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International Information for International Business

VOLUME 20, NUMBER 6 >>> JUNE 2014

CHINA

Detailed Rules on QFII, RQFII Trading Issued by Shanghai, Shenzhen Exchanges

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The Shanghai Stock Exchange (“SSE”) issued its Detailed Implementation Rules (“SSE Rules”) for Securities Trading by Qualified Foreign Institutional Investors (“QFIIs”) and Renminbi Qualified Foreign Institutional Investors (“RQFIIs”, and, together with QFIIs, “Qualified Investors”) effective as of March 19, 2014. Shortly afterwards, the Shenzhen Stock Exchange (“SZSE”) issued its own rules (“SZSE Rules”) effective as of April 25, 2014, which are substantially the same as the SSE Rules. (For the purposes of this report, the SSE Rules and the SZSE Rules are referred to as the “Qualified Investor Rules”.)

Under the Qualified Investor Rules, QFIIs and RQFIIs are consolidated for uniform regulation in light of the similarities between the two programs.

This is the first time that Qualified Investors are expressly allowed to invest in asset-backed securities.

The Qualified Investor Rules reflect the most recent regulatory requirements of the China Securities Regulatory Commission (“CSRC”) under its July 2012 QFII

Provisions (*see WSLR, August 2012, page 3*) and its March 2013 RQFII Provisions (*see WSLR, April 2013, page 9*) (collectively, the “CSRC Regulations”).

The key features of the Qualified Investor Rules are as follows:

Eligible Product Types

The CSRC Regulations specify the scope of products eligible for investment by Qualified Investors, including but not limited to stocks, bonds and warrants traded or transferred on the SSE/SZSE. The Qualified Investor Rules further enumerate the foregoing eligible stock-exchange traded or transferred products as follows (Qualified Investors are allowed to subscribe for initial public offerings of stocks, issuances of bonds, and follow-on stock issuances and share allotments):

- stock, including common stock, preferred stock and other stock recognized by the SSE/SZSE;
- bonds, including treasury bonds, when-issued trading treasury bonds, local government bonds, corporate bonds, enterprise bonds, convertible corporate bonds, convertible corporate bonds with warrants, exchangeable corporate bonds, privately placed bonds by small and medium enterprises, policy-oriented financial bonds, subordinated bonds, and other bond products recognized by the SSE/SZSE;
- funds, including various types of exchange traded funds, closed-end funds, open-end funds, money market funds and other fund products recognized by the SSE/SZSE;
- warrants;

- asset-backed securities; and
- other types of securities products permitted by the CSRC.

This is the first time that Qualified Investors are expressly allowed to invest in asset-backed securities.

Maximum Shareholding Percentage Requirements

The Qualified Investor Rules reiterate the restrictions on maximum shareholdings set forth under the CSRC Regulations, with minor technical clarifications:

- a single foreign investor's investment in the shares of a China-listed company held through Qualified Investor(s) shall not exceed 10 percent of the total shares of the listed company; and
- the total number of A shares held by all foreign investors in a single China-listed company shall not exceed 30 percent of the total shares of the listed company.

Under the Qualified Investor Rules, if the total number of A shares held by all foreign investors in the same listed company reaches or exceeds an aggregate of 26 percent of the total shares of a company, the SSE/SZSE will publish this aggregate percentage on its website before the opening of the following trading day.

The Qualified Investor Rules also set out detailed procedures for close-out/reduction of excessive positions in order to ensure the above-mentioned maximum threshold is kept.

Reporting Requirements

The PRC custodian bank and the PRC securities company(ies) of a Qualified Investor are required to file with the SSE/SZSE basic information on the Qualified Investor as well as basic information on the PRC custodian bank and the PRC securities company(ies). The PRC custodian bank is required to report relevant information upon the occurrence of any specified major event on the part of the Qualified Investor within five business days of the occurrence of the event, such as when 1) the Qualified Investor changes its name or legal representative; 2) the controlling shareholder of the Qualified Investor is changed; 3) the Qualified Investor increases or decreases its capital; 4) the Qualified Investor is implicated in any material proceeding or other material event; 5) any major sanctions are imposed on the Quali-

fied Investor outside China; or 6) the Qualified Investor is sanctioned by the CSRC or the State Administration of Foreign Exchange, *etc.*

In the event of any irregular trading, the SSE/SZSE may require the Qualified Investor to report the securities trading of the *de facto* investor(s) underlying the Qualified Investor as well as the shareholding held by the Qualified Investor.

Computation of Shareholdings for the Purpose of Information Disclosure

The Qualified Investor Rules require that, when making disclosures in accordance with its disclosure obligations, each Qualified Investor and *de facto* investor underlying the Qualified Investor shall separately compute its aggregate holdings of the onshore listed shares and offshore listed shares of the same listed company, and comply with the relevant laws and regulations governing information disclosure.

This provision is helpful to clarify the long-questioned issue of whether the shares held by a Qualified Investor and its *de facto* investors should be calculated on a consolidated basis for the purpose of the PRC securities and company laws. According to this provision, for information disclosure purposes, the shares held by the Qualified Investor and its *de facto* investors will not be calculated on a consolidated basis solely because a *de facto* investor indirectly invests in A shares through a Qualified Investor.

Conclusion

The Qualified Investor Rules will help to promote the development of the QFII program and the RQFII program by clarifying the scope of eligible products traded or transferred on the SSE and the SZSE and some technical issues.

The text of the Shanghai Stock Exchange Rules is available, in Chinese, at http://www.sse.com.cn/lawandrules/sserules/trading/universal/c/c_20140319_3777697.shtml.

The text of the Shenzhen Stock Exchange Rules is available, in Chinese, at <http://www.szse.cn/main/files/2014/04/25/172194890409.pdf>.

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