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Impact of Key Points for Fund Filing on Private Securities Fund Business

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On 2 June 2022, the Asset Management Association of China (the "**AMAC**") released the *Notice on Matters Related to Registration and Filing of Private Fund Managers (Zhongjixiezi [2022] No.203)* (the "**Notice**"). The checklists of registration application documents for private securities fund managers and private equity fund managers have been updated with a 3-month transition period for formal implementation. In addition, AMAC released the key points for filing of private securities funds and private equity funds respectively, which have come into force and been implemented as of the issuance date. In terms of the *Key Points for Filing of Private Securities Investment Funds* (the "**Key Points for Fund Filing**") applicable to private securities funds, most contents therein are the reaffirmation of relevant provisions of existing laws, regulations and self-discipline rules, which, by listing key points, provides more comprehensive compliance guidance to private fund managers in design of fund products and preparation of fund documents, etc. This article will provide detailed analyses in respect of the following points in combination with our experience in dealing with relevant projects:

1. Product Design

(1) Fund Term

Article (II) in Part II of the Key Points for Fund Filing reaffirms the requirement in the *Instructions for Filing of Private Investment Funds* issued in 2019 (the "**Instructions for Fund Filing**") that the fund term shall be specified in the fund contract. The fund contract shall not stipulate that the term of the fund is "perpetual" or the fund "has no fixed term" while the fund term shall be specific. In practice, for the funds that do have plan about long fund term, the fund contract may provide an initial fixed fund term with automatic extension arrangement after expiration of the initial term, and investors should be reminded of reading and paying attention to such arrangement.

(2) Ad Hoc Dealing Day

Article (IV) "Dealing Arrangements" in Part II of the Key Points for Fund Filing reaffirms the provisions on setting dealing days as stipulated in Article 31 of the Instructions for Fund Filing, which requires that the conditions triggering ad hoc dealing days shall be specific. The fund manager may intend to give itself the discretion to set ad hoc dealing days as the case may be in the fund contract, which, in our view, does not comply with the requirement that the conditions triggering ad hoc dealing days shall be specific. It is recommended that the fund managers set more specific and reasonable conditions triggering ad hoc dealing days in the fund contract.

(3) Setting of Share Classes

Article (V) in Part II of the Key Points for Fund Filing emphasizes that AMAC pays attention to whether different closing periods, lock-up periods, subscription and redemption time are imposed against different share classes. The subscription fees, redemption fees and management fees can be different.

In some previous feedbacks of AMAC on fund filing shared in public channels, we notice that AMAC did not allow the setting of different closing periods, lock-up periods, subscription and redemption time for different share classes, and required the fund managers to modify the terms of setting different lock-up periods for different share classes. The arrangements about charging different subscription fees, redemption fees and management fees are workable, which have already been reflected in the setting of AMAC's AMBERS system earlier.

As to this Article (V), we view that, for the subscription fees and redemption fees attributable to the fund manager or the distributor, it is not inappropriate to set different subscription and redemption fee rates for different share classes. The fund manager and the distributor may decide the subscription and redemption fee rates at their discretion based on the cost of sales. However, if all redemption fees will be attributable to the fund assets, based on the principle that "the fund manager shall not treat different fund assets under its management unfairly" as stipulated in the *Interim Measures on Supervision and Administration of Private Investment Funds*, there is a lack of fairness and rationality for the setting of differentiated redemption fee rates for different share classes. If partial redemption fees will be attributable to the fund assets while partial redemption fees will be attributable to the fund manager or the distributor, considering that the cost of sales for the fund manager or the distributor to distribute different share classes may differ, we tend to view that it is feasible to set differentiated redemption fee rates provided that the proportion of redemption fees to be included in the fund assets for different share classes shall be the same.

For the management fee, though AMAC allows setting differentiated management fee rates for different share classes, as far as we are concerned, it does not indicate that differentiated management fee rates could be set freely. The fund managers shall still abide by the principle of treating different fund assets fairly, and the rationality of setting differentiated management fee rates shall be reflected in the standards for classification of share classes. For example, if the only difference between two share classes is the distribution channel (i.e., fund manager or distributor) but different management fee rates are set for such two share classes, it is suspected of breaching the principle of treating fund assets fairly. In addition, some fund managers used to set dedicated share class for investment by their employees, which enjoys a lower management fee rate but is imposed with a longer lock-up period as trade-off, and the foregoing arrangement was successfully passed in fund filing at the time being. After the release of the Key Points for Fund Filing, if it is considered to adopt such approach to set different share classes with differentiated lock-up periods and management fee rates, it may be necessary to further communicate with AMAC for confirmation.

(4) Structured Arrangement

Article (VI) in Part II of the Key Points for Fund Filing clarifies the requirements on leverage ratio of structured funds, i.e., the leverage ratio of fixed income funds shall not exceed 3:1, the leverage ratio of futures and other derivatives funds shall not exceed 2:1, and the leverage ratio of equity funds, hybrid funds shall not exceed 1:1. These requirements are consistent with the requirements on leverage ratio of private asset management schemes as stipulated in the *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* and the rules of the China Securities Regulatory Commission that govern private asset management business.

In addition, the Key Points for Fund Filing puts forward that special attention will be paid to the preferred share class with ratio of returns it generates or losses it bears being lower than 30%, and the subordinated share class with ratio of returns it generates or losses it bears being higher than 70%. Compared with private asset management schemes, where the net asset value per unit of a private asset management scheme is lower than 1, the ratio of losses borne by its preferred share class should not be lower than 10%.

(5) Performance Fee

Article (VII) "Performance Fee" in Part II of the Key Points for Fund Filing generally reaffirms the provisions in Article 32 "Standardizing Performance Fee" of the Instructions for Fund Filing, and explicitly requires, for the first time, that, unless all the investors are institutional investors throughout the fund term, the performance fee could be accrued on the premise that the fund units generate positive returns.

Previously, for funds that adopt market index or indexes portfolio as the benchmark for performance fee, as long as the fund generates "relative returns" compared to the benchmark for performance fee, the performance fee can be accrued, regardless of whether the fund units generate positive returns. After the release of the Key Points for Fund Filing, if a new fund intends to adopt the market index or indexes portfolio as the benchmark for performance fee, it is also worth noting the premise that the fund units shall generate positive returns at the same time. Meanwhile, AMAC also explains in particular that such requirement applies to the situations where investors include individual investors or may include individual investors in the future. For institutional investors with high risk identification capability and risk tolerance capability, AMAC fully respects their willingness to make investment independently.

2. Duties of the Custodian

Article (VIII) "Custody Requirements" in Part II of the Key Points for Fund Filing points out that AMAC focuses on whether the fund contract clearly provides the statutory duties of the custodian and other relevant contents stipulated in Chapter III of the *Securities Investment Fund Law of the People's Republic of China* (the "**Funds Law**"). Chapter III of the Funds Law stipulates the duties of securities investment fund custodians and other relevant provisions, which shall generally apply to the custodians of securities investment funds, no matter retail securities investment funds or private securities investment funds. Following Article 3 "Custody Requirements" of the Instructions for Fund Filing, the Key Points for Fund Filing emphasizes that the custodians of private securities funds shall assume the duties of custodians stipulated in Chapter III of the Funds Law once again. Therefore, the fund custodians shall not restrict or be exempted from their statutory duties stipulated in the Fund Law (such as “convening the general meeting of fund unitholders in accordance with relevant provisions”) by the fund contract, nor is it recommended to remove such statutory duties from the fund contract by interpreting that they could be covered by the miscellaneous provisions.

3. Explicit Disclosure of Portfolio Manager(s)

Article (IX) “Portfolio Manager” in Part II of the Key Points for Fund Filing reaffirms the requirement in the *Guidelines for Private Investment Fund Contracts* and the Instructions for Fund Filing that the portfolio managers shall be specified in the fund contract. Where some WFOE or JV private fund managers manage private funds in the form of investment teams (such as a portfolio manager and multiple assistant portfolio managers), the portfolio manager shall also be specified in the fund contract. In addition, according to our experience in previous projects, AMAC pays attention to whether the portfolio manager(s) filed in the AMBERS system are consistent with whom agreed in the fund contract. If a private fund manager intends to fill in any assistant portfolio manager in the AMBERS system, such assistant portfolio manager shall be clearly disclosed and agreed in the fund contract as well.

4. New Requirements for Risk Disclosure Letter

According to paragraph 2 of Article (XII) “Risk Disclosure Statement” in Part II of the Key Points for Fund Filing, based on the current template of risk disclosure letter released by AMAC and the requirements of the Instructions for Fund Filing, the fund managers shall also make risk disclosure in the section “Special Risk Disclosure” of the risk disclosure letter with respect to the following arrangements:

(1) The fund is a structured fund;

(2) The fund mainly invests in instruments with low liquidity;

For “instruments with low liquidity”, we understand that the definition of assets with restricted liquidity in the *Provisions on the Liquidity Risk Management of Publicly-Offered Open-ended Securities Investment Funds* can be taken as reference.

(3) The fund mainly invests in offshore investment instruments;

For private funds that mainly invest in offshore securities market through QDLP, Hong Kong stocks or Hong Kong ETFs in the future through Stock Connect between Mainland China and Hong Kong, CDRs through depository receipts transaction under the stock connect scheme between domestic and overseas stock exchanges, or Hong Kong bonds through the Southbound under mutual bond market access between Mainland China and Hong Kong, special risk disclosures shall be made in this regard.

(4) The fund mainly invests in over-the-counter derivatives such as return swaps and over-the-counter options;

(5) The investment in other instruments with high risk will be involved;

(6) Other special risks or business arrangements that require disclosure.

Given that the Notice mentions that the Key Points for Fund Filing is formulated to "facilitate private fund managers to understand the filing requirements in advance", we tend to view that the Key Points for Fund Filing mainly provides the requirements for filing of new funds. However, we also suggest preparing updated risk disclosure letter for the existing funds when onboarding new investors.

5. Key Points for Fund Managers with No Fund Under Management Within 1 Year

Article (XVII) in Part II of the Key Points for Fund Filing reaffirms the administrative measures against fund managers as stipulated in the *Notice on Matters Related to Strengthening the Self-discipline Management of Institutions with Abnormal Operations* released by AMAC in January 2022. According to the *Notice on Matters Related to Strengthening the Self-discipline Management of Institutions with Abnormal Operations*, for a private fund manager that has no fund under management within 1 year after all funds under its management are liquidated, AMAC will require the fund manager to take the following actions within 3 months: (1) to complete the filing of new private fund product; (2) to ask the fund custodian to issue due diligence records or due diligence explanatory documents for the fund manager and the new fund; (3) to engage lawyers to issue a special legal opinion. If the forgoing requirements cannot be fulfilled on time, AMAC will cancel its registration of private fund manager.

On this basis, the Key Points for Fund Filing puts forward several new key points for launching new funds by fund managers that have no fund under management for more than 1 year:

(1) Firstly, AMAC pays attention to whether the fund is actually raised capital towards external investors, which is also in line with AMAC's requirement that there must be at least 1 external investor for fund filing, i.e., the investors of a fund shall not be the fund manager and its employees only for fund filing.

(2) Secondly, AMAC pays attention to whether the paid-in capital of the new fund reaches RMB 10 million. It is undoubted that such requirement on fund size may pose a great challenge to fund managers with no fund under management within 1 year.

(3) Thirdly, AMAC pays attention to whether the fund manager has the behavior of "protection of shell resource" and other suspicious behaviors previously.

6. Electronic Contract

AMAC also released the *Notice on Issuing the Administrative Measures for the Electronic Contract Business of Private Investment Funds (Trial)* (the "**Notice on Issuing Measures for Electronic Contracts of Private Funds**") on the same day when the Key Points for Fund Filing was released. The *Administrative Measures for the Electronic Contract Business of Private Investment Funds (Trial)* (the "**Measures for Electronic Contracts of Private Funds**") allows the parties concerned of private funds to appoint electronic contract business service providers registered with AMAC to provide electronic contract business services such as identity verification for the parties concerned, electronic contract signing, and query of electronic contract data. Fund documents that can be signed in electronic form include fund contracts (including supplementary contracts), risk disclosure letters, subscription forms, etc. In addition, fund managers may be able to complete confirmation of specific targets, investors suitability matching, fund risk disclosure, anti-money laundering, unit registration and other business through electronic contract business services.

Electronic contract business service providers do not fall within the scope of "information technology system service providers" under the *Administrative Measures on Private Investment Fund Service Business (Trial)* (the "**Fund Service Business Measures**"). However, AMAC will refer to the relevant self-discipline rules governing private fund service business to conduct self-discipline management on electronic contract business service providers registered with AMAC, including requiring them to report information in accordance with the self-discipline rules governing private fund service business, conducting assessment against them on a regular basis, etc. In addition, it is provided in the Measures for Electronic Contracts of Private Funds that, where a party concerned of a private fund conducts activities such as confirmation of specific targets, investors suitability matching, fund risk disclosure, anti-money laundering, unit registration by engaging an electronic contract business service provider, the responsibilities to be borne by the party of the private fund pursuant to the law shall not be waived by using the electronic contract business service, and this provision echoes the requirement in Article 43 of the Fund Service Business Measures that "the responsibilities to be borne by the private fund manager pursuant to the law in fund offering such as investors suitability check and veracity, etc. shall not be waived by execution of the outsourcing agreement of the electronic contract platform".

The Measures for Electronic Contracts of Private Funds has been implemented as of the issuance date. According to the Notice on Issuing Measures for Electronic Contracts of Private Funds, electronic contract business service providers shall apply for registration through the AMBERS system, and the relevant system tests, data submission interface specifications and the open of the registration filling system will be notified separately.

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