Introduction

Over the years, Hong Kong has established itself as an international asset management centre due to the presence of investment talents and professionals, having a first class legal and regulatory system as well as our close ties with the Mainland.

Hong Kong also enjoys a unique position of strength in developing its offshore renminbi (RMB) business. Offshore RMB business in Hong Kong developed rapidly with the Mainland government's policy support, resulting in an increasing breadth of innovative products and offerings. In Hong Kong, RMB products authorized by the Securities and Futures Commission (SFC) have grown from literally nothing three years ago into a sizeable product category. As of 30 September 2014, there were 161 SFC-authorized RMB products, including RQFII unlisted funds and ETFs, RMB dim sum funds, RMB gold ETF, RMB REIT, RMB paper gold ETF and RMB unlisted structured products.

Notably, Hong Kong is the first market to launch RQFII funds and ETFs. These products have been successful. Today, every aspiring offshore RMB centre wants a piece of the RQFII quota. Many fund managers here also have the first mover advantage and have accumulated abundant experience in managing such products. The RQFII's success underscores the strong appeal of the RMB and the attraction of the Mainland market.

The success we enjoy in this endeavour has laid the groundwork for our next breakthrough. The mutual recognition of funds will be another first in the global asset management universe, and a significant milestone in the RMB internationalisation journey.

Overview of mutual recognition of funds

The mutual recognition of funds arrangement (MRF) aligns with one of the goals set out in the National 12th Five Year Plan, which is to support Hong Kong to develop into an offshore RMB centre and an international asset management centre.

MRF will be the first mutual recognition of funds arrangement between the Mainland and a foreign market. This will be a game changer for the asset management industry in Hong Kong. For the first time, funds manufactured outside the Mainland can be directly sold in the Mainland.

Under the proposed MRF framework, qualified funds approved by the China Securities Regulatory Commission (CSRC) established in the Mainland and managed by CSRC-licensed management firms will be subject to a streamlined authorization process by the SFC.
Similarly, qualified SFC-authorized funds domiciled in Hong Kong and managed by SFC-licensed management companies will be subject to a streamlined approval process by the CSRC. Upon registration by the CSRC or authorization by the SFC, the qualified funds can be offered to the public in the Mainland and conversely in Hong Kong (as the case may be).

In view of the Mainland’s capital controls, it is envisaged that the MRF will be subject to a quota system.

**Regulatory approach towards MRF**

The SFC’s regulatory approach towards mutual recognition arrangement has always been to promote cross-border offering of funds so as to broaden investment choice available to the public, without compromising promoting investor protection.

Needless to say, mutual recognition arrangements (whether with the Mainland or with any other jurisdiction) are premised on the fundamental requirements that there is broad equivalence in regulatory standards and investor protection, and satisfactory mutual regulatory assistance and cooperation arrangements being in place between the two markets.

We, together with our Mainland counterparts, devised the mutual recognition of funds framework with an aim: (1) to facilitate a fair, efficient, competitive, transparent, orderly markets in both jurisdictions; (2) to ensure the interests of the investing public are adequately protected; and (3) to promote long-term prosperity and stable development of both markets.

To this end, we adhere to four principles that have guided the design of this initiative: (1) upholding of investor protection; (2) a gradual, measured and pragmatic approach; (3) mutuality and respect; and (4) facilitating industry participants’ operation.

1. **Upholding investor protection**
   To ensure investor protection is not compromised, we have carried out mapping of the regulatory requirements in both markets to ensure that both regimes offer substantially the same level of investor protection.

2. **A gradual, measured and pragmatic approach**
   As with any other pilot programme, a measured, gradual and pragmatic approach will be taken to facilitate a successful launch of the MRF. As such, only regular and plain-vanilla type products would be eligible at the initial stage. Upon successful implementation, we will consider to expand the types of eligible funds to offer greater diversity of investment products.

3. **Mutuality and respect**
   The formulation of the MRF framework is largely driven by this principle – we must respect the rules and regulations of our respective jurisdictions. Neither side should expect any preferential treatment. The SFC and Mainland authorities will also agree on common rules and standards that recognised funds from both the Mainland and Hong Kong will have to meet. These rules will be transparent and we will publish them.

4. **Facilitating industry participants’ operation**
   We have considered existing practice in the design of the MRF rules, so as to minimise disruption to the existing setups and operations of the industry participants.
in both sides of the border where possible. Industry have raised concerns about differences in both markets relating to omnibus account, registration and transfer agent issues. To ensure smooth implementation, we have initiated a technical working group comprising industry representatives from both sides, the SFC, the CSRC, State Administration of Foreign Exchange and China Clear to discuss and resolve various operational and technical issues in relation to the MRF.

Proposed MRF rules

A basic understanding on the MRF framework has been reached with the CSRC on the following six key areas:

1. Types of recognised funds – qualified recognised funds shall be established and authorized in accordance with the Mainland or Hong Kong laws and regulations and initially covers simple and regular type of fund products. The types of recognised fund products may be expanded in the future;

2. Eligibility requirements of management firms – management firms shall be registered in the Mainland/Hong Kong and must be licensed by the CSRC/SFC to manage publicly offered securities investment funds;

3. Approval/vetting process of recognised funds – recognised funds shall be subject to a streamlined vetting process by the host regulator;

4. Fund operation – the eligibility and the regulatory supervisory requirements for management firm and trustee, and the requirements relating to investment restrictions, dealing, valuation, audit, meetings shall comply with the laws and regulations of the home jurisdiction;

5. Disclosure of information – Insofar as the offering documents and regular reports of the recognised funds are concerned, the host regulator may impose supplementary requirements, on matters such as the content, format and frequency of update of these documents; and

6. Investor protection – the SFC and the CSRC will strengthen the regulatory cooperation and assistance to each other, and to clearly specify the dispute resolution mechanisms to ensure that investors in both jurisdictions receive the same level of investor protection.

All key terms of the MRF has been agreed. The approval is now going through the final round of administrative procedure.

We will issue an official announcement on the detailed arrangements once the final procedures are completed.

Potential benefits of MRF

It is envisaged to be a significant step for the asset management industry as a whole, bringing new opportunities to the industry as well as investors in both markets.
**Enrich product offerings**

From the investors' perspective, MRF will enrich product offerings available, resulting in greater investor choice and enabling investors to better manage their portfolio to meet their investment objectives and diversify their risk and assets.

**Enormous business opportunities**

From the fund industry’s perspective, MRF will create an abundance of business opportunities for both Mainland and Hong Kong fund managers. These funds managers together can develop a fund platform in the region with much broader spectrum and depth. That will, in turn, promote a healthy fertilization of asset management skills, adding to the vibrancy and richness of our talent pool.

The rapid growth of the Chinese economy, the world’s most populous country with 1.3 billion people, has been one of the most significant economic stories of the past two decades.

Many are keenly aware of the Mainland market’s potential and the growing needs for a wider variety of financial instruments - high savings rate, low market penetration, rapid economic growth and a society that will have to start dealing with aging.

- In 2013, the savings deposit of urban and rural households was RMB 44.7 trillion. This pool of money needs to be managed.

Currently, there is no channel for Hong Kong-authorized funds to be directly sold to investors in the Mainland, and investors outside the Mainland cannot invest in Mainland public funds. The MRF will open the gate to this mutual traffic flow. Hong Kong fund managers will have unprecedented access to a 1.3 billion potential investors encompassing not only a swelling middle class, but also a large number of high net worth individuals and families.

**Hong Kong as a major fund domicile and moving up in the value chain**

MRF could transform Hong Kong from a fund distribution centre into a major fund domicile. Mainland initiatives, particularly the RQFII scheme and the impending MRF, already fuelled the growth of SFC-authorized Hong Kong-domiciled funds.

- Since the launch of the RQFII scheme in 2011, the number of SFC-authorized Hong Kong-domiciled funds increased by more than 62%, with an average annual growth of around 17% year-on-year.

- As of the end of September 2014, there were 548 SFC-authorized Hong Kong-domiciled funds, an increase of 23% compared to end of September 2013.

- Up to the end of September 2014, out of the 139 funds that were authorized by the SFC, 48% or 67 of them were Hong Kong-domiciled funds.

According to the latest Fund Management Activities Survey, 2013 saw a notable shift within the talent pool in Hong Kong’s fund management business away from sales and marketing and into the high-value end of the business, with about 14% growth in the number of staff engaged in portfolio management, fund administration, research and dealing.

We believe MRF will provide further catalyst to this growth, supporting the development of a seamless end-to-end fund servicing value chain in Hong Kong.
International exposure to Mainland managers

Mainland fund managers can utilise Hong Kong’s distribution platform to promote and distribute their Mainland funds to international investors. Through this access, they will attain a better understanding of the requirements and preferences of international investors, gain exposure to global financial practices, build international branding and expand their distribution network.

From the macro perspective, MRF is a very positive development which reinforces the continual commitment of the Mainland to open its market. The MRF will benefit the long-term prosperity and stable development of both markets.

Next step for the industry participants

If you wish your funds to participate in the MRF, you must make sure that they are domiciled in Hong Kong, authorized by the SFC and managed by SFC-licensed fund managers. In the last two years, we have seen fund managers re-domiciling their funds from other locations to Hong Kong and adding a RMB share class to their funds. You should also equip yourselves with the necessary infrastructure, systems and support, so as to capture the new opportunities that lie ahead.

You may also want to explore the distribution networks in the Mainland, investigate the operational flows and work on brand-building in the Mainland. While you may be big names internationally, mainlanders may not know you well.

For those of you that are already operating in Hong Kong managing funds domiciled here and authorized by us, you may wish to start thinking about which of your products would be suitable for the Mainland market, why they would be suitable, who your target investors are, and how your products would help them.

Concluding remarks

Hong Kong is a preeminent asset management centre underpinned by a robust regulatory regime and a pool of investment professionals. Our asset management has now grown into a sizable scale where the combined fund management business in Hong Kong sustained year-on-year growth of 27% to achieve a record high of HK$16 trillion as at the end of 2013, according to the latest Fund Management Activities Survey.

The road to success has not been easy. Years of hard work and dedication was involved in this transformation process. Hong Kong’s strength in product innovation and in its role as the world’s leading provider of RMB products outside the Mainland is one of the key drivers behind the growth of its fund management business. We believe the MRF will mark another important milestone in our growth story.

As a regulator, it is our core statutory duty to provide reasonable protection for members of the public investing in or holding financial products. We are responsible for the authorization of retail investment products and their offering documents. In our authorization process, we focus on whether information necessary for investors to make an informed investment decision is disclosed in the offering documents. Our authorization is not a guarantee, nor should it be taken as an endorsement, that the product will be successful under any circumstances.
Each product has its own features and risks. Different investors have different investment needs and risk appetite. It is important that investors do their homework to understand a product's features and the associated risks so that they can assess whether the product is suitable for them and will meet their needs and risk appetite. Just as importantly, those of you in distribution, sales and investment advisory services must do your product due diligence, know your client, and take care to ensure that the products you offer to your clients are suitable to them.

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