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Implementing rules issued for foreign investors to access the China inter-bank bond market

The Announcement No 3 issued by the People's Bank of China (PBoC) on 24 February 2016 (Announcement) opened up the China Interbank Bond Market (CIBM) to a wider group of foreign institutional investors. On 27 May 2016, PBoC Shanghai Head Office issued the long-awaited implementing rules relating to the Announcement with immediate effect. The rules on foreign exchange, fund remittance and repatriation relating to access to the CIBM were also issued by the State Administration of Foreign Exchange (SAFE) on the same day.

The Announcement, which marked a major step in liberalizing the CIBM, cannot be implemented until the release of its corresponding operating rules. On 27 May 2016, PBoC Shanghai Head Office issued the long-awaited implementing rules with immediate effect (**Implementing Rules**). Both central PBoC and PBoC Shanghai Head Office issued FAQs to clarify certain key issues. On the same day, SAFE also issued a circular (**SAFE Circular**) to provide details on the requirements on registration, foreign currency accounts, fund remittance and repatriation in relation to trading in the CIBM; in addition, the China Central Depository & Clearing Limited, the Shanghai Clearing House and the China Foreign Exchange Trade System jointly released the *Operation Guidelines on the Network Connection and Account Opening for foreign institutional investors to Access the CIBM*.

The following key aspects have been clarified:

- ***Eligibility assessment***

For the eligibility assessment of "medium- and long-term" institutional investors under the Announcement, discretion is delegated to onshore settlement agents, who are required to apply the general principles of "Know Your Client", "Know Your Business" and due diligence to onboard a client as an eligible investor for trading in the CIBM. PBOC Shanghai Head Office will monitor settlement agents and investors on an on-going basis to ensure compliance.

- ***Who to file***

The Implementing Rules attach two sets of filing forms, one for "Incorporated Entities" and the other for "Unincorporated Entities". This suggests that an investment product (such as a fund or a managed account) managed by an asset manager may access the CIBM as an eligible investor, as indicated in the Announcement. PBoC Shanghai Head Office also clarified in its FAQ that for multiple products managed by one institution, separate filings should be made for each product for asset segregation and recognition of beneficial owners, but one settlement agency agreement would be sufficient.

- ***What needs to be filed***

While there is no investment quota restriction, each investor has to file its anticipated investment size and term with PBoC Shanghai Head Office. If an investor fails to remit investment principal matching at least 50% of its anticipated investment size within nine months after filing with PBoC Shanghai Head Office, the investor will need to make an updated filing through its settlement agent.

- ***Investing as QFII/RQFII***

If an investor chooses to access the CIBM in its capacity as QFII/RQFII, it will also need to comply with the Announcement, the Implementing Rules and the SAFE Circular for such access, and at the same time remains subject to the specific restrictions and compliance requirements under the

QFII/RQFII regime (such as investment quota). However, it remains unclear as to whether such an investor may also trade in the CIBM under the Announcement not as QFII/RQFII and therefore not be subject to any quota limitation.

- ***Available trading methods***

While the Announcement only expressly mentions spot trade as a trading type available to the participants, the FAQs clarify that foreign investors may also engage in other types of trading, such as bond lending, bond forwards, or interest rate swap for hedging purposes.

- ***Fund remittance and repatriation***

Investors may remit investment principal in RMB or foreign currency into China for investing in the CIBM. According to the SAFE Circular, where an investor repatriates funds out of China, the ratio of RMB to foreign currency (Currency Ratio) should generally match the original Currency Ratio when the investment principal was remitted into China, with a maximum permissible deviation of 10%. For the initial repatriation, the aforesaid Currency Ratio requirement can be waived provided that the foreign currency or RMB to be repatriated may not exceed 110% of the foreign currency or RMB remitted into China in aggregate.

Conclusion

There are still some outstanding issues to resolve, such as tax treatment of investments in the CIBM. However, there is now at least a regulatory basis for foreign investors to commence filing and account opening with onshore settlement agents to trade in the CIBM under the Announcement.

For foreign institutional investors, entering the CIBM is just the first step and there are further issues to consider once they hold onshore bonds. These include, but are not limited to, whether investors may issue offshore market access products linked to bonds traded in the CIBM (such as those who do not qualify as eligible investors themselves), whether offshore credit-linked products are permitted to help foreign investors hedge the risks of potential bond defaults and taking security over onshore bonds.

We have prepared the English translations of the Implementing Rules, FAQs and the SAFE Circular for easy reference. Please let us know should you wish to receive a copy.

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