Private Equity Law

AMAC Issued New Guidance on Private Fund Service Business

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On March 1, 2017, Asset Management Association of China (the "**AMAC**") promulgated the Administrative Measures for Private Investment Fund Service Business (Trial) (the "**Administrative Measures**") which became effective on the same day. The *Administrative Measures* superseded the Guidelines on Fund Outsourcing Services (Trial) issued in February 2015 (the "**2015 Guidelines**") and became the new guidelines for institutions that desire to provide various professional services for private fund within China.

The *Administrative Measures*, having taken into consideration the public comments on the consultation draft released late 2016, is comprised of eight chapters with a total of 59 articles. It clarifies the legal relationship between a private fund service institution (a "**PFSI**") and a private fund manager (a "**PFM**"), classifies different types of external private fund services, defines responsibilities or scopes of different types of services, specifies the registration requirements and self-disciplinary administration requirements, and introduces a deregistration mechanism for PFSIs.

Legal Relationship

The *Administrative Measures* makes it clear that the relationship between a PFM and a PFSI is that of a principal-agent relationship, so that the obligations imposed on the PFM under applicable laws and regulations shall not be exempted due to such delegation, and PFSIs are prohibited from further contracting out private fund services undertaken by it directly or in a disguised manner to any third party.

Categories

The *Administrative Measures* classifies private fund services into five main categories, namely, fundraising, investment advisory, fund interests registration, valuation and verification, and information technology system services. The *Administrative Measures* focuses on the last three types of private fund service business, while fundraising and investment advisory would be separately regulated by AMAC.

Scopes and Responsibilities

The *Administrative Measures* defines the responsibilities or scopes of the three types of private fund service business as follows:

➢ PFSIs that engage in fund interests registration service should establish and manage the investors' fund accounts. They should also be responsible for fund interests registration, capital settlement, trade confirmation, dividend distribution, keeping of registers of investors, and other responsibilities required by applicable laws or service agreements.

➢ PFSIs that engage in fund valuation and verification service should carry out financial accounting and valuation, prepare reports and statements, keep business documents, and work with auditors engaged by PFMs in their audits, as well as other functions required by relevant laws, regulations or service agreements.

➢ PFSIs that engage in information technology system services should provide core application systems, operation maintenance and other safety protection services for PFMs, custodians or other PFSIs. The core application system includes the distribution system, investment trading management system, fund interests registration system, capital settlement system and valuation system. PFSIs providing core application systems to private funds are prohibited from engaging in the underling fund services of the corresponding information technology system.

Qualification Requirements

In order to commence private fund service business, a PFSI is required to register with AMAC and become a member thereof. The following are several general requirements for the AMAC registration of a PFSI.

(i) It is required to have good operation status with paid-in capital no less than RMB 50 million (applicable only to institutions engaged in private fund interests registration service or information technology system service);

(ii) It is required to have optimized corporate governance structure with efficient internal control;

(iii) It is required to have been operating in a compliant manner, with no previous incident of material violation of law or regulation within the most recent three years;

(iv) It is required to have a complete organizational structure, with dedicated service business teams and senior executives who are able to ensure the completeness and independence of operation, and the teams are required to have necessary fixed places of business and safety protection measures;

(v) It is required to be equipped with corresponding software and hardware facilities and safe, independent, efficient and stable business technology systems, and all of the systems are required to have passed the related business network tests, including the data backup platform as designated by AMAC;

(vi) The heads of private fund service business departments and the legal representatives of independent third-party PFSIs are required to obtain qualifications for private fund business. All employees engaged in the provision of private fund services are required to obtain qualifications for private fund business within 6 months from the commencement of their engagement in such service, and are required to participate in the subsequent professional training;

(vii) It is required to evaluate its business to determine whether there is any conflict of interest and establish corresponding firewall systems;

(viii) Its information technology system is required to comply with laws and regulations, and rules of China Securities Regulatory Commission ("**CSRC**") and AMAC, establishing network insulation, safety protection and emergency plan and other risk management systems and disaster backup systems;

(ix) Information technology PFSIs is required to have qualifications or conditions required by relevant authorities, have similar service experience, be equipped with all necessary business conditions including but not limited to professionals, facilities, intellectual properties and good safety operation records;

(x) Other conditions as may be required by AMAC.

After satisfying all those requirements, a PFSI may submit its application by uploading all materials required by AMAC, including a PRC legal opinion, on an AMAC-designated online system, which will be opened for registration as of May 2, 2017. Once all materials meet AMAC's requirements, AMAC would issue a registration certification and publicize the result within two months of its acceptance of the application.

Business Rules

The *Administrative Measures* specifies a number of business rules for PFSIs. In brief, a PFSI is required to:

(i)   sign written service agreements concerning some necessary content with PFMs;

(ii)   sign practice memos or other legal documents acknowledged by all parties concerning some necessary content with relevant parties such as PFMs, custodians and brokers;

(iii)   set a reasonable and clear fee standard, and is prohibited from providing services below cost;

(iv)   establish fund accounts and investor accounts, and keep fund assets and investors' assets independent from its own assets to ensure safety of assets;

(v)   have the operation capacity and risk tolerance to carry out private fund service, prudently evaluate the risks and conflicts of interest of the private fund service, and establish strict firewall systems;

(vi)   not be entrusted to be the custodian for the same private fund, unless it can reasonably insulate its fund service functions from custody functions and disclose such to investors;

(vii)   establish sound document management systems;

(viii) engage qualified accounting firms to issue annual audit report;

(ix)   provide regular reports to AMAC on a quarter and annual basis as well as reports in the case of material changes, including but not limited to shareholding changes, regarding the PFSI.

Deregistration Mechanism

The *Administrative Measures* requires that a PFSI commence fund service business within six months from its registration with AMAC, or its registration will be revoked by AMAC.

Transitional Arrangements

PFSIs that have already engaged in fund interests registration, valuation and verification or information technology system services but have not registered with AMAC prior to the implementation of the *Administrative Measures*, shall, within six months from the date when the specific system is available for registration (expected to be May 2, 2017), complete the registration in accordance with relevant requirements of the *Administrative Measures*. No new private fund service business is allowed until the completion of registration.

Foreign-invested PFSIs

While the *Administrative Measures* does not expressly exclude foreign-invested PFSIs from its application, it is our understanding that the new registration system currently does not contemplate the registration by foreign-invested PFSIs.   Certain foreign-invested PFSIs, such as those engaged by QDLP funds to provide fund administration services since the inception of the Shanghai QDLP pilot program in 2012, however, have been providing services well before the 2015 Guidelines.   There also are foreign-invested PFSIs that have been engaged in the business in the past two years following the 2015 Guidelines.   All of those foreign-invested PFSIs have been operating in a legally murky space.   It remains to be seen whether and how CSRC and AMAC will act to include foreign-invested PFSIs so that a fair level playing field can be created for all PFSIs alike.

● **Important Announcement**

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