

10 April 2015

Asia Region Funds Passport Working Group

Submitted via submission form on <http://fundspassport.apec.org/consultation-on-rules/>

Re: Consultation on the rules and operational arrangements (2015)

Dear Sirs

We, the CFA Societies in Australia, Korea, New Zealand, the Philippines, Singapore and Thailand (jointly, the “CFA Societies”), welcome the opportunity to participate in the Asia Region Funds Passport Working Group’s consultation on the detailed rules and operational arrangements. In our engagement with regulators, the investment industry and investors – not only in the Asia Pacific but also in markets worldwide – we have always been a strong advocate of corporate governance measures that enhance market integrity and trust in the finance industry.

The Asia Region Funds Passport (the “Passport”) is one of three fund passporting schemes that have emerged in Asia as part of recent initiatives. Although there are challenges to implementing the Passport, we believe that the Passport will ultimately benefit retail investors in the Asia Region by encouraging fund managers to compete, lower costs and find ways to offer better services and fund products.

In formulating our views and response, the CFA Societies also considered the views of CFA Institute and the requirements of CIS schemes in various regimes. Please find our consolidated comments to the consultation paper as set out below.

Consultation question 1: For certainty, the Working Group intends to provide a table which will specify who is a qualified distributor in a Participant. This will reflect the approach identified in subsection (3) above, although there will be some differences.

For Singapore, a qualified distributor may be restricted to certain entities such as banks and holders of a capital markets service licence. For Australia, a qualified distributor would be the holder of an Australian financial services licence authorised to deal in interests in managed investment schemes.

The Working Group is seeking feedback on whether, in relation to each economy, there are adequate avenues through which an Operator is able to market a Passport Fund without obtaining a licence in that economy.

The CFA Societies are of the view that there are at present adequate avenues through which an Operator is able to market a Passport Fund without obtaining a licence in that economy. Our comments about the respective economies are as follows:

| Economy | Comments |
|-------------|--|
| Australia | Funds may be marketed by financial advisory firms and fund supermarkets holding an appropriate Australian Financial Services Licence (AFSL). |
| New Zealand | Funds may be marketed by independent financial advisers and fund supermarkets. The marketer/distributor of a financial product has to be |

| | |
|-------------|--|
| | an Authorised Financial Adviser (AFA) under New Zealand's regulatory regime. |
| Philippines | Funds may be marketed by banks and insurance companies. |
| Singapore | Marketing of CIS is regulated under the Financial Advisers Act. Qualified distributors include licensed financial advisers and exempt financial advisers (e.g. banks and holders of capital markets services licence). |

Consultation question 2: The financial resources test is set with reference to a specific currency, USD. Is it appropriate to set the currency as USD for the purposes of the requirements, given possible fluctuations in currency?

The CFA Societies agree that given the participation of various Asia Pacific economies in the Passport, the use of a globally accepted currency such as the USD to measure financial resources is appropriate. We suggest the Working Group consider giving the participants an option of using either the spot rate or an average exchange rate (say, over a three year period) to provide some buffer allowance in the event of large currency fluctuations.

On a related note, subsection 7(1) states that the Operator of a Passport Fund must at all times meet the financial resources test. Operators are usually audited once a year. We would like the Working Group to clarify if the annual audit on an Operator is sufficient to show that it meets the financial resources test at all times. We would also like to seek the Working Group's clarification if currency hedging is allowed.

Consultation Question 3: The Passport rules currently do not allow Passport funds to short sell, both synthetically and physically. Nevertheless, the Working Group acknowledges the importance of using financial derivative instruments for hedging and netting off existing exposure. Exceptions are therefore provided for a Passport fund to take a short position in derivatives that are subject to hedging or netting arrangements.

The Working Group notes this proposed Passport rules may be stricter than some existing cross border frameworks for retail CIS and is considering the conditions and what additional safeguards should be introduced to ensure short selling will not result in the Passport funds taking excessive risks.

The Working Group would like to seek industry input on whether physical or synthetic short selling should be restricted, and if so, what safeguards would be appropriate to mitigate risks associated with physical or synthetic short selling:

(1) Synthetic short selling – Are the current safeguards relating to derivatives, such as global exposure limit (section 39), cover rule (section 42), quality of counterparty to derivatives (section 27), and general requirements for derivatives (section 25) sufficient to mitigate the risk of synthetic short selling? What other safeguards should be considered?

(2) Physical short selling – Some existing cross border frameworks for retail CIS jurisdictions do not currently permit retail CIS to carry out physical short selling, citing increased settlement risk involved in and absence of requirements governing such transactions. Should Passport Funds be permitted to engage in securities borrowing and physical short selling transactions? Accordingly, what requirements and safeguards should be introduced to ensure that Passport Funds minimise the risks arising from securities borrowing and physical short selling transactions, if such transactions were to be allowed? For example, what are some of the safeguards available to ensure that a Passport Fund's short positions in such transactions are fully covered at all times?

The CFA Societies agree that there should be provisions to permit short selling provided that certain safeguards are in place.

In Singapore, the Code on CIS prohibits short selling for retail CIS except where this arises from financial derivatives which are invested in accordance with other requirements in the Code such as exposure limits, counterparty limits, quality of collateral, etc. in Hong Kong, the Code on Unit Trusts and Mutual Funds allows short selling of a security within 10% of the CIS' total NAV and the security which is to be sold short must be actively traded on a market where short selling activity is permitted. Within the UCITS framework, physical (uncovered) short selling is not permitted in UCITS funds, although certain synthetic shorting strategies are possible through financial derivative instruments.

Consultation question 4: Should the single entity limit be 10% in all cases, as opposed to the graduated approach as drafted under section 30? Would this significantly reduce the extent to which diversification is used in Passport Funds to reduce risk? Does the wording in the text give rise to practical problems?

The CFA Societies are of the view that Option 2 as drafted in paragraph 50 of the Feedback Statement is most straightforward, where a Passport Fund's investment limit is restricted to no more than 10% of the adjusted value of the assets in a single entity without a requirement for being assessed as having acceptable risk or an aggregate restriction of 40% of the adjusted value of the assets for arrangements in single entity holdings exceeding 5% of the adjusting value of the assets that have not been assessed as having acceptable risk. We note that the 10% single entity restriction on portfolio allocations is generally prescribed in the Singapore Code on CIS, Hong Kong Code on Unit Trusts and Mutual Funds and UCITS in relation to transferable securities or money market instruments.

Consultation question 5: The Working Group is seeking feedback on whether the proposal in subsection 30(2) to increase the single entity limit to 15% for banks regulated under Basel Guidelines is preferable to having a separate limit for derivatives from other forms of counterparty exposure.

We do not have an opinion on this question.

Consultation question 6: Should the acceptable risk assessment apply even if the total of holdings that exceed the limit in subsection 30(1) was less than 40%? Would this significantly reduce the risk of such exposures? What, if any, costs of practical problems would arise?

The CFA Societies suggest the Working Group consider adopting the 5/10/40 rule in UCITS which does not require Operators to carry out an acceptable risk assessment within a period of no more than one month before the last acquisition of the asset in holding by the Operator.

Consultation question 7: For the entity limits (subsection 30(1), 30(2), 30(4), 30(8) and 31(1)), the Working Group has taken the approach to disregard the offsetting effects of derivatives as this is a more conservative approach. Would this be unduly restrictive for industry?

The CFA Societies agree that the more conservative approach of disregarding the offsetting effects of derivatives should be used.

Consultation question 8: Would the proposed Passport Rules on the charging of performance fees be unduly burdensome? What impact, if any, would this have on current commercial arrangements?.

Taken as a whole, section 47 may become burdensome. For example, the description in subsection 47(1)(a), “excessive risks taken by the Operator in relation to the Passport Fund”, lends itself to wide interpretation on how excessive risks may be quantified. The focus of subsection 47(1)(a) should be on behaviour contrary to the investment objectives and strategy of the fund. We suggest deleting the words “excessive risks being taken by the Operator in relation to the Passport Fund”, with the test being limited to the “investment objectives and strategy not being followed”.

In subsection 47(1)(b) we suggest adding “or auditor” to the verification process to better capture practices that already exist.

In subsection 47(1)(c) we suggest adding “or their existing nominee” after “independent oversight entity”. We believe the test is appropriate but by being too prescriptive on the parties to the written statement it may create duplicative work within some jurisdictions.

In a 2013 CFA Institute report on Packaged Retail Investment Products: Investor Disclosure Considerations for a Key Information Document, a key finding was that performance fees tend to be imposed by hedge funds but are not common in retail funds. The report also recommended that costs, including performance fees where applicable, should be disclosed under a standard label and location within the key information document. Therefore the CFA Societies suggest that section 47 should also state that performance fees, where payable, should be disclosed with numerical examples of how the performance fee is calculated.

Consultation question 9: Would the proposed Passport Rules over suspension of redemptions be too restrictive? What impact, if any, would this have on current commercial arrangements?

The CFA Societies agree that the proposed rules around redemptions are fair.

Consultation question 10: Should the value referred to in subsection (1)(b) above be market value or notional value of the equivalent position in the underlying asset, whichever is the more conservative?

The CFA Societies agree that the more conservative valuation approach should be used.

Other Matters

The CFA Societies would like the Working Group to consider elements from other frameworks such as the AIFM, ELTIF, etc. that are available in the EU as a next step for the Passport (please see http://ec.europa.eu/finance/investment/index_en.htm).

Given the importance of ensuring comparability and presentation of investment performance of passport funds, we would like the Working Group to consider incorporating requirements for full disclosure and fair representation of investment performance results such as the Global Investment Performance Standards (GIPS®). GIPS® are a rigorous set of voluntary investment performance measurement standards, based on the fundamental principles of full disclosure and fair representation of investment performance results. By choosing to comply with GIPS®, investment management firms assure prospective clients that the historical “track record” they report is both complete and fairly presented. GIPS® compliance allows firms to expand their business territories and to participate in competitive bids against other compliant firms globally. The GIPS® standards make it possible for investment managers around the world to “transport” their historical investment returns to other countries without having to restate these figures using different calculation and presentation rules. This standardization creates an even playing field for compliant firms and gives current and prospective clients more confidence in the integrity of the performance reporting.

The CFA Institute currently partners with local sponsoring organizations, referred to as GIPS® “country sponsors” in 37 countries/regions around the world to ensure effective implementation of the GIPS® standards and ongoing operation within a country. Country sponsors are present in the represented countries of the Working Group. They are:

| Country | GIPS® Sponsor |
|-------------|--|
| Australia | Financial Services Council (FSC) |
| Korea | Korea Investment Performance Committee (KIPC) |
| New Zealand | CFA Society New Zealand |
| Philippines | CFA Society Philippines Fund Managers Association of the Philippines (FMAP) |
| Singapore | Investment Management Association of Singapore (IMAS) |
| Thailand | The Association of Provident Fund (AOP) |

Please see www.gipsstandards.org for more information.

The CFA Societies would also suggest the Working Group consider incorporating the CFA Institute Asset Manager Code of Professional Conduct (“AMC”) as part of the Passport framework, and in particular as an additional test under the Good Standing of Operator, Rule 10. The AMC provides a uniform global standard for comparing managers from different regions, under different regulatory regimes. The AMC in particular stresses safeguarding client interests and ensuring that asset managers have robust processes in place with regard to their investment approach and maintaining market integrity. The AMC is designed to be broadly adopted within the industry as a template, and also serve as a guidepost for investors seeking asset managers who adhere to sound ethical practice.

- The Asset Manager Code is voluntary and investor-focused. It embodies the fundamental ethical principles at the core of the investment management industry.
- It states that managers have these responsibilities to their clients:
 - o To act in a professional and ethical manner at all times
 - o To act for the benefit of clients

- o To act with independence and objectivity
 - o To act with skill, competence, and diligence
 - o To communicate with clients in a timely and accurate manner
 - o To uphold the rules governing capital markets
- The Asset Manager Code is global. Investment management firms from around the world, of different structures, size, and complexity, adopt the Code to demonstrate their commitment to best ethical practice. Nearly 1,100 firms from over 30 countries claim compliance with the Code.
 - AMC adoption ensures that the firm is complying with global best practice in safeguarding client interests. It allows firms to demonstrate their commitment to ethical practice. Adoption creates a strong reputation for a firm's values that can help retain and attract clients.

We understand that most countries/regulators have adopted a code of conduct of some form and that some of the principles from the AMC would also be reflected in these codes. That is why we suggest the AMC be used as an additional test to local regulatory requirements. The AMC will set a uniform high standard and act as a common benchmark for Operators participating in the Asia Region Funds Passport.

Please see this link www.cfainstitute.org/assetcode for additional information.

Concluding Remarks

The CFA Societies would like to thank you for the opportunity to furnish our comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us on this or any other issues in future.

Please note that all feedback is made in our personal capacities as CFA Society members and do not necessarily represent the views of the organizations where we work.

Yours sincerely,

CFA Societies Australia
CFA Society Korea
CFA Society New Zealand
CFA Society Philippines
CFA Society Singapore
CFA Society Thailand