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Growing Asia's Markets

Foreign Institutional Investment in China

Various Access Channels

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Accessing China's Capital Market

With the gradual opening to foreign institutional investors ("FIIs") of China's capital market beginning in 2002, FIIs now have many ways of accessing China's capital market. This paper sets out the various investment access channels for FIIs and captures the major developments since our March 2019 paper on Foreign Institutional Investment in China: *An Asset Management Perspective*.

I. Access from onshore

The first avenues for FIIs to invest in China's capital markets were from onshore, which mean that FIIs have to first set up an account in China, convert foreign currency ("FX") into Renminbi ("RMB") onshore (also referred to as "CNY"), make the investments onshore, and when they want to repatriate the income and profit from these investments, convert CNY back into FX and remit offshore.

The issues for FIIs with investing from onshore in China include having to work with a trading, clearing and settlement infrastructure that is often incompatible with what they are used to globally, being exposed to foreign exchange risk with limited hedging options and the risk of repatriation being delayed or blocked. However, these issues are often offset by access to a bigger range of securities and investment products than investing from offshore as detailed below.

1.1 QFI

QFII

China opened its capital markets to FIIs initially through the Qualified Foreign Institutional Investor ("QFII") scheme which was introduced in 2002. Under the QFII scheme, FIIs must first qualify as a QFII with the China Securities & Regulatory Commission ("CSRC") and then obtain a quota amount for their investments from the State Administration of Foreign Exchange ("SAFE"). The initial quota for the whole QFII scheme was USD 4 billion, which was increased to USD 10 billion in 2005, USD 30 billion in 2007, US$80 billion in 2012, US$150 billion in 2013 and US$300 billion in 2019.

RQFII

With China deciding in 2009 to promote the internationalization of the RMB, the first Renminbi Qualified Foreign Institutional Investor ("RQFII") scheme was launched in Hong Kong in December 2011 to enable FIIs to invest in China with offshore RMB (also referred to as "CNH"). The main differences between the QFII scheme and the RQFII scheme are RQFIIs would use offshore RMB or CNH rather than onshore RMB or CNY to invest in China, and RQFIIs had to be domiciled in one of the designated RQFII jurisdictions with an allocated RQFII quota. There were other differences between the two schemes, which the Mainland authorities tried to align in recent years and finally eliminated in 2020.

The initial quota for the RQFII scheme in Hong Kong was RMB 20 billion, which was increased to RMB 70 billion in April 2012, RMB 270 billion in November 2012 and RMB 500 billion in 2017. The RQFII scheme was subsequently expanded to London and Singapore in 2013, and to more cities/countries thereafter. As of May 2020, 19 countries or jurisdictions were granted a RQFII quota totalling RMB 1,940 billion.

Removal of all quotas

All quotas for both the QFII and RQFII schemes were eliminated from 6 June 2020 under the Regulations on Funds of Securities and Futures Investment by Foreign Institutional Investors (the "New QFI Capital Management Regulations") issued by the People's Bank of China ("PBOC") and SAFE on 7 May 2020[1].

Merger of QFII and RQFII schemes

The QFII and RQFII schemes were also formally merged into a single Qualified Foreign Investor ("QFI") scheme when the long-awaited Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Investors and the Provisions on the implementation of such Measures (the "New QFI Regulations") were issued in September 2020[2], more than 18 months after the draft regulations came out for public consultation in January 2019.

As proposed, the New QFI Regulations merged into one set of regulations what used to be separate regulations for the QFII and RQFII schemes, with eligible FIIs being able to apply in a single application to be a QFI and to invest using either CNY or CNH without any quota limitation. As of November 2020, CSRC has granted licenses to a total of 535 QFIs (i.e. QFIIs and RQFIIs).

Eligible institutions

Before November 2020, only asset managers, banks, insurance companies, securities companies and other types of FIIs such as pension funds, charitable funds, endowment funds, trust companies, government investment management institutions, with a certain amount of assets under management ("AUM") and number of years of operations were eligible to apply for a QFII or RQFII license.

These eligibility requirements were substantially relaxed under the New QFI Regulations. In addition to the aforementioned types of FIIs, the New QFI regulations included futures companies, sovereign funds and international organizations. The specific AUM and years of operation requirements for QFIs were removed and replaced with general requirements such as financial soundness, good credit records, experience in securities and futures investment, sound and effective governance structure, internal control, compliance management regime and procedures, and no record of major regulatory penalties in the latest three years or since establishment. Notably, a new requirement was added that QFIs should not be in a position to have a significant impact on the overall domestic capital market.

[1] Regulations on Funds of Securities and Futures Investment by Foreign Institutional Investors. PBOC and SAFE. 7 May 2020. http://www.safe.gov.cn/safe/2020/0507/16130.html

[2] Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Investors and the Provisions on the implementation of such Measures. PBOC, CSRC and SAFE. 25 September 2020. http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202009/t20200925_383652.html

Investment scope

The investment scope of QFIs also expanded over time. Below is a table showing the gradual expansion of the investment scope and activities for QFIs:

	QFI's investment scope
Dec 2002	• Stocks and bonds listed on stock exchanges
From May 2011	• Stock index futures
From July 2012	• Fixed income products on the China interbank bond market ("CIBM") • Publicly offered securities investment funds • Asset-backed securities ("ABS") listed on stock exchanges • Subscriptions for IPOs, convertible bond issuances, secondary share offerings and share allocations on Shanghai Stock exchange ("SSE") and Shenzhen Stock Exchange ("SZSE")
From Nov 2017	• FX derivatives for hedging purpose only
From June 2019	• Shares listed and traded on SSE's Science & Technology Innovation Board ("STAR") market
From November 2020	• Shares listed and traded on the National Equity Exchange & Quotation ("NEEQ") • Derivatives on bonds, interest rates and foreign exchange on the CIBM • Financial futures listed and traded on the China Financial Futures Exchange ("CFFEX") • Commodity futures contracts listed and traded on approved futures exchanges • Options listed and traded on approved exchanges • Private investment funds whose investments falls within the QFI investment scope • Subscription for bond issuance • Subscription for IPOs, secondary share offerings and share allocations on NEEQ • Margin trading and securities financing on stock exchanges, and securities lending to securities finance company • QFI can appoint its affiliated PFM WFOE as its investment adviser

When applying for a QFI license, FIIs need to disclose their investment plan or strategy to the CSRC. In the new QFI application template issued by the CSRC in December 2020, the QFI applicant is required to disclose their investment strategies for stock, bond, commodity, market neutral, macro and event-driven, for each account. QFIs are required to keep their investment behaviour consistent with such disclosed strategies and notify the CSRC before making any changes thereto.

Other permitted activities

QFIIs/RQFIIs were allowed under the original regulations to entrust the management of their securities investment in China to domestic asset management institutions including securities companies but this was not included in the New QFI Regulations. In response to ASIFMA's query, CSRC confirmed that QFIs may no longer entrust their domestic securities investment management to retail fund management companies ("FMCs"), for example, through an investment management arrangement. However, under the New QFI Regulations, QFIs may invest in private investment funds issued by securities and futures operating institutions and private investment fund managers ("PFMs") registered with the Asset Management Association of China ("AMAC"). They may also entrust their affiliate PFMs to provide investment advice to them.

In addition, QFIs may entrust their cash and financial assets to a single asset management scheme of a securities and futures operating institution (which would include FMCs) according to the Administrative Measures for the Private Asset Management Business of Securities and Futures Operating Institutions issued by the CSRC in October 2018[3].

Lock-up

QFIIs used to be subject to a lock-up period of a year, which was then reduced in 2009 to three months for pension funds, insurance funds, mutual funds, charitable funds, endowment funds, government and monetary authorities and open-ended funds, and in 2016 to all types of QFIIs. RQFIIs were also subject to an initial lock-up period of one year, which was reduced to three months in 2016 but RQFII open-ended funds were never subject to any lock-up period.

The lock-up requirement for both QFIIs and RQFIIs were removed in 2018.

Holding structure

Securities acquired by QFIs may be held in accounts either named as: (a) QFI + Proprietary Funds, (b) QFI + Client Name, (c) QFI + Fund, or (d) QFI + Client Fund. The ownership of the securities held in (b), (c) and (d) above belongs to the client or the fund and shall be kept independent of the assets of the QFI and its custodian.

Repatriation

Before June 2018, QFIIs were subject to restrictions on repatriation in that their monthly repatriation could not exceed 20% of their total net asset value at the end of the previous year and they had to file with the local tax authorities and obtain a tax certificate after audit before they can actually repatriate or remit funds abroad. The monthly repatriation limit for QFIIs was removed in June 2018.

The New QFI Capital Management Regulations, which became effective in June 2020, further facilitated QFIs' profit repatriation by replacing the tax clearance or audit requirement with just an

[3] Administrative Measures for the Private Asset Management Business of Securities and Futures Operating Institutions. CSRC. 22 October 2018. http://www.csrc.gov.cn/pub/zjhpublic/zjh/201810/P020181022804792210933.pdf

undertaking from the QFI that it will fulfil all the tax liabilities without it having to pay all the taxes before it can repatriate.

Custodians

QFIs are required to appoint an onshore custodian who is responsible for safekeeping of their assets, providing investment clearing and settlement, FX settlement, and sales and recordkeeping services to them, monitoring their investment activities, and providing reports or information to the CSRC, PBOC and SAFE according to the rules and regulations.

Before June 2020, QFIIs can only appoint one onshore custodian while RQFIIs can appoint three onshore custodians. The New QFI Capital Management Regulations removed this limit.

Brokers

QFIIs and RQFIIs were limited to trading through a maximum of three brokers on each of the SSE and SZSE. Moreover, shares purchased through one broker must be sold through the same broker. The New QFI Regulations removed the limit on the number of brokers that QFIs may use but they still need to sell the securities they acquired through the same broker.

Trading and settlement

QFI's trading follows the China onshore settlement cycles. For stock trading, the movement of securities occurs on trade day ("T") while the movement of cash occurs on T+1. For bond trading, investors have the choice of settling their trade on T, T+1, T+2 and T+3 and even T+4 and beyond for overseas investors that are facing different local holiday arrangements.

Due to equity securities settling on T onshore in China, QFIs generally have to pre-fund their buy orders by transferring the necessary funds onshore by T-1, which is highly undesirable. And because securities settle on T while cash settles on T+1, there is no delivery against payment ("DvP") particularly for QFIs selling equity securities which is problematic. FIIs would like to see China move towards a T+2 settlement cycle, which is the norm globally, or at least a T+1 settlement cycle, for equities so that there would be DvP.

1.2 CIBM Direct

Bonds are traded on two markets in China: (a) CIBM where the government and policy bank bonds are traded, and (b) the stock exchanges or exchange market where the corporate bonds are traded. CIBM is the much larger market, accounting for almost 85% of all bonds traded in China as of November 2020. Trading under CIBM is regulated by PBOC and cleared and settled by China Central Depositary & Clearing Corporation ("CCDC") while bonds traded in the exchange market are regulated by CSRC and cleared and settled by Shanghai Clearing House ("SCH").

In July 2020, PBOC and CSRC announced that CIBM and the exchange bond market will be connected so that qualified investors can trade bonds on both markets through connected infrastructures. Details for implementing such connectivity has not been released yet.

Eligible institutions

In 2010, China took the first step to launch a pilot allowing foreign central banks and monetary authorities, foreign RMB clearing banks and participating banks to invest in the CIBM under what is known as the "CIBM Direct". The participation of this first group of FIIs in the CIBM Direct was subject to PBOC approval and a quota granted by SAFE. But the quota requirement for CIBM Direct was removed in July 2015.

QFIIs and RQFIIs were also allowed to invest under the CIBM Direct in 2011 and 2013, respectively, subject to CSRC and PBOC approval. In July 2015, China announced that international financial organizations and sovereign wealth funds could also invest in the CIBM. The types of FIIs that can participate in CIBM Direct was further expanded in February 2016 to include foreign financial institutions such as commercial banks, insurance companies, securities companies, fund management companies and other asset management institutions, and the investment products issued by such financial institutions as well as medium and long term institutional investors approved by PBOC such as pension funds, charity funds and endowment funds.

As of the end of 2020, there were 468 FIIs investing through the CIBM Direct and foreign institutions' total holdings in the CIBM amounted to RMB 3.25 trillion, accounting for approximately 3.2% of the total bond holdings in the CIBM.

Investment scope

Under CIBM Direct, foreign reserve institutions (i.e. central banks, monetary authorities, international financial organizations and sovereign wealth funds) may invest or conduct transactions in cash bonds, bond repos, bond borrowing and lending, bond forwards, interest rate swaps ("IRS"), forward rate agreements ("FRA") and other transaction types as permitted by the PBOC while the other FIIs may invest only in cash bonds and engage, for hedging purposes only, in bond borrowing and lending, bond forwards, FRA and IRS. CIBM Direct investors as well as QFIIs were also allowed to hedge their FX risks using FX derivatives onshore starting from 24 February 2017.

On 2 September 2020, PBOC, CSRC and SAFE issued a Consultation on the Announcement on Matters related to FIIs investing in China's Bond Market (the "China Bond Market Consultation") which proposed to further expand the China bond market investment scope for foreign investors under all access channels to include cash bonds (both traded on the CIBM and the exchanges), the derivatives thereof, bond funds (including exchange traded funds ("ETFs")) and other instruments permitted by PBOC and CSRC. ASIFMA responded to this Consultation and is looking forward to the issuance of the final Announcement.

Investment currency

CIBM Direct investors may invest in the CIBM using either CNY or CNH but they must ensure that they repatriate in the same CNY or CNH with which they invested, and the ratio of FX to RMB in the accumulated outward remittance must basically be in line with that of the accumulated inward remittance and should not vary by more than 10% upward or downward (except for the first outward remittance). However, in the Consultation on Regulations on Capital Management of FIIs investing in

China's Bond Market issued by PBOC and SAFE on 21 September 2020, the foregoing requirements were replaced with the proposal that for CIBM Direct investors investing with both FX and CNH, the accumulated FX remitted outbound shall not exceed 1.2 times of the accumulated FX remitted onshore (except for remittances from investment liquidations).

Bond Settlement Agent

Under CIBM Direct, FIIs need to entrust a bond settlement agent ("BSA") onshore to engage in trading and settlement for them. The BSA is responsible for making a filing on behalf of the FII with PBOC Shanghai head office, opening accounts at China Foreign Exchange Trade System ("CFETS"), CCDC and SCH in the name of the FII, and trade on behalf of the FII.

In the China Bond Market Consultation issued in September 2020, it was proposed that FIIs may entrust a local custodian, directly or through its offshore custodian, to hold their assets onshore, which suggests that CIBM Direct investors may no longer need to appoint a BSA and that their global custodian can appoint the local custodian without the FII having to do so themselves.

Trading and settlement

FIIs under CIBM Direct used to have to obtain price quotations and trade through their BSA. However, on 1 September 2020, CFETS launched its CIBM Direct RFQ service which allows FIIs to directly send request for quotations ("RFQ") to onshore dealers and then complete the trade through certain foreign third party platforms that are connected to CFETS without going through their BSA. The minimum size of each trade that FIIs can do under this service is RMB 10,000 with minimum increments of RMB 10,000.

The trading hours in the CIBM used to be from 9:00 am to 12:00 pm and from 1:30 pm to 4:30 pm China Standard Time ("CST"). However, from 21 September 2020, the afternoon session for cash bond transactions that settle on T+1 or beyond is extended from 1:30 pm to 8:00 pm CST.

Trading in the CIBM settles on a DvP basis and FIIs have the option to settle at T, T+1, T+2 and T+3, and even T+4 and beyond for overseas investors that are facing different local holiday arrangements according to the Joint Notice on Extension of Bond Settlement Cycle for Overseas Institutional Investors issued by CFETS, CCDC and SCH in August 2019 and the notices on flexible settlement arrangements for foreign institutional investors issued by CCDC and SCH in March 2020.

In response to ASIFMA's recommendation to avoid failed trades having to be cancelled resulting in the need to re-price a trade the following business day, rolling settlement was introduced for FIIs by CCDC and SCH in March 2020 whereby, upon agreement of the counterparties, the settlement date of a failed trade can be extended by three working days.

Again, at the persistent urging of ASIFMA, CFETS enhanced its system and was able to introduce on 4 January 2021 a feature known as the "dealer pay model" whereby FIIs can request a price quotation from onshore bond dealers with CFETS' trading fee built into the bond price.

Non-trade transfers

In response to ASIFMA's request to enable FIIs to consolidate their securities holdings under various China access schemes, PBOC and SAFE issued a Notice on 30 September 2019 that allows FIIs, starting from 15 November 2019, to make non-trade transfers of their bond holdings and cash between their QFII/RQFII account and their CIBM Direct account.

The aforementioned Notice does not extend to non-trade transfers with Bond Connect or Stock Connect accounts as these are offshore access channels as opposed to QFI and CIBM Direct which are onshore access channels. For FIIs that want to consolidate or transfer their securities holdings between onshore and offshore schemes, they currently are only able to do so by selling their holdings under one scheme and using the proceeds thereof to invest through the other scheme. The foregoing has a lot of disadvantages for FIIs, such as incurrence of transactional costs and taxes, risk of foreign exchange and market movements, etc.

II. Access from offshore

To further attract foreign investment in China's capital markets, China introduced a number of "Connect" schemes starting in 2014 whereby foreign investors (mainly FIIs but also retail investors in the case of Stock Connect) can invest in China's capital markets from outside the Mainland, primarily from Hong Kong, without having to open accounts onshore in China.

Many FIIs prefer investing through the offshore schemes set up in Hong Kong because Hong Kong's trading, clearing and settlement infrastructure is comparable those of the international markets and they also do not have to worry about repatriation risks. However, the offshore Connect schemes generally are more limited in their investment scope and permitted activities than those of the onshore schemes.

2.1 Stock Connect

2.1.1 Mainland-Hong Kong

The first Connect scheme was introduced in 2014 with the launch of the Shanghai-Hong Kong Stock Connect in November 2014 followed by the launch in December 2016 of the Shenzhen-Hong Kong Stock Connect (collectively referred to as "Stock Connect"). The Stock Connect operates both ways, where foreign investors can invest into the Mainland market and Mainland investors can invest into the Hong Kong market. This paper, however, will focus only on the access by FIIs into the Mainland market.

Eligibility

Stock Connect is opened to both individual and institutional investors, except that (i) only Mainland individual investors with RMB 500,000 in their securities and cash accounts may invest through southbound Stock Connect, and (ii) only institutional professional investors are allowed to invest in stocks listed and traded in SZSE's ChiNext Board and starting from 1 February 2021, also stocks in SSE's STAR Board, through the northbound Stock Connect.

At the urging of ASIFMA, the Stock Exchange of Hong Kong ("SEHK"), on 15 November 2019, extended the dispensation from the requirement that brokers look through to ensure that the underlying investors of ChiNext shares are institutional professional investors for asset managers not only with a Type 9 license in Hong Kong but also for those asset managers regulated under the law of any place outside Hong Kong.

Investment scope

The investment scope under Stock Connect is narrower than that for QFIs and is limited to (a) all the constituent stocks of the SSE 180 Index and the SSE 380 Index, (b) all the constituent stocks of SZSE Component Index and the SZSE Small/Mid Cap Innovation Index which have a market capitalization of not less than RMB 6 billion, and (c) all the SSE/SZSE-listed A shares that are not included as constituent stocks of the relevant indices but which have corresponding H shares listed on the SEHK, except for those shares that are not traded in RMB or are under risk alert.

As a result, as of 15 January 2021, only 574 out of a total of 1,846 securities listed in the SSE (Main Board, STAR Board) and only 884 out of a total of 2,361 securities listed in the SZSE (Main Board, SME and ChiNext) are eligible for trading under the Stock Connect. FIIs obviously would like to see the investable universe greatly expanded under Stock Connect as many prefer investing through this offshore investment channel.

Quota

Stock Connect was launched with both an aggregate quota of RMB 300 billion for northbound and RMB 250 billion for southbound Stock Connect as well as a daily quota of RMB 13 billion for northbound and RMB 10.5 billion for southbound Stock Connect.

The aggregate quota for Stock Connect was removed in August 2016 and while the daily quota remains, it was quadrupled on 1 May 2018 to RMB 52 billion for each of the northbound Stock Connect and to RMB 42 billion for each of the southbound Stock Connect at the urging of ASIFMA in anticipation of MSCI's inclusion of A-shares into its global emerging market indices in May and August that year.

Holding structure

Foreign investors' securities acquired through the Stock Connect are registered in the name of Hong Kong Securities Clearing Company Limited ("HKSCC"), as nominee, and held in accounts maintained by HKSCC with China Securities Depository and Clearing Co., Ltd ("CSDC"). CSRC clarified in May 2015 that HKSCC is the nominee holder and that foreign investors enjoy the beneficial ownership and rights in the securities purchased through Stock Connect.

Investor ID

To protect investors, ensure market efficiency and transparency and reduce systemic risk, regulators globally are gradually introducing investor ID requirements. An investor ID regime was introduced under northbound Stock Connect in September 2018 which is aligned with the see-through model in the Mainland market. Foreign investors investing through Stock Connect are assigned a unique number known as the "broker-to-client assigned number" (BCAN) at either fund level or fund manager level. Brokers will provide "client identification data" (CID) related to the BCAN to SEHK, which will forward the information to the Mainland exchanges, and will tag all buy and sell orders with the appropriate BCAN for market monitoring and surveillance purposes.

SPSA and Master SPSA

Due to the fact that in the Mainland investors are only allowed to sell stocks that are available in their accounts at the end of the previous day (i.e. T-1), pre-trade checking is required for trading through the northbound Stock Connect. To facilitate pre-trade checking without requiring foreign investors to transfer securities to their broker on T-1, SEHK introduced in a Special Segregated Account ("SPSA") service in 2015 whereby an investor or its custodian can open a SPSA at the HKSCC's Central Clearing and Settlement System ("CCASS") and CCASS will take a snapshot of the securities under each SPSA and replicate such holdings to the SEHK's China Stock Connect System for pre-trade checking. And, to further facilitate trading by asset managers, SEHK introduced on 10 July 2020 an enhanced Master SPSA service whereby securities holdings in various SPSA accounts managed by the same asset manager can be aggregated under that manager's Master SPSA for ease of pre-trade checking and trading.

Settlement

At the urging of ASIFMA, SEHK introduced DvP settlement for northbound Stock Connect in 2016 and Realtime DvP (RDvP) on 20 November 2017 as an additional option.

In addition, foreign investors investing through Stock Connect could only use CNH for cash settlement before May 2018. However, PBOC issued on 18 May 2018 a Circular that allows foreign institutions in Hong Kong to conduct CNY spot FX and hedging services for Stock Connect investors which means that foreign investors can also settle trades using USD and HKD.

2.1.2 Shanghai-London

A Stock Connect between Shanghai and London was formally launched in June 2019 whereby eligible SSE-listed companies can list Global Depositary Receipts ("GDRs") on the London Stock Exchange ("LSE") for investment by foreign investors (i.e. westbound) and eligible LSE-listed companies can list Chinese Depository Receipts ("CDRs") on the SSE for investment by Mainland investors (i.e. eastbound). The Shanghai-London Stock Connect was launched with an aggregate quota of RMB 300 billion for westbound and RMB 250 billion for eastbound. As of the end of 2020, there are four GDRs listed on the LSE while no CDRs has been listed on the SSE yet.

2.2 Bond Connect

Following the launch of CIBM Direct in 2010, a northbound Bond Connect scheme was introduced on 3 July 2017 between the Mainland and Hong Kong.

Eligibility

The scope of FIIs that are eligible to invest through Bond Connect is the same as that for CIBM Direct, which include central banks, monetary authorities, international financial organizations and sovereign wealth funds, foreign established commercial banks, insurance companies, securities companies, fund management companies and other asset management institutions, and the investment products issued by them, as well as medium- and long-term institutional investors approved by PBOC such as pension funds, charity funds and endowment funds. As of the end of 2020, 625 FIIs have entered the CIBM through Bond Connect compared to 468 FIIs through CIBM Direct.

Investment scope

FIIs investing through Bond Connect currently have access only to cash bonds and primary issuances in the CIBM. However, their investment scope is expected to be further expanded to include exchange cash bonds, relevant derivatives, bond funds (including ETFs) as proposed in the China Bond Market Consultation issued in September 2020 by PBOC, CSRC and SAFE.

Investment currency and FX banks

Under Bond Connect, FIIs are able to use both FX (to be converted into CNY) and CNH to invest and can hedge their CNY exposures with FX derivatives. Until recently, Bond Connect investors could only select one FX bank in Hong Kong for FX conversion and hedging purposes. But CFETS announced on 24 September 2020 that FIIs can select up to three FX banks. The implementation arrangements thereof are currently being ironed out and expected to be introduced later this year.

Holding structure

Bonds purchased by FIIs through Bond Connect are held in the nominee account opened by the Hong Kong Monetary Authority ("HKMA")'s Central Moneymarkets Unit ("CMU") at CCDC and SCH. FIIs can open sub-accounts with CMU through their Hong Kong custodian (which has to be a CMU member) which will maintain the record of the FII's bond holdings. PBOC clarified on 22 June 2017 that FIIs enjoy the rights and interests of the bonds held for its account according to law.

Trading and settlement

Unlike CIBM Direct, FIIs under Bond Connect are able to trade directly through the approved offshore trading platforms (which currently include Tradeweb and Bloomberg) by obtaining quotes from approved onshore dealers or market makers (of which there are currently 56 of them) through RFQs and completing trades with them. In addition, FIIs investing through Bond Connect as well as CIBM Direct are now able to allocate block trades to multiple client accounts (up to 99) prior to the trades.

Trading through Bond Connect settles on a DvP basis and FIIs have the option to settle at T, T+1, T+2 and T+3, and even T+4 and beyond for overseas investors that are facing different local holiday arrangements. In addition, Bond Connect Company Limited ("BCCL") announced on 31 March 2020 the availability of special settlement cycles and recycling settlement (i.e. rolling settlement) under Bond Connect which were both suggested in ASIFMA's March 2019 China paper.

Trading fees and price with built-in fees

Besides CFETS' fee onshore, FIIs trading through Bond Connect have to pay an offshore fee to BCCL for their account opening services and if they use a trading platform that charges for each trade (e.g. Tradeweb), the fee of the offshore platform provider. Currently, the platform providers are responsible for collecting these fees from the FIIs using Bond Connect and paying the relevant parties. FIIs receiving these monthly bills from their platform providers then have to try to allocate these fees to their underlying funds and clients which they are not used to doing as bond trades elsewhere in the world typically are done with all fees incorporated in the price of the bonds being quoted or traded. At ASIFMA's urging, CFETS has upgraded their system which enables these trading-related fees to be built into the price of the bonds being quoted by onshore dealers. This feature (or referred to as the "dealer pay model") has been introduced under CIBM Direct with Tradeweb at the beginning of 2021 and is expected to be launched under Bond Connect soon.

2.3 Wealth Management Connect

To facilitate cross-boundary investment by individual residents in the Guangdong-Hong Kong-Macao Greater Bay Area (the "GBA"), PBOC, HKMA and the Monetary Authority of Macao announced on 29 June 2020 that they have decided to implement a cross-boundary wealth management connect pilot scheme ("Wealth Management Connect") in the GBA.

Under the Wealth Management Connect, individual residents in the GBA can carry out cross-boundary investment in wealth management products distributed by banks in the GBA. For example, under northbound Wealth Management Connect, residents of Hong Kong and Macao can invest in eligible wealth management products distributed by Mainland banks in the GBA by opening designated investment accounts with these banks in the Mainland while under southbound Wealth Management Connect, residents of the Mainland cities in the GBA can invest in eligible investment products distributed by banks in Hong Kong and Macao by opening designated investment accounts with these banks in Hong Kong.

The implementation details for the Wealth Management Connect are still being worked out among the three authorities. But it is expected that only simple and low to medium risk products will be available at least in the initial stage and investors will be subject to both an individual quota and an aggregate quota.

2.4 MRF

It is also worth mentioning that foreign investors interested in investing in Mainland retail funds may do so under the Mainland-Hong Kong Mutual Recognition of Funds ("MRF") scheme that was introduced on 22 May 2015 to enable eligible Mainland and Hong Kong retail funds to be registered and distributed in the other market. However, as of December 2020, 50 southbound funds from the Mainland are approved for sale in Hong Kong with cumulative net sales totalling RMB 0.33 billion (as of November 2020) as compared with 29 northbound funds from Hong Kong approved for sale in the Mainland with cumulative net sales totalling RMB 14 billion (as of November 2020). The cumulative net sales in both directions of the MRF take up a small share of the two-way RMB 300 billion aggregated quota allocated at the launch of this scheme.

2.5 ETF Cross-listings

While a Mainland-Hong Kong ETF Connect was reportedly in discussion for a number of years, no such scheme has been introduced to date. However, China approved two cross-listings of ETFs between SSE and the Tokyo Stock Exchange ("TSE") in June 2019 and between SZSE and SEHK in October 2020. These cross listings allow foreign investors to invest in TSE- or SEHK- listed ETFs that invest 90% or more of their assets in an ETF listed in the Mainland and Mainland investors to invest in similar ETFs listed on SSE or SZSE which invest more than 90% of their assets in an ETF listed in Japan or Hong Kong.

There are currently four TSE-listed ETFs and four SSE-listed ETFs under the SSE-TSE ETF "Connect" and two SEHK-listed ETFs and two SZSE-listed ETFs under the SZSE-SEHK ETF "Connect".

III. Comparison Tables

For ease of reference, set out below are comparisons of the differences between the various schemes for FII investment in China equities and fixed income.

3.1 Equities

Table 1: Comparison of Access Channels to China Equities Market

	QFI	Stock Connect (Northbound)
Eligible investors	FIIs including fund management companies, banks, insurance companies, securities companies, futures companies, trust companies, government investment management companies, sovereign funds, pension funds, charity funds, endowment funds, international organizations and other institutions recognized by the CSRC.	All foreign investors including individuals (but only institutional professional investors for SZSE ChiNext shares and SSE STAR shares).
Regulatory approval	CSRC license	None
Quota	None	Northbound daily aggregate quota of RMB 52 bn
Account structure	Onshore account with custodian in the name of "QFI + Proprietary Funds", "QFI + Client Name", "QFI + Fund", or "QFI + Client Fund"	Offshore investor account in HK via custodian with onshore nominee omnibus account at CSDC
Holding structure	QFI maintains account directly with CCDC and SCH	HKSCC, as nominee holder for investor
Eligible investments	• All securities listed on SSE/SZSE/NEEQ • Securities investment funds, including close-ended, open-ended and ETFs • Private investment funds issued by securities futures operating institutions or AMAC-registered private fund managers • Financial futures, commodity futures and options traded on approved exchanges • IPOs, securities lending and margin trading and securities financing • FX derivatives (for hedging purpose only)	Approximately 1460 stocks as of 15 January 2021: • 574 SSE shares: constituents of SSE 180 Index and 380 Index and dual SSE-HKEX listed shares • 884 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	CNY or CNH	CNH, HKD and USD
Pre-funding	Required (cash available on T-1)	None

	QFI	Stock Connect (Northbound)
Repatriation limit	None	N/A
Block trading	Yes	No
Short selling	Yes	Yes, but only covered shorts and not naked ones
Securities lending	Yes	Permitted with restrictions

3.2 Fixed Income

Table 2: Comparison of Access Channels to China Bond Markets

	QFI	CIBM Direct	Bond Connect
Eligible investors	FIIs including fund management companies, banks, insurance companies, securities companies, futures companies, trust companies, government investment management companies, sovereign funds, pension funds, charity funds, endowment funds, international organizations and other institutions recognized by the CSRC.	• 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	Pre-filing with PBOC	Pre-filing with PBOC
Quota	None	None	None
Account structure	Onshore account with custodian in the name of "QFI + Proprietary Funds", "QFI + Client Name", "QFI +	Onshore account with custodian	Offshore investor account at CMU in HK via custodian with onshore nominee omnibus account at CCDC and/or SCH

	QFI	CIBM Direct	Bond Connect
	Fund", or "QFI + Client Fund"		
Holding structure	QFI maintains account directly with CCDC and SCH	Investor maintains account directly with CCDC and SCH	CMU, as nominee holder for investor
Eligible investments	• CIBM: Products and derivatives on bonds, interest rates and FX • Exchange market: government bonds, enterprise bonds, corporate bonds, convertible bonds, etc. • Financial futures (e.g. CGB futures) traded on CFFEX	• Foreign reserves institutions: all cash bonds, repos, bond borrowing and lending, bond forwards, IRS, FRA, etc. • Other foreign institutions: all cash bonds and engage, for hedging purposes only, in bond borrowing and lending, bond forwards, IRS, FRA, etc.	All cash bonds
Investment currency	CNY or CNH	CNY or CNH	CNY or CNH
Pre-funding	Required (cash available on T-1)	None	None
Repatriation limit	None	None, but ratio of inbound CNH/CNY and outbound CNH/CNY should be similar, and 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	N/A, but a similar proportion of CNY, after investment, must be converted back into foreign currency if not re-invested
Block trading	Yes	Yes	Yes

IV. Glossary

Term	Definition
ABS	Asset-backed securities
AMAC	Asset Management Association of China
ASIFMA	Asia Securities Industry & Financial Markets Association
AUM	Asset under management
BCCL	Bond Connect Company Limited
BSA	Bond settlement agent
CCASS	Central Clearing and Settlement System
CCDC	China Central Depository & Clearing Co., Ltd.
CDRs	China Depositary Receipts
CFETS	China Foreign Exchange Trade System
CFFEX	China Financial Futures Exchange
CGB	China government bonds
China/Mainland	Mainland China excluding Hong Kong, Macao and Taiwan
ChiNext	SZSE's high tech board
CIBM	Chinese Interbank Bond Market
CMU	HKMA's Central Moneymarkets Unit
CNH	Offshore Renminbi
CNY	Onshore Renminbi
CSDC	China Securities Depository and Clearing Co., Ltd.
CSRC	China Securities Regulatory Commission
CST	China Standard Time
DvP	Delivery against payment
ETFs	Exchange traded funds
FIIs	Foreign institutional investors
FMCs	Fund management companies
FRA	Forward rate agreements
FX	Foreign exchange
GBA	Greater Bay Area
GDRs	Global Depositary Receipts
HKD	Hong Kong Dollar
HKMA	Hong Kong Monetary Authority
HKSCC	Hong Kong Securities Clearing Company Limited
IPO	Initial public offering
IRS	Interest rate swaps
LSE	London Stock Exchange
Master SPSA	Master Special Segregated Account
MRF	Mainland-Hong Kong Mutual Recognition of Funds
NEEQ	National Equities Exchange and Quotations Co., Ltd
PBOC	People's Bank of China

Term	Definition
PFM	Private securities fund managers
PFM WFOE	Wholly foreign-owned private fund manager
QFI	Qualified Foreign Investor
QFII	Qualified Foreign Institutional Investor
RFQ	Request for quotation
RMB	Renminbi
RQFII	Renminbi Qualified Foreign Institutional Investor
SAFE	State Administration of Foreign Exchange
SCH	Shanghai Clearing House
SEHK	Stock Exchange of Hong Kong
SPSA	Special Segregated Account
SSE	Shanghai Stock Exchange
STAR	Science & Technology Innovation Board
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
TSE	Tokyo Stock Exchange
USD	U.S. Dollar

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