Luxembourg/Hong Kong: Mutual Recognition of Funds

In January 2019, the Securities and Futures Commission (SFC) of Hong Kong and the Commission de Surveillance du Secteur Financier (CSSF) of Luxembourg entered into a Memorandum of Understanding on Mutual Recognition of Funds. Pursuant to the MoU, the two jurisdictions have established a streamlined process that allows eligible Hong Kong public funds and Luxembourg UCITS funds to be distributed in each other's market. The SCF has specified the recognition regime pertaining to Luxembourg funds that are eligible for SFC authorisation or have received SFC authorisation ("Luxembourg Covered Funds") by way of a circular.

As a fundamental principle, the authorisation of funds for offering to the public in Hong Kong requires their compliance with the relevant Hong Kong laws and regulations, including the Securities and Futures Ordinance, the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, as well as the circulars, guidelines and other requirements that the SFC may issue from time to time. Under the recognition scheme, a fund that complies with the relevant Luxembourg laws and regulations and the conditions as set out in the circular is generally deemed to have complied in substance with the relevant Hong Kong laws and regulations. By way of consequence, it shall benefit from a streamlined process of authorisation for offering to the public in Hong Kong.

In light of the differences between the regulatory regimes of the two jurisdictions, to ensure adequate investor protection and consistency with the existing Hong Kong regime for authorised retail funds, the circular specifies: (a) the additional requirements with which a Luxembourg Covered Fund must comply when applying for SFC authorisation for offering to the public in Hong Kong under the Memorandum, as well as (b) other requirements which Luxembourg Covered Funds and management companies that are entitled to manage such funds ("Luxembourg Covered Management Companies") must observe after obtaining SFC authorisation.

Specifically, the circular sets out the following six eligibility requirements for a Luxembourg Covered Fund. First, the fund must be established, domiciled and managed in accordance with the Luxembourg laws and regulations and its constitutive documents. More especially, it must be a UCITS formally authorised by the CSSF pursuant to the Law of 17 December 2010 Relating to Undertakings for Collective Investment ("Law of 2010"). Second, the fund must belong to one of the fund types established under the Hong Kong Code on Unit Trusts and Mutual Funds ("UT Code"): (i) a general equity fund, a bond fund or a mixed fund; or (ii) a feeder fund, where the underlying fund falls within one of the fund types mentioned under (i). Third, the fund must not use leverage (arising from derivatives) exceeding 100% of its net asset value. Fourth, the fund must not invest in (i) physical commodities including precious metals or commodity-based investments or real estate, (ii) crypto-assets or crypto-currencies, or (iii) certificates representing the assets referred to under (i) or (ii). Fifth, the fund must not have share classes with hedging arrangements other than currency hedging. Sixth, the fund must have at least one dealing day for redemption every two weeks.

Apart from these eligibility criteria, all Luxembourg Covered Funds need to satisfy a range of further requirements.

To begin with, each fund must appoint a firm in Hong Kong as its representative in accordance with the conditions set out in the UT Code. Moreover, the fund must, on an ongoing basis, remain authorised by the CSSF for offering to the public in Luxembourg. Similarly, the Luxembourg Covered Management Company of the fund at issue must remain authorised by the CSSF to manage UCITS in accordance with the Law of 2010. Finally, the fund as well as its management company must be subject to ongoing regulation and supervision by the CSSF.

In addition, any proposed changes to a Luxembourg Covered Fund that fall within the UT Code and revisions made to its offering documents relating to such changes must be submitted by its Luxembourg Covered Management Company for approval by the SFC. These changes may only take effect upon approval by the SFC and compliance with any relevant notice requirement. Any proposed changes to a Luxembourg Covered Fund that do not require SFC's prior approval pursuant to the UT Code and revisions made to its offering documents relating to such changes must be filed with the SFC and comply with the relevant requirements set out in the circular. Finally, the investors in Luxembourg and Hong Kong need to be notified at the same time.

In the case of a breach of Luxembourg domestic laws or the requirements set out or referred to in the circular, which is notifiable to the CSSF and which could affect Hong Kong investors in a Luxembourg Covered Fund, the Luxembourg Covered Management Company must notify the CSSF and the SFC at the same time and rectify the breach without delay.

The sale and distribution of a Luxembourg Covered Fund in Hong Kong must be conducted by intermediaries properly licensed by or registered with the SFC. They also must comply with the relevant Hong Kong laws and regulations.

A Luxembourg Covered Fund may use the prospectus approved by the CSSF. Unless otherwise provided for in the circular, matters such as the type of documents, content, format, frequency of update and the updating procedures must comply with the applicable Luxembourg laws and regulations and the provisions of its constitutive documents. The CSSF-approved prospectus may be supplemented by a Hong Kong covering document to satisfy the disclosure requirements set out in the circular. The prospectus should also disclose any other information which may have a material impact on investors in Hong Kong.

Furthermore, the Luxembourg Covered Management Company of a Luxembourg Covered Fund must take reasonable steps and measures to ensure that the ongoing disclosure of information of the Luxembourg Covered Fund.

The offering documents and notices to Hong Kong investors of a Luxembourg Covered Fund must be provided in English and Chinese.

Applications of Luxembourg Covered Funds seeking authorisation under the MRF received by the SFC will be processed under the revamped fund authorisation process ("Revamped Process"). Under the Revamped Process, applications of the Luxembourg Covered Funds will be classified into "Standard Applications" and "Non-standard Applications". Standard Applications will be fast tracked with an aim that SFC's authorisation (if granted) will be given on average between 1 to 2 months from the take-up date of the applications. Non-standard Applications will be processed under an enhanced process with an aim that SFC's authorisation (if granted) will be given on average within 2 to 3 months from the take-up date of the applications.

Under the mutual recognition scheme, the CSSF has spelled out analogous rules in a document entitled "CSSF streamlining requirements and process for mutual recognition of Hong Kong funds".