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14 April 2015

Financial Services Unit
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: fundspassport@treasury.gov.au

Dear Sir / Madam

Arrangements for an Asia Region Funds Passport: Feedback Statement and Consultation on Draft Rules

We welcome the opportunity to provide our comments on the Asia Region Funds Passport proposed draft rules (**the Passport Regime**).

Pitcher Partners is strongly supportive of the proposed introduction of the Passport Regime and have long advocated the introduction of these measures to facilitate cross border funds management business practices in an efficient manner.

However, we raise our concern with two aspects of the proposed regime. The first is that we highlight that the Passport Regime is strongly geared towards larger fund administrators and does not provide appropriate (or any) relief for those funds that require the most assistance from such a regime. We believe that this outcome would be inconsistent with the recent release of the Murray Report in 2014 which advocated an increase in competition and a reduction to barriers. In particular, the measures (as drafted) would seem to do the opposite. While we understand that certain measures are required for consumer protection, we highlight that the Australian registered managed funds industry is highly regulated and thus we believe that these additional requirements are somewhat unnecessary.

The second is the restriction on asset classes and (in particular) the exclusion of the management of real property in Australia. While Australia is in the process of making significant income tax developments that would encourage and enhance the establishment of REITs in Australia (to be managed on behalf of offshore investors), it is concerning that the Passport Regime does not extend to these registered managed funds. Accordingly, such funds will continue to be required to double compliance costs in offering their products in multiple jurisdictions.

We have also provided our response to question 8 and highlight that the rule, as drafted would seem to be inconstant with the majority of managed funds that charge an outperformance fee in Australia. We would recommend some flexibility in the setting of fees so that they do not fall foul of the Passport Regime to the extent that the Home Regulator has approved such fee structures for the purpose of the domestic regime.

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We have provided our more detailed comments and recommendations in the attachment to this letter. We request that these items be considered in finalising the MOU. I would be more than happy to discuss these recommendations and issues further at any time. I can be contacted on (03) 8610 5170 or at alexis.kokkinos@pitcher.com.au.

Yours sincerely

A M KOKKINOS
Executive Director

1 ATTACHMENT – DETAILED COMMENTS

1.1 Contextual background

1.1.1 The Australian managed funds industry is significant, with over $2.4 trillion of unconsolidated assets under management. Currently, only 3.6% of these funds are managed on behalf of non-resident investors.

1.1.2 There are significant impediments for marketing Australian managed investment scheme products throughout Asia. Unless these impediments are appropriately addressed, Australia will remain uncompetitive within the Asian Pacific region.

1.1.3 We acknowledge that increasing competition throughout the Asian market and facilitating cross border funds management opportunities comes with its risk and that consumer protection is paramount. However, the Australian registered management funds industry is highly regulated and accordingly we believe that the increased regulatory requirements that are to be imposed by the Passport Regime would unnecessarily add to complexity and would inappropriately remove smaller fund administrators from accessing the regime.

1.1.4 As outlined below, we believe that the regime would provide the most benefits to such funds given the high proportionate regulatory cost for managing a fund in two or more jurisdictions.

1.2 Removing barriers and increasing completion

1.2.1 In November 2014, Mr David Murray released the Financial System Inquiry Final Report. The report made important recommendations in relation to increasing competition and removing barriers to entry.

> Competition
>
> Competition and competitive markets are at the heart of the Inquiry's philosophy for the financial system. The Inquiry sees them as the primary means of supporting the system's efficiency. Although the Inquiry considers competition is generally adequate, the high concentration and increasing vertical integration in some parts of the Australian financial system has the potential to limit the benefits of competition in the future and should be proactively monitored over time.
>
> The Inquiry's approach to encouraging competition is to seek to remove impediments to its development. The Inquiry has made recommendations to amend the regulatory system, including: narrowing the differences in risk weights in mortgage lending; considering a competitive mechanism to allocate members to more efficient superannuation funds; and ensuring regulators are more sensitive to the effects of their decisions on competition, international competitiveness and the free flow of capital.

1.2.2 Following this report, we are therefore deeply concerned with the overly restrictive requirements that are contained in the proposed Passport

Regime that would act to limit a significant number of smaller funds and (what may be referred to as) start-up funds.

1.2.3 We highlight that these types of fund administrators incur disproportionately high compliance costs as compared to larger fund administrators. Accordingly, it is these funds that would benefit the most from the compliance cost savings associated with a Passport Regime.

1.2.4 We note that Australia has a highly rigorous financial services regulatory regime, aimed at providing consumer protection. Accordingly, we are unsure why it would be believed that the requirements of the Corporations Act for registered managed investment schemes (MIS), would be insufficient to deal with Passport Funds.

1.2.5 We therefore raise our concerns with the overly restrictive additional requirements being proposed by the draft MOU. In particular, we highlight the following restrictions and our comments for consideration:

- The financial asset test – we do not believe that there is a need to have funds under management of USD 500 million. We currently assist clients with schemes of between USD 50 million to USD 150 million, operating as cross-border funds. The reporting, compliance and scrutiny for such clients is exactly the same as those with USD 500 million. These fund operators are significantly substantial and there is no reason why they should be precluded from the Passport Regime.

- Qualification requirements – We find the qualification of officer requirements contained in Annexure 3, Rule 6 to be unnecessary in an Australian context, given that registered schemes require an appropriate responsible entity with an Australian Financial Services Licence (AFSL) in Australia. We believe that the requirements placed under the Corporations Act on establishing a responsible entity and obtaining an AFSL are more than adequate to cover this issue and therefore it is not clear how these additional requirements add further protection over and above the Corporations Act requirements.

- Delegation requirements – We note that similar issues arise in respect of the delegation requirements contained in Rule 11, especially where Investment Managers to a responsible entity would need to hold an AFSL and would be heavily regulated under the Corporations Act.

- Equity held – to the extent that the financial assets test requirement is reduced per our recommendations below, we believe that the requirements of holding equity should also be substantially reduced and should also be in line with the requirements of the Corporations Act for responsible entities.

- Track record – We believe that a five year track record is again overly restrictive and believe that a responsible entity in Australia that has a proven track record of three years should qualify for this regime. This requirement is a significant impediment for fund managers seeking to establish their own funds management business, whereby they would

need to wait over five years to be able to qualify. Accordingly, the rules do not encourage new fund managers to establish new business operations. We further note that the proposed Rule 9(3) does not assist in this manner, as the previous entity would not be regarded as a "Related party" to the new business. We see no reason why the Home Regulator should not be given further discretion to allow for this test to be taken to be satisfied.

1.3 Recommendations to deal with competitive barriers

1.3.1 We believe that the majority of these issues could be addressed if the Home Regulator is provided with a power to waive certain requirements on funds by way of an application of the Fund. This would be a discretionary power contained in respect of the Registration powers of the home regulator contained in Annexure 2, Rule 3. For example, to the extent that a fund administrator has a proven track record (but is starting a new business), the Home Regulator could waive the five year requirement.

1.3.2 The same type of solution could be utilised for all issues identified. For example, the USD 500 million asset test could be waived or reduced having regard to the type of fund and the history of the fund.

1.3.3 Where this is not accepted, we strongly request that APEC consider reducing the overly burdensome thresholds that have been provided for in the draft MOU. We highlight the uncompetitive nature of these restrictions for smaller funds and its inconsistency with the Murray report.

1.4 Real estate investment property trusts (REITs)

1.4.1 We highlight the significant submission previously provided by the Property Council of Australia on requesting the inclusion of REITs within the Passport Regime. We strongly support this submission.

1.4.2 Australia is in the process of introducing new funds management rules which are heavily geared toward establishing Australian REITs, where property is held for long term passive rental purposes. The new managed investment trust provisions, released on 9 April 2015, provide tailored rules that are highly supportive in the facilitation of cross-border REITs.

1.4.3 Australia provides concessional tax rates (15% as compared to 30%) where property is managed on behalf of non-residents. Accordingly, Australia provides incentives for foreign asset management in the class of real property. We note that this does not include property held for resale or development, which is strictly prohibited by this regime through the Australian public trading trust provisions. Accordingly, there are appropriate safe guards to ensure that the land is only (or predominantly) used for deriving rent.

1.4.4 We therefore highlight that there should be no reason why this asset class should be excluded from being a permitted asset as defined in the proposed rules. The exclusion of such assets is unlikely to reduce the number of managed funds that attempt to access offshore markets – however, what it

does is (instead) systemically increases the cost of doing business unnecessarily.

1.4.5 We would strongly recommend that APEC consider expanding the range of permissible assets, such that it either included real property. Alternatively, if the various jurisdictions are opposed to this outright recommendation, we see no reason why a Home Regulator should be precluded from adding an asset class to the list of permissible assets where the asset class meets certain requirements.

1.5 Fees paid to a responsible entity

1.5.1 We highlight that it is common for most managed funds in Australia to include an outperformance fee, based on a hurdle test rate or benchmark. It is noted that RG 134, issued by ASIC, allows the following:

> (a) All the variables in calculating a fee should be set out in the constitution. Responsible entities can set out a maximum fee or performance fee based on a benchmark.

1.5.2 We are concerned that Rule 47 (as currently drafted and contained in Annexure 3) could preclude the charging of such fees.

1.5.3 In response to Question 8, we would recommend that the Passport Regime provide some scope or discretion for the Home Regulator to be able to accept fee structures that are appropriate under the Home Regulators domestic regulations. As such fees are acceptable under RG 134, such a power would remove the requirement for all existing funds to change their fee structure in Australia.

1.5.4 Accordingly, if Rule 47 included the above type of rule, or alternatively was subject to a Home Regulator‘s discretion, we believe that this issue would be resolved.