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June 22, 2022

China Revised Public Fund Manager Regulations

[34190]

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TO: ICI Global Members
Global Regulated Funds Committee
Global Regulated Funds Committee - Asia SUBJECTS: Compliance
Distribution
International/Global
Investment Advisers
Operations RE: China Revised Public Fund Manager Regulations

The Chinese Securities Regulatory Commission (CSRC) recently revised the regulatory framework governing the establishment and operation of public fund management businesses in China. This memorandum summarizes the new Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds ("Measures")[1] as well as the relevant Implementation Provisions.[2]

Since the CSRC removed the shareholding limits for public fund management companies on April 1, 2020, several ICI Global members have either applied for setting up a wholly foreign-owned (WFOE) public fund management company or approval for taking majority ownership of their existing foreign-Sino fund management joint ventures. Currently, one global asset manager has commenced the operation of its WFOE public fund management company, and two global asset managers have obtained the initial approval for establishing the WFOE public fund management companies. These joint-venture and WFOE public fund management companies are expected to observe the requirements set forth in the Measures, in particular, the qualification requirements for shareholders.

The Measures described below became effective as of June 20, 2022.

A Common Regulatory Framework for Public Fund Managers

As background, publicly offered mutual funds in China can be managed either by fund management companies that are licensed by the CSRC to offer mutual funds to the public ("FMCs") and by other asset management institutions[3] for whom CSRC has granted a public fund license ("PFMCs"). For historical reasons, PFMCs hold their public fund licenses under different rules and regulations administered by the CSRC.[4]

The new Measures adopt a unified regulatory framework for all institutions that engage in the management of publicly offered investment funds. In relation to their public fund management businesses, PFMCs are now subject to the same regulatory requirements as the FMCs, with a few exceptions where rules such as shareholder qualification apply only to FMCs. This is a significant step the CSRC has taken to promote "regulation by function," a regulatory model advocated in many circles of China's financial industry over the years.

For ease of reference, FMCs and PFMCs are collectively referred to as "Public Fund Companies" in this memorandum.

Strengthening Requirements on Corporate Governance

The Measures provide that Public Fund Companies should establish a corporate governance structure, comprising the shareholders, Board of Directors, Board of Supervisors and senior management, and clearly set out the roles and responsibilities of each party.

Appointment of Independent Directors. Public Fund Companies should appoint a minimum of three independent directors and, in any event, at least one-third of its Board members must be independent directors. Major associated transactions, audit matters, and appointment or change of auditors must be examined by the Board and passed by a vote of at least two-thirds of all independent directors. Where the largest shareholder of a Public Fund Company is a natural person, at least half of the Board members must be independent directors. Independent directors are required to prepare annual reports on the discharge of duties. Such reports should be reviewed in the shareholder meetings and retained for future reference.

Enhanced Qualifications for FMC Shareholders

Shareholders of an FMC are classified into three categories:

- Primary Shareholders: shareholders who hold over 25% equity in the FMC, or the largest shareholder who holds over 5% equity if there is no single shareholder holding over 25% equity;
- Non-primary Shareholders: shareholders who hold over 5% equity and are not the Primary Shareholders; and
- other shareholders holding less than 5% equity.

Requirements for Primary and Non-Primary Shareholders. A Non-Primary Shareholder, if it is a corporation, must have net assets of not less than RMB 100 million (around USD 15 million) in the recent year, with good asset quality, financial health, corporate governance, internal controls, and risk management. A Primary Shareholder, if it is a corporation, should be a licensed financial institution[5] or a corporation managing at least one licensed financial institution, with net assets of not less than RMB 200 million (around USD 30 million) in the recent year. Also, it has to show profits in the most recent three years. A Primary Shareholder must be in a position to provide continuous capital/liquidity support to the FMC appropriate for the FMC's business and operational needs, and contingency plans for situations when the FMC may not be able to operate adequately.

Requirements for Foreign Shareholders. A foreign shareholder should show that globally it "ranks at the top" in the size of its financial assets management, revenue, profit, and market share,[6] and its long-term credit has been maintained at a high level in the last three years. Furthermore, the foreign shareholder should show that, in the recent three years, it has been in full compliance with the laws and regulations of its home country, and it is located in a country or jurisdiction where its home regulator has entered into a

Memorandum of Understanding with the CSRC.

Optimizing "One Control, One Participation" Policy

Until now, under the current "One Control, One Participation" (1+1) policy, a shareholder could wholly- or majority-own one FMC and at the same time have a minority stake in another FMC, provided that the two companies have complete fire walls, each with separate management teams and separate boards (i.e., no directors or senior managers in either company holds concurrent positions), and there is no sharing of systems or information, etc.

The CSRC is now further relaxing this 1+1 policy. While a global asset manager may have one wholly- or majority-owned FMC and one minority-owned FMC, the asset management institutions within its same group company in China may also apply for public fund licenses, provided that they meet the eligibility criteria.[7]

Enhancing Requirements on FMCs in Setting Up Branches and Subsidiaries

Upon approval from the CSRC, subsidiaries of FMCs may engage in asset management-related businesses, including publicly offered funds management (e.g., index funds, fund of funds, pension investment products, and REITs), private equity investment management, investment advisory, and distribution of financial products. An FMC will not be granted approval if it has violated any material regulatory measures within the last three years, or is currently under investigation for suspected material breach or misconduct or undergoing a process of rectification.

In principle, the subsidiary should be wholly owned by the FMC. The FMC should have net assets of not less than RMB 600 million (around USD 90 million) and, in the last two years, the quarterly average AUM of all its actively managed equity funds[8] should be no less than RMB 20 billion (around USD 3 billion).

An FMC must have a centralized and uniform management system to manage its branches and subsidiaries, including the business activities, compliance management, risk management control, information technology system, and employee performance appraisals. The FMC is required to establish a firewall to separate the business activities among its subsidiaries, and between its subsidiaries and itself.

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endnotes

[1] Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds, May 20, 2022, available (in Chinese only) at http://www.csrc.gov.cn/csrc/c101953/c2804634/content.shtml. The CSRC consulted on a

draft in July 2020. See Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds (Draft for Comments), July 31, 2020, available (in Chinese only) at http://www.csrc.gov.cn/pub/zjhpublic/zjh/202007/t20200731_380932.htm. Also See ICI Memorandum [32668], dated August 11, 2020, available at https://www.ici.org/memo32668.

[2] See Provisions on Issues Concerning the Implementation of the Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds, May 20, 2022, available (in Chinese only) at http://www.csrc.gov.cn/csrc/c101954/c2804866/content.shtml.

[3] These asset management institutions include asset management subsidiaries of securities companies, insurance asset management companies, bank wealth management subsidiaries, and private investment fund managers who are registered with the Asset Management Association of China (AMAC). See Measures, supra note 1, at Chapter 1, Article 2.

[4] PFMCs were regulated by the Interim Provisions on the Public Securities Investment Fund Management Business Operated by Asset Management Entities, which is now replaced by the Measures on June 20, 2022. See Interim Provisions on PFMCs, February 18, 2013, available (in Chinese only) at http://www.gov.cn/zwgk/2013-02/19/content_2334338.htm.

[5] A licensed financial institution includes securities companies, futures companies, commercial banks, trust companies, insurance companies, insurance asset management companies, and other financial institutions recognized by the CSRC. See Implementation Provisions, supra note 2, at Chapter 2, paragraph 6.

[6] The foreign shareholders should satisfy any one of the following requirements: (i) the relevant indicators of securities investment funds or publicly offered securities investment funds under its management "rank at the forefront internationally", or (ii) the relevant indicators of stocks, bonds, ETFs, REITs, pensions, insurance funds and other single-class assets under its management, or the relevant indicators of discretionary management or ESG should "rank globally at the forefront", or (iii) other circumstances recognized by the CSRC. See Implementation Provisions, supra note 2, at Chapter 2, paragraph 11.

[7] See Measures, supra note 1, at Chapter 2, Article 14.

[8] For the actively managed equity funds, the equity allocation indicated in the fund document should be at least 60%. FMCs should not include index funds in the calculation of the quarterly average AUM of their actively managed equity funds. See Implementation Provisions, supra note 2, at Chapter 2, paragraph 26.