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Update on ICI Global's Recent Meetings with CSRC and AMAC Regarding China Market Access

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June 19, 2019 TO: ICI Global Members
ICI Global Pacific Chapter
ICI Global Regulated Funds Committee
International Operations Advisory Committee SUBJECTS: International/Global RE: Update on ICI Global's Recent Meetings with CSRC and AMAC Regarding China Market Access

ICI Global met with officials from the China Securities Regulatory Commission (CSRC) and the Asset Management Association of China (AMAC) in Beijing in early June 2019. The purposes of the meetings were to hear from the regulators their views on the progress of and way forward for China's capital market opening, share with them the concerns, issues and challenges faced by foreign investment managers when they invest in China, and seek clarification on current uncertainties. This memo highlights the key messages from our meetings.

1. Roadmap towards 100% Foreign-Owned Fund Management Company

On 10 November 2017, the State Council announced that China would allow foreign ownership of fund management companies: foreign asset managers could raise their ownership stake in domestic asset management company to 51%, and up to 100% in 2021. Yet there seems to be a lack of clarity on the procedures and qualification requirements for a 100% foreign-owned mutual fund management company. As US-China trade tension escalates, foreign investment managers have expressed concerns that there might be further delay in the opening-up of China's capital market.

CSRC affirmed that they have reached internal consensus that the capital market opening-up and reform should continue in full force; the pace and magnitude of reform will not be affected by external factors. CSRC pointed out that despite the US-China trade tension, they have recently approved the applications of two major global firms to increase to 51% their equity shareholding in their respective asset management JV. The CSRC reassured us that an application that meets all requirements will not be rejected, delayed, or fast-forwarded because of the applicant's place of origin.

2. WFOE's Public Mutual Fund License

Many foreign investment managers are concerned that there are no clear rules governing how a WFOE could qualify for a mutual fund license. CSRC explained that there will not be a different set of rules or requirements for firms under foreign ownership. Foreign-owned investment managers (whether in the form of JV's or WFOE's) wishing to apply for a license to manage and offer public funds will be subject to the same set of rules and requirements as those that apply to non foreign-owned investment managers. These requirements are broadly on a par with those in overseas markets (*i.e.,* asset managers must have proper systems and internal controls, adequate capital and staff with experience in managing public funds, *etc.*). WFOEs can apply for mutual fund licenses as soon as the equity control restrictions are lifted in 2021.

2.1 Transition from private fund management company to mutual fund management company

During our meeting with AMAC, we discussed the difficulties foreign investment managers currently face as they map the way forward for their WFOEs to obtain a full mutual fund license in China. AMAC believes that currently the easiest way for a WFOE would be to first apply for a private fund license (PFM) from AMAC. This would allow the WFOE to start building its own onshore team with portfolio experience, understand the terrain, establish relationships with key players in the ecosystem, build/strengthen its onshore branding, and generally start preparing for public fund management. Once the equity control restrictions are fully lifted in 2021, the WFOE will be in a good position to demonstrate that it meets/can meet the public fund license requirements.

According to AMAC, a company with a PFM license can adopt any one of three routes towards getting a mutual fund license:

1. A PFM company that meets all qualification requirements for a mutual fund license can directly apply for a mutual fund license (meaning the company will end up holding both a private and a mutual fund license, which is common among domestic asset managers). AMAC believes this is the most straightforward and least time-consuming route, and that this route is open to WFOEs with a PFM license once the foreign ownership restrictions are completely lifted.
2. A PFM company can acquire all or a majority of the issued equity of a mutual fund company, thus becoming the sole or majority shareholder of the mutual fund company.
3. The senior management of the PFM can set up another company to apply for the mutual fund business. This will be time-consuming as it involves applying for a full license from scratch.

2.2 Seeding (Fundraising challenges for PFM WFOEs)

Foreign investment managers often find it difficult to promote their private funds due to a lack of track record in China. They also encounter difficulty raising the threshold amount of RMB200m within the six-month period prescribed by AMAC – getting distributors to sell their funds is very difficult. The new QFII/RQFII rules might help to ease the fundraising pressure. However, it is not clear when the new rules could be promulgated.

AMAC acknowledged that they are aware of these difficulties. AMAC pointed out that currently there are two developments that could help to ease the fundraising difficulty faced by PFM WFOEs.

2.2.1 Bank Wealth Management Subsidiaries

In China, retail banks are currently curtailed in their ability to sell wealth management products (which include private funds) under the China Banking and Insurance Regulatory Commission (CBIRC) regulations. CBIRC is pushing banks to subsidiarize their wealth management business. Once banks have established their own wealth management subsidiaries, these subsidiaries will want third-party products on their shelves, or to wrap these products into their own funds. PFM WFOEs will find it easier to get these bank subsidiaries to sell their funds.

2.2.2 Proposal to extend the fund-raising period from six months to twelve months

According to AMAC, they have submitted a proposal to the State Council to extend the fund-raising period under the Private Fund Law from six months to twelve months. AMAC clarified that the six-month requirement is an investor protection mechanism, applicable to all private funds sold in China (including both WFOE private funds and private funds set up by domestic players who may or may not have good professional standards). Although the proposal is already with the State Council, AMAC cannot predict when the final rules will be approved and released.

In the meantime, AMAC is happy to help foreign investment managers to bridge the current gap. AMAC mentioned two methods. First, when a WFOE's private fund-raising proposal has cleared all hurdles, AMAC is prepared to hold off issuing the formal approval, which would have started the six-month clock ticking, until the WFOE confirms that it is ready for the formal approval to be issued. This effectively gives the WFOE a much longer period within which to raise funds.[1] Second, even if a private fund launch failed to meet the RMB200m threshold within the six-month period, the WFOE could resubmit the same proposal later, with a legal opinion stating that all terms and conditions remain the same. AMAC will not examine the proposal *de novo*, and approval could be granted within one week.

2.3 One Control One Participation ("1+1") Policy

Some foreign investment managers have expressed concern that if their WFOE has a private fund license, it may be more difficult for the WFOE to obtain a mutual fund license, especially if the foreign manager already has a JV asset management mutual fund company in China, and its Chinese partner is not ready to relinquish majority control. Foreign managers are aware that China takes a strict view on conflicts of interest where the same set of shareholders control or have an interest in two separate fund management companies.

AMAC acknowledged that China does take a very strict approach to requiring asset managers to remove (not just manage) conflicts of interests. AMAC believes, however, that there is room for extending the "1+1" policy - which currently is only available to domestic entities - to foreign managers. Under this policy, a shareholder can wholly-own one mutual fund company and at the same time own/control a minority stake in another mutual fund company, provided that the two companies have complete Chinese walls, each with separate management teams and separate boards (no directors or senior managers in either company holds concurrent positions), and there is no sharing of systems or information, *etc*. While only available to domestic players at this time, there may be room to consider opening this policy to foreign managers in the foreseeable future. Should this policy become available, foreign managers will be able to apply for a mutual fund business license under their WFOE and continue to retain a minority interest in their existing JV.[2]

3. New QFII/RQFII Rules

On 31 January 2019, the CSRC released the Draft Measures on QFII and RQFII rules which are intended to remove some of the existing hurdles, thus making QFIIs more attractive as a tool for accessing China's capital market. Until now, the rules have not been released. While acknowledging that there is no timetable yet for the release of the new rules, CSRC indicated that its intention is to release the rules as soon as they have cleared all internal procedures. We have invited CSRC officials to visit Hong Kong once the rules are released so that they can introduce the new rules to the market and clarify any queries that the market may have.

4. Third Pillar Pension Reform

The 1st May national roll-out of the tax-deferred third pillar pension scheme has been delayed. Apparently, investor take-up under the 2018 test pilot in Shanghai, Fujian Province, and Suzhou in Jiangsu Province was not particularly exciting. In the test pilot, individual retirement accounts can be established by individuals as an investment account. Contributions into and income from investments in this account enjoy tax deferral up to a certain limit. Only commercial pension insurance products are approved as the underlying products, and distribution is restricted to direct sales by insurance companies only. It appeared that investors find it inconvenient to operate the retirement account.

CSRC's policy goal is to include public funds in the tax-deferred private pension third pillar scheme, and this is very much a work-in-progress. Until now, the CSRC has approved a number of target-date funds. However, none of them has any tax deferral feature.

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endnotes

[1] Given that a firm that is granted a PFM license is required to launch a private fund within six months, and it cannot start raising funds until its proposed private fund has been approved by AMAC, it is not clear how this suggestion would work. Nevertheless, this idea demonstrates the willingness on the part of AMAC to help WFOEs find solutions.

[2] CSRC Chairman, Mr. Yi Huiman, has now confirmed in a keynote speech at the Lujiazui Forum in Shanghai on 13 June that the "1+1" policy will be extended to foreign investment managers.

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