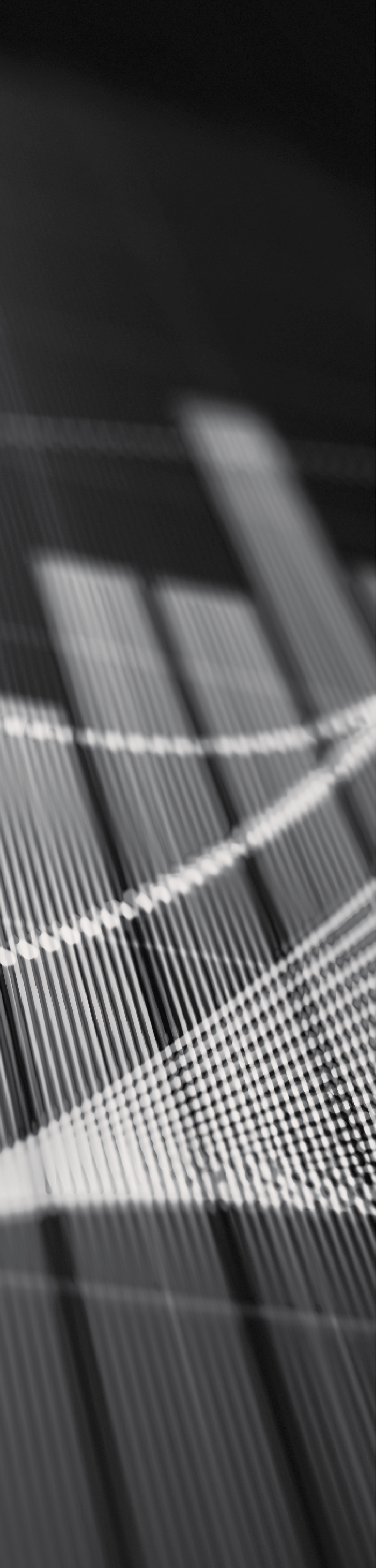
# REVISED QFII SCHEME BROADENS MARKET ACCESS TO PRC EXCHANGE-TRADED COMMODITY FUTURES AND OPTIONS CONTRACTS

## At a glance

In the People's Republic of China ("PRC"), the Qualified Foreign Institutional Investor ("QFII") scheme went through a major overhaul in November 2020 which substantially relaxed its qualification and regulatory requirements, opening it up to a broader class of offshore investors, including offshore commodities traders. Since 2 September 2022, it has offered an alternative path for offshore investors to trade commodity futures and options on the main Chinese commodity futures exchanges. Offshore commodities traders may wish to consider this new access path to commodity futures and options products that were previously only accessible to on-shore Chinese entities. QFII licence holders may wish to consider extending their services to potential new commodity clients.



# "Indeed, the first commodity futures contract traded through the New QFII Scheme was executed by UBS Futures Co. Ltd."

## Introduction

The China Securities Regulatory Commission ("CSRC"), the People's Bank of China ("PBOC") and the State Administration of Foreign Exchange ("SAFE") officially issued the Administration Measures on Onshore Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors ("New QFII Measures") on 25 September 2020. Simultaneously, the CSRC issued the final version of the Provisions on Relevant Issues with respect to Implementing the Administration Measures on Onshore Securities and Futures Investments by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors ("New QFII Implementing Provisions"). The New QFII Measures and New QFII Implementing Provisions (collectively the "New QFII Scheme") entered into effect on 1 November 2020.

Previously, the only way offshore market participants could access certain commodity futures markets in the PRC without establishing an onshore business presence in the PRC, was via the Overseas Trading Participant[1] route. This allowed qualifying offshore market participants to access certain limited offshore commodity futures contracts on the Shanghai International Energy Exchange (INE), the Dalian Commodity Futures Exchange (DCE) and the Zhengzhou Commodity Futures Exchange (ZCE). Access enabled profits, made from trading positions on PRC commodity futures, to be repatriated out of the PRC. However, not all commodity futures products of the abovementioned exchanges and not all exchanges (for example the Shanghai Futures Exchange (SHFE)) were accessible under the Overseas Trading Participant Route.

The New QFII Scheme provides qualifying offshore investors a second route to access PRC commodity futures. It could not be operationalised for commodity futures or options until 2 September 2022, when the main four commodity futures exchanges named the specific commodity futures contracts and options that offshore investors may invest in through the New QFII Scheme. Offshore market participants may wish to consider the key features of the New QFII Scheme and its relative advantages and disadvantages compared with the Overseas Trading Participant route.

## Key Changes under New QFII Scheme

### Integration of QFII and RQFII Schemes

The QFII and RMB Qualified Foreign Institutional Investors ("RQFII") schemes, which were previously separate, have been integrated into the unified New QFII Scheme. Under this, an eligible foreign institutional investor only needs to apply to the CSRC for one QFII Licence, rather than a separate QFII Licence and RQFII Licence for its proposed investments using foreign currency and offshore RMB. Further, the unified QFII Licence holder can use either (i) foreign currency, (ii) offshore RMB or (iii) both foreign currency and offshore RMB, to make investments into the permitted products offered by PRC onshore markets.

1 China Securities Regulatory Commission, Interim Measures on the Administration of Overseas Trading Participants' and Overseas Brokerage Institutions' Engagement in the Trading of Certain Domestic Futures Products, Interim Measures for the Administration of Overseas Traders' and Overseas Brokers' Engagement in the Trading of Specified Domestic Futures Products_CSRC.

| New QFII Scheme | Overseas Trading Participant Route |
|---|---|
| **Shanghai Futures Exchange (SHFE)**[3] | |
| **Futures:** Gold, Silver, Copper, Aluminum, Zinc, Steel Rebar, Hot Rolled Coils | **Futures:** N/A |
| **Options:** Gold, Copper, Aluminum, Zinc | **Options:** N/A |
| **Dalian Commodity Exchange (DCE)**[4] | |
| **Futures:** No.1 Soybean, No.2 Soybean, Soybean Meal, Soybean Oil, RBD Palm Olein, Iron Ore, LLDPE | **Futures:** Iron Ore, RBD Palm Olein |
| **Options:** No.1 Soybean, No.2 Soybean, Soybean Meal, Soybean Oil, RBD Palm Olein, Iron Ore, LLDPE | **Options:** RBD Palm Olein |
| **Zhengzhou Commodity Exchange (ZCE)**[5] | |
| **Futures:** PTA, Methanol, White Sugar, Rapeseed Oil, Rapeseed Meal, Peanut Kernel, Polyester Staple Fiber | **Futures:** PTA |
| **Options:** PTA, Methanol, White Sugar, Rapeseed Oil, Rapeseed Meal, Peanut Kernel | **Options:** N/A |
| **Shanghai International Energy Exchange**[6] | |
| **Futures:** Crude Oil, TSR20, LSFO, Bonded Copper | **Futures:** Crude Oil, TSR20, LSFO, Bonded Copper |
| **Options:** Crude Oil | **Options:** Crude Oil |

## Expansion of Investment Scope to Commodity Futures and Options

Under the New QFII Scheme, approved commodity futures and options ("Eligible Commodity Contracts") are now included in the investment scope. In addition to Eligible Commodity Contracts, the products that a QFII Licence holder may invest in is expanded to include the following:

- Financial futures listed on China Financial Futures Exchange (CFFEX)
- Shares and other securities listed on the National Equities Exchange and Quotations (NEEQ)
- Stocks, Depository receipts, bonds, bond repos, asset-backed securities traded on stock exchanges
- PRC inter-bank bond market products and derivatives on bonds, interest rates and foreign exchange as permitted by the PBOC
- Options listed on the relevant exchanges
- FX derivatives for hedging purposes as permitted by SAFE
- Securities margin trading and securities lending
- Private investment funds whose investments fall within the above underlined investment scope.[2]

In the table above, we list the Eligible Commodity Contracts and compare them against the commodity futures contracts and options available for trading through the Overseas Trading Participant Route.

## Lowering Qualification Requirements for QFII Licensee

The quantitative qualification requirements for foreign institutional investors to qualify to apply for QFII Licences under the original QFII rules included a minimum USD 500 million asset under management and/or a

2 Please note that although QFII License holders are now permitted to invest in private (unlisted) investment funds whose investment scope is to invest in securities which the QFII License Holder could directly invest in, no equivalent permission is granted to QFII License holders to invest in private investment funds whose investment scope is to invest in commodities products, even if those commodities products are limited to Eligible Commodities Contracts.

3 Shanghai Futures Exchange, Circular on the Participation of Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors in Commodity Futures and Options Trading, Circular on the Participation of Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors in Commodity Futures and Options Trading (shfe.com.cn). Shanghai Futures Exchange, Articles of Association, http://shfe.com.cn/en/RULES/SHFERules/ArticlesofAssociation/, Art 17 defines Member as an entity that is a PRC-registered entity and there are no implementing rules which allow for non-Members to conduct trading.

4 Dalian Commodity Exchange, Frequently Asked Questions, http://www.dce.com.cn/DCE/Education/Market%20Services/Resources/8515318/2022092217042915384.pdf. Dalian Commodities Exchange, Measures for Overseas Special Participants Management of Dalian Commodity Exchange, http://www.dce.com.cn/DCE/RulesRegulation/6146719/6146731/6146739/6269159/index.html.

5 Zhengzhou Commodities Exchange, Circular on the Participation of Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors in Commodity Futures and Options Trading, http://english.czce.com.cn/enportal/News/Announcements/webinfo/2022/09/1655821721132453.html.

6 Shanghai International Energy Exchange, Circular on the Participation of Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors in Commodity Futures and Options Trading, https://www.ine.cn/en/news/notice/6192.html. Dalian Commodities Exchange, Product Investment Guide, http://www.dce.com.cn/DCE/Education/Market%20Services/Resources/index.html

minimum capital or net asset size requirements for the applicant, and a minimum period of operation requirement for different types of applicants. The revised qualification requirements under the New QFII Scheme are less prescriptive, thereby potentially allowing a wider number of foreign institutional investors to qualify to apply for QFII Licences. The qualification requirements are now as follows:

1. The applicant is of sound financial condition and has a good credit standing, with proven experience in securities and futures investment
2. The applicant's investment managers responsible for managing the applicant's proposed PRC investments possess the relevant professional qualifications required by the home jurisdiction of the applicant (where applicable)
3. The applicant has a sound and effective governance structure, internal control system and compliance management regime, and appoints a supervisor to oversee the compliance with legal and compliance requirements of the applicant's proposed investments in the PRC
4. The applicant's operations are well-managed, and the applicant has not been subject to major regulatory actions from regulatory authorities in the last three years, or since its establishment
5. There exists no circumstance that may have a material impact on the PRC domestic capital markets.

### Streamlining Application Process

Under the New QFII Scheme, an applicant for a QFII Licence should submit an application form via the CSRC's official website and also submit, through its onshore custodian bank, the physical application document package to the CSRC.

The application package has removed some burdensome requirements that existed under the old QFII rules. For instance:

- the audited financial statements for the applicant's latest financial year are no longer required.
- the certificate of incorporation and the authorisation letter to the custodian bank are no longer required to be notarised and/or legalised in the home jurisdiction of the applicant.

The timeframe for CSRC's review of the QFII Licence application has been shortened from 20 working days to 10 working days as from the date when the CSRC accepts the application.

Lifting Investment Quota Restrictions and Streamlining Funds Repatriation

In anticipation of the New QFII Scheme, the PBOC and the SAFE relaxed regulatory requirements with respect to the New QFII Scheme in May 2020 in the following respects:

- a QFII Licence holder's investments into PRC onshore markets are no longer limited to an investment quota.
- the process for repatriating investment capital and profits out of the PRC by the QFII Licence holder is simplified. For example, an audit report and tax payment certificate / tax filing with the tax authority are no longer required.
- Remittances in different currencies are permitted. If remitting in foreign currency ("FX") only, then a FX special account and a corresponding RMB special deposit account will be needed to be opened with the Custodian Bank. The repatriation currency for investment should be the same as the currency remitted inwards.

## Conclusions

Historically, QFII Licence holders tended to be financial institutions and large asset managers with a long-term investment horizon in the PRC, particularly in relation to stocks, bonds and other securities.[7] This was due to the relatively limited investment scope as well as the more stringent qualification requirements. The New QFII Scheme is now open to a wider class of investors, including offshore commodities traders, thanks to the expanded investment scope and lower qualification requirements for offshore investors wherever they may be located. As of 2020, there were 558 QFIIs located all over the world including in the US, Canada, Cayman Islands, Hong Kong, Singapore, Australia, Japan, South Korea, France, Germany, UK and the UAE, to give readers a feel for the international reach of this opportunity.

Further, the New QFII Scheme enables access to commodity futures and options contracts which offshore investors are currently not able to trade via the Overseas Trading Participant route. For instance, a market participant looking to trade the currency and price spread between the LME Aluminium futures contract and the Shanghai Aluminium Futures Contract can now more readily do so via the New QFII route. This is currently not possible under the Overseas Trading Participant route. The key need for the offshore commodity trader in this example is to be able to offset its LME futures position with its SHFE futures position. Provided that can be done, the arbitrage trade via the New QFII Scheme makes sense.

If a commodity trader does not meet the eligible QFII applicant criteria, it can trade though a financial institution or broker who does. Many well-known financial institutions including Goldman Sachs International, Schroder Investment Management, JP Morgan Asset Management, Nomura Asset Management etc are QFII licence holders.[8] Indeed, the first commodity futures contract traded through the New QFII Scheme was executed by UBS Futures Co. Ltd.[9]

Financial institutions that are QFII licence holders may wish to consider providing a wider range of products and services to their commodity clients.

7 HSBC, China Market Access – Major Reforms to QFII, China market access – major reforms to QFII (hsbc.com)

8 For a full list of QFIIs see Qualified Foreign Investors (csrc.gov.cn).

9 Caixin, UBS Becomes First Foreign Firm to Trade Chinese Commodity Futures Through QFII, UBS Becomes First Foreign Firm to Trade Chinese Commodity Futures Through QFII (caixinglobal.com).

For more information, please contact the authors of this briefing:

**PETER ZAMAN**
Partner, Singapore
**T** +65 6411 5305
**E** peter.zaman@hfw.com

**BRINTON SCOTT**
Partner, Shanghai
**T** +86 21 2080 1068
**E** brinton.scott@hfw.com

**DANIELLE PENG**
Of Counsel, Shanghai
**T** +86 21 2080 1059
**E** danielle.peng@hfw.com

**JEFFERSON TAN**
Associate, Singapore
**T** +65 6411 5307
**E** jefferson.tan@hfw.com

**CHRISTOPHER ONG**
Associate, Singapore
**T** +65 6411 5378
**E** christopher.ong@hfw.com


**HFW has over 600 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our commodities capabilities, please visit hfw.com/Commodities.**


© 2023 Holman Fenwick Willan LLP. All rights reserved. Ref: 004738

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice. Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please email hfwenquiries@hfw.com