

# Retail investment funds in China: regulatory overview

by **James Yong Wang, Partner**, Han Kun Law Offices

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A Q&A guide to retail investment funds law in China.

This Q&A is part of the global guide to investment funds. It provides a high level overview of retail investment funds in China. Areas covered include a market overview, legislation and regulation, marketing, managers and operators, restrictions and requirements, tax and upcoming reform.

To compare answers across multiple jurisdictions, visit the retail investment funds *Country Q&A tool*. For a full list of jurisdictional Q&As visit [www.practicallaw.com/investmentfunds-guide](http://www.practicallaw.com/investmentfunds-guide).

## Retail funds

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Under the Securities Investment Funds Law (as amended on 24 April 2015) securities investment funds established in China are categorised into retail funds (publicly offered funds) and non-retail funds (privately placed funds).

### Retail funds

Retail funds refer to any fund that is offered to unspecified investors or more than 200 specified investors, and any other funds otherwise classified as retail funds under the applicable Chinese laws.

Securities investment funds can take the form of closed-ended funds, open-ended funds, or other forms permitted under the applicable Chinese laws.

Retail funds can only be offered and managed by:

- Fund management companies that are regulated by the China Securities Regulatory Commission (CSRC) (Fund Management Companies).
- Asset management institutions approved by the CSRC (Asset Management Institutions). Only the following entities can qualify as an Asset Management Institution:
  - China-incorporated securities companies;
  - China-incorporated insurance asset management companies;

- other China-incorporated asset management institutions specialising in the management of non-retail securities investment funds;
- China-incorporated equity investment management institutions;
- China-incorporated venture capital investment management institutions.

Retail funds can generally be divided into:

- Equity funds, where 80% or more of the assets should be invested in privately held shares.
- Bond funds, where 80% or more of the assets should be invested in bonds.
- Money market funds, where the assets should be invested only in money market instruments.
- Fund of funds, where 80% or more of the assets should be invested in other fund units.
- Hybrid funds, where the assets are invested in privately held shares, bonds, money market instruments or other fund units.
- Qualified domestic institutional investor (QDII) funds (that is, funds with approved foreign exchange quotas that can make investment in the offshore securities market).
- Other types of funds permitted by the CSRC.

There are also exchange traded funds (ETFs) and listed open-ended funds (LOFs).

### **Open-ended retail funds**

Open-ended retail funds have developed into the most popular form of retail funds in the Chinese market since the first open-ended fund was established in 2001.

### **Closed-ended retail funds**

Under the Securities Funds Law, retail funds can also be closed-ended. Generally, closed-ended retail funds are subject to the same regulatory regime in China as open-ended retail funds.

## **Regulatory framework and bodies**

2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

### **Open-ended retail funds**

**Regulatory framework.** The Securities Funds Law is the main piece of legislation for securities investment funds, including open-ended funds and closed-ended funds. Within the regulatory framework established by the Securities Funds Law, the China Securities Regulatory Commission (CSRC) has promulgated a series of regulations on the operation and management of funds and fund managers, including the following:

- Administrative Measures on the Operation of Publicly Offered Securities Investment Funds.
- Administrative Measures on the Marketing of Securities Investment Funds.
- Administrative Measures on the Information Disclosure of Securities Investment Funds.
- Administrative Measures on Securities Investment Fund Management Companies.
- Administrative Measures on the Qualification Requirements for Senior Officers of Securities Investment Fund Management Companies.
- Measures on the Compliance Management of Securities Companies and Securities Investment Fund Management Companies.

Under this regulatory framework, the offering and marketing, registration, trading, day-to-day management, custody, valuation and accounting, taxation, profit distribution, and information disclosure in relation to securities investment funds are heavily regulated.

In addition, the China Insurance Regulatory Commission (CIRC) has provided additional regulations to regulate insurance asset management companies engaging in funds management businesses.

**Regulatory bodies.** The China Securities Regulatory Commission (CSRC) is the primary authority in charge of supervising and regulating securities investment funds in China. The CSRC responsibility in this respect is discharged by an internal division named the Fund Regulatory Division.

The following actions, among others, require prior registration with or approval from the CSRC:

- Offering of any retail fund.
- Establishment of any fund management company.
- Conducting of retail funds management business by asset management institutions.

The Asset Management Association of China (AMAC) is a self-regulatory organisation that represents the securities investment funds industry. It is dedicated to enhancing compliance operations and improving industry integrity by exercising industry self-regulation.

The China Insurance Regulatory Commission (CIRC) is responsible for regulating insurance asset management companies engaged in funds management businesses.

### **Closed-ended retail funds**

**Regulatory framework.** Open-ended retail funds and closed-ended funds are essentially subject to the same regulatory regime in China (*see above, Open-ended retail funds: Regulatory framework*).

**Regulatory bodies.** See above, *Open-ended retail funds: Regulatory bodies*.

3. Do retail funds themselves have to be authorised or licensed?

### **Open-ended retail funds**

The offering of open-ended retail funds and closed-ended retail funds is subject to approval by the China Securities Regulatory Commission (CSRC). To register the offering of a retail fund, the fund manager must submit the following documents to the CSRC:

- Application letter.
- Draft fund contract.
- Draft custodian agreement.
- Draft fund prospectus.
- Legal opinion issued by qualified legal counsel.
- Other documents as may be requested by the CSRC.

The CSRC will decide whether or not to approve the application within six months. Only after obtaining CSRC approval will the fund manager be permitted to publish the prospectus and offer fund units to investors.

### **Closed-ended retail funds**

See above, *Open-ended retail funds*.

### **Marketing**

4. Who can market retail funds?

### **Open-ended retail funds**

After a retail fund has been duly approved/registered with the China Securities Regulatory Commission (CSRC) (*see Question 3, Open-ended retail funds*), the units of that fund can be offered to the investors. Only Chinese retail funds that have been registered with the CSRC can be marketed in China. Foreign retail funds cannot be registered with the CSRC and cannot be marketed in China.

The manager of a retail fund (whether open-or closed-ended) and the qualified fund distributors engaged by the fund manager are permitted to market and promote the retail fund. Fund distributors in this context include:

- Commercial banks (including foreign banks having business presence in China).
- Securities companies.
- Futures companies.
- Insurance institutions.

- Securities investment consultancy institutions.
- Independent funds distribution institutions.
- Other institutions that have been approved by the local CSRC to engage in the business of retail fund unit distribution.

Each fund distributor must satisfy the conditions imposed by the CSRC and be pre-approved by the CSRC before marketing and distributing fund units.

The promotion materials of the fund manager must be reviewed and approved in writing by a member of the manager's senior management in charge of fund distribution and the manager's compliance officer. Once approved, the promotion materials must be filed with the local CSRC within five days of their public offering.

The promotion materials of the fund distributors (other than the fund manager) must be reviewed and approved in writing by a member of the senior management of the fund distributor in charge of funds distribution and legal compliance. After being so approved, the promotion materials must be filed with the local CSRC within five days of their public offering.

In addition, the promotion of retail funds is subject to various restrictions. For example, the promotion materials must not include forecast on investment returns, guaranteed return on investments and misleading information.

#### **Closed-ended retail funds**

See above, *Open-ended retail funds*.

5. To whom can retail funds be marketed?

#### **Open-ended retail funds**

After due approval/registration with the China Securities Regulatory Commission (CSRC), retail funds (both open-ended retail funds and closed-ended retail funds) can be marketed to the general public in China in writing or through electronic or any other means, such as newspapers, internet and television. Foreign retail funds cannot be registered with the CSRC and cannot be marketed in China.

#### **Closed-ended retail funds**

See above, *Open-ended retail funds*.

#### **Managers and operators**

6. What are the key requirements that apply to managers or operators of retail funds?

### **Open-ended retail funds**

Fund management companies and asset management institutions that have been incorporated in China, and have been duly approved by the China Securities Regulatory Commission (CSRC) can only serve as the manager of retail funds in China. Foreign fund managers are not permitted to act as the fund manager of any Chinese retail funds.

**Fund management company.** The conditions for a fund management company to act as the manager of retail funds include the following:

- The articles of association must be in conformity with the relevant provisions of the New Funds Law and the Company Law.
- There must be a minimum paid up capital of CNY100 million.
- There are certain requirements for principal shareholders, as follows:
  - good business performance;
  - financial standing and social reputation in the financial business or management of financial institutions;
  - appropriate assets scale;
  - compliance with the applicable regulations.
- Business staff, directors, supervisors and senior management must possess corresponding qualifications.
- Appropriate offices and facilities for engaging in retail fund management businesses.
- Sound and complete internal governance structure, regulations and rules.
- Other conditions stipulated by the CSRC.

**Asset management institution.** The conditions for an asset management institution to act as the manager of retail funds include:

- At least three years of experience in the management of securities assets, provided the managed securities have performed well in the last three years.
- Sound corporate governance, sophisticated internal control system and effective risk management.
- Good state of operation and sound financial performance in the last three years.
- Good faith and legally compliant operation.
- Admitted as a member of the Asset Management Association of China (AMAC).
- Other conditions stipulated by the CSRC.

**Securities companies.** Additionally, securities companies must:

- Have a total scale of asset management not less than CNY20 billion or have a scale of collective asset management business of no less than CNY2 billion.
- Have all risk control indicators meeting the prescribed standards on an ongoing basis in the last 12 months.

**Insurance asset management companies.** Additionally, insurance asset management companies must satisfy the following requirements:

- Have asset under management of no less than CNY20 billion.
- Have net assets of no less than CNY500 million at the end of the most recent quarter.

**Private equity securities fund management institutions.** They must satisfy the following additional requirements:

- Have a paid-in capital (in the case of private equity securities fund management institutions in the form of corporations) or actual paid-in contribution (in the case of private equity securities fund management institutions in the form of limited partnerships) of no less than CNY10 million.
- Have securities assets under management of no less than CNY2 billion in the last three years.

### **Closed-ended retail funds**

This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

### **Assets portfolio**

7. Who holds the portfolio of assets? What regulations are in place for its protection?

### **Open-ended retail funds**

The following position applies under the Securities Funds Law:

- Assets of a securities investment fund must be distinct from and not combined with the assets of the fund manager and the fund custodian.
- Portfolio of assets of each securities investment fund must be held by the custodian of the fund for and on behalf of that fund. The cash and securities comprising the assets of a fund must be maintained in the cash/securities account opened in the name of that fund.
- Debts and liabilities of a securities investment fund must be repaid from the assets of that fund, and unless otherwise provided in the fund contract, the unitholders will be liable to the fund's debts and liabilities only to the extent of the unitholders' capital contribution to the fund.
- Where the manager or custodian of a securities investment fund is dissolved, liquidated, revoked, or declared bankrupt, the assets of that fund will not constitute part of the manager's/custodian's liquidation assets.

Only the following two categories of institutions satisfying all conditions under the Securities Funds Law can serve as the custodian of a securities investment fund:

- Commercial banks that have been duly approved by the CSRC and the China Banking Regulatory Commission (CBRC).

- Other financial institutions that have been duly approved by the CSRC.

### **Closed-ended retail funds**

This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

### **Legal fund vehicles**

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

### **Open-ended retail funds**

**Legal vehicles.** A retail fund is typically set up as a unit trust/asset management scheme, under which the fund manager is entrusted to manage the funds and the custodian bank will hold fund assets in custody for the benefit of the fund unitholders. The rights and obligations of fund managers, custodian bank and fund unitholders must be provided in the relevant fund contracts. The participants' interests in the retail fund are called units or interests.

**Advantages.** Retail funds organised in the form of a unit trust/asset management scheme enjoy many advantages, including tax transparency, better protection of unitholders' interests through contractual arrangements, separation of assets and fiduciary duties for the fund manager and fund custodian.

**Disadvantages.** As a trust/asset management scheme is traditionally a legal concept under common law, its adoption in the civil law system of China inevitably gives rise to issues and challenges. Due to the absence of legal tradition and the concept of trust in China, the rights and obligations in the governance of unit trusts/asset management schemes are not clearly defined. In particular, the custodian is not fully independent from the fund manager, and the functions and powers of the general meeting of the fund may not be completely realised.

### **Closed-ended retail funds**

**Legal vehicles.** This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

**Advantages.** This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

**Disadvantages.** This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

### **Investment and borrowing restrictions**

9. What are the investment and borrowing restrictions on retail funds?



### **Open-ended retail funds**

The retail fund property must be used for the investment in:

- Listed stocks and bonds.
- Other securities and derivatives provided for by the China Securities Regulatory Commission (CSRC).

The retail fund property cannot be used to participate in the following activities:

- Underwriting securities.
- Extending loans or providing guarantees to a third party.
- Assuming unlimited liability in investment activities.
- Investing in another fund, unless otherwise permitted by the CSRC.
- Investing in the fund manager or the fund trustee.
- Insider dealing, manipulating securities prices or other wrongful securities dealings.
- Other activities prohibited by laws, regulations or the CSRC.

The following requirements apply when trading, using fund assets, or for securities that are issued or underwritten by the fund manager, the fund custodian, the controlling shareholder or the actual controlling person of those people, or in relation to other material related-party transactions:

- The fund unitholders' interests must be accorded first priority.
- Any conflict of interest must be avoided.
- Regulations of the CSRC must be complied with.
- Appropriate disclosure must be made.

Other investment restrictions and guidelines may be imposed by the fund contract.

### **Closed-ended retail funds**

This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

### **Open-ended retail funds**

The fund contract and prospectus usually provides the conditions and procedures for the issue and redemption of fund interests. The fund manager may require a lock-up period after the establishment of the fund, which must not exceed three months. The manager may reject subscription and/or redemption request in certain circumstances in accordance with the fund contract. In practice, most open-ended retail funds are open for subscription and redemption on each trading day on the local stock exchange, and the fund manager provides a minimum requirement for each issue and redemption.

### **Closed-ended retail funds**

The closed-ended retail fund units can only be traded on a stock exchange. The relevant stock exchange rules apply.

11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

### **Open-ended retail funds**

Fund units may be traded on a stock exchange in accordance with the laws and regulations, or transferred under the provisions of laws and regulations and fund contract at trading counters recognised by the China Securities Regulatory Commission (CSRC) or by any other permitted means. The fund unitholders cannot transfer their fund units to a third party by entering into an agreement with that third party. In certain circumstances, such as death of a natural person, or merger or bankruptcy of a legal person, the fund unit holder's units can be assigned to the relevant parties' subject to laws and regulations.

### **Closed-ended retail funds**

Closed-ended retail fund units can only be traded on a stock exchange. The relevant stock exchange rules apply.

### **Reporting requirements**

12. What are the general periodic reporting requirements for retail funds?

### **Open-ended retail funds**

**Investors.** The fund manager has the obligation to:

- Disclose the net asset value of fund assets and fund units at least once a week before processing purchases or redemptions of fund units.
- Disclose the net value and net accumulated value of fund units on the day following each trading day.

- Publish the net value of fund assets and fund units on the last trading day of each semi-annual period.
- Publish an annual fund report within 90 days after the end of each calendar year.
- Publish a semi-annual fund report within 60 days after the end of the first half of each calendar year.
- Publish a quarterly fund report within 15 working days after the end of each calendar quarter.

**Regulators.** There are no periodic reporting requirements for the regulators.

### **Closed-ended retail funds**

**Investors.** The requirements are the same as for the open-ended retail funds (*see above*), except that the fund manager of closed-ended retail funds must publish the net asset value of each share at least once a week.

**Regulators.** There are no periodic reporting requirements for the regulators.

### **Tax treatment**

13. What is the tax treatment for retail funds?

### **Open-ended retail funds**

**Funds.** For retail funds in the form of privately raised pooled trust plans, asset management schemes and contract funds, VAT at a rate of 3% will generally be imposed on the fund managers with respect to VAT taxable activities during the fund term. However, income received on the transfer of securities and bonds are not subject to VAT.

**Resident investors.** Generally, if the retail fund is principle guaranteed, income received on liquidation of the funds by the investors (including individual and institutional investors) is subject to VAT at the rate of 6%. If the retail fund is not principle guaranteed, no VAT will be levied on such income.

The income received on the transfer of funds interests is not subject to VAT and individual income tax for individual investors (except for income attributable to the transfer of corporate bonds, where individual income tax will be levied), whereas VAT at a rate of 6% and corporate income tax at a rate of 25% are imposed on institutional investors for such income.

**Non-resident investors.** Due to the foreign exchange control system in China, foreign investors are not allowed to directly invest in local retail funds that are denominated in CNY. The following exemptions apply:

- Qualified foreign institutional investors (QFIIs) that have obtained a QFII licence from the China Securities Regulatory Commission (CSRC) and an investment quota granted by the State Administration of Foreign Exchange can directly invest in retail funds in China.
- Hong Kong subsidiaries of Chinese mutual fund managers, securities companies, commercial banks and insurance companies as well as other financial institutions organised and having its principal place of business

in Hong Kong can use offshore CNY to invest in China's securities markets through the Renminbi Qualified Foreign Institutional Investor (Rmb-QFII) pilot programme. A licence/quota must be obtained from the CSRC.

- Foreign strategic investors that comply with any applicable regulations.
- Non-resident investors (including QFIIs, Rmb-QFIIs and foreign strategic investors) are liable to withholding income tax at the rate of 10% for China-sourced dividend and interest income. Capital gains obtained by QFIIs and Rmb-QFIIs are not subject to VAT, but other non-resident investors should generally be subject to VAT at the rate of 6% for the price difference arising from the purchase and sale of fund units. For the QFII, Rmb-QFII that has not set up any establishment in China, or that only has establishment within China which are not related to the income obtained, the income derived from transfer of stocks and other equity investment assets in China are not subject to the corporate income tax for now.
- Non-resident investors (including QFIIs, Rmb-QFIIs and foreign strategic investors) may apply to the relevant China tax authorities to benefit from applicable tax treaties if a more preferential withholding income tax arrangement is provided in the tax treaty. However, whether QFIIs and Rmb-QFIIs may apply for treaty benefits in relation to China-sourced capital gains has yet to be clarified by the tax authorities.

### **Closed-ended retail funds**

This is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

**Resident investors.** This is the same as for open-ended retail funds (*see above*), except that gains arising from the purchase and sale of corporate bonds derived by individual investors from a close-ended fund are subject to individual income tax at the rate of 20%, while those derived by institutional investors are not subject to corporate income tax.

**Non-resident investors.** This is the same as for open-ended retail funds (*see above, Open-ended retail funds: Non-resident investors*).

### **Quasi-retail funds**

14. Is there a market for quasi-retail funds in your jurisdiction?

Quasi-retail funds do not exist in China.

### **Reform**

15. What proposals (if any) are there for the reform of retail fund regulation?

On 17 November 2017, China issued the Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Soliciting Opinions) to unify rules covering asset management products managed by financial institutions, which mainly include:

- Commercial banks.
- Trust companies.
- Securities companies.
- China Securities Regulatory Commission licensed fund management companies.
- Futures companies.
- Insurance companies.

The Draft for Soliciting Opinions have been issued with a view to tighten the supervision of asset management business in China. The authors believe such guidelines, once effective, will have a significant great impact on onshore retail funds.

## Online resources

### **China Securities Regulatory Commission (CSRC)**

**W** [www.csrc.gov.cn/pub/csrc\\_en/](http://www.csrc.gov.cn/pub/csrc_en/)

**Description.** The official website of the CSRC where a copy of the Securities Funds Law and other relevant regulations can be accessed. The CSRC is the primary regulator of retail funds in China. The translation of this website may not be up to date and is to be used for guidance only.

### **Asset Management Association of China (AMAC)**

**W** [www.amac.org.cn/cms/site/preview?ID=23](http://www.amac.org.cn/cms/site/preview?ID=23)

**Description.** The AMAC is the primary regulator of retail fund managers in China. The translation of this website may not be up to date and just for guidance only.

## Contributor profiles

**James Yong Wang, Partner**

**Han Kun Law Offices**

T+86 185 1188 0418 /138 1149 9450

Ejames.wang@hankunlaw.com

Wwww.hankunlaw.com/enIndex.html

**Professional qualifications.** New York; Special Administrative Region of Hong Kong (expected)

**Areas of practice.** China and international Investment funds; asset management.

**Non-professional qualifications.** J.D., Columbia Law School; LL.M. in Tax law, New York University School of Law; LL.B. and B.A. in German, Peking University.

**Recent transactions**

- Acting for SBI in setting up the first RMB QFLP pilot fund in Shanghai.
- Representing global asset managers such as BlackRock, Invesco and Hall Capital in the formation and operation of QFII funds in China.
- Representing international and domestic PE and hedge fund sponsors in setting up QDII funds.

**Languages.** Mandarin Chinese, English, German and Cantonese (fluent)

**Professional associations/memberships.** Member of the expert review committees for the QFLP Pilot Program and QDLP Pilot Program in Shanghai.

**Publications.** *Private Equity Review (China Fundraising Chapter)*, *Law Books Review (2014 to 2018 editions)*

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