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Comparative Analysis of Legal Issues in Relation to the Management of Designated Accounts

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On 29 November 2007, the CSRC promulgated the Experimental Measures on the Management of Designated Client Assets by Fund Management Companies (《基金管理公司特定客户资产管理业务试点办法》, "Experimental Measures") and the Notice on the Implementation of the Experimental Measures (《关于实施<基金管理公司特定客户资产管理业务试点办法>有关问题的通知》), which stipulate that, from 1 January 2008, fund managers can conduct their asset management business for designated clients on a one-to-one basis, namely, the business of Wealth Management of Designated Accounts. This article will analyze the legal issues related to the Wealth Management of Designated Accounts for funds by comparing the Wealth Management of Designated Accounts with securities investment funds and the securities company-oriented asset management business.

According to Article 2 of the Experimental Measures, the Wealth Management of Designated Accounts means activities of fund managers to raise capital for, or appointed as asset managers by specific clients, with commercial banks acting as asset custodians and making securities investments with the entrusted assets for the benefit of the entrusting clients. According to the Law of Securities Investment Funds of the People's Republic of China, the Experimental Measures and the Trial Measures on the Client Asset Management by Securities Companies (《证券公司客户资产管理业务试行办法》, "Trial Measures"), with reference to the Implementation Rules on the Asset Management Business of Securities Companies (Draft for Comments) (《证券公司定向资产管理业务实施细则》(征求意见稿), "Trial Measures Draft"), the Wealth Management of Designated Accounts by fund managers, securities investment funds and securities company-oriented asset management businesses mainly differ from each other as follows:

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	Wealth Management of Specific Accounts by funds	Securities Investment Funds	Securities Company -Oriented Asset Management Business
Entrusting Party	Single client with an asset value of RMB50,000,000 or more	Individual investors, institutional investors, QFIIs and other investors permitted to purchase open-ended securities investment funds by laws and regulations or the CSRC	Single client with a net asset value of RMB1,000,000 or more
Manager	Fund manager qualified for the asset management business for designated clients	Fund manager	Fund manager qualified for a client's asset management business
Custodian	Commercial bank qualified for fund custody	Commercial bank qualified for fund custody	Asset custodian (if applicable)
Legal Mode	Trust or entrustment (not specified)	Trust	Entrustment
Legal Documents	Asset management contract	Prospectus, fund contract, custody agreement	Asset management contract
Management commission	Fixed management fee and performance pay	Fixed management fee	Management pay
Type of entrusted assets	Cash and securities	Cash	Cash, equity shares, bonds, securities investment funds or other financial assets permitted by laws and regulations
Scope of investments	Equity shares, bonds, securities investment funds, instruments of the central bank, short-term financing debentures, asset-backed securities, financial derivatives and other investments stipulated by the CSRC	Listed equity shares, bonds and other securities stipulated by the CSRC	Bank deposits, bonds and bonds repurchase, equity shares, title certificates and other investments permitted by laws and regulations
Product Application	Ex-post filing	Prior approval	Ex-post filing
Way of Product Issuance	Promotion of specified plan for clients' asset management business through public media is prohibited.	Raising of securities investment funds through public sale of fund shares	Non-public offering

Since the Experimental Measures set forth relatively detailed prescriptions on the Wealth Management of Designated Accounts, this article will analyze the Wealth Management of Designated Accounts from the view of the parties to the Wealth Management of Designated Accounts and their legal relationships, based on the above comparison of the Wealth Management of Designated Accounts with securities investment funds and securities company-oriented assets management businesses.

Parties to the Wealth Management of Designated Accounts

According to the prescriptions of the Experimental Measures, the Wealth Management of Designated Accounts by funds involves three parties, namely, the asset entrusting party, the asset manager and the asset custodian.

The asset manager shall be fund managers qualified for asset management for designated clients. According to the Experimental Measures, not all fund managers capable of conducting the business of raising and managing securities investments can engage in the Wealth Management of Designated Accounts. Fund managers who intend to engage in the Wealth Management of Designated Accounts shall fulfil specific conditions and obtain the approval of the CSRC.

The asset custodian shall be commercial banks qualified for fund custody. According to the Experimental Measures, all the commercial banks capable of conducting the business of securities investment fund custodian can carry on the business of asset custody for designated clients without applying for CSRC approval. Meanwhile, in contrast to the securities company-oriented asset management business, clients who purchase wealth management services provided by fund management companies must appoint asset custodians, rather than having an option of not appointing such custodians.

The asset entrusting party shall be a single client owning assets of at least RMB50,000,000 but the Experimental Measures are silent as to the scope of such client. For example, they do not specify whether a qualified foreign institutional investor ("QFII") is within the scope of such client and whether other financial institutions, on the account of themselves or on behalf of their clients, can become a single client.

Alternative Legal Modes for the Wealth Management of Designated Accounts and Potential Problems

The Experimental Measures fail to provide for the legal modes for the Wealth Management of Designated Accounts. In our opinion, the modes of "Co-trustee", "Trust Plus Entrustment" and "Bi-entrustment" can be used in the Wealth Management of Designated Accounts by fund managers.

- Differences between Trust and Entrustment

  According to the Trust Law of the People's Republic of China, trust means that the entrusting party entrusts the entrusted party with the property rights of the entrusting party, based on its trust in the entrusted party, who shall manage or dispose of such property rights in its own name in accordance with the will of the entrusting party, for the benefit of the beneficiary or specific purposes. On the other hand, the Contract Law of the People's Republic of China defines the entrustment contract as a contract whereby the entrusting party and the entrusted party agree that the entrusted party shall deal with the affairs of the entrusting party. From the above definitions, at least the following key differences between trust and entrustment can be observed:

Differences	Trust	Entrustment (in a narrow sense, which excludes the concept of entrustment mentioned in the Trust Law)
Ownership of the entrusted property	The ownership of the property under trust shall be transferred form the entrusting party to the entrusted party.	The entrusted property shall always be owned by the entrusting party and the ownership shall not be transferred.
Nature of the entrusted property	The property under trust shall be independent from other properties of the entrusting party and the entrusted party. The creditors of the entrusting party and the entrusted party shall not claim against the property under trust.	The entrusted property shall be owned by the entrusting party, and the creditors of the entrusting party can claim against such property.
Scope of authorization	The entrusted party shall manage and dispose of the property under trust with full authorization and generally the entrusting party shall not intervene. Subject to the statutory or contractual limitations, the entrusted party shall have all the authorizations necessary and appropriate for performance of its trust obligations.	Subject to the scope authorized by the entrusting party, according to the Contract Law, the entrusting party shall have the right to terminate the entrustment at any time.
Nominal party dealing with the entrusted affairs	The entrusted party of trust shall establish legal relationships with third parties in its own name.	Generally, the entrusted party shall deal with the entrusted affairs in the name of the entrusting party.

➢ Legal structures that may be adopted for designated account management:

- "Co-trustee" mode - both the asset manager and custodian act as trustees of the asset entrusting party under the legal relationship of trust. It is generally accepted that such a mode is adopted in the securities investment funds. Under this mode, the ownership of the entrusted property, namely whether the entrusted property is owned by the asset manager or custodian, may be unclear.

- "Trust Plus Entrustment" mode - the asset manager acts as the trustee of the asset entrusting party under the legal relationship of trust and the assets custodian acts as the entrusted party, i.e. as a custodian, of the asset manager under the legal relationship of entrustment. The asset manager shall use the entrusted property to make securities investments in its own name for the benefit of the asset entrusting party, and entrust the asset custodian with the custody service regarding the entrusted property. The "Trust Plus Entrustment" mode solves the problem of ambiguousness of the ownership of the entrusted property under the "Co-trustee" mode, but may encounter problems in title change registration regarding the entrusted property.

According to the Experimental Measures, the entrusted property shall include currencies and securities. The entrusted property in the form of cash may be transferred from the asset entrusting party to the asset manager through bank payment. With respect to the change of title registration from the asset entrusting party to the asset manager regarding the entrusted property in the form of securities, it is proposed that the "Non-trade Title Change Registration" may be adopted.

According to the Rules on Securities Registration issued by the China Securities Depository and Clearing Co., Ltd. (《中国证券登记结算有限责任公司证券登记规则》), if securities are transferred because of a share transfer by agreement, judicial remittance, administrative transfer, inheritance, donation, lawful property division, merger or division of legal entity, loss of legal personality due to dissolution, bankruptcy or lawful closedown by order of a court, acquisition of a listed company, share repurchase by a listed company, implementation of a share incentive plan by a listed company and other circumstances stipulated by the relevant laws, administrative regulations, rules of the CRSC and operational rules of China Securities Depository and Clearing Co., Ltd., the Non-trade Title Change Registration may be adopted.

Based on the above circumstances, where application for Non-trade Title Change Registration is permitted, the Non-trade Title Change Registration is not applicable to securities transfers arising by way of trust at this stage. Therefore, the problem of the possession transfer of the entrusted property needs to be solved if fund managers are to engage in the business of Wealth Management of Designated Accounts by way of trust.

- "Bi-entrustment" mode. Under such mode, the asset manager and asset custodian both act as the entrusted parties of the asset entrusting party under the legal relationship of entrustment. Under this mode, the issue of the possession transfer of the entrusted property may not be involved. The asset manager conducts securities investment activities through the account of the asset entrusting party, who opens the capital account in its own name with the asset custodian and entrusts the asset custodian with the custody service regarding the entrusted property. It is generally accepted that such a mode is adopted in the securities company-oriented asset management business. Under this mode, because the entrusted property is owned by the asset entrusting party, in the event of bankruptcy of the asset entrusting party, the asset manager is only regarded as a general creditor of the asset entrusting party and shall have no priority in collecting the payment of management commission. Such a risk may become one of the risks which the fund manager will bear when carrying out the business of Wealth Management of Designated Accounts by way of Bi-entrustment. On the other hand, according the Contract Law, the entrusting party can terminate the entrustment contract at any time, and therefore the fund manager needs to consider a way of ensuring the long-term stability of the investment and operation of the entrusted property.

Account Opening for the Business of Wealth Management of Designated Accounts

If different legal relationships are applicable, in theory, the fund manager may involve different asset account opening rules under different legal relationships. (1) Under the "Co-trustee" mode, with reference to the present operational measures of securities investment funds, the custodian bank or the fund manager shall open an independent account and act as a trustee to manage the trusted properties. (2) Under the "Trust Plus Entrustment" mode, it may be necessary to open different specific accounts for trusts for different investors in the name of the fund manager. (3) Under the "Bi-entrustment" mode, the account can be opened in the investor's own name, but there is a question whether such investor is able to open more than one securities account so as to separate assets under entrustment from the assets actually managed by investor itself. It can be seen from the current practice and rules of the China Securities Depository and Clearing Co., Ltd. that the above demands of account opening are not fully met, so we believe that the smooth operation of this business by fund managers requires full coordination between supervisory authorities and the China Securities Depository and Clearing Co., Ltd. so that appropriate operational rules for fund managers to provide such services can be formulated.

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