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Private securities fund management businesses are now open for foreign investors: Access and Opportunity

On 30 June 2016, Asset Management Association of China (AMAC) issued “Q&A on private securities fund registration (No 10)”, allowing qualified Wholly Foreign-Owned Enterprises and Sino-foreign joint enterprises to apply and register as private securities fund management institutions and carry out private securities funds management business.

On 30 June 2016, Asset Management Association of China (“AMAC”) issued “Q&A on private securities fund registration (No. 10)” (“Q&A 10”), allowing qualified Wholly Foreign-Owned Enterprises (“WFOE”) and Sino-foreign joint venture enterprises to set up private securities fund management institutions to carry out private securities fund management business, including investments in securities on secondary market. The Q&A 10 also specified the entry conditions and procedure.

Background

The issuance of “Q&A 10” is based on China’s commitment to open up the fund industry to foreign participation as a result of the discussions during the Seventh and Eighth Round of Sino-US Strategic and Economic Dialogue and the Seventh Sino-U.K. Economic and Financial Dialogue. Prior to the release of this Q&A 10 and under the prevailing rules, foreign shareholding in the securities investment fund manager company should be limited to 49%. With the announcement of “Q&A 10”, foreign shareholding can now reach 100% for fund manager company engaging in private securities fund management business within the PRC. This is an important milestone for China to fulfil its plan to gradually open up the fund management sector for foreign asset manager and a welcoming news for those foreign asset managers who wish to enter into the Chinese market or to expand their existing asset management business into other investment funds categories.

“Q&A 10” was issued by AMAC, a fund industry society that was organized by and affiliated with the China Securities Regulatory Commission (“CSRC”). AMAC is mainly responsible for governing the private investment fund sector that include private fund manager registration, private products registration and so on. Under the prevailing rules and procedures, registration at AMAC is required in order to carry-out private fund management business. However, in the past, AMAC rarely accepts the application of foreign-invested private securities

managers to engage in domestic asset management business due to the lack of clear guidance on whether foreign firms can participate in such market.

While there exists some wholly foreign-owned private securities investment management institutions in Shanghai, Shenzhen and etc., these institutions were generally set up under the Qualified Domestic Limited Partner pilot programme (“QDLP pilot programme” or equivalent one in Shenzhen), which mainly engage in cross-border (outbound) securities investment management rather than domestic asset management.

Now, with the release of the “Q&A 10” that specifies that wholly foreign-owned and Sino-foreign joint venture private securities fund management institutions can register as private securities fund managers with AMAC in order to carry out domestic private securities fund management business. This indicates the AMAC will now accept such registration and open the path for foreign investors to engage in asset (securities) management business in the PRC, although at this point it is still limited to fund management of privately-raised securities investment funds.

Entry Conditions

According to “Q&A 10”, foreign investors should not only meet the common requirements on making or managing investments in the PRC according to the relevant laws and regulations, but will also need to meet the following conditions to register with AMAC for carrying out domestic private securities investment fund management business:

- (1) Establish a private securities fund management company in the PRC;
- (2) The foreign shareholder of the fund management company should be a financial institution approved or licensed by its home country national or regional financial regulatory authority AND such home country national or regional securities regulatory authority has already entered into a Memorandum of Understanding on Securities Regulatory Cooperation (MOU) with the CSRC or other institutions recognized by CSRC;
- (3) The foreign shareholder of the fund management company were not subject to any severe sanction or punishment imposed by its regulator and judiciary organization in recent three years.

The actual controlling shareholders or owners in the overseas (if any) of the proposed private securities investment fund management company shall also follow the above No. (2) and No. (3) requirements.

In the meantime, “Q&A 10” also stipulates that the business operational requirements of wholly foreign-owned and Sino-foreign joint venture private securities fund management companies as follows:

- (1) Cross-border capital flow and usage shall follow the relevant regulations of State Administration of Foreign Exchange (“SAFE ”);
- (2) Investment decisions on the security and future trading in the PRC shall be performed independently. The trading order should not be placed via offshore institutions or systems.

Impact and Opportunity

We will share our view through the perspectives of business plan, location selection and tax considerations.

Business Plan

“Q&A 10” allows offshore asset managers to carry out asset management business in the PRC, and consequently provides them with more growth opportunities. Taking advantage of this opportunity, offshore institutions should comprehensively consider the potential business opportunities and their China strategy when deciding investment in the PRC.

From a business planning perspective, given the growing demands of PRC institutional and high net worth investors of diversification and increasing global asset allocation, foreign assets managers could also consider carrying out cross-border asset management business in addition to the domestic asset management business. For example, foreign assets managers could consider whether to apply for QDLP pilot programme in Shanghai, Shenzhen or other cities, to obtain domestic and cross-border two-way asset management business opportunities.

Meanwhile, looking into the business development in the future, the foreign assets managers should also consider whether to conduct mutual fund management business in the PRC once permitted by the regulators. If this is the China strategy going forward, one could consider to set up a private securities investment fund management company first. This may help facilitate the future application for mutual fund management licence. Setting up private securities management company will also provide an opportunity to gain better understanding of the Chinese market, and be prepared for a broader scope of business in China in the future.

Location Selection

Undoubtedly, a first-tier city such as Shanghai will be a preferred choice in the PRC to carry out asset and wealth management businesses. Foreign investors normally choose to register investment funds management institutions in one of the major cities. However, when considering to establish a presence in these major cities, investors should also consider if there are any local government support or special measures that tailored for asset and wealth management businesses.

At present, some are cities have provided local supportive measures to attract asset management institutions. For example, Shanghai is now considering to release related supportive measures for foreign asset management institutions to establish regional operational centre in Shanghai. Foreign investors can compare the availability and details of those local supportive policies before deciding the location of the fund management company in China.

Tax Impact

Tax is undoubtedly another important factor that foreign investors need to consider when they plan the PRC asset management business. From tax perspective, foreign investors need to consider the following key issues:

(1) PRC tax implications on asset manager, especially if foreign investors set up more than one asset management institutions in the PRC to deal with different types of asset management business for regulatory reasons. Foreign investors need to consider potential tax and transfer pricing implications when deciding on the assignment of duties for their onshore personnel, as well as analysing the functions and roles of different onshore asset management institutions.

(2) PRC tax implications on different investment fund structures. For example, PRC taxation of a partnership form of investment fund can be very different from a contractual form of investment fund. Meanwhile, there are still many uncertain PRC tax treatments for each of these investment fund structures ranging from investment returns distribution, investment redemptions or even tax reporting requirements. Managers need to analyse these potential tax impacts to reduce the related PRC taxes risk.

In addition, the VAT reform for financial services sector was just launched on 1 May 2016. The foreign invested managers should take a closer look on the indirect tax implications of the investment funds. For further information, please refer to KPMG China Tax Alert Issue 10: China's new VAT rates & rules – Financial Services impacts.

(3) Transfer pricing implications on cross-border transactions. It is an important consideration especially under the current development of tax base erosion and profit shifting (“BEPS”) initiative in China and the recently released country-by-country (“CBC”) reporting requirement issued by State Administration of Taxation (“SAT”). Where there is any service provision arrangement between the domestic and overseas related/affiliated asset management institutions, investors shall pay special attention on transfer pricing issues in order to avoid potential compliance risks. For more analysis, please refer to KPMG China Tax Alert Issue 23: SAT Issued Announcement on the Enhancement of the Reporting of Related Party Transactions and Administration of Contemporaneous Documentation.

(4) If investors intend to establish regional asset management operational centre in the PRC, they also need to consider how to maximize the opportunity and potentials of any regional preferential policies offered by local government.

Overall this is a welcoming news that foreign assets managers are now provided with more channels to enter the asset management market in China. For any questions relating to market entrance, entity establishment, taxation, operational matters in connection to the asset management business in the PRC, please kindly contact KPMG professionals for more details.

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

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