

**MEMO# 31902**

August 15, 2019

## **Update on ICI Global's Meetings in Beijing Regarding China Market Access (Part 2)**

[31902]

August 15, 2019 TO: ICI Global Members

Global Operations Advisory Committee

ICI Global Pacific Chapter

ICI Global Regulated Funds Committee SUBJECTS: International/Global

Investment Advisers RE: Update on ICI Global's Meetings in Beijing Regarding China Market Access (Part 2)

Following our June 2019 trip to Beijing[\[1\]](#), ICI Global went to Beijing again in early August to meet with key officials from the China Securities Regulatory Commission (CSRC), the People's Bank of China (PBoC), the State Administration of Foreign Exchange (SAFE), and the Asset Management Association of China (AMAC). On different occasions in July, Chinese officials reiterated China's commitment to market reforms – the most significant of these iterations being the announcement by Chinese Premier Li Keqiang that China would fast forward the removal of foreign ownership limits on the securities, futures, and insurance industry from 2021 to 2020. The purposes of our Beijing meetings were to understand from the regulators the latest progress of and way forward for China's capital market opening. This memo highlights the key messages from our meetings.

### **1. Roadmap Towards 100% Foreign-Owned Fund Management Company**

During our meetings with CSRC officials, they stressed that the US-China trade tension would not affect China's market opening. CSRC repeated their earlier message given to us in June – that all applications for mutual fund or broker licenses will be treated equally, irrespective of an applicant's place of origin.

CSRC advised that they are on track in terms of preparation for the complete opening of the asset management industry in 2020. For example, CSRC is now drafting rules to regulate connected (intragroup) transactions between asset managers/brokers and other members within their groups. CSRC's concerns are that once China opens the capital market, connected (intragroup) transactions between Wholly Foreign-Owned Enterprise (WFOE) mutual fund and securities companies and their offshore parent or group companies could lead to excessive build-up of risks within the group, or risks that could pose systemic

issues. Currently, there is some practice that restricts this behavior among domestic firms but the rules are not clear enough. CSRC, therefore, is working on rules to properly regulate this risk. Related transactions would not be completely banned but there will be restrictions to prevent build-up of such financial risks. CSRC said these rules could be introduced as soon as the end of 2019. They will also announce in those rules a date in 2020 when CSRC will start accepting applications from WFOEs for mutual fund licenses.

## **2. Update on the One Control One Participation (“1+1”) Policy**

CSRC’s Chairman Yi Huiman announced at the June 2019 Lujiazui Forum that the “1+1” policy will be extended to foreign managers. CSRC confirmed that this policy extension has already become effective. Foreign managers who currently own a minority equity interest in a joint venture (JV) mutual fund company can move ahead to set up a WFOE or prepare their existing WFOE for a mutual fund license, without worrying whether continuing to hold a minority stake in their mutual fund JV company would create a licensing problem for the WFOE, provided that the board, management and systems, *etc.*, of the two companies are completely separate and independent of one another.

## **3. Private Fund Business Under WFOE**

During our meeting with CSRC, we discussed the difficulty foreign fund managers currently face when they sell private funds in China. CSRC acknowledged the challenge and pointed out that domestic fund managers are also having a difficult time selling their private funds. China’s private banking system within commercial banks is not yet fully developed. At present, only three banks – China Merchant Bank (CMB), China Construction Bank (CCB), and the Industrial and Commercial Bank of China (ICBC) – have a relatively developed private banking business. The private banking business of other banks is still at an embryonic stage and their business model still centers on deposit-taking and lending. The private bank itself is small due to lack of brand awareness and a small pool of customers.

Most private funds in China are not sold through commercial banks. Small funds generally raise funds through private relationships. Most of the players are fund managers who left large mutual fund companies to set up their own private funds, which they offer to their former customers who agree with their investment philosophy and ability. Others are partnerships with trust companies. The trust company has the ability to raise funds, and the private fund manager has the ability to invest. Together, they grow from small to big. Moreover, raising funds through commercial banks all occurred during the period when China's bank supervision of wealth management products was quite chaotic. Today, the banking sector is tightly regulated and commercial banks are required to subsidiarize their asset management business.

Commencing in late 2018, Chinese banks have been able to subsidiarize their wealth (asset) management business. In July of this year, the PBoC announced new measures allowing these wealth (asset) management bank subsidiaries to in turn set up their own subsidiaries (effectively grandchildren bank subsidiaries) and permit foreign investors to take majority stakes in these grandchildren. However, it is not clear how attractive grandchildren bank wealth (asset) management subsidiaries are to foreign investors.

## **4. New QFII/RQFII Rules**

On 31 January 2019, the CSRC released the Draft Measures on Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) rules, which were intended to remove some of the existing hurdles, thus making QFIIs more attractive as a tool for accessing China’s capital market. Although the final rules have not

been released, in his Lujiazui speech (see 2 above), CSRC Chairman Yi Huiman announced that CSRC would start implementing the policies in the proposed measures. One such policy is that WFOEs can start managing/advising QFII funds belonging to their parent or group companies. Apart from providing a new avenue for earning income, this measure also gives WFOEs an opportunity to start building their onshore asset management skills in preparation for the 2020 opening. WFOEs who desire to take advantage of this relaxation should discuss the matter with AMAC as soon as possible.

In addition, CSRC has relaxed the requirement that private funds need a quota before they can invest in markets outside China. Managers of private funds can now use the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect to trade shares listed in Hong Kong. We were also told that the CSRC will soon issue rules to clarify the criteria for foreign private funds to participate in China's interbank bond market.

In our meeting, SAFE also advised us that it will soon remove the quota requirement/restriction for QFIIs. Foreign investors will only need to obtain a QFII license.

## **5. Third Pillar Pension Reform**

The planned 1st May 2019 national roll-out of the tax-deferred third pillar pension scheme has been delayed. CSRC indicated that they aim to have mutual fund products included in the national third pillar pension scheme, and their policy objective is to allow securities brokers and mutual fund managers to participate. Under the pilot program, only insurance companies have a role. The current policy thinking is to encourage investors to open individual investment accounts under the national third pillar scheme. On the scheme platform will be various types of investment products/vehicles which investors can choose to put into their individual retirement accounts. CSRC-approved target-date funds will be among these vehicles. The system will require qualified and professional independent financial advisers (IFAs) to serve and advise individual investors. We expect the regulator also will be focusing on the regulatory requirements for IFAs. The annual tax exemption for third pillar investments, currently set at RMB1000 in the pilot scheme, would likely increase after the national roll-out has been operating smoothly.

## **6. Talent Recruitment in China**

It is difficult to recruit suitable asset management talent in China. Top talents tend to set up their own private funds with small-scale fundraising. For foreign firms, language could also be a barrier. Foreign asset management companies who wish to hire local talent with English language skills may find that the most experienced asset managers may not always have the best English language skills. Foreign firms can, of course, bring in their own staff from overseas. Depending on the nature of their roles in China, these people may have to take the CSRC licensing exam and apply for a license. Underscoring the country's determination to open up to and integrate overseas talents, the CSRC and AMAC have just launched China's licensing exam in English.

ICI Global will continue to monitor developments in China and provide timely updates.

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**endnotes**

[1] See ICI Global Memorandum No. 31814, *Update on ICI Global's recent meetings with CSRC and AMAC regarding China market access*, dated 19 June 2019, available at: <https://www.iciglobal.org/iciglobal/pubs/memos/memo31814>

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