

Haiwen Finance and Asset Management Monthly (August)

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Introduction

To make the finance and asset management industry keep abreast of the latest industry developments, Haiwen prepares the "*Haiwen Finance and Asset Management Monthly*". This monthly reading aims to introduce and provide brief comments on regulatory development and industry news.

In August of 2023, **for new rules and regulations**, the Securities Association of China (SAC) has released the *Guidelines for Internal Audits in Securities Companies*; the China Futures Association (CFA) has initiated a public consultation on the *Special Guidelines for Contracts in Futures and Derivative Investment Funds*; the State Council of the PRC has issued the *Opinions on Further Optimizing the Foreign Investment Environment and Strengthening Efforts to Attract Foreign Investment*. The Shanghai Stock Exchange (SSE), the Shenzhen Stock Exchange (SZSE), and Beijing Stock Exchange (BSE) have revised the implementation rules for margin financing and securities lending transactions, lowering the minimum margin requirement.

For industry news, the China Securities Regulatory Commission (CSRC) has issued the *Guidelines on Further Regulating Share Reduction Activities*; the Asset Management Association of China (AMAC) has published the first issue of *Private Fund Registration and Filing Updates*; the CSRC and the Securities and Futures Commission of Hong Kong (SFC) have jointly announced a consensus on introducing block trades (manual trades) into the Stock Connect mechanism; the CSRC official has responded to media inquiries about invigorating the capital market and boosting investor confidence; the Ministry of Finance, in conjunction with relevant departments, has announced tax incentives to support the sustained and healthy development of the capital market.



I Latest Rules and Regulations

1. The SAC Released the *Guidelines for Internal Audits in Securities Companies*

The SAC released the *Guidelines for Internal Audits in Securities Companies* (the "**Internal Audit Guidelines**") on August 7, 2023, which will be implemented starting January 1, 2024.

The Internal Audit Guidelines establish the organizational structure, authority, work procedures, application of results, liability, and self-regulation for internal auditing within securities companies. Key points include, but are not limited to: (1) emphasizing that the board of directors bears the ultimate responsibility for the independence and effectiveness of internal audits; (2) stating that securities companies "may" establish a chief audit executive system; (3) mandating that the number of internal audit staff should generally be no less than 0.5‰ of the total employee count, and not fewer than five people; (4) clarifying that the scope of internal audit oversight covers the headquarters, branches, subsidiaries, and other subordinate units; (5) highlighting the importance of utilizing digital technology in internal auditing tasks.

Haiwen Comments

The Internal Audit Guidelines fill the void of unified regulatory guidance for internal audits within securities companies, effectively address and resolve, at the level of self-regulatory rules, issues identified by the SAC in its 2021 questionnaire survey on securities companies' internal audits, such as full coverage, safeguarding mechanisms, and application of audit results, and aim to improve the effectiveness of internal audits and contribute to the high-quality development of the securities industry.

2. The CFA initiated a public consultation on the *Special Guidelines for Contracts in Futures and Derivative Investment Funds*

On August 11, 2023, the CFA initiated a public consultation on the *Special Guidelines for Contracts in Futures and Derivative Investment Funds* (the "**Special Guidelines**"). The Special Guidelines are intended to supplement and strengthen the existing regulatory framework for privately-managed asset management products/funds that invest in futures and derivatives. They operate within the purview of the *Private Investment Fund Agreement Guidelines* set forth by the AMAC. The Special Guidelines emphasize various areas such as enhanced risk disclosure, strengthened requirements for information disclosure, clarification of investment strategies to prevent style drift, methods of valuation, disclosures of significant events, the establishment of dynamic risk management systems for fund managers, and outlining baseline prohibited behaviors.

The explanatory draft of the Special Guidelines states that CFA members are required to strictly adhere to its provisions. Fund managers who are not CFA members should refer to the relevant requirements of the Special Guidelines for self-regulation.

Haiwen Comments

The intrinsic leveraging and trading complexity unique to the futures and derivatives market call for more stringent regulations on asset management products, particularly in areas such as risk disclosure, the cultivation of qualified investors, and information disclosure. The Special Guidelines present additional and enhanced requirements for contracts of asset management products/funds investing in futures and derivatives markets. This serves as an important step by the CFA in implementing the *Futures and Derivatives Law*, reinforcing self-regulation, and safeguarding investor interests. However, given that these product contracts currently only need to be registered with AMAC, how these new guidelines will be implemented in practice awaits further coordination between the CFA and AMAC.

3. The State Council of the PRC issued the *Opinions on Further Optimizing the Foreign Investment Environment and Strengthening Efforts to Attract Foreign Investment*

On August 13, 2023, the State Council of the PRC released the *Opinions on Further Optimizing the Foreign Investment Environment and Strengthening Efforts to Attract Foreign Investment* (the "**Opinions**"). The following day, the State Council Information Office held a routine policy briefing to provide detailed explanations of the content of the Opinions.

The Opinions outline twenty-four specific policy measures in six key areas, including but not limited to: (1) encouraging eligible foreign investors to establish investment companies and regional headquarters, with the companies established by the relevant investment companies enjoying benefits as per foreign-invested enterprise regulations; (2) deepening the implementation of the QFLP pilot programs in domestic investments, streamlining QFLP foreign exchange management, and supporting investments in the mainland with funds raised in foreign RMB; (3) establishing a green channel for qualified foreign-invested enterprises to efficiently conduct evaluations for the secure outbound flow of critical data and personal information, promoting the orderly and free flow of data, etc. Supporting initiatives in Beijing, Tianjin, Shanghai and the Guangdong-Hong Kong-Macao Greater Bay Area to test and explore the formulation of a general list of freely transferable data as part of the implementation of the data transfer system and building service platforms to provide compliance services for cross-border flow of data.

In addition, at the policy briefing held on August 14, 2023, the Ministry of Commerce announced plans to revise the *Administrative Measures for Strategic Investment in Listed Companies by Foreign Investors*, further easing restrictions on foreign investors making strategic investments in listed companies.

Haiwen Comments

The issuance of the Opinions and the policy measures therein are important indicators of China's commitment to higher-level opening-up and stabilizing the fundamentals of foreign trade and investment in the current environment. It should be noted that not all of the twenty-four

policy measures are entirely new. We suggest that foreign investors pay close attention to, and comply with, currently released or pilot complementary specific measures and details (e.g., QFLP pilot policies) and keep a close eye on future reforms and the rollout of new complementary specific measures and details.

4. The SSE, SZSE, and BSE have revised the implementation rules for Securities Margin Trading, reducing the minimum margin ratio.

On August 27, 2023, the SSE, SZSE and BSE, with approval from the CSRC, announced revisions to the implementation rules for securities margin trading, reducing the minimum financing margin ratio from 100% to 80%. This adjustment will be officially implemented after the market close on September 8, 2023. It shall be further noted that, the revised margin ratio not only applies to new margin financing contracts, but also give securities firms the option to renegotiate the margin ratio for ongoing contracts that have not been settled before the implementation of this adjustment.

Haiwen Comments

This adjustment to the margin ratio is a key measure taken by the SSE, SZSE and BSE in response to the CSRC's comprehensive policy framework aimed at "activating the capital market and boosting investor confidence". Reducing the margin ratio can increase the amount of funds available for margin trading, revitalize existing capital, and attract new funds, and is expected to provide enhanced liquidity support to the A-share market and active the capital market.

// II Industry News

1. The CSRC issued the *Guidelines on Further Regulating Share Reduction Activities*

On August 27, 2023, the CSRC issued the *Guidelines on Further Regulating Share Reduction Activities* (the "**New Share Reduction Guidelines**"). The New Share Reduction Guidelines stipulate that for listed companies that have experienced stock price declines below the issuance price or net asset value, or that have not issued cash dividends in the past three years, or whose cumulative cash dividends are less than 30% of their average net profit over the past three years, the controlling shareholders and actual controllers are prohibited from reducing their shareholdings through the secondary market. The same requirements also apply to the persons acting in concert with the controlling shareholders and actual controllers. For companies without a controlling shareholder or actual controller, the largest shareholder and its actual controller must abide by these requirements.

Additionally, the CSRC announced it is in the process of amending the *Several Provisions on Reduction in Shareholding by Shareholders, Directors, Supervisors, and Senior Management Personnel of Listed Companies*, aimed at elevating the effectiveness of existing regulations, refining the relevant responsibility clauses, and increasing penalties for non-compliance.

Since the issuance of the New Share Reduction Guidelines, hundreds of listed companies have announced the early termination of share reduction plans, voluntary commitments from shareholders not to reduce their shareholdings, and/or extensions of the share lock-up periods.

2. The AMAC published the first issue of *Private Fund Registration and Filing Updates*

On August 11, 2023, the AMAC published the first issue of *Private Fund Registration and Filing Updates* (the "**Updates**"), the Updates (1) summarizes the new requirements reflected in venture capital funds, fund contract content, managing partners, fundraising promotional materials, and risk disclosure statements following the implementation of the *Methods for Registration and Filing of Private Investment Funds* (the "**Methods**"); (2) explains common issues in private fund registration practice since the implementation of the Methods, including

lacking essential elements in the core terms regarding related transactions, information disclosure, and maintenance operational mechanisms in fund contracts or risk disclosure documents; (3) gives targeted summaries and provides reference examples regarding the aforementioned core terms.

The content of the Updates will be updated periodically based on market demand. Private fund managers are advised to continually pay attention to the Updates released by AMAC, and update relevant fund registration documents timely, in accordance with their own, the funds, and investment projects' specific situations.

3. The CSRC and the SFC jointly announced a consensus on introducing block trades (manual trades) into the Stock Connect mechanism

On August 11, 2023, the CSRC and the SFC released a announcement (the "**Joint Announcement**"), declaring a consensus to include block trades (manual trades) in the Stock Connect mechanism between Mainland and the Hong Kong stock markets. This means that offshore investors can engage in block trades on the SSE and SZSE through the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect. Meanwhile, mainland investors can participate in manual trades on the Hong Kong Exchanges and Clearing Limited (HKEX) through the Hong Kong Stock Connect. This move is expected to further enrich the trading methods under the Stock Connect mechanism.

According to the Announcement, the next steps for the CSRC and SFC will be to guide the exchanges and clearing institutions in both areas to formulate implementation plans regarding business, technology, and regulatory arrangements for block trades (manual trades). On the same day, the SSE, SZSE, and CSDC released related announcements, emphasizing their commitment to fully implementing the important consensus between the regulatory bodies of Mainland and the Hong Kong.

4. The CSRC official has responded to media inquiries about invigorating the capital market and boosting investor confidence

On August 18, 2023, relevant CSRC official participated in a media interview to discuss the implementation status of the policy to invigorate the capital market and boost investor confidence, (1) elaborating on six key areas, including, among others: (i) accelerating reforms on the investment side, with a focus on expanding equity funds, (ii) enhancing trading mechanisms to improve transaction convenience, (iii) supporting the development of the Hong Kong market while coordinating the increased activity of both A-shares and Hong Kong stocks, etc.; and (2) highlighting specific measures that include (i) lowering the fee rates for publicly offered funds, (ii) directing leading fund companies to increase the proportion of equity fund issuance, (iii) reducing transaction handling fees in sync with brokerage commission rates, (iv) expanding the scope for margin trading and short selling while reducing their rates, (v) continually optimizing cross-border trading mechanisms, (vi) expanding the scope of eligible securities under the Stock Connect programs; and (vii) supporting the dual listing of Chinese concept stocks in the US and HK, etc.

The CSRC official also addressed recent market concerns such as the pace of IPOs, share repurchases, major shareholder sell-offs, T+0 trading system, and reducing the securities transaction stamp duty rate.

5. The Ministry of Finance, in conjunction with relevant departments, has announced tax incentives to support the sustained and healthy development of the capital market

At the end of August 2023, the Ministry of Finance, in conjunction with the State Taxation Administration, the CSRC and other relevant authorities, released an announcement extending a set of six tax incentives aimed at fostering the sustainable and healthy development of the capital market. These policies will be in effect until the end of either 2025 or 2027 and include, but are not limited to, the following:

(1) Continuing to temporarily exempt individual mainland investors from income tax on capital gains earned from investing in Hong Kong-listed stocks via the SH-HK Stock Connect and SZ-HK Stock Connect, as well as capital gains from buying and selling HK mutual fund shares

through the Mutual Recognition of Funds.

(2) Temporarily exempting foreign individual investors from income tax on earnings obtained from investing in crude oil and other commodities futures approved for foreign access by the State Council.

(3) Temporarily waiving VAT on bonded delivery of goods futures approved for foreign access by the State Council.

(4) Treating gains from the transfer and dividends earned from holding CDRs of innovative companies by QFII and RQFII as equity transfer gains and dividend income from the underlying stocks for corporate income tax purposes.

(5) Temporarily exempting VAT on capital gains earned by QFII and RQFII when entrusting domestic companies to transfer CDRs of innovative companies.

(6) Continuing the implementation of the personal income tax policy for individual partners of venture capital enterprises (or funds, "VC Enterprises") until December 31, 2027, where VC Enterprises choose to account for their operations based on a single investment fund, their individual partners deriving capital gains and dividend income from such a fund will continue to be taxed at a 20% rate on those earnings.

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