

**MEMO# 35353**

June 21, 2023

# China Consults on Rules on Fund Investment Advisory Activities

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TO: ICI Global Members

Asia Regulatory and Policy Committee SUBJECTS: International/Global RE: China Consults on Rules on Fund Investment Advisory Activities

On June 9, 2023, the China Securities Regulatory Commission (CSRC) launched a public consultation on the rules governing public fund investment advisory activities,[\[1\]](#) which is currently conducted under a pilot scheme introduced in October 2019. Under the pilot scheme, eligible fund management companies, among other institutions, may apply for pilot approval for advising clients on strategies for investing in a portfolio of funds, including offering discretionary investment management services.[\[2\]](#) The Draft Measures would strengthen the pilot regulatory framework in order to facilitate the transition of the fund advisory pilot scheme to a permanent program.

In particular, the Draft Measures strengthen the requirements on investment management processes and governance, and clarifies the maximum allocation to a single fund for discretionary portfolios. The Draft Measures also introduce new requirements on marketing and advisory processes, with the goal of curbing product-based investment advice and ensuring investment advice is offered based on investors' long-term financial goals and needs.

The Draft Measures are open for public comment until July 9, 2023. Separately, the CSRC plans[\[3\]](#) to finalize this year the regulatory framework for a broader range of investment advisory activities, which would include investment advice on individual securities and on funds.[\[4\]](#) ICI Global will continue to track these developments and assess the potential implications for global asset managers.

## Major Proposed Requirements in the Draft Measures

### Adjust Requirements for Discretionary Portfolio Mandates

*Daily Disclosure on Portfolio Reference Market Value.* Fund advisors would be required to disclose to clients the daily reference market value of the discretionary portfolios, instead of the previous day's net asset value as required under the current pilot framework. The

Draft Measures further state that fund advisors should have a review mechanism in place to ensure such reference market value is true and complete.

*Clarify Maximum Portfolio Allocation to a Single Fund.* Under the current pilot framework, each discretionary portfolio should not allocate more than 20% of its assets to a single fund. The Draft Measures clarify that this restriction would be exempted if the relevant fund is a money market fund, a broad market index fund (including an enhanced index fund), a pension target fund, or a fund of funds.

*Clarify Consolidated Concentration Limit in Fund.* The Draft Measures maintain that the discretionary portfolios managed by the same fund advisor on a consolidated basis should not own more than 20% of the total fund units of a money market fund or an open-ended bond fund. However, the Draft Measures raise the concentration limit in other types of funds to 50%. Notably, the Draft Measures require fund management companies to strengthen the liquidity risk management for funds whose units are largely owned on a consolidated basis by the discretionary portfolios under a single fund advisor. The fund management companies should alert the relevant fund advisor within two working days if the consolidated number of fund units owned by the fund advisor's discretionary portfolios reaches 45% of the total fund holding, or 15% in cases where the relevant fund is a money market fund or an open-ended fund.

#### **Emphasize Serving Clients' Long-term Financial Goals and Investment Needs**

*Restrictions on Presenting Portfolio Strategies and Historical Performance.* A fund advisor must conduct a suitability assessment to understand a client's investment goal, investment horizon, risk preference, and risk tolerance level, before presenting clients with any portfolio strategies. The fund advisor then may show the historical performance of the strategies that match the client's profile, along with the relevant risk indicators, e.g., volatility and maximum drawdown.

*Expectations on Advisory Practices.* The Draft Measures indicate that fund advisors should follow the principle of long-term investing, and effectively control the turnover ratio of the portfolio of funds. Fund advisors are also expected to enhance the quality of their advisory services and provide guidance on clients' investment behavior. In particular, fund advisors should proactively conduct investor education to promote long-term investing.

*Encourage Serving Clients' Retirement Needs.* The CSRC indicated in its Explanatory Memorandum of the Draft Measures that it will allow fund advisory services under China's voluntary private pension scheme as the scheme matures. As a first step in guiding the industry to serve the different retirement needs, the Draft Measures require fund advisors to integrate their capabilities in capital planning, asset allocation, and fund investment research when providing retirement planning services. Fund advisors are also encouraged to provide fund advisory services to China's pillars 1 and 2 pension systems, i.e., the National Social Security Fund (NSSF), Enterprise Annuity, and Occupational Annuity. The Draft Measures exempt advisory services provided to these institutional investors from certain restrictions, for example, the restrictions on presenting portfolio strategies and historical performance, managing portfolio turnover ratio, and maximum portfolio allocation to a single fund.

#### **Strengthen Requirements on Investment Processes and Governance**

*Clarify the Responsibilities of Investment Management Committees.* The Draft Measures

clarify that, in addition to the design of and adjustment to portfolio strategies, a fund advisor's Investment Management Committee would be responsible for revising the risk ratings, target asset allocation, and risk-return characteristics of a portfolio of funds, determining the list of funds eligible for selection, and adjusting the number and types of funds underlying the portfolios. Changes to the number and types of underlying funds due to portfolio rebalancing would not require pre-approval from the Investment Management Committee, provided that no changes are made to the target asset allocation.

*Enhance the Prevention and Management of Conflicts of Interest.* The Draft Measures specify that any fund advisors who are also fund distributors should adjust their fee arrangements as appropriate to avoid conflicts of interest, including offsetting transaction fees against advisory fees for portfolio strategies with annual turnover ratios higher than one. When advising clients to invest in funds managed by the fund advisors themselves or affiliated parties, in addition to disclosing the potential conflicts of interest as required under the current pilot regulatory framework, the Draft Measures add that such fund advisors should obtain clients' prior written acknowledgement of this disclosure.

*Partnership with Fund Distributors and other Fund Advisors.* The Draft Measures include new requirements for fund advisors in relation to partnerships with fund distributors and other fund advisors. The fund advisor should ensure there is a clear separation between its advisory activities and its partners' activities. In cases where its partner has not obtained fund advisory qualification, such partner should not be involved, in any form, in activities related to fund advisory work. Where a fund distributor partners with fund advisors to provide fund advice for its clients, the fund distributor is restricted from providing granular details of the portfolio strategies offered by its partnering advisor.

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#### Notes

[1] See Administrative Measures on Investment Advisory for Publicly Offered Securities Investment Funds (Draft for Comments) ("Draft Measures"), June 9, 2023, available (in Chinese only) at <http://www.csrc.gov.cn/csrc/c101981/c7413553/content.shtml>.

[2] On October 25, 2019, the CSRC issued the Notice on the Pilot Implementation of Investment Advisory for Public Securities Investment Funds, outlining the eligibility criteria for providing advice on investment in a portfolio of funds and the relevant requirements on investment management, internal control, and governance. To be eligible, a fund management company should have in place strong compliance and risk management process, and a strong team of research analysts on funds and investment advisors, among other eligibility criteria. Such advisory services can only be provided for investments into funds and does not include individual securities.

[3] CSRC noted in its work plan for 2023 that it intends to publish the Administrative Measures on Securities and Funds Investment Advisory Activities, which was first consulted in April 2020. See CSRC releases legislative work plan for 2023, dated April 14, 2023, available (in Chinese only) at

<http://www.csrc.gov.cn/csrc/c100028/c7402448/content.shtml>.

[4] The draft framework covered advising on securities (including derivatives), advising on funds, and issuing securities research reports. See ICI Memorandum [32424], dated April 28, 2020, available at <https://www.ici.org/memo32424>.

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