

Client Alert

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China Plans to Further Open Domestic Private Securities Investment Fund Management Business to Foreign-Owned Managers

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On June 30, 2016, the Asset Management Association of China (“**AMAC**”) released the *Q&A Regarding Registration and Filing of Private Funds (No. 10)* (“**Q&A No. 10**”), which confirmed that both wholly foreign-owned and Sino-foreign-invested joint venture (“**JV**”) private securities investment fund management companies (“**PSFMC**”) are now permitted to register as private securities investment fund managers (“**PSFMs**”) with AMAC. Q&A No. 10 was endorsed by the China Securities Regulatory Commission (“**CSRC**”) on the same day.

CURRENT REGULATORY LANDSCAPE FOR PRIVATE SECURITIES INVESTMENT FUND MANAGEMENT

Under the Measures for Registrations of Private Investment Fund Managers and Record Filings of Funds (Trial Implementation), in order to carry out fund raising and investment activities, all PSFMCs and PEFMCs (as defined below) have been required to register with AMAC since early 2014. Prior to the release of Q&A No. 10, certain Sino-foreign-invested JV PSFMCs were permitted to register with AMAC as PSFMs. Q&A No. 10 will allow all PSFMCs, regardless of their ownership structures, to register with AMAC as PSFMs once established.

Q&A No. 10 appears to further open the private domestic securities investment fund management business to foreign asset managers and to allow such foreign asset managers engaging in raising and managing private securities investment funds to raise such funds from qualified Chinese investors through private placement and to invest in China’s public market. In China, private equity investment funds and private securities investment funds and their respective managers are treated differently and subject to different regulations under some circumstances. For example, the establishment of PSFMCs is subject to approval of both the CSRC and the Ministry of Commerce (“**MOFCOM**”). Meanwhile, the establishment of a foreign-invested private equity investment fund management company (“**PEFMC**”) is only subject to MOFCOM’s approval.

Under the Catalogue for the Guidance of Foreign Investment Industries (as amended in 2015) (“**2015 Catalogue**”), jointly promulgated by the National Development and Reform Commission (“**NDRC**”) and MOFCOM, a foreign investor is permitted to hold up to a 49% equity interest in a Sino-foreign-invested PSFMC. The negative lists (“**Negative Lists**”) applicable within the Free Trade Zones in Shanghai, Guangdong, Tianjin and Fujian (“**FTZs**”) have not liberalized the foreign ownership percentage in PSFMCs incorporated in any of the FTZs. However, the 2015 Catalogue does not impose the restriction on foreign ownership in a PEFMC. As a result, such PEFMCs have been formed as wholly foreign-owned enterprises that, in some circumstances, have been seen as consulting-type entities in China in order to advise China-incorporated private equity investment funds, such as RMB funds, in connection with their investment activities.

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REGISTRATION REQUIREMENTS UNDER Q&A NO. 10

A. Who can be registered with AMAC?

In accordance with Q&A No. 10, qualified foreign-invested PSFMCs (including both wholly foreign-owned enterprises and Sino-foreign-invested JVs) duly incorporated in China can only carry out the private securities investment fund management business in the PRC after they are registered with AMAC as PSFMs.

In order to register, a PSFMC must satisfy all of the following requirements:

- (i) it must be a company incorporated in China;
- (ii) the foreign shareholder must be a financial institution approved or licensed in a country or region of its domicile, and the securities regulatory authorities of such country or region must have entered into a memorandum of understanding (“**MOU**”) with the CSRC or a CSRC recognized institution to cooperate with each other; and
- (iii) the registering entity and its foreign owner must not have been subject to any material penalty by any securities regulator or judicial department in the preceding three years.

If a foreign-invested PSFMC has any foreign *de facto* controller, such foreign *de facto* controller must also satisfy the requirements listed under (ii) and (iii) above.

B. What should be submitted for the registration?

Q&A No. 10 also provides that, to complete the registration requirements, a foreign-invested PSFMC is required to submit the following information and documents to AMAC:

- (i) a copy of its business license and articles of association; a list of its major shareholders, and basic information of its senior management personnel and other information as may be required by AMAC;
- (ii) an undertaking letter regarding the registration as a PSFM and filing of private securities investment funds confirming that all submitted information and materials are true, accurate and complete, and contain no false statements, misleading representations or material omissions, and undertaking to comply with PRC laws, regulations and self-regulatory rules in relation to private funds; and
- (iii) a legal opinion on the registerability of the PSFMC as a PSFM duly issued by a qualified PRC law firm and its relevant attorneys at law of such PRC law firm. The legal opinion is required to cover, among other things, the legality of the incorporation and existence of the PSFMC, its business scope, its corporate equity structure and *de facto* controller, the satisfaction of the requirements and conditions to its business operation, the qualifications of its senior management, and the completeness of its risk management and internal control regulations.

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C. How long will the registration process take?

Q&A No. 10 provides that it takes twenty days for AMAC to complete the registration after AMAC accepts all the required documents. As widely understood, currently it takes a very long time for both PSFMCs and PEFMCs to complete their registrations with AMAC. Pending completion of registration, such PSFMCs and PEFMCs would not be able to commence their contemplated fund-raising activities in China. It is not clear that under Q&A No. 10 AMAC aims not only to allow all qualified foreign-invested PSFMCs to register with AMAC but also to accelerate the registration process.

D. What are other major requirements for PSFMs to operate funds?

- (i) In accordance with Q&A No. 10, PSFMCs shall make their investment decisions independently in connection with any securities and future transactions and shall not place trading orders through their overseas institutions or systems. However, it remains unclear in practice what benchmark AMAC would apply to decide whether a particular investment decision is independent or not. Precedents in this area of law are still yet to be developed to guide future operation.
- (ii) Q&A No. 10 further requires that PSFMCs use the proceeds from capital investments and Renminbi amounts converted from any foreign-currency investments in compliance with the relevant provisions issued by China's foreign exchange authorities.

KEY OBSERVATIONS

- (i) Q&A No. 10 only allows a PSFMC to register with AMAC provided that its foreign shareholder or *de facto* controller meets the requirements set forth under (ii) and (iii) discussed in Section A above.

Note that the CSRC has entered into a MOU with the securities regulatory authorities in more than sixty countries or regions. However, the CSRC has not done so with many tax-attractive countries or regions, such as the Cayman Islands and Bermuda. Any PSFMCs whose foreign shareholders or *de facto* controller is set up in those countries or regions will not be eligible for the registration with AMAC. In addition, given Q&A No. 10 provided no definitions for the term "*de facto*," in the event that this term was interpreted broadly, such broad interpretation would cause greater uncertainty in practice.

- (ii) Under the 2015 Catalogue and the Negative Lists, foreign ownership in a PSFMC currently may not exceed 49%. It appears that Q&A No. 10 may allow PSFMCs with any foreign ownership to be registered with AMAC, which implies that a 100% foreign-owned PSFMC is also permitted. However, given the effectiveness of the 2015 Catalogue, it remains unclear whether a wholly foreign-owned PSFMC is permitted to register solely based on Q&A No. 10.

It is expected that the relevant Chinese government authorities may discuss and coordinate to address the foreign-ownership-restriction issues. In this conjunction, there is no assurance whether and when this issue can be solved.

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(iii) In reality, the branches of the State Administration for Industry and Commerce (“SAIC”) in a number of cities, such as Beijing, Shanghai and Shenzhen, suspended the registration of PEFMCs and PSFMCs as PSFMs earlier this year in response to an overheating fund-raising market. Such suspension has affected the formation of PSFMs invested by Chinese and foreign investors. With the release of Q&A No. 10, it remains unclear when those SAIC branches will resume the registration of PSFMs in their localities.

Q&A No. 10 may bring positive development in the PSFMC area with a desire to attract more qualified private securities investment fund managers and institutional investors, such as private securities investment funds, for China’s A-share market. Foreign-invested PSFMCs would be permitted to register with AMAC to carry out their businesses. On the other hand, PSFMs may still face uncertainty as to whether they can set up a wholly owned PSFMC in the near future and whether they can still adopt their preferred offshore corporate structure in certain tax-attractive jurisdictions. Further, it remains to be seen whether the registration can actually be completed within twenty days after AMAC accepts all the required documents as expressly provided in Q&A No. 10.

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