Key risks involved in RQFII Funds in general

Risks relating to the RQFII regime

The RQFII policy and rules have only been announced in recent years and there may be uncertainty as to its 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 the RQFII fund.

Risks relating to Mainland markets

The concentration of RQFII fund's investment in securities, bonds or other CSRC-approved financial instruments issued in the Mainland may result in greater volatility than portfolios which comprise broad-based global investments.

Investing in Mainland-related companies and in Mainland markets involve certain risks and special considerations not typically associated with investment in more developed economies or markets, such as greater political, tax, economic, foreign exchange, liquidity and regulatory risks.

Risks relating to Mainland capital gains tax liability

While the Mainland authorities announced the capital gain tax ("CGT") policies on RQFIIs with effect from 17 November 2014 to clarify certain aspects of its application, there are still risks and some residual uncertainties associated with the current Mainland tax laws, regulations and practice in respect of capital gains realised by the fund on its investments in the Mainland (eg in relation to equity investments made before 17 November 2014 and tax treatment on investments in fixed income securities).

It is a matter of professional and commercial judgement on the part of each fund manager, acting in the best interest of investors after taking professional tax advice, to consider and decide the provisioning policy for the fund's potential CGT liability or to change the fund’s existing CGT provisioning policy from time to time. As a result, each fund’s tax provisioning policy may be different. There may be funds without making any CGT provision at all. Even if a fund makes CGT provision, such provision may be excessive or inadequate.

The Mainland tax rules and policies are subject to changes. There are risks that CGT may be enforced by the Mainland tax authorities and that such enforcement may be on a retrospective basis. If and when CGT is collected by the Mainland tax authorities, any shortfall between the provisions (if any) and actual tax liabilities will have to be paid out of the fund's assets and could have a material adverse impact on the fund's net asset value (NAV), whereby causing significant losses to investors.

Enforcement of the CGT by the Mainland tax authorities and/or change in tax provisioning policy by a fund manager will impact investors remaining in the fund. Investors who have sold/redeemed their interests prior to such enforcement and/or change will not be impacted. Likewise, such investors will not benefit from any release of tax provisions back into the fund. Investors may be advantaged or disadvantaged depending upon whether and how the CGT will ultimately be taxed and when the investors invest in the fund.

Investors should carefully read the CGT provisioning policy of a fund and the associated risks as disclosed in the offering documents before investing in the fund. If in doubt, they should consult their professional advisors.

Currency risk

Since an RQFII fund is denominated in renminbi, non-renminbi based investors are therefore exposed to fluctuations in the renminbi exchange rate against their base currency. Like any currency, the exchange rate of renminbi may rise or fall.

Renminbi is currently not freely convertible and is subject to 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 payment.

The underlying investments of an RQFII fund may fall in value and therefore your investment in the fund may suffer loss even if renminbi appreciates.

Additional risk factors concerning an RQFII fund that invests in renminbi bonds or other debt instruments issued in the Mainland

Interest rate risk

The value of fixed income instruments is expected to be inversely correlated with changes in interest rates. Any increase in interest rates or changes in macro-economic policies on the Mainland (including monetary policy and fiscal policy) may adversely impact the value of the fund's bonds or debt instruments portfolio.

Credit risk

Investment in bonds or debt instruments is subject to the credit risk of the issuers which may not be able to make timely payments of principal and/or interest. 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 as a result.

The RQFII fund may also encounter difficulties or delays in enforcing its rights against bond or debt instruments issuers who will generally be incorporated on the Mainland and therefore not subject to the laws of Hong Kong.

Risks of investing in Mainland bond markets and of unrated or lower rated bonds
Some of the bonds or debt instruments held by the RQFII fund may be rated lower or may not be rated by any rating agency. Such bonds or debit instruments are generally subject to a higher degree of credit risk and a lower degree of liquidity, which may result in greater fluctuations in their values and, consequently, the net asset value (NAV) 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 may lack transparency and the rating standards may be significantly different from that 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 renminbi bonds, whether traded in the inter-bank market or listed bond market, may be high and the RQFII fund may therefore incur significant trading costs and may even suffer losses when selling such investments.

In the absence of a regular and active secondary market, the RQFII fund 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 until their maturity date.

If sizeable redemption requests are received, the fund may need to liquidate its listed bonds or debt instruments at a discount in order to satisfy such requests and the fund may suffer losses as a result.

Source: Investor Education Centre (A subsidiary of the Securities and Futures Commission)