OnPoint Dechert LLP

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Door to PRC Domestic Funds Market Nudged Open?

While Hong Kong's retail market remains dominated by European Undertakings for Collective Investment in Transferrable Securities (UCITS) (up to about 70% of the funds authorised in Hong Kong for retail distribution are UCITS), both local and international fund managers have shown interest of late in adding a Hong Kong-domiciled collective investment scheme to their stable of funds authorised by the local Securities and Futures Commission (SFC). The reasons are two fold: part pragmatic - having a locally domiciled fund targeted at the local or regional market reduces the number of regulators having supervision over the product (and potentially conflicting regulations and policies) one has to deal with, and part speculative - when the attractive domestic funds market on Mainland China one day opens its doors to foreign funds, funds that are constituted and authorised in Hong Kong should be first in line.

That speculation paid off this past week when a senior executive director of the SFC announced that the SFC and the China Securities Regulatory Commission (CSRC) are working on measures to allow the mutual recognition of funds from both sides of the border. While a full scale passporting system (similar to that of the UCITS passport) has been deemed too ambitious and is firmly not on the cards, the mutual recognition of Hong Kong-based and authorised funds in Mainland China will allow both Hong Kong and global fund managers, issuers and product distributors to go the next best step in applying to the CSRC for approval for such funds to be distributed in the Mainland Chinese market. PRC funds will receive reciprocal treatment and be able to apply for SFC authorisation to be distributed in Hong Kong. Both such steps are currently not possible under existing legislation in both Mainland China and Hong Kong.

The fine details are still being worked out by the respective regulators. There is no indication when the applicable rules will be issued or when the first set of such applications may be made. Apart from the immediate surge in new business opportunities which may be tapped by fund managers on both sides of the border (including fund managers who may not yet have a Hong Kong authorised product but who may now be rethinking their China / North-east Asia distribution strategy), in the long run, this develpment will likely also encourage a revamp of Hong Kong's current state of mutual funds legislation as well as renew interest in an Asia-Pacific funds passporting arrangement.

Hong Kong-domiciled open-ended collective investment schemes must currently be constituted as unit trusts due to challenges posed by the existing companies laws and the absence of any customized mutual funds law. It is hoped that this significant development in the local funds sector will demonstrate the need for, and incentivise the development of, such a mutual funds law. As for an Asia-Pacific funds passport, support for such an arrangement has also been recently overshadowed by the faster rise of an ASEAN funds passport, but, again, this new development will likely turn the spotlight back to an Asia-Pacific equivalent.

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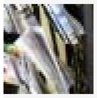

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