
**Mainland-Hong Kong Mutual Recognition of Funds
Initiative to Launch on 1 July 2015:
China Distribution Opportunities for Hong Kong Funds**

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INTRODUCTION

The much anticipated Mainland-Hong Kong Mutual Recognition of Funds Initiative (**MRF**) will be launched on 1 July 2015 with a total investment quota of RMB 600 billion following a [Joint Announcement](#) made by Hong Kong's Securities and Futures Commission (**SFC**) and the China Securities Regulatory Commission (**CSRC**) on 22 May 2015. The two regulators have signed a Memorandum of Regulatory Cooperation on Mainland-Hong Kong Mutual Recognition of Funds which will allow Mainland and Hong Kong funds authorised for retail distribution in their home jurisdiction to follow a streamlined procedure to obtain authorisation for retail distribution in the other market. The initiative does not permit funds authorised for retail distribution in their home market to be privately placed in the other market.

The MRF represents a further step in the opening up of Mainland China's capital market and follows the success of the Shanghai-Hong Kong stock connect programme launched in November 2014. The stock connect programme allows international investors to trade Shanghai-listed A-shares through Hong Kong and Chinese investors to trade Hong Kong-listed shares and is set to be replicated between Shenzhen and Hong Kong in the coming months.

The SFC and CSRC expect the MRF to enhance the international competitiveness of both Mainland and Hong Kong fund markets and fund management companies and encourage the provision of more diverse fund investment products for Mainland and Hong Kong investors.

100 Hong Kong-domiciled funds and 850 Mainland funds would currently be eligible under the MRF.¹ The MRF is expected to further consolidate Hong Kong's position as Asia's leading asset management centre since only funds domiciled in Hong Kong and managed by an SFC-licensed fund manager will be eligible to apply for authorisation for Mainland retail distribution under the MRF. For further information on the requirements for licensing fund managers under Hong Kong's licensing regime, please see Charltons' note at: <http://www.charltonslaw.com/hong-kong-law/the-licensing-regime-under-the-securities-and-futures-ordinance/>.² It will also be a requirement that the fund is established in Hong Kong. Currently, open-ended funds can be established as unit trusts but not in corporate form due to various restrictions on capital reduction under the Hong Kong Companies Ordinance. The Financial Services and Treasury Bureau however published a consultation paper in March 2014 setting out proposals for a new open-ended fund company structure to be established under the Securities and Futures Ordinance which would facilitate the establishment of open-ended investment funds in corporate form with limited liability and

¹ The Financial Times. "Hong Kong-China Mutual Fund Recognition Scheme Reveals Quotas". 31 May 2015.

² Charltons. "The Licensing Regime under the Securities and Futures Ordinance" at <http://www.charltonslaw.com/hong-kong-law/the-licensing-regime-under-the-securities-and-futures-ordinance/>.

variable share capital. For further details of the proposals, please see Charltons' newsletter [FSTB Consults on Open-ended Fund Company Structure](#).³

QUOTAS

The MRF's initial investment quota will be RMB 300 billion for in and out fund flows each way.

REGULATION

The SFC has prepared the "[Circular on Mutual Recognition of Funds between the Mainland and Hong Kong](#)"⁴ (the **MRF Circular**), while the CSRC has issued the "[Provisional Rules for Recognised Hong Kong Funds](#)"⁵ in Chinese. These two documents set out the eligibility criteria, the procedures for application, the operational requirements and the MRF's regulatory arrangements. They form the basis for regulation and enforcement of the MRF.

GENERAL PRINCIPLES

The basic principle underlying the MRF is that funds that have been authorised or registered with the relevant authority in one jurisdiction (the **Home Jurisdiction**) will be able to seek authorisation or approval for retail distribution in the other jurisdiction (the **Host Jurisdiction**). In general, funds seeking retail distribution authorisation under the MRF must:

- a) satisfy the eligibility requirements imposed by the regulator of the Home Jurisdiction;
- b) remain authorised by or registered with the Home Jurisdiction regulator and be permitted to be marketed to the public in the Home Jurisdiction;
- c) generally operate and be managed in accordance with relevant laws and regulations of the Home Jurisdiction and their constitutive documents;
- d) be sold and distributed in the Host Jurisdiction in compliance with the laws and regulations of the Host Jurisdiction;
- e) comply with the additional rules released by the relevant authority in the Host Jurisdiction relating to authorisation or registration, post-authorisation and on-going compliance, and the sale and distribution of the fund in the Host Jurisdiction; and

³ Charltons. "[FSTB Consults on Open-ended Fund Company Structure](#)", April 2014 at <http://www.charltonslaw.com/fstb-consults-on-open-ended-fund-company-structure/>.

⁴ Circular on Mutual Recognition of Funds (MRF) between the Mainland and Hong Kong. 22 May 2015. Available at: <http://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=15EC29>.

⁵ <http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201505/P020150522552573901196.pdf>

- f) treat investors in the Home and Host Jurisdictions fairly and equally, including in respect of investor protection, exercise of rights, compensation and disclosure of information. Responsibility for this is placed on the fund manager.

AUTHORISATION OF HONG KONG FUNDS FOR MAINLAND DISTRIBUTION

The CSRC has issued Provisional Rules for Recognised Hong Kong Funds (the **Provisional Rules**) explaining the eligibility requirements for Hong Kong funds seeking authorisation for distribution in the Mainland as a Recognised Hong Kong Fund.

Eligible Funds

Types of Funds Allowed

Initially, only the following fund types will be eligible for MRF authorisation:

- a) general equity funds;
- b) bond funds;
- c) mixed funds;
- d) unlisted index funds; and
- e) physical index-tracking ETFs.

The MRF may be extended to include other fund types in the future.

Eligibility Requirements

Funds seeking CSRC authorisation must satisfy the following requirements:

- a) they must be established and operated in Hong Kong in accordance with Hong Kong laws and regulations;
- b) they must be authorised by the SFC for retail distribution and regulated by the SFC;
- c) they must have been established for at least 1 year;
- d) they must have a custody arrangement and have a trustee and custodian that meet the relevant SFC requirements;
- e) they must have a minimum size of at least RMB 200 million or its foreign currency equivalent;
- f) the value of the fund's shares/units which are sold to investors in the Mainland must be 50% or less of the value of the fund's total assets;

- g) where the trust deed or constitutive documents provide for dispute resolution by way of litigation, the Mainland courts must not be excluded from entertaining an action in relation to the fund; and
- h) they must not primarily invest in the Mainland market.

The requirement that funds must be established in Hong Kong means that funds that are established outside Hong Kong but are authorised for public distribution in Hong Kong, such as UCITS funds, will not be able to obtain authorisation under the MRF for Mainland distribution.

Requirements for Fund Managers of Hong Kong Funds

The Provisional Rules require the fund manager of a Recognised Hong Kong Fund to:

- a) be licensed by the SFC to conduct Type 9 (Asset Management) regulated activity;
- b) not have been subject to any material penalty imposed by the SFC during the previous 3 years (or since the date of its establishment if it has been established for less than 3 years); and
- c) not delegate its investment management function to a party operating outside Hong Kong.

Mainland Agent

The CSRC requires a Recognised Hong Kong Fund to engage a Mainland agent that is qualified to perform public fund management or custodial activities in Mainland China⁶ to be responsible for:

- a) the Recognised Hong Kong Fund's registration and distribution in Mainland China;
- b) conducting compliance reviews;
- c) the distribution agreements with Mainland distributors (which can also be appointed by the fund manager);
- d) disclosure of information to Mainland investors via designated hubs;
- e) Mainland customer service; and
- f) regulatory reporting to the CSRC.

⁶ The CSRC maintains a list of qualified custodians in PRC (Chinese only):
http://www.csrc.gov.cn/pub/zjhpublic/G00306208/201504/t20150424_275543.htm

The Provisional Rules also require the fund manager to sign an agency agreement with the Mainland agent which clearly outlines matters such as the obligations of each party and the arrangements for expiry or termination of the agreement.

Sale, Distribution and Relevant Disclosure

Disclosure

Hong Kong laws and regulations will govern the type of ongoing disclosure documents, the format, content, timing and frequency of disclosure, and the matters to be disclosed, unless the Provisional Rules provide otherwise.

The offering document of a Recognised Hong Kong Fund must be based on its SFC-approved offering document and must include additional information to address:

- a) risk factors and information specific to the MRF;
- b) the type, timing and means of fund disclosures to Mainland investors, including where these documents can be inspected;
- c) the rights and obligations of parties to the fund, including the procedures and requirements for fund investor meetings, the grounds on which fund documents may be terminated, and the dispute resolution mechanism;
- d) the types and nature of services provided to fund investors and relevant contact details;
and
- e) any major difference between the rights of Mainland and Hong Kong investors, and any other material information relevant to Mainland investors.

Recognised Hong Kong Funds are required to make the following documents available to Mainland investors 3 days prior to their Mainland distribution:

- a) a supplementary statement and disclosure of specific risks associated with Recognised Hong Kong Funds under the MRF in the product key facts statement;
- b) announcement of offering of fund units informing investors about matters such as account opening, settlement and clearance, registration, timing, and the fund's distribution channels; and
- c) the fund's trust deed or constitutive documents.

Announcements and financial reports in relation to Recognised Hong Kong Funds are required to be:

- a) released simultaneously to Mainland and Hong Kong investors;
- b) filed with the CSRC and SFC at the same time; and
- c) published on a website designated by the CSRC or on the Mainland agent's own website.

Language

Recognised Hong Kong Funds are required to prepare their offering document and other documents, including notices and announcements made to Mainland investors, in simplified Chinese and they should ensure that translation from other languages gives a true and accurate reflection of the original version, taking into account market practice and customary use of Chinese language in Mainland China.

Distribution

As mentioned above, a qualified Mainland distributor⁷ is required to be appointed either by the fund manager or the Mainland agent. The parties need to sign a distribution agreement outlining their respective responsibilities.

Distribution of Hong Kong Recognised Funds under the MRF will also be subject to relevant Mainland laws on marketing and promotion. The Provisional Rules provide that:

- a) the Mainland agent will be responsible for reviewing and commenting on marketing or promotional materials (where these are produced by the fund manager or another entity engaged by the manager) to be distributed to Mainland investors as to compliance with relevant Mainland laws and for filing the materials with the CSRC within 5 days of issue; and
- b) where marketing or promotional materials are prepared by the Mainland fund distributors, their senior management will be responsible for reviewing and commenting on those materials as to compliance with relevant Mainland laws and for filing the materials with the CSRC within 5 days of issue;
- c) marketing and promotional materials for Recognised Hong Kong Funds should be comprehensive, accurate and clear, and should indicate that the establishment, operation and disclosure of information regarding the funds are governed by Hong Kong law and regulations; and

⁷ The CSRC maintains a list of qualified fund distributors in PRC (Chinese only):
http://www.csrc.gov.cn/pub/zjhpublic/G00306208/201504/t20150414_275012.htm

- d) marketing and promotional materials which refer to appraisals or ratings by non-Mainland institutions should clearly indicate any difference in appraisal methods and results between non-Mainland and Mainland appraisal institutions.

CSRC Authorisation Application Procedures

An eligible Hong Kong fund may apply to the CSRC for authorisation for Mainland distribution under the MRF by submitting:

- a letter of application;
- the fund's constitutive documents or trust deed;
- the offering document and product key facts statement;
- the latest audited annual report;
- an agency agreement between the fund manager and the appointed Mainland agent;
- documents establishing the qualifications of the fund manager, trustee and custodian and of the Mainland agent under Mainland law;
- a legal opinion;
- other materials as may be requested by the CSRC; and
- an explanation of any key differences between the version of the above documents authorised by the SFC and the version submitted to CSRC.

The CSRC will review the application in accordance with Article 55 of the Fund Laws and inform applicants of the results of authorisation within 6 months of accepting the application.

Enforcement and Regulator Briefings

The CSRC and SFC have established cooperation mechanisms for cross-border regulation and enforcement to ensure the protection of Hong Kong and Mainland investors.

Both the SFC and CSRC plan to hold briefing sessions to explain the application procedures and requirements.

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This note is provided for information purposes only and does not constitute legal advice. Specific advice should be sought in relation to any particular situation. This note has been prepared based on the laws and regulations in force at the date of this note which may be subsequently amended, modified, re-enacted, restated or replaced.