OUTLOOK 2021: China to open capital markets still further to foreign investors by fine-tuning infrastructure schemes

Published 11-Feb-2021 by
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China is expected to continue the opening of its capital markets by allowing foreign institutional investors to invest in its domestic markets from both onshore and offshore financial centres in the year ahead, industry officials said. This will include the implementation of the expanded investment scope and permitted activities opened to qualified foreign investors under the new Qualified Foreign Investor (QFI) regulations issued in September 2020, they said.

"[We also expect] clarification on how foreign institutional investors can access them, such as [through] financial futures, commodity futures, options and margin trading and securities financing as well as new bond and equity issuances," said Eugenie Shen, managing director and head of the asset management group at the Asia Securities Industry & Financial Markets Association in Hong Kong.

Qualified Foreign Investor scheme

China merged Qualified Foreign Institutional Investor (QFII) and Renminbi-Qualified Foreign Institutional Investor (RQFII) schemes into a single Qualified Foreign Investor scheme in September 2020. Both QFII and RQFII programmes allowed foreign institutional investors to invest in the Chinese markets directly through the country's stock exchanges.

The types of financial futures, commodity futures and options, and the ways in which they are traded, will be subject to further approval in future by the China Securities Regulatory Commission (CSRC) and its relevant exchanges, according to Yin Ge, a partner specialising in the asset management industry at Han Kun Law Offices in Shanghai.

"As of today, we have not yet seen any such product being approved by CSRC, except for the stock index futures which were permitted for trading by QFIs before the [launch] of the new QFI scheme," Ge said. "It is expected that futures and options products will start [getting] approved in 2021."

There is likely to be increase in the number of QFIs, Shen said. "There won't be any new enhancements in the near future but rather implementation and refinement of what was introduced last year," she said.

CIBM and exchange bond market connect

Last July, Chinese authorities announced a connect between the China Interbank Bond Market (CIBM) and the exchange bond market. In September they released a consultation draft on investment in China's bond markets by foreign institutional Investors.

This allows foreign institutional investors who already have access to CIBM either through CIBM Direct Access or Bond Connect to access the exchange bond market.

Chinese regulators are expected to solve some of the outstanding issues ahead of implementation of the connect between CIBM and exchange bond market, according to Ge.

The CIBM adopts a gross or net settlement regime, depending on the types of bonds under settlement, while the exchange bond market adopts net settlement regime. Regulators need to establish how best to connect the different settlement regimes between those two markets, Ge said.

Foreign institutional investors can access CIBM either via CIBM Direct Access or Bond Connect, but the two schemes have very different investment scopes. Under CIBM Direct Access, investors may engage in cash bond trading, bond lending, bond forwards, forward rate agreements and interest rate swap transactions. Under Bond Connect, investors can only trade cash bonds.

"The uncertainty comes from whether the foreign investors under different schemes are also subject to different investment scopes when accessing the exchange market via the connect between CIBM and exchange bond market," Ge said.

"The focus in 2021 will be to introduce the expanded investment scope in the CIBM for foreign institutional investors, as proposed by [the Chinese authorities] in September 2020," Shen said.

Transactions under CIBM are conducted over the counter via one-to-one negotiation between institutional participants on the China Foreign Exchange Trade System, while transactions in the exchange bond market are conducted by placing orders with exchanges. These orders are anonymously matched and executed, Ge said.

"The connect between the CIBM and the exchange bond market also needs to address the different trading systems," she said.

Stock Connect scheme

Foreign institutional investors have been allowed to invest in mainland China's capital markets through Stock or Bond Connect schemes from Hong Kong or London since 2014, without having to set up accounts onshore in China.

These connect programmes between the mainland and Hong Kong have been a big success, Eddie Yue, chief executive of the Hong Kong Monetary Authority (HKMA), said at the Annual Conference of Financial Street Forum 2020, held in the city last year. "Looking ahead, there will be a long-term upward trend in foreign investors' demand for renminbi asset allocation," Yue said.

"The HKMA will attempt to launch more connect schemes for other asset classes, such as stock and bond derivative products, to meet the increasing demand [from] foreign asset managers to hedge risk exposures from holding renminbi-denominated assets," Ge said. "It is expected that the HKMA and mainland financial regulators will cooperate together to promote the expansion of asset classes of connect schemes to include bond and equity derivatives."

Shanghai Stock Exchange's Sci-Tech Innovation Board shares were included in Stock Connect in January 2021. "This is a step toward expanding the investment scope under Stock Connect," Shen said.

Holiday trading is expected to be introduced for northbound Stock Connect this year, she said.

The Master Special Segregated Account service is also expected to be further enhanced to make it more attractive to, and easy to use by, portfolio managers who are managing a lot of funds, she said. The Master Special Segregated Account service was introduced by the Hong Kong Stock Exchange last July to allow fund managers to place orders on behalf of multiple funds' special segregated accounts.

"We also hope that the securities borrowing and lending [service], which is allowed under Stock Connect, [will] be more useful if it is not limited to just exchange participants, i.e., brokers, but extended to asset managers or affiliates or institutional clients of exchange participants who actually own the shares," she said.

Bond Connect scheme

Mainland Chinese investors are anticipating the launch of the southbound Bond Connect scheme in 2021, which would allow them to participate in the Hong Kong's bond market, following the scheme's northbound trading set-up on July 3, 2017.

"Stay tuned for more breakthroughs: Wealth Management Connect and South-bound Bond Connect, just to mention two near-term initiatives to create more policy headroom," Yue said in the latest insights published by the central bank.

"Mainland and Hong Kong regulators are currently working closely to roll out the Wealth Management Connect scheme as soon as practicable," Ge said.

A dealer pay model is also expected to be introduced shortly under Bond Connect, whereby the trading fees would be built into the price of the bonds quoted so that foreign institutional investors would not receive a separate bill for such fees, Shen said.

"We are also expecting the implementation of third-party FX under Bond Connect, where foreign institutional investors can use up to three FX banks to do their FX conversion and hedging, instead of the current one under Bond Connect," she said.

Complaints Procedure

Produced by Thomson Reuters Accelus Regulatory Intelligence 11-Feb-2021