Impact of the Measures for the Supervision and Administration of Publicly-offered Securities Investment Fund Managers on WFOE FMCs

By Sandra Lu

On 20 May 2022, the China Securities Regulatory Commission ("CSRC") promulgated the *Measures for the Supervision and Administration of Managers of Publicly-offered Securities Investment Funds* ("Measures"), making significant adjustments to the rules governing the establishment of retail fund managers and the operation of retail fund management business in Mainland China. The Measures are a large revamp of the *Administrative Measures for Securities Investment Fund Management Companies* which came into force in 2012 and will have a far-reaching impact on the development of the retail fund industry. The Measures have come into force on 20 June 2022.

Since 1 April 2020, the CSRC has permitted qualified overseas financial institutions to establish wholly foreign-owned retail fund management companies ("WFOE FMCs") in Mainland China. As of the date of this article, BlackRock Fund Management Co., Ltd. has obtained the Securities and Futures Business License in June 2021 and has launched the retail fund management business in Mainland China. Neuberger Berman and Fidelity International (FIL) have obtained the approval for the establishment of WFOE FMC on 22 September 2021 and 5 August 2021 respectively and are preparing for the on-site inspection by the CSRC. The applications of AllianceBernstein, VanEck and Schroders to establish WFOE FMCs have also been accepted by the CSRC. In addition, JP Morgan, Morgan Stanley, and Manulife will achieve their goal of having a WFOE FMC or foreign-controlled retail fund management company ("FMC") in Mainland China through acquiring additional equity interest in their existing JV FMCs.

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With China's continued opening up, more and more international asset management institutions will have the chance to carry out retail fund management business in Mainland China by establishing WFOE FMCs. This article will focus on the impact of the Measures on WFOE FMCs.

1. WFOE FMC Shareholder Qualification

Only overseas institutions satisfying the regulatory conditions of the CSRC may apply for WFOE FMC establishment in Mainland China. According to the Measures, a WFOE FMC shareholder should meet the following conditions:

(1) The WFOE FMC shareholder is incorporated in accordance with the laws of the country or region where it is located and legally exists, the country or region where the shareholder is located has a sound securities law framework and regulatory system, and the securities regulatory authority of such country or region has signed a memorandum of understanding on securities regulatory cooperation ("Regulatory Cooperation MOU") with the CSRC or any other organization recognized by the CSRC and maintains effective regulatory cooperation.

(a) The overseas shareholder of a WFOE FMC should be duly incorporated and legally exist under the laws of its jurisdiction. This is a necessary condition and is reasonable and understandable.

(b) So far, the CSRC has entered into Regulatory Cooperation MOUs with 79 countries and regions, covering most of major markets globally.

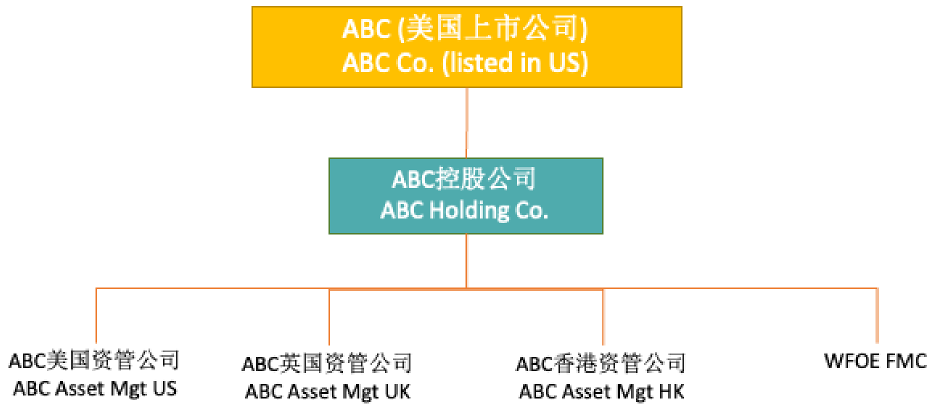
(c) Pursuant to the Measures, if the regulatory authority of the country or region where the overseas shareholder is located has not yet entered into a Regulatory Cooperation MOU with the CSRC but has entered into a memorandum of understanding with any other organization recognized by the CSRC, this condition may also be deemed to be satisfied.

(2) A WFOE FMC shareholder should be a financial institution with financial asset management experience or an institution managing financial institution(s).

(a) According to the Measures, a WFOE FMC shareholder may be a financial institution with financial asset management experience or an institution managing financial institution(s).

(b) The so-called "institutions managing financial institution(s)" mainly refers to institutions which directly hold a more than 50% equity interest in financial institutions and continuously manage financial institutions for at least one full fiscal year.

(c) Allowing "institutions managing financial institution(s)" to become a WFOE FMC shareholder is a breakthrough for the qualification of overseas shareholder, the main purpose of which is to cope with the current practice that overseas asset management institutions usually use one or more holding companies to hold regulated institutions. For example:



The above chart shows that, if ABC Holding Co. holds a 100% equity interest in the regulated entities ABC Asset Mgt US, ABC Asset Mgt HK and ABC Asset Mgt HK, and such holding continues for at least one full fiscal year, ABC Holding Co. may meet the qualification requirements for a WFOE FMC shareholder. This provision is in line with the practice of establishing global business framework of overseas institutions and is expected to be widely welcomed by the industry.

It is noteworthy that, if a WFOE FMC shareholder is a holding company, at least one of its subsidiary financial institutions should "have good management performance and social reputation, the net assets for the last one year should be no less than RMB200 million or the equivalence in a freely convertible currency, and it should have been profitable for the last three consecutive years."

(3) The major regulatory indicators of a WFOE FMC shareholder in the last three years comply with the laws of its home country or region and the requirements of regulatory authorities.

(a) This requirement is relatively broad. As for the means to prove a WFOE FMC shareholder complies with the major regulatory indicators in the last three years, this still needs further exploration in practice, e.g. a self-declaration statement by the shareholder, or a certificate by the regulatory authority in the home country or region of the shareholder issue. In case the shareholder is an institution managing financial institution(s), if the shareholder itself is not a regulated institution, and there are no applicable regulatory indicators, will it be sufficient to prove that one of the regulated entities under its control complies with the local regulatory indicators? These questions still need further exploration in practice.

(b) WFOE FMC shareholders may be located in different countries and regions, where the laws, regulations and regulatory requirements vary greatly. Therefore, the meaning of "major regulatory indicators" varies in different countries and regions. WFOE FMC shareholders should demonstrate that their satisfaction with such condition based on the requirements of their home countries or regions.

(4) A WFOE FMC shareholder should have good international reputation and operational performance, and its financial asset management business should rank top globally in terms of scale, revenue, profits, market share and other indicators in the last three years.

According to the implementing rules of the Measures, "ranking top globally in terms of relevant indicators" means that an overseas shareholder of a WFOE FMC (or its parent company of the group) satisfies any of the following conditions:

(a) The indicators such as scale, revenue, profits, market share, etc. of the securities investment funds under its management (including both retail and private securities investment funds) rank top globally;

(b) The indicators such as scale, revenue, profits, market share, etc. of the retail securities investment funds under its management rank top globally;

(c) The indicators such as scale, revenue, profits, market share, etc. of any single asset class, e.g. stocks, bonds, ETFs, REITs, pension funds, insurance funds, etc., under its management rank top globally;

(d) The indicators such as scale, revenue, profits, market share, etc. of asset management products such as actively managed products, ESG products, etc. under its management rank top globally.

As can be seen, the Measures not only require a WFOE FMC shareholder to have "good operational performance" in principle, but also define "good operational performance" as "ranking top globally in terms of scale, revenue, profits, market share, etc. of the financial asset management business in the last three years". In the meantime, the Measures provide specific, multi-dimensional and practical guidance on the definition of "ranking top globally in terms of relevant indicators". No matter which indicator is relied upon by the overseas shareholder, it must prove that it "ranks top globally" in respect of such indicator. Therefore, arguably, the Measures raise the entry threshold for overseas shareholders to some extent. Many overseas institutions that have already become a non-controlling shareholder of a Sino-foreign JV FMC may not be qualified to set up a WFOE FMC under the Measures.

(5) A WFOE FMC shareholder must have good asset quality and financial conditions

Having "good asset quality and financial conditions" means that all of the following conditions should be satisfied:

(a) Its net assets are not less than 50% of its paid-in capital;

(b) Its contingent debts are less than 50% of its net assets;

(c) Not being unable to pay off its due debts;

(d) Having moderate level of debt and leverage, and its net assets should in principle be not less than 30% of its total assets;

(e) Having no deficit that has not been made up.

(6) A WFOE FMC shareholder should have been profitable for the last three consecutive years.

According to the CSRC's requirements, in applying for the establishment of a WFOE FMC, an overseas institution should submit its financial statements for the last three full fiscal years. The financial statements should demonstrate that it has been profitable for three consecutive years.

(7) The net assets of a WFOE FMC shareholder for the last one year should not be less than RMB200 million or the equivalence in a freely convertible currency.

The "last one year" refers to the beginning and end of last one year. In practice, it is no longer feasible to make temporary capital injection into the WFOE FMC shareholder to satisfy the requirement of net assets of RMB200 million. The WFOE FMC shareholder should maintain net assets of not less than the equivalence of RMB200 million for at least one full fiscal year.

(8) A WFOE FMC shareholder should have the continuous capital replenishment capability commensurate with the business operations of the WFOE FMC and have in place a reasonable and effective risk disposal plan in case the WFOE FMC is unable to operate normally due to risk events.

This is a new requirement prescribed by the Measures. On one hand, it emphasizes that a WFOE FMC shareholder should have the capability to continuously replenish the capital of the WFOE FMC, mainly considering that long-term loss making of a WFOE FMC may cause lack of capital and may affect the operation of the WFOE FMC and harm the interests of public investors. Under such circumstance, the WFOE FMC shareholder should have the capability to make capital injection to the WFOE FMC. On the other hand, the WFOE FMC shareholder should also prepare a risk disposal plan specific to the WFOE FMC, including without limitation the WFOE FMC shareholder's plan to provide liquidity support to the WFOE FMC, the plan to properly handle the exit of the WFOE FMC, etc.

(9) A WFOE FMC shareholder should have a clear self-constraint mechanism to maintain the independence of the operation and management of the WFOE FMC, prevent risk contagion, improper interest tunneling, etc.

Prevention of interest tunneling and risk contagion has long been the focus of the CSRC. In reviewing the applications for WFOE FMC establishment, the CSRC generally requests the offshore institutions to explain the arrangements for prevention of the conflicts of interests and risk contagion between WFOE FMCs and offshore institutions/related parties.

(10) The long-term credit standing of a WFOE FMC shareholder should remain at a high level in the last three years.

This is a new requirement. WFOE FMC shareholders may be required to engage professional credit rating agencies to issue relevant reports to prove that their long-term credit standing remains at a high level in the last three years.

(11) A WFOE FMC shareholder should have proper corporate governance and sound internal control mechanism.

(12) A WFOE FMC shareholder should have a good risk control system and can provide support for enhancing the comprehensive competitiveness of the WFOE FMC.

(13) The investment by a WFOE FMC shareholder into the WFOE FMC should be in line with its long-term strategy and conducive to the development of its main business.

(14) The shareholders of a WFOE FMC should have feasible plans and arrangements for improving the governance of the WFOE FMC and promoting the long-term development of the WFOE FMC.

The requirements of items (12) to (14) emphasize that the shareholders should have a long-term strategy for investing in the WFOE FMC and should be able to provide comprehensive support for the development of the WFOE FMC. These requirements may be reflected in the business plan for the application to establish the WFOE FMC.

(15) A WFOE FMC shareholder should have a clear shareholding structure that can penetrate to the ultimate beneficial owner level by level and involves no asset management product.

Although many foreign-invested asset management institutions have a clear shareholding structure, their shareholding structure usually involves family trusts or employee shareholding trusts. While these arrangements do not violate the said provision, there is sometimes legal or confidentiality hurdle to penetrate to the ultimate beneficial owner under such circumstance.

(16) A WFOE FMC shareholder should not have any record of major violation of laws and regulations or any record of major dishonesty in the last three years.

The Measures require that a WFOE FMC shareholder should not have any record of major violation of laws and regulations in the last three years, which is a significant legislative update. Prior to the

Measures, the CSRC regulations required that overseas shareholders should not have been subject to "any" administrative penalties in the last three years. It is a pity that some well-known overseas institutions were no longer qualified as a WFOE FMC shareholder because they were subject to some penalties that were not too serious.

Although the Measures do not provide a quantitative standard for "materiality", this leaves enough room for interpretation of possible situations in practice.

(17) A WFOE FMC shareholder and the institutions under its control should have good credit and compliance records.

This provision not only requires WFOE FMC shareholders to have good credit and compliance records, but also requires the institutions under their control to have good credit and compliance records. If a WFOE FMC shareholder controls several, or even dozens of, institutions, there may be certain operational difficulties to prove the credit and compliance status of all the institutions under its control, e.g. they have not been subject to punishment by regulatory authorities in the last three years.

(18) A WFOE FMC shareholder should not be under the situation of having been subject to any criminal punishment for intentional crimes and there having been less than three years since the completion of the criminal punishment.

(19) A WFOE FMC shareholder should not be under investigation or under rectification due to any suspected major violation of laws and regulations.

In recent years, regulatory authorities worldwide have enhanced the investigation and enforcement against illegal activities in the securities and asset management industries. Quite a number of internationally renowned financial institutions have been investigated by overseas regulatory authorities. The CSRC has been paying close attention to such enforcement activities and recently requested certain overseas institutions to provide detailed explanations of relevant matters under investigation in relevant feedback opinions.

(20) A WFOE FMC shareholder should not be involved in any major event such as guarantee, litigation, arbitration, etc. that may seriously affect its ongoing operations.

Involvement in major litigations and arbitrations has also long been the focus of the CSRC. Any litigation, arbitration or guarantee that may seriously affect the operations of a WFOE FMC shareholder should be disclosed to the CSRC and provide the CSRC with an explanatory statement on whether such matter will affect the ongoing operations of the WFOE FMC shareholder.

(21) A WFOE FMC shareholder should not have conducted any behavior that harms the clients' interests such as misappropriation of client's assets.

(22) A WFOE FMC shareholder should not be under any situation that may affect the exercise of its shareholder's rights or performance of its shareholder's obligations, such as failure to actually carry out business for a long period of time, suspension of business, bankruptcy and liquidation, lack of governance structure, internal control failure, etc.

(23) A WFOE FMC shareholder should not have caused any significant public concern or serious adverse social impact due to their dishonesty or non-compliant acts, and such impact has not yet been eliminated.

(24) A WFOE FMC shareholder should not have borne significant liability for the business failure of any company it invested in during the last three years.

Finally, it should be noted that the above shareholder qualification requirements set forth in item (1) to (4) and item (10) only apply to the offshore shareholders of an FMC. Other qualification requirements generally apply to both domestic and offshore shareholders of an FMC.

2. Qualification Requirements of the Actual Controller of A WFOE FMC

According to the *PRC Company Law*, an "actual controller" refers to a person who is not a shareholder but can actually control the acts of the company through an investment relationship, agreement or other arrangements. In practice, tracing upward from a WFOE FMC to the top level according to control relationship, the institution or individual at the top level will be considered as the actual controller of a WFOE FMC. The actual controller of a WFOE FMC may be an institution (such as a listed company) or a natural person.

The actual controller of a WFOE FMC should meet the following conditions:

(1) Its net assets are not less than 50% of the paid-in capital;

(2) Its contingent debts are less than 50% of its net assets;

(3) Not being unable to pay off its due debts;

(4) The actual controller of a WFOE FMC should also meet items (8), (9), (14), (15), (16), and (18) - (24) of the qualification requirements for WFOE FMC shareholders.

3. Application Materials and Process for Establishment of A WFOE FMC

As the Measures substantially revise the qualification requirements of the shareholders and actual controller of a WFOE FMC, it is expected that the application materials for establishment of a WFOE FMC will need to be substantially revised accordingly to reflect the new requirements of the Measures. Based on the past regulatory practice, the CSRC will release the updated Service Guidance on Administrative Licensing Matters for establishment of an FMC on its website. It is advisable to pay close attention on this.

Furthermore, with respect to application materials for establishment of a WFOE FMC, According to the Measures, if a WFOE FMC or its shareholder or actual controller conceals relevant information or provides false materials in applying for administrative license, the CSRC should not accept the application or should not grant the administrative license; if the administrative license has already been granted, such administrative license should be revoked; and the responsible senior management personnel, the personnel in charge and directly responsible personnel should be subject to administrative penalty in light of the severity of relevant circumstances.

4. Lock-up Period

As a WFOE FMC has only one shareholder, the shareholder is considered to be the major shareholder of the WFOE FMC. According to the Measures, the applicable lock-up period for major shareholders is 48 months. Therefore, unless otherwise prescribed by the CSRC, a WFOE FMC shareholder should not transfer its equity interest to a third party or place any pledge on its equity interest within 48 months after it becomes the shareholder of the WFOE FMC.

In practice, overseas asset management institutions sometimes need to transfer the equity interest in the WFOE FMC from one group entity to another entity according to their global shareholding arrangements. According to the Measures, such transfer of equity interest in an FMC between different parties controlled by the same actual controller may be exempted from the lock-up period requirement. This facilitates the intra-group transfer of equity interest in a WFOE FMC by overseas institutions. The transferee, of course, still should satisfy the qualification requirements for a WFOE FMC shareholder.

5. Interim Reporting Matters of the Shareholder and Actual Controller of A WFOE FMC

In case any of the following circumstances occurs to the shareholder or actual controller of a WFOE FMC, relevant matters should be reported to the local securities regulatory bureau within 10 working days, and the WFOE FMC should be notified in writing:

(1) Change of its name or domicile;

(2) Change of its controlling shareholder or actual controller;

(3) Incurring losses for three consecutive years or having a relatively large amount of due debts that have not been paid off;

(4) The equity interest in the WFOE FMC held by the shareholder or actual controller becomes the subject of a litigation or arbitration or is imposed with such measures as property preservation, compulsory enforcement, etc. by a judicial authority;

(5) Disposal of, pledge of or release of pledge of its equity interest in a WFOE FMC;

(6) Merger, division or material restructure of assets or debts;

(7) Under investigation by any regulatory authority or judicial organ, or having been subject to any criminal or administrative penalty for major violation of laws and regulations;

(8) Having been subject to such measures as business suspension for rectification, appointment of a custodian or receiver, revocation, etc., or entering into bankruptcy and liquidation proceedings;

(9) Being unable to exercise shareholder's rights or perform shareholder's obligations;

(10) Other circumstances that may have a major impact on the business operations of the WFOE FMC.

It is noteworthy that the shareholder and actual controller of a WFOE FMC are the obligors of the aforesaid reporting and notification matters and should submit relevant reports and notifications within 10 days from the occurrence of relevant matters. This requirement is a brand new requirement and needs to be reflected in the compliance obligations of WFOE FMC shareholders.

6. Regular Reporting Obligations of WFOE FMC Shareholders to WFOE FMC

According to the Measures, a WFOE FMC shareholder should, within three months from the end of each year, report the following information to the WFOE FMC:

(1) The shareholder's exercise of shareholder's rights and performance of shareholder's obligations in the previous year;

(2) The shareholder's performance of its commitments and implementation of the law, regulations and regulatory requirements;

(3) The shareholder's qualification and the changes thereof;

(4) The qualification of the shareholder's actual controller and the changes thereof;

(5) The shareholder's equity interest in the FMC is subject to property preservation or compulsory enforcement;

(6) The shareholder's equity interest in the FMC is pledged or released from pledge;

(7) Other circumstances that may change the qualification of the shareholder and its actual controller or result in change of the shareholder's equity interest in the FMC.

A WFOE FMC should, within five working days of receipt of all the information set out in the preceding paragraph, report to the local securities regulatory bureau.

7. Extended Inspection by the CSRC on the Shareholder and Actual Controller of A WFOE FMC

According to the Measures, the CSRC and its local securities regulatory bureau may conduct extended inspection on the shareholders and the actual controller of the shareholders of retail fund managers. For a WFOE FMC, as both its shareholder and actual controller are overseas parties. As to how the CSRC will conduct the extended inspection, further discussion and test are needed based on the regulatory cooperation between the CSRC and overseas regulatory authorities.

8. Shareholder Qualification Verification and Compliance Notification Obligations of A WFOE FMC

(1) According to the Measures, a WFOE FMC should, in the course of day-to-day operation, strengthen the examination of the shareholders' qualification, verify the information of its shareholder and the controlling shareholder, actual controller, affiliates, parties acting in concert and ultimate beneficial owner of the shareholder, keep track of any change of such information, determine the shareholder's impact on the operation management of the WFOE FMC, and report relevant information in a timely, accurate and complete manner according to the law.

In addition, the Measures provide that the chairman of board of directors should be the chief person responsible for the equity management of a WFOE FMC.

(2) According to the Measures, a WFOE FMC should also perform the compliance notification obligation to its shareholder, notifying its shareholder of the compliance requirements relating to its shareholder in the course of corporate governance and business operation. We understand that a WFOE FMC should incorporate such compliance notification obligation into its compliance management and may consider comprehensively informing the shareholder of the compliance requirements under the current laws and regulations after the Measures take effect. Thereafter, whenever there is any change in the laws, regulations, or regulatory requirements, the WFOE FMC

may report to the shareholder in a timely manner. Alternatively, the WFOE FMC may also consider periodically reporting to its shareholder regarding any change in the relevant compliance requirements.

9. Strengthening the Function and Role of Independent Directors

According to the Measures, an FMC should have no less than three independent directors, and the number of independent directors should not be less than one third of the total number directors on the board. Each special committee under the board of directors should have at least one independent director.

With respect to the duty performance of independent directors, the Measures stipulate that independent directors should make independent, objective, fair and professional judgments on the following major matters concerning fund assets and company operation in accordance with the law and may require the senior management personnel or other employees of the FMC to accept inquiries, give explanations or provide necessary materials for such issues. Where an independent director finds that a major matter may harm the interests of the fund unitholders, cause significant losses or operational risks to the FMC, he/she is obliged to report to the board of directors and the local securities regulatory bureau in accordance with the law in a timely manner.

(a) Whether the management and operation of various assets entrusted to the WFOE FMC harm or may harm the interests of fund unitholders;

(b) Appointment and dismissal of senior management personnel of the WFOE FMC;

(c) Safeguards for duty performance of the WFOE FMC's compliance function;

(d) Equity incentive scheme of the WFOE FMC;

(e) Changes in the shareholding structure and actual controller of the WFOE FMC;

(f) Significant amendments to the articles of association of the WFOE FMC;

(g) Setting of special committees under the board of directors of the WFOE FMC, appointment of their members and formulation of their respective rules of procedure;

(h) Matters that may cause significant losses or operational risks to the WFOE FMC;

(i) Matters that may harm the interests of minority shareholders (since the WFOE FMC has only one shareholder, this item does not apply to the WFOE FMC);

(j) Other matters that may harm the interests of fund unitholders.

10. Establishing A Long-term Incentive and Restraint Mechanism

The Measures put forward the following new requirements for the long-term incentive and restraint mechanism of an FMC from the regulatory perspective:

(1) Employee assessment: the Measures set forth the following requirements with respect to the employee assessment:

(a) The Board of Directors should conduct long-term assessment covering a period of at least three years on the management team of the FMC. Such requirement is not mandatory for other personnel (management team includes the company's general manager, deputy general manager, chief information officer, chief financial officer and other personnel actually assuming the above roles);

(b) The assessment of key employees such as investment, research and sales personnel should consider the funds' long-term track records, compliance and risk management, level of professional ethics, etc. and should not take the scale ranking, management fee income and short-term track records as the main basis of compensation assessment ("long-term track records" refer to the funds' track records for the last three or more years; use of single indicator in relevant assessment should be avoided, and the weight of relative ranking should be reduced).

(2) Compensation deferral: the Measures set forth the following requirements with respect to compensation deferral:

(a) Establishing a compensation deferral payment mechanism for chairman of the board of directors, senior management personnel, heads of main business departments, heads of branches, and core business personnel;

(b) The proportion of deferred compensation of senior management personnel, portfolio managers and other key personnel should not be less than 40% in principle, and the deferral period should not be less than three years.

(3) Recourse and clawback mechanism: where an employee fails to perform his/her duties diligently or is responsible for violations of laws and regulations or operational risks of the company, an FMC should:

(a) Establishing a recourse and clawback system that expressly stipulates the conditions and measures of recourse and clawback, including suspending the payment of the unpaid remuneration of relevant responsible persons, and requiring them to return relevant bonus of the year when relevant act occurs, or ceasing to grant long-term incentives to such persons;

(b) Stipulating clear recourse and clawback clauses in employment contracts;

(c) The aforesaid recourse and clawback provisions should also apply to ex-employees.

(4) Mechanism of skin in the game: the senior management, heads of main business departments and portfolio managers of retail fund managers should invest a certain percentage of performance bonus into the retail funds managed by the company or themselves. The Measures, for the first time, make co-investment an obligation under the regulations.

(5) Extension of silence period: major investment and research personnel such as portfolio managers of retail funds should not engage in activities such as investment management of non-retail funds within one year from their departure (i.e. the prior silence period requirement that portfolio managers should not engage in investment management of non-retail funds within six months from their departure has been extended for another six months).

Internationally leading asset management institutions usually have their own unique incentive and restraint mechanisms, which are often the secret of their commercial success. It remains further exploration in practice as to how to effectively combine the aforesaid regulatory requirements with the incentive and constraint mechanisms of the group to which the overseas shareholder belong.

11. Service Outsourcing

Overseas asset management institutions usually outsource their middle and back office activities such as TA, FA, etc. to independent fund administrators. However, such outsourcing model is not popular in Mainland China. Even though few FMCs have adopted the service outsourcing model, there is no clear rules regarding the qualification, registration and filing procedures and legal liabilities of fund service providers as the regulatory authority has not promulgated any specific regulation. The promulgation of the Measures is very beneficial to the outsourcing service industry.

The Measures provide that an FMC may engage properly qualified fund service providers to handle matters such as transfer agency, accounting, valuation, investment adviser, asset appraisal, real estate project operation management, etc. for funds. Specifically:

(1) Fund service providers which can carry out transfer agency, accounting, valuation, etc. of retail funds should be financial institutions prescribed by the CSRC such as commercial banks, securities companies, etc., and subsidiaries of FMCs specializing in fund-related middle and back office services. Such institutions should have been engaging in retail fund management or custody business for at least three years before carrying out transfer agency, accounting, valuation, etc. of funds. In Mainland China, there are also some independent outsourcing service providers which are not commercial banks or securities companies but have been registered as private investment fund

service providers with the Asset Management Association of China. Such independent outsourcing service providers cannot provide TA and FA services to WFOE FMCs.

(2) Where a WFOE FMC engages a fund service provider to handle certain activities on its behalf, the WFOE FMC should make adequate assessment and make decisions prudently, ensure that the fund service provider involved in relevant activities has relevant qualification, has been registered or filed in accordance with the requirements of the CSRC, and has adopted effective measures to ensure that relevant activities are conducted in accordance with the requirements of the CSRC.

(3) A WFOE FMC should, within five working days after signing an engagement agreement with a fund service provider, report to the local securities regulatory bureau on the scope and contents of the outsourced activities, basic information of the fund service provider and its business preparation conditions, major risks and relevant risk prevention measures.

(4) A WFOE FMC should disclose the relevant information of the outsourced activities in the fund prospectuses, fund contracts, annual reports and interim reports of funds and FMC annual reports.

It is believed that the regulatory authority will soon release detailed rules on the registration and filing of fund service providers. The fund service providers will soon be subject to normalized regulation.

12. FMC Subsidiaries

The Measures supports FMCs to carry out various types of asset management businesses and asset management-related businesses by setting up a domestic subsidiary. Specifically:

(1) A WFOE FMC may set up a domestic subsidiary to engage in the following businesses:

(a) Retail fund management (specializing in the management of index funds, FOF, pension investment products, REITs)

(b) Management of private equity investment (PE) funds

(c) Investment adviser

(d) Pension financial services

(e) Distribution of financial products

(f) Transfer agency, valuation, and accounting (TA/FA)

(2) To establish a domestic subsidiary, a WFOE FMC should meet the following conditions:

(a) The net assets of the WFOE FMC should be no less than RMB600 million.

(b) The quarterly average AUM of actively managed equity retail funds (excluding index funds) of the WFOE FMC in the last two years should be no less than RMB20 billion.

(c) The WFOE FMC should have reasonable and effective risk disposal plans, etc.;

(d) The WFOE FMC should hold a 100% equity interest in its subsidiaries (except for the subsidiary specializing in REITs business).

13. Financial Indicators of A WFOE FMC

A WFOE FMC should attend to satisfy the following financial indicators during its operation:

(1) The total debts of the WFOE FMC should not exceed 100% of its net assets;

(2) If the net assets of a WFOE FMC are less than RMB50 million, or its current assets such as cash, bank deposits and treasury bonds that can be used are less than RMB20 million and less than its operating expenditure of the preceding fiscal year, the CSRC may take measures such as (a) suspend the acceptance and approval of its applications for registration of the fundraising of its products, or (b) suspend other business applications; and (c) require the WFOE FMC to improve its financial conditions within a specified period of time; and, in case the WFOE FMC's financial conditions keep deteriorating, (d) suspend its business for rectification.

14. Foreign Related Matters

According to the Measures, overseas securities regulatory authorities should not directly conduct investigation and evidence collection in the PRC. Without the approval by the CSRC and competent authorities under the State Council, no entity or individual may provide the documents and materials relating to securities business activities overseas.

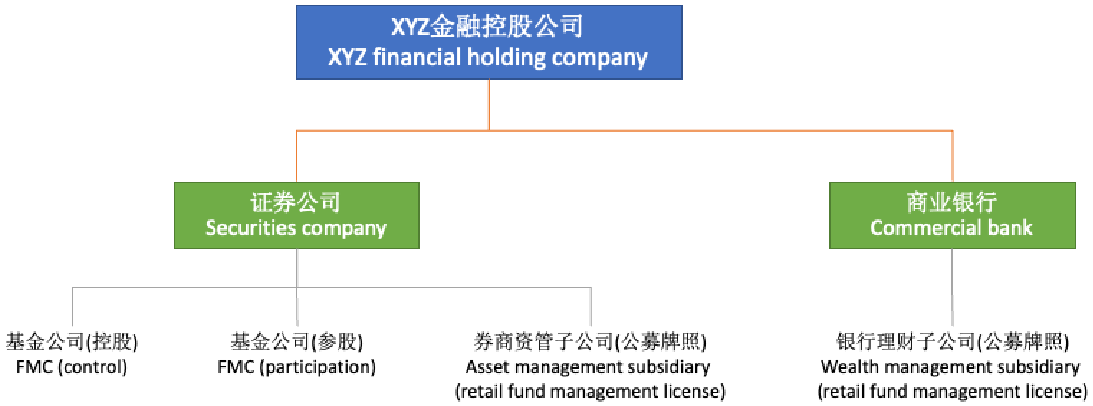
Such provision is firstly seen in the *PRC Securities Law* that took effect on 1 March 2020. However, as FMCs are not subject to the *PRC Securities Law* in respect of institutional supervision, the CSRC includes a similar provision in the Measures so that such provision on foreign related matters could also apply to retail fund managers.

Similarly, there are similar provisions in a series of recently promulgated laws relating to national security, cyber security, data security and personal information security. It can be said that such requirements have become an institutional arrangement relating to national security. A WFOE FMC should incorporate the requirements of these provisions in the relevant legal documents, policies and procedures for information and data exchange with its overseas shareholder and overseas related parties.

15. Impact of the Measures on the Competitive Landscape of the Industry

According to the Measures, China will establish a retail fund business license management system of "one participation, one control, multiple retail fund management licenses".

According to the Measures, any wealth management subsidiary of a commercial bank, insurance asset management company or asset management subsidiary of a securities company that meets the regulatory requirements of the CSRC may apply for the retail fund management license upon the satisfaction of relevant conditions (without the need to establish another company, the applications may be submitted by the aforesaid legal entities themselves). The grant of such retail fund management license will not affect the restriction of "one participation and one control" for investing in FMCs by the group to which the aforesaid entities belong. For example:



The licensing system of "one participation, one control, multiple retail fund management licenses" may result in fiercer market competition faced by WFOE FMCs in Mainland China.

In conclusion, the Measures put forward updated requirements for applying for the establishment and operation of WFOE FMCs by overseas asset management institutions in Mainland China. We will pay close attention to the changes in regulatory supervision and market practice brought about by the Measures and will share with overseas asset management institutions any relevant information in a timely manner.

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