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Han Kun Newsletter

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Legal Updates

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1. CSRC to Open up Securities/Funds Investment Advisory Industry

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Background

Securities investment advisory services are regulated in China as an important part of capital market intermediary services, with the key rules being the *Interim Measures for Administration of Securities and Futures Investment Advisory Services,* promulgated by the Securities Commission of the State Council (the regulatory predecessor to the China Securities Regulatory Commission/CSRC) in 1997 (《证券、期货投资咨询管理暂行办法》, the "**1997 Measures**"). Under the 1997 Measures, securities/futures investment consulting is broadly defined as the provision of analysis, predictions or recommendations for investments in securities or futures and such service is subject to a prior license from CSRC. As of today, CSRC has granted 84 investment advisory licenses in total but has suspended issuing such license since 2014[1], due to relevant issues in the investment advisory industry, such as unsustainable business models and lack of sufficient internal control, among other reasons.

To proactively address the issues and to resume grants for market entry driven by the continuous development and demands of the market, on 17 April 2020, CSRC issued the long-awaited consultation draft of the *Measures for Administration of Securities and Funds Investment Advisory Services*［《证券基金投资咨询业务管理办法（征求意见稿）》, the "**Consultation Draft**"］.

We have summarized below notable key aspects of the Consultation Draft.

Key Aspects

I Opening Up of Securities/Funds Investment Advisory Industry

Due to the lack of clear legal basis, in practice, CSRC has never granted an investment advisory license to a wholly foreign-owned enterprise (WFOE). As an encouraging development, the Consultation Draft specifically provides eligibility requirements for foreign shareholders of securities/funds investment advisors, which suggests that WFOEs may be allowed to apply for securities/funds investment advisory licenses from CSRC after the Consultation Draft takes effect. This is consistent with the current regulatory trend toward further opening up financial service industries to foreign investors, particularly the recent development that, as of 1 April 2020, both fund management companies and securities firms can be WFOEs.

II Definition and Applicable Scope of "Securities/Funds Investment Advisory Services"

In the Consultation Draft, "securities/funds investment advisory services" is defined to include securities investment advisory, funds investment advisory, publishing securities research reports, and

[1] The full list of 84 investment advisory licensees: http://www.csrc.gov.cn/pub/zjhpublic/G00306205/201510/t20151028_285725.htm.

other securities and funds investment advisory services as provided by laws, regulations and CSRC. "Securities" is defined to include stocks and bonds issued and traded either on domestic or overseas exchanges.

Accordingly, the Consultation Draft applies to the following categories of services:

1. securities investment advisory services refer to the business activities of accepting client appointments, providing clients with investment advice on securities, derivatives and other CSRC-approved investment types, and assisting clients in making investment decisions in accordance with agreements;

2. funds investment advisory services refer to the business activities of accepting client appointments, providing clients with investment advice on securities investment funds and other CSRC-approved investment products, and assisting clients in making investment decisions or processing transactions on behalf of clients in accordance with agreements;

3. publishing securities research reports refers to the business activities of analyzing and predicting the overall or partial trends in securities markets, or analyzing the investment value and price fluctuations of stocks, bonds, and other CSRC-approved investment types, and publishing research reports or analyses to clients to directly or indirectly obtain economic benefits; and

4. other securities or funds investment advisory services recognized by CSRC.

It is worth noting that, under the Consultation Draft, funds (but not securities) investment advisors are allowed to make investment decisions on behalf of their clients, which is referred to as discretionary investment advisory ("管理型投顾") and subject to additional requirements which will be separately issued by CSRC. This is the first time for formal CSRC rules to expressly distinguish between discretionary and non-discretionary investment advisory services. We expect the market to welcome this distinction as a response to the more sophisticated and diversified practices.

It is worth noting that CSRC issued the *Circular on the Pilot Work of Publicly-offered Securities Investment Funds Investment Advisory Services* (《关于做好公开募集证券投资基金投资顾问业务试点工作的通知》)[2] and launched a pilot program in October 2019 for discretionary investment advisory services that allows funds investment advisors to have full investment discretion over their clients' accounts. The pilot program aims to test a new business model for discretionary funds investment advisors (buy-side funds investment advisory model), i.e. discretionary funds investment advisors may charge their clients based on fund assets under management and performance-based fees, in addition to the traditional consulting fees. To date, CSRC has approved 18 participants for the pilot program, including 5 fund management companies (or their subsidiaries), 7 securities companies, 3 commercial banks, and 3 third-party fund distribution firms. In particular, an affiliate of Ant Financial, Ant (Hangzhou) Fund Distribution Co., Ltd., ("**Ant Hangzhou**"), is one of the three approved fund distribution firms and, according to public information, the joint venture set up by Ant Hangzhou and Vanguard Investment Management (Shanghai) Limited in June 2019 has started to provide discretionary funds investment advisory services since March 2020.

[2] http://www.xinhuanet.com/finance/2019-11/05/c_1210341159.htm.

III Licensing Requirements and Applicable Exemptions

As a general principle under the Consultation Draft, CSRC requires prior approval to engage in securities investment advisory services or publishing securities research reports, and requires prior registration to engage in public funds investment advisory services.

For now, considering the sensitivity around securities research reports, only CSRC-regulated securities firms and their subsidiaries are qualified to apply for a securities/funds investment advisory license to publish securities research reports.

The above license or registration will be valid for three years and may be extended, subject to separate applications with CSRC within six months prior to the expiry of the license or registration.

The Consultation Draft also provides limited scenarios which may be exempted from the above licensing requirements, which include:

1. securities companies providing securities investment advisory services to their brokerage clients as part of the brokerage service, provided that securities companies do not sign a separate investment advisory agreement with such clients or charge fees separately for the investment advisory services so provided, nor do such securities companies provide discretionary investment advisory services;

2. publicly-offered securities investment fund distribution companies which provide fund investment advisory services to their clients as part of distribution services, provided that fund distribution companies do not sign a separate investment advisory agreement with such clients, or charge fees separately for the investment advisory services so provided, nor do such fund distribution companies provide discretionary investment advisory service; and

3. securities companies, fund management companies and futures companies, or their asset management subsidiaries providing securities and funds investment advisory services to asset management products[3], provided that they shall report with the local CSRC bureau within five business days of their commencing securities/funds investment advisory services.

IV Eligibility Requirements

The Consultation Draft provides eligibility requirements for securities/funds investment advisory institutions in terms of, amongst others, net assets, shareholding structure, staffing requirements, business premises, IT systems, business facilities, effectiveness and efficiency of internal controls, compliance management and risk control systems, and track records. CSRC will separately provide for additional requirements for discretionary fund investment advisors.

[3] The Consultation Draft does not provide a definition of "asset management products", but by reference to the *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* (《关于规范金融机构资产管理业务的指导意见》) jointly issued by CSRC and other financial regulators, the scope should generally cover both publicly-offered products and privately-placed asset management products offered by securities companies, fund management companies, futures companies and their respective subsidiaries, insurance asset management companies and financial asset investment companies.

1. Staffing

For example, staff members of a securities/funds investment advisory institution that engage in certain activities must satisfy relevant qualification requirements and register as practitioners, and senior management personnel must additionally have at least three years of experience in the securities or funds industry or five years of experience in another financial industry, and two years of experience in the management of the business for which he or she is responsible.

For a securities/funds investment advisory institution that engages in only one of the three investment advisory services stated above in Section II.1-3, it may have not less than 10 staff members with the required qualifications and more than three years of relevant business experience; for an securities investment advisory institution that engages in more than one of the three investment advisory business stated above in Section II.1-3, it shall have not less than 20 staff members with the required qualifications and more than three years of relevant business experience.

2. Requirements for Shareholders

The shareholder(s) of a securities/funds investment advisory institution also need to satisfy relevant eligibility requirements in terms of, amongst others, net assets, financial condition, capital replenishment capability, and track records. Specifically, for an offshore shareholder, the offshore shareholder must be a financial institution and the securities regulatory authority in its home jurisdiction must have signed a regulatory memorandum of understanding and maintain an effective regulatory cooperative relationship with CSRC.

3. Rule of "Control One and Participate in One"

As with other financial institutions, the Consultation Draft provides that any shareholder (together with its controllers) in a securities/funds investment advisory institution may take equity stakes in up to two investment advisory institutions and may control only one of those institutions, unless otherwise provided by CSRC. This is consistent with CSRC's position applicable to shareholders of fund management companies and securities companies.

Generally speaking, the Consultation Draft has greatly increased the threshold requirements for setting up a securities/funds investment advisor, which demonstrates CSRC's intention to only allow market players with stronger overall capabilities (in terms of capital, staffing, shareholder backgrounds, infrastructure, internal controls, etc.) to enter into this form of regulated business activity.

V Investor Suitability

The Consultation Draft introduces investor suitability management obligations and requires securities/funds investment advisory institutions to classify their clients, fully disclose relevant risks, provide products and services corresponding to clients' ability to identify and tolerate risk based on a risk-matching principle.

As a general principle, investors are classified as common investors and professional investors, and securities/funds investment advisory services for high-risk assets, such as stocks, structured products and derivatives, cannot be made available to common investors, unless the common investors are

proactively willing to receive such services and certain CSRC-prescribed prudential requirements are satisfied.

VI Outsourcing Permissible

The Consultation Draft allows securities/funds investment advisors to outsource parts of their services, e.g. provision of research reports, investment advice, and design, operation and maintenance of algorithms and models, to another licensed securities/funds investment advisor. Such outsourcing arrangements, however, do not exempt outsourcing advisors from the obligations and liabilities they owe to their clients.

VII Risk Reserve Requirement

The Consultation Draft requires securities/funds investment advisory institutions that provide discretionary investment advisory services or high-risk asset investment advisory services to provide for risk reserves to indemnify their clients for any losses caused by their violations of law, breaches of contractual agreements, operational errors or technical failures.

VIII Special Carve-outs

While the Consultation Draft is intended to unify the relevant rules applicable to securities and funds investment advisory services and standardize market practices, it specifically provides for the application of carve-outs as below to harmonize with the existing regulatory framework:

1. For Financial Institutions

Certain requirements in the Consultation Draft will not be applicable to financial institutions providing securities/funds investment advisory services, because they are already under competent regulatory supervision in respect of eligibility criteria, such as securities companies, fund management companies, futures companies, commercial banks, insurance companies and other CSRC-recognized financial institutions. Such requirements include but are not limit to eligibility requirements for shareholders and requirements for corporate governance, internal controls and compliance and licensing extensions.

Where any of the above financial institutions uses its wholly-owned subsidiary to apply for a securities/funds investment advisory license, CSRC will consider the application on a consolidated basis for the purpose of eligibility requirements (considering the subsidiary and its parent financial institution as a single entity).

2. For Private Fund Managers (PFMs)

Where PFMs provide investment advisory services for asset management products, or affiliated qualified overseas institutional investors (R/QFIIs), the provisions as otherwise provided by CSRC will prevail.

Notably, under currently valid PRC laws and rules, a PFM (including a WFOE PFM) may apply for an investment advisory license from the Asset Management Association of China (AMAC), provided that the PFM satisfies the so-called “1+3+3” eligibility requirements of AMAC membership, staffing requirements and track record. The AMAC-issued investment advisory license allows a PFM to

provide investment advisory services for private asset management products issued by securities companies, futures companies and fund management companies and their subsidiaries, and commercial bank wealth management subsidiaries in China[4]. Once the Consultation Draft is formally promulgated, subject to CSRC's discretion, it is possible that PFMs may still be subject to the current AMAC licensing requirements, rather than the licensing requirements under the Consultation Draft, to the extent that PFMs only provide investment advisory services for private asset management products issued by the aforementioned financial institutions.

It should also be noted that currently R/QFIIs may not appoint PFMs to provide investment advisory services, until the consultation drafts for the amended R/QFII rules, which were issued by CSRC on 31 January 2019, are formally promulgated and become effective.

IX Programmatic Advisory Service

The Consultation Draft specifically provides for reporting obligations over the provision of programmatic advisory services, i.e. a securities/funds investment advisory institution using algorithms, models and other information technology means to provide clients with automated securities and funds investment advisory services. These obligations include reporting to the local CSRC bureau relevant technical solutions, model parameters, investment logic and other information and materials.

X Transitional Period

The Consultation Draft provides transitional periods for institutions to conform to the requirements as follows:

1. for institutions which have previously obtained a securities investment advisory license under the 1997 Measures but do not meet the requirements of relevant internal management and business norms under the Consultation Draft, rectifications are to be completed within one year from the effective date of the Consultation Draft;

2. shareholders which do not meet the eligibility requirements provided in the Consultation Draft are to complete rectifications within five years from the effective date of the Consultation Draft;

3. institutions which have not obtained a securities/funds investment advisory license before effectiveness of the Consultation Draft but have engaged in securities/funds investment advisory services in accordance with relevant rules (e.g. discretionary funds investment advisors under the pilot program) should apply for approval or registration with CSRC within one year from the effective date of the Consultation Draft in accordance therewith; and

4. institutions (a) which are not securities companies or their subsidiaries but have engaged in publishing securities research reports or (b) which have provided common investors with high-risk asset investment advisory services but do not meet relevant requirements for the protections afforded to common investors before effectiveness of the Consultation Draft must cease developing new business

[4] As from 1 May 2020, a PFM with an AMAC-issued investment advisory license may also be allowed to provide investment advisory services for private asset management products issued by insurance asset management companies.

by the effective date of the Consultation Draft and allow the existing business to terminate upon its expiration.

Outlook

The Consultation Draft provides clear access standards for engaging in securities/funds investment advisory services, clarifies the applicable scope and strengthens on-going compliance requirements. However, there are still some outstanding issues or points which will require further clarification, such as how to address commodity futures investment advisory services, whether the securities covered by the Consultation Draft will also include relevant securities issued by overseas companies and traded on overseas exchanges, how to apply the "control one and participate in one" rule where financial institutions and their subsidiaries all engage in securities investment advisory services, and the relationship between AMAC's investment advisory licenses available to PFMs.

The consultation period will end on 17 May 2020. According to CSRC's 2020 legislation plan issued on 17 April 2020, the Consultation Draft is one of the key rules to be promulgated within this year. We will submit our comments to CSRC and will continue to work with market participants in exploring business opportunities as the market and regulatory framework develop.

We have prepared an English translation of the Consultation Draft. Please let us know should you wish to receive a copy.

2. China Strengthens Fight Against Malicious Trademark Registrations

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A focus for Chinese trademark law and practice in recent years has been strengthening the fight against malicious trademark registrations. On November 1, 2019, the amended *Trademark Law of the People's Republic of China* (the **"Trademark Law"**) was officially implemented, in which Article 4 primarily embodies China's determination to strengthen the fight against malicious trademark registrations, **greatly lowering the threshold for attacking malicious registrations and also potentially serving as the latest weapon in cracking down on malicious registrations**. In addition, the Trademark Law, as amended, also provides other provisions to fight against malicious trademarks, such as defenses against malicious trademark agencies and raising the amount of compensation for malicious trademark infringement, etc. At the judicial level, it is clear that the number of cases has increased significantly, such as raising damage awards against trademark infringers and not supporting malicious trademark infringement lawsuits.

For example, Article 4 of the Trademark Law stipulates that **"[m]alicious registration applications for trademarks not for the purpose of use shall be rejected**". A short time has passed since this legal provision came into effect, but many national intellectual property administrations around the world which have actively invoked similar legal provisions to strike a blow against malicious registrations, including one dental company in the United States that submitted an application for invalidation against a U.S. company over a trademark on nine types of electrical switch goods. Moreover, one U.K. company submitted an application for invalidation against another U.K. company for the same trademark on three types of cosmetics. The China National Intellectual Property Administration has actively cited Article 4 of the Trademark Law in analyzing the maliciousness of disputed trademarks, an example of which is presented in the following ruling excerpt:

Where the respondent repeatedly applied for registration of the same trademark in multiple product categories … and the respondent failed to defend and prove the source of the trademark design of the disputed trademark, our administration reasonably believes that the respondent has the purpose of making a profit by improperly utilizing the trademark of the applicant. ***This form of rushed registration violates the principle of acquiring trademark rights based on the necessity of actual use as stipulated in Article 4 of the Trademark Law of the People's Republic of China.***

Under the framework of the Trademark Law, Article 4.1 and Article 44.1 are the operative provisions of law primarily aimed at fighting malicious registrations. **However, the threshold in Article 4 for "malicious" is lower compared to Article 44.1**.

The important requirements in Article 4 of the Trademark Law are: "not for the purpose of use" and "malicious". The requirement of **"not for the purpose of use"** can be judged, for example, by whether actions have been taken to prepare the trademark for use or the registrant actively defends the trademark. **For the second element, "malicious", relevant judicial interpretations** identify as malicious circumstances such as: the trademark applicant has no legitimate reason for the application, knew or should have known of others who were using the trademark, or the trademark has a certain degree of visibility or strong influence. As in the above cases, it can be proven that a respondent meets **the two**

requirements of Article 4 at the same time if the disputed trademark for registration is the same as that of a previous registrant of the trademark which has a strong influence, the respondent has no explanation for the origin of the trademark, or the respondent has used the trademark across the multiple product categories.

Compared to Article 4 of the Trademark Law, in Article 44.1, the "other improper means" provision protects the public interest rather than individual civil rights and interests. **Therefore, the malicious registration of a trademark by an applicant must be considered to have resulted in "harming the public interest" to a severe degree, such as hoarding hundreds of trademarks**. In the trademark invalidation case "SHEER LOVE", the court applied Article 44.1 to reject the registration applications of the respondent, who had copied for sale over 700 of the trademarks of others.

Before the implementation of the amended Trademark Law, Article 44 of could only be applied when the number of trademarks an applicant had hoarded in bad faith was especially large (such as hundreds or thousands) or the applicant's conduct was particularly malicious. Article 4 of the Trademark Law lowers the threshold for attacking malicious trademark registrations and allows for action to be taken against malicious trademark registrations which have not reached the level of harming the public interest. In light of the amended Trademark Law, the key point for us is to make full use of the relevant judicial interpretations to clarify the two elements of "not for the purpose of use" and "malicious", so as to effectively and accurately strike against malicious trademark registrations.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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