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10 July 2014

Manager  
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The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Ms Wykes,

**RE : ARRANGEMENTS FOR AN ASIA REGION FUNDS PASSPORT**

Perpetual Corporate Trust is a division of Perpetual Limited and acts as trustee, responsible entity and/or custodian for a wide range of financial services and products across both the retail and the wholesale market in Australia and Singapore. This submission largely goes to the Q3.17 of the Consultation Paper: Arrangements for an Asia Region Funds Passport, and discusses the policy objective of ensuring independent oversight. This an area in which Perpetual Corporate Trust has particular experience, insight and track record. We also address some general issues associated with the proposed arrangements for an Asia Region Funds Passport.

Yours faithfully

**Rupert Smoker**  
Head of Responsible Entity Services  
Perpetual Limited

# Perpetual Corporate Trust Submission “APEC Consultation Paper: Arrangements for an Asia Region Funds Passport”

Rupert Smoker  
Head of Responsible Entity Services  
Perpetual Limited  
11 July 2014

*Executive summary.* The Asia Region Funds Passport (the **Passport**) represents a significant opportunity for the regions’ funds management industry and other associated industries. The Passport will provide a compelling platform for the sector to capture the immense opportunities coming out of Asia’s economies. It would also serve to increase competition amongst the region’s prominent fund managers, which will lead to innovation, efficiency and better outcomes for investors. The Passport need not be an invention; it should replicate the success of UCITS funds. In particular, the Passport platform should seek to mirror the key investor protection, independence and product requirements of UCITS. Central to this is independent oversight of the collective investment scheme operators by gatekeepers and regulators. Australia’s single responsible entity regime is contrary to both the UCITS funds model and the fund model adopted by most of our counterparts in the Asia-Pacific region. For Australia to integrate its collective investment market into the global system, we must consider how to improve independent governance within our legislative framework (or change the framework).

Developing the Passport will require significant effort amongst member economies, particularly in respect of tax regimes and permissible product structure. However getting some important key structural issues settled ahead for 2016 will be important to the long term success of the Passport system.

## 1. About Perpetual Corporate Trust

- Perpetual Corporate Trust (**Perpetual**) is a division of Perpetual Limited and is the leading provider of fiduciary services to the debt capital markets and the funds management industry in Australia. It currently administers over A\$548 billion in assets on behalf of a global network of clients (as at 31 December 2013).
- Perpetual has over 125 years’ experience as a trustee company and acts as trustee, responsible entity (**RE**) and/or custodian for a wide range of financial services and products across both the retail and the wholesale market in Australia and Singapore. Our core services include:



## 2. Focus of this submission

- This submission largely goes to the **Q3.17** of the APEC Consultation Paper: Arrangements for an Asia Region Funds Passport (**Consultation Paper**), which discusses the policy objective of ensuring independent oversight. This an area in which Perpetual Corporate Trust has particular experience, insight and track record. We also address some general issues associated within the proposed arrangements for an Asia Regional Funds Passport.

## 3. General Statements

- Perpetual supports the Passport, and the objectives stated in the Consultation Paper. Like other Australian financial institutions, integrating our services within Asia is a key strategic priority. Through our ownership of The Trust Company, we have a longstanding presence in Singapore, where we are licensed as a trustee by the Monetary Authority of Singapore.
- We believe a passport system will further promote the free flow of funds to those financial institutions within our region who can demonstrate excellence in a competitive multi-national environment. In that regard, Australia has enjoyed great success in attracting foreign capital in recent years.

## 4. Context for Australia

- The 2013 Australian Investment Managers Cross-Border Flows Report commissioned by the Financial Services Counsel and The Trust Company (Part of Perpetual Limited) identified that foreign fund flows into Australia have increased by 78% since January 2010. As set out in the table below as at 31 December 2012, some 66% of foreign inflows have originated from the Asia-Pacific region, representing a total amount of \$18.71b. As the report notes, with the right policy settings in place, Australia can take advantage of the potential for domestic fund managers to form a significant and growing proportion of future export activity.

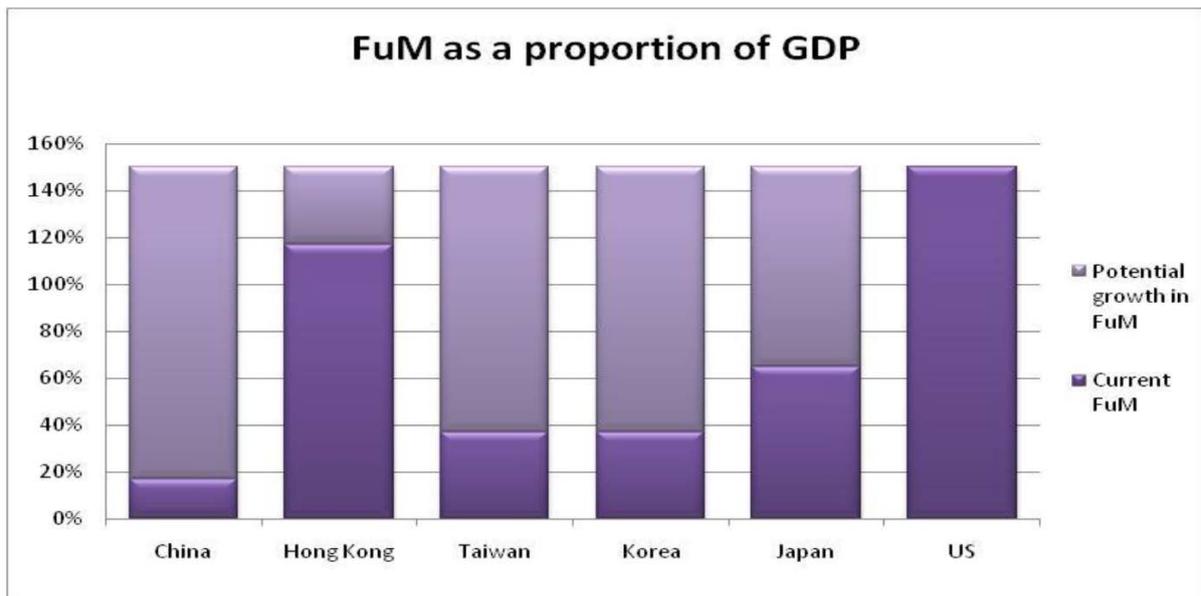
| Region          | Funds at<br>1 January 2010 |              | Funds at<br>31 December 2012 |              | Increase over<br>Period<br>A\$ billion | Increase<br>p.a. over<br>Period |
|-----------------|----------------------------|--------------|------------------------------|--------------|--|---------------------------------|
|                 | A\$ billion                | %            | A\$ billion                  | %            |  |                                 |
| Asia Pacific    | 14.75                      | 67.6         | 18.71                        | 66.1         | 3.97                                   | 8.26%                           |
| Europe          | 2.80                       | 12.8         | 5.13                         | 18.1         | 2.34                                   | 22.47%                          |
| Middle East     | 1.21                       | 5.6          | 1.77                         | 6.3          | 0.56                                   | 13.41%                          |
| United Kingdom* | 2.32                       | 10.6         | 1.66                         | 5.9          | -0.66                                  | -10.49%                         |
| United States*  | 0.67                       | 3.0          | 0.13                         | 0.5          | -0.54                                  | -42.26%                         |
| Other Regions*  | 0.07                       | 0.3          | 0.91                         | 3.2          | 0.84                                   | 136.33%                         |
| <b>Total</b>    | <b>21.80</b>               | <b>100.0</b> | <b>28.31</b>                 | <b>100.0</b> | <b>6.51</b>                            |                                 |

\* United States data may have also been included within Other Regions in the 31 December 2012 data. In the table above, the United Kingdom and United States data at 31 December 2012 is partial and may in fact be included (but not reported) under Other regions.

Source: FSC/The Trust Company (Part of Perpetual Limited)<sup>1</sup>

<sup>1</sup> 2013 Australian Investment Managers Cross-Border Flows Report commissioned by the Financial Services Counsel and The Trust Company (Part of Perpetual Limited)

- As the above data suggests, the Australian funds management industry has performed well in absolute terms in recent times. However, there remains significant potential within the economies of the Asia-Pacific region as they continue to undergo a period of significant economic growth and transformation. More specifically for fund managers, the current assets/funds under management as a proportion of GDP in most Asian nations are currently well below their potential (compared to the US). The following table sets out the proportion of national funds under management as a percentage of GDP. It shows the sheer potential of economies such as China, Taiwan, Korea and Japan.



Source: PwC<sup>2</sup>

## 5. Global Context and UCITS

- As global capital flows become easier there has been significant demand for, and growth in the number of, cross-border collective investment funds. Cross-border funds are funds operated out of one jurisdiction and sold into another. PwC<sup>3</sup> has tracked the number of cross-border funds operating globally, and suggest that between 2001 and 2013, there was an increase of 200% of the number of cross-border funds. The number now stands at 9,869, the majority of which are registered in Luxemburg and Ireland, and are UCITS funds. Asian appetite for UCITS funds is strong, and Asia represents between 30-40% of net sales into UCITS funds. Most of retail investments into collective investment vehicles in Singapore, Hong Kong and Taiwan are now made into UCITS funds indicating that the investing public are comfortable with the structure of these products. Also, Australian fund managers are now creating UCITS funds to attract foreign investment. As an example, AMP Capital announced in April 2014 that it had created both a Global Listed Infrastructure Fund and a Global Real Estate Securities fund targeting investors in the Eurozone, Asia and the Americas.<sup>4</sup>
- Australian fund managers targeting Asian investors through the promotion of the Passport should look at the successful penetration of European fund managers into

<sup>2</sup> PwC, Asset Management Insights, Distributing funds in Asia's growth market:

<sup>3</sup> PwC Global Fund Distribution 2014

<sup>4</sup> Investor Daily, AMP Capital Expands UCITS platform to Asia, 14 June 2014.

key Asian market. We can only infer that the structure of the UCITS platform is part of that success. Essentially, UCITS funds have the following features:

- They are approved in their home country;
  - They have investment restrictions (securities traded on markets, certain money market instruments, derivatives with risk limits);
  - They must have specific diversity with the fund's portfolios;
  - They must be open ended; and
  - They have specified financial reporting and disclosure obligations.
- A key feature of UCITS funds are that they must use a separate custodian and must be subject to independent oversight from an external party referred to as a "depository". The depository has a blended role consistent with the role played by a traditional trustee and by a custodian. The depository concept is not dissimilar to many economies within the Asia-Pacific, whose collective investment laws recognise the need for both an investment manager and an independent guardian (normally a trustee) who oversees the collective investment so that it is operated in the best interests of its investors.
  - Unfortunately, according to the Australian Government corporate law adviser CAMAC, UCITS funds cannot be registered as a managed investment scheme under the Corporations Act, as the UCITS structure does not recognise Australia's single responsible entity regime. Conversely, it is not possible for a registered scheme (that is, a managed investment scheme registered under Chapter 5C of the Corporations Act) to be a UCITS fund, again, because of the single responsible entity regime. Structurally, Australia cannot integrate its funds into the UCITS platform. This alone stands to question whether Australia should reconsider both the single responsible entity regime as it considers entering the global funds management community through the Passport.

## **6. Analysis of the independent oversight within Australia's Collective Investment market**

- Perpetual agrees with the Consultation Paper statements about the importance of independent oversight. The paper states:

"A key element of CIS governance is the presence of independent oversight over performance of the operator's duties. Internationally, independent entities are the primary source of independent oversight.

The independent entity's main objective is to ensure that operators comply with the applicable rules, their contractual obligations, and their duties from 'an outside perspective', and, therefore, protect members from divergent behaviours of the operator.<sup>5</sup>"

- We agree with the duties that should be imposed upon the independent entity enumerated in the Consultation Paper. However, we consider that further duties should be vested in the independent entity. In particular, the independent entity should have duties in relation to:
  - Any disclosure documents issued by the collective investment operator, to be satisfied they do not contain misleading or deceptive statements;

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<sup>5</sup> ARFP Consultation Paper p21.

- financial reports issued in respect of a collective investment vehicle to ensure disclosures meet statutory and accounting standard requirements;
  - supervision of related party transactions by the collective investment; and
  - fees paid to the operator of the collective investment (including performance fees).
- The Consultation Paper would appear to suggest that Australia’s single responsible entity regime can achieve the equivalence of independent oversight or an “outside perspective” without the use of an independent entity (such as a trustee or depository). It suggests that the outside perspective may be achieved through either a majority of independent directors on the board of a RE or through an independent compliance committee. For a few select financial institutions in Australia, represented by its banks and the largest fund managers, we agree with this position. However, for a large majority of the Australian funds management sector, the protections of either independent directors of an RE or a Compliance Committee are illusory.
  - A feature of Australia’s regulatory regime for managed funds market is that it is relatively simple to apply for and be authorised as an RE. It is similarly simple to apply for and have registered a managed investment scheme. As such, Australia has approximately 500 licensed responsible entities, which is far more than other jurisdictions given its open regulatory architecture. This is the perfect illustration of Australia’s efficient markets approach to financial regulation emanating from the 1997 Wallis Inquiry. While recent regulatory enhancements have led to improving the financial capacity of REs (through increasing regulatory capital requirements), there are many recent examples of the inadequacy of the single responsible entity regime. These inadequacies have led to numerous reviews by Government authorities including two reviews by the Parliamentary Joint Committee on Corporations and Financial Services<sup>6</sup>.
  - The collapses and failures of various schemes over the past few years as the result of the financial and economic conditions have “stress tested” Australia’s collective investment regulatory framework for the first time since its introduction in 1998. This has highlighted numerous weaknesses in the robustness of the regime. With regard to the objectives of ensuring a single point of accountability and improving the compliance culture across the industry we believe that the single responsible entity regime has been successful. However, we believe that many of the recent failures have raised the question of whether the independence of decision making of some REs was adequate.
  - Unlike the directors of a listed company, independent directors of an RE are pitted against the resources of an institution over which they do not have the power to hire or fire. Even where there are a majority of independent directors in place, the majority is generally slight (as opposed to a clear majority in the case of a listed company). This “horizontal” dynamic (where the independents are effectively “visitors” to an organization) as opposed to a “vertical” dynamic (where the independents clearly feel “top of the tree”) cannot be over-emphasised. The additional responsibility to ensure the separation of the activities to those of the sponsoring entity also requires close attention. These factors heighten the required qualities of the individual to ensure robust questioning and scrutiny.

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<sup>6</sup> The Inquiry Into the Collapse of Trio Capital, 2012. Inquiry into Financial Products and Services in Australia. 2010.

- The option of having a majority of independent members on a Compliance Committee to satisfy the test of independence is a weakness in the framework since a Compliance Committee has a far more limited role to that of a responsible entity. Many decisions that can cause prejudice to investors can be made without Compliance Committee involvement. Furthermore, the Compliance Committee does not necessarily provide real-time monitoring or check an RE's actions and is similarly appointed and may be dismissed at the whim of the RE.
- The single responsible entity model is a source of, at a minimum, consternation, if not strong aversion from many overseas institutional investors, especially in the UK and Europe. Even when the scheme sponsor possesses an excellent pedigree, many institutional investors from these jurisdictions may be reluctant to invest in any vehicle that does not have an independent trustee. The potential for conflict in the single responsible entity regime is perceived to be unacceptable by many foreign investors and the regime flies in the face of what is regarded as internationally accepted investment standards such as UCITS funds.
- We note that another passporting concept by member nations of ASEAN is being floated for launch in 2014. The ASEAN Collective Investment Scheme Framework (ACIS) involves collaboration by Singapore, Malaysia and Thailand and seeks to achieve similar outcomes as the passport. Like the UCITS platform, ACIS will also require passporting funds/operators to be overseen by an independent trustee or supervisor<sup>7</sup>.
- Following on from the global financial crisis, we have also seen strong investor demand for the installation of independent entities to oversight the operation of collective investment vehicles. Under the single responsible entity regime, independent REs are not compulsory. However, Perpetual has conducted \$10.5 billion in public market transactions since 2010 and is seeing listed entities whose structures incorporate a registered management investment scheme increasingly recognise the benefits of appointing an independent RE. The market appears to support our view that, outside of the largest banking and financial institutions in Australia, independent REs ensure best in breed corporate governance and risk management.
- The concept of independent oversight by an independent entity such as a trustee or depository is widely accepted as an appropriate way to enhance the interests of investors and minimise risks. Such an entity is there to protect investors from non-compliant, illegal and fraudulent conduct of the schemes operator (investment manager). It is desired by, and understood by global investors. In developing a lasting structure to advance the chances of success of the passport, we should adopt this global standard. We therefore suggest that an operator of a CIS participating on the Passport platform may only be supervised by an independent entity that is licensed to do so.

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<sup>7</sup> Are we ready? Hong Kong –mainland China mutual fund recognition – considerations and future outlook. EY