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CHINA LEGAL REPORT

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The Measures on the Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors (QFII)

The *Measures on the Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors (QFII)* (the “Measures”) have been promulgated jointly by the China Securities Regulatory Commission (CSRC), the People’s Bank of China (PBC), and the State Administration of Foreign Exchange (SAFE) on 24th August 2006, in order to regulate the investment activities of QFII in the securities market within the PRC customs territory, and to promote the development of China's securities market.

The previous Interim Measures on the Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors (the “Interim Measures”), which came into force as of December 1, 2002 is therefore replaced by the Measures.

1. Economic development longing for the revision

As of China’s entry into the World Trade Organization (WTO), the mutual influence between China and international community has mounted to a large extent. Therefore, China needs to further open its market in order to ensure the stable and fast development. Chinese government has made its resolution to modernize China’s capital market.

The experiences of many developing countries have shown that the opening of domestic capital market can not only help to attract foreign investment but also promote the development of domestic capital market and domestic enterprises. The QFII system has been regarded as successful methods to introduce the international participation and expertise to Chinese capital market, to improve the risk management, and to encourage the domestic listed companies to perfect their governance structures. However, since the environment related to QFII has been greatly changed thanks to the economic development of China over these years, the Interim Measures can no longer meet the needs arising out of the development. QFIIs have come to play a substantial role on China’s capital market and are appealing for more flexibility in carrying out their investments, and meanwhile China’s supervisory bodies have gained a great deal of experience and confidence from the past years’ trial and are ready to introduce ambitious aims in modernizing the market regulations. It comes to the time to update the regulations on QFII, and the recent revisions and innovations of China’s QFII system have well reflected the pursuit of such aims.

2. Perfecting the previous Interim Measures

There are 37 articles in the Measures in total, among which 4 articles are newly added, and 29 articles are revising the original provisions in the Interim Measures.

According to the Measures, a QFII is allowed to open multiple accounts, in addition to the securities account opened in its own name, for the assets it manages for clients. Such independent administration of accounts may enable a more flexible management of assets by a QFII under the same umbrella and in the meantime bring more transparency from a supervision point of view. For instance, a QFII providing assets management for its clients may open a nominal holder's account and is obliged to disclose the interests of the beneficiary owners of the investments in such nominal account. Where the QFII is mandated to manage public offering funds, insurance funds, pension funds, charity foundation, donation foundation, government investment foundation, or other long term funds, the QFII may apply separate securities account for those funds with the name of "QFII plus Foundation" and the assets in such account belong to the property of the foundation and are legally independent from the QFII and its custodian bank. The beneficiary owners of the assets are obliged to fulfil their information disclosure requirement through QFII on the stock exchanges. And the QFIIs have the duty to ensure that the ultimate foreign investors strictly satisfy the respective disclosure obligations. Obviously, the creation of such multiple and independent accounts may make the assets of the ultimate clients bankruptcy remote, and the accompanying requirement on information disclosure makes it easier for the supervisory bodies to monitor the true holders behind the QFIIs and their investment activities on the market, which is seen as indispensable and hand-in-hand measures to effectively implement the reinforced disclosure and mandatory tender offer obligations under the new regulations for acquisition of listed companies.

Moreover, while reiterating the up-limits that a QFII may hold 10% shares the most in one single listed company and that several QFIIs may at the most collectively hold 20% shares in one single listed company, the Measures exceptionally open a door for foreign strategic investors by providing that the foregoing limit may be upheld in the case of foreign strategic investment by acquiring A shares. This provision seems to be catering for the needs of the foreign investors who wish to accomplish their acquisition of Chinese listed companies by employing QFIIs, and is compatible with the Administrative Measures for Strategic Investments to Listed Companies by Foreign Investors of 31st December, 2005.

Furthermore, to facilitate the investment activities of QFIIs and for the purpose of risk diversification, the Measures allow each of the QFIIs to mandate three Chinese securities companies as brokers respectively on Shanghai and Shenzhen securities markets to carry out additional securities trading.

There are still more revisions and improvements under the Measures, including lowering the assets-locking period from one year to three months for pension funds, insurance companies and mutual fund, encouraging the participation of long-term funds (including those managed by pension funds and insurance companies) by lowering the requirements on the value of total assets and years of operation, etc..

3. Definitions of the QFII[1]

The QFIIs stated in the Measures refer to fund management institutions, insurance companies, securities companies and other assets management institutions outside the PRC customs territory which meet the qualifications stipulated in the Measures, and have been approved by the CSRC to invest in China's securities market and granted investment quotas by the SAFE.

A QFII shall mandate domestic commercial banks as custodians to manage assets, and shall entrust domestic securities companies to handle securities trading activities within the PRC customs territory.

[1] See: Art. 2 and 3 of the Measures

4. Requirements for being a qualified QFII[2]

In order to qualify as a QFII, an applicant shall meet the following requirements:

1. The applicant is financially stable and of good credit, meets the asset size and other requirements set by the CSRC; and has a risk control index that complies with the law of, and the requirements of the securities regulatory institutions in the country or region of its domicile;

2. Employees of the applicant shall meet relevant professional qualification requirements of the country or region of its domicile;

3. The applicant has a solid corporate governance structure and well defined internal control system, conducts business in accordance with relevant regulations, and has not been subject to any serious penalties by regulators in the country or region of its domicile during the most recent three years;

4. The country/region where the applicant domiciles shall have a sound legal and regulatory system, and the securities regulator of such country or region has signed a Memorandum of Cooperation and Understanding and maintains an effective co-operative relationship in supervision with the CSRC; and

5. Any other requirements prescribed by the CSRC based on prudential regulatory principles.

5. Requirements for being a qualified custodian[3]

A custodian shall meet the following requirements:

1. Having a dedicated custody department;

2. Having no less than RMB 8 billion in paid-up capital;

3. Having sufficient professionals who are familiar with custodial business;

4. Having facilities for safekeeping all fund assets;

5. Having secure and efficient delivery and trading capabilities;

6. Being qualified as a designated foreign exchange bank and for conducting RMB business; and

7. Having no record of severe violation of foreign exchange administrative rules in the most recent three years.

8. Local branches of foreign-funded commercial banks that have continuously operated for more than three years may apply for acting as a custodian, with its paid-in capital calculated with reference to its offshore head office.

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[2] See: Art. 6 of the Measures
[3] See: Art. 11 of the Measures

6. Responsibilities of a custodian[4]

A custodian shall perform the following responsibilities:

1. Safekeeping all assets entrusted by a QFII;

2. Handling foreign exchange sale, purchase, receipt and payment, and Renminbi clearance business for the QFII;

3. Monitoring the investment activities of the QFII, and reporting in time to the CSRC and the SAFE in case its investment instructions are found to have violated laws or regulations;

4. Reporting to the SAFE the QFII's inward/outward remittance of investment principal or proceeds and foreign exchange sale and purchase within two working days after the remittance is made;

5. Reporting to the SAFE on the assets allocation and the receipt and payment to and from the QFII's special Renminbi account and its foreign exchange account, and reporting to the CSRC on the investment and trading of its securities account within eight working days following the end of each month;

6. Preparing an annual financial report on the domestic securities investment of the QFII for the previous year and submitting the same to the CSRC and the SAFE within three months following the end of each fiscal year;

7. Preserving materials related to the QFII's inward/outward remittance, foreign exchange conversion, foreign exchange receipt and payment, and fund movement records for no less than twenty years;

8. Preparing statistical declaration of international revenues and expenditures according to the relevant provisions on state administration on foreign exchange.

9. Other responsibilities stipulated by the CSRC and the SAFE according to the principles of prudential supervision.

7. Supervision and management[5]

A QFII shall report to the CSRC and the SAFE for record within five working days should any of the following circumstances occur:

1. Change of custodians;

2. Change of legal representatives;

3. Change of controlling shareholders;

4. Adjustment of registered capital;

5. Involvement in litigation or other major events;

[4] See: Art. 13 of the Measures
[5] See: Art. 30 of the Measures

6. Severe penalty being subjected to outside PRC customs territory; and

7. Other circumstances defined by the CSRC and the SAFE.

8. Application for a new securities investment license[6]

A QFII shall apply for a new securities investment license should any of the following cases occurs:

1. Change of its institutional name;

2. Acquisition by or merger with other institution(s);

3. Other circumstances defined by the CSRC and the SAFE.

9. Surrender of license and certificate[7]

A QFII shall surrender its securities investment license and foreign exchange registration certificate to the CSRC and the SAFE respectively should any of the following cases occurs:

1. All principal has been remitted out;

2. Investment quota has been transferred;

3. The legal entity is proposed to be dissolved, has entered into bankruptcy procedures, or its assets have been taken over by a trustee;

4. Other circumstances defined by the CSRC and the SAFE.

10. Conclusion

The Measures are expected to create better legal environment for QFII investing on Chinese market, and therefore are believed to be propitious to QFII to actively participate into reform and development of Chinese capital market. And meanwhile the investment and the inward and outward remittance of fund of QFII will be more effectively supervised.

Powered by an average annual GDP growth rate of around 10%, China's financial market is emerging as one of the best -performing markets in the world. In short, the QFII program will serve as a marvelous driving force for the globalization of Chinese economy and will reward all participants with enormous benefits.

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[6] See: Art. 31 of the Measures
[7] See: Art. 32 of the Measures