

China Further Liberalizes Bond Market for Foreign Investors

On 24 February 2016, the People's Bank of China (PBOC) issued Announcement No 3 (Announcement) to further open up the China Interbank Bond Market (CIBM) to a wider group of foreign institutional investors. This is a breakthrough development following on from Notice No 220 issued by PBOC in 2015 which removed the quota requirements applicable to foreign central banks, international financial organisations and sovereign wealth funds for trading in the CIBM.

Since Renminbi was included in the Special Drawing Rights (SDR) basket in November 2015, the demand for financial products denominated in RMB has increased. In order to meet this rising demand and also to combat the recent pressure of capital outflow and RMB depreciation, the PRC government has decided to open up the CIBM to a wider group of foreign institutional investors so as to further liberalize its financial market.

Key changes under the Announcement

▪ *More eligible investors*

The most noteworthy development is the expansion of the list of eligible investors in the CIBM. It now covers various types of overseas financial institutions including commercial banks, insurance companies, securities companies, fund managers, and other asset management institutions, as well as their investment products. This suggests that a qualified foreign asset manager may now launch a pure offshore fixed-income fund to invest in the CIBM which is not achievable under the current QFII regime.

In addition, other medium and long-term institutional investors recognized by PBOC may now invest in the CIBM,

such as pension funds, charity funds and donation funds.

▪ *No quota restriction*

Rather than imposing a restriction on quota for trading, PBOC will now conduct "macro-prudential" management on the CIBM investments. This generally means that PBOC may adjust its regulation of trading in the CIBM according to the changes in the macro environment.

▪ *More extensive role on settlement agents*

Eligible overseas institutional investors must engage qualified PRC settlement agents to handle trading and settlement on the CIBM. Settlement agents will review the eligibility of investors and will accept appointments only from qualified investors. In addition, the settlement agents will conduct filings with PBOC on behalf of the investors.

▪ *Impact on QFII/RQFII*

The Announcement applies to QFII/RQFII's investments in the CIBM by reference.

Pending Issues

- The term "medium and long-term institutional investors" is not clearly defined. One may infer

from the unclear definition that hedge fund managers may be excluded. It is also unclear whether a hedge fund adopting a long-only strategy would be excluded.

- The Announcement only expressly mentions spot trades as a trading type available to the investors. Whether they may engage in other types of trading, such as bond repo, bond forwards, or interest rate swaps, remains unclear.
- It is yet to be clarified as to whether an eligible investor may issue market access products in respect of its positions in the CIBM.

Conclusion

This Announcement is a major step China has taken towards giving wider foreign direct access to its bond market in line with the internationalization of the RMB.

It is expected that PBOC Shanghai Headquarter will release detailed implementing measures and filing forms following the Announcement.

We have prepared an English translation of the Announcement. Please let us know should you wish to receive a copy.

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