HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref: B1/15C
G16/1C

18 January 2012

The Chief Executive
All Registered Institutions

Dear Sir / Madam,

Selling of Renminbi Qualified Foreign Institutional Investor (RQFII) Funds

I am writing to draw your attention to the Frequently Asked Questions published by the Securities and Futures Commission (SFC) on its InvestEd website on 10 January 2012 to help investors understand the key features and risks of RQFII funds[1].

RQFII funds allow investors to invest renminbi (RMB) directly in the Mainland bond and equity markets through the RQFII quota. Registered Institutions (RIs) selling RQFII funds should have a thorough understanding of the relevant features and risks and ensure that these are adequately taken into account in their product due diligence process (including the product risk rating assessment) and suitability assessment. RIs should also ensure that the key features and risks of such products are properly disclosed and explained to customers during the sales process. Below are a number of key risks specific to investing in an RQFII fund. This is however not an exhaustive list.

- **Risks relating to the RQFII regime:** The RQFII policy and rules have only been recently announced and there may be uncertainty as to their implementation and such policy and rules are subject to change and interpretation by Mainland authorities. The uncertainty and change of the laws and regulations on the Mainland (including the RQFII policy and rules) may adversely impact an RQFII fund.

- **Risks relating to Mainland markets:** An RQFII fund invests in a single country, namely, Mainland China, and therefore there is a concentration risk that may result in greater volatility than portfolios which comprise broad-based global investments. There are also risks and uncertainties associated with the current Chinese tax laws applicable to investments made by an RQFII fund. Although some RQFII funds may have made tax provision in respect of potential tax liability that may arise from their investments, the provision may not be sufficient or may even be excessive. Any shortfall between the reserves and actual tax liabilities may have to be covered by the fund's assets and may adversely affect the fund's asset value.

[1] RQFII is granted to qualified Mainland fund managers and securities companies to allow their Hong Kong subsidiaries to channel RMB raised in Hong Kong to invest directly in the Mainland securities markets. Currently, RQFII funds must invest primarily (at least 80% of the fund's assets) in RMB bonds and bond funds issued in Mainland China; and the remaining portion may be invested in A-shares or other permissible investments. Subscriptions and redemptions of units in the fund must be settled and paid in RMB.

55th Floor, Two International Finance Centre,
8 Finance Street, Central, Hong Kong
Website: www.hkma.gov.hk

香港中環金融街8號國際金融中心2期55樓
網址：www.hkma.gov.hk

- **Currency risk:** Investors converting a local currency (Hong Kong dollar) to take up units of an RQFII fund are exposed to fluctuations in the RMB exchange rate, as well as exposure to Mainland China's exchange controls and restrictions.

- **Market / investment risk:** An RQFII fund is an investment fund product and not a bank deposit. In general, there is no guarantee of the repayment of principal or dividend payments. The underlying investments may fall in value and suffer loss even if RMB appreciates.

- **Additional risks pertaining to an RQFII fund that invests substantially in bonds or other debt instruments issued in Mainland China:**

  - ***Interest rate risk:*** Any increase in interest rates or changes in macro-economic policies on the Mainland (including monetary and fiscal policies) may adversely impact the value of the fund's bonds or debt instruments portfolio.

  - ***Credit risk:*** In the event of a default or credit rating downgrading of the issuers of the bonds or debt instruments held by the fund, valuation of the fund's portfolio may become more difficult and investors may suffer a substantial loss. The RQFII fund may also encounter difficulties or delays in enforcing its rights against bond or debt instrument issuers incorporated in the Mainland and therefore not subject to the laws of Hong Kong.

  - ***Risks of investing in Mainland bond markets and of unrated or non-investment graded bonds:*** Some of the bonds or debt instruments held by the RQFII fund may be rated below investment grade or may not be rated by any rating agency of an international standard. Such bonds or debt instruments are generally subject to higher credit risk and lower liquidity, which may result in greater fluctuations in their values, and consequently, the net asset value of the fund.

  - ***Risks associated with local Mainland credit ratings:*** Some of the bonds or debt instruments held by the RQFII fund may have been assigned an investment grade rating by a local credit rating agency on the Mainland. However, the local rating process on the Mainland may lack transparency and the rating standards may be significantly different from those adopted by internationally recognised credit rating agencies.

  - ***Liquidity risk:*** Mainland's bond market is still in a stage of development and the bid and offer spread of RMB bonds may be high and the RQFII fund may therefore incur significant trading costs and may suffer losses when selling such investments. In the absence of a regular and active secondary market, the RQFII fund manager may not be able to sell its bond or debt instrument holdings at prices the fund manager considers advantageous and may need to hold the bonds or debt instruments until their maturity. Further, if sizable redemption requests are received, the fund may need to liquidate its bonds or debt instruments at a discount to satisfy such requests and the fund may suffer losses as a result.

Investors should be advised to carefully read the offering documents including the product key fact statements to fully understand how a particular RQFII fund works and the associated

risks before making an investment in such funds, and to consult their intermediaries when in doubt. RIs should ensure that frontline staff properly handle customer enquiries.

Yours faithfully,

Meena Datwani
Executive Director (Banking Conduct)

c.c. SFC (Attn: Mr Stephen Po, Senior Director of Intermediaries Supervision)