

CSRC Clarifies Beneficial Ownership Issue under QFII/RQFII Regime - an effort to include A-shares in the MSCI index

Lack of clarity on ownership of securities invested through separate accounts is one of three key concerns that MSCI had when they decided not to include A-shares into its Emerging Market Index. On 6 May 2016, the China Securities Regulatory Commission (CSRC) issued a FAQ¹ after its weekly press conference which recognized the concepts of "nominee holder" and "beneficial owner of securities", and further clarified its position on the rights and interests of beneficial owner of securities held in the nominee accounts opened by QFII/RQFII.

This is not the first time that CSRC has issued a FAQ to clarify its positions over the beneficial ownership issues. In May 2015, CSRC published a FAQ to clarify the beneficial ownership of overseas investors in China A-shares in the omnibus account under the Shanghai–Hong Kong Stock Connect scheme (Stock Connect). This move was applauded by MSCI as providing international investors additional confidence in using the Stock Connect scheme.

In the QFII/RQFII context, the beneficial ownership of onshore assets has generally been less of an issue to foreign investors. This is especially the case where the assets are held in a "QFII/RQFII – Open-ended Fund" securities account given there is a statutory recognition of ownership under the relevant QFII rules, as opposed to the "QFII/RQFII – Client Name" account or "QFII/RQFII – Client Assets" omnibus account for separate account products for which the former structure could not be used. The latest CSRC's FAQ is focused on eliminating concerns arising from having separate accounts.

¹ An English version is available at:
http://www.csrc.gov.cn/pub/csrc_en/newsfacts/PressConference/201605/t20160506_297075.html.

■ Key points of the latest FAQ

It is confirmed by CSRC that the concepts of "nominee holder" and "beneficial owner of securities" are recognized under relevant CSRC rules.

The latest FAQ also confirms that the legal relationship between the beneficial owner of securities (client) and QFII/RQFII nominee holder (client's asset manager), including the arrangements to segregate client's assets from those of the asset manager, will be defined by legal contracts between the client and the asset manager, and be governed by the laws of the jurisdiction where they are entered into. CSRC fully respects the provisions of such contracts including those concerning client's rights and interests over relevant assets.

In addition, the latest FAQ confirms that the A-share account system can support the recognition of rights and interests of beneficial owners of securities held in the nominee accounts opened for the QFII/RQFII separate account (managed account) products. A QFII/RQFII may choose to open accounts in the form of "QFII - Client Assets" or "QFII – Client Name" to further demonstrate that assets in such accounts belong to the relevant beneficial owner, and that they are separate from and independent of those of the asset manager.

■ Our observation

The latest FAQ certainly provides helpful clarification of CSRC's position on the beneficial ownership of assets in certain onshore account structures.

To ascertain the legal relationship between the beneficial owner and the account holder, CSRC now refers to the laws of jurisdiction where the legal contract is entered into. Trying to identify where a contract is entered into may not be straight-forward in practice. We think the choice of governing law will be an important factor, although the FAQ is silent on this point.

MSCI will decide whether to include China A-shares in its Emerging Market Index in June 2016. Following the recent relaxation of the QFII quota and funds repatriation controls initiated by the State Administration of Foreign Exchange, the FAQ is obviously another positive push for this inclusion.

We will continue to monitor the developments and provide further insight on a timely basis.

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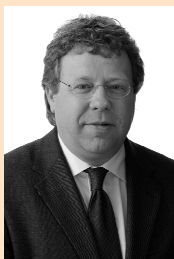
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