

MEMO# 32746

September 8, 2020

China Revised Regulations on Fund Marketing and Distribution Activities

[32746]

September 8, 2020 TO: ICI Global Members

ICI Global Pacific Chapter

ICI Global Regulated Funds Committee SUBJECTS: International/Global

Operations RE: China Revised Regulations on Fund Marketing and Distribution Activities

On 28 August 2020, the China Securities Regulatory Commission (CSRC) released a set of measures and implementation rules governing the supervision of promotion and distribution of publicly offered securities investment funds. These are (1) Measures for the Supervision and Administration of Sales Agencies for Publicly Offered Securities Investment Funds^[1] (“Measures”), (2) Rules for the Implementation of the Measures for the Supervision and Administration of Sales Agencies for Publicly Offered Securities Investment Funds^[2] (“Implementation Rules”) and (3) Interim Rules for Marketing and Promotional Materials of Publicly Offered Securities Investment Funds^[3] (“Interim Marketing Rules”). These measures and rules will all come into effect on 1 October 2020. The Implementation Rules and Interim Marketing Rules are hereafter collectively referred to as the “Rules.”

The existing regulatory framework that governs fund marketing and distribution activities was first introduced in 2004 and revised in 2011 and 2013. The Measures refine internal control, risk management, and investor protection requirements when distributing funds. While substantial parts of the Measures govern fund distributors only, fund managers are required to comply with requirements on business practices, internal control, and risk management set forth in the Measures, and also requirements outlined in the Rules. As it is increasingly common that fund managers cooperate with third-party online platforms that do not hold any financial license to distribute funds, the Implementation Rules stipulate baseline requirements and clarify the business boundaries between asset managers/distributors and third-party online platforms.

Global asset managers who set up public fund companies in China are expected to observe requirements in the sale, distribution, and marketing of their public mutual funds and privately offered asset management portfolios and also in the preparation of marketing materials. This memo gives a brief explanation of these requirements.

Standards of Conduct and Requirements on Business Practices

To ensure the suitability of recommendations or solicitations made, fund managers shall

follow the risk matching principle and distribute funds with appropriate risk ratings based on the investor's risk profile and risk tolerance (Measures: Chapter 3, paragraph 17). The Implementation Rules further state that, when promoting a fund product to investors, the distributor shall not assign to a fund product a risk level lower than that determined by the fund manager (Implementation Rules: paragraph 11).

Fund managers and distributors both have the duty of advising investors, prior to their subscriptions, to read the fund contract, prospectus, and fund factsheet, and make proper and clear risk disclosure to investors (Measures: Chapter 3, paragraph 17). The Measures provide that fund managers should, at least on an annual basis, provide investors with the outstanding balance of the fund units that investors have subscribed (Implementation Rules: paragraph 13). Fund managers are also required to provide investors with real-time access to certain basic information such as fund names, identification numbers, names of portfolio managers, risk levels, and net asset values (Measures: Chapter 3, paragraph 22).

In fulfilling their due diligence obligations on anti-money laundering, counter-financing of terrorism, and tax information relating to any non-residential financial accounts, fund managers may rely on distributors to verify the identity of investors and understand the legitimacy of investors' source of funds (Measures: Chapter 3, paragraph 18).

Limits on Trailer Commissions Paid to Distributors

A fund manager should specify the percentage of the management fee that will be paid to the distributor as compensation for distribution costs in the distribution agreement.

Distributors are required to disclose in writing to investors the level of trailer commissions before investors purchase the funds.

For the first time, the CSRC has set a ceiling for trailer commissions a fund manager may pay to its distributors. Trailer commissions shall not exceed 50% of total management fee for funds distributed to retail investors, nor shall they exceed 30% of total management fee if the funds are distributed to institutional investors. If subscription requests are directly made to the fund manager by investors, the fund manager may not pay trailer commissions to the distributor. Hiding trailer commissions in the guise of other payments, such as compensation paid to a distributor for its client maintenance costs, is prohibited (Implementation Rules: paragraph 12).

Internal Control and Risk Management Requirements

The Measures introduce a new section, titled "Internal Control and Risk Management," which details the requirements a fund distributor should follow in establishing and implementing its internal control and risk management processes. A distributor is required to appoint designated compliance personnel to review the operation of the fund distribution business, internal systems, fund marketing and promotional materials, new products for sales and marketing, and new business plans (Measures: Chapter 4, paragraph 26).

Moreover, a distributor should strengthen its monitoring system to prevent conflicts of interest and prudently evaluate potential conflicts of interests between its fund distribution activities and other business activities (Measures: Chapter 4, paragraph 31).

Paragraph 62 under Chapter 6 of the Measures stipulates that asset managers are required to also comply with these internal control and risk management requirements in relation to the distribution of their funds. Thus, they should ensure that their distributors and themselves are in compliance with these requirements when engaging in fund distribution businesses.

Baseline Requirements on Distributing Funds via Third-Party Online Platforms

According to the Implementation Rules, third-party online platforms refer to portals, applications, and other online service platforms operated and managed by third-party institutions instead of investors, fund managers, and fund distributors. Where a fund manager rents the business cyberspace of third-party online platforms to market and distribute its funds, e.g. linking the fund manager's network pages carrying marketing and distribution activities to the third-party online platform in the form of floating windows, the fund manager must ensure that investors are clearly informed that it is the fund manager, not the platform, that is distributing the products. All marketing and distribution activities are, and shall be, conducted by the fund manager. Third-party online platforms are only responsible for providing a "place" of business in cyberspace and shall not intervene in any part of the process of the fund distribution business. These platforms shall not collect, transmit, or retain any fund trading information of investors.

Fund managers shall continuously evaluate the compliance and safety performance of the third-party online platforms. Within ten working days after the service agreement is signed with a third-party online platform, the fund manager shall report to the regional office of CSRC in the place where the principal business office is situated (Implementation Rules: paragraph 24).

Preparation and Distribution of Marketing and Promotional Materials

Promotional materials, as defined in the Measures, refer to materials distributed or made available to the public for promoting funds, in the form of paper, electronic or other media (Measures: Chapter 6, paragraph 61). Fund managers are required to comply with the requirements outlined in the Interim Marketing Rules when preparing and using promotional materials. The Interim Marketing Rules provide that marketing and promotional materials shall not use content prohibited by the Advertising Law, the Anti-Unfair Competition Law, or the Anti-Monopoly Law (Interim Marketing Rules: paragraph 15).

Past performance of a fund and other funds managed by the same portfolio manager, along with the performance of the fund's benchmark, are allowed to be presented in the promotional materials, except for funds in existence for less than six months. The Interim Marketing Rules standardize the requirements applicable to presentations of historical performance in promotional materials. For a fund of one to five years, the promotional materials may capture all its historical performance over the past accounting years since inception. For a fund of over five years, its performance over the recent five accounting years shall be presented (Interim Marketing Rules: paragraph 4).

It is no longer required to submit marketing and promotional materials to the CSRC for filing. Nevertheless, these materials should still be reviewed by the senior management personnel and the compliance officer of a fund manager/distributor responsible for the fund distribution business. Compliance examination opinions should be issued after review. A record of these opinions shall be preserved (Measures: Chapter 4, paragraph 26; Interim Marketing Rules: paragraph 16).

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endnotes

[1] The Measures (available in Chinese) are *available at*
http://www.csrc.gov.cn/pub/zjhpublic/zjh/202008/t20200828_382328.htm.

[2] The Implementation Rules (available in Chinese) are *available at*
http://www.csrc.gov.cn/pub/zjhpublic/zjh/202008/t20200828_382329.htm.

[3] The Interim Marketing Rules (available in Chinese) are *available at*
http://www.csrc.gov.cn/pub/zjhpublic/zjh/202008/t20200828_382330.htm.

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