

A large, abstract graphic of a network or sphere made of interconnected blue nodes and lines, positioned in the upper right background of the page.

China

Regulation

FUNDS AND FUND MANAGEMENT 2009

2.1 Type of Funds

A securities investment fund may be established as either a closed-end fund or an open-end fund under the Securities Investment Fund Law of the People's Republic of China (the Law) approved by the State Council and promulgated by the China Securities Regulatory Commission (CSRC) on 28 October 2003. The Law has been in effect as of 1 June 2004 and supersedes the previous Provisional Measures on Securities Investment Fund. The Law covers both open and closed-end funds.

According to the investment criteria stated in the fund prospectus, funds can be divided into the following types:

- Equity funds, of which over 60 percent of the fund assets is invested in equities.
- Bond funds, of which over 80 percent of the fund assets is invested in bonds.
- Money market funds, of which fund assets are only invested in money market instruments.
- Balanced funds, of which fund assets can be invested in equities, bonds, and money market instruments. The fund does not have to comply with the investment ratios mentioned above.
- Index funds, of which investment objective typically is to achieve approximately the same return as a particular market index. An index fund will attempt to achieve its investment objective primarily by investing in the securities of companies that are included in a selected index.

2.2 Laws and regulations

The principal laws, regulations, rules, and standards governing funds in the People's Republic of China are:

- Securities Laws

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- Company Laws
- Securities Investment Fund Laws
- Measures for Securities Investment Fund Management Companies
- Measures for Securities Investment Fund Operations
- Measures for Selling Securities Investment Funds
- Stock exchange listing rules for Securities Investment Funds
- Instructions for Fund Management Company Internal Controls
- Guidelines for the Governance of Securities Investment Fund Management Companies (for Trial Implementation)
- Measures for Qualification of Securities Investment Fund Custodians
- Measures for Commercial Banks to Establish a Fund Management Company
- Rules for Money Market Funds Management
- Trial Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors
- Various notices from China Securities Regulatory Commission on Relevant Issues Regarding Risk Reserves of Securities Investment Fund Management Companies
- Various standards governing disclosure requirements, including notices, quarterly, half-yearly and annual reports.
- Trial Measures for Fund Management Companies to Provide Asset Management Services for Specific Clients
- Notice of China Securities Regulatory Commission of Improving the Risk Management of the Fund Industry
- Various guidelines from China Securities Regulatory Commission regarding Securities Investment Funds Sales
- Various guidelines from China Securities Regulatory Commission regarding Securities Investment Funds Sales
- Regulations for Securities Investment Fund Management Company to set up Establishments in Hong Kong

- Guiding Opinions on the Fair Trading System of Securities Investment Fund Management Companies
- Guiding Opinions on Further Regulating the Valuation Business of Securities Investment Funds

The CSRC is empowered to authorize unit trusts, and license and monitor activities of fund management companies.

2.3 Fund management companies, and custodians

When a fund is to be established, it should be launched by a qualified fund management company and be put in the charge of a custodian, which must be a qualified commercial bank (a custodian bank). A fund management company operates and manages the fund, while the custodian bank holds the assets of the fund in trust.

The fund management company and the custodian bank must be independent of each other in all respects of administration, finance and management.

Fund management company

To establish a fund management company, the following qualifications shall be met:

- It is set up and registered in the PRC and has a company constitution which complies with Securities Investment Fund Laws, Company Laws, and the CSRC's related instructions.
- The minimum amount of paid-up capital must be no less than CNY 100 million.
- At least 15 persons at the senior management level possess the required securities fund business experience.
- Duties must be adequately segregated.
- There are adequate internal control procedures in compliance with CSRC requirements.

Any main shareholder (being a shareholder holding not less than 25 percent equity interest):

- is either a securities, securities consulting, or trust investment company established according to the relevant provisions of the PRC;
- has contributed paid-up capital of no less than CNY 300 million;

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- is a reputable business entity with quality assets;
- has over three complete accounting years of consecutive operating periods with healthy corporate governance and internal control systems;
- has incurred no penalty from regulatory bodies nor criminal offences in the last three years arising from non-compliance with laws or regulations;
- has no negative records in institutions such as tax and industry, and commerce authorities, financial regulation, self-regulation institution, and commercial banks, etc. in the last three years;
- has not misappropriated clients' assets; and
- meets other qualifications as provided by the CSRC.

Fund custodian

The following qualifications are required for a commercial bank to be a qualified fund custodian:

- It must meet the net asset and capital requirements of relevant regulations.
- It has a separate custody department.
- The fund custodian department has senior management personnel who comply with legal qualifications, and also has over five employees with fund operation qualifications who operate fund settlements, provide investment supervision, information disclosure, and internal audit inspection, etc.
- It must keep all client assets under safe custody.
- It has the capacity to settle and deliver securely and efficiently.
- Internal control and risk management procedures are in place.
- It has incurred no penalty from regulatory bodies nor criminal offences in the past three years arising from non-compliance with laws and regulations.

The custodian fee, fund management fee, and other fees and remuneration deductible from the fund assets shall be charged according to the relevant provisions of the state, and shall be set forth in the fund contract and the custody agreement.

2.4 Investment restrictions

The investment portfolio of an open-end or closed-end fund should be in compliance with the following provisions:

- The percentage of a fund investing in designated investments (such as stocks or bonds) shall not be less than 80 percent of the total value of the assets of the fund.
- The total investment by a fund in the stock of a single listed company shall not exceed 10 percent of the net assets value of the fund.
- The total investment by all the funds under the same fund management company in the securities issued by one company shall not exceed 10 percent of the said securities.
- The investment scope, strategies, and portfolio mix should be in line with the prospectus.
- The portfolio should reflect other percentage limits as provided by the CSRC.

The following are also prohibited:

- Investments by funds in each other
- Investments in funds by custodian banks and commercial banks
- Purchase or sale of securities in the name of the fund by the fund management company using any capital which does not belong to the fund
- Any kind of securities underwritten by the fund management company or self-dealing in any securities other than State bonds by the fund management company
- Borrowing and lending of money by the fund management company
- Investments in funds using money held on trust by the banks
- Speculation in the funds by State-owned enterprises in violation of the relevant regulations of the State
- The fund assets being used for mortgage, guarantee, borrowings or loans
- Funds entering into securities margin transactions
- Fund assets being used for investment in real estate properties
- Investments which may incur unlimited liability of the fund

- Fund assets being used for investment in securities issued by companies in which the custodian bank or the fund management company has an interest
- Purchases by one fund on any trading date wherein the total amount of warrants exceeds 0.5 percent of that fund's net assets on the preceding trading day
- The market value of warrants held by one fund exceeds 3percent of the fund's net assets of the previous trading day
- Total warrants held by the funds of one fund management company exceed 10 percent of the total amount of the warrants
- Illegal benefits obtained through insider information, or manipulation of options prices or the prices of related securities, or transfer of benefits during warrants investments
- Other activities prohibited by the CSRC

2.5 Borrowing

Borrowing and lending of money by the fund management company are prohibited.

2.6 Accounts and prospectus

The promoters of a fund should issue a prospectus in accordance with the related requirements of the Measures for Securities Investment Funds Operations. The promoters of the fund should confirm that the prospectus does not contain any misinformation or misleading statements, or omit any information required. The prospectus should be published after it is approved by the CSRC.

Funds have an obligation to publish their annual accounts which should be audited by qualified CPAs within 90 days of the end of their accounting year, and file the audited accounts with the CSRC on the next working day of the publishing date. They are also obliged to publish their interim and quarterly accounts, which need not be audited, within 60 days and 15 days respectively of the period end, and file the accounts with the CSRC on the next working day thereafter.

Open day

An open-end fund should clearly specify in the prospectus date (the open date) when the fund investors can apply for purchase or redemption of funds.

When the fund management company receives an application for purchase or redemption of funds from investors, they should confirm the validity of the transaction within three working days. The company should make redemption payment to fund investors within seven working days after they accept the valid redemption application.

A large redemption occurs when the net redemption applications exceed 10 percent of the total allotment of a single fund in a single open day. When a large redemption occurs, the fund management company can defer its payment for the applications that exceeds 10 percent of the total allotment. However the redemption payment on that day, on a pro rata basis, should not be less than 10 percent of the total allotment.

2.7 Supervision

The supervision authority for funds is:

Department of Funds Supervision
China Securities Regulatory Commission (CSRC)
Focus Place
19 Jin Rong Street
West District
Beijing 100032
P.R.China

2.8 Fund structure

Funds are not permitted to make investments in each other.

Hedge funds are not permitted in China. A hedge fund is a mutual fund that uses hedging practices by purchasing stocks on margin, selling short, or trading in options in an effort to maximize its profits at risk. Short sales or selling short is prohibited by the CSRC.

2.9 Stock exchange

Closed-end funds approved by the CSRC are listed on the stock exchanges in China.

Open-end funds can obtain a quote on the stock exchanges, with the contents of the listing document being based closely on the prospectus or offering document already required under the CSRC regulations.

Foreign funds are not entitled to be registered on local stock exchanges in China.

2.10 Bank secrecy

Anti-money laundering laws and regulations are in place.

2.11 Fund set-up

A closed-end fund has a minimum duration of five years. The amount of capital raised should not be less than CNY 200 million, and the number of subscribers should exceed 1,000. A capital-raising period of three months commences on the date of the approval of the fund. Where the closed-end fund has, within the three months of its date of approval, raised more than 80 percent of the approved capital of the fund, the fund will be established. Where the closed-end fund has, upon expiry of its capital-raising period, raised less than 80 percent of the approved capital of the fund, the fund will not be established.

An open-end fund has a fund-raising period of three months, commencing on the date of the publication of the fund-raising prospectus. Where the open-end fund attains more than CNY 200 million net sales and gains a minimum of 200 subscribers within the period, the fund can be established. If these requirements are not met, the fund will not be established.

A fund management company should launch the fund within six months of obtaining approval documents from the CSRC. The launch period should not exceed the fund launch period approved by the CSRC. The launch period begins on the date of the fund's initial public offering.¹

2.12 Foreign funds

No foreign funds can be traded or listed in the stock exchanges in China.

¹ The above regulations governing funds shall only apply to the Securities Investment Funds which are publicly raised in the People's Republic of China.

2.13 Bearer shares

Bearer units are not used in the People's Republic of China.

2.14 Use of the internet

The use of the internet as a marketing tool for stock brokerage activities including the transaction of funds is acceptable and is becoming more popular in China.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.