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December 2, 2002

On November 28, 2002, the State Administration of Foreign Exchange of China promulgated supplementary regulations for the Interim Measures for the Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors promulgated on November 5, 2002 and effective on December 1, 2002. These supplementary regulations are also effective December 1, 2002, and are an attempt to further clarify QFII-related operational questions and details, primarily with respect to foreign exchange control issues.

Attached is a Paul,Weiss memorandum discussing these important supplementary regulations.

Please note that this memorandum is intended solely for general informational purposes and should not be construed as, or used as a substitute for, legal advice with respect to specific transactions, since such advice requires an evaluation of precise factual circumstances. Please note that Paul, Weiss maintains a registered foreign law firm representative office in Beijing, and is not authorized to practice PRC law. If you need additional assistance or information concerning any issue raised by the attached, or on any related issues, please contact the following Paul, Weiss attorneys:

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China - SAFE Issues Supplementary Regulations on Foreign Exchange Aspects of China's QFII Program

On November 28, 2002, the State Administration of Foreign Exchange ("SAFE") promulgated supplementary regulations for the Interim Measures for the Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors ("the QFII Measures") promulgated on November 5, 2002 and effective on December 1, 2002. These supplementary regulations -- the Interim Regulations for the Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors (the "QFII Regulations") – are also effective December 1, 2002, and in the words of a spokesman for SAFE: "... further clarify [QFII-] related operational questions and details, primarily from a foreign exchange point of view." (On December 1, 2002, the China Securities Regulatory Commission also posted Application forms for qualified foreign institutional investors ("QFIIs") and "custodians".)

Indeed, it is noteworthy that the QFII Regulations are promulgated only by SAFE, without SAFE's partner for the basic QFII Measures (the China Securities Regulatory Commission). They are an expression of SAFE's jurisdiction over important foreign exchange control aspects of the QFII initiative, most critically the size of foreign investment capital that will be allowed into China (and later permitted to be repatriated out of China).

The QFII Regulations clarify the following key aspects of the QFII Measures and the QFII program generally:

- Investment "quota" brought into China by each individual QFII for securities investment (i) may not be less than US$50 million, and (ii) is capped at US$800 million. SAFE holds the power under the QFII Regulations to adjust this range in accordance with the capital markets and international payments situations of the PRC. This range is consistent with the high qualification standards for QFII participants set forth in the QFII Measures.

- As implied in the QFII Measures, the QFII Regulations make clear that only one (1) special RMB settlement account can be established per QFII, no doubt to better regulate QFII activity. In addition, there are now explicit SAFE application and approval requirements for the establishment of such account.

- The QFII Regulations provide no relief from the high qualification thresholds for QFII candidates set forth in the QFII Measures (US$10 billion of assets under management for fund management companies, insurance companies, securities companies and commercial banks, seasoning requirements for fund management companies (5 years), insurance companies (30 years) and securities companies (30 years), and total assets threshold for commercial banks (must be ranked in the "top 100" in total assets in the world)).

- The QFII Regulations add to the power conferred on SAFE in the QFII Measures, which give SAFE the power to adjust and shape proposed conversions of investment returns into hard currency and remittance out of the PRC, by also stipulating that SAFE may command adjustments to the time schedule for the original remittance into the PRC of hard currency to fund a QFII program (in accordance with China's "international payments" situation).

Other items of note include:

- The stipulated conversion rate for hard currency brought into China to fund a QFII account (either the People's Bank of China's promulgated "basic exchange rate" or the custodian's posted median buying and selling rate for the day).
- The fleshing out of re-application requirements for new or revised "investment quota", and for transfer of investment quota to another QFII, in whole or in part.
- Specific application requirements for approval of the remittance of investment principal and capital gains out of China, and even dividends (which as current account items should be convertible and able to be remitted without SAFE approval).
- Details on how to wind up the special Renminbi account when all monies are finally remitted out of China at the conclusion of a QFII investment program, or when the QFII is dissolved or bankrupt, etc.
- Explicit qualification and application requirements for commercial banks (including foreign banks) which seek to act as "custodians" under the QFII program.
- Details on the QFII program "annual inspection", and provision for the closing down of a QFII establishment if a QFII does not pass such annual inspection.

Some of the thinking behind the structure of the entire QFII initiative, and these QFII Regulations in particular, is well expressed in the statement of the SAFE official who commented on the same day as the QFII Regulations were announced:

"One of the big warnings of the Asian Financial Crisis was that when employing foreign securities investment, the inflow of short term capital should be avoided, with an emphasis on attracting medium and long term funds. China's Taiwan region, India and South Korea all have experience in attracting QFIIs, with two important lessons being taken away: the first is that medium and long term investment should be encouraged; the second is that the channel through which funds are remitted in and out [of China] should be controlled. These experiences have been important in informing our formulation of QFII-related laws and regulations."

The previous Paul,Weiss memorandum on the QFII Measures and the Paul, Weiss translation of the QFII Measures are available on request.