it will add China A shares traded on the Stock Connect to its Global Benchmark Indices on 23 September 2019; and

- MSCI's announcement on 28 February 2019 that it will increase the weight of China A shares in the MSCI Indexes from the current 5% to 20% in three steps, starting in May and then August and November 2019. On the completion of the three steps, there will be 253 large and 168 mid cap China A shares, including 27 ChiNext shares, on a pro forma basis in the MSCI Emerging Markets Index, representing a weight of 3.3% in the pro forma index.

Similarly, on the fixed income side, Bloomberg's announcement of the addition of Chinese RMB-denominated government and policy bonds to the Bloomberg-Barclays Global Aggregate Bond Index over a 20-month period starting on 1 April 2019 means that upon completion of the phase-in, Chinese bonds will represent 6.03% of the US$54.07 trillion index and will be the fourth largest currency component in the index following US dollar, Euro and Japanese yen bonds.

As a result, increased FII investments in the China bond market can be expected. According to HKEx, by the end of January 2019, the number of FIIs registered with PBOC for the Bond Connect, one of several channels to access the China bond market, already reached 598[30]. Figure 2 below indicates the total number of accounts opened by foreign investors in the CIBM across the various channels.

Figure 2: Foreign investors' CIBM accounts



Source: HKEx

[30] Source: HKEx

D. Investing into China

FIIs encounter different issues when they invest in the equity and debt markets in China and depending on which access channels or schemes they choose. This section of the Paper focuses first on the equities issues and then the debt issues.

1. Equities

There are currently three channels through which FIIs can gain access to China's equities market: QFII, RQFII and Stock Connect. Set out below is a comparison of the different requirements of these channels:

Table 1: Comparison of Access Channels to China Equities Market

	QFII	RQFII	Stock Connect (Northbound)
Eligible investors	Foreign institutions in markets which entered into MoU with China meeting the following requirements: • *Commercial banks*: ≥ 10 years operation, ≥ USD 5 bn AUM, ≥ USD 300 mm Tier 1 capital • *Securities companies*: ≥ 5 years operation, ≥ USD 5 bn AUM, ≥ USD 500 mm capital • *Asset management institutions, insurance companies and others*: ≥ 2 years' experience, ≥ USD 500 mm AUM	Foreign institutions in 19 approved RQFII jurisdictions (including asset management institutions, securities companies, commercial banks, insurance companies and overseas subsidiaries of PRC FMCs)	All foreign investors including individuals (but only institutional professional investors for SZSE ChiNext shares)
Regulatory approval	• CSRC license • SAFE quota	• CSRC license • SAFE quota	None
Quota	• Total: USD 300 bn (USD 101 bn allocated as of 29 Dec 2018) • Varies for each investor (minimum basic quota is USD 20 mm)	• Varies for each region (RMB 647 bn allocated in total as of 29 Dec 2018) • Varies for each investor	Northbound daily quota of RMB 52 bn
Eligible investments	• All securities listed on SSE/SZSE • Securities investment funds, including close-ended, open-ended and ETFs • Warrants, index futures, IPOs, FX derivatives (for	• All securities listed on SSE/SZSE • Securities investment funds, including close-ended, open-ended and ETFs • Warrants, index futures, IPOs and others	Approximately 1320 stocks as of 1 February 2019: • 579 SSE shares: constituents of SSE 180 Index and 380 Index with market cap ≥ RMB 6 bn and

	QFII	RQFII	Stock Connect (Northbound)
	hedging purpose only) and others		dual SSE-HKEX listed shares • 740 SZSE shares: constituents of SZSE Component Index and SZSE Small/Mid Cap Innovation Index with market cap ≥ RMB 6 bn and dual SZSE-HKEX listed shares
Investment currency	USD or other FX (convert to RMB onshore)	Offshore RMB (CNH)	Offshore RMB (CNH), HKD and USD
Prefunding	Required (cash available before a trade)	Required (cash available before a trade)	None
Block trading	Available	Available	No
Short selling	No	No	Yes, but only covered shorts and not naked ones
Securities lending	No	No	Permitted with restrictions

We applaud CSRC's efforts over the past few years to align the terms and conditions of the QFII and RQFII schemes and its recent proposal to merge and consolidate the requirements of the two schemes. FIIs would like to see at some point in the not too distant future alignment of the terms and conditions of all the schemes to those of the most flexible channel as well as fungibility of positions across the different channels.

1.1 QFII/RQFII

The QFII scheme was introduced back in 2002 with an initial quota of USD 20 billion and is the earliest of the China market access channels to be introduced for FIIs. It was followed by the RQFII scheme which was launched in 2011 in Hong Kong with an initial quota of RMB 20 billion as part of an effort to internationalize the Renminbi ("**RMB**"). The RQFII scheme was expanded to London and Singapore in 2013 and more cities later. As of the end of 2018, there are 19 countries or regions having obtained an RQFII quota. See table below.

Table 2: RQFII jurisdictions and quotas

	Jurisdiction	Total quota approved (RMB billion)	Quota allocated (SAFE)	
			Quota (RMB billion)	No. of firms
1	Hong Kong	500	318.6	84
2	US	250	29.8	7
3	Japan	200	3	1
4	South Korea	120	72.9	35
5	Singapore	100	74.7	32
6	UK	80	46.5	19
7	France	80	24.0	7
8	Germany	80	10.5	3
9	Australia	50	32.0	3
10	Luxemburg	50	15.2	7
11	Canada	50	8.7	3
12	Switzerland	50	7	1
13	Malaysia	50	1.6	1
14	Thailand	50	1.1	1
15	Ireland	50	1.1	1
16	Chile	50	-	
17	Hungary	50	-	
18	UAE	50	-	
19	Qatar	30	-	
Total:		**1,940**	**646.7**	**205**

Qualification and quota

Over time, the eligibility requirements for both QFIIs and RQFIIs were relaxed while the upper limit for an individual QFII's quota was increased and then entirely removed. A simplified quota granting process was introduced in 2016 where a QFII/RQFII's quota is based on its AUM and only when a QFII/RQFII wants a quota above its base quota will approval of SAFE be required. The lock-up period for QFIIs was shortened in the same year and completely removed for both QFIIs and RQFIIs in June 2018.

In January 2019, the total QFII quota was doubled from USD 150 billion to USD 300 billion while the RQFII quota is at RMB 1,940 billion.

As with all the market access channels, the rules become more relaxed with the newer channel. From day one, RQFII open-ended funds, for example, were allowed to have daily redemptions and RQFIIs were not subject to any cap on profit repatriations as QFIIs were.

The removal of the 20% monthly cap on repatriations by QFIIs in June 2018 was a long-awaited and welcomed development. FIIs appreciate the efforts of the Mainland authorities to align the requirements for QFIIs and RQFIIs and to simplify the quota issuance process and are particularly excited by the Proposed New QFII/RQFII Measures issued by the CSRC for consultation on 31 January 2019.

While most if not all of the proposed amendments to the QFII/RQFII regulations are welcomed, there are some other areas that we would like to suggest some changes. For example, QFII/RQFII license and quota are currently granted to a single entity and cannot be transferred. We suggest that the Proposed New QFII/RQFII Measures explicitly allow the quota under the QFII and RQFII regimes for the different jurisdictions to be used interchangeably by entities within the same corporate group and/or the quota to be transferred across jurisdictions as the usage in some jurisdictions lags behind usage in other jurisdictions. Allowing applicants to apply for QFII/RQFII quota from any eligible jurisdiction, in the name of the group entity for usage by members of the group, and allowing RQFII and QFII quota to be used interchangeably would greatly simplify the QFII/RQFII licensing and quota process for many global investment managers and encourage them to bring in more long-term investment into China's capital markets.

Investment scope

FIIs welcome the expansion of QFIIs/RQFIIs/ investment scope under the Proposed New QFII/RQFII Measures, especially investment in private securities investment funds, because (a) they can leverage off the PFM WFOE's portfolio managers based in China who would have a closer and deeper knowledge of the China market than they would; (b) such portfolio managers, if they are part of the same international fund management group, would have a better understanding of their culture, operation and investment objective(s); and (c) they can help seed their affiliate PFM WFOEs' funds and support their development as PFM WFOEs try to build a brand and track record with Mainland investors.

Moreover, just as QFIIs/RQFIIs are allowed to entrust the management of its securities investment in China to Mainland securities companies and other investment management institutions, they would like to be able to entrust management of their securities investment in China to PFM WFOEs or at least those affiliated with them as proposed in the Proposed New QFII/RQFII Measures.

Proceed repatriation and tax clearance

Although there is no longer any restriction on repatriations, QFIIs/RQFIIs need to perform a record filing with the local tax bureau and submit the tax record filing forms with local tax bureau's stamp on them to the remitting bank before their proceeds from China can be repatriated.[31] The supporting documents to be filed by the QFII/RQFII with the local tax bureau include a tax certificate or audit report from a local tax consultant, which takes time to prepare. Take the example of a QFII who has a year-end in December, their audit report will not be available until the following March or April which makes any earlier repatriation impossible. In addition, due to resource constraint of some local tax bureaus, they would entertain such applications only on a particular day of the week.

In view of the announcements on tax exemptions for foreign investors on bonds and equities, we understand that this record filing requirement may be for foreign exchange control purposes only and

[31] Regulations on Foreign Exchange Administration for Domestic Securities Investments by Qualified Foreign Institutional Investors. SAFE. 12 June 2018. http://www.safe.gov.cn/safe/2018/0612/9320.html
Circular of the People's Bank of China and the State Administration of Foreign Exchange on the Management of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors. PBOC and SAFE. 12 June 2018. http://www.safe.gov.cn/safe/2018/0612/9321.html

not for tax liability determination. We, therefore, suggest removing the requirement for a tax certificate or audit report from the local tax consultant to improve the repatriation process.

Perhaps the SAT can set up an online data sharing platform with SAFE and/or remitting banks so that the authorities can still have access to the information needed to monitor the foreign exchange situation while QFIIs and RQFIIs are relieved from the record filing process or they can go through a simplified process when repatriating or making outbound payments from China.

The inability of QFIIs/RQFIIs to repatriate their proceeds in a timely manner is a major disincentive for FIIs to invest through the QFII/RQFII schemes. Many of them are either open-ended funds which need the liquidity to meet potential redemptions or investors who need the flexibility to change asset allocation in response to market conditions and investment views.

We are therefore disappointed by Article 26 of the Proposed New QFII/RQFII Measures which states explicitly that remittance and repatriation of proceeds by QFIIs/RQFIIs are subject to China's economic and financial conditions, supply and demand on the foreign exchange market and balance of international payments. This will create uncertainty over foreign investors' ability to freely repatriate proceeds out of China. To provide confidence to international investors on their ability to participate in the Chinese markets without limitation on their capital movement, we would ask that this provision be removed from the final Measures.

Number of brokers

QFIIs/RQFIIs are currently restricted to trade through a maximum of three brokers on each of the Shanghai Stock Exchange ("**SSE**") and Shenzhen Stock Exchange ("**SZSE**"). Moreover, shares purchased through one broker must be sold through the same broker. As many FIIs (particularly investment managers) are subject to a duty to secure best execution for their clients and funds, their ability to use multiple brokers becomes important.

As additional foreign entrants to China's brokerage industry can be expected in light of the recent lifting of ownership cap and the expansion of business scope for foreign-owned securities firms in China[32], the current limit of three brokers appears to be a protectionist measure that hinders new entrants to the market. Therefore, we urge CSRC to remove the limit or expand the number of brokers that QFIIs/RQFIIs can use.

In the same vein, we also urge CSRC to remove the requirement that the same broker must be used for both the purchase and sale of the same shares, which effectively reduces the three brokers per investor to actually only one broker which would not satisfy the best execution requirement. We are not aware of such practice in any other markets where investors are generally free to buy and sell shares through any broker of their choice.

The aforementioned improvements will not only enable QFIIs/RQFIIs to meet their best execution obligation but also lead to more open competition among brokers and better service to investors.

[32] Administrative Measures for Foreign-invested Securities Companies. CSRC. 28 April 2018. http://www.csrc.gov.cn/pub/zjhpublic/zjh/201804/t20180428_337509.htm

1.2 Stock Connect

Stock Connect was launched between Hong Kong and Shanghai in 2014 and between Hong Kong and Shenzhen in 2016. Unlike QFIIs and RQFIIs which are allowed to invest in all listed shares and stock index futures, foreign investors under the Stock Connect have a much more limited selection of investable securities, comprising only of the constituent stocks of the SSE 180 Index and the SSE 380 Index, the constituent stocks of the SZSE Component Index and the SZSE Small/Mid Cap Innovation Index which have a market capitalization of not less than RMB 6 billion, and all the other SSE/SZSE-listed A shares which have corresponding H shares listed on HKEx.

Investment universe

As of 1 February 2019, only 579 out of a total of 1,453 securities listed under the SSE and only 740 out of a total of 2,130 securities listed under the SZSE (Main Board, SME and ChiNext) are eligible for trading under the Stock Connect.[33] FIIs would like to see the investable universe under the Stock Connect expanded to all stocks listed on SSE and SZSE and index futures listed on CFFEX. Expanding the product universe tradeable under the Stock Connect is especially important in light of MSCI's expansion of its index universe from China A large caps to mid caps and ChiNext shares starting in May 2019.

FIIs welcome CSRC's recent proposal to allow QFIIs/RQFIIs to invest in NEEQ-listed securities and look forward to being able to do the same through Stock Connect. FIIs investing through Stock Connect would also like to be able to invest in exchange traded funds ("ETFs"), warrants, index futures and initial public offerings ("IPOs") that QFIIs/RQFIIs are allowed to do as well as bond futures, commodity futures, repos and fixed term deposits to diversify their investments and increase their risk management capability.

Securities borrowing and lending

An efficient SBL environment helps enhance overall equity market efficiency, enable efficient hedging to better manage risks and protect against fail trades that may arise due to the tight settlement timeframe. Brokers/exchange participants who know that a settlement failure may occur because of operational constraints before it happens would benefit from being able to take action to avoid this failure, such as temporarily borrowing shares from the account of its affiliates to prevent a settlement failure.

Although SBL is allowed under Stock Connect, it is barely used in Hong Kong because the only parties permitted to engage in SBL are exchange participants (i.e. brokers). Brokers typically do not hold stock inventory. It is their affiliates or investment managers or their lending agents (e.g. custodians), who are not exchange participants, that have stock inventory to lend. We, therefore, suggest that the aforementioned parties be allowed to participate in SBL.

In addition, more clarity on the rules on how SBL would work under each of the different access channels would be welcomed.

[33] Source: HKEx, SSE, SZSE

Short selling limits

The current Stock Connect rules allow covered (but not naked) short selling for northbound trades subject to certain requirements. For example, the number of shares which may be short sold is limited to 1% of the total number of the same shares held by Hong Kong investors on a trading day (calculated in real time throughout the trading day) and no more than 5% cumulatively over 10 successive trading days (calculated at the end of each trading day). These limits are not known until after the market closes and therefore, in practice, it would be difficult to engage in short selling.

1.3 General equities related matters

CSRC issued a notice on 30 October 2018[34] that it will, among other things, (a) upgrade the quality of listed companies, strengthen their corporate governance, standardize information disclosure and increase transparency, (b) optimize trading monitoring and supervision, reduce trading obstacles, strengthen market liquidity and reduce unnecessary intervention in the trading process so that the market has a clear expectation of what is being regulated and investors have a fair opportunity to trade, and (c) encourage value investing and unleash the role of institutional investors such as insurance, social security, various securities investment funds and asset management products to bring more medium and long-term capital into the market.

Window guidance

Shortly after issuance of the aforementioned CSRC notice, SSE announced[35] that they would stop giving verbal instructions such as "window guidance" and only suspend trading accounts and use other regulatory measures under strict and prudent conditions. FIIs welcome the cessation of this practice because it is difficult to tell whether the verbal "window guidance" given to a particular company is an official policy directed at that company or all companies in the industry or given by a particular official who may or may not speak on behalf of the authorities.

For example, while the 20% monthly cap on repatriations by QFIIs was still in place, some QFIIs reported that they received a call not to repatriate the entire 20% of their net asset value ("**NAV**") or to repatriate only 10%. FIIs are particularly sensitive to any restriction on their ability to repatriate proceeds as many of them are investment managers who manage funds and/or client mandates which expect prompt payback of their investment should they decide to redeem from the funds or exit their investments at any time.

FIIs are glad that both SSE and SZSE stated they will stop the practice of issuing "window guidance" and we hope that all governmental and regulatory authorities in China will do the same. If it is a policy or directive that is to be applied to the industry, it should be published in the form of a written circular or official announcement, preferably with advance notice before the effective date, by the relevant authority so that there is full transparency on the policy and the scope of its applicability.

[34] CSRC Notice. CSRC. 30 October 2018. http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201810/t20181030_345922.html
[35] SSE Media conference No. 147. 2 November 2018. http://www.sse.com.cn/home/apprelated/news/c/c_20181102_4671287.shtml

Market intervention

Global investors are skeptical of any type of market intervention by a government as it impedes the proper functioning of the markets. We believe that it is important to let market forces determine the price of each listed security and reflect the economic fundamentals. When the market price of a particular stock falls to a certain level, there are bound to be investors who would see value and want to buy the stock so it is best left to the market decide.

Market stability can only be achieved by bringing in more long term capital and by broadening the investor base and increasing the diversity of market players. Attracting more foreign institutional capital will help achieve this goal.

Improvement of IPO process

With regard to participation in IPOs, FIIs and likely domestic institutional investors as well would like to see a more market-oriented approach to access IPO shares instead of the current lottery mechanism that is in place. We believe introducing a market-oriented approach to China's IPO process that includes a book building process to set the issue price and allocations for IPOs would help price discovery, improve the quality of the shareholder base and stabilize share prices of newly listed companies.

Trading suspensions

Trading suspensions are particularly problematic for foreign fund managers as they need to value their funds often on a daily basis. When securities invested in by their funds are suspended, they are obligated to fair value those suspended securities using proxies instead of actual pricing resulting in uncertainty on the valuation of the whole fund. Where there is a large number of securities in a fund that are suspended at the same time, this can lead to liquidity issues for the fund. Suspensions of securities also prevent investors from being able to replicate indices. This problem will be exacerbated when MSCI includes mid-cap securities into its index as the current suspensions affect more the smaller cap companies.

We believe the only legitimate reason for suspending the trading of a listed company's shares is the occurrence of a major unexpected event that may have an impact on the share price of the company. In addition, the suspension should only be for a short period of time so that the listed company can prepare and disseminate the relevant information to all of its investors. We believe that all investors, not just FIIs, value the ability to trade freely and will be very concerned if they are prevented from buying or selling shares of a listed company for a lengthy period of time. Ensuring that accurate information is provided promptly and at the same time to all investors and limiting the period of any type of trading suspension to the minimum are the best ways to protect both retail and institutional investors.

FIIs applaud the steps taken by the SSE and SZSE in December 2018 to further limit the circumstances under which listed companies can suspend trading of their stock and to reduce the duration of such suspensions. We note there has been a significant decrease in the number of suspended stocks in China; for example, the number of suspended stocks on SSE has gone from 70 stocks in December

2016 to three as at the end of 2018[36]. We would urge the Chinese stock exchanges to monitor and keep the number and duration of trading suspensions to a minimum.

Settlement cycle and DvP

Equity trading

China's settlement for shares and cash differs markedly from other markets where settlement for both stock and cash occur on a DvP basis, typically two days after the trade day ("**T+2**"). Due to time zone differences, FIIs in the U.S. and Europe (which are 6 to 16 hours behind China) have to pre-fund their buy trades and/or opt for single-sided settlement for their sell trades when trading in China A shares which is not only costly but raises counterparty risk. FIIs, particularly collective investment schemes or mutual funds, are subject to strict DvP requirements. Time zone differences and multi-layer custodian arrangements associated with a lot of cross-border institutional investments require major work-arounds by market participants when investing in China in order to satisfy their respective regulators and legal and compliance requirements.

Although real time DvP has been introduced for Stock Connect, it works only for Hong Kong dollar ("**HKD**") settlement and not U.S. dollar ("**USD**") settlement and some FIIs cannot take advantage of it due to the tight cut-off times for settlement instructions and the number of market participants (e.g. investment manager, its global custodian and sub-custodian) that are involved in a trade. FIIs would like to see China move to a **T+2 settlement** in the long run for both stock and cash so that they can invest in China more easily, cost efficiently and free of delivery and counterparty risk.

Markets around the world are harmonizing towards DvP in a T+2 settlement cycle. In addition to the U.S. market which moved from a T+3 to T+2 settlement in March 2017, several Asian markets such as India, South Korea, Taiwan, Thailand, Indonesia and Singapore have already moved, or in the case of Japan and Malaysia are planning to migrate this year, to T+2 settlement so as to better serve global institutional investors. Harmonization around the same settlement timing for securities and cash globally leads to greater efficiency for and facilitates more investment by FIIs.

Omnibus trading

For investment managers which manage multiple funds/client mandates, the ability to place a single order on behalf of all the funds/client mandates that they manage instead of multiple orders for each fund/client mandate will be more efficient from both a time and cost perspective. Brokers also favor omnibus trading because of the short timeframe for foreign investors to place orders and for them to execute such orders given China's T/T+1 stock settlement cycle. It has the added advantages of improving throughput capacity via throttle on demand which would provide added flexibility for algorithmic trading and accommodate additional volumes in the closing auction session.

More important, omnibus trading allows investment managers to do average pricing for their funds/client accounts as separate orders may generate different prices for different funds/client accounts, which is problematic for investment managers who have a duty to treat all their

[36] Source: SSE. http://www.sse.com.cn/disclosure/dealinstruc/suspension/

clients/funds fairly. Reducing noise of competing orders in the market, especially when there is sensitivity around trading at the close of the market, is another benefit of omnibus trading.

Currently, under northbound Stock Connect investment managers are able to do omnibus trading, post-trade allocation and achieve average pricing for their buy trades. However, they are not able to do omnibus trading for sell trades due to the pre-trade checking requirement at each fund or SPSA level.

Allowing omnibus trading does not deny regulators transparency over the identity of end investors of the trades as investment managers will have details of the client orders before trading and will allocate shares to their funds and/or client accounts after the trade (i.e. post-trade allocation). Investment managers can make such details available to the regulators so that omnibus trading does not impede market surveillance.

Block trading

The ability to transact large block trades with minimal slippage and interference is a key feature of equity markets across the globe. Block trades are important tools used by institutional investors to reduce impact costs, the largest component of total transactions costs. Block trades enable institutional investors to adjust their portfolios more efficiently, thus increasing the attractiveness of markets where such trades are allowed. Most exchanges and regulators recognize the need of institutional investors to transact business that is separate or away from the normal market order book. The current onshore block trading window from 15:00 to 15:30 China Standard Time ("**CST**") is too limited and too manual in operation which may explain the lack of its usage by QFIIs and RQFIIs. It would be helpful if this block trading window can be expanded, possibly throughout the entire trading day, and automated via standardized interface to broker systems.

While block trading is permitted on both SSE and SZSE if certain conditions are met, it is not currently allowed under the Stock Connect. In light of its importance to FIIs, we would like to see block trading made available under the northbound Stock Connect.

Distinction between investment manager from its funds/clients

Chinese regulations require the holdings in a listed company by a group to be aggregated for shareholding disclosure and this includes the holdings of proprietary investments, all onshore and offshore funds and client mandates over which members of the group have investment discretion, whether it is made through the QFII/RQFII or Stock Connect schemes. However, the holdings of domestic retail funds need not be aggregated for purposes of the shareholding disclosure requirement in China.

Disclosure of shareholding

We note that the Proposed New QFII/RQFII Measures draw a distinction between the QFII/RQFII and the foreign investors for whom they invest when it comes to disclosure obligation. However, we are concerned that under the aforementioned Proposed Measures, the QFII/RQFII is obligated to ensure that the foreign investors under its name comply strictly with the information disclosure rules. We wish to stress that clients of an investment manager may engage multiple investment managers that invest for them in China through different access channels and one manager will not know how much the other managers may have invested in shares of the same listed company for those clients. We, therefore, hope that CSRC would clarify in its final Measures that the QFII/RQFII is only responsible for the investments of a foreign investor that it manages.

Under the aforementioned Proposed Measures, the foreign investor is obligated to aggregate its holding in the shares of the same company listed in the Mainland stock exchanges, NEEQ and overseas and also disclose the shareholdings of person acting in concert with him/her. However, we would like confirmation from the relevant regulator(s) that investment managers would not be considered persons "acting in concert" with a foreign investor/client just because they have investment discretion or exercise the voting rights relating to the shares owned by such foreign investor/client.

Even though the investment manager is managing the investments for those funds and/or client mandates, it is doing so based on the separate strategy and mandate of each of those funds/clients which own the investments and which have the right to terminate or replace the investment manager whenever they want, and the control of voting rights is usually ancillary to investment discretion. Therefore, it is critical that holdings in a listed company are calculated at the level of each of their funds and client mandates.

Otherwise, if investment managers are treated as persons acting in concert with their underlying funds/clients for purposes of the short swing profit rule, it would greatly disadvantage the larger global investment managers with significant amount of funds and client mandates under their management as they would have to limit the investment of each of the funds and/or client mandates under their management so as to avoid exceeding the 5% threshold under the short swing profit rule.

Short swing profit rule

More than anything else, the short swing profit rule is the most troubling to global investment managers who manage a significant amount of funds and client mandates. Typically, jurisdictions which have a short swing profit rule use it to prevent or deter insider trading. The PRC Securities Law requires profits made by directors, supervisors, senior managers and substantial shareholders who owns 5% or more of the shares of a listed company who sell their shares in the listed company within six months of purchasing them or who purchase shares in the listed company within six months of selling them to disgorge or return such profits to the listed company.[37]

While an individual shareholder holding 5% or more of the shares of a listed company is likely to be an insider or may be able to exercise control over a listed company, investment managers who manage assets for different funds or client mandates are generally not insiders nor are they privy to inside information even where their percentage of shareholding in a listed company, when aggregated across all clients and/or funds managed by them and their group, exceeds 5%. This is why investment managers are usually exempt from the short swing profit rule in many jurisdictions such as the U.S.

In the absence of any clarity on how persons acting in concert is interpreted, many global investment managers may be forced to take a cautious approach and limit the individual holdings of each of its funds and/or clients so that in the aggregate their shareholdings in a listed company do not exceed

[37] Article 47 of the China Securities Law. http://www.csrc.gov.cn/pub/shenzhen/ztzl/ssgsjgxx/jgfg/zh/201506/t20150612_278981.htm

the 5% threshold which would trigger the short swing profit rule. This will disadvantage not only the investment managers with a large number of funds and/or clients but also each of their funds and clients, which cannot be the intention of the short swing profit rule.

An exemption for investment managers from the short swing profit rule is more important now than ever given the expected large inflow of foreign investment into China's equities market with the various index inclusions this year.

Clarification of the meaning of "acting in concert" as it relates to financial groups, particularly global ones, is also necessary and important. Typically, global financial groups have different affiliates that operate independently from each other (e.g. JP Morgan Bank and JP Morgan Asset Management or HSBC Bank and HSBC Global Asset Management). Even within an investment management group, funds managed by different fund management entities or fund managers are often independent and separate. We would respectfully suggest that CSRC indicate the circumstances in which such affiliates would not be treated as "acting in concert" as it is important for FIIs to have complete clarity and certainty on the interpretation of this term, especially for the short swing profit rule. This is the biggest obstacle for the larger FIIs.

Exemption for retail and other funds

If a complete exemption for investment managers or financial groups is not possible, at least shares held by publicly offered retail and mutual funds, pension funds and social security funds, whether within or outside China, should be excluded from the calculation of the holdings of the investment manager for the purpose of the short swing profit rule.

The shareholdings in a listed company by publicly offered domestic funds and certain specified funds in China (such as social security fund, pension insurance fund and enterprise annuities) are not required to be aggregated in the shareholding calculation for information disclosure purposes[38]. Since there is a recognition that these funds should be treated differently, we strongly urge that similar funds managed overseas be accorded the same treatment, not only for shareholding disclosure purposes but also for the short swing profit rule.

Foreign ownership limits

Perhaps, it is also timely to reconsider the 10% individual and 30% aggregate foreign ownership limits in a listed company in view of the likely increase of inflows into China's capital markets when global indices move to full inclusion of China A shares. It is unclear what the consequences will be when these limits are breached particularly when foreign ownership of domestic and overseas listed shares need to be aggregated. If these limits are not removed, we are afraid that FIIs may not be able to invest in some of the listed companies particularly the small cap companies.

[38] SSE & SZSE Guidelines on Information Disclosure for Takeovers and Change of Shareholding in Listed Companies (Consultation Draft) issued on 13 April 2018. http://www.sse.com.cn/disclosure/announcement/general/c/c_20180412_4499779.shtml http://www.szse.cn/main/disclosure/bsgg_front/39778750.shtml

2. Fixed Income

Bonds are mainly traded on two markets in China: CIBM where most of the government and policy bank bonds are traded and the exchange market where most of the corporate bonds are traded. CIBM is the much larger market, accounting for almost 88% of all bonds traded in China as of the end of 2018[39]. Trading under CIBM is regulated by PBOC while bonds traded in the exchange market are regulated by CSRC.

There are currently four channels through which FIIs can access China's debt markets: QFII, RQFII, CIBM Direct and Bond Connect. A comparison of the different requirements of these channels are set out below:

Table 3: Comparison of Access Channels to China Onshore Bonds

	QFII	**RQFII**	**CIBM Direct**	**Bond Connect**
Eligible investors	Foreign institutions in markets which entered into MoU with China meeting the following requirements: • *Commercial banks*: ≥ 10 years operation, ≥ USD 5 bn AUM, ≥ USD 300 mm Tier 1 capital • *Securities companies*: ≥ 5 years operation, ≥ USD 5 bn AUM, ≥ USD 500 mm capital • *Asset management institutions, insurance companies and others*: ≥ 2 years' experience, ≥ USD 500 mm AUM	Foreign institutions in 19 approved RQFII jurisdictions (including asset management institutions, securities companies, commercial banks, insurance companies and overseas subsidiaries of PRC FMCs)	• Foreign reserves institutions • Offshore RMB clearing/ participating banks • Foreign financial institutions (commercial banks, insurance companies, securities companies, FMCs and other asset management institutions) and investment products issued by them • Other medium and long term institutional investors approved by PBOC	Same as CIBM Direct
Regulatory approval	• CSRC license • SAFE quota	• CSRC license • SAFE quota	• Pre-filing with PBOC, with need to indicate Bond Settlement Agent (BSA)	Pre-filing with PBOC
Quota	• Total: USD 300 bn (USD 101 bn allocated as of 29 Dec 2018)	• Varies for each region (RMB 647 bn allocated in	None	None

[39] 2018 Financial Market Operation Conditions. PBOC. 25 January 2019. http://www.pbc.gov.cn/jinrongshichangsi/147160/147171/147173/3752805/index.html

	QFII	RQFII	CIBM Direct	Bond Connect
	• Varies for each investor (minimum basic quota is USD 20 mm)	total as of 29 Dec 2018) • Varies for each investor		
Account structure	Onshore account with custodian	Onshore account with custodian	Onshore account with custodian	Onshore CMU omnibus account at CCDC and/or SCH; offshore investor account at CMU in HK via custodian
Holding structure	QFII maintains account directly with CCDC and SCH	RQFII maintains account directly with CCDC and SCH	Investor maintains account directly with CCDC and SCH	CMU, as nominee holder for investor
Eligible investments	• Interbank market: cash bonds • Exchange market: government bonds, enterprise bonds, corporate bonds, convertible bonds, etc.	• Interbank market: cash bonds • Exchange market: government bonds, enterprise bonds, corporate bonds, convertible bonds, etc.	• Foreign reserves institutions: all cash bonds, repos, bond borrowing and lending, bond forwards, IRS, FRA, etc. • Other foreign institutions: all cash bonds and other products permitted by the PBOC	All cash bonds
Investment currency	USD or other FX (convert to RMB onshore)	Offshore RMB (CNH)	Onshore RMB (CNY)/ Offshore RMB (CNH)	Onshore RMB (CNY)/ Offshore RMB (CNH)
Trade size	None	None	Normally RMB 10 mm minimum as industry conventions and incremental	RMB 100,000 minimum and incremental as per each security
Repatriation limit	None	None	None, but ratio of inbound CNH/CNY and outbound CNH/CNY should be similar, and	None, but a similar proportion of CNY,

	QFII	RQFII	CIBM Direct	Bond Connect
			its variation upward or downward should not exceed 10%, and outbound CNY/CNH should not exceed 110% of inbound CNY/CNH in the first remittance	after investment, must be converted back into foreign currency if not re-invested

With the proposed merger and consolidation of the QFII and RQFII regulations, FIIs look forward to similar alignment of the rules for QFIIs/RQFIIs, CIBM Direct and Bond Connect when it comes to investing in the China bond markets, with the terms and conditions of all the schemes to be aligned to those of the most flexible channel. For ease of management, FIIs would like to be able to consolidate their bond positions under one scheme so allowing a one-time transfer of their positions from one scheme to another would be much appreciated.

2.1 QFII/RQFII

QFIIs and RQFIIs can invest in all securities listed on the two Mainland Stock Exchanges, which include listed bonds that are mostly corporate bonds as well as bonds traded on the CIBM, subject to CSRC approval and filing with PBOC and the granting of a quota by SAFE. In June 2018, QFIIs/RQFIIs were allowed to engage in FX derivatives transactions for hedging purposes. Just as FIIs investing through CIBM Direct are allowed to, QFIIs/RQFIIs would like to be able to hedge their interest rate exposures by entering into bond forward transactions, forward rate agreements, interest rate swaps, options and bond borrowing lending transactions in relation to their bond investments in China.

If an FII is investing in the CIBM through QFII/RQFII and wants to consolidate its positions by transferring the cash and assets in its QFII/RQFII account to its CIBM Direct account, it currently needs to first liquidate its holdings in the former, repatriate and then fund its CIBM Direct account with "new money". The FII needs to go "in and out" and conduct sell and buy trades unnecessarily for the transfer from one channel to the other, which is costly and runs the risk of foreign exchange and market movements. For China, the "in and out" process creates the risk of leakage, i.e. some of the funds repatriated may not be reinvested into China. Therefore, FIIs would like the ability to transfer, at least on a one-time basis, positions in their QFII/RQFII account (with the quota being released after such transfer) to their CIBM account.

2.2 CIBM Direct

CIBM was first opened to FIIs in 2010 when central banks and monetary authorities, RMB clearing banks in Hong Kong and Macau and overseas banks participating in the RMB settlement of cross-border trades were allowed to invest in the CIBM[40]. The participation of this first group of FIIs was

[40] Notice on Issuing the Measures for the Administration of RMB Bank Settlement Accounts of Overseas Institutions。PBOC. 31 August 2010. http://www.pbc.gov.cn//zhifujiesuansi/128525/128535/128620/2811661/index.html

subject to PBOC approval and a quota granted by SAFE and they can invest only in cash bonds and bond repos. QFIIs and RQFIIs were allowed to apply for CIBM access in 2011 and 2013, respectively, subject to CSRC and PBOC approval and the granting of a quota by SAFE but they can invest only in cash bonds.

CIBM Direct was further extended in 2015 to foreign central banks, international financial organizations and sovereign wealth funds[41] and in 2016 to commercial banks, securities companies, insurance companies, fund management companies, other financial institutions and medium and long term FIIs, such as pension funds, charitable and endowment funds and including investment products issued by them, without the need for approval or a quota[42].

Under CIBM Direct, foreign central banks, international financial organizations and sovereign wealth funds can invest in cash bonds and engage in bond lending, bond forwards, interest rate swaps, forward rate agreements and bond repos (which RMB participating/dealing banks can also engage in). Medium and long term FIIs can invest in cash bonds and only engage in bond lending, bond forwards, interest rate swaps and forward rate agreements for hedging purposes.[43] Allowing FIIs, particularly global investment managers, to do bond repos would be highly desirable.

The biggest advantage of CIBM Direct is that it offers FIIs access to more onshore hedging instruments (e.g. interest rate swaps and in the case of foreign central banks and RMB Participating and Clearing Banks, repos) while Bond Connect investors only have access to FX hedging tools. However, FIIs wishing to participate in CIBM Direct have to appoint a local Bond Settlement Agent ("**BSA**") which usually is the local custodian or an affiliate of a local custodian.

Account opening process

It usually takes a few weeks but can take longer to complete the account opening under CIBM Direct for an FII with CCDC and SCH due to the requirement of physical submission of documents. Enabling the submission of documents online or electronically (with scanned copies followed by originals to be delivered later) would shorten the account opening process.

The need to negotiate and enter into an agreement with a BSA takes time and is usually what holds up the account opening process. For a lot of FIIs, they already have a regional custody agreement in place with their global custodian and local custodian which covers all aspects related to the FII custody service. To expedite the account opening process, it would be helpful if the BSA agreement between the FII and the BSA can be replaced with a letter of authorization from the parties to the regional custodian agreement, to be followed later with a separate agreement between the FII and the BSA, if necessary.

[41] Notice of the People's Bank of China on Matters concerning the RMB Investment in the Interbank Market by Foreign Central Banks, International Financial Organizations and Sovereign Wealth Funds. PBOC. 14 July 2015http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/2813723/index.html

[42] PBOC Notice No. 3 [2016]. 24 February 2016. http://www.pbc.gov.cn/english/130721/3037272/index.html

[43] Q&As on the Administration of Filing of Foreign Institutional Investors' Investment in the Inter-Bank Bond Market. PBOC Shanghai Head Office. 9 September 2016. http://shanghai.pbc.gov.cn/fzhshanghai/113595/3070360/index.html

Streamlining KYC checks

The BSA must have clearing capability for international trading and settlement. It conducts Know-your-client ("**KYC**") checks based on PBOC requirements and assists investors to open the relevant accounts with the depositories, CCDC and SCH.

There are no clear rules or guidelines for the BSA's KYC checks especially with respect to alternatives funds and separate mandate accounts. Streamlining KYC processes and increasing transparency over KYC requirements would facilitate investments in the CIBM by FIIs.

Foreign exchange execution

Although there is no pre-funding requirement under CIBM Direct, FIIs have to arrange funding (either onshore or through FX conversion from offshore) to ensure that funding is available before the settlement cut-off time, which is at 17:00 CST and five hours later than for Bond Connect. Due to time zone differences, many FIIs have to get funding into China one day before the settlement date, which entails additional funding cost.

Allowing all BSAs to provide an intraday overdraft facility to FIIs just in case their cross-border funding does not come through from their RMB clearing bank in time for the settlement cut-off time would be very helpful. Allowing foreign exchange to be traded with third parties besides the BSAs would also provide better liquidity and pricing.

Trading execution efficiencies

All trades on the CIBM, regardless of access channel, must be booked, confirmed and recorded on CFETS. In addition, although QFIIs/RQFIIs and CIBM Direct participants are allowed to access CFETS directly, CFETS' requirements (e.g. the requirement to enter the counterparty contact in Chinese) forces FIIs to outsource their confirmation process to their BSA. The trade information that must be sent to the BSA is unique and manual compared with other markets.

FIIs would like to see the CFETS entry process simplified by reducing the number of fields that need to be completed and the CFETS confirmation process to be automated as online confirmation is more efficient. FIIs would also like to see the offshore module of CFETS improved so that it offers an intuitive, user-friendly English version which conforms to International Information Security Standards.

PBOC's approval of the linkage between CFETS and Bloomberg on 29 November 2018 means that trading efficiency under CIBM Direct will improve as the dependency on the input of trade details by the BSA will be alleviated. However, we understand that the BSA is still required to confirm the trade before it can be executed in CFETS. It would be more efficient if CFETs can enable an "auto affirmation" function to achieve straight through processing.

FIIs would also like to encourage onshore brokers to connect to global trading confirmation platforms or direct confirmation in accordance with internationally accepted standards such as FIX and SWIFT so that they can more easily engage such brokers.

Block trading

Given the inclusion of China bonds into the Bloomberg-Barclays Global Bond Index on 1 April 2019 and the possibility of large volume trades on index rebalancing days, it is important that block trades be made available through CFETS or other additional means under CIBM Direct. The requirement to include the CFETS trade deal number as a criterion to match and settle a trade also makes block trades processing challenging. A more feasible alternative to this requirement is needed.

FX to RMB ratio

Even though FIIs under CIBM Direct can invest either with CNY or CNH, they must ensure that they repatriate in the same CNY or CNH as they have invested. There is a requirement under CIBM Direct that the ratio of foreign currency to RMB in the accumulated outward remittance must basically be in line with that of the accumulated inward remittance with fluctuations having to be within +/- 10% except for the first outward remittance which should not exceed 110% of the inward remittance. The complications involved in the ratio calculation and the required continual monitoring are operationally challenging for FIIs and their service providers (e.g. global custodian, local custodians and BSAs). It would be helpful if the +/- 10% tolerance for foreign currency to RMB flow can be removed as it introduces investment process complexity especially for investment managers with a large number of funds and/or clients.

2.3 Bond Connect

Bond Connect for northbound only was launched in 2017 not long after CIBM Direct for the same type of FIIs. With the announcement in November 2018 of the addition of Bloomberg as the second trading platform under the Bond Connect and the inclusion of China bonds in the Bloomberg-Barclays Global Bond Index on 1 April 2019, Bond Connect is expected to bring in even more foreign participants this year. By the end of January 2019, for example, the number of FIIs registered with PBOC for the Bond Connect already reached 598[44].

The biggest advantage of Bond Connect is that it enables FIIs to trade bonds in the CIBM through an international electronic platform (i.e. Tradeweb or Bloomberg) outside China on which they can obtain bids and quotes from approved onshore market makers (34 approved by CFETS as of 31 December 2018) through a request for quotation (RFQ) process. Bond Connect participants can also leverage on their existing offshore custodian without a need to appoint a BSA in China.

Unlike Stock Connect and trading in China equities in general, Bond Connect allows settlement up to T+2 which is still tight for some FIIs. To make Bond Connect more attractive, extending the possible settlement cycle to T+3 or longer would be helpful.

Trading fees

The current billing of the CFETS and BCCL fees and other charges to the trading platform (i.e. Tradeweb or Bloomberg), which then passes them on to the FIIs on a monthly basis, poses a significant problem for FIIs that are investment managers who need to be able to efficiently pass on those fees and charges

[44] Source: HKEx

to their clients and/or funds. In other bond markets around the world, the relevant fees and charges are typically built into the bond price rather than charged separately to the investment managers.

As it is operationally difficult for the investment manager to split up these monthly fees and charges and re-allocate to their underlying funds/clients, in the short run, it would be helpful if these fees and charges can be included with each trade confirmation and settled by the custodians on behalf of the investment managers.

In the long run, FIIs would like to see the fees and charges related to bond trading built into the bond price like they are done elsewhere around the world. Dealers would then be responsible for handling the fees.

Choice of FX counterparties

Many FIIs, especially fund managers, rely on their global custodians to arrange the FX conversion for investment and hedging under the Bond Connect.

Under Bond Connect, these custodians would appoint a sub-custodian ("**CMU Custodian**") which must be a member of the Central Moneymarkets Unit ("**CMU**") under the Hong Kong Monetary Authority ("**HKMA**"). Each CMU custodian is allowed to appoint only one FX settlement bank which is normally the CMU member itself or an affiliate of the CMU member. FIIs, whether investing through QFII/RQFII, CIBM Direct or Bond Connect, are also required to use the same FX settlement bank for its inward and corresponding outward remittance, which limit their choice of FX counterparties. Allowing a CMU member to appoint multiple FX settlement banks or a FX settlement bank at the account level would greatly improve the situation.

Hedging onshore

The ability to hedge interest rate and gain access to the onshore bond futures and repo markets for hedging purposes is important to FIIs. Allowing Bond Connect participants to engage in bond borrowing and lending, bond forwards, interest rate swaps and forward rate agreements like the FIIs investing through CIBM Direct is what FIIs want to see most. In addition, opening up China's bond repo and futures market to FIIs under Bond Connect would help increase foreign investors' interest in this channel and contribute to liquidity in these markets.

Standardize operational infrastructure and requirements

Currently, Bond Connect only supports manual trade confirmations, which increase the risk of errors and failed trades. In addition, each global custodian has to build their own system to direct instructions from their clients to the relevant market and to the sub-custodian to process a trade and to differentiate the funding channel. This is incredibly inefficient and costly so introducing an automated solution for trading instructions and confirmations would be highly desirable and helpful. The industry would be happy to work with the relevant authorities (e.g. PBOC and HKMA) and depositories (e.g. CMU, CCDC and SCH) to develop such a solution.

We understand that HKEx is planning to use blockchain or distributed ledger technology to deliver greater post-trade efficiency for Stock Connect. It would be ideal if the post-trade process under Bond

Connect can be harmonized with that of Stock Connect to reduce complexity since many FIIs invest in both equity and fixed income products.

Another challenge is that if FIIs invest through the Bond Connect using CNY, the sale proceeds from bonds purchased with CNY must be re-invested or repatriated within a reasonable time. What is "reasonable" is not specified in the regulation and therefore left to the FX settlement banks to define, which leads to different interpretations from different FX settlement banks. FIIs would like PBOC to clarify what is meant by "reasonable" so that it can be applied consistently and what penalties, if any, are involved if there is a breach of the aforementioned requirement.

In addition, both the FX settlement bank and the CMU custodian have a responsibility to ensure that the FII's currency conversion and hedging transactions are "genuine and reasonable" in light of the settlement and holding information of the FII. If the FX settlement bank appointed by the CMU custodian has suspicion about the genuineness and reasonableness of such transactions, it may request further clarification and information from the CMU custodian. Due to the lack of a common understanding of what "genuine and reasonable" means, this has led to further confusion among FIIs on what is or is not permitted. Therefore, FIIs would like PBOC to clarify what they consider to be genuine and reasonable transactions.

Removing these rules altogether would alleviate confusion in the market and increase alignment of China's bond market with the global bond markets.

Tracking CNH vs. CNY

We understand the policy desire to require the tracking of the use of the CNH and CNY channel for purchasing bonds through the Bond Connect. However, as noted earlier, the lack of a uniform coding system and/or market practice to distinguish CNH from CNY means that investment managers and their custodians have to each come up with a way to monitor such usages which is time-consuming, inefficient and costly. This tracking requirement also makes the handling of gains/losses and interest income operationally difficult. FIIs look forward to the introduction of system coding and/or market norms that could easily distinguish onshore versus offshore RMB, which would make tracking such usage easier for all market participants.

Reporting failed trades

Like CIBM Direct trades, trades on Bond Connect could fail. When a trade fails, it has to be cancelled in the market and if required, a new trade has to be executed. Both the foreign investor and the onshore counterparty have to file a failed trade report with CFETS and the relevant depository. These reports have to be in Chinese and the process is not standardized, and it also depends on whether the trade has been confirmed by CMU. It would be beneficial to standardize the failed trade reporting process by permitting such reports to be done in English and for the fail reason to be reported to the CMU custodian (similar to the BSA under CIBM Direct) and for the CMU custodian to file the failed trade report to CFETS and the relevant depository. Having a centralized source of the reasons for failed trade at the CMU level would improve efficiency in this regard. Perhaps BCCL can be the sole entity responsible for all the failed trades reporting so that they can share the required information in data/file format with CCDC, SCH and CMU instead of having both the foreign investor for which inputting information in Chinese is a challenge and onshore counterparty file the fail trade reports.

Block trading

On 31 August 2018, Bond Connect launched block trade allocation services, which allow investment managers to allocate block trades to multiple client accounts prior to the trades. With the pre-trade allocations function, FIIs can execute a single block trade and allocate specific percentages or amounts of the trade to up to 30 individual accounts. For large investment managers with a lot of funds and/or clients under their management, it would be helpful if there is no limit on the number of accounts that can be included in a single block trade. In addition, there are some other requirements, such as the requirement to include CFETS trade deal number as a criterion to match and settle the trade, that make the processing of block trades challenging. We suggest that there be working group(s) comprising of the relevant Bond Connect stakeholders (e.g. CFETS, CCDC, SCH, CMU, BCCL, PBOC and HKMA) and representatives from the industry to find a solution for these types of issues.

2.4 General debt related issues

Set out below are some issues that apply generally to FIIs' debt investment in China.

Access to bond repos and bond futures

When making investment decision, the ability to recycle limited investment capital is one of the considerations for FIIs. QFIIs, RQFIIs and FIIs investing through CIBM Direct and Bond Connect would like to be able to access the bond repo market which are currently only opened to foreign central banks, international financial organizations, sovereign wealth funds and RMB clearing banks. Bond repos would enable FIIs to allocate and invest their capital in a more efficient way.

In addition, FIIs often use bond futures as an effective duration management tool given their substantial liquidity and generally low cost. As domestic investors are allowed to use bond futures, we ask that FIIs be allowed to do the same.

Derivatives and derivatives documentation

Currently, QFIIs/RQFIIs and FIIs investing under CIBM Direct are able to engage in FX derivatives transactions for hedging purposes. However, they must do so with their custodian or BSA only. FIIs would like to have more choices to trade FX derivatives, such as with third party brokers besides their custodian or BSA in order to get better liquidity and pricing. FIIs would also like to be able to invest or use derivatives beyond hedging purposes, such as for more efficient portfolio management, cost optimization, etc.

FIIs under CIBM Direct are allowed to engage in bond lending, bond forward, interest rate swaps and forward rate agreements for hedging purposes but they must use National Association of Finance Market Institutional Investors (NAFMII) documentation for non-FX derivatives transactions and centrally clear them through SCH. Most FIIs prefer to use globally recognized documentation from the International Swaps and Derivative Association (**ISDA**) documentation for their derivatives transactions as it allows them to net liabilities with counterparties using the same documentation, which is critical given the capital requirements placed on a lot of foreign derivatives counterparties. Allowing FIIs to use ISDA documentation would facilitate greater foreign engagement in derivatives transactions in China.

Remaining tax clarifications

Lack of clarity on the tax treatment of bond interest received by FIIs had been a major reason why many FIIs have held back investing through CIBM Direct and Bond Connect. The State Council finally announced on 30 August 2018 a three-year exemption from withholding tax ("**WHT**") and value added tax ("**VAT**") on interest income derived by FIIs on onshore China bonds. This was followed by the notice issued by the Ministry of Finance ("**MOF**") and SAT on 7 November 2018 (the "**Joint Tax Notice**") that the three-year exemption on bond interest WHT and VAT for FIIs will commence on that day[45].

However, FIIs are still waiting to see the implementation details as there are still a number of areas which require clarification.

Exemption retroactivity

According to the Joint Tax Notice, interest income from onshore bonds purchased by FIIs is exempted from WHT and VAT for three years from 7 November 2018. However, for the period prior to that date, the tax treatment is unclear for foreign investors. As there has been a lack of effective withholding mechanism for the collection of WHT or VAT, it would be difficult if not impossible for these taxes to be withheld prior to that date. FIIs, particularly funds and fund managers, have struggled to decide on whether to make a provision for such taxes on their funds' balance sheet. Any such provision will have a direct impact on the expected return from the funds' bond investment. And, any retroactive collection of such taxes from fund unitholders is impractical if not impossible.

As foreign funds and fund managers need certainty, they would be grateful if the MOF and SAT can provide clarity on whether WHT and VAT are due for bond interest received for the period prior to 7 November 2018 and preferably confirm that they would not seek to change or challenge the past treatment adopted by foreign funds and fund managers regardless of whether tax has or has not been withheld or provided for in the past. Such clarification or confirmation from MOF and SAT would be beneficial to the whole fund industry. Without clarity and certainty as to whether WHT and VAT are payable on bond interest derived prior to 7 November 2018, FIIs would face difficulties and undue delay in the tax clearance process when they decide to repatriate profits. FIIs are also concerned that without clear guidance from MOF and SAT, different local tax bureau may adopt different stance and practice resulting in inconsistent and undesirable outcomes for FIIs.

Permanency of Exemption

In addition, as the tax exemption is for a three-year period only, FIIs would like sufficient notice in advance, preferably at least six months prior to the end of the three-year period. As most jurisdictions such as the United States, Japan and Australia exempt foreign investors from WHT in respect of interest on government bonds and certain corporate bonds, FIIs would welcome a permanent tax

[45] Notice on Policies on Enterprise Income Tax and Value-added Tax for Overseas Institutions Investing in the Domestic Bond Market issued by MOF and SAT on 7 November 2018. http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201811/t20181122_3073546.html

exemption for China bonds. We also note that, to the best of our knowledge, China is the only jurisdiction which applies a VAT to non-government bond interest income and other financial products. By eliminating VAT permanently on bond interest income, China would attract more FIIs to invest in its bond markets. Importantly, in the event that the WHT and VAT exemption will not be renewed, there would need to be detailed withholding mechanisms in place to support the tax compliance and payment process, and reasonable notice to foreign investors such that they have sufficient time to implement the proper process and procedures.

Scope of the exemption

The aforementioned State Council announcement and Joint Tax Notice referred generally to WHT and VAT exemption for FIIs. We assume that, such exemption applies to all FIIs regardless of the access channel used by them to purchase bonds in China in the past or in the future. It would be helpful to have this confirmed in writing by MOF or SAT.

In addition, it would be helpful to clarify that the scope of exemption is not limited to "bonds" but rather that it was intended to apply to all "debt instruments". There are various types of tradeable instruments in the CIBM besides bonds (e.g. treasury bonds, local government bonds, central bank bonds, financial and corporate bonds) such as asset backed securities, certificate of deposits, etc. There are also derivatives such as bond lending, bond forwards, forward rate agreements and interest rate swaps that FIIs are allowed to invest in or trade under the CIBM Direct. Clarification by SAFE on which of these instruments are covered by the tax exemption would be helpful.

Certainty of tax treatment on their investments is an important consideration for foreign investors and implementation rules on these areas will be most beneficial for further development of the China bond market.

Trading hours

The trading hours in the CIBM are from 9:00 to 12:00 and from 13:30 to 16:30 CST, which make it difficult for FIIs based in Europe and the U.S. to trade. Extending trading hours or at least encourage market makers to provide liquidity during non-CST hours would facilitate more foreign investment in the CIBM. In addition, we note that the settlement cut-off times for CIBM Direct is 17:00 but 12:00 CST for Bond Connect. Aligning the trading hours, settlement cut-off times, and minimum trade size under the CIBM Direct and Bond Connect would help optimize FIIs' operational processes, reduce confusion and ensure consistency between the two channels.

Rolling settlement

To avoid failed trades having to be cancelled and the need to re-price a trade the following business day, it would be helpful to introduce rolling settlement for China bonds if the counterparties agree. Rolling settlement means that if a trade fails to settle on settlement, there is an option to roll over the settlement date to the next business day if the counterparties agree so that there is no need to re-price the deal.

Auction process

China's new bond issue or auction process can be streamlined as there is no official records between the auction date and the listing date, for example. Official transaction records should be made on the date of the auction or new issue to reflect the investor's true market exposures so that the NAV, in the case of funds, can be reported accurately to the market and for regulatory reporting purposes such as in the case of European funds which are subject to the Markets in Financial Instruments Directive (MiFID).

Liquidity difference between on-the-run and off-the-run government bonds

Once Chinese government bonds have moved from on-the-run to off-the-run, there is a significant drop off in liquidity, making it especially difficult for passive funds to completely replicate the indices. The cost of switching from the previous on-the-run bonds to the new on-the-run bonds can also be material. To improve liquidity of China bonds, we suggest in the short run, reducing the number of new bond issuances, allowing more re-tapping by existing bonds, introducing buy-back mechanisms and exchange programs, and allowing outright repos and not just pledged repos; and in the long run, allowing a more diverse group of investors with different investment strategies and horizons into China's bond markets.

E. Operating in China

Foreign investment managers that want to operate in China have several options depending on their business strategy.

Representative offices and consulting WFOEs

Historically, foreign investment managers entered China either by establishing a representative office or a wholly owned consulting company or advisory company in China to provide unregulated liaison, general consulting and advisory services (including research on the A share market) to their offshore affiliates.

FMC JVs

Since 2002, foreign investment managers have been able to own a minority interest in an FMC JV that engages in the mutual fund management business. In 2008, FMCs were also allowed to engage in the segregated account asset management business thereby enabling them to manage segregated account mandates for, or sell private funds to, one or more institutional investors.

As noted earlier, it was announced in 2018 that foreign investors can now own up to 51%, and by 2021 100%, of an FMC. To be able to launch retail funds in China is the ultimate goal of many foreign investment managers.

PFMs

Private funds are funds that are offered to a limited number of investors (i.e. no more than 200), typically to qualified investors, including high net worth individuals, corporates and other financial products. There are four types of private fund managers: (a) private equity and venture capital fund managers; (b) private securities investment fund managers; (c) other private alternative investment managers (e.g. QDLP managers); and (d) private asset allocation managers. For the purposes of this Paper, we will focus mainly on the private fund managers in (b) and (c) above.

Private securities investment funds, which invest in listed securities, bonds traded in the CIBM and financial derivatives, were recognized and allowed following the implementation in 2013 of the *PRC Securities Investment Fund Law*. Starting from 2014, all investment managers that want to engage in private securities investments must register with AMAC before they can launch private securities investment funds or provide investment management or advisory services to such funds. For the latter, a PFM has to satisfy certain conditions in order to qualify as an investment advisor to specified institutional investors or certain AMPs, such as private asset management schemes regulated by CSRC, private funds filed with AMAC or wealth management products regulated by CBIRC.

Since 30 June 2016, PFM WFOEs have been allowed to register with AMAC[46]. A PFM must launch its first fund within six months of its registration and the fund must have at least RMB 1 million of AUM. Quite a large number of investment management WFOEs have been set up by foreign investors, mostly in Shanghai but also in Beijing and Shenzhen. However, many have not yet registered as a

[46] Q&A No. 10 on the Relevant Questions Regarding the Registration and Filing of Private Funds. AMAC. 30 June 2016. http://www.amac.org.cn/xhdt/zxdt/390744.shtml

PFM WFOE with AMAC because of the requirement that within six months of such registration the PFM WFOE must launch its first fund. As of January 2019, 16 PFM WFOEs have been registered with AMAC.

As of December 2018, 25 private funds have been launched by 14 of these PFM WFOEs with eight of them being equity funds, five fixed income funds, 11 mixed funds and one futures and other derivatives fund[47].

QDLP/QDIE managers

Foreign investment managers that want to raise money from Chinese investors for their international strategies can set up a QDLP in Shanghai or QDIE in Shenzhen or other cities in China which has an equivalent QDLP scheme. As the QDLP and QDIE schemes are launched by local governments, they are governed by local regulations although SAFE grants the quota for each QDLP and QDIE product. Many foreign investment managers that would like to manage these products have been disappointed by the lack of transparency on both the granting of QDLP and QDIE licenses and the granting of their quota. Quotas for these products have been granted very sporadically and to only a few investment managers in recent years and there is currently no timetable for the future release of such quotas.

Below is a table on the types of foreign owned investment management entities in China and their permissible activities.

Table 4: Comparison of Foreign Owned Investment Management Entities in China

	FMC	PFM	QDII	QDLP/QDIE
Eligible investors	• Retail funds • Private AMPs with different minimum subscription amount for fixed income, mixed, equity, commodities and financial derivatives AMPs for: o *Qualified individual investors* that have over two years' investment experience, and one of the following: - ≥ RMB 3 mm of net financial assets at the household level, - ≥ RMB 5 mm of financial assets at the household level, or	• *Qualified Individual investors who invest at least RMB 1 mm in a single private fund and* meet one of the following: - have financial assets of at least RMB 3 mm, or - average annual personal income of at least RMB 500,000 in the past three years • *Qualified Institutional*	• Different retail investors or qualified investors depending on the types of QDII (i.e. bank, FMC, securities company or trust company)	• Qualified investors (as applicable to PFM), but for investors of - QDLP fund in the form of LLP: the minimum subscription amount is RMB 5 mm - QDIE funds: the minimum subscription amount is RMB 2 mm

[47] Source: AMAC. http://gs.amac.org.cn/amac-infodisc/res/pof/manager/index.html

	FMC	PFM	QDII	QDLP/QDIE
	- ≥ RMB 400,000 average annual income over the past three years at the individual level ○ *Qualified institutional investors* that have at least than RMB 10 mm of net assets at the end of the previous year ○ *Other qualified investors* recognized by CSRC	*investors* that invest at least RMB 1 mm in a single private fund and have net assets of at least RMB 10 mm • *Other qualified investors* recognized by financial regulators		
Regulatory approval	• CSRC license	• AMAC registration	• CSRC/CBIRC license • SAFE quota	• Shanghai or Shenzhen government license • SAFE quota • AMAC registration
Eligible investments	• Stocks and bonds listed and traded on stock exchanges • Bonds traded on CIBM • Financial derivatives prescribed by CSRC (e.g., stock index futures) • Retail funds • Other securities and their derivatives allowed by CSRC	• Stocks and bonds listed and traded on stock exchanges • Bonds traded on CIBM (if the PFM has AUM of RMB 2 billion and above) • Futures • Options • Retail funds and other AMPs • Other types of investment products agreed to in fund contracts	• Equities, bonds and retail funds traded mainly on overseas secondary markets	• Various type of overseas investments including private equities, REITS and hedge funds

Source: Llinks Law Offices

Competition

The recent rule changes governing Bank WM Subsidiaries suggest that a Bank WM Subsidiary is expected to succeed to all or a majority of the current wealth management businesses from its bank parent and will be a new type of investment manager[48]. These Bank WM Subsidiaries will be a major

[48] Administrative Measures for the Supervision and Administration of Wealth Management Business of Commercial Banks. CBIRC. 26 September 2018. http://www.cbrc.gov.cn/chinese/newShouDoc/8F256782CDD74BABB776B1B33F1B6BC0.html
Administrative Measures for Banks' Wealth Management Subsidiaries. CBIRC. 2 December 2018. http://www.cbrc.gov.cn/chinese/newShouDoc/EC5C3807543C4B0EA9DF5A8267B59433.html

competitor of FMCs and PFMs as they can offer both private and retail wealth management products. It will be interesting to see how the Bank WM Subsidiaries develop their business strategies and how other investment managers, such as FMCs and PFMs, compete or collaborate with them.

The rest of this section of the Paper will focus on foreign owned FMCs and PFMs while QDLPs and QDIEs are dealt with in the next section of the Paper.

1. Fund Management Companies

Foreign investors were allowed to enter the mutual fund business in China when China joined the World Trade Organization (WTO) in 2001. However, their ownership interest in an FMC was initially limited to 33%, which was increased to 49% in 2005. As of the end of 2018, 44 global investment managers have equity interests in an FMC JV[49]. In 2013, Hong Kong and Macau domiciled investment managers were first allowed to set up a majority owned FMC JV pursuant to Supplement X to CEPA[50]. On 1 July 2016, HSQH FMC became the first "foreign" (i.e. Hong Kong) majority owned (70%) FMC JV in China.

During the eighth round of the China-US Strategic and Economic Dialogue in June 2016, China agreed to increase gradually the foreign ownership limit of certain financial institutions. On 10 November 2017, the State Council announced that the permitted level of foreign ownership of FMCs would increase initially to 51% and to 100% within three years[51]. On 28 April 2018, CSRC confirmed that the raising of the foreign ownership limit to 51% does not entail any changes to the existing FMC regulations but foreign investors still have to apply to CSRC to change the actual controller of an existing FMC JV or to set up a new foreign majority-owned FMC.[52]

Clear roadmap to majority foreign ownership

Some foreign investors are reportedly in discussion with their local JV partner to increase their ownership to 51% while others are in the process of establishing or contemplating the establishment of their own majority-owned FMC JV. Increasing the foreign shareholding level in these JVs requires CSRC approval but there is limited clarity on all the steps that are required to be taken and CSRC's considerations and conditions for granting such approval. FIIs, therefore, would like to see a clearer roadmap for them to transition from a minority shareholding interest to 51% ownership and from 51% ownership to 100% ownership of an FMC.

2. Private Fund Management Companies

Since foreign investment managers were allowed to register PFM WFOEs in June 2016, there has been quite a lot of interest. To register a PFM WFOE, the foreign shareholder(s) or controller(s) of the PFM WFOE must meet the following eligibility requirements: (a) they must be a financial institution licensed by a financial regulatory authority in their home jurisdiction, (b) the securities regulatory authority in

[49] Source: CSRC. http://www.csrc.gov.cn/pub/zjhpublic/G00306205/201509/t20150924_284315.htm
[50] Supplement X to CEPA, signed on 29 August 2013. https://www.tid.gov.hk/english/cepa/legaltext/cepa11.html
[51] State Council announcement. 10 November 2017. http://appbriefing.scio.gov.cn/data/gxbimg/gxbwap/2017/11/10/cms_2433509307089920.html
[52] Q&A by CSRC spokesperson on Administrative Measures for Foreign-Invested Securities Companies. 28 April 2018. http://www.csrc.gov.cn/pub/csrc_en/newsfacts/PressConference/201804/t20180429_337512.html

their home jurisdiction must have entered into a memorandum of understanding on securities regulatory cooperation with the CSRC or other institutions recognized by the CSRC, and (c) they must not have been subject to any material penalty by a regulatory or judicial department in the past three years.

Seeding

Once established, a PFM WFOE must launch its first product (i.e. private securities investment fund) within six months of its registration with AMAC. While there is no statutory minimum number of investors in the regulations, AMAC has told some PFM WFOEs that "collective" PFM products (as opposed to mandates for a single client) must have at least two investors at fund launch. In addition, a minimum subscription amount of RMB 1 million per investor is required.

It is common practice globally for fund managers to provide the initial investment in their funds in order to establish a track record for their investment strategy and to provide confidence to third party investors when the fund manager is ready to distribute the fund more widely. However, in China, it is extremely difficult for PFM WFOEs to seed their own funds because they are not allowed to use their registered capital[53] to seed their funds. They can only use their profits or other legitimate revenue to seed their funds. Being start-up companies, PFM WFOEs are unlikely to have any revenue or profit for a while. Of course, PFM WFOEs can also get their onshore affiliates to invest in their funds provided that those affiliates are permitted to invest in private funds. But many of them are unlikely to have any affiliates onshore. If at least two investors are required at the launch of a PFM fund, PFM WFOEs will not be able to rely only on seed capital which may make it challenging for some of them.

Currently, QFIIs/RQFIIs are permitted to invest in publicly offered securities investment funds as well as segregated account mandates of FMCs. CSRC recently proposed to allow QFIIs/RQFIIs to invest also in private securities investment funds. The industry is waiting for confirmation that the revised permissible scope of QFII/RQFIIs will be sufficiently wide and aligned with the investment scope of the private securities investment funds. If this proves to be the case, this development will be most welcomed and much appreciated by FIIs as it would provide a ready source of seeding monies for the private funds of PFM WFOEs. Allowing QFIIs/RQFIIs to be an initial investor into a PFM WFOE's fund would allow the PFM WFOE to launch more funds and establish a track record that should enhance Chinese investors' confidence in those funds.

Broadening the investor base of PFM funds

Other eligible investors of PFM products include privately raised WMPs of Bank WM Subsidiaries, proprietary capital of FMCs and their subsidiaries, segregated account mandate products of FMCs and their subsidiaries, proprietary capital of securities companies that are licensed for proprietary securities trading business, privately raised collective asset management schemes and targeted client asset management schemes offered by securities companies or their asset management subsidiaries, targeted client asset management schemes offered by insurance asset management companies (but not insurance companies themselves), proprietary capital and trust products (collective or single investor) of trust companies, proprietary capital and privately raised asset management products of

[53] Notice of the State Administration of Foreign Exchange on Reforming and Standardizing the Administrative Provisions on Capital Account Foreign Exchange Settlement. SAFE. 15 June 2016. http://www.safe.gov.cn/safe/2016/0615/6836.html

futures companies or their asset management subsidiaries, charitable funds, proprietary capital and private funds of other PFMs registered with AMAC[54].

We understand that Chinese insurance companies are currently allowed to invest in private equity funds but not private securities investment funds. PFM WFOEs would like to see Chinese insurance companies be allowed to invest in private securities investment funds so that these can be another source of capital for PFM funds. Similarly, expanding the type of investors for private securities investment funds to include the national social security funds, pension funds and enterprise annuities would also be helpful to sustain the development of PFM WFOEs.

Fundraising or distribution challenges

As PFM WFOEs are new to the China market, they rely heavily on commercial banks, securities companies and FMCs to invest in or help raise monies for their funds.

Bank WMPS

Currently, commercial banks in China are not allowed to invest, directly or indirectly, their proprietary capital in stocks and therefore private securities investment funds. They are allowed to invest, through their WMPs, in private securities investment funds of financial institutions only. However, since the issuance of the Guiding Opinions, commercial banks should establish a Bank WM Subsidiary to conduct their wealth management business.

Because PFMs are not considered "financial institutions", the way banks used to invest in or raise funds for PFM products is that they would distribute or invest in an AMP issued by a financial institution (e.g. trust company, securities company or FMC subsidiary) that invests in a PFM product (a "**Wrapper Product**") or that is advised by a PFM.

Under CBIRC's implementing measures for the supervision and administration of the wealth management business of commercial banks and their subsidiaries issued in 2018[55], both commercial banks and their Bank WM Subsidiaries can launch and manage retail and privately raised WMPs. However, bank WMPs are no longer allowed to invest in private funds. And, only privately raised WMPs (not retail WMPs) of Bank WM Subsidiaries are allowed to invest in private funds, provided that such funds are managed by a PFM that (a) is registered with AMAC as a private securities investment fund manager for at least one year, (b) has no previous record of serious violation of laws and regulations, and (c) is a member of AMAC.

Since many banks are just beginning to set up their Bank WM Subsidiary, for the time being PFM WFOEs can only rely on securities and futures operators as well as third party distribution platforms (e.g. Tiantian, Howbuy and Noah) to help raise capital for their private funds.

More than 20 commercial banks have announced that they will establish a Bank WM Subsidiary and applications by Bank of China, Agricultural Bank of China, China Construction Bank, Industrial and

[54] Capital-Raising Channels for WFOE PFMs. Llinks Law Offices. September 2017. http://www.llinkslaw.com/uploadfile/publication/57_1515137830.pdf

[55] Administrative Measures for the Supervision and Administration of Wealth Management Business of Commercial Banks. CBIRC. 26 September 2018. http://www.cbrc.gov.cn/chinese/newShouDoc/8F256782CDD74BABB776B1B33F1B6BC0.html
Administrative Measures for Banks' Wealth Management Subsidiaries. CBIRC. 2 December 2018. http://www.cbrc.gov.cn/chinese/newShouDoc/EC5C3807543C4B0EA9DF5A8267B59433.html

Commercial Bank of China and Bank of Communications have already been approved by CBIRC. As a new type of financial institution, these Bank WM Subsidiaries can issue both public and private WMPs and their private WMPs can be a source of funding for private funds of PFM WFOEs. But they also pose a competitive threat to PFM WFOEs.

Private AMPs of securities and futures operators

CSRC's implementing measures for the private asset management business of securities and futures operators issued on 22 October 2018[56] confirmed that private AMPs of all securities and futures operators may invest in private funds managed by PFM WFOEs provided that any conflict of interest is managed if they are affiliates of the PFM WFOE.

These measures also provide that unless some exceptional requirements are satisfied, (a) a collective AMP (i.e. AMP with two or more investors) issued by the securities and futures operators shall not invest more than 25% of its net assets in a single asset (e.g. specific security or investment portfolio), and (b) the amount invested in an asset by all collective AMPs offered by the same securities and futures operator shall not exceed 25% of the asset (referred herein as the "**double 25% requirement**").

The double 25% requirement effectively means that a Wrapper Product issued by a securities and futures operator needs to invest in at least four unrelated private funds or a private fund needs to have at least four unrelated investors, which make product design and operation of the PFM's private fund and the Wrapper Product extremely complicated and almost impossible to implement. As a result, fundraising by private funds has become even more challenging than it used to be.

While we understand the objective of the Guiding Opinions is to prevent multi-layer product investments, it does have an impact on PFM WFOEs' and QDLP managers' ability to raise funds from AMPs especially through fund-of-fund products which already have two layers of funds. It also restricts the capability of implementing a multi-asset investment strategy to onboard any AMP client as the multi-asset strategy needs to leverage the underlying equity and fixed income private funds as building blocks.

FIIs would like Chinese regulators to review the investment concentration limits as they are applied to Wrapper Products as these types of products are very common overseas. The double 25% requirement would severely limit the ability of PFM WFOEs to raise capital for their funds from securities and futures operators and to bring more investment strategies to the China market that would meet Chinese investors' needs. We suggest that there be a removal of the double 25% requirement as well as a relaxation of the multi-layer investment restriction if there is a legitimate reason or strategy for having more than two layers of investment (e.g. asset allocation, master feeder structure). Otherwise, these requirements will make it difficult for newly-established PFM WFOEs and QDLP managers with few onshore clients to raise capital for their funds from securities and futures operators and may decrease the interest of some potential foreign investors in establishing a presence in China.

[56] Administrative Measures for Securities and Futures Operating Institutions' Privately Offered Asset Management Businesses. CSRC. 22 October 2018. http://www.csrc.gov.cn/pub/zjhpublic/zjh/201810/P020181022804792210933.pdf
Administrative Regulations on the Operation of Securities and Futures Operating Institutions' Privately Offered Asset Management Schemes. CSRC. 22 October 2018. http://www.csrc.gov.cn/pub/zjhpublic/zjh/201810/P020181022809298932631.pdf

Investment advisory services

PFM WFOEs are also allowed to provide investment advisory services to privately raised WMPs offered by Bank WM Subsidiaries[57] as well as private AMPs offered by securities and futures operators and private funds issued by other PFMs[58] if they (a) have been registered with AMAC as a private securities investment fund manager for at least one year, (b) have at least three investment management personnel, each of whom should have a track record of at least three consecutive years' in securities or futures investment management and no bad track record, (c) are a member of AMAC; and (d) have no previous record of serious violation of laws and regulations. This is known as the "**1+3+3 requirement**"[59].

Since some of the investment personnel of PFM WFOEs are likely to have an investment management track record overseas, PFM WFOEs would like the overseas investment management experience of these investment personnel to be counted towards the required track record. We understand that AMAC indicated to existing PFM WFOEs in 2018 that overseas investment management track records will be recognized. We look forward to seeing this policy confirmed in writing.

It would also be helpful if investment management personnel include not just portfolio managers but also investment analysts (equity, fixed income and/or credit) who play an important role in the investment decision-making process. If investment management personnel refer only to portfolio managers with local experience, PFM WFOEs may have to recruit them externally which is not ideal because of the costs involved and the time needed to train any newcomer to the culture and investment style of the particular PFM WFOE.

FIIs also welcome CSRC's recent proposal in the Proposed New QFII/RQFII Measures to allow a QFII/RQFII to appoint its affiliate PFM to provide investment advisory services to it. Besides providing a source of revenue to its affiliate PFM WFOE, a QFII/RQFII is able to utilise the PFM WFOE's onshore investment staff. We would like to request that if a PFM WFOE can meet the 1+3+3 requirement, it be allowed to provide investment advisory services to other domestic institutional investors such as pension funds, insurance companies and other domestic investment managers. This would provide PFM WFOEs with much-needed additional sources of income which should also mean more profits made in China and more taxes paid in China.

Investment threshold and scope

While PFM WFOEs are allowed to invest in bonds traded on the CIBM, to open an account in the CIBM, a PFM WFOE has to be one of the "leading" firms within the industry, which has been interpreted to be firms with significant AUM, i.e. AUM of RMB 2 billion and above. As most PFM WFOEs are start-up entities, they are unlikely to have built up the required AUM on their own. PFM WFOEs would like to include the assets managed by its affiliates that are invested in China's securities

[57] Administrative Measures for Banks' Wealth Management Subsidiaries. CBIRC. 2 December 2018. http://www.cbrc.gov.cn/chinese/newShouDoc/EC5C3807543C4B0EA9DF5A8267B59433.html

[58] Administrative Measures for Securities and Futures Operating Institutions' Privately Offered Asset Management Businesses. CSRC. 22 October 2018. http://www.csrc.gov.cn/pub/zjhpublic/zjh/201810/P020181022804792210933.pdf
Administrative Regulations on the Operation of Securities and Futures Operating Institutions' Privately Offered Asset Management Schemes. CSRC. 22 October 2018. http://www.csrc.gov.cn/pub/zjhpublic/zjh/201810/P020181022809298932631.pdf

[59] Article 14 (8) of the Interim Administrative Provisions on the Operation of the Private Asset Management Business of Securities and Futures Operation Institutions. CSRC. 14 July 2016. http://www.csrc.gov.cn/newsite/qhjgb/qhbzcfg/201805/t20180509_337965.html

market, whether through QFII, RQFII, Stock Connect, Bond Connect or CIBM Direct. We understand that AMAC issued a notice to existing PFM WFOEs in December 2018 that for purposes of this requirement, the AUM of equities and bond investments made by a PFM WFOE, its offshore parent company and affiliates, through QFII, RQFII, CIBM Direct, Bond Connect and Stock Connect schemes, can be aggregated. We hope that AMAC will make publicly available this notice as well as any other notice or circular that applies to PFM WFOEs so that foreign investment managers intending to set up PFM WFOEs can have a clearer picture of their investment scope or permissible activities.

There is also concern over the restricted investment scope of PFM WFOEs, which are not allowed to invest in assets (e.g. Hong Kong stocks through the southbound Stock Connect and onshore funds) that provide exposure to overseas assets while local PFMs are not restricted in the same way. Domestically owned investment management entities already have certain natural advantages given their longer history and experience in the China market as well as greater brand awareness. Depriving PFM WFOEs access to offshore assets not only accentuates the unlevel playing field between foreign and domestic owned PFMs but also denies Chinese investors an opportunity to invest with foreign investment managers who have more experience investing in the overseas markets.

Moreover, FIIs, particularly foreign investment managers, would like PFM WFOEs to be given access to the QDII program (see Section F below) which would enable them to offer Chinese investors variations of their international strategies, provided that there is a tax safe harbor available to do so (see below for details). Foreign investment managers are clearly well placed to manufacture these international strategies onshore in China and enabling PFM WFOEs to do so would help transfer knowledge of international investing into the Chinese investment management talent pool.

Given that investors in PFM products are more sophisticated, the investment scope of these products can be broader. We suggest that private securities investment funds be allowed to invest in other assets such as cross-border ETFs, QDII funds and other assets and financial instruments that FMCs can invest in.

Distribution of offshore products to domestic institutional investors

Currently, FIIs can only distribute private funds that invest in China or offshore strategies via the QDLP or QDIE schemes. Until this restriction is lifted, foreign investment managers will continue to market their international strategies to investors such as Asian Infrastructure Investment Bank, China Investment Corporation, SAFE and QDIIs on a fly-in, fly-out basis from places like Hong Kong, London, New York and Singapore generating revenue, profit and taxes payable outside China. Enabling employees of PFM WFOEs to promote international strategies, particularly those of their group, to Chinese institutional investors would keep more of the economics of doing so inside China. It would also enable the asset management talent pool in China to become much more knowledgeable about international investment. Allowing PFM WFOEs to promote their offshore affiliates' strategies works to the advantage of both the China asset management industry and the foreign investment managers. It will also allow the PFM WFOEs to deploy their sales teams more flexibly between promoting domestic products and offshore strategies.

Acquisition of domestic PFMs

FIIs interested in acquiring a domestic PFM would like to see some guidance or clarity on how this can be achieved, such as the feasibility of such acquisition and the regulatory and operational process involved (e.g. whether it entails just a change in shareholder of the domestic PFM or a new PFM WFOE has to be set up first and then merged with the domestic PFM or assets of the domestic PFM are transferred to the new PFM WFOE).

Transition to FMC

When setting up a fund management business in China, foreign investors can either set up a 51% majority-owned FMC JV now and hope to increase its ownership to 100% after three years or set up a 100% owned PFM now and hope to be allowed to manage public funds and/or convert to an FMC three years later.

A PFM can apply to engage in the mutual fund management business if it satisfies the following conditions[60]:

(a) it has at least three years of securities investment management experience and the performance of the securities products under its management in the past three years has been good;

(b) it has sound corporate governance and internal controls as well as effective risk management;

(c) it has good operating conditions and sound financial condition during the past three years;

(d) it has no record of serious breaches of laws and regulations in the past three years or been subject to any investigation for legal and regulatory breaches by a regulatory authority or any rectification period;

(e) it is a member of AMAC;

(f) its paid-up or actual contributed capital is not less than RMB 10 million;

(g) its securities under management each year for the past three years is not less than an average of RMB 2 billion; and

(h) it meets other conditions prescribed by the CSRC.

We understand that no PFM has been approved to manage public funds so far although one has been approved to convert into an FMC. For those foreign investors trying to make a decision between the two aforementioned options, it would be helpful to have some clarity on the "other conditions" that the CSRC may prescribe to allow a PFM WFOE to also engage in the mutual fund management business after three years and whether there is any difference between a PFM being allowed to manage public funds and an FMC. It would be helpful to understand the difference between a PFM that is allowed to manage public funds and an FMC which manages public funds.

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[60] Article 5 and Article 8 of the Interim Provisions on the Management of Publicly-raised Securities Investment Funds by Asset Management Institutions. CSRC. 18 February 2013. http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/jj/gszl/201310/t20131021_236629.html

We are of the view that if a PFM is allowed to manage public funds, then it essentially becomes an FMC and should be allowed to conduct all the activities of an FMC. Otherwise, it will create further confusion among FIIs and unnecessary complexity over the many different types of investment management entities that already exist. In addition, it would be more optimal to allow a PFM to transition to an FMC by merely extending its license or license conditions than requiring the shareholder of the PFM to set up a new FMC and for the assets and businesses of the PFM to be transferred to the new FMC.

3. General issues operating in China

Below are some general issues faced by foreign institutions operating in China.

Single entity with multiple licenses

It is worth noting that in most developed markets a single investment management entity can engage in a broad range of investment management activities such as public securities investment funds, private securities investment funds, private equity funds, fund of funds, pension focused products, and investment advisory. The global regulatory trend is to regulate by products and by activities rather than by entity.

China already has a highly fragmented investment management marketplace with multiple types of asset management entities each with different permissible activities. Allowing the same entity to hold separate licenses for different activities would promote better human resource management, cost efficiency and uniform governance and compliance standards.

It would be helpful to simplify the types of investment management entities and standardize the activities that they can engage in across the different financial services sector and without regard to whether they are foreign or domestically owned.

"One Control One Participation" Policy

It is our understanding that the policy of "One Control and One Participation" (一参一控)[61] means that an FMC shareholder is limited to having control over one FMC and participation (i.e. not control or only a minority stake) in another FMC. We understand that in practice CSRC will not allow a foreign investor to have equity interests in more than one FMC. We also understand that this policy applies only to FMCs and not to other types of investment management companies and that the same ultimate controller is allowed to own a majority interest in multiple PFMs or QDLPs if it can provide a sound explanation of the reasons for setting up such entities. In support of the principle of level playing field between foreign and domestic investors, we would ask that foreign investors be accorded the same treatment and be permitted to have "One Control and One Participation" as domestic investors are allowed to do so.

[61] Article 11 of Measures for the Administration of Securities Investment Fund Management Companies. CSRC. 7 November 2012. http://www.csrc.gov.cn/pub/shanghai/xxfw/gfxwj/201211/t20121107_216586.htm

Leverage group resources

Under the general corporate governance principles of the *PRC Company Law*, shareholders are not allowed to interfere with the independent operation of an FMC. This appears to limit the ability of foreign investment managers to share their international experience and best practices in investment decision-making, corporate governance, compliance standards and procedures with the FMC. Foreign shareholders of FMCs would like to be able to apply to the FMC their global trading, compliance and risk control practices so clarification of the ways in which they can do so without interfering with the independent operation of the FMC would be much appreciated.

Group data sharing

FIIs are also concerned about whether they are treated as a Critical Information Infrastructure Operator under the *PRC Cybersecurity Law* which requires them to keep important data and personal information stored in China and limits their ability to share data with their group entities offshore. It is important that FII operations in China can connect with their global trading and operation platforms. Not only does this enhance operational efficiency, it is also critical for risk management. For example, data exchange of shareholdings in Chinese companies is essential for the shareholding disclosure calculation.

Extension of tax preferences

Local onshore products of PFMs and QDLP managers are currently subject to 3% VAT on trading gains from shares and bonds and interest income from policy bank bonds and financial bonds. However, there is a VAT exemption for public securities investment funds ("**SIFs**"). As PFM funds and QDLP/QDIEs are in many ways similar to SIFs, we ask that VAT exemption for SIFs be applied to PFM funds and QDLP/QDIEs.

Tax safe harbour for foreign investment funds and institutional accounts

Foreign investment managers need tax certainty for their funds and clients before basing portfolio managers in China or using onshore portfolio managers to manage their international funds and institutional clients' accounts. Under current Chinese tax law, having a portfolio manager based in China manage or partly manage these international strategies may expose offshore funds/clients to incremental China tax that would not be the case if those funds or client mandates are managed by an offshore portfolio manager. This is because the portfolio manager in China may be considered a non-independent onshore agent of the offshore investor.

Many major financial centres, such as Hong Kong, U.S., U.K., Japan, Singapore and Australia, have positioned themselves as global asset management centres to bring onshore the much-coveted portfolio management aspect of the business. These leading financial services centres have all confirmed or clarified that appointing a local portfolio manager generally does not expose foreign investors to any risk of incremental taxation in their jurisdiction. As a result, investment managers are basing or prefer to base portfolio managers, research analysts, centralised trading desks and a broad range of support roles as well as sales staff in these jurisdictions due to the tax clarity provided.

In order to leverage the investment personnel of FMCs and PFMs to provide investment management services for overseas funds and client mandates, it would be helpful for the MOF and SAT to clarify that foreign investors would not, by virtue of their using a portfolio manager or trader located in China or their placing or doing trades in China, be:

- subject to more onerous China tax (including VAT on management fees) or
- considered as a tax resident or non-resident with an establishment or place of business in China.

Treating onshore managers as independent agents of the offshore funds and institutional client accounts for whose assets they manage is very important as continued uncertainty on this issue may deter foreign investment managers from setting up operations in China, require them to change their business model, result in their incurrence of additional costs and underutilisation of onshore resources, and limit the career opportunities of their onshore staff. We wish to stress that the foregoing would not affect foreign investment funds and institutional client accounts from continuing to pay any China tax due on their China sourced income and capital gains at non-resident rates.

F. Raising funds in China for overseas investment

1. QDII

The QDII program was launched in April 2006 to allow domestic institutional investors to access foreign markets. As at the end of 2018, USD 103 billion quota had been allocated to 152 approved QDIIs that are made up of banks, securities companies, FMCs, insurance companies and trust companies[62]. On 11 April 2018, after three years of hiatus, SAFE announced that it would start granting new QDII quotas, enhance the QDII program and study how the scheme should be improved. However, since June 2018, there has been no additional quota granted.

Below is a table of the different types of QDIIs.

Table 5: Types of QDIIs

Regulating Authority	QDII type	Institution type	QDII product/capital
CBIRC	Bank QDII	Commercial Banks	Overseas wealth management products
	Trust QDII	Trust Companies	Unit trust products and collective trust plans of overseas financial management institutions
CBIRC	Insurer QDII	Insurance institutions, insurance asset management institutions	Insurance funds, Insurance asset management company retained capital
CSRC	Fund QDII, Securities Company QDII	FMCs	QDII funds, QDII mandates
		Securities Companies	QDII collective investment schemes, QDII targeted-client asset management schemes

The QDII program has been an effective channel for Chinese institutional and high net worth individuals to access overseas markets, and to diversify their asset pools and risks. It has also provided a great platform for QDII quota owners to build up their in-house investment capabilities.

Foreign investment managers, in particular, would like to see more quota granted to QDIIs and a schedule for the release of further QDII quota. While it is desirable for China to have an influx of capital into the country, it is equally important to allow capital outflows to support the desire of domestic investors to have a legal channel through which to diversify their investments abroad.

FIIs would like to see a significant increase in QDII quota especially for insurance companies. Current regulations already permit insurance companies to invest in overseas markets via QDII, up to a

[62] Source: SAFE. http://www.safe.gov.cn/guangdong/2019/0107/1294.html

maximum of 15% of their balance sheet and assets.[63] However, the amount of insurance QDII quota is miniscule compared to their asset base. For example, while the total assets of all Chinese insurance companies are USD 26 trillion as at November 2018[64], the total QDII quota for the whole insurance industry amounts to only USD 34 billion[65] as at December 2018, roughly 0.1% of the total insurance assets. An increased quota would provide insurance companies much more flexibility to allocate assets and risk. This is particularly important for life insurance companies that have to match their assets with long liabilities (e.g. 30 years), which they can barely do in the domestic market. In addition, an increase in QDII quota would allow them to capture yield as well as diversify their home bias.

We understand that due to the lack of QDII quota, any unused QDII quota will be cancelled. Owners of QDII quota need more flexibility on the holding period before they have to return the quota back to SAFE because the usage of QDII quota is highly dependent on investor sentiment and global market conditions.

2. QDLP/QDIE

In 2012, Shanghai launched a QDLP program that permits foreign managers to set up an onshore WFOE to act as the manager of QDLP fund(s) and to raise domestic capital from qualified investors in China to invest in overseas securities. Like the QDII scheme, QDLP/QDIEs are subject to a quota. In addition, like a PFM, a QDLP manager also needs to register with AMAC and comply with both QDLP regulations and the general rules applicable to PFMs.

In December 2014, Shenzhen launched a similar QDIE program in Qianhai that allows foreign or domestic investment managers to set up QDIE funds and to raise domestic capital onshore to invest offshore. The QDIE program is generally similar to the QDLP program. As of the end of 2018, 26 QDLP managers and 25 QDLP funds have been registered with AMAC[66].

In January 2019, PBOC and seven other ministries and commissions issued a plan to further develop the QDLP scheme[67] while Shenzhen also issued measures to develop the QDIE scheme[68] further. Foreign investment managers eagerly await the details of this plan and would like to see greater transparency on both the granting of licenses to QDLP and QDIE managers and quota for these products.

FX hedging

QDLPs/QDIEs raise funds in RMB in China before converting them into FX for outbound investments and then converting FX back into RMB on inward remittances. As a result, they run a FX risk which they would like to be able to hedge onshore. Confirmation that QDLPs/QDIEs are allowed to engage in FX hedging onshore similar to that allowed by QFIIs recently would be helpful.

[63] Interim Measures for the Administration of Overseas Investment with Insurance Funds. PBOC, CIRC and SAFE. 26 July 2007. http://bxjg.circ.gov.cn/web/site0/tab5224/info50270.htm
[64] Source: CBIRC. http://bxjg.circ.gov.cn/web/site0/tab5257/info4129066.htm
[65] Source: SAFE. http://www.safe.gov.cn/guangdong/2019/0107/1294.html
[66] Source: AMAC. http://gs.amac.org.cn/amac-infodisc/res/pof/manager/index.html
[67] Shanghai International Financial Center Construction Action Plan (2018-2020). 23 January 2019. http://www.pbc.gov.cn//zhengwugongkai/127924/128038/128109/3758540/index.html
[68] Shenzhen Measures to Promote the Development of Venture Capital Industry. 24 December 2018. http://www.sz.gov.cn/zfgb/2019/gb1084/201901/t20190108_15265373.htm

Fundraising currency

In addition, as noted earlier, the QDLP scheme would further benefit greatly from harmonization with QDII in terms of fundraising currency. Currently QDLP funds are only able to raise funds in RMB, while QDIIs can raise funds in other currencies. Giving QDLP funds the flexibility to raise assets in other currencies would allow investment managers to offer the currency that end investors demand at the point in time of fundraising. Given the challenges of needing to launch a fund within six months, and the difficulty in predicting market conditions, this flexibility would greatly increase the ability of QDLPs to launch their funds on time, and also provide more investment options for foreign currency saving pools in China.

QDLP funds are typically structured as master feeders as they target to invest into offshore master funds. It is unclear whether they are caught by the Guiding Opinions as multi-layer funds. Foreign investment managers would like CSRC to confirm in writing that the two-layer limitation under the Guiding Opinions and the investment concentration limit under the CSRC implementing measures do not apply to QDLP products.

3. Mutual Recognition of Funds

The MRF was launched in May 2015 and was seen at the time as the most promising of the three Asian fund passporting schemes given the size of China's domestic market. However, as at the end of December 2018, only 17 northbound funds from Hong Kong have been approved for sale in China compared to 50 southbound funds from China that have been approved for sale in Hong Kong.

Below is a table of the number of northbound and southbound funds approved each year since the launch of the MRF.

Table 6: Number of funds approved under the MRF (as of December 2018)[69]

	Northbound		Southbound	
	HK funds approved	**Total net capital outflow (as of end of the year)**	**Mainland funds approved**	**Total net capital inflow (as of end of the year) *** **
2015	3	N.A.	13	N.A.
2016	3*	RMB 7.77 billion	35	RMB 0.10 billion
2017	4**	RMB 12.46 billion	2	RMB 0.33 billion
2018	7	RMB 9.02 billion	0	RMB 0.43 billion
Total:	17		50	

* All three funds were approved before March 2016
** Approval of northbound resumed in May 2017
*** Amounts from SAFE website

[69] Source: CSRC, SFC & SAFE. http://www.csrc.gov.cn/pub/zjhpublic/
https://www.sfc.hk/productlistWeb/searchProduct/UTMF.do.
http://www.safe.gov.cn/safe/2018/0424/8884.html
http://www.safe.gov.cn/safe/2018/0424/8885.html

For the foreign fund houses which either have funds established in Hong Kong or have intentionally set up funds in Hong Kong to take advantage of the MRF, it has been a long and disappointing process. The lack of success of the MRF is due to a number of reasons but in the eyes of foreign investors, China's concern over capital outflows during the past few years clearly contributed to the small number of northbound funds approved by the CSRC. It has been reported that a number of northbound funds met the requirements and yet waited more than a year before they received CSRC approval. In fact, it was only in 2017 that northbound funds began to be approved again after a hiatus of 15 months (i.e. no approval between March 2016 and May 2017). We are encouraged to see that two new northbound funds were approved in January 2019.

As of the end of December 2018, the total inflows into the 17 northbound funds amounted to RMB 9.02 billion, 21 times more that the total inflows of RMB 0.43 billion into the 50 southbound funds. The appeal of Mainland mutual funds to Hong Kong investors has been somewhat muted due to the wide availability of existing funds with a China focus and the very disappointing investment returns from the China market in the last few years. Contrast this to the greater appeal for Mainland investors to be able to access global stock and bond markets through Hong Kong, which had previously been unavailable to them and where the range of investment returns has been significantly better than that offered by investments in the China markets.

While FIIs understand the reciprocal nature of the MRF, such as requiring half the assets of a fund to be raised in the fund's home jurisdiction and the other half in the host jurisdiction, the undeniable fact is that the China market is so much larger than Hong Kong's and it would be very difficult for Hong Kong funds to grow their AUM in Hong Kong to match that in the Mainland. Until such requirement is amended to take into consideration the relative size of the Hong Kong market to the Mainland market, it will not be profitable or attractive for global fund managers to set up funds in Hong Kong to meet this requirement under the MRF. We understand, for example, that many global fund managers who have been considering expanding their establishment in Hong Kong, especially to take advantage of the MRF, have decided not to proceed until such time as more demonstrable success has been achieved by northbound MRF participants.

For fund managers as well as fund investors, scale matters because it brings down costs and enables better management of risks of the fund. If the MRF is intended to provide investors in both the Mainland and Hong Kong an opportunity to diversify their investments and leverage the expertise of fund managers in another market, then allowing more diversity in the type of funds allowed to be offered under the MRF, delegation of investment management to offshore entities, and revising the 50/50 AUM requirement for northbound Hong Kong funds would be beneficial to investors and would make the MRF more attractive to fund managers.

When the MRF was established, there was an agreed two-way quota of RMB 300 billion[70]. Clearly the rate of development of MRF to date has gotten nowhere near this amount. Approving funds based solely on their satisfaction of the eligibility requirements and stated conditions would provide the necessary certainty to foreign fund managers who are considering setting up funds in Hong Kong for

[70] Operating Guidelines for the Administration of Cross-Border Issuance and Sales of Securities Investment Funds between Mainland China and Hong Kong. PBOC & SAFE. 6 November 2015. http://www.gov.cn/xinwen/2015-11/06/content_2962192.htm

sale in China. It would also provide investors with the diversification of investment for which the MRF was intended and foster greater market competition among local and international fund managers.

For northbound funds that have already been approved, some fund managers would like CSRC to accept and approve applications for additional share class(es). As of today, there is no formal procedure in place for such product development. It is normal market practice in the fund industry to accept different class features, such as multi-fee levels, currencies and distribution frequencies. This allows investors to receive differentiable investment returns while ultimately being exposed to the same underlying pool of assets. Recognizing the importance of meeting changing market demands, a practical approach to new share class applications for existing funds is important. We request that the CSRC consider these needs and consider application for additional share class(es) for an existing MRF fund.

4. ETF Connect

When the announcement of a potential ETF Connect scheme between Hong Kong and China was first made in August 2016 (to sit alongside the successful Stock Connect and Bond Connect schemes), many in the fund management industry, especially ETF issuers or product providers, were very excited. Japan's ETF market is the second highest after the U.S. ETF market[71] in terms of turnover. However, the combined turnover of China's and Hong Kong's ETF markets is the biggest in Asia, almost 58% higher than that of Japan's. Therefore, we believe ETF Connect would likely spur regional and international investors to trade ETFs in Hong Kong and China instead of just trading them in the U.S. or the U.K.

Unfortunately, in December 2018, it became known that the progress of ETF Connect had hit a number of stumbling blocks and thus was unlikely to proceed in the near term. Instead, it was reported that Hong Kong and China may be discussing an ETF Depositary Receipt programme or cross-listings for ETFs which already exists in Hong Kong for overseas ETFs. Eligibility of which ETFs to include in such a scheme and how to address the different settlement infrastructure for ETFs in the two markets are some of the areas that need to be worked out.

For foreign fund managers and Chinese fund managers operating in Hong Kong, ETF Connect would have provided an opportunity for them to achieve a critical mass for the AUMs of their Hong Kong listed ETFs. For foreign and Chinese investors alike, ETF Connect would have given them an opportunity to dip their toes in the capital market outside their home jurisdiction in a relatively easy and low-cost manner.

Within China, there is little choice for investors beyond stocks, mutual funds and ETFs that invest in domestic securities. In the interest of diversification as well as risk minimization, domestic institutional investors have been investing or looking to invest globally and are able to do so through the QDII scheme and investment in QDLPs and QDIEs. Some of these domestic institutional investors, such as China's major sovereign wealth funds, are major investors of ETFs issued by global fund managers overseas and currently listed mostly in the U.S. (i.e. NASDAQ, NYSE and BATS) or the U.K. (i.e. LSE). An ETF Connect could bring more overseas ETFs to Hong Kong, which, from both a proximity

[71] Source: World Federation of Exchanges. http://www.world-exchanges.org/home/index.php/members

and time zone consideration, is more convenient and easier for decision-making purposes for Mainland institutional and retail investors to invest in.

In view of the many advantages ETF Connect can bring to Mainland investors, it would be a missed opportunity if its launch is stalled by operational challenges and system incompatibility. We look forward to the continual collaboration between the regulatory authorities, stock exchanges and depositories in both the Mainland and Hong Kong to find creative solutions for this Connect program.

G. Glossary

Term	Definition
2017 Paper	ASIFMA Paper "China's Capital Markets: Navigating the Road Ahead" issued in March 2017
AAMG	ASIFMA Asset Management Group
AMAC	Asset Management Association of China
AMP	Asset management product
ASIFMA	Asia Securities Industry & Financial Markets Association
AUM	Asset under management
Bank WM Subsidiaries	Commercial banks' wealth management subsidiaries
BCCL	Bond Connect Company Limited
BSA	Bond settlement agent
CBIRC	China Banking and Insurance Regulatory Commission
CCDC	China Central Depository & Clearing Co., Ltd.
CEPA	Mainland and Hong Kong Closer Economic Partnership Arrangement / Mainland and Macao Closer Economic Partnership Arrangement
CFETS	China Foreign Exchange Trade System
CFFEX	China Financial Futures Exchange
China/Mainland	Mainland China not including Hong Kong, Macao and Taiwan for purposes of this Paper
CIBM	Chinese Interbank Bond Market
CIBM Direct	Direct access to the CIBM
CMU	Central Moneymarkets Unit
CNH	Offshore Renminbi
CNY	Onshore Renminbi
CSRC	China Securities Regulatory Commission
DvP	Delivery against payment
ETF	Exchange traded fund
FII	Foreign institutional investors
FMC	Fund management companies
FX	Foreign exchange
HKD	Hong Kong Dollar
HKEx	Hong Kong Stock Exchange
HKMA	Hong Kong Monetary Authority
HSQH FMC	Hang Seng Qianhai Fund Management Company
IPO	Initial public offering
ISDA	International Swaps and Derivative Association
JV	Joint venture
MiFID	Markets in Financial Instruments Directive
MOF	Ministry of Finance
MRF	Mainland-Hong Kong Mutual Recognition of Funds
NAFMII	National Association of Financial Market Institutional Investors

NAV	Net asset value
NEEQ	National Equities Exchange and Quotations System Co., Ltd
PBOC	People's Bank of China
PFM	Private fund management companies
PFM WFOE	Wholly foreign owned private securities investment fund management entities
QDIE	Qualified Domestic Investment Enterprise
QDII	Qualified Domestic Institutional Investor
QDLP	Qualified Domestic Limited Partnership
QFII	Qualified Foreign Institutional Investor
RFQ	Request for quotation
RMB	Renminbi
RQFII	Renminbi Qualified Foreign Institutional Investor
SAFE	State Administration of Foreign Exchange
SAT	State Administration of Taxation
SBL	Securities borrowing and lending
SCH	Shanghai Clearing House
SIF	Securities Investment Funds
SPSA	Special Purpose Segregated Accounts
SSE	Shanghai Stock Exchange
SZSE	Shenzhen Stock Exchange
T / T+1 / T+2 / T+3 / T-1	Trade date / the day after trade date / two days after trade date / three days after trade date / the day before the trade date
USD	U.S. Dollar
VAT	Value added tax
WFOE	Wholly Foreign Owned Enterprises
WHT	Withholding tax
WMP	Wealth management product
Wrapper Product	AMP issued by a financial institution that invests in a PFM product

Growing Asia's Markets

UNIT 3603, TOWER 2

LIPPO CENTRE

89 QUEENSWAY

ADMIRALTY

HONG KONG

TEL +852 2531 6500

WWW.ASIFMA.ORG