

**MEMO# 32465**

May 18, 2020

# China Issued Consultation to Allow Foreign Banks to be Fund Custodians

[32465]

May 18, 2020 TO: ICI Global Members

ICI Global Pacific Chapter

ICI Global Regulated Funds Committee SUBJECTS: International/Global

Operations RE: China Issued Consultation to Allow Foreign Banks to be Fund Custodians

On 9 May 2020, the China Securities Regulatory Commission (CSRC) released for public consultation the *Measures for the Administration of Securities Investment Fund Custody Business (Consultation Paper)*<sup>[1]</sup> (“Measures”) outlining proposed amendments to the existing guidelines for fund custodian operations in China. The consultation is open for public comment until 23 June 2020.

Under the Measures, China will allow eligible domestic branches of foreign banks to provide onshore public funds custodian services to its domestic mutual fund industry. Prior to the announcement, domestic commercial banks dominated the custodian segment of China’s mutual fund market. The Measures specify the requirements for domestic branches of foreign banks to offer fund custody services in China. By opening up the fund custody business to foreign banks, China aims to reassure global investors that it is committed to further opening its financial market. It also signifies China’s commitment to honor Phase One of the US-China trade agreement signed in January 2020. Besides specifying the entry requirements for foreign banks, the CSRC also aims to unify the entry criteria and regulatory requirements for commercial banks and non-bank financial institutions acting as fund custodians by incorporating the requirements for custody business conducted by non-bank financial institutions into the proposed Measures. By opening the industry to a wider scope of eligible players, the Measures will usher in more healthy competition in the fund custodian industry. Global asset managers planning to set up public mutual fund companies (FMC) in China will soon have the option of appointing domestic branches of foreign banks to act as their fund custodians.

This memo highlights the key requirements for foreign banks to qualify as fund custodians in China’s domestic mutual fund market.

## **Eligibility and Internal Control Requirements for Foreign Banks**

The Measures introduce new provisions regarding eligibility and internal control requirements for foreign banks acting as custodian of securities investment funds. It also

revises the net asset requirements and other risk management and internal control requirements for all fund custodians. Under the Measures, domestic branches of foreign banks that have been operating in China for three or more consecutive years and can demonstrate good business performance are eligible to apply for a mutual funds custodian license. To qualify, such a branch must have good asset quality and sufficient working capital for developing the fund custodian business.

While currently domestic commercial banks acting as fund custodians are required to have net assets of RMB 2 billion (US \$281.55 million), the amount will increase to RMB 20 billion (US \$2.82 billion) in the proposed Measures. This is to ensure that fund custodians have stronger capital and are more resistant to risks. For domestic branches of foreign banks, the net assets of the parent company's overseas assets will be taken into consideration in the calculation.

The Measures further provide that the parent company of an applicant should enjoy an international reputation and must be located in a country or jurisdiction where its home regulator has entered into a Memorandum of Understanding with the CSRC. It should also have a well-established internal control management system and demonstrate good business performance. When filing the application with the CSRC, the applicant is required to provide a letter issued by the home regulator of its parent company confirming that in the recent three years, the parent company has been in compliance with the law and regulation of its home country, and it has not been subject to any material regulatory sanctions in its home country nor is it currently under investigation for gross violations of law or regulation. The applicant will also need to provide supporting documents to demonstrate that, in the recent three years, its parent company is one of the leading companies in fund custody in terms of its size, revenue and profit, and has maintained a healthy long-term credit level.

### **Other Risk Management Requirements for Foreign Banks**

The CSRC will establish a cross-border information disclosure and accountability system. As cross-border data transfer may be involved when foreign banks start their fund custodian services in China, the domestic branch of the foreign bank is required to implement measures to separate the two systems, establish a Chinese wall between the parent company and itself, and monitor the cross-border data transfer. Furthermore, the parent company should, based on the size of the custodian business of its domestic branch, establish a liquidity support mechanism accordingly. The Measures state that the parent company shall bear the civil liabilities for its domestic branch if the domestic unit violates any rules or regulations in China. The responsibilities of the parent company should be clearly specified in the legal documents including the fund contract, fund prospectus, and custodian agreement.

The CSRC has also strengthened the internal control and risk management requirements based on past practices. A fund custodian should establish a robust control and monitoring system to actively monitor the settlement and clearing risks of different products under its custody and business activities. The Measures state that a fund custodian is allowed to enter into an agreement with the fund manager to provide short-term financing to meet investors' redemption requests arising from sudden liquidity needs. The fund custodian should report to the CSRC on the day that it provides short-term financing to the fund manager.

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#### **endnotes**

[1]The Measures (available in Chinese) is available at:  
[http://www.csrc.gov.cn/pub/zjhpublic/zjh/202005/t20200509\\_376034.htm](http://www.csrc.gov.cn/pub/zjhpublic/zjh/202005/t20200509_376034.htm).

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