

HONG KONG FINANCIAL REGULATION ALERT

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Hong Kong and China to launch fund mutual recognition on 1 July

Regulators announce scheme that is beneficial to both Hong Kong and Mainland Chinese investors

Highlights

- *The Memorandum of Regulatory Cooperation on Mainland-Hong Kong Mutual Recognition of Funds will enable qualifying Mainland China and Hong Kong funds to be distributed in each other's market.*
- *The scheme is scheduled for implementation on 1 July 2015.*
- *It is expected that around 100 Hong Kong funds as at the end of 2014 whilst around 850 Mainland funds as at the end of first quarter would satisfy the requirements set out by the Hong Kong Securities and Futures Commission (SFC) and the China Securities Regulatory Commission (CSRC).*

The Hong Kong Securities and Futures Commission (SFC) and the China Securities Regulatory Commission (CSRC) last week concluded a co-operation agreement (*Memorandum of Regulatory Cooperation on Mainland-Hong Kong Mutual Recognition of Funds*, "the Memorandum"), that will enable qualifying Mainland China and Hong Kong funds to be distributed in each other's market. What this in effect means is that a fund that is authorised by one domestic jurisdiction may apply for authorisation for retail distribution in the other jurisdiction provided that certain requirements are met. The scheme is scheduled for implementation on 1 July 2015.

This is a quantum shift in the broadening the availability of fund products to investors in Hong Kong and Mainland China and the opening up of the Mainland's funds market to offshore funds. The move is expected to be warmly welcomed by the asset management industry in both territories and will further promote the integration and development of the Asian asset management capability.

The CSRC and SFC have produced documents setting out the qualifying criteria, application procedures, operational requirements and regulatory arrangements of the Mutual Recognition of Funds which will form the basis of regulation and participants' business operations. They are, respectively, referred to as the "Provisional Rules for Recognised Hong Kong Funds" and "Circular on Mutual Recognition of Funds between the Mainland and Hong Kong".

The CSRC and SFC have also established co-operation structures for cross-border regulation and enforcement which will ensure that Hong Kong and mainland investors receive equal protection under the Memorandum. The initial investment quota for the scheme will be RMB 600 billion evenly split between the two markets.

Qualification criteria for Mainland funds applying for SFC authorisation:

- the fund is established and managed and operates in accordance with Mainland laws and regulations and its constitutive documents;
- the fund is a publicly offered securities investment fund registered with the CSRC under the Securities Investment Fund Law of the People's Republic of China;
- the fund must be established for more than 1 year;
- the fund must have a minimum fund size of not less than RMB200 million or its equivalent in a different currency;
- the fund must not primarily invest in the Hong Kong market; and
- the value of shares/units in the fund sold to investors in Hong Kong shall not be more than 50% of the value of the fund's total assets.
- initially, only general equity funds, bond funds, mixed funds, unlisted index funds and physical index-tracking exchange traded funds would be eligible under the scheme.

Hong Kong funds seeking CSRC's approval under the scheme must conform to the Provisional Rules for Recognised Hong Kong Funds issued by the CSRC.

Qualifying criteria for Hong Kong funds applying for CSRC authorisation:

- the fund is established and managed in accordance with Hong Kong laws and regulations and approved by the SFC for public offer in Hong Kong and regulated by the SFC;
- the fund shall adopt the custodian or trustee arrangement that satisfies the SFC requirement;
- the manager is established and operated in Hong Kong, licensed by the SFC to conduct asset management function and has not delegated the investment management function to non-Hong Kong establishment;
- no penalties have been imposed by the SFC on the fund in the recent three years or since its date of inception;
- the fund must be established for more than 1 year;
- the fund must have a minimum fund size of not less than RMB200 million or its equivalent in a different currency;
- the fund must not primarily invest in the Mainland market; and
- the value of shares/units in the fund sold to investors in the Mainland shall not be more than 50% of the value of the fund's total assets.
- initially, only general equity funds, bond funds, mixed funds, unlisted index funds and physical index-tracking exchange traded funds would be eligible under the scheme.

It is expected that around 100 Hong Kong funds as at the end of 2014 whilst around 850 Mainland funds as at the end of first quarter would satisfy the above requirements.

The mutual recognition of fund will deepen the exchange and cooperation of the Mainland and Hong Kong asset management industries, encourage the transformation of Asian savings into cross-border investments and enhance international competitiveness of the Mainland and Hong Kong fund markets.

Both regulators have indicated that they will hold information sessions before the 1 July introduction and will also publish briefing notes and guidelines on application procedures.

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