

# Legal Commentary

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## CSRC to Overhaul Mutual Fund Manager Rules

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On July 31, 2020, the China Securities Regulatory Commission (“**CSRC**”) issued consultation drafts of the *Administrative Measures for Publicly-Offered Securities Investment Fund Managers* (《公开募集证券投资基金管理人监督管理办法(征求意见稿)》) and the *Provisions on Issues Concerning the Implementation of the Administrative Measures for Publicly-Offered Securities Investment Fund Managers* (《关于实施〈公开募集证券投资基金管理人监督管理办法〉有关问题的规定(征求意见稿)》)<sup>1</sup> (collectively the “**Draft Rules**”). The Draft Rules are revised versions of earlier consultation drafts issued by CSRC on May 17, 2013<sup>2</sup>.

The Draft Rules are intended to apply to both fund management companies (“**FMCs**”) and other asset management institutions that are allowed to obtain mutual fund licenses, including wealth management subsidiaries of commercial banks (“**WMSs**”), securities firms’ asset management subsidiaries, insurance asset management companies and private securities investment fund managers (“**PFMs**”) registered with the Asset Management Association of China (“**AMAC**”), all of which are collectively referred to as “**Mutual Fund Managers**”.

This article is focused on the key aspects that may affect the business strategies of foreign asset management firms to set up, make equity investments in, mutual fund management platforms (such as FMCs, WMSs and securities firms) in China, or to apply for mutual fund licenses in the future via existing PFM WFOEs.

### Requirements for FMC shareholders

The Draft Rules propose to classify shareholders of FMCs into three types: (i) shareholder with no more than 5% stake, (ii) non-major shareholder with more than 5% stake, and (iii) major shareholder with more than 5% stake, each of which is subject to different regulatory/qualification requirements. For example, the Draft Rules add negative requirements for any shareholder with no more than 5% stake and increase the net capital requirement for any non-major shareholder holding more than 5% stake. It is also worth

<sup>1</sup> Please see the details at: [http://www.csrc.gov.cn/pub/zjhpublic/zjh/202007/t20200731\\_380932.htm](http://www.csrc.gov.cn/pub/zjhpublic/zjh/202007/t20200731_380932.htm).

<sup>2</sup> Please see the details at: [http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201305/t20130517\\_228404.htm](http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201305/t20130517_228404.htm).

noting that the definition of “major shareholder” ( “主要股东” ) of an FMC is “the largest shareholder with more than 5% stake” under the Draft Rules, rather than “the largest shareholder with no less than 25% stake” under the current FMC rules.

The Draft Rules also provide further specific requirements for foreign shareholders of an FMC. For example, foreign shareholders are required to comply with relevant regulatory indicators in their local jurisdictions in the past three years, hold leading positions in the past three years in international markets in respect of assets under management, income, profits and market share, and maintain high credit statuses for the past three years.

Further, under the Draft Rules, subject to limited exceptions, the lock-up period is 48 months for major shareholders of FMCs (i.e. the largest shareholder with more than 5% stake) and the lock-up period is 36 months for non-major shareholders of FMCs with more than 5% stake. By contrast, the current FMC rules only require major shareholders of FMCs (i.e. the largest shareholder with no less than 25% stake) to hold their shares for three years.

The Draft Rules also require FMC shareholders to report to CSRC on an ad hoc basis under certain situations (including changes to its financial status), which indicates regulators’ intention to strengthen the oversight of FMC shareholders.

### **PFM as Mutual Fund Manager**

Based on the Draft Rules, a PFM is allowed to apply for a mutual fund license if it satisfies the applicable requirements provided in the Draft Rules. The Draft Rules also provide some general principles on how to handle existing private fund management business for a PFM which has obtained a mutual fund license. In addition, the Draft Rules clearly provide that a PFM with a mutual fund license (among other types of Mutual Fund Managers) may convert to an FMC upon CSRC approval, which is expected to provide more clarity on the means of conversion.

### **WMS as Mutual Fund Manager**

The Draft Rules also allow any qualified WMS to apply for a mutual fund license, which is a novel initiative. Based on the current WMS rules, WMSs may issue public wealth management products that are regulated by the China Banking and Insurance Regulatory Commission (“**CBIRC**”). If a WMS also obtains a mutual fund license from CSRC, its asset management business would be regulated by both CSRC and CBIRC, whose regulatory regimes are expected to be further clarified.

Following the *11 Measures on Further Opening-up the Financial Industry* (《关于进一步扩大金融业对外开放的有关举措》) issued by Office of the Financial Stability and Development Committee on July 20, 2019<sup>3</sup>, foreign asset management firms may set up foreign-controlled joint venture WMSs with a level-1 WMS of a commercial bank. In the meantime, foreign asset managers are also allowed to establish wholly-owned FMCs since April 1, 2020. Considering WMSs can also apply for mutual fund licenses and the trend of more overlapped business scope between FMCs and WMSs, foreign asset managers may want to further

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<sup>3</sup> Please see the details at: <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3863019/index.html>.

consider how to optimize their presence in China.

### **Rule of “One control, One participation, One license (一参一控一牌)”**

The Draft Rules specifically allow a single shareholder to concurrently control an FMC and another type of Mutual Fund Manager (such as a WMS with a mutual fund license) while participating in another FMC, or the shareholder is allowed to have one controlling stake in a non-FMC Mutual Fund Manager and hold participating (minority) stakes in two FMCs. Foreign asset managers may further plan their onshore equity investments accordingly, to make the best of the relevant platforms and resources.

### **Impact on FMC establishment application**

Once the Draft Rules become formal rules, they will generally apply to all the outstanding FMC applications already submitted to CSRC before the effective date unless the applications were submitted before July 2016 but yet to be approved. As a result, for the WFOE FMC applications, CSRC may require the relevant applicants to submit supplemental documents to comply with the Draft Rules. Foreign asset managers considering to set up WFOE FMCs are also advised to take into account all the new requirements applicable to FMCs and their shareholders earlier than later at the preparation stage.

### **FMC subsidiaries**

Based on the current FMC rules, an FMC may set up specialized subsidiaries to provide services to the FMC, such as private fund management business, fund distribution, private equity fund management business and IT services. Notably, according to the Draft Rules, FMC subsidiaries can engage in business broader in scope than under the current FMC rules, including mutual fund management, private asset management, investment advisory services, pension financial services, and fund distributions, etc.

The Draft Rules also provide specific requirements on setting up FMC subsidiaries (including financial requirements such as net capital, AUM and risk reserve funds), how to manage FMC subsidiaries and how to deal with the FMC subsidiaries during exit procedures.

### **FMC personnel requirements**

Compared to the current FMC rules, the Draft Rules impose stricter requirements on FMC personnel. For example, the Draft Rules provide that (i) where the total stake of a single shareholder and its affiliates exceeds 50% or the major shareholder is a natural person, the number of independent directors can be no fewer than 1/2 of the total directors on the board; while the current FMC rules generally require FMCs to have no fewer than three independent directors and the number of independent directors can be no fewer than 1/3 of the total directors; (ii) FMC applicants are required to have at least 30 employees while the current FMC rules only require 15; (iii) where an FMC sets up a board of supervisors, the number of the employee representative supervisors can be no fewer than 1/2 of the total number of the board of supervisors, which is stricter than the current requirements under the PRC Company Law (i.e. 1/3).

## Data transfer

Consistent with the current FMC rules, the Draft Rules require FMCs to segregate business and key client information from their shareholders. The Draft Rules further prohibit any individual or entity from transferring offshore any documents and materials related to securities business without approval from CSRC and other competent regulators. This is one of the aspects which will require special attention for foreign asset managers proposing to set up WFOE FMCs.

While there is no timetable for issuance of the final rules, the revision of the current FMC rules is included in CSRC's legislation plan for 2020<sup>4</sup>. Therefore, it is highly likely that the Draft Rules will be finalized and promulgated within this year. Once the Draft Rules become effective, they will replace the existing FMC rules, namely the *Measures for the Administration of Securities Investment Fund Management Companies* (《证券投资基金管理公司管理办法》), the *Provisions on Issues Concerning the Implementation of Measures for the Administration of Securities Investment Fund Management Companies* (《关于实施<证券投资基金管理公司管理办法>有关问题的规定》) and the *Interim Provisions on Public Securities Investment Fund Management Business Engaged by Asset Management Institutions* (《资产管理机构开展公募证券投资基金管理业务暂行规定》).

We will continue to monitor the development of the Draft Rules and work with industry players to make submissions in the consultation period.

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<sup>4</sup> Please see details at: [http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202004/t20200417\\_373996.html](http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202004/t20200417_373996.html).

***Important Announcement***

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