12.1 INTRODUCTION

During the last quarter century, mutual funds have become the investment vehicle of choice for most American investors. Six percent of US households had $135 billion invested in mutual funds in 1980, and by the end of 2004, 48 percent of households had $8.1 trillion invested in mutual funds (Investment Company Institute, 2005). There are now more than 8,000 US mutual funds, compared with only 564 in 1980 (ibid.).

The popularity of mutual funds in the USA has been attributable to their operational structure and, in no small part, to the regulatory regime under which they operate. Mutual funds generally offer the benefits of diversification and professional management at substantially lower cost than individual brokerage accounts. Buying and selling mutual fund shares is a simple process, and fund shares, even shares of funds that invest in less liquid asset classes, are highly liquid, because US law requires that funds value their shares at their market value, honor redemption requests at the same-day closing price of the fund, and pay the proceeds shortly thereafter. Fund fees and investment performance are standardized and relatively transparent, thereby facilitating comparisons among different funds. In contrast, the rules governing the operation of unregistered funds, known as hedge funds, vary substantially by fund.

In comparison to the US mutual fund industry, mutual funds in China are a nascent industry – only $52 billion in assets – with a nascent regulatory structure (Hamlin, 2005). In the last few years, China has adopted a
slew of statutes and rules for mutual funds. If the US experience is any guide, the success of the Chinese mutual fund industry will depend greatly on the efficacy of the regulatory system under which it operates. This chapter surveys key aspects of the current state of Chinese mutual fund regulation and compares these aspects to regulation in the USA. The ensuing discussion addresses the following topics: fund offerings; fund governance; disclosure requirements; fund fees; distribution compensation; pricing, sales and redemptions; affiliated transactions; and money market funds.

12.2 BACKGROUND

The primary regulator of US mutual funds is the Securities and Exchange Commission (SEC), which is responsible for administering and promulgating rules under the Investment Company Act of 1940 and other federal securities laws. The primary regulator of Chinese mutual funds is the Chinese Securities Regulatory Commission (CSRC), which is responsible for administering and promulgating rules under the Law of the People’s Republic of China on Securities Investment Fund (Investment Fund Law) and other national statutes. Both the SEC and CSRC are independent agencies with primary authority over securities regulation. Neither agency has the authority to bring criminal cases, but both may refer securities cases to the relevant prosecutorial authority and provide support in criminal proceedings brought by criminal prosecutors.

In both the USA and China, mutual funds are primarily regulated under a statute that specifically governs the operation of investment companies, including mutual funds: the Investment Company Act in the USA, and the Investment Fund Law in China. Mutual funds may also be directly or indirectly regulated under other securities laws, including particularly statutes relating to the offer and sales of securities, the regulation of brokers and investment advisers, and the operation and structure of companies.

One significant difference between US and Chinese mutual fund regulation is that the SEC’s authority is not exclusive. The SEC shares authority over certain aspects of securities regulation with the legislatures and securities regulators of the states. The states generally have the authority to enact securities legislation, adjudicate civil claims, and bring enforcement cases related to securities activities within their jurisdictions unless there is a direct conflict with federal law. During the last ten years, the US Congress has enacted legislation substantially limiting states’ securities regulatory authority, but states continue to have the ability to substantially influence securities regulation in the USA. In contrast, Chinese securities regulation finds its exclusive source in national law. There are no Chinese legislative bodies or securities regulators that can operate independent of the oversight of the Standing Committee of the National People’s Congress and the CSRC under the State Council.