

Impact of New Fund Distribution Rules on Northbound MRF Funds

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On 28 August 2020, China Securities Regulatory Commission (“CSRC”) released the *Measures for Supervision and Administration of Distributors of Publicly-offered Securities Investment Funds* (公开募集证券投资基金销售机构监督管理办法, the “**Distribution Measures**”) and its supporting rules (collectively, the “**New Fund Distribution Rules**”), which will come into effect from 1 October 2020. The *New Fund Distribution Rules* contain the provisions on distribution of retail funds. As Article 15 of the *Interim Provisions on the Administration of Recognised Hong Kong Funds* (香港互认基金管理暂行规定, the “**MRF Interim Provisions**”) sets out a basic principle that the Mainland distribution of Northbound MRF funds should follow Mainland laws and regulations about distribution of Mainland retail funds as well as the *MRF Interim Provisions*, the provisions on distribution business stipulated in the *New Fund Distribution Rules* will also apply to the Mainland distribution of Northbound MRF funds. This article briefs the key impacts of the *New Fund Distribution Rules* on Mainland distribution of Northbound MRF funds.

I. Trailer Fee

Trailer fee is also called client maintenance fee. Trailer fee is paid out of the fund’s management fee to a distributor, calculated in accordance with an agreed fee rate based on the assets under management maintained by the distributor, for the purpose of covering the costs in connection with the distributor’s ongoing client services and other distribution activities.

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1. Upper Limits of Trailer Fee

The *New Fund Distribution Rules* imposes upper limits on the trailer fee rate. As to the assets under management maintained by a distributor sourced from the distribution to individual investors, the trailer fee should not be more than 50% of the management fee generated therefrom. As to the assets under management maintained by a distributor sourced from the distribution to non-individual investors, the trailer fee should not be more than 30% of the management fee generated therefrom. Such provision also applies to the trailer fee payable to Mainland distributors of Northbound MRF funds.

According to the first paragraph in Article 28 of the implementing provisions of the *Distribution Measures*, we view that, the above upper limits will from 1 October 2020 apply to not only newly-established distribution arrangement of Northbound MRF funds, but also potential payment incurred from existing distribution arrangement of Northbound MRF funds. We therefore suggest that the fund managers and Mainland agents of Northbound MRF funds check the existing distribution agreements. In case that any agreed trailer fee rate is higher than the upper limits, such fee rate should be adjusted by entering into a supplemental agreement.

2. Disclosure of Trailer Fee

Pursuant to the *New Fund Distribution Rules*, before Mainland investors subscribe for a Northbound MRF fund from a Mainland distributor, the Mainland distributor should disclose the level of trailer fee it charges in writing and in the format that will be issued by Asset Management Association of China (“AMAC”). This disclosure requirement should be implemented before 30 September 2021. The trailer fee arrangement agreed between Northbound MRF fund’s manager and any Mainland distributor should be disclosed to investors. Therefore, the fund managers of Northbound MRF funds may consider to clarify the key points with respect to such disclosure arrangements in the distribution agreement.

II. Requisite Content of Distribution Agreement

Article 9 of the implementing provisions of the *Distribution Measures* lists out several items that must be covered in a fund distribution agreement. Among which, as to item (6) in such provision (i.e., client service arrangement after termination of the distribution relationship with the distributor), most distribution agreements might only have general clauses but lack of detailed arrangement based on our experience.

We therefore suggest that the fund managers and Mainland agents of Northbound MRF funds go through the existing distribution agreements to check whether such requisite contents are fully embodied. Newly executed distribution agreements should cover those requisite contents. For existing distribution agreements, it is suggested to check and sign supplemental agreement as soon as possible given there is no transition period.

III. Regular Delivery of Statement of Account

Article 22(3) of the *Distribution Measures* requires the fund distributors to provide each investor with the information about such investor's units holding in the fund proactively and regularly (at least annually per the implementing provisions of the *Distribution Measures*).

So far, most of the Northbound MRF funds' PRC offering documents disclose that, Mainland investors may order and check the statement of account to Mainland distributors in order to understand the investor's own units holding information. According to the *New Fund Distribution Rules*, however, the Mainland distributors should proactively and regularly provide such units holding information to investors.

Pursuant to the implementing provisions of the *Distribution Measures*, the above requirement should be implemented before 30 September 2021. Thus, the PRC offering documents of Northbound MRF funds should also be updated before 30 September 2021 to reflect the proactive and regular delivery of statement of account by Mainland distributors.

In addition, it is suggested that the proactive and regular delivery of statement of account should be agreed in the distribution agreements with the Mainland distributors.

IV. New Requirements on Marketing Materials

The marketing materials of Northbound MRF funds should comply with the *MRF Interim Provisions*, and the requirements on marketing materials of retail funds in the *New Fund Distribution Rules* should also be taken for reference. Please refer to the table below listing some new requirements in the *New Fund Distribution Rules* that are noteworthy for Northbound MRF funds' managers and Mainland agents.

The new requirements on marketing materials will be implemented from 1 October 2020. Northbound MRF fund managers should polish the marketing materials in use according to the *New Fund Distribution Rules*, and the newly produced marketing materials should also follow the *New Fund Distribution Rules*.

	Former Rules	<i>New Fund Distribution Rules</i>
1. Publication of fund performance	To publish the performance of a fund which has been established for more than 10 years, the performance of each year for the most recent 10 years should be published.	The requisite period is shortened from 10 years to 5 years. That is, to publish the performance of a fund which has been established for more than 5 years, only the performance of each year for the most recent 5 years should be published.
	If the marketing material which includes the information of performance is to be published in the	Delete the requirement about publishing the performance of the first half year, but add a new requirement:

	second half year, the performance of the fund in the first half year should be contained.	- Where the fund performance is to be published, any period of performance in the marketing material should be longer than 6 months. 【Note: Some Northbound MRF fund managers would follow the offshore disclosure practice to disclose the performance of the fund for the most recent 3 months or 6 months. Such disclosures should be adjusted to ensure that the period of performance should be longer than 6 months.】
2. Reference of the fund's rating	- Marketing materials which mention a rating by a fund rating agency ...shall state the name of the fund rating agency and the date of rating. - Where the fund management company or its funds are awarded, only the awards that are recognized by the industry as authoritative can be quoted, and any awards obtained 2 years ago should not be quoted.	- Marketing materials which mention a rating by a fund rating agency shall ...state the name of the fund rating agency and the date of issuance of the rating. The timeliness of the rating should be paid attention to. <u>Marketing materials cannot merely quote the rating(s) 2 years ago since the issuance of the marketing materials.</u> 【Note: As to the awards obtained by the Northbound MRF fund or its manager, it is no longer prohibited from quoting the awards obtained 2 years ago, but the awards obtained within the most recent 2 years should also be quoted at the same time.】
3. Additional Disclosure Requirements		- Where the fund is categorized as a special fund type, the marketing materials of the fund should especially disclose its investment scope, investment strategy, risk and return characteristics, etc. 【Note: It is very likely that Northbound MRF funds are deemed as a special fund type, and the marketing materials should include the above additional disclosures.】
4. Updates to Risk Disclosure Letter	Former CSRC rules provide the "Necessary Contents of Risk Disclosure Letter".	The updated template of risk disclosure letter will be released by AMAC.

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