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Highlights of the Guidelines for Operation of Private Securities Investment Funds

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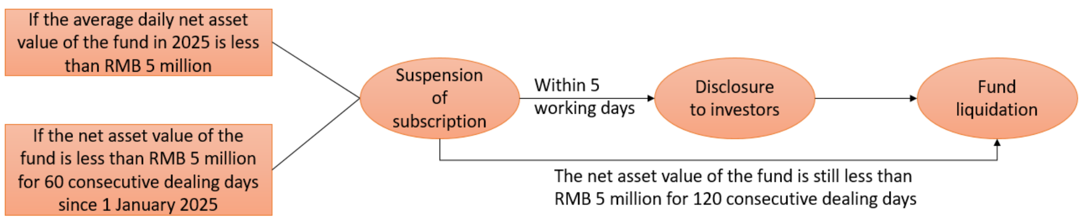
In order to strengthen the self-disciplinary management of private securities investment funds and standardize the private securities investment fund business, the Asset Management Association of China ("**AMAC**") released the *Guidelines for Operation of Private Securities Investment Funds* ("**Operation Guidelines**") on 30 April 2024. The AMAC has previously released the *Guidelines for Operation of Private Securities Investment Funds (Draft for Consultation)* ("**Operation Guidelines (Draft for Consultation)**") on 28 April 2023. After full research and consideration of reasonable feedbacks from all parties, the relevant articles in the Operation Guidelines (Draft for Consultation) have been adjusted and optimized. Besides, the Operation Guidelines focus on the implementation of the *Regulation on the Supervision and Administration of Private Investment Funds* ("**Private Fund Regulation**") released by the State Council which came into effect on 1 September 2023, and coordinate with a series of private fund regulations to be released by the China Securities Regulatory Commission ("**CSRC**"). The Operation Guidelines have a significant and far-reaching impact on the operation of private securities investment funds. The highlights of the Operation Guidelines are briefed as follows:

I. Transitional Arrangement

According to the *Announcement on the Release of the Guidelines for Operation of Private Securities Investment Funds* ("**Announcement**") issued by the AMAC, the Operation Guidelines will come into force on 1 August 2024. The private securities investment funds which complete the fund filing after the effective date of the Operation Guidelines shall comply with the requirements of the Operation Guidelines. Besides, the Operation Guidelines provide special provisions for certain circumstances as follows:

1. Failure to Meet the Minimum AUM Requirement

Article 4 of the Operation Guidelines provides the minimum AUM for a private securities investment fund, that is, if the fund AUM is less than RMB 5 million for a long time, its subscription shall be suspended and even it is subject to liquidation. The Announcement specifies that any private securities investment fund which has completed the fund filing before 1 August 2024 shall also comply with Article 4 of the Operation Guidelines, and it sets 1 January 2025 as the starting date for calculation of "less than RMB 5 million for a long time".



For an existing private securities investment fund, it is suggested that the private fund manager ("**PFM**") sort out whether the termination and liquidation events in the fund contract include a catch-all provision such as "circumstances under which the fund shall be terminated pursuant to laws and regulations". If not, it is suggested to amend the fund contract to include the circumstance of the fund AUM being below RMB 5 million for a long time as one of the trigger events for fund liquidation, so as to avoid the failure of fund liquidation when such a situation arises but the fund investors disagree to the liquidation.

2. Failure to Conduct the OTC Derivatives Transactions as Required

Article 17 of the Operation Guidelines stipulates relevant requirements from the perspective of the net asset value of products, investment ratio, margin management and investor suitability, etc. for private securities investment funds to carry out OTC derivatives business. As of 1 August 2024, if Article 17 is not met, the private securities investment fund shall not onboard new investors or extend the fund term, and except for the need to raise funds for additional margin, the private securities investment fund shall not increase fundraising scale; and shall be subject to liquidation upon expiration of the relevant contract.

If an existing private securities investment fund already engages in OTC derivatives business (especially participating in DMA-Swap business and snowball structured derivatives), it is suggested that before the implementation of the Operation Guidelines, the PFM shall review the investment operation of the fund and, as appropriate, expand the scope of asset allocation, reduce leverage and check whether there is any product investor with multiple tranche arrangement.

In addition, based on our observation, fund contracts generally do not specify the exact investment ratio and margin ratio for derivative investments, but rather provide general principles. However, if a specific ratio is agreed upon in the fund contract, it is suggested to revise the ratio in accordance with Article 17 of the Operation Guidelines. Without such revision, the private securities investment fund can only be liquidated upon expiration (and shall not onboard new investors or extend the fund term, and new fundraising is not allowed (except for the need to raise funds for additional margin)).

3. Failure to Meet the Requirements on Investment Ratio and Leverage Ratio

Articles 12, 13, 15, 16 and 19 of the Operation Guidelines stipulate the investment ratio and leverage ratio of a private securities investment fund. For a private securities investment fund that does not meet such ratio restrictions, the Operation Guidelines provide for a transition period of 24 months as follows:

Items	**Transition Period and Rectification Requirements**
Failure to meet diversified investment requirements (double 25%)	- A transition period of 24 months is granted, during which the fund can continue to open for subscription and redemption and carry out investment operations as before.

<table>
<tr><td>Failure to meet leverage ratio requirement (200% in normal circumstances and 120% in special circumstances)</td><td rowspan="3">- If the requirements are still not satisfied after the expiry of the transition period (i.e. from 1 August 2026), the fund shall not carry out new fundraising, onboard new investors or extend the fund term, and shall be subject to liquidation upon expiration of the contract.

- If the fund term is changed during the transition period, the fund contract shall be amended to provide that the requirements shall be met within 24 months since the implementation of the Operation Guidelines (i.e. to avoid evading the rectification requirements during the transition period through arbitrary extension of fund term).</td></tr>
<tr><td>Failure to meet shareholding proportion limit in a single listed company (30%)</td></tr>
<tr><td>Failure to meet investment ratio limit for bonds (double 10% and double 25%)</td></tr>
</table>

As the investment ratio is usually agreed upon in fund contracts, it is suggested that PFMs review the relevant clauses of the fund contracts: if there are any circumstances that do not comply with Articles 12, 13, 15, 16 and 19 of the Operation Guidelines, fund contracts shall be amended before 1 August 2026, otherwise the funds are subject to liquidation upon expiration (and shall not carry out new fundraising, onboard new investors or extend the fund term).

In addition, it is suggested that PFMs review the internal investment transaction and risk control policies and make supplements and improvements according to the requirements of the Operation Guidelines. Meanwhile, the statutory investment ratio control indicators under the Operation Guidelines shall be embedded in the relevant systems and business processes of investment risk management.

4. Fund Contracts with No Fixed Term

Private securities investment funds without a fixed term shall, within 24 months since the implementation of the Operation Guidelines (i.e. before 1 August 2026), amend the fund contracts in accordance with the Operation Guidelines and the AMAC provisions. If rectification is not made upon expiration, the funds shall not conduct fundraising or onboard new investors.

5. Requirements for Amendment of Fund Contracts

In accordance with Article 4 of the Announcement, in respect of the existing private funds, starting from 1 August 2024, if any amendments to the fund contracts are subject to the corresponding provisions in the Operation Guidelines, the fund contracts shall be amended in accordance with the Operation Guidelines.

II. Regulatory Requirements for Fundraising and Marketing of Private Securities Investment Funds

1. Clarification That Risk Tolerance Capability of Private Securities Investment Fund Investors Shall Not Be Lower Than the Fund Risk Rating

Previously in the fundraising of private fund, investors are divided into professional investors and ordinary investors, professional investors are not required to undergo risk assessment, and theoretically professional investors could purchase fund products of any risk rating. Ordinary investors are required to take risk assessment. If the ordinary investors take the initiative to purchase the fund products which do not match their risk tolerance capability, the PFMs may sell the relevant fund products to the ordinary investors after performing special notification and warning procedures (i.e. mismatch is conditionally allowed). Article 5 of the Operation Guidelines provides that "the risk tolerance capability of private securities investment fund investors shall not be lower than the risk ratings of the funds", which aligns the investor suitability management requirements of private securities investment funds with those of private asset management ("**PAM**") business, i.e. no mismatch is allowed.

According to the *Administrative Measures on Suitability of Securities and Futures Investors* (CSRC Decree No. 130) issued by the CSRC, ordinary investors shall be subject to risk tolerance test and the grading of risk tolerance capability, while professional investors may but are not required to undergo the grading of risk tolerance capability. In light of this, "the risk tolerance capability of private securities investment fund investors shall not be lower than the risk ratings of the funds" as provided in Article 5 of the Operation Guidelines mainly applies to ordinary investors who are required to take risk assessment.

Based on our observation, there is a practice pattern in the PAM business where professional investors provided in Items 1, 2 and 3 of Article 8 of the *Administrative Measures on Suitability of Securities and Futures Investors* (including financial institutions, products issued by financial institutions, pension funds and charity funds, etc.) are usually not subject to risk assessment. However, some managers of PAM schemes may carry out risk assessment towards professional investors provided in Items 4 and 5 of Article 8 of the *Administrative Measures on Suitability of Securities and Futures Investors* (i.e. general institutions and natural persons whose assets and investment experience have reached certain threshold) and prohibit mismatch. When implementing Article 5 of the Operation Guidelines, PFMs may also consider drawing on the aforesaid practice for the purpose of prudence if necessary.

In order to comply with Article 5 of the Operation Guidelines, PFMs need to optimize the fundraising process of private funds. It is suggested to pay attention to the following points at least:

(1) To update the investor forms in accordance with the latest requirements, and remove the notifications and warning documents relating to mismatching;

(2) To update the internal policies, operation specifications and online fundraising process (for instance, online fundraising through APP) with respect to fundraising of private funds in accordance with the latest requirements;

(3) To review the agreements or other documents signed with distributors, and modify the investor suitability management standards agreed therein if they are inconsistent with Article 5 of the Operation Guidelines;

(4) If online signing procedure is adopted for fundraising of private fund, to communicate with relevant electronic contract signing service providers to confirm whether the template documents used for online signing procedure need to be updated.

2. Standardizing the Disclosure of Private Securities Investment Funds' Performance

Article 6 of the Operation Guidelines regulates in detail the marketing and disclosure of the performance information of private funds.

Items	**Specific requirements**
Principle requirements	Objectivity, authenticity, accuracy and completeness
Contents of disclosure	At least including the complete historical net asset value, historical AUM, investment strategy and portfolio manager, etc., during the fund term
Recipients of disclosure	- Qualified investors that have undergone the process for identifying specific targets; - Qualified fund evaluation institutions (list disclosed on the official website of AMAC: https://www.amac.org.cn/fwdt/wyc/jgcprycx/jgcx/xjjjpjjgml/) - Shall not disclose net asset value of the fund and other performance-related information to institutions or individuals that do not have an engagement relationship for private securities investment fund distribution
Requirements on displaying and delivering	Only PFMs and fund distributors with which fund distribution agreements have been signed may display and deliver the net asset value of the fund.
Prohibited actions	- Shall not use the past performance of any private securities investment fund with an AUM of less than RMB 10 million or established for less than six months for marketing, distribution or ranking - Shall not selectively display part of performance of the private securities investment fund or the performance of the private securities investment

	fund during certain operating periods for the purpose of misleading investors - Shall not display the fund performance not reviewed by private fund custodians - Shall not rank the fund performance with a period of less than six months If the fund investors only include the PFM or its shareholder, partner, actual controller or employee, the PFM and fund distributor shall also disclose such information when marketing, distributing or ranking the fund

Article 6 of the Operation Guidelines allows only PFMs and fund distributors to display or deliver the net asset value and other performance information of a fund. The current practice of third-party institutions displaying or ranking fund performance information will be effectively regulated, which will help guide investors to focus on long-term performance and strengthen the management of investors' short-term investment.

To comply with Article 6 of the Operation Guidelines, private fund manages shall pay attention to the following matters:

(1) To update internal policies and operation specifications with respect to marketing of private funds in accordance with the latest requirements;

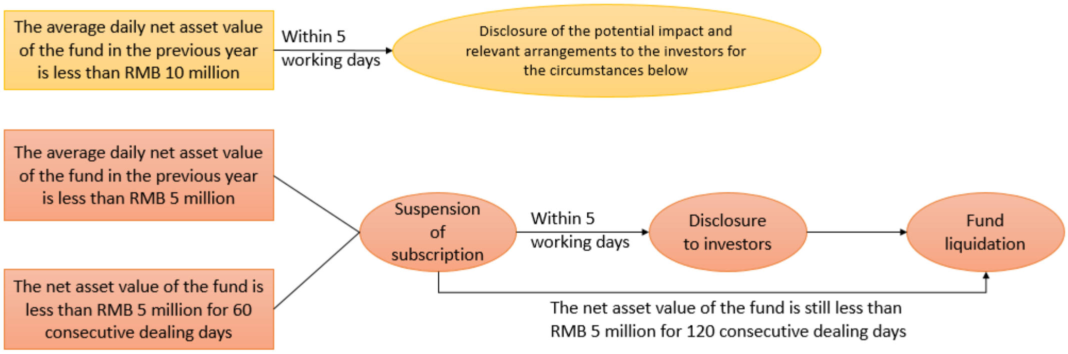
(2) To improve the template of marketing materials of private funds and strengthen the review of marketing materials;

(3) To strictly manage and control disclosure of the fund performance information.

3. Requirements on Initial Fundraising Size and Ongoing Fund AUM

The Operation Guidelines inherit the requirement in the *Measures for Registration and Filing of Private Investment Funds* ("**Registration and Filing Measures**") that the initial paid-in capital raised for a private securities investment fund shall be no less than RMB 10 million, and emphasize that investors shall not evade the aforesaid requirement by means of redemption in a short term.

On top of the above, the Operation Guidelines also specify the requirements on the minimum AUM of a private securities investment fund on an ongoing basis, as shown in the chart below.



Note: If a private securities investment fund has been established for less than one year, the average daily net asset value of the fund in the previous year is calculated for the period commencing from the establishment date of the fund to the end of the previous year.

Where a PFM has more than one private securities investment fund with the net asset value of less than RMB 10 million, the AMAC may require the PFM to make explanations. If it is found that multiple funds fail to actually carry out investment business and there is no reasonable explanation, the AMAC may suspend the filing of its private funds according to relevant provisions.

4. Arrangement for Fund Term, Dealing Period and Lock-up Period

Article 7 of the Operation Guidelines explicitly stipulates the requirements on fund term, dealing period and lock-up period of a private securities investment fund.

Type of fund	**Fund term**	**Dealing period**	**Lock-up period for unitholding**
Open-ended private securities investment funds	Consistent with the existing regulations, i.e. the fund term shall be reasonably determined and shall not be permanent	- Open for the subscription and redemption once a week at most, and each opening shall not last for more than 2 days - If the total investment in the credit bonds (excluding convertible bonds) rated AA or below and the liquidity-restricted assets[1] exceed 20% of the net asset value of the fund, the fund shall open for subscription and	- Setup of a lock-up period for unitholding of no less than 3 months, or short-term redemption fee arrangement corresponding to the fund unitholding period (redemption fee charged shall be attributed to the fund assets)

[1] The term "liquidity-restricted assets" is defined in Article 41 of the Operation Guidelines. The same below.

		redemption once a quarter at most and each opening shall not last for more than 5 days	- Where a PFM and its employees invest in the fund under its management, the lock-up period shall be no less than 6 months
Closed-ended private securities investment funds	No less than one year, and shall provide regular dividend distribution	/	/

III. Regulatory Requirements for Investment Operation of Private Securities Investment Funds

1. Explicit Prohibition on Channel Business

The Operation Guidelines emphasize that PFMs shall perform fiduciary duties, and for the first time, explicitly state that channel business shall not be conducted. The AMAC has often mentioned the prohibition on channel business in the past case reports, new rules training and regulatory practice. Through the Operation Guidelines, it is the first time for the AMAC to formally and explicitly impose such requirement at the level of self-disciplinary rules, and the Operation Guidelines specify two common types of channel business:

(1) “Transfer” of management discretion under which the investor or third party gives investment instructions or takes charge of investment operation;

(2) Providing investors, securities issuers, financial institutions, other PFMs, asset management products, other private funds and other third parties with channel services to evade regulatory requirements such as investment scope, leverage restrictions and investor criteria.

2. Reiteration of Prohibition on Multi-layered Nesting Structure

The Operation Guidelines reiterate the prohibition on multi-layered nesting structure, and emphasize that where a private securities investment fund accepts the investment from other private funds and asset management products, or invests in other private funds and asset management products, it shall comply with the investment layer requirements stipulated by laws, administrative regulations and CSRC.

3. Clarification of Product Type

<table>
<tr><th>Product type</th><th>Definition</th><th>Note</th></tr>
<tr><td>Fixed-income private securities investment fund</td><td>A fund whose investment in deposits, bonds and other debt assets is not less than 80% of the invested assets of the private securities investment fund</td><td rowspan="5">The invested assets do not include cash management instruments.[2]</td></tr>
<tr><td>Futures and derivatives private securities investment fund</td><td>A fund whose notional value of positions of futures and derivatives is not less than 80% of the invested assets of the private securities investment fund, and the interests in the futures and derivatives account exceeds 20% of the invested assets of the private securities investment fund</td></tr>
<tr><td>Equities private securities investment fund</td><td>A fund whose investment in stocks and other equity assets is not less than 80% of the invested assets of the private securities investment fund</td></tr>
<tr><td>Hybrid private securities investment fund</td><td>A fund whose investment in fixed-income, equities, futures and derivatives assets does not reach the standards for the aforesaid three types of funds</td></tr>
<tr><td>Private securities investment FOF</td><td>A fund whose portfolio investment in other securities investment funds is not less than 80% of the invested assets of the private securities investment FOF</td></tr>
</table>

Currently, the classification of private funds mainly refers to the criteria listed in the *Explanations of the "Fund Type" and "Product Type" of Private Investment Funds* released by the AMAC long ago. The Operation Guidelines refine the classification of private securities investment funds so that the classification of private securities investment funds is basically in line with that of asset management products of financial institutions. Based on the classifications in the Operation Guidelines, the following points are worthy of attention:

(1) For calculating the investment ratio, the denominator is "invested assets" (excluding cash management instruments), different from the denominator of "total assets" in PAM business. The calculation method in the Operation Guidelines is expected to ensure that each stage of investment and each investment of a fund matches as closely as possible with its product type, including during the ramp-up period. The *Explanations of the "Fund Type" and "Product Type" of Private Investment Funds* do not specify the denominator when defining "equities fund" and "fixed-income fund", and in practice, the denominator is usually the total asset. After the implementation of the Operation Guidelines, PFMs, private fund custodians or relevant service providers may be required to upgrade the system and update the business process to ensure the compliance with the Operation Guidelines.

[2] According to the definition in Article 41 of the Operation Guidelines, cash management instruments refer to cash management instruments recognized by the CSRC, such as demand deposits, China government bonds, central bank bills, policy bank bonds, local government bonds and money market funds.

(2) In line with the regulatory rules in the PAM business, the Operation Guidelines also stipulate corresponding provisions for situations where the investment ratio is passively breached (i.e. passive breach). That is, where the investment ratio of a private securities investment fund does not conform to the provisions of the Operation Guidelines or the fund contract due to the impact of factors beyond the control of the PFM such as fluctuations in the securities and futures market, merger of securities issuers and changes of AUM of the private securities investment fund, the PFM shall make adjustment to comply with the relevant requirements within 20 dealing days. Where the aforesaid adjustment cannot be completed due to liquidity constraints of assets, the PFM shall make adjustment to comply with the requirements within 20 dealing days from the date when the relevant assets can be sold, transferred or resumed for trading.

4. Investment Ratio Requirement

For a long time, private securities investment fund industry has lacked regulations on diversified investment. The Operation Guidelines, which for the first time impose requirements on diversified investment of private securities investment funds, will have a significant impact on the investment operation of private securities investment funds.

(1) Diversified Investment Requirement (Double 25%)

$$\frac{\text{Investment in the same asset by a single private securities investment fund}}{\text{The net asset value of a single private securities investment fund}} \leqslant 25\%$$

Figure 1

$$\frac{\text{Investment in the same asset by all the private securities investment funds managed by a private fund manager}}{\text{The same asset}} \leqslant 25\%$$

Figure 2

In accordance with Article 22 of the Operation Guidelines, when calculating the above double 25% limit, the investment ratio may be calculated by adopting the lower of the purchase cost or market value. This approach, while emphasizing the diversification of investment risks, also allows some flexibility for the investment by private securities investment funds.

(a) Exemptions

Exemption from the application of double 25% limit in both of Figure 1 and Figure 2	**Exemption from the application of the 25% limit in Figure 2**
- Investment in cash management instruments, general bond pledge-style repurchase, mutual funds and other	Private securities investment funds that

investment instruments recognized by the CSRC and the AMAC - Closed-ended private securities investment funds of which the fund contracts provide that the fund shall only invest in the shares of a listed company by way of strategic placement, non-public offering, block trades and transfer by agreement, and all the investors are professional investors, and the investment amount of a single investor is no less than RMB 3 million (determined on a look-through basis) (e.g. closed-ended funds participating in private placement) - A fund of which the fund contract provides that more than 90% of the fund assets invest in a single private fund satisfying the diversified investment requirements (feeder-master structure) - Closed-ended private securities investment funds whose investors are all professional investors, and the investment amount of a single investor is not less than RMB 10 million (determined on a look-through basis)	comply with the diversified investment requirements in Figure 1 may be exempt from the investment limitation shown in Figure 2 when investing in a single private fund.

(b) Identification of the Same Asset

Type of asset	**Identification standard**
Standardized equity assets	Shares and depository receipts publicly issued by a single listed company shall be deemed as the same asset
Standardized debt assets	Single bond, central bank bill, asset-backed securities and debt financing instruments of non-financial enterprises shall be deemed as the same asset
Non-standardized debt assets	Such as principal-guaranteed income certificates, pledge-style quotation-based repurchase, pledge-style repurchase on a negotiated basis and standardized notes issued by a securities company. Non-standardized debt assets of the same “financing entity” and its related parties shall be deemed as the same asset
Fund Assets	Single securities investment fund or asset management product shall be deemed as the same asset
Standardized Futures and Derivatives Assets	Single future contract or option contract shall be deemed as the same asset

OTC derivative assets	- OTC options and non-principal-guaranteed income certificates issued by a securities company which have the same "counterparty" shall be deemed as the same asset - Return swaps: the same asset shall be determined according to the specific assets to which the contracts are linked

It is worth paying attention to:

(i) The "look-through" regulatory requirement applies in the PAM business. Where a PAM scheme invests in other asset management products, calculation on a look-through basis is required, including (i) when calculating the total asset of such PAM scheme, the total asset of the invested asset management products shall be calculated on a look-through basis; and (ii) when calculating the investment ratio in the same asset, it shall be calculated on an aggregated and look-through basis. The Operation Guidelines do not specify the verification requirement on a look-through basis, and investment in a single securities investment fund or asset management product shall be deemed as the same asset.

(ii) The Operation Guidelines are silent on how to calculate the corresponding ratios for standardized futures, options and OTC derivative assets. Referring to the practice in the PAM business, for standardized futures and option assets, the proportion of margin is usually adopted for calculation.

(2) Investment Ratio Limit for a Single Stock (30%)

$$\frac{\text{A single stock held by the private securities fund managers controlled by the same actual controller (including investment with proprietary funds + self-managed products + investment advisor products) on an aggregated basis}}{\text{The outstanding shares of a single listed company}} \leqslant 30\%$$

Figure 3

(3) Investment Ratio Limit for Bonds

Private securities investment funds that involve bond investments are subject to further tightened investment ratios as stipulated by the Operation Guidelines which is shown as below. It is worth noting that China government bonds, central bank bills, policy bank bonds, local government bonds, convertible bonds, exchangeable bonds and other investment instruments recognized by the CSRC and the AMAC may be exempted from the following investment ratio limits.

(a) Investment ratio limit for the same bond (double 10%)

$$\frac{\text{Investment in the same bond by a single private securities investment fund}}{\text{Net asset value of a single private securities investment fund}} \leqslant 10\%$$

Figure 4

$$\frac{\text{Number of the same bond held by all the private securities investment funds managed by a private fund manager}}{\text{Outstanding Number of the same bond}} \leqslant 10\%$$

Figure 5

It is worth noting that the benchmark for assessment in Figure 5 is the number of bonds instead of the investment amount in the same bond. In addition, the Operation Guidelines exempt the passive breach caused by the change in number of bonds, i.e. exemption for the circumstance where the issuer exercises its call option or conducts bond buyback, and other holders exercise their put option.

(b) Investment ratio limit for the bonds issued by the same issuer and its related parties (double 25%)

$$\frac{\text{Investment by a single private securities investment fund in the bonds issued by the same issuer and its related parties in aggregate}}{\text{Net asset value of a single private securities investment fund}} \leqslant 25\%$$

Figure 6

$$\frac{\text{Total number of bonds issued by the same issuer and its related parties held by all the private securities investment funds managed by private fund managers under the control of the same actual controller}}{\text{Outstanding number of the relevant bonds}} \leqslant 25\%$$

Figure 7

(c) Other investment ratio limits

When a private securities investment fund conducts bond pledge-style repurchase on a negotiated basis, (a) the aforesaid limit of double 10% and double 25% shall apply to the concentration of a single bond pledged or accepted for pledge; (b) the amount of repurchase transactions with a single counterparty shall not exceed 10% of the net asset value of the fund.

In addition, pursuant to Article 22 of the Operation Guidelines, when calculating the ratio limits listed in the above Items (1), (2) and (3), the investment ratio can be calculated based on the lower of purchase cost or market value. While emphasizing the diversification of investment risks, the Operation Guidelines provide some flexibility for the investment by private securities investment funds.

(4) Leverage Ratio Requirement

The Operation Guidelines inherit the 200% leverage ratio requirement, requiring that the total asset of a private securities investment fund shall not exceed 200% of the net asset of the fund.

Meanwhile, the Operation Guidelines explicitly emphasizes that it is not permitted to evade leverage restrictions through OTC derivatives and other instruments.

On the basis of above, the Operation Guidelines further refine the arrangements for risk prevention and control. Where the total investment by a private securities investment fund in the credit bonds rated AA or below (excluding convertible bonds) and the liquidity-restricted assets exceed 20% of its net asset value, the total asset shall not exceed 120% of the net asset value of such fund, except for the closed-ended private securities investment funds whose investors are all professional investors and the investment amount of a single investor is not less than RMB 10 million (determined on a look-through basis).

(5) Exemptions for Passive Breach

The Operation Guidelines not only stipulate various investment ratio requirements for the private securities investment funds, but also provide the exemptions for passive breach. That is, where the investment ratio of a private securities investment fund does not conform to the provisions of the Operation Guidelines or the fund contract due to the impact of factors beyond the control of the PFM such as fluctuations in the securities and futures market, merger of securities issuers and changes of AUM of the private securities investment fund, the PFM shall make adjustment to comply with the relevant requirements within 20 dealing days. Where the aforesaid adjustment cannot be completed due to liquidity constraints of assets, the PFM shall make adjustment to comply with the requirements within 20 dealing days from the date when the relevant assets can be sold, transferred or resumed for trading.

5. Requirements for Bond Investments

In order to prevent the credit risks of bond investments, since last year, the AMAC has strengthened its focus on the filing of private securities investment funds involving bond investments. It has paid more attention to the concentration of underlying investments, risk control measures for investment in bonds, whether the products under management encounter any downgrade in bond ratings or potential risk of redemption, and whether the PFM has disclosed the relevant risks to investors. The Operation Guidelines, in light of the feedbacks given in fund filing cases, clearly stipulate the requirements for bond investments. In addition to the specific investment ratio limit in respect of investment concentration, the Operation Guidelines also stipulate the requirements on bond investments in respect of risk management and avoidance of transfer of improper benefits, including:

(1) Prudently and reasonably setting up risk control indicators such as the concentration level of the issuers and their regions and industries, price deviation, leverage ratio, issuer rating and issue rating;

(2) Promptly making disclosures to the investors as provided in the fund contracts, and reporting to the securities trading venues as required in the event of any abnormality in any of the indicators such as price deviation;

(3) Emphasizing that the PFMs and their related entities shall not participate in the structured issuance of bonds, shall not be involved in the bond holding on behalf of others, and shall not receive, directly or in disguised forms, fees or deposits paid by the bond issuers and third parties for underwriting services, consulting services, etc.

6. Special Requirements for OTC Derivatives

The Operation Guidelines put forward relevant requirements from the perspective of the net asset value of products, investment proportion, margin management and investor suitability, etc. for private securities investment funds to carry out OTC derivatives business. Among these, certain rules are reiterations of the relevant regulations on the derivatives management (such as the *Administrative Measures for the OTC Option Business of Securities Companies* and the *Administrative Measures for the Return Swap Business of Securities Companies)*, and some new requirements are put forward in order to reduce leverage and prevent risks of private securities investment funds. Please refer to the table below for details:

Type of transaction	**Requirements of the Operation Guidelines**	**Existing rules**
Execution of OTC option contracts with counterparties	Net asset value of the fund ≥ RMB 50 million (except for trading of commodity OTC option transactions only)	If the products participate in the OTC option business, the size of the products shall not be less than RMB 50 million; if a single investor holds more than 20% of the product among the clients after the penetration, such investor shall meet the basic standards for professional investors specified in the *Administrative Measures for the Suitability of Securities and Futures Investors*, have financial assets of no less than RMB20 million at the end of the last year, and have more than three years of investment experience in securities, funds, futures, gold, foreign exchange, etc.
	The total OTC option trading margin and premium paid to **all the counterparties** shall not exceed 25% of the net asset value of the fund	The total of the option premium and initial margin paid for the purchase of OTC options shall not exceed 30% of product size.

Execution of return swap contract with counterparties	Net asset value of the fund ≥ RMB 10 million	The current regulations for private funds require that the initial fundraising size shall be no less than RMB 10 million.
	The margin paid to the counterparty for the participation in equity return swaps linked to equity securities or equity indexes shall be no less than 50% of the notional principal of the contract (We understand that the purpose of this article of the Operation Guidelines is to increase the margin ratio in the DMA-Swap. For the regular return swap business, if the existing rules of the securities company have higher ratio requirements, such requirement shall still be complied with.)	Where a securities company conducts equity return swap with a single counterparty and meet certain conditions (satisfying certain conditions of diversification, correlation and exposure of the underlying assets, with the most typical business type being the DMA-Swap business), the margin charged by the securities company from a single counterparty shall cover risk exposure of the transaction or derivatives, and shall not be less than 25% of the higher notional principal of long or short position with a single counterparty. Except for the above specific circumstances, the following rules shall be applied: - If the underlying assets are equities, narrow-based equity indexes and related products, and credit bonds, the margin charged by the securities company from a single counterparty shall not be less than 100% of the notional principal of the contract (unless otherwise specified); - If the underlying assets are broad-based equity indexes and related products and there is no corresponding futures contract, the margin charged by the securities company from a single counterparty shall not be less than 50%; if there is a corresponding futures contract or centralized trading product, the margin charged by the securities company from a single counterparty shall not be less than the margin corresponding to the same variety of futures or centralized trading product.
Participating in the OTC options	The notional principal of the contract shall not	The regulators have strictly regulated and controlled the risks of snowball products. At

or income certificates with knock-in and knock-out structures (such as snowball structured derivatives) issued by securities companies and other institutions	exceed 25% of the net asset value of the fund, except for the closed-ended private securities investment fund whose investors are all professional investors and the investment amount of a single investor is not less than RMB 10 million (determined on a look-through basis)	present, the 25% ratio requirement has been implemented in the field of PAM business. The Operation Guidelines impose the same requirements for private securities investment funds

(1) No Multiple Tranche Arrangement for Private Securities Investment Funds and Their Investors

This requirement has already been reflected in the rules of OTC derivatives transactions of securities companies. Both the *Administrative Measures for the OTC Option Business of Securities Companies* and the *Administrative Measures for the Return Swap Business of Securities Companies* require that the products conducting such business shall be non-structured products established in compliance with the relevant regulations. However, the Operation Guidelines also put forward corresponding requirements for the investors of the products. Therefore, if a private securities investment fund participates in OTC derivatives transactions, as part of the investor suitability management, it shall be required to additionally verify whether investors have any multiple tranche arrangement.

(2) Emphasis on the Suitability Management of Derivatives Transactions and Prohibition on Provision of Channel Services by Private Securities Investment Funds

The Operation Guidelines stipulate that it is not allowed to dissimilate OTC derivatives transactions to leveraged financing instruments for exchange-traded instruments such as stocks and bonds, provide channel services to fund distributor to sell OTC derivatives with specific structures to natural person investors, and provide channel services to investors to evade the requirements of OTC derivatives transactions.

Given the high risks associated with OTC derivatives transactions, the regulators have always emphasized the importance of the suitability management of investors engaging in OTC derivatives transactions. For example, ordinary investors are not allowed to participate in OTC option transactions or return swap business, and only qualified professional institutional investors are allowed. In the past practice, there were cases where products distributed by securities companies (including those invested by individual investors), via the private funds, fully invest in snowball structured derivatives issued by the securities companies as the counterparty (the Public Disclosure of Private Fund Filing Cases (2022 Issue No. 2, Total No. 3 published by the AMAC reported on relevant cases). Such products carry out channel business for the purpose of regulatory arbitrage, which is contrary to the requirements that PFMs shall carry out active investment management, and the AMAC has taken the measures not to file such private funds. The Operation Guidelines clarify the relevant regulatory requirements as reported in the case report.

7. Requirements for Conducting Program Trading

Article 21 of the Operation Guidelines sets out requirements for private securities investment funds that mainly engage in program trading. Most of the provisions in the Operation Guidelines are consistent with the provisions in the *Administrative Provisions on Program Trading in Securities Market (Trial) (Draft for Consultation)* recently issued by the CSRC. In addition, the Operation Guidelines put forward several new requirements:

(1) PFMs shall establish and effectively implement business procedures for the research and development, testing, verification, compliance review and launch of program trading strategies. Therefore, when implementing new strategies, PFMs engaging in program trading shall pay attention to the completeness of business procedures (with a focus on the early involvement of compliance review), so as to ensure the subsequent effective implementation of the strategies;

(2) PFMs shall establish risk control system for investment transactions, such as liquidity, concentration of shareholding, leverage, trading frequency, cash-futures matching, style factor exposure and instantaneous large-amount transactions and implement the same effectively. We suggest that PFMs engaging in program trading should review and update the relevant policies for investment transactions and risk control;

(3) PFMs shall keep historical trading records, written descriptions of algorithms or strategies and other investment decision-making and transaction-related materials, and the retention period is extended from 10 years (as required by the AMAC for the retention period of fund investment business materials) to 20 years, starting from the date of the completion of fund liquidation.

8. Refinement of the Duties of Private Fund Custodians

To ensure the standardized operation of private securities investment funds, the Operation Guidelines take into account past practices and refine the duties of private fund custodians in the following aspects:

(1) The Operation Guidelines emphasize that securities funds shall be held in custody, and restate the duties of private fund custodians, such as net asset value review and monitor of investment operations.

(2) The Operation Guidelines detail reporting requirements for private fund custodians. Where a private fund custodian finds that the investment and operation of a private fund violates the relevant regulations or the fund contract, the private fund custodian shall immediately notify the PFM, report to the CSRC and the AMAC within **5 working days**, and reject the investment operation instructions that have not yet been implemented.

(3) To facilitate private fund custodians in fulfilling duties of investment supervision and valuation review, the Operation Guidelines provide legal safeguard for how private fund custodians can obtain relevant materials / information when private securities investment funds participates in OTC transactions.

(a) Where a private securities investment fund participates in OTC derivatives transactions, the PFM shall, before the next valuation day of the fund, provide the private fund custodian with information on the OTC derivatives transactions and transaction documents. Besides, when a PFM signs an OTC derivatives transaction document, it shall explicitly authorize the counterparty and the clearing house of the relevant transaction to directly provide the private fund custodian with the OTC derivatives transaction documents before the next valuation day of the fund, and provide valuation information on a continuous basis.

(b) Where a private securities investment fund conducts bond pledge-style repurchase on a negotiated basis, the PFM shall, before the next valuation day of the fund, provide the private fund custodian with the transaction documents, counterparties, pledge subjects and other information for participation in bond pledge-style repurchase on a negotiated basis.

In addition, for a private securities investment fund which is the underlying investment of other private funds, in order to avoid information asymmetry, the Operation Guidelines require that the PFM of the underlying private securities investment fund shall authorize its private fund custodian to directly provide the reviewed fund valuation information to the custodians of the private funds which are the investors of the underlying private securities investment fund.

(4) The Operation Guidelines emphasize the need to supervise the liquidation process of a private fund, including the case where the fund AUM is less than RMB 5 million for a long time, the private fund custodian shall supervise the PFM in liquidating the fund in a timely manner as required; and the case where the fund enters the liquidation process, the private fund custodian supervises the fund in not making any new fundraising or investment.

Fund contracts of private funds generally contains provisions on the duties and duty boundaries of private fund custodians as well as the process of information exchange between private fund custodians and PFMs or other parties. PFMs and private fund custodians are advised to update and enhance relevant clauses based on the above provisions of the Operation Guidelines.

9. Other New Requirements Specified in the Operation Guidelines

(1) The Guidelines for Filing of Private Investment Funds 1-Private Securities Investment Funds ("Filing Guidelines No. 1") issued by the AMAC on 28 September 2023 has set forth specific provisions on the setting of the performance fee for private securities investment funds. On this basis, the Operation Guidelines further specify that the performance fee for private securities investment funds shall be calculated based on the overall return of a single fund unit, and shall not accrue performance fee respectively for different strategies of the same fund.

(2) In principle, open-ended funds shall not set warning lines and stop-loss lines. The AMAC has emphasized in the past that the warning lines and stop-loss lines shall be set in a prudent manner. The Operation Guidelines take a negative attitude towards the design of warning lines and stop-loss lines for open-ended funds for the first time.

(3) The fund contract shall clarify the redemption gates and consecutive redemption gates.

According to the *Guidelines on Fund Contracts of Private Investment Funds No. 1 (Guidelines on Content and Format of Fund Contracts of Contractual Private Funds)* issued by the AMAC, the fund contracts shall expressly specify the determination and handling methods of redemption gates. The Operation Guidelines further provide in detail that the fund contract of an open-ended private securities investment fund shall expressly specify matters such as the threshold for determining redemption gate and consecutive redemption gates of the fund, redemption sequence, determination of redemption price, payment of redemption proceeds, method of notifying investors, and pre-registration of application for large redemption by investors. Upon the occurrence of any of the aforesaid circumstances, liquidity management measures, such as deferring the processing of the gated redemption applications, suspending the acceptance of redemption applications, delaying the payment of redemption proceeds, and charging short-term redemption fee, may be adopted according to the fund contract.

We suggest that PFMs check fund contracts to see if there is any missing content. For example, according to our observation, currently fund contracts seldom specify pre-registration of application for large redemption, which needs to be supplemented in the future.

IV. Requirements on Operation of PFMs

Under the framework established by the Private Fund Regulation and Registration and Filing Measures, the Operation Guidelines reiterate the requirements on operation of PFMs and further refine the relevant operational rules, so as to ensure that PFMs are able to "develop and improve corporate governance, internal control, compliance management and risk management systems, formulate reasonable and stable investment strategies, and ensure that the business development matches capital strength, investment management capability, information technology and risk control ability, and effectively prevent and control risks", specifically:

1. Improvement of the Internal Mechanism for Preventing Conflicts of Interest and Transfer of Improper Benefits

   (1) According to Article 31 of the Operation Guidelines, PFMs shall establish the management policies for declaration, registration, examination and disposal in respect of personal dealing in **securities, private funds, etc.** by practitioners and the code of integrity practices. On the one hand, Article 31 of the Operation Guidelines, with respect to private securities fund sector, echo Article 26 of the Private Fund Regulation, which requires PFMs to "establish the management policies for declaration, registration, examination and disposal in respect of personal dealing by practitioners". On the other hand, Article 31 of the Operation Guidelines is a supplement to Article 10 of the *Guidelines for Registration of Private Fund Managers No.1 – Basic Requirements for Business Operation* ("**Registration Guidelines No. 1**"), which requires that PFMs must have the policies on declaration of securities trading by practitioners. The Operation Guidelines clarify in detailed provisions that the personal dealing declaration policies of PFMs shall cover at least two types of investment instruments, namely securities and private funds.

   (2) Article 32 of the Operation Guidelines, to a certain extent, reflects the consistent regulatory requirements on PAM business, specifically:

      (a) Paragraph 1 of Article 32 of the Operation Guidelines requires PFMs to establish the fair trading policy and the mechanism to monitor abnormal transactions in respect of their day-to-day transactions, which reflects further enhancement of the AMAC's regulation on transactions conducted by PFMs. The fair trading policy has been required in the *Announcement on Certain Matters Concerning Further Regulating the Registration of Private Fund Managers* and the Registration Guidelines No. 1, while the Operation Guidelines, for the first time, explicitly set out the requirement on monitoring abnormal transactions of private securities investment funds at the level of AMAC's self-disciplinary rules. Previously, the mechanism to monitor abnormal transactions is mainly required in relevant rules governing PAM business. The Operation Guidelines impose the requirement on monitoring abnormal transactions in private fund business which is aligned with the requirement in PAM business.

         Although the Operation Guidelines set out the requirement on monitoring abnormal transactions of private securities funds for the first time, in practice, the mechanism to monitor abnormal transactions has long been an indispensable part of risk control in investment of private funds. Both stock exchanges and futures exchanges regulate the abnormal transactions conducted by investors. The requirement in the Operation

Guidelines that PFMs shall establish the mechanism to monitor abnormal transactions aims to regulate investment operation behaviors from the investment side, complementing the existing regulatory framework of the exchanges.

(b) Paragraph 2 of Article 32 of the Operation Guidelines provides the requirements on day (turnaround) trading by PFMs, which strictly prohibits any day (turnaround) trading that may result in unfair trading or transfer of improper benefits. Although the Operation Guidelines impose strict restrictions on day (turnaround) trading, the Operation Guidelines also take into account the fact that PFMs may have genuine need to carry out day (turnaround) trading due to investment strategies or liquidity needs. The Operation Guidelines leave room for the aforesaid conditions, requiring the portfolio managers to provide the decision-making basis and keep records for inspection. This is also in line with the regulatory approaches in public fund business and PAM business.

(c) Paragraph 3 of Article 32 of the Operation Guidelines provides that Article 32 shall also apply to the transactions between the investment accounts for proprietary funds of PFMs and their practitioners and the private securities investment funds under their management or the asset management products to which they serve as investment advisors.

2. Restrictions on Investments with Proprietary Funds

Article 33 of the Operation Guidelines introduces the requirements on management of investments by PFMs with proprietary funds, and clarifies that employees of PFMs, natural person shareholders or partners and natural person actual controllers involving in the actual business operation after look-through as well as the funds actually controlled by the aforesaid persons shall be subject to the requirements in the preceding two paragraphs of this Article when they carry out investments in securities, private funds, etc. In accordance with Article 33 of the Operation Guidelines, the basic requirements that PFMs shall comply with when carrying out investments with proprietary funds are as follows:

(1) Carrying out investments with proprietary funds on the premise that risks are measurable, controllable and bearable;

(2) Establishing a policy on management of investments with proprietary funds and a mechanism for aligning the interests with external investors;

(3) Ensuring the safety and liquidity of the investments with proprietary funds, which shall not affect the normal operation of PFMs and private securities investment funds under their management;

(4) Effectively segregating investments with proprietary funds (investments through separate accounts, private funds or asset management products, etc.) from their private fund management business which shall be reported to AMAC as required; and

(5) Treating equally the investments with proprietary funds and the investments made by the private securities investment funds under their management or the asset management products to which they serve as investment advisors, not taking advantage of funds, information, technology, strategies or other advantages to seek improper benefits for proprietary funds, preventing conflicts of interests, and prohibiting transfer of improper benefits.

On the one hand, Article 33 of the Operation Guidelines further implements the requirement of effective segregation between investments with proprietary funds and private fund business as prescribed in the Registration and Filing Measures. On the other hand, it also reflects the requirement in the *Measures on Supervision and Administration of Private Investment Funds (Draft for Consultation)* that PFMs shall carry out investments with proprietary funds in a prudent manner. Meanwhile, the Operation Guidelines emphasize that investments with proprietary funds shall not affect the normal operation of PFMs or private securities investment funds under their management, which echoes the requirements specified in the Private Fund Regulation and the Registration and Filing Measures that PFMs shall have sound financial standing and working capital commensurate with its business type and AUM to ensure their normal operation.

3. Information Technology Development

Article 34 of the Operation Guidelines imposes the requirement on the development of information technology systems of PFMs for the first time. It further details the requirement as prescribed in Article 7 of the *Measures on Supervision and Administration of Private Investment Funds (Draft for Consultation)* that PFMs "shall have qualified **information technology systems**, security facilities and other facilities and independent business premises in relation to their private fund management business". Compared with the impact on general PFMs, this Article 34 has a more significant impact on PFMs that rely on computer technology to conduct quant trading. PFMs that engage in quant trading shall establish and maintain stable information technology systems based on their trading and business models, ensure the security of systems and data, and implement effective risk control and emergency management. Meanwhile, this Article 34 requires that the operation of the information technology systems of PFMs shall not affect the security of information systems of the securities and futures trading venues, which is the implementation of Article 45 of the *Securities Law of the People's Republic of China* that "program trading carried out through automatic generation or issuance of trading instructions by a computer program shall not affect the security of systems or the normal trading order of stock exchanges".

4. Liquidity Risk Management

Article 35 of the Operation Guidelines provides that PFMs shall, in light of market conditions and their own management capabilities, formulate and continuously update liquidity risk emergency plans, and PFMs that meet conditions such as AUM scale exceeding a certain level shall continuously establish and improve the liquidity risk monitoring, early warning and emergency response mechanism and conduct stress test at least once a quarter. What constitutes "meet conditions such as AUM scale exceeding a certain level" still begs further implementation rules promulgated by the AMAC. The requirements under this Article 35 is similar to the regulatory standards applicable to securities and futures business institutions that engage in PAM business. Article 63 of the *Administrative Measures on Private Asset Management Business of Securities and Futures Business Institutions* provides that securities and futures business institutions shall establish and improve liquidity risk monitoring, early warning and emergency response policies, and introduce regular stress test mechanism into the PAM business with the stress tests being conducted at least once a quarter. However, compared with the requirement on the PAM business, the Operation Guidelines narrow down the applicability scope of conducting quarterly stress test to the PFMs that "meet conditions such as AUM scale exceeding a certain level", which aligns with the practice of the private fund industry. For the avoidance of doubt, regardless of the AUM scale, PFMs shall formulate and continuously update liquidity risk emergency plans in light of market conditions and their own management capabilities, and clarify circumstances for triggering the plans, emergency procedures, measures, etc.

5. General Requirements on Information Disclosure

Article 36 of the Operation Guidelines only provides general provisions on the information disclosure obligations of PFMs and other information disclosure obligors, i.e. "PFMs and other information disclosure obligors shall disclose information to investors in accordance with laws, administrative regulations, rules of the CSRC and the AMAC, as well as fund contracts, and ensure the authenticity, accuracy, completeness and timeliness of the disclosed information." The specific scenarios requiring special disclosure listed by the Operation Guidelines (Draft for Consultation) (e.g. investments in foreign assets, leveraged transactions, derivatives transactions, etc.) have been removed from the Operation Guidelines. It is expected that the provisions concerning information disclosure of private funds will be revamped comprehensively on the basis of the *Administrative Measures on Information Disclosure of Private Investment Funds* promulgated by AMAC in 2016, and that may be reason that there are not detailed information disclosure requirements in the Operation Guidelines.

6. Accrual of Risk Reserves

Article 37 of the Operation Guidelines provides that PFMs that meet conditions such as AUM scale exceeding a certain level shall set aside risk reserves as required, which shall mainly be used to make up for the losses caused to private securities investment funds or investors due to PFMs' violation of laws and regulations, breach of contract, operation errors or technical failures, etc. The Operation Guidelines have not yet clarified the AUM scale and other conditions that lead to PFMs' being subject to such requirement, nor do the Operation Guidelines provide the method for accrual of risk reserves, which is expected to be clarified by the AMAC in future rules.

V. Application of the Operation Guidelines by Securities-Type QDLP Funds

QDLP funds are commonly structured as feeder-master fund. A PFM with QDLP qualification and quota launches a QDLP fund; the QDLP fund, as the feeder fund, invests substantial portion of its assets (usually more than 90%) in a single offshore fund launched and managed by the parent company or an offshore affiliate of the PFM. This structure is unable to follow the "double 25%" requirement on investment proportion set out in Article 12 of the Operation Guidelines, nor does it fall under the exemptions under item (2) of Article 13 of the Operation Guidelines that "private securities investment funds of which the fund contracts provides that more than 90% of the fund assets invest in a single private fund satisfying the diversified investment requirements stipulated in Article 12 hereof". The QDLP pilot program has been implemented in Shanghai, Shenzhen, Beijing, Tianjin, Hainan, Qingdao, Chongqing, Jiangsu, Guangdong, Ningbo and other cities for many years, while there have been a large number of QDLP fund managers and QDLP funds that adopt feeder-master structure. It is eagerly expected that the regulator will pay attention to the special features of securities-type QDLP funds, and provide clarification and guidance as soon as possible on the application of the Operation Guidelines by securities-type QDLP funds (in particular, whether the "double 25%" requirement on investment proportion can be exempted).

We also notice that Article 20 of the Operation Guidelines provides that "when investing in offshore assets, private securities investment funds shall comply with the relevant laws, regulations and business rules on cross-border investment". It is also expected that the regulator will further clarify the scope and content of the said "relevant laws, regulations and business rules on cross-border investment" (e.g., whether the regulator will issue dedicated QDLP rules).

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