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AMAC Updated Filing Notice on Private Funds

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On 23 December 2019, AMAC issued the updated *Filing Notice on Private Funds* ("***Filing Notice***"). We have summarized key points that may affect the business of wholly foreign owned private securities investment fund managers ("**WFOE PFM**") and their subsidiaries/affiliates engaging in QDLP business ("**QDLP Entity**").

I. Applicable Laws, Regulations and Rules

The *Filing Notice* has enumerated major laws, regulations and rules applicable to private funds, and we noticed that the *Guiding Opinions on Regulating Financial Institutions' Asset Management Business* ("***PBOC Guiding Opinion***") jointly issued by PBOC, CSRC, CBIRC and SAFE on 27 April 2018 has not been included.

In practice, the private fund industry as a whole so far has not yet taken on to adopt the *PBOC Guiding Opinion*. We believe that the *Filing Notice* has further proved that AMAC will not require private fund managers to overall follow the *PBOC Guiding Opinion* at this stage.

II. Qualified Investor

After the promulgation of the *PBOC Guiding Opinion*, opinions varied as to whether and how the *PBOC Guiding Opinion* shall apply to private funds with respect to the qualified investor issue. In practice, some distributors for prudence, have requested WFOE PFM and QDLP Entity to follow the criteria on qualified investors provided in the *PBOC Guiding Opinion*.

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Now this issue is settled as it is provided in the *Filing Notice* that qualified investors shall still be subject to eligibility requirements under the *Interim Measures for Supervision and Administration of Private Investment Funds* ("***Interim Measures***") issued by CSRC in year 2014.

III. Look-through

According to the *Interim Measures*, where an investor is in unincorporated forms such as a partnership or a contractual product, it is required to take a look-through approach, review whether the ultimate investors are qualified investors or not and calculate in a consolidated manner the number of investors, provided however the following investors will not be subject to look-through.

(1) Social security funds, enterprise annuities and other pension funds, the charitable fund and other social non-profit funds; and
(2) Duly-established investment schemes that have been filed with the AMAC.

Among all kinds of asset management products as investors of private funds, only those filed with AMAC have been exempted from look-through, which means trust products of trust companies and wealth management products of commercial banks under CBIRC regulatory regime and not subject to AMAC-filing requirements shall be looked through. However, it is hard to implement the look-through rule for private fund managers and distributors in practice.

Now, this issue is settled from the core, as it is provided by the *Filing Notice* that any and all asset management products duly filed according to applicable rules (including AMAC-filed ones and those filed with other regulators like CBIRC) are exempted from look-through.

IV. Investment Capacity

According to the *Measures for the Administration of Fundraising Practices of Private Investment Funds* ("***Fundraising Measures***"), after disclosing risks to investors and before execution of fund contract by investors, fundraisers shall go through the procedure for confirmation of qualified investors. Fundraisers shall require investors to provide necessary asset proof document or income proof, and verify whether the investors are in compliance with the qualified investor criteria.

Now, further to the *Fundraising Measures*, the *Filing Notice* requires the fundraisers to verify whether the subscription/purchase amount paid by an investor is compatible to its investment capacity.

V. Permitted Investment before Completion of Filing

According to the *Guidelines on the Content and Format of Contracts of Contractual Private Investment Funds* ("***Guidelines on Fund Contract***"), the fund contract shall stipulate that the private fund will not make investment or operate until it completes the filing with AMAC.

Now, the restriction has been relaxed a little. It is provided by the *Filing Notice* that before completion of filing with AMAC, for the purpose of cash management, the private fund is permitted to invest to demand deposit, Treasury Bonds, central bank bills, money market funds and other cash management instruments permitted by CSRC.

VI. Duration Term

The *Filing Notice* provides that there shall be a fixed duration term for a private fund.

<table>
<tr><th>Manager</th><th>Securities Investment Fund</th><th>PE Fund</th></tr>
<tr><td>WFOE PFM</td><td rowspan="2">No statutory requirement on the length of duration as long as it is a fixed duration term.</td><td>Not applicable to WFOE PFM</td></tr>
<tr><td>QDLP Entity</td><td>For a QDLP fund investing in offshore PE fund, the duration term should be no less than 5 years; and 7 years or more is encouraged.</td></tr>
</table>

AMAC has a control mechanism via AMBERS as to the duration term of private funds. According to the *Filing Notice*, if the private fund manager does not submit application to AMAC via AMBERS for extension of the term of the fund or liquidation of the fund when the term of a fund has come to an end, AMAC will suspend reviewing the filing application of any new fund of the private fund manager.

VII. Affiliated Transaction

According to the *Securities Investment Fund Law of the PRC* ("***PRC Fund Law***"), where fund assets are used for trading the securities issued or underwritten by the manager, the custodian, the controlling shareholder or the actual controller thereof, or other companies having major interested relationship therewith or where other major affiliated transactions are conducted, the principles of giving priority to the interests of the fund unit holders and preventing conflict of interest shall be upheld, the provisions of CSRC shall be complied with, and information disclosure obligations shall be performed.

The *Filing Notice*, echoing the *PRC Fund Law*, has provided similar requirement. According to the *Filing Notice*, affiliated transaction refers to the transaction between a private fund and its manager, investor(s), private funds managed by the manager or other fund manager(s) under the same control of the actual controller, or other affiliate(s) having major interested relationship with the aforesaid entities.

Comparing the *PRC Fund Law* and the *Filing Notice*, we noticed that the scope of affiliates covered therein are different. For example, custodian is only covered by the former; while investor is covered by the latter only. Given that there is an all-in provision (i.e., other entities having major interested relationship therewith) under both, we understand that the provisions by both the *PRC Fund Law* and the *Filing Notice* need to be counted in when determining the scope of affiliates of a private fund. WFOE PFM and QDLP Entity shall update their internal policy timely.

Further, the *Filing Notice* provides that:

(1) Where an affiliated transaction is conducted, it shall be clearly provided in the fund contract relevant arrangement on (i) ex-ante and ex-post information disclosure, and (ii) special decision-making mechanism and recusal system in relation to affiliated transaction.

(2) Consistent with the original requirement, it is required by the *Filing Notice* to submit (i) materials to certify fair valuation of underlying assets (if any), (ii) effectively implemented risk control mechanism on affiliated transaction, and (iii) undertaking letter on not harming the legitimate rights and interests of investors, when submitting filing application.

VIII. Audit on Annual Report

According to previous applicable AMAC rules, the annual financial report of WFOE PFM and QDLP Entity shall be audited while there is no such audit requirement for the annual report of private funds (neither PE funds nor securities investment funds). Now, according to the *Filing Notice*, the annual report of PE funds shall be audited.

Given that under applicable QDLP rules, annual report of QDLP funds shall be audited as well, the *Filing Notice* does not add additional burden on WFOE PFM and QDLP Entity as to audit related matters.

IX. Reporting of Material Changes

According to the *Measures for the Registration of Private Investment Fund Managers and Record-filing of Funds (for Trial Implementation)* (“***Registration and Filing Measures***”), if any of the following major matters happens during the operation of a private fund, the manager shall report the matters to the AMAC within five working days:

(1) A major change happens to the fund contract;
(2) Number of investors fails to comply with laws and regulations;
(3) The fund is dissolved or wound up;
(4) The manager or custodian is changed; or
(5) Other matters that have a material impact on the fund's sustainable operation, investor interests or net asset value.

Now, according to the *Filing Notice*, if any of the following major matters happens, the manager shall report the matters to the AMAC within five working days:

(1) The manager or custodian is changed;
(2) A major change happens to the fund contract;
(3) Large amount redemption is triggered; *(new)*

(4) Material litigation, arbitration or property dispute occurs in connection with the asset management business, the fund assets or the fund custodian business; *(new)*

(5) Planned exit from any investment to a project with the investment amount reaching 50% or more of the net assets of the fund is delayed; *(new)* or

(6) Other matters that have a material impact on the fund's sustainable operation, investor interests or net asset value.

Given that there is an all-in provision (i.e., "other matters that have a material impact…") under both, we understand that the provisions by both the *Registration and Filing Measures* and the *Filing Notice* need to be counted in as material changes that need to be reported to AMAC timely.

X. Public Notification by AMAC

Among others, the *Filing Notice* provides that if the AUM of a private fund is less than RMB5 million, AMAC will publicly disclose such information on its website until the AUM reach RMB5 million or more.

We understand the AUM of some private funds of WFOE PFMs is less than RMB5 million. Although it is not a violation of applicable laws, such WFOE PFM may have concern over its "reputation" as such AUM information will be publicly disclosed and available to all potential investors.

XI. No Rigid Payment

The performance benchmark and the benchmark for calculation of performance fee shall have their real meaning, and the manager and fund distributors shall not imply any income expectation to investors by setting up such benchmark.

Management fee accrued shall not be refunded to investors, nor shall the manager make use of other means to adjust the income or loss of private funds.

XII. Different Share Classes

It is forbidden by the *Filing Notice* to set up different share classes for a private fund if the assets of different share classes will be invested separately to different underlying assets, so that the investors will not be treated unfairly and the manager cannot circumvent its duties to launch and file a new private fund.

In other words, the *Filing Notice* does not forbid in a clean-cut way on the setup of different share classes. We understand that, if the assets of the fund is operated as a whole, and it is justifiable that investors are treated fairly and different share classes are set up reasonably, it is still acceptable to AMAC, subject to AMAC's further guidance.

XIII. Investment Concentration

Portfolio investment with asset allocation is encouraged but there is no statutory requirement on the restriction of investment concentration according to the *Filing Notice*. In other words, the feeder-master structure is still feasible.

XIV. Custodian

To be consistent with previous window guidance by AMAC, it is provided in the *Filing Notice* that a contractual private fund shall have a custodian, although no such stringent requirement under *PRC Fund Law* and the *Interim Measures*.

According to the *Filing Notice*, the rights, duties and obligations of the custodian shall be provided in the fund contract according to the *PRC Fund Law*, the *Interim Measures* and other laws, regulations as well as self-disciplinary rules (at least including the *Guidelines on Fund Contract*).

In practice, many custodians tend to mitigate their duties and obligations in the fund contract. Previously AMAC has issued relevant notice to public fund management companies, securities companies, futures companies and their asset management subsidiaries on filing of private asset management products, according to which, if the duties of the custodian is reduced in the asset management agreement, the filing application will be rejected by AMAC. Therefore, we understand that by the *Filing Notice*, AMAC has intended to show similar attitude although not explicitly provided.

XV. Special Requirements for Securities Investment Funds (FOF included)

This section is applicable to both WFOE PFM and QDLP Entity.

1. Dealing Day

The dealing day shall be reasonably set up by taking into comprehensive consideration of the liquidity of investment targets, investment strategies, investment restrictions, fund distribution channels, potential investors and their risk appetite etc. The manager shall strengthen the control on investors' frequent purchasing and redeeming.

Where interim dealing days are set up in the fund contract, the conditions triggering the interim dealing days shall be clearly provided in the fund contract as well. In principle, the interim dealing days shall not be used for onboarding new investors or additional purchase by existing investors.

2. Performance Fee

The performance fee shall not exceed <u>60%</u> of the investment return above the benchmark provided in the fund contract. In case the manager charges the performance fee, there should be an interval of at least 3 months (although 6 months or longer is encouraged) between every two times' performance fee charge, provided that the performance fee accrued when the investors redeem from the fund or the fund is liquidated shall not be subject to such restriction on interval.

XVI. Special Requirements for PE Funds (FOF included)

If a QDLP fund is a contractual PE fund, it should be a close-end fund according to the *Filing Notice*. After the filing is completed, purchase and redemption should not be allowed. For avoidance of doubt, dividend distribution, distribution due to withdrawals from the invested projects and transfer of fund units according to applicable rules are not forbidden.

XVII. Risk Disclosure

Compared with previous requirement on risk disclosure letter, the *Filing Notice* has provided more details on the required matters to be disclosed. Among others, the following matters (if applicable) shall be disclosed as "special risks" to investors:

(1) The affiliated relationship between the manager and fund distributors;
(2) 100% investment to a single target;
(3) Investment to underlying assets through SPV;
(4) Any nominee shareholding arrangement with respect to the manager of contractual funds; and
(5) Risk on failure to file the fund with AMAC.

Pursuant to the *Filing Notice*, the business continuity arrangement due to the dysfunction of the fund manager should be included in the risk disclosure letter (see XIX for more details).

Further, it is provided that the following entities are exempted from signing the risk disclosure letter, which helps relieve the burdens of fundraisers:

(1) Financial institutions;
(2) Social security funds, enterprise annuities and other pension funds, the charitable fund and other social non-profit funds;
(3) Duly-established investment schemes that have been filed with the AMAC;
(4) Financial products regulated by PRC financial regulators; and
(5) Private fund manager and its fund practitioners that invest to the funds managed by it.

XVIII. Undertaking Letter

We understand that template of the undertaking letter, which shall be submitted to AMAC when applying for filing, will be further updated, because according to the *Filing Notice*, the manager shall further undertake that

(i) fundraising has completed, and (ii) it has been fully aware of criminal, administrative and disciplinary consequences of illegal fundraising.

XIX. Business Continuity Plan

The fund contract and risk disclosure letter shall clearly stipulate the business continuity plan on safekeeping fund assets and maintaining operation or liquidation of the fund as well as dispute resolution mechanism once the manager objectively loses the ability to continue to manage the private fund.

XX. Transition Period

From 1 April 2020 on, AMAC will not accept filing application of private funds violating the *Filing Notice*, and the filing application under review by AMAC will be rejected as well. With the promulgation of the *Filing Notice*, even for the new private funds planned to be launched before 1 April 2020, we suggest following the *Filing Notice* for prudence so as to lessen back and forth with the case officer.

Private funds that have completed filing with AMAC prior to 1 April 2020 will not be affected by the *Filing Notice* unless such funds have been involved in some forbidden debt investment as provided by the *Filing Notice* (e.g., entrusted loan or unregulated private loan), which we do not think is a concern by WFOE PFM and QDLP Entity.

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