Foreign Institutional Investors (FII) Brochure Special Edition

Preface

The Foreign Institutional Investor (or FII) Programme is a certification system that allows licensed professional foreign investors to trade Chinese yuan renminbi (RMB) denominated securities on China's mainland stock exchanges by converting foreign currency to RMB or remitting offshore RMB. FII Programme includes The Qualified Foreign Institutional Investor (or QFII) Programme and RMB Qualified Foreign Institutional Investor (or RQFII) Programme.

By 2001, the Chinese securities market had already developed into one of the largest and the most vibrant securities markets in Asia. However, the level of institutional investors in the Chinese securities and capital market lagged far behind that of developed markets, and has therefore restricted its development. To remedy this, the QFII Programme was introduced. On 5 November 2002, the "Provision on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors" was introduced. Since the implementation, the QFII programme has operated fairly smoothly despite the fact that China's capital markets have not fully "opened-up" and the RMB is not fully convertible. The programme gradually attracted foreign investment and slowly opened up the domestic capital market. Through the QFII practices over the past 10 years, China has established sound policies and regulations, as well as business management mechanisms. At the same time, China has accumulated experience, laying the foundation for the launch of the RQFII programme. On 16 December 2011, the "Measures for the Pilot Program of Domestic Securities Investment by Fund Management Companies and Securities Companies RMB Qualified Foreign Institutional Investors" (abolished) was introduced, making the official start of the RQFII programme. RQFII business has grown in recent years with the continuous expansion and development of China's economy.

Because institutional investors often have a long-term investment strategy, the FII Programme has enriched the investment structure, enhanced the internationalisation of the domestic capital market, raised the quality of listed companies and increased global awareness of the economic and social development in China. Financial institutions such as domestic banks, securities companies, fund management companies and asset management arms of insurance companies have also improved their quality of service offerings, and cultivated talent through the FII Programme. The FII Programme has played a key role in encouraging domestic financial institutions to expand into the international market. The FII's investment in the China capital market and the fund flow from daily repatriation and remittance activity has increased China's exposure in cross-border securities investment and capital movement. It has also facilitated the further opening of the capital market and the exchange of RMB in capital projects.

Preface (Cont'd)

In its 20 years of development, QFII has played a prominent role in the market. As China's economy growth continues and its capital market keeps developing, there is an increased need to invest into China from foreign institutional investors. To support the further opening of China's capital market, the "Provisions on Fund Administration of Domestic Securities and Futures Investment by Foreign Institutional Investors" was introduced on 7 May 2020 by the People's Bank of China and the State Administration of Foreign Exchange (SAFE), removing the limitation on FII's investment quota. By the end of June 2023, 772 institutions were approved and granted FII licenses. The number of foreign institutions planning to apply for FII licenses continue to increase steadily.

As the leading service provider of FII audit and tax services in China (see Appendix 2), we have received many queries about FIIs – how they are set up, operated, among other issues. In this Brochure, we share some insights with you – on FII regulatory developments and related hot topics including accounting, auditing and tax. We hope this Brochure will be a valuable reference for you.

Should you have any further questions, please feel free to contact us. We look forward to working with you.

Yours faithfully

October 2023


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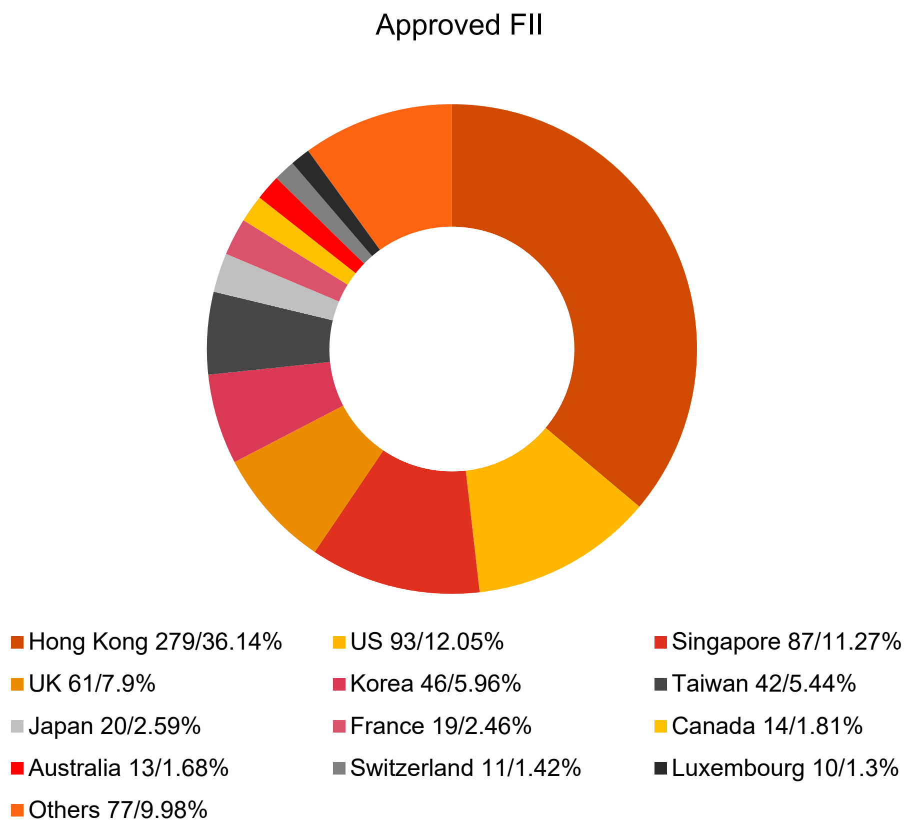
Overview of China's FII Market

By the end of June 2023, 772 foreign institutions had been approved and granted FII licences. From a geographical point of view, FII came from 41 countries and regions, including 499 in Asia, 136 in Europe, 117 in North America, 15 in Oceania, 4 in Africa, and 1 in South America. More specifically, the countries and regions include Hong Kong SAR (Hong Kong as follows), the United States, Singapore, the United Kingdom, South Korea, Taiwan, Japan, France, Canada, Australia, Switzerland, Luxembourg, Cayman Islands, Thailand, Germany and other countries and regions.

On 7 May 2020, the "Provisions on Fund Administration of Domestic Securities and Futures Investment by Foreign Institutional Investors" (Notice (2020) No.2) was introduced by the People's Bank of China and SAFE, removing the limitation on FII's investment quota. From May 2020, SAFE has stopped publishing the QFII and RQFII investment quota approval list.

The chart below illustrates approved FII by country / region: (unit: number)



Overview of China's FII Market (Cont'd)

Chinese regulators have actively promoted a series of reforms to support China's "opening up", which has led to increased interest from foreign investors. Both China's stock and bond markets are now included on many major global indexes, and foreign investors now view Chinese financial markets as a suitable place for investment. We expect more investors will enter the Chinese market and FII will become an even more important class of investors in the China A Share Market.

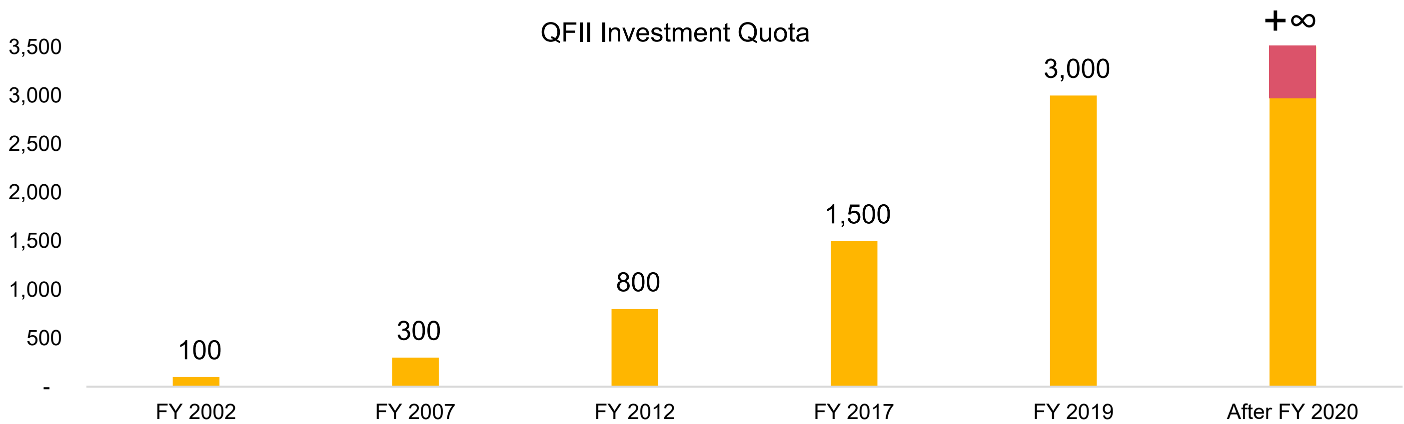
On 4 May 2011, the CSRC issued "Trading Guidelines on Stock-Index Futures Investment of Qualified Foreign Institutional Investors" (Notice (2011) No.12)(abolished), authorising QFII to trade in stock index futures based on hedging.

On 27 July 2012, the CSRC issued "Provisions Concerning Issues Related to the Implementation of the Administrative Measures for Securities Investments in China by Qualified Foreign Institutional Investors" (Notice (2012) No.17) (abolished), expanding QFII investment scope and relaxing restrictions on investment shareholding ratios from 20% to 30%.

On 3 February 2016, the SAFE issued "Provision on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors" (Notice (2016) No.1) (abolished), relaxing the upper limit of the investment quota of a single QFII institution, and allowing QFII institutions to obtain an investment quota that does not exceed a certain percentage of their asset size or the size of securities assets under management through filing. At the same time, the investment principal lock-up period was shortened from one year to three months. Regarding the inbound and outbound fund remittance, open-end funds are allowed to process fund remittance on a daily basis according to the net amount of subscription or redemption.

On 10 June 2018, the SAFE issued "Provision on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors" (Notice (2018) No. 1) (abolished), removing the limit on the monthly fund remittance of 20% of the total domestic assets.

The chart below illustrates total available quota of QFII: (unit: USD 100 million)



Overview of China's FII Market (Cont'd)

In December 2011, the CSRC, the People's Bank of China and SAFE jointly announced the RQFII pilot quota of RMB 20 billion. They specified that no less than 80% of the funds should be invested in fixed income securities, including bonds and fixed income funds; and no more than 20% in stocks and stock funds.

In April 2012, the CSRC, the People's Bank of China and SAFE jointly decided to increase the RQFII investment quota to RMB 50 billion, allow pilot institutions to issue RMB denominated A-share ETFs, and invest in A-share indices and products that can be listed on the Hong Kong Stock Exchange.

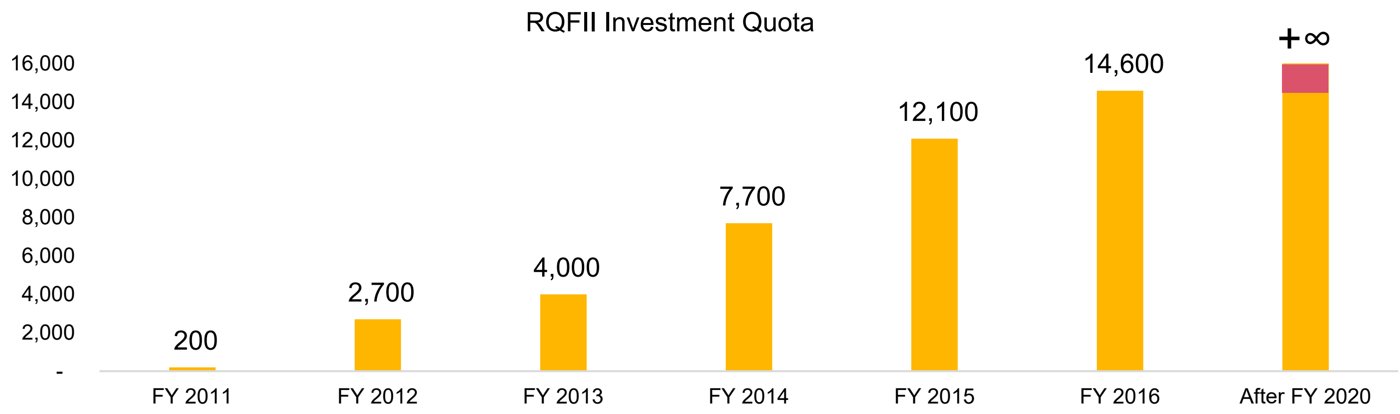
In March 2013, the "Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors" and the "Provisions on the Implementation of the Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors" were issued to expand the list of allowable institutions, investment scope, and also allowed institutions to decide on the product type in accordance with market conditions.

In August 2016, the "Notice on Matters Relating to the Management of Securities Investment by RMB Qualified Foreign Institutional Investors" was issued, abolishing the procedures for investment quota applications and relaxing the restrictions on investment principal and lock-up period.

In June 2018, the "Notice on Matters Relating to the Management of Securities Investment by RMB Qualified Foreign Institutional Investors" was updated, abolishing the principal lock-up period requirement, and allowing the use of hedging to reduce foreign exchange rate risk.

On 7 May 2020, the People's Bank of China and SAFE issued the "Provisions on Fund Administration of Domestic Securities and Futures Investment by Foreign Institutional Investors" (Notice (2020) No.2), removing the limitation on FII's investment quota.

The chart below illustrates total available quota of RQFII: (unit: RMB 100 million)



Overview of FII's Regulatory Development

Under the FII Programme, FIIs refer to fund management companies, insurance companies, securities companies and other asset management companies that comply with relevant regulations, and have been approved to invest in China's securities and futures market.

QFII Programme

The QFII Programme is a securities investment mechanism that is implemented before the complete opening-up of the Chinese capital market to foreign investments. Under the QFII Programme, foreign investors may remit a certain amount of foreign currency and convert it into local currency with the approval of relevant authorities. Foreign investors can therefore make investments in the local securities market through special purpose accounts. Their investments are under strict review. The capital gains and dividends received can be converted back into foreign currency for repatriation upon approvals. The key parts of the Programme include meeting the qualification conditions, approval and registration, investment ratio, quota lims, investment operation, trading framework, and controls over inbound and outbound fund remittance. RQFII is a subset of the QFII programme, introducing offshore RMB into domestic securities investments.

On 5 November 2002, the China Securities Regulatory Commission (CSRC) and the People's Bank of China jointly promulgated "Temporary Regulation on Domestic Securities Investment by Qualified Foreign Institutional Investor" (QFII Temporary Regulation), forming the regulatory foundation for the operation of the QFII Programme. On 24 August 2006, CSRC, the People's Bank of China and SAFE jointly issued "Measures on Administration of Domestic Securities Investment of Qualified Foreign Institutional Investors" (QFII Measures on Administration), which replaced the QFII Temporary Regulation. The QFII Measures on Administration regulates the operation of QFIIs in various ways, including the qualification conditions, the approval procedure, custody, registration and accounting, investment operation, capital management and supervision. On the same day, CSRC issued the "Notice on the Implementation of Measures on Administration of Domestic Securities Investment of Qualified Foreign Institutional Investors" (the Notice), which clarified the specific operational details of the QFII Programme. On 24 May 2011, the CSRC issued "Trading Guidelines on Stock-Index Futures Investment of Qualified Foreign Institutional Investors"(abolished), to authorise and regulate QFII's trading in stock index futures.

On 27 July 2012, the CSRC issued "Provisions Concerning Issues Related to the Implementation of the Administrative Measures for Securities Investments in China by Qualified Foreign Institutional Investors" (abolished), which replaced the Notice. The major amendments include: (1) to reduce the minimum AUM requirements for asset managers and institutional investors to qualify as a QFII; (2) to enhance operational efficiency; (3) to expand QFII investment scope; and (4) to relax restrictions on investment shareholding ratios. The qualifying conditions and investment restrictions were also further relaxed.

On foreign exchange administration, SAFE issued "Temporary Regulations on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors" (Circular [2002] No. 2) and "Notice on QFII's Foreign Exchange Management of SAFE's Comprehensive Office" (Huizongfa [2003] No. 124). These were subsequently replaced by the "Provisions on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors" (the Provisions) in 2009, setting out provisions on the management of investment quota, capital account, foreign exchange management, statistics and supervision and management of QFII operation. SAFE then amended the Provisions (abolished) towards the end of 2012 and reissued them at the beginning of 2016 and in June 2018 respectively, providing further guidance on the foreign exchange administration of QFII's Chinese securities investments.

Overview of FII's Regulatory Development (Cont'd)

RQFII Programme

On 16 December 2011, the CSRC, SAFE and People's Bank of China jointly released the "Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors by Fund Management Companies and Securities Companies" (the 2011 Measures), forming the regulatory foundation for the operation of the RQFII programme. On 1 March 2013, the CSRC, SAFE and People's Bank of China jointly released the "Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors" (the New RQFII Regulations), replacing the 2011 Measures. The New RQFII Regulations regulate the operation of RQFIIs in various ways, including the qualification conditions, the approval procedure, custody, registration and settlement, investment operation, capital management and supervision. On the same day, the CSRC issued the "Notice on the Implementation of Measures on Administration of Domestic Securities Investment of RMB Qualified Foreign Institutional Investors" (the Notice), clarifying on the detailed provisions of the RQFII programme.

The above expands the scope of qualified RMB investors from domestic fund management companies and Hong Kong subsidiaries of securities companies authorised by the CSRC with approved investment quotas from SAFE to domestic fund management companies and securities companies, commercial banks, insurance companies' Hong Kong subsidiaries or financial institutions registered or have its main trade or business in Hong Kong.

On July 2013, the CSRC announced to extend the scope of the pilot programme from Hong Kong to Taiwan, London and Singapore. Financial institutions participating in the RQFII pilot programme in Taiwan, Singapore and London will refer to the existing laws and regulations implemented in Hong Kong.

On foreign exchange administration, SAFE previously issued Huifa [2011] no. 50 "Notice on matters relating to Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors by Fund Management Companies and Securities Companies", which was subsequently replaced in 2013 by the "Notice on matters relating to Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors". On 30 August 2016, the People's Bank of China and SAFE jointly issued the "Notice on Matters Relating to the Management of Securities Investment by RMB Qualified Foreign Institutional Investors", and abolished the 2013 notice issued.

Subsequently, on 12 June 2018, the People's Bank of China and SAFE jointly issued the "Notice on Matters Relating to the Management of Securities Investment by RMB Qualified Foreign Institutional Investors", replacing the 2016 notice. The 2018 notice removed the lock-up period requirement, and allowing RQFIIs to use hedge to reduce their foreign exchange risk.

In January 2019, the CSRC consulted the public for comments on the "Issues Related to the Implementation of the Administrative Measures for Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors" (the Draft Consultation). The Draft Consultation expanded the QFII investment scope to include shares traded on the New Third Board, i.e. National Equities Exchange and Quotations System Co. Ltd. (NEEQ), bond repos, private investment funds, financial futures listed and traded on the China Financial Futures Exchange (CFFEX), commodity futures traded on futures exchanges approved by CSRC, and options traded on futures exchanges approved by the State Council or CSRC.

Overview of FII's Regulatory Development (Cont'd)

FII Programme

To improve the QFII and RQFII Programme, implement a high-level opening of the capital market, and introduce more long-term overseas funds, on 31 January 2019, the CSRC revised and integrated "Measures on Administration of Domestic Securities Investment of Qualified Foreign Institutional Investors" and "Measures for the Pilot Program of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors", forming the "Administrative Measures for Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors" (draft for comments) (Administrative Measures) and "Regulations on Issues Related to the Implementation of the Administrative Measures for Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors" (draft for comments)(Regulations on Implementation).

The main amendments are as follows: First, the QFII and RQFII Programmes are merged into one Programme. The unified Administrative Measures and Regulations on Implementation were integrated and formed, based on the QFII rules and absorbing the content of the RQFII rules. Foreign institutional investors only need to apply for the qualification once, and institutions in countries and regions that have not yet obtained the RQFII quota can still invest in foreign currencies.

Second, the access conditions of QFIIs and RQFIIs are unified. The access conditions are relaxed with quantitative index requirements cancelled, retaining compliance conditions including financial stability, good credit, securities and futures investment experience, sound and effective governance structure, internal control and compliance management systems, no major penalties from regulatory agencies for last 3 years or since establishment, etc.

Third, the investment scope is expanded. In addition to the original products, qualified investors can invest in (1) shares traded on NEEQ; (2) bond repo; (3) private investment funds; (4) financial futures; (5) commodity futures; (6) options, etc. At the same time, it is allowed to participate in margin trading on the stock exchange.

Fourth, the management of custodians is optimized. The qualified foreign institutional investors are under record management instead of qualification approval. Limit on the number of custodians appointed by qualified investors is removed while a principal custodian is required designating if more than two custodians.

Overview of FII's Regulatory Development (Cont'd)

Fifth, continuous supervision is strengthened with account management and analysis mechanism improved. The ownership of assets under the securities and futures accounts opened by qualified investors for the client funds under management shall be clarified. It is required that custodians should make regular submission of regulatory documents. Custodians, securities companies, futures companies should monitor the trading behavior and inbound and outbound fund remittances of foreign institutional investors, and report any abnormal situation timely to the CSRC, the People's Bank of China and the SAFE.

The regulations on QFII and RQFII are abolished with the re-enactment and release of the "Provisions on Fund Administration of Domestic Securities and Futures Investment Funds of Foreign Institutional Investors" (New Provisions) by the People's Bank of China and SAFE on 7 May 2020. Both QFIIs and RQFIIs, collectively referred to as FIIs, are regulated by the New Provision.

The funding management requirements are clarified and simplified for domestic securities and futures investment by FIIs, further facilitating foreign investors to participate in China's capital market. The main regulations include the following: First, implement the removal of the management requirements for domestic securities investment quotas for QFIIs and RQFIIs, and implement registration management for inbound and outbound fund remittances and exchanges of FIIs. Second, implement integrated management of domestic and foreign currencies, allowing FIIs to choose the currency and timing of remittances independently. Third, simplify substantially the procedures for the outbound remittance of domestic securities investment income by FIIs, requiring only a commitment letter issued by FIIs to pay taxes in full, instead of capital gains audit report issued by Chinese CPA and tax filing form. Fourth, remove the limit on the number of custodians, allow multiple domestic custodians appointed by a single FII, and implement the principal reporter system. Fifth, improve the foreign exchange risk and investment risk management requirements of domestic securities investment by FIIs. Sixth, strengthen the supervision by the People's Bank of China and the SAFE.

On 25 September 2020, the CSRC, the People's Bank of China, and SAFE issued the "Administrative Measures for Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors" (FII Administrative Measures), and the CSRC issued simultaneously the supporting rules "Provisions on Issues Concerning the Implementation of the Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors" (FII Provisions on Implementation). The FII Administrative Measures and FII Provisions on Implementation will come into force on the date of 1st November 2020. The FII Administrative Measures and its supporting rules have further revised and improved the Administrative Measures and the Regulations on Implementation. The revision mainly involves three aspects: First, lower the entry threshold, and facilitate investments and operations, by way of relaxing access conditions, simplifying application documents, shortening the time for approval, and implementing simplified administrative licensing procedures. Second, the scope of investment is expanded orderly. FIIs are newly allowed to investment in NEEQ listed securities, private investment funds, financial futures, commodity futures and options, and to participate in bond repurchases, margin trading on the stock exchange, and lending transactions of refinancing securities. Third, strengthen continuous supervision, etc.

Overview of FII's Regulatory Development (Cont'd)

With the implementation of the Administrative Measures and the Regulations on Implementation, the CSRC further issued the "Announcement on the Participation of QFII and RQFII in Financial Derivatives Transactions" in 2021 (Announcement 24). FIIs are allowed to trade commodity futures, commodity options, and stock index option contracts listed and traded in the Exchanges, and approved by the State Council or the CSRC while the purpose of participating in stock index options trading is limited to hedging transactions, effective from November 1, 2021. On September 2, 2022, Shanghai Futures Exchange, Shanghai International Energy Exchange, Dalian Commodity Exchange, Zhengzhou Commodity Exchange, and China Financial Futures Exchange respectively announced specific futures contracts that FII can participate in. Currently, FIIs can engage in the trading of 23 different commodity futures in China, with an addition of 16 commodity options contracts and stock index options (limited to hedging transactions).

In order to further promote FII's investments in China's bond market in accordance with law and compliance, on May 27, 2022, the People's Bank of China, the CSRC and the SAFE issued Joint Announcement No. 4, "Relevant Matters Concerning Further Facilitating Foreign Institutional Investors to Invest in China's Bond Market"(Announcement 4), which comes into effect on June 30, 2022.

Further expanding the two-way opening of the financial market, on November 18, 2022, the People's Bank of China and the State Administration of Foreign Exchange jointly issued the "Administrative Provisions for Foreign Institutional Investors to Invest in the China Bond Market" (Administrative Provisions), improving and clarifying the requirements for the management of funds for FIIs to invest in the China bond market, which will come into force on January 1, 2023. The release of Administrative Provisions is conducive to further facilitating FII's investments and enhancing the attractiveness of the China bond market to FIIs.

An overview of Administrative Provisions:

1. Unify and standardize the rules on capital accounts, capital receipt and payment, capital exchange, and statistical monitoring involved in foreign institutional investors' investment in China's bond market.
2. Improve the management of spot settlement and sale of foreign exchange, allow FIIs to handle through third-party financial institutions other than settlement agents.
3. Optimize foreign exchange risk management policies, further expand foreign exchange hedging channels for FIIs, and remove the restrictions on the number of counterparties for over-the-counter transactions.
4. Optimize the management of matching outbound and inbound currencies, improve the convenience of FIIs remitting investment funds, and encourage long-term investment in China's bond market.
5. Clarify the foreign exchange management requirements of sovereign institutions. Sovereign institutional investors who invest through custodians or settlement agents (commercial banks) should register with the bank.

For more details on the applicable laws and regulations, please refer to Appendix 1.

Overview of FII's Investment Scope

FII Provisions on Implementation issued by CSRC on 25 September 2020 further expands FII's investment scope, including shares traded on NEEQ, private investment funds, financial futures, commodity futures, options, margin trading, securities lending on the exchanges, and securities lending to the securities finance company, etc..

<table>
<tr><th colspan="2">Investment scope of FII</th></tr>
<tr><th>Before</th><th>After the FII Provisions on Implementation</th></tr>
<tr><td>• A-shares</td><td>• Depository receipts, bond repos traded on stock exchanges</td></tr>
<tr><td>• Bonds</td><td>• Shares traded on NEEQ</td></tr>
<tr><td>• Public Security Investment Funds</td><td>• Financial products traded on the China Interbank Bond Market and PBOC-approved derivatives products related to bonds, interest rates, and foreign exchange</td></tr>
<tr><td>• Warrants</td><td>• Financial futures listed and traded on the China Financial Futures Exchange</td></tr>
<tr><td>• Assets-backed securities</td><td>• Commodity futures traded on futures exchanges approved by CSRC(23 commodity futures)
<table>
<tr><td>Gold</td><td>Aluminum</td><td>Hot-rolled coil</td><td>White sugar</td><td>Yellow soybean No. 1</td><td>Soybean oil</td><td>Crude oil</td><td>Low sulfur fuel oil</td></tr>
<tr><td>Silver</td><td>zinc</td><td>PTA</td><td>Rapeseed oil</td><td>Yellow soybean No.2</td><td>Palm oil</td><td>Glue No.20</td><td>Linear low density</td></tr>
<tr><td>Copper</td><td>Rebar</td><td>Carbinol</td><td>Staple fiber</td><td>Soybean meal</td><td>Iron ore</td><td>International copper</td><td>Polythene</td></tr>
</table></td></tr>
<tr><td>• Stock index futures</td><td>• Options traded on exchanges approved by the State Council or CSRC(16 commodity option contracts and stock index options)
<table>
<tr><td>Gold</td><td>PTA</td><td>Yellow soybean No. 1</td><td>Palm oil</td></tr>
<tr><td>Copper</td><td>Carbinol</td><td>Yellow soybean No. 2</td><td>Iron ore</td></tr>
<tr><td>Aluminum</td><td>White sugar</td><td>Soybean meal</td><td>Linear low density polyethylene</td></tr>
<tr><td>Zinc</td><td>Rapeseed oil</td><td>Soybean oil</td><td>Crude oil</td></tr>
<tr><td>CSI 300 stock index options</td><td>China Securities 10</td><td></td><td></td></tr>
</table></td></tr>
<tr><td rowspan="4">• Other financial instruments allowed by CSRC</td><td>• Foreign exchange derivatives products permitted by SAFE for hedging purposes</td></tr>
<tr><td>• Private investment funds</td></tr>
<tr><td>• Other financial instruments allowed by CSRC</td></tr>
<tr><td>• FIIs will also be allowed to participate in margin trading, securities lending on the exchanges, and securities lending to the securities finance company</td></tr>
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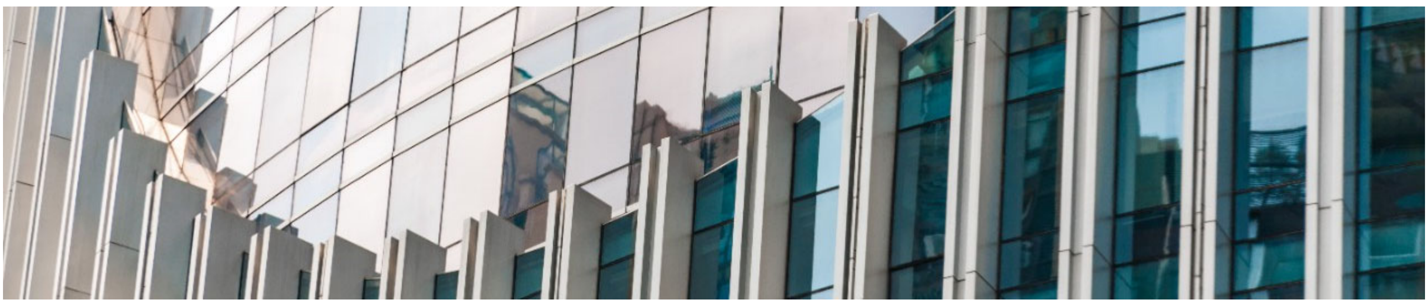

Overview of FII's Investment Scope (Cont'd)

After the FII Provisions on Implementation, FII has more choices with large and comprehensive scale of investments compared to investors of Shanghai-Hong Kong and Shenzhen-Hong Kong Connect, who can only invest in certain range of A-shares. Below is the comparison of investment scope:

SH-HK/SZ-HK Connects' investment Scope	FII's Investment Scope
Shanghai Stock Connect	A-shares, depository receipts, bonds, bonds repos and assets-backed securities traded on stock exchanges
A stock that is a constituent of the Shanghai A-Share Index and meets all of the following conditions within 6 months prior to the stock adjustment inspection (if the stock has been listed on the Stock Exchange for less than 6 months, it is calculated according to the actual trading days) : 1. The average daily market value is not less than RMB 5 billion; 2. The average daily transaction amount is not less than 30 million yuan (excluding the trading day when trading is suspended all day); 3. The number of days of one-day trading suspension accounted for less than 50% of the total trading days.	Shares traded on NEEQ
	Financial products traded on the China Interbank Bond Market and PBOC-approved derivatives products related to bonds, interest rates, and foreign exchange
SSE-listed A-share stocks of companies dually listed on SSE and SEHK ("A+H companies")	Public Security Investment Funds
Shenzhen Stock Connect	Financial futures listed and traded on the China Financial Futures Exchange
A stock that is a constituent of the Shenzhen Composite Index and meets all of the following conditions within 6 months prior to the stock adjustment inspection (if the stock has been listed on the Stock Exchange for less than 6 months, it is calculated according to the actual trading days) : 1. The average daily market value is not less than RMB 5 billion; 2. The average daily transaction amount is not less than 30 million yuan (excluding all day suspension trading days); 3. The number of days of one-day trading suspension accounted for less than 50% of the total trading days.	Commodity futures traded on futures exchanges approved by CSRC
	Options traded on exchanges approved by the State Council or CSRC
	Foreign exchange derivatives products permitted by SAFE for hedging purposes
	Other financial instruments allowed by CSRC
	FIIs will be allowed to participate in subscription for new share issuance, bond issuance, asset-backed securities issuance, follow-on share offerings, and right issue on stock exchanges and NEEQ, and also engage in margin trading, securities lending on the exchanges, and securities lending to the securities finance company
SZSE-listed A shares of A+H companies that are dual-listed on the Exchange and the SEHK	Private investment funds

Setting up and operating a FII Relevant Market Intermediaries

Setting up and operating a FII

Application & Set up

- Appoint a principal reporter to submit the application*;
- File an application to the CSRC for a license to operate securities and futures business; then file an application to SAFE for a business registration**;
- After obtaining the qualification license from the CSRC, together with the business registration certificate issued by the SAFE, FIIs can apply for one or more special accounts at the custodian according to investment and fund remittance needs;

Principal Remittance & Investment Operation

- Foreign Currency Remittance: FIIs can notify their custodian bank to directly settle and transfer foreign currency to their RMB special account corresponding of foreign currency account for their investments timely based on their investment plan;
- RMB Remittance: FIIs can notify their custodian bank to directly transfer offshore RMB to their RMB special account for their investments based on their investment plan.

Principal and Profit Repatriation

- For profit repatriation, the following are required - a written application or instruction from FIIs and a commitment letter issued by FIIs to pay taxes in full in accordance with relevant domestic tax laws and regulations;
- For liquidation, the following are required - custodian banks should proceed capital repatriation and account closure with written application or instruction from FIIs and other necessary documents***.

* According to SAFE, for FII appointing more than one custodian bank, a principal reporter shall be designated among them (if there is only one custodian, the custodian is assumed to be the principal reporter).

** FII should submit the "Registration Form for Foreign Institutional Investors" and a copy of the license for securities and futures operations when applying for business registration with the SAFE.

*** To liquidate its assets, the custodian bank can submit a written application or instruction from the FIIs, a special audit report on investment income issued by a Chinese CPA firm, and a tax filing form to complete the capital repatriation and account closure.

Intermediaries

Intermediaries	Applicable Stage	Service Content
Custodian Bank	Set up, operation, exit	Asset custody, transaction execution, account services
Investment Advisor	Operation	Recommendation on asset allocation and individual investments
Securities Company	Operation	Investment transactions
Public Accounting Firm	Operation, exit	Annual audit, consulting services such as tax advisory (e.g. tax liquidation)
Law Firm (optional)	Set up, operation, exit	Legal consulting services

FAQ about FII Accounting and Auditing

1. Under which circumstance is audit required?

If the FII is planning to liquidate its assets, the custodian bank should submit a written application, together with a capital gains audit report signed and issued by Chinese CPA firm, a tax filing form (except for those not required to provide according to regulations) to complete the capital remittance and account closure.

2. Can liquidation-purpose financial statements can cover multiple periods?

For FII liquidation, the tax authorities have specific requirements for liquidation-purpose financial statements. Audit opinion is usually required for each and every year under operation, separately. And financial statements that cover one full calendar year and one period is accepted in some cases. However, if an annual audit has never been conducted before, the FII would need to submit audited financial reports for each and every year or period in operation starting from the beginning year of operation before liquidating the account. In short, FII audit requirement is not cancelled, it is just postponed to the time when FII plans to liquidate.

In light of the delay of FII audit requirement to the time of liquidation, our observation shows that most of the market participants still choose to carry out annual audits rather than do a one-time audit for all the past unaudited year when liquidating. The rationales are elaborated as follows:

1) Time sensitivity: the accounting data for more than one year in the main custodian bank usually will be archived and will be difficult to retrieve later.
2) Staff turnover: the accounting or operating personnel of the custodian bank who understands the operation of FII may have left the custodian bank or be transferred to other departments.
3) Lengthy process: It usually takes a long time to audit financial statements for multiple years, and there is a risk that the time requirement for the FII clearing process will not be met in the time of liquidation.

3. What are the applicable accounting standards for FII in China?

The Ministry of Finance (governing body responsible for accounting standards in China) has not clarified which accounting standards are applicable for FIIs. However from a regulatory perspective, the format of FIIs' financial statements is outlined in one of SAFE's regulations (please refer to the appendix 3&4). A FII's major accounting policies are primarily drafted by custodian banks and sent to the FII license holder for final confirmation. Any special basis of preparation and significant accounting policies are fully disclosed in FII's annual financial statements. The FII license holder and custodian banks jointly assume the accounting responsibilities. We set out a comparison of two major accounting policies adopted by the majority of FII custodian banks below:

	Method A	Method B
Trading expenses in the initial recognition	Into Costs	Into P&L
Accrual of bond interest or not	No	Yes
Bond valuation at period-end	Gross price	Net price

FAQ about FII Accounting and Auditing (Cont'd)

4. What is the FII's accounting year?

The FIIs' accounting year is a full calendar year, i.e. starts on 1 January (or the date of commencement) and ends on 31 December.

5. Can we issue separate audit report for a FII's subaccount?

No. For some FIIs constituted by different sub-accounts, if one sub-account requires profit repatriation, the competent tax authority would not accept remittance requests for individual sub-account at this stage. As such, we cannot issue separate audit reports for subaccounts.

Hot Topics on FII Taxation

What types of tax are applicable for FIIs?

Now, FIIs are subject to withholding income tax ("WHT") and Value-added Tax ("VAT"). The effective FII tax regulations are as follows:

VAT:

According to Cai Shui [2016] No. 36, Pilot Collection of Value-added Tax in lieu of Business Tax has been carried out nationwide as from 1 May 2016, and financial industry is included in the pilot scope. Pursuant to the regulations stipulated in Notice 36, the portfolio is currently exempted from VAT on realised capital gains from securities trading business.

The MOF and SAT jointly issued Cai Shui [2018] No. 108 (Notice 108) to provide that from 7 November 2018 to 6 November 2021, foreign institutions can enjoy VAT exemption treatment for the bond interest income derived from their investment into the domestic bond market of Mainland China. In November 2021, MOF and SAT further issued Cai Shui [2021] No. 34 (Notice 34), which extended the preferential tax policies under Notice 108 and temporarily exempted the VAT on the bond interest income obtained by overseas institutions investing in Chinese bond market. The exemption period is from November 7, 2021 to December 31, 2025.

WHT:

According to Guoshuihan [2009] No. 47 "Circular on WHT on dividends and interest derived by QFIIs from PRC tax resident enterprises" issued by the State Administration of Taxation, Pursuant to the new China Income Tax Law, QFIIs are subject to WHT at 10% of PRC sourced dividends and interest. For WHT on dividends, the PRC enterprises making the distribution should be the withholding agents. For WHT on interest, PRC enterprises making the payment should withhold the tax upon payment or when the payment is due.

For FIIs which are entitled to preferential tax treaty benefits for WHT of dividend and interest, FIIs are required to submit application to the competent tax authority and can enjoy the relevant treaty benefits after obtaining approvals from the competent tax authority.

The MOF, SAT and China Securities Regulatory Commission (CSRC) jointly published Cai Shui [2014] No. 79 (Notice 79) to clarify the withholding tax (WHT) policy for capital gains specifically for the FII Programme. Under Notice 79, QFIIs without an establishment or place (E&P) in China, or FIIs with E&P in China but the income derived in China is not effectively connected with their E&P, are temporarily exempt from WHT on gains derived from the trading of equity investment assets (including shares), effective from 17 November 2014.

The MOF and SAT jointly issued the Notice 108 to provide that from 7 November 2018 to 6 November 2021, foreign institutions can enjoy WHT exemption treatment for the bond interest income derived from their investment into the domestic bond market of Mainland China. As mentioned above for VAT, Notice 34 extended the preferential tax policies under Notice 108 and temporarily exempt WHT on the bond interest income obtained by overseas institutions investing in Chinese bond market. The exemption period is from November 7, 2021 to December 31, 2025.

Follow-up tax management for investment income of FII and tax issues pending for solution

Tax exemption of bond interest income:

As far as we know, the competent tax authorities of QFIIs in Beijing and Shanghai adopt different VAT treatment on the bond interest income generated before the VAT exemption period defined by Notice 108 (i.e. before 7 November 2018). The Shanghai tax authority imposes VAT on bond interest income generated by QFIIs on accrual basis, while the tax authority in Beijing adopts cash basis. Meanwhile, there is no clear guidance on the recognition of the realised capital gain and interest income for zero-coupon bonds, to which QFIIs should pay more attention.

In addition, we notice that local tax authorities from different areas have not reached an agreement on the recognition of bond interest income that can be included in the scope of VAT exemption. If the debt financing instruments (such as asset-backed securities, interbank certificates of deposit, etc.) issued in the domestic bond market and invested by FIIs are not recognized as bond investments falling into the scope of tax exemption in practice, there is a risk that FIIs may have to pay additional tax on the respective interest income.

Hot Topics on FII Taxation (Cont'd)

The tax treatment of some domestic investments pending solution:

Regarding Caishui [2008] No. 1, investors can enjoy WHT exemption treatment for the dividend income from securities investment funds. However, whether FII falls within the scope of the aforementioned investors has yet to be clearly stipulated. Therefore, local tax authorities have different standards for whether FIIs are subject to WHT of dividend income from securities investment funds (such as money market funds and open-end index funds).

With the implementation of the latest regulations of FII and the expansion of investment scope, the issue of tax exemption of FII income from new investment vehicles has attracted FII's attention. The recent increase in specific trading varieties such as commodity futures, commodity options, and stock index options has stimulated FII investment motivation, but the relevant tax treatment and practice remain to be clarified. According to Caishui [2018] No. 21 ("Circular 21"), corporate income tax shall not be levied on the income of foreign institutional investors engaged in crude oil futures trading in China (excluding physical delivery). Meanwhile, Circular 21 further expands the above tax exemption treatment to the investment gains derived from trading other varieties of commodity futures approved by The State Council for opening to overseas investors' participation in the future. However, it is still unclear whether preferential tax treatment of Circular 21 can be appliable to FIIs trading the newly permitted commodity future contracts that are accessible by FIIs. Also, no document has been issued to clarify whether the income obtained from FII investment in domestic commodity options, stock index options and other financial derivatives can be exempted from VAT following the tax rules of securities trading business. In summary, the Chinese tax authorities have not given any oral or written confirmation regarding the tax treatment of income derived from the aforesaid newly permitted investment instruments, and it is expected to be clarified in future.

Tax practice of cross-border repatriation for FII investment income

With the completion of tax reporting in many FIIs and impacts such as the downturn in the domestic securities investment market and continuous depreciation of RMB, quite a number of FIIs have started cross-border profit repatriation or FIIs exiting China faced liquidation of gains .

On May 7, 2020, the People's Bank of China and the SAFE jointly issued [2020] No.2 Announcement "Provisions on Fund Administration of Domestic Securities and Futures Investment by Foreign Institutional Investors" ("Circular 2"), which simplified requirements on FII's profit repatriation. Circular 2 clarifies that the custodian can execute profit repatriation with FII's written application or instruction, and the commitment letter issued by FII to pay taxes in full in accordance with relevant domestic tax laws and regulations.

As the "tax clearance certificate on profits or evidence of tax-related filing" issued by the competent tax authority used to be a necessary document for FII's profit repatriation, the simplified requirement under Circular 2 is undoubtedly good news for FIIs.

However, while Circular 2 has brought positive benefits, FIIs still needs to pay attention to the following issues:

- Circular 2 does not uniformly stipulate the form of the commitment letter issued by the FII, and the specific commitment clauses that need to be included. Will different custodian banks have different enforcement methods in practice?
- However, given the current uncertainty regarding some tax issues under the FII scheme, how can the FII ensure its tax compliance in the form of a commitment letter?
- Are there any incidental liabilities related to the content of the commitment letter issued by FII? Should the incidental liabilities be supervised by the tax authority or the custodian bank?

We understand that recently it is common for FII to carry out profit repatriation with a letter of commitment, and it is expected that more and more FII will benefit from the simplified profit repatriation process of Circular 2 in the future.

However, FII should continue to pay attention to whether there are any potential tax problems or uncertainty during its operation, and consider whether it is necessary to make provision for relevant tax effects, so as to better manage tax risks and prevent large tax costs in the liquidation process, so as to avoid adverse tax effects on managers and investors who have not withdrawn their investments.

Our Tax Consulting Services

Tax costs have a direct impact on the total return to the investors as well as the performance fee received by the investment manager. It is imperative for the FIIs to have a thorough understanding on the potential tax exposures in China and to formulate a strategy to deal with any unforeseen issues.

PwC can provide assistance to you on the following areas:

1. Provide consulting services to the FII on the current China tax environment, including the FII holding and business structure, housekeeping rules & regulations, etc. with a view to minimizing potential China tax liabilities
2. Provide the following compliance service:
    a. Ascertain the competent tax authority of the FII
    b. Agree with the competent tax authority on the tax basis
    c. Calculate the taxable income of the FII
    d. Prepare and submit the tax returns on behalf of the FII
    e. Apply for double tax treaty protection, if eligible
    f. Assist FII in completing tax payment and obtaining tax clearance certificate
    g. Confirm the specific external payment procedures, requirements and standards under Circular 2 with the competent tax authority and the custodian bank, and provide necessary tax assistance

Appendix

Major FII's regulations in effect

Appendix I

FII's regulations in effect

25 September 2020

Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors(Decree No. 176 of the Securities Regulatory Commission, the People's Bank of China, the State Administration of Foreign Exchange)

25 September 2020

Provisions on Issues Concerning the Implementation of the Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Notice (2020) No.63 of the Securities Regulatory Commission)

7 May 2020

Provisions on Fund Administration of Domestic Securities and Futures Investment by Foreign Institutional Investors (Notice (2020) No. 2 of the People's Bank of China, the State Administration of Foreign Exchange)

Regulation evolution of QFII and RQFII

12 June 2018

Notice on Matters Relating to the Management of Securities Investment by RMB Qualified Foreign Institutional Investors (12 June 2018, the People's Bank of China, the State Administration of Foreign Exchange) (Notice [2018] No. 157) (abolished)

30 August 2016

Notice on Matters Relating to the Management of Securities Investment by RMB Qualified Foreign Institutional Investors (30 August 2016, the People's Bank of China, the State Administration of Foreign Exchange) (Notice (2016) No.227) (abolished)

1 March 2013

Provisions on the Implementation of the Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors (1 March 2013, Notice (2013) No. 14 of the Securities Regulatory Commission) (abolished)

1 March 2013

Measures for the Pilot Program of Securities Investment in China by RMB Qualified Foreign Institutional Investors (1 March 2013, Decree No. 90 of the Securities Regulatory Commission, the People's Bank of China, the State Administration of Foreign Exchange) (abolished)

21 March 2012

Notice on Issues Relating to Opening Bond Accounts in Inter-bank Bond Market of Domestic Securities Investments of Renminbi-Denominated Qualified Foreign Institutional Investors by Fund Management Companies and Securities Companies(21 March 2012, Zhongzhai zi (2012) No. 16, China Central Depositary Clearing Co., Ltd.) (abolished)

15 February 2012

Notice on Issues Relating to Depository, Clearing and Settlement of Domestic Securities Investments of Renminbi-Denominated Qualified Foreign Institutional Investors by Fund Management Companies and Securities Companies(15th February 2012, China Securities Depository and Clearing Co., Ltd.)

RQFII's regulations

16 October 2019

Notice of the People's Bank of China and the State Administration of Foreign Exchange on Further Facilitating Foreign Institutional Investors' Investment in the Interbank Bond Market (Notice (2019) No.240) (abolished)

12 June 2018

Provision on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors (Notice (2018) No. 1 of the State Administration of Foreign Exchange) (abolished)

3 February 2016

Provision on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors (Notice (2016) No. 1 of the State Administration of Foreign Exchange) (abolished)

27 July 2012

Provisions Concerning Issues Related to the Implementation of the Administrative Measures for Securities Investments in China by Qualified Foreign Institutional Investors (Notice (2012) No. 17 of the Securities Regulatory Commission) (abolished)

4 May 2011

Trading Guidelines on Stock-Index Futures Investment of Qualified Foreign Institutional Investors (Notice (2011) No. 12 of the Securities Regulatory Commission)

24 August 2006

Administrative Measures for Securities Investment in China by Qualified Foreign Institutional Investors (Decree No. 36 of of the Securities Regulatory Commission, the People's Bank of China, the State Administration of Foreign Exchange) (abolished)

QFII's regulations

Appendix II

PwC — the leading services provider to the asset management industry

A global firm with a strong reputation

PwC has a history in client services that dates back to the nineteenth century. PwC's accounting practice originated in London and as times changed, PwC expanded worldwide. PwC is now a global network of more than 327,947 people in 152 countries across 6 continents by the end of June 2022. As the world's largest professional financial advisory organisation, PwC had total revenues of US$50.3 billion in fiscal year ended 30 June 2022. With the strength of our global services network, we are well positioned to help our clients whenever and wherever they are based. PwC is a consistent leader in all major global industries, offering high-quality services, abundant network resources and shared practical experience.

China's largest accounting firm

PwC is the largest accounting firm in China and has ranked number one for 19 years in a row in the Top 100 Annual Accounting Firms' comprehensive assessment report, which is published by the Chinese Institute of Certified Public Accountants. As for China Mainland and Hong Kong, we have over 28,307 professionals, of which 1,115 are partners and directors. We have branches in 34 cities across Mainland China, as well as in Hong Kong, Macao and Taiwan. In addition to domestic specialists, our accounting and advisory firms also have partners and managers from around the world, including the United States, Britain, Germany, Australia, Hong Kong SAR, Taiwan region, Japan, South Korea, Singapore and Malaysia.

PwC's multi-disciplinary financial services team

PwC has financial services industry specialists worldwide, spanning multiple disciplines, providing professional services to clients in the asset management field, banking and capital markets sector, insurance industry, among others. Financial service accounts for 30% of PwC's global income. PwC leads the way in global financial industry.

PwC's domestic and global strength in the asset management

PwC is experienced in providing professional services for investment management companies in China and the world. We provide professional services to 71 of the top 100 largest fund management companies in the world. We have the largest market share of the Chinese fund industry since 1998 and are the market leaders for fund management companies, joint-venture fund management companies in China.

As for the China FII audit service market, According to the "List of Qualified Foreign Investors" published by the CSRC, there are 772 foreign institutions that have obtained FII qualifications as of June 2023. We provide annual audit services for 240 of these FII operating in Mainland China. We have an excellent business relationship with all the major FII custodian banks in China including Deutsche Bank (China) Corporation Ltd, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank Corporation Ltd, Citi Bank Corporation Ltd, Bank of China Corporation Ltd, Industrial and Commercial Bank of China Corporation Ltd, China Construction Bank Corporation Ltd, Bank of Communications Corporation Ltd, Agricultural Bank of China Corporation Ltd and more.

All-round quality services

PwC offers experienced and comprehensive help for a wide range of business needs, and can help you to work smarter and reach your goals.

By integrating our global network of resources, PwC provides various professional services for our clients, including assurance services, consulting and advisory, and taxation services. Our core business includes financial statements audit, compliance reporting services, internal audit, compliance with the Sarbanes-Oxley Act, audit of and consulting on capital market transactions, international taxation, mergers and acquisitions, transfer pricing, tax management, corporate restructuring, risk management, human resource management, financial functions improvement, value assessment, information technology consultation, and others.

In addition to our core business, PwC also has back-office support departments, including risk management, accounting technology consultation, audit technology support, information technology support and training, to ensure that our PwC professionals provide the best services to you.

Illustrative financial statements of domestic securities investment of QFII

Appendix III

Balance Sheet

QFII Name: Custodian: Unit: Yuan (RMB)

Assets	
Cash in bank	
Investment in stocks	
Investment in government bonds	
Investment in other bonds	
Other investments	
Prepayment for purchase of securities	
Receivable for sale of securities	
Dividends receivable	
Interest receivable	
Other receivables	
Liabilities	
Management fee payable	
Custodian fee payable	
Taxes payable	
Payable for purchase of securities	
Other payables	
Net assets	
Injected funds	
Accumulated gains	
In which: Net gains/(losses) of current year	

Person preparing the financial statements: Person in-charge:
Contact phone number: Date:

Notes: The price of stocks, government bonds, other bonds and other investments are valued using the closing price of the last trading day of the year.

Illustrative financial statements of domestic securities investment of QFII (Cont'd)

Appendix III

Income Statement

QFII Name: Custodian: Unit: Yuan (RMB)

Income	
Dividend income	
Interest income	
Other income	
Expenses	
Custodian fee	
Management fee	
Tax expenses	
Other expenses	
Realised capital gains/(losses)	
Unrealised capital gains/(losses)	
Net gains/(losses) of current year	
Accumulated gains at the beginning of the year	
Accumulated gains at the end of the year	

Person preparing the financial statements: Person in-charge:

Contact phone number: Date:

Illustrative financial statements of domestic securities investment of RQFII

Appendix IV

Balance Sheet

RQFII Name: Custodian: Unit: Yuan (RMB)

Assets	
Cash in bank	
Investment in stocks	
Investment in bonds	
Investment in funds	
Asset-backed securities investments	
Warrants	
Other investments	
Prepayment for purchase of securities	
Receivable for sale of securities	
Receivable from subscription	
Dividend receivable	
Interest receivable	
Settlement deposit	
Financial assets purchased under agreements to resell	
Other receivables	
Liabilities	
Management fee payable	
Custodian fee payable	
Taxes payable	
Payable for purchase of securities	
Interest payable	
Financial assets sold under agreements to repurchase	
Payable from redemption	
Transaction fee payable	
Other payables	
Net Assets	
Injected funds	
Accumulated gains	
In which: Net gains/(losses) of current year	

Person preparing the financial statements: Person in-charge:

Contact phone number: Date:

Notes: The price of stocks, bonds, funds, asset-backed securities investments, warrants and other investments are valued using the closing price of the last trading day of the year

Illustrative financial statements of domestic securities investment of RQFII (Cont'd)

Appendix IV

Income Statement

RQFII Name: Custodian: Unit: Yuan (RMB)

Income Dividend income Interest income Profits/(losses) from fair value change Investment income/(losses) Other income	
Expense Custodian fee Management fee Tax expenses Other expenses	
Net gains/losses of current year	
Accumulated gains at the beginning of year	
Accumulated gains at the end of year	

Person preparing the financial statements: Person in-charge:

Contact phone number: Date: