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APEC Consultation Paper: Arrangements for an Asia Region Funds Passport

Henry Davis York welcomes this APEC initiative and the opportunity to comment on the APEC Consultation Paper: Arrangements for an Asia Region Funds Passport (**Consultation Paper**).

Our submission, responding to specific questions posed in the Consultation Paper, is set out in the attachment to this letter.

Yours faithfully
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APEC Consultation Paper: Arrangements for an Asia Region Funds Passport

1 Background

The Asia Region Funds Passport (**Passport**) is an APEC initiative to create a regulatory arrangement for the cross-border offer of collective investment schemes (**CIS**) in participating jurisdictions. The stated objectives of the Passport proposal include:

- providing investors with greater diversity of investment opportunities;
- promote regional financial integration, to assist Asia-Pacific capital markets to grow and deepen;
- growing the pool of funds invested in the region, including by assisting with keeping funds in the region;
- maintaining frameworks (legal and regulatory) which promote investor protection and fair, efficient and transparent markets.

Treasury and ASIC are to be commended for their role in progressing the Passport proposal and their active engagement concerning the Passport with Australian fund managers and other participants in the funds management sector in Australia. However, whilst the Passport as envisaged under the Consultation Paper has many positive features, in our view many of the rules currently proposed risk impeding the success of the Passport as the Asia-Pacific's answer to the EU's successful UCITS framework (or "Undertakings for the Collective Investment in Transferable Securities").

2 Submission

2.1 Types of CIS

Q2.1: *Should there be any restrictions on the legal form of passport funds in some or all economies for example an exclusion of CIS that are partnerships? If so, why?*

Issue

Currently it is proposed that Australia will nominate a registered scheme under the Corporations Act 2001 (Cth).

It is also currently proposed that the rules will not restrict the legal structure of passport funds other than to require that they are regulated as a CIS by the home

regulator in a manner which is consistent with the IOSCO principles and assessment methodology relating to CIS.

Recommendation

As many industry commentators have suggested, the proposal to nominate a registered scheme for Australia represents a serious flaw in the Passport proposal from the perspective of Australian fund managers. This is because the registered scheme, typically structured as a unit trust, is a form of CIS which is unfamiliar to most if not all offshore investors and which will therefore be quite uncompetitive. We note the long-standing challenges faced by Australian fund managers when trying to market and explain a MIS and the unit trust structure to prospective foreign investors, and we don't see this changing under the Passport. Instead, Australian Passport fund operators will just be at a competitive disadvantage when seeking to promote their Passport funds in the Asia-Pacific in participating Passport countries.

Secondly, as to the issue of restrictions on the form of CIS, in our view the Passport should provide for a universal CIS which is universally recognised (or "passportable") within the region. If there are too many variations of CIS across the region, then the concern is that the Passport proposal will not be successful in achieving its objectives.

Furthermore, the universal CIS needs to adapt many of the features of UCITS with which investors are already comfortable. As a final point, we and others in the Australian funds management industry recognise that Australia's current single responsible entity regime is inconsistent not only with many CIS structures in the Asia-Pacific region but also the UCITS model.

2.2 Track record of operator

Q3.10 Is this restriction on counting the experience of an operator or related party under different control sufficient to ensure that the operator has the capability to act as a passport fund operator? Would the restriction give rise to any practical problems? If the experience of the operator is permitted to be counted despite a change in control because it meets the requirements about continuity of staffing and decision making processes, should there be additional documentation requirements? If so please explain.

Issue

We think that this proposed restriction seems fairly reasonable and provides sufficient flexibility to accommodate a range of prospective Passport fund operators.

Recommendation

We suggest that there should be clarity provided as to the process that a home regulator will follow in determining when in its opinion a jurisdiction which has a CIS regulatory framework is "comparable" to that of the home economy. For example, is it envisaged that ASIC would automatically approve jurisdictions that it has previously viewed as providing a sufficiently equivalent regulatory framework to Australia, for example in the context of providing relief from the Australian financial services licensing requirements for certain foreign financial services providers who are subject to sufficiently equivalent overseas regulation? We think this would be a

sensible approach and could assist in encouraging global fund managers to establish a presence in Australia, from which they could seek to launch Passport funds.

Q3.11 Should operators be allowed to count experience operating other types of retail investment schemes (for example, pension funds) as the requirement is currently drafted? Are there other types of experience which should be allowed to be counted?

Issue

We broadly support this proposal.

Recommendation

We note the requirement that "There must be at least one person responsible for making discretionary investment decisions for the passport fund who is an officer or employee of the operator of the passport fund". Given that many Australian registered MIS have an outsourced responsible entity (**RE**) who does not perform discretionary investment management functions, we presume that this is not intended to require that, in the case of a registered MIS which is a Passport fund and which has an outsourced RE, someone who is an officer or employee of the RE must be responsible for making discretionary investment management decisions. If that were the case, then obviously it would preclude all registered MIS with an outsourced RE from qualifying as a Passport CIS.

2.3 FUM requirement

Funds under management

Issue

We note that it the operator of a proposed Passport fund and its related entities will be required to have AUM in investment schemes of at least USD 500 million.

Whilst this is explicitly intended to ensure Passport fund operators have the experience and capacity to manage sizeable funds, we note that it will effectively exclude many sizeable Australian fund managers. In particular, if the Australian dollar were to depreciate significantly against the US dollar, then this FUM requirement would become especially limiting.

Recommendation

We request further consideration of these restrictions given their likely impact on Australian fund managers.

2.4 Investment restrictions

CIS Limit

Issue

We note that it is proposed to impose two restrictions on a Passport fund holding assets which are interests in regulated CIS, namely the "single CIS limit" and the "total CIS limit".

Many large Australian fund managers, especially hedge fund managers, invest in global products via feeder fund structures, and so these restrictions will prevent these fund managers from participating in the Passport unless they adopt different structures.

Recommendation

We request further consideration of these restrictions given their likely impact on Australian fund managers who have existing feeder fund structures in place.

2.5 Delegation

Q3.26 and 3.27

Issue

We have no comment on these questions.

However, we note that under the proposal, a Passport fund operator is restricted in its ability to delegate portfolio management functions to managers outside of the region. These restrictions effectively prevent a Passport fund operator from delegating any portfolio management functions to a delegate who is not regulated by the Passport regime in the delegate's home economy. This will be fundamentally problematic for many Passport fund operators who manage global portfolios, for example global equities, as it will prevent them from appointing investment managers who are located and regulated outside participating Asia-Pacific countries.

This will impede the competitiveness and attractiveness of many Asia-Pacific fund managers' offerings who should be open to draw on the expertise of investment managers across the globe in delivering funds management.

Recommendation

This delegation restriction should be removed from the passport Proposal.

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