Date: 09/April/2015

To the Committee members:

MSCI is a leading provider of investment-decision support tools to over 6,000 clients worldwide, ranging from large pension plans to boutique hedge funds. We offer a range of products and services — including indexes, portfolio risk and performance analytics, and ESG data and research — from a number of internationally recognized brands such as Barra, RiskMetrics, and IPD. Located in 23 countries, and with over 2,600 employees, MSCI is dedicated to supporting the increasingly complex needs of the investment community with groundbreaking products, quality data, superior distribution, and dedicated client support.

MSCI appreciates the opportunity to provide feedback on the Asian regional fund passport, and we see this as an important and strategic development for the regional fund management industry, one that has the potential to increase the capacity and competitiveness of the industry. We also see such an initiative as having the potential to develop a more tightly integrated fund management industry, which in turn presents a long term benefit to investors in terms of an increased range of investment options for clients across the region, better diversification for investors, lower costs for investors, and potentially lower risks and higher investment returns. All of these benefits are a recipe for significant growth in the Asian fund management industry.

A key factor for the success of such an important and strategic initiative is for the fund passport platform to develop an early reputation for supporting more transparent and well regulated funds, especially granular transparency in risk and performance. Our response is drafted to reinforce the level of risk and performance transparency within Asian markets to ensure that the platform achieves this objective.

We suggest the creation of a minimum standard of risk management. A consistent risk transparency standard for funds, irrespective of their home countries, is an important consideration for the committee members. This serves two objectives: 1) to protect investors from undesirable risks to which funds licensed under fund passport may be exposed; and 2) to help prevent any regulatory arbitrage, and hence foster mutual confidence.

For similar schemes globally, the important dimension of a robust risk management framework that management companies should follow includes the following process:

1. Define Goals:

    a. Client or firm risk tolerance
    b. Relationship between performance outcomes and client expectations
2. Understand Risk Exposures:
    a. Define drivers according to investment horizons
3. Use Effective Models:
    a. Level of model sophistication, designs, ownership, etc.
4. Develop Sustainable Risk Monitoring and Management:
    a. Organizational design of risk management
5. Create Solutions for Clients
    a. Many institutional investors need advice on how to manage and budget risk.
    b. Better comprehension of risk can add significant value to clients and drive greater shares of client portfolios.

Investors in such schemes are subject to various types of risk that may result in capital losses or poor investment performance. These include both financial risks and operational risks. Our response to this consultation paper emphasizes the issues relating to financial risks.

To assess financial risks, management companies should consider the following aspects:

1. Identifying the risks to which the management company is exposed
2. Identifying the correct measures of risk — to make sure firms are getting a comprehensive view of the risks to which they are exposed
3. Identifying an appropriate risk model — this includes identifying the necessary risk factors to forecast portfolio risk

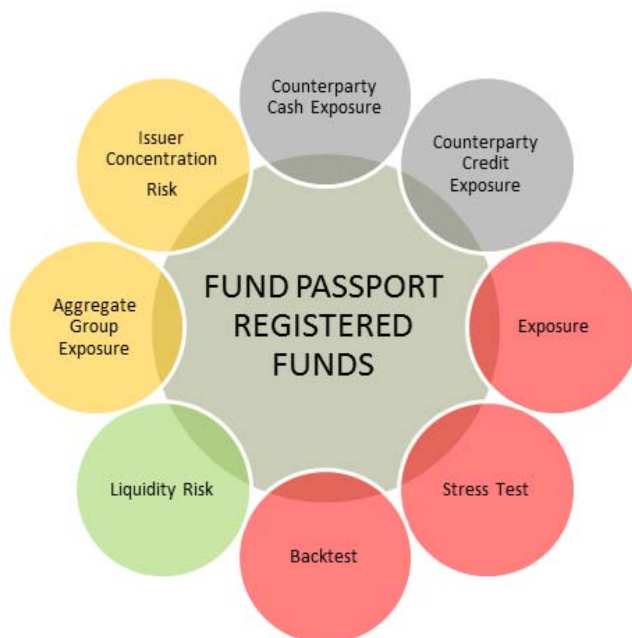
Identifying the risks to which the management company is exposed:

One consideration for committee members is the provision that “the management or investment company must employ a risk management process which enables it to monitor and measure at any time the financial risk of the positions in the portfolio as well their contribution to the overall risk of the portfolio.” The institution’s risk management framework must at minimum address:

1. Market and investment risk
2. Credit risk
3. Counterparty risk
4. Liquidity risk

And over all of these, the institutions must address:

1. Concentration risk
    a. Single security concentration
    b. Issuer-level / counterparty concentration
    c. Aggregated group-level concentration, (e.g., sector)
2. Event risk (stress testing) — assessing the effect of a risk event, e.g., in the case of a stressed credit event, how does the liquidity risk change?



For sake of clarity, the definition of the terms above can be found in Appendix 1.

Identifying the correct measures of risk:

Ongoing risk management operations may involve the computation of a number of quantitative measures, such as an overall exposure summary, standard deviation, VaR, risk contribution by risk type (both incremental and marginal), issuer-level concentrations, counterparty exposures, expected shortfall, diversification benefits, and others. These operations generally aim to address the effects of market risk and credit risk (including issuer risk, counterparty risk, and liquidity risk). The risk management techniques should be able to adapt easily to enable the adequate measurement of risks in periods of increased market turbulence.

Another type of analysis that may be useful for management firms to perform is "stress testing." Stress tests are usually meant to capture the possibility of rare and severe losses that could occur during market shocks but are unlikely to be measured by models, because they tend to follow structural breaks in the functional relationship between market variables. Such risks might include, for example, unexpected changes to price correlations or asset liquidity.

Identifying an appropriate risk model:

This process includes identifying the necessary risk factors and model to forecast portfolio risk. The quality of risk model used has a direct relationship with the accuracy of such analyses. The management companies should employ effective techniques and review as necessary to ensure that they remain the appropriate solutions in the interest of the investors.

There may be cases in which the investment management companies also invest in complex structured financial instruments. Many of the structured products represent nonlinear payoffs; hence, the risk factors associated with any of those components should be appropriately identified and managed. This includes due diligence concerning the characteristics of the underlying assets and the overall risk profile of the instruments, including the material risks to which they are exposed.

Another important dimension for committee members is "backtesting" the portfolio to compare actual portfolio returns to the predicted risk, such as predicted standard deviation and predicted VaR. Backtesting helps to assess the quality of the risk model-based forecast. Such backtesting should be performed on the risk management framework and supplemented with ongoing monitoring to ensure that the framework remains viable and robust over a long period.

If robust market prices are available, then the risk measures should be computed by relying on a complete and adequate time series of marked-to-market values. However, when measuring the risk of illiquid assets, managers should thoroughly check the robustness of their estimates, testing the data used for the computation against the valuation of actual comparable trades (proxies) where available. Assumptions and models underlying the prices of assets requiring complex evaluation, such as illiquid structured financial instruments or derivatives, should be

consistent with the broader risk management framework. This framework should be maintained and revised over time.

Additional Comments:

Reporting: The committee members may also consider asking the management or investment companies to set up a process for ensuring the risk tolerances of each fund are set at an appropriate level and aligned with the investment policy, including limit rules, based on the estimate of the effect in the event that a risk tolerance level is breached and the likelihood that each material risk is realized. This means, for each material risk, the maximum level of risk within which the institution is willing to operate, expressed as a risk limit and based on its risk appetite, risk profile, and capital strength. Regular reporting on all material risks to monitor any breaches to the competent authority, as well as to the investors, may also facilitate investment companies keeping the material risks a high priority.

In closing, we reiterate our support of the Committee's efforts to introduce a significant step in enhancing the capacity and competitiveness of the industry and the overall improvement of regional liquidity, and we applaud this insightful consultation document. We appreciate the opportunity to comment, and we look forward to continuing to contribute to the dialogue. We are available for further comments or clarifications as necessary, and we welcome future communications.

Sincerely,

Sumit Sethi
Vice President
MSCI
sumit.sethi@msci.com
+65 6701 1170
+65 8571 3977

Appendix 1

Market Risk: Market risk is typically referred to as the risk of fluctuations in the market value of the securities invested by the funds, which may vary over time, reflecting different market conditions.

Credit Risk: Credit risk is defined as the risk that funds may face should one or more of their investment-related counterparties fail to meet their financial obligations.

Counterparty Risk: Counterparty risk is defined as the risk that funds may face should a counterparty not meet its contractual obligations.

Liquidity Risk: Liquidity risk is defined as the risk that funds may face should they be unable to unwind their portfolio's positions at a suitable market price.

Concentration Risk: Concentration risk is defined as the risk of loss arising from a large position in a single asset or market exposure.