

## Executive Summary

China Securities Regulatory Commission (CSRC) on 22<sup>nd</sup> May, 2015 along with Hong Kong Securities & Futures Commission (SFC) announced that a memorandum of Regulatory Co-operation as the Mainland-HK Mutual Recognition of Funds (MRF) has been signed and ready for implementation from 1<sup>st</sup> July, 2015.

Terms of the MRF have been published through “Provisional Rules for Recognised Hong Kong Funds” – essentially setting the stage for many plain-vanilla fund structures (Equity, Bond, balanced and some physical index ETF structures) to be sold to Mainland Investors.

Household savings, Insurance and mutual fund assets in China are estimated at over \$7.5 Trillion and it is reasonable to expect that a portion of these will flow into the new passport funds. Market commentators estimate the growth potential to \$400 billion within 10 years – putting this market inside the top 10 markets globally.

This article proposes to discuss a key aspect of the framework and tries to identify potential challenges to be overcome by the Intermediaries.

## Key Aspect – Fund Agent

The memorandum describes the ‘Fund Agent’ as a licensed entity required to be a part of the workflow, managing:

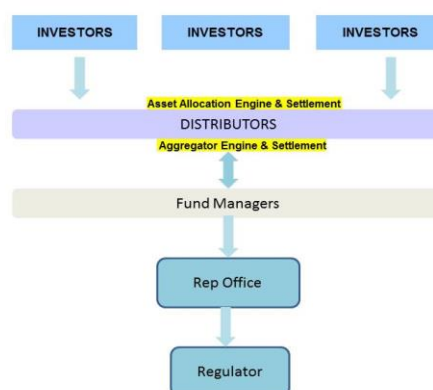
- ‘Custody’
- ‘Acting’ for the registration of the product
- Information Disclosure
- Arrangement for sale & distribution of the funds
- Fund Settlement

- Provision of Supervisory Reports
- Correspondence & Liaison
- Provision of Customer Service and
- Supervisory Controls

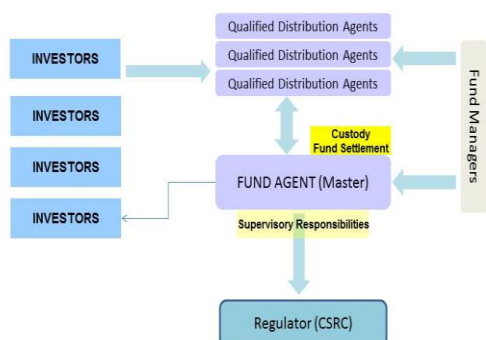
These requirements put together indicate that only Commercial Banks would be eligible to offer services as a ‘Fund Agent’. The expectations on the ‘Fund Agent’ are best understood by looking at involved workflow.

Let’s look at ‘typical’ workflow vs the workflow under MRF to understand the key differences:

### Typical Workflow



### Workflow under Mutual Recognition Framework



As can be seen from above, the workflow closely resembles a **Master Agent** framework implemented in Taiwan for the off-shore fund industry.

However, it is not clear at the time of writing this blog on the actual ‘settlement’ approach i.e. whether the Master Agent directly settles with the ‘Investor/s’ or through the ‘Qualified Distribution Agents’.

This has a significant bearing on the infrastructure that may be required at the disposal of the ‘Master Agent’.

KYC / AML, Settlement – are two key areas to be impacted. Interestingly, news articles talk about HKMA (Hong Kong Monetary Authority) is working closely with Mainland institutions to establish an efficient Fund Processing platform to provide an automated channel for cross border transactions & settlement.

In our view, this initiative could be very similar to the one in the Taiwan market where Euroclear with TDCC has implemented a centralised funds aggregation and settlement platform.

The proposed structure under MRF is a forward looking initiative that requires significant automation for its success. It is understood that ‘Fund Agents’ and ‘Qualified Distribution Agents’ – need to re-look at the type and level of automation.

Retail Investors in Hong Kong, Singapore or other Asian markets like Malaysia, India or Thailand have an higher understanding of the investment vehicle as in ‘Mutual Funds’.

The same is not true of the Mainland market as speculative element is still high. Hence, Investor education is expected to see a higher budgetary allocation.

### Key Observations & Conclusions

‘Fund Agent’ – have to ramp up on skill sets, increase spend on automation

‘Qualified Distributors’ – increase understanding of KYC/AML(FATCA perspective), look to automate order management

Fund Managers – Increase investor education; increased budgetary allocation for supervisory reporting.

While 100 odd Hong Kong funds qualify (as per various reports) to be launched in the Mainland, the above challenges will most likely limit the number of players likely to take the plunge come 1<sup>st</sup> July, 2015.

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