



漢坤律師事務所
HAN KUN LAW OFFICES

Newsletter

China Practice

Global Vision



2nd Edition of 2017



Legal Updates

1. AMAC Issued New Guidance on Private Fund Service Business
2. Brief Comment on the General Provisions of the Civil Law



Legal Updates

1. AMAC Issued New Guidance on Private Fund Service Business (Authors: James Yong WANG, Shawn Xiao DING)

On March 1, 2017, Asset Management Association of China (the “**AMAC**”) promulgated the Administrative Measures for Private Investment Fund Service Business (Trial) (the “**Administrative Measures**”) which became effective on the same day. The *Administrative Measures* superseded the Guidelines on Fund Outsourcing Services (Trial) issued in February 2015 (the “**2015 Guidelines**”) and became the new guidelines for institutions that desire to provide various professional services for private fund within China.

The *Administrative Measures*, having taken into consideration the public comments on the consultation draft released late 2016, is comprised of eight chapters with a total of 59 articles. It clarifies the legal relationship between a private fund service institution (a “**PFSI**”) and a private fund manager (a “**PFM**”), classifies different types of external private fund services, defines responsibilities or scopes of different types of services, specifies the registration requirements and self-disciplinary administration requirements, and introduces a deregistration mechanism for PFSIs.

Legal Relationship

The *Administrative Measures* makes it clear that the relationship between a PFM and a PFSI is that of a principal-agent relationship, so that the obligations imposed on the PFM under applicable laws and regulations shall not be exempted due to such delegation, and PFSIs are prohibited from further contracting out private fund services undertaken by it directly or in a disguised manner to any third party.

Categories

The *Administrative Measures* classifies private fund services into five main categories, namely, fundraising, investment advisory, fund interests registration, valuation and verification, and information technology system services. The *Administrative Measures* focuses on the last three types of private fund service business, while fundraising and investment advisory would be separately regulated by AMAC.

Scopes and Responsibilities

The *Administrative Measures* defines the responsibilities or scopes of the three types of private fund service business as follows:

- PFSIs that engage in fund interests registration service should establish and manage the investors' fund accounts. They should also be responsible for fund interests registration, capital settlement, trade confirmation, dividend distribution, keeping of registers of investors, and other responsibilities required by applicable laws or service agreements.
- PFSIs that engage in fund valuation and verification service should carry out financial accounting and valuation, prepare reports and statements, keep business documents, and work with auditors engaged by PFMs in their audits, as well as other functions required by relevant laws, regulations or service agreements.
- PFSIs that engage in information technology system services should provide core application systems, operation maintenance and other safety protection services for PFMs, custodians or other PFSIs. The core application system includes the distribution system, investment trading management system, fund interests registration system, capital settlement system and valuation system. PFSIs providing core application systems to private funds are prohibited from engaging in the underlying fund services of the corresponding information technology system.

Qualification Requirements

In order to commence private fund service business, a PFSI is required to register with AMAC and become a member thereof. The following are several general requirements for the AMAC registration of a PFSI.

- (i) It is required to have good operation status with paid-in capital no less than RMB 50 million (applicable only to institutions engaged in private fund interests registration service or information technology system service);
- (ii) It is required to have optimized corporate governance structure with efficient internal control;
- (iii) It is required to have been operating in a compliant manner, with no previous incident of material violation of law or regulation within the most recent three years;
- (iv) It is required to have a complete organizational structure, with dedicated service business teams and senior executives who are able to ensure the completeness and independence of operation, and the teams are required to have necessary fixed places of business and safety protection measures;
- (v) It is required to be equipped with corresponding software and hardware facilities and safe, independent, efficient and stable business technology systems, and all of the systems are required to have passed the related business network tests, including the data backup platform as designated by AMAC;
- (vi) The heads of private fund service business departments and the legal representatives of independent third-party PFSIs are required to obtain qualifications for private fund business. All

employees engaged in the provision of private fund services are required to obtain qualifications for private fund business within 6 months from the commencement of their engagement in such service, and are required to participate in the subsequent professional training;

- (vii) It is required to evaluate its business to determine whether there is any conflict of interest and establish corresponding firewall systems;
- (viii) Its information technology system is required to comply with laws and regulations, and rules of China Securities Regulatory Commission (“**CSRC**”) and AMAC, establishing network insulation, safety protection and emergency plan and other risk management systems and disaster backup systems;
- (ix) Information technology PFSIs is required to have qualifications or conditions required by relevant authorities, have similar service experience, be equipped with all necessary business conditions including but not limited to professionals, facilities, intellectual properties and good safety operation records;
- (x) Other conditions as may be required by AMAC.

After satisfying all those requirements, a PFSI may submit its application by uploading all materials required by AMAC, including a PRC legal opinion, on an AMAC-designated online system, which will be opened for registration as of May 2, 2017. Once all materials meet AMAC’s requirements, AMAC would issue a registration certification and publicize the result within two months of its acceptance of the application.

Business Rules

The *Administrative Measures* specifies a number of business rules for PFSIs. In brief, a PFSI is required to:

- (i) sign written service agreements concerning some necessary content with PFMs;
- (ii) sign practice memos or other legal documents acknowledged by all parties concerning some necessary content with relevant parties such as PFMs, custodians and brokers;
- (iii) set a reasonable and clear fee standard, and is prohibited from providing services below cost;
- (iv) establish fund accounts and investor accounts, and keep fund assets and investors’ assets independent from its own assets to ensure safety of assets;
- (v) have the operation capacity and risk tolerance to carry out private fund service, prudently evaluate the risks and conflicts of interest of the private fund service, and establish strict firewall systems;

- (vi) not be entrusted to be the custodian for the same private fund, unless it can reasonably insulate its fund service functions from custody functions and disclose such to investors;
- (vii) establish sound document management systems;
- (viii) engage qualified accounting firms to issue annual audit report;
- (ix) provide regular reports to AMAC on a quarter and annual basis as well as reports in the case of material changes, including but not limited to shareholding changes, regarding the PFSI.

Deregistration Mechanism

The *Administrative Measures* requires that a PFSI commence fund service business within six months from its registration with AMAC, or its registration will be revoked by AMAC.

Transitional Arrangements

PFSIs that have already engaged in fund interests registration, valuation and verification or information technology system services but have not registered with AMAC prior to the implementation of the *Administrative Measures*, shall, within six months from the date when the specific system is available for registration (expected to be May 2, 2017), complete the registration in accordance with relevant requirements of the *Administrative Measures*. No new private fund service business is allowed until the completion of registration.

Foreign-invested PFSIs

While the *Administrative Measures* does not expressly exclude foreign-invested PFSIs from its application, it is our understanding that the new registration system currently does not contemplate the registration by foreign-invested PFSIs. Certain foreign-invested PFSIs, such as those engaged by QDLP funds to provide fund administration services since the inception of the Shanghai QDLP pilot program in 2012, however, have been providing services well before the 2015 Guidelines. There also are foreign-invested PFSIs that have been engaged in the business in the past two years following the 2015 Guidelines. All of those foreign-invested PFSIs have been operating in a legally murky space. It remains to be seen whether and how CSRC and AMAC will act to include foreign-invested PFSIs so that a fair level playing field can be created for all PFSIs alike.

=====

2. Brief Comment on the General Provisions of the Civil Law (Author: Han CHEN)

As a prelude to the civil code of the People's Republic of China, the General Provisions of the Civil

Law of the People's Republic of China (the “**General Provisions**”) was adopted with votes at the Fifth Session of the 12th National People's Congress on March 15, 2017 and will enter into force on October 1, 2017. This marks an important first step of China on its path to compiling a civil code.

The General Provisions, together with the Supplementary Provisions, comprise a total of 11 chapters and 206 articles. The General Provisions are nearly the same structurally to the General Principles of Civil Law of the People's Republic of China (the “**General Principles**”), which are still in force and have not been expressly abolished. However, the contents of General Provisions see remarkable changes compared to the General Principles, and some of these changes are noteworthy for the professional legal operators.

This article will briefly comment on several provisions of the General Provisions by analyzing the influence of those provisions on business and commercial activities.

Important changes to sources of law

Article 10. *Civil relations shall be dealt with in accordance with the laws and regulations; **where no relevant provision is prescribed by the laws or regulations, customs may apply**, provided the application of customs shall not violate public order and good morals.* (Translation quoted from Lexiscn.com.)

This article clearly stipulates "customs" as a source of law and deletes the old provision of the General Principles that provided for “policy” as a source of law. This provision is considered to have great significance, not only because it will help to reduce the “uncertainty caused by the instability of policy,” but it will also aid in resolving disputes involving local customs, such as disputes related to betrothal gifts. What will need to be further clarified in judicial practice is whether business practices (trade practices) will be accepted as a source of law. Article 61 of the Contract Law of the People's Republic of China provides that: “[f]or a contract that has become valid, where the parties have not stipulated the contents regarding quality, price or remuneration or the place of performance, or have stipulated them unclearly, the parties may supplement them by agreement; if they are unable to reach a supplementary agreement, the problem shall be determined in accordance with the related clauses of the contract or with trade practices.” This means that trade practices have, to some extent, been identified as a source of law in judicial practice. We will wait and see whether the legal status of business practices (trade practices) will be further improved in the future.

Provisions on voluntary guardianship

Article 33. *For an adult with full capacity for civil conduct, he or she may negotiate with his or her close relatives or other individuals or relevant organizations which are willing to act as the guardian in advance and determine his or her guardian in writing. When such adult loses or partly loses the capacity for civil conduct, the guardian determined through negotiations shall then assume the guardianship responsibility.* . (Translation quoted from Lexiscn.com.)

This article relates to voluntary guardianship, which gives a person the right to choose a legal guardian outside of statutory guardianship. The General Provisions expand on the applicable scope of guardianship since a similar provision exists in the Law on the Protection of Rights and Interests of the Elderly. Although voluntary guardianship appears to be a term found in the practice of family law, it has great economic significance in practice by helping enterprises to prevent unexpected losses. Natural person shareholders who become partially or fully lose the capacity for civil conduct due to serious illness, becoming comatose or for other reasons, where the person has not designated a guardian, his or her spouses or other family members shall act as his or her legal guardian. However, the legal guardian may not be able to exercise the rights of shareholders properly. Under voluntary guardianship, a natural person shareholder may appoint as his or her guardian someone who is trustworthy and who has the requisite professional knowledge. The natural person can clearly identify the powers and duties of the guardian in advance, and if the natural person loses or partially loses the capacity for civil conduct due to an unexpected event, the appointed guardian may exercise those rights on behalf of the natural person. This will help to protect the interests of enterprises and prevent internal family disputes from affecting the development of the enterprise.

Provisions on agency duties

Article 170. *Where a person who performs work tasks for a legal person or an unincorporated association performs civil juristic acts related to matters within his or her scope of functions and powers in the name of the legal person or the unincorporated association, such acts shall have binding force on such legal person or unincorporated association.* (Translation quoted from Lexiscn.com.)

Any restrictions imposed by the legal person or unincorporated association on the scope of functions and powers of the person performing work tasks for the legal person or unincorporated association shall not be a valid defense against any bona fide other party. (Translation quoted from Lexiscn.com.)

This provision on agency duties represents a new provision compared to the General Principles. From the perspective of legislative intent, Article 170, particularly paragraph 2, is clearly intended to protect the interests of counterparties, particularly bona fide counterparties. From a business perspective, this increases the risk that employees or executives may engage in unauthorized representations. Enterprises should therefore take appropriate measures to reduce such risks.

Provisions on the termination of entrusted agency

Article 174. *The acts of agency performed by an entrusted agent after the principal dies shall be valid under any of the following circumstances ... (3) the power of attorney explicitly states that the power of agency shall terminate upon completion of the matters entrusted.* . (Translation quoted from Lexiscn.com.)

Similar entrusted agency provisions can be found in earlier lower-hierarchy judicial interpretations,

and the inclusion of this provision in the General Provisions greatly elevates the legal status and acceptance of entrusted agency upon the death of a principal. In complex business structure arrangements, such as VIE arrangements, it is often necessary to entrust all or part of the shareholders' rights to a designated person. The greatest risk in such trust arrangements is that it is uncertain whether the successor to the principal will accept the trust arrangement after the principal dies. This provision provides a clear legal basis for the duration of the entrustment stipulated under the power of attorney and clearly provides that such entrustment may survive the principal.

Provisions on the limitation of action

Article 188. *The limitation of actions regarding applications to a people's court for protection of civil rights shall be three years. Where there are other provisions in the law, such provisions shall apply.* (Translation quoted from Lexiscn.com.)

The provision on the limitation of actions is one of the least controversial provisions of the General Provisions. The General Provisions extend the limitation of action to three years from the previous two years. In addition, Article 179 clearly stipulates that the periods, calculation methods, and the reasons for a suspension or interruption with respect to the limitation of action must be prescribed by the law; additional reasons to which parties may otherwise agree are null and void.

In addition, the General Provisions also contain some untested clauses, whose degree of application and impact are still unclear and are awaiting investigation and evaluation in judicial practice. For example, Article 111 prescribes that the personal information of natural persons is subject to legal protection. Whether this provision will impact relevant industries and enterprises remains to be observed. In the past, personal information has been protected mainly through criminal means, that is, punishing criminally the conduct of "selling, illegally providing citizens' personal information." Civil claims were rarely raised for improperly using personal information. Under the General Provisions, personal information is to be protected as an individual right and interest. Therefore, we expect to see civil claims to be filed in future litigation for improperly using personal information collected through commercial activities, for the failing to fulfill notice obligations, etc.

The General Provisions are not only a summation of past legislation and judicial trial practice, but is also a response to new societal needs, and a reflection of China's standing internationally. The promulgation of the General Provisions marks the beginning of compiling a civil code in China. According to the legislative plan, specific subparts of the General Provisions are scheduled to be released in the next three years. Under the background of integrating civil and commercial law, the Chinese legislative system is expected to undergo fine adjustments over the next three years. Therefore, we recommend researchers, practitioners and civil and commercial entities to consistently pay attention to the legislative process and to be fully prepared for relevant changes. Interested parties should express their reasonable requests by submitting opinions during the invitations for public comment or through other channels.



Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact:



Contact Us

Beijing Office

Tel.: +86-10-8525 5500
9/F, Office Tower C1, Oriental Plaza
No. 1 East Chang An Ave.
Beijing 100738, P. R. China

Estella CHEN Attorney-at-law

Tel.: +86-10-8525 5541
Email: estella.chen@hankunlaw.com

Shanghai Office

Tel.: +86-21-6080 0909
Suite 5709, Tower 1, Plaza 66, 1266 Nanjing
West Road,
Shanghai 200040, P. R. China

Yinshi CAO Attorney-at-law

Tel.: +86-21-6080 0980
Email: yinshi.cao@hankunlaw.com

Shenzhen Office

Tel.: +86-755-3680 6500
Room 2103, 21/F, Kerry Plaza Tower 3, 1-1
Zhongxinsi Road, Futian District, Shenzhen
518048, Guangdong, P. R. China

Jason WANG Attorney at-law

Tel.: +86-755-3680 6518
Email: jason.wang@hankunlaw.com

Hong Kong Office

Tel.: +00852-2820 5600
Suite Rooms 2001-02, 20/F, Hutchison
House, 10 Harcourt Road, Central,
Hong Kong, P. R. China

Dafei CHEN Attorney at-law

Tel.: +852-2820 5616
Email: dafei.chen@hankunlaw.com