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An initiative of the APEC Finance Ministers' Process

# **ASIA REGION FUNDS PASSPORT**

## **Joint Committee Report**

### **Submissions on the Guidance on Host Economy Laws and Regulations relating to the Asia Region Funds Passport**

**January 2018**

## About this report

This report sets out the submissions that were received in response to the public consultation on the 'Guidance on Host Economy Laws and Regulations Relating to the Asia Region Funds Passport' (Guidance). The interim Guidance was released on 25 July 2017, and consultation closed on 19 September 2017.

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# Introduction

## Overview of ARFP

1. The Asia Region Funds Passport (the Passport) is intended to establish a regional market for collective investment schemes (CISs) by facilitating cross-border offerings across participating economies. It will reduce regulatory duplication for CIS operators by establishing a standardised set of requirements, and benefit investors through broader and more diverse fund offerings, while maintaining investor protection. It will also strengthen the capacity, expertise and international competitiveness of regional financial markets and the CIS industries of the participating economies.
2. The Joint Committee (JC) is the governing body of the Passport. It was established under the 'Memorandum of Cooperation on the Establishment and Implementation of the Asia Region Funds Passport' (MoC).
3. The functions of the JC include:
  - 3.1. monitoring the Passport arrangements and operations, including ensuring the consistent application of the Passport Rules and resolving differences of interpretation;
  - 3.2. recommending any amendments necessary to Passport policies, including the Framework Document and the MoC;
  - 3.3. where appropriate, developing and publishing information that serves as general guidelines to operators, investors and passport regulators on the operation of the passport, including processes for registration of passport funds, the admission of passport funds in each host economy and the interpretation of Passport Rules for CIS operators and investors;
  - 3.4. considering and, if agreed, making recommendations to the participants about aspects for the form or content of the application for registration of a passport fund or entry to a host economy that are to apply; and
  - 3.5. assessing nominations from economies that wish to participate in the Passport.

## Guidance on host economy laws and regulations

4. In July 2017, the JC published interim 'Guidance on Host Economy Laws and Regulations Relating to the Asia Region Funds Passport' (Guidance).<sup>1</sup>
5. The Guidance is intended to assist CIS operators make an initial assessment of the requirements under the Passport, and is not intended to be a substitute for independent legal advice, which all CIS operators interested in participating in the Passport should obtain.
6. The Guidance sets out a number of key regulatory matters applicable to CIS operators seeking to enter Japan, Australia, South Korea, New Zealand or Thailand under the Passport. Matters covered include:
  - 6.1. disclosure;
  - 6.2. capital controls;

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<sup>1</sup> <http://fundspassport.apec.org/consultation-on-arfp-guidance-2017/>

- 6.3. taxation;
  - 6.4. distribution;
  - 6.5. local agents;
  - 6.6. access to financial markets to sell exchange traded funds (ETFs); and
  - 6.7. privacy and anti-money laundering (AML) legislation.
7. However, the Guidance is not intended to be a comprehensive statement about Host Economy laws and regulations applicable to potential Passport fund operators that may consider using the Passport.
  8. The matters covered in the interim Guidance were based on the JC's understanding of the main provisions of the Host Economies that are likely to be applicable to Passport fund operators under the Passport regulatory framework. In some areas the legal requirements that will apply in Host Economies are not settled. The content of the Guidance was not intended to be taken as a statement of policy by any of the participating economies.
  9. The JC intends to update the Guidance as the applicable legal requirements become clear, and taking into account industry submissions.

## Consultation process

10. The JC invited public submissions on the interim Guidance. The JC received three submissions from industry and international industry groups. They were generally supportive of the Passport, and provided useful submissions on the matters sets out in the Guidance, and on a range of other issues. The JC thanks submitters for their helpful comments.
11. This report highlights the key themes that arise from the industry submissions received on the interim Guidance, and outlines the Joint Committee response to those themes.
12. The key themes to emerge from the submissions included:
  - 12.1. Tax – submissions indicated a preference for neutral or better treatment of Passport funds versus local funds;
  - 12.2. Harmonisation of regulations and Passport Rules – submissions recommended that the participating economies promote coordination, convergence, standardisation and harmonisation;
  - 12.3. Implementation – submissions indicated a preference for a pilot program, and early promotion to set the Passport's reputation as a well-regulated system; and
  - 12.4. Enlargement – submissions indicated a preference to open up the ARFP to other regional economies, and to make it operable with other regional mutual recognition frameworks.
13. Following receipt of submissions, the JC held its third face-to-face meeting in Bangkok, Thailand, on 3 – 4 October 2017. Included in the JC's discussions in Bangkok were the three submissions on the Guidance.

## Key themes raised in submissions

### Taxation

14. All the respondents commented on taxation issues. The general tenor of submissions was that tax should not be a barrier to investing in Passport funds.
15. Respondents commented that the Guidance does not set out the principles of tax neutrality that should be made applicable to Passport funds.
16. One respondent commented on the need for tax neutrality between resident and non-resident funds, investors and Passport fund operators.
17. Another respondent submitted that there should be incentives to purchase Passport Funds over local funds, that is, it is important that Passport funds receive the same (if not more favorable) tax treatment to the local funds of the participating economies. They encouraged the JC to identify and resolve any mismatches to the tax treatment between Passport and local funds, including tax neutrality for resident investors.

#### JC response:

We have established a Tax Working Group to examine the existing barriers in tax laws and where possible identified how they can be overcome. We aim to release an update from the Tax Working Group later.

However, we note the Passport is not a tax treaty and changes to domestic taxation law remain the responsibility of participating economies to resolve.

### Harmonisation of regulations and Passport Rules

18. One respondent submitted that the participating economies should promote regulatory coordination, convergence and harmonisation, as follows:
  - 18.1. coordination – compare domestic legal and regulatory approaches, operational and supervisory practices, and capital controls;
  - 18.2. convergence – monitor and analyse participating economies' implementation to develop solutions when areas of divergence arise;
  - 18.3. harmonisation – seek to develop a common approach across participating economies to reduce complexity.
19. The respondent considered that a common approach should apply to registration and marketing, including a common investor disclosure document, to provide investors across economies with a common investor experience.
20. Another respondent also made a submission in support of standardising and harmonising the regulations of participating economies to reduce complexity for Passport fund operators, and strengthen investor confidence in the Passport.
21. A particular area for harmonisation that was mentioned by one respondent was a suggestion that rules on the method of calculation and disclosure of performance figures and fees in the prospectus of Passport funds be established in order to ensure investors are able to conduct a fair comparison of the available Passport funds.
22. Commissions and fees were also raised, with one respondent questioning whether or not there should be a policy on sales fees/commissions, as differences need to be understood by investors in each market, and should also be reflected in the relevant

fund documentation. Perhaps the Passport needs to clearly state the respective position of each jurisdiction with regard to commissions on sales of funds.

23. One respondent also suggested that participating economies should work towards according equivalent priority in promoting Passport funds so that they are treated on a basis that is comparable to domestic funds. This spirit of reciprocity will allow the ARFP to facilitate greater financial integration.

JC response:

We acknowledge the respondents' preference for a Passport that seeks to develop a harmonized approach across participating economies where possible to reduce complexity and cost. This is our medium to long term aim.

In the implementation of the Passport, each participating economy is working closely together sharing their views about how the Passport Rules should be applied. For example, we have shared for comments on draft guidance, raised interpretation issues for discussion and resolution between each other. We acknowledge the importance of consistency between each participating economies' application of the Passport Rules.

We continue to identify those areas that we consider would lead to the greatest reduction of complexity and costs within the Passport framework. We agree with the respondents that the areas of registration, disclosure and distribution are likely to produce the greatest benefits. As the Passport progresses, we are committed to looking at areas to improve it and reduce costs for passport fund operators, distributors and their advisors. We welcome continued engagement with industry about the areas that might provide the greatest benefit.

At the last JC meeting, we agreed to enhancements to the MoC to provide flexibility to meet the future growth and development of the Passport. We are currently working on this initiative.

Taking into account submissions received, we propose to update our Guidance to include guidance about commissions and fees in each participating economy

## Implementation

24. One respondent submitted that the JC should launch a 'pilot program' with two or more participating economies, which would assist in understanding potential hurdles that could be identified and remedied relatively early in the implementation of the Passport.
25. Another respondent submitted that the Passport should develop an early reputation for transparency and strong regulation by providing clarity on implementation issues before full implementation of the Passport. This could involve an approach to ensure:
- 25.1. remaining aspects of implementation are settled and communicated to Passport fund operators well in advance; and
  - 25.2. sufficient number of participant economies are ready and able to operate.

JC response:

We agree with respondents that a pilot is an important way to understand potential hurdles in connection with operating under the Passport. Each participating economy intends to work with its domestic industry to find Passport fund operators, distributors and advisers willing to participate in a pilot. Participating economies will also ask industry bodies to help conduct an expression of interest campaign to find these willing participants

## Enlargement and interoperability with other regional agreements

26. All respondents suggested enlargement of the Passport to include other economies in the region.
27. One respondent commented that enlarging the number of participating economies and making the Passport flexible would encourage other economies (such as Singapore and Taiwan) in the region to join. The participation of as many economies as possible in the Passport, particularly at the outset, and the opportunity for future enlargement would incentivise active participation by financial service providers in the Passport, increasing the Passport's coverage and thereby increasing intra-regional capital market integration.
28. One respondent submitted that the JC should begin engaging with non-member regulators with a view to facilitating the cross-border distribution of Passport funds beyond participating economies. Passport funds should eventually be permitted to be offered in non-member economies in the same way that UCITS funds may be distributed in non-EU economies.
29. Another respondent noted the importance of the Passport being flexible enough to interoperate with other regional investment schemes, such as Hong Kong-China Mutual Recognition of Funds, the ASEAN Collective Investment Scheme Framework and other bilateral frameworks to facilitate future convergence of the various initiatives and structures. Interoperability with other regional schemes would create greater economies of scale, reduce market fragmentation and improve financial market integration, while ensuring that alternatives continue to be available to retail investors.

### JC response:

We note that there is no restriction or impediment to the Passport operating with other initiatives such as the ASEAN Collective Investment Scheme Framework and Hong Kong-China Mutual Recognition of Funds Scheme.

We acknowledge the benefits of enlarging participation in the ARFP where new participating economies can meet the eligibility criteria. We continue to engage with economies who are interested in participating in the Passport at a future time. We held a technical workshop in Kuala Lumpur in November 2017 to assist developing economies understand the Passport and the potential benefits it may bring to participating economies.

We remain committed to engaging with interested economies about the Passport and its operation.

## Other Issues

31. As part of the consultation, respondents were also invited to make submissions in relation to any other matters not included in the Guidance.

### Distribution

32. One respondent considered that it should be permitted to use Passport funds for retirement and long-term savings schemes (e.g., by clarifying the eligibility of Passport funds as investment options within retirement and long-term savings schemes, and identifying and removing any impediments and barriers to investment).

JC response:

At this stage, we have no plans to amend permitted investments, restrictions and limitations in the Passport Rules to permit the use of Passport Funds for retirement and long-term savings schemes. However, it may be possible to make changes to other relevant laws or, where possible and necessary, clarify the existing operation of those other relevant laws to ensure Passport funds may be invested in as part of retirement and long-term savings schemes.

We will review these issues within two years of commencement.

### Privacy and anti-money laundering (AML) legislation

33. One respondent submitted that there should be a common standard of requirements for AML and Know Your Client/Customer practices across all participating locations. The respondent questioned whether there is a need for the JC to outline some basic requirements across all jurisdictions.

JC response:

We note that international efforts are underway in relation to harmonisation of privacy and AML measures. We will monitor these developments and how they impact on the Passport.

### Operations

34. One respondent submitted that the Passport should facilitate cross-border provision of operational functions for Passport funds. The introduction of an 'operational' passport would enable a service provider in one country to perform activities for Passport funds in other jurisdictions. Such arrangements would potentially enhance efficiency, increase competition, provide Passport funds with more choice of service providers, and enhance existing practices of some participant economies that allow offshoring of back room operations (e.g., use of offshore custodial service providers).

JC response:

We note that the Passport Rules do not prohibit cross-border provision of operational services. However, the JC considers that initiatives to facilitate the cross-border provision of operational functions should be developed by industry. We encourage further industry dialogue to help in the development of more effective operational arrangements and services.

## Currencies

35. One respondent questioned whether or not it is a legal requirement for Passport participants to create share classes in the currency of the target economy. Second, industry notes that since it might be some time before capital controls are removed in certain jurisdictions like South Korea and Thailand, it would be helpful if the Passport could find a way to reduce the impact of these restrictions. For example, consider allowing funds to flow out under the Passport with a cap.

JC response:

We note that there are no requirements in the Passport Rules that require the creation of individual currency classes. However, because of the difference in currency between the jurisdictions, we consider that practically passport funds it may be necessary to create separate currency classes.

We do not consider that it would not be appropriate to impose a cap on capital flows, and we do not propose to do so.

For Thailand, we note that although Thailand has capital controls on foreign investment, foreign investment products (except foreign ETFs listing on SET) offered in Thailand can be in either Thai baht or any foreign currencies. This includes the units of Passport funds issued and offered by a foreign CIS Operator.

## Common language – English

36. One respondent noted that there is a requirement for English language documentation (and disclosures) to be certified by the local regulator. Since English is not the language commonly used, or required, by local funds, Thailand, Korea and Japan may need to change domestic regulations or provide a waiver for Passport Funds.
37. One respondent commented that it is not clear whether local regulators in Korea and Thailand are prepared to verify English language documentation for Passport applicants. Industry also suggested that the development of pro-forma standard documentation template, e.g. prospectus, key facts, etc., be prepared for Passport Funds, to ensure commonality among all participants.

JC response:

We note that only Part A of the common application is required to be in English. Passport regulators are not expected to verify English language documentation. Operators will need to arrange translations to the satisfaction on the relevant Passport regulators.

Supporting documentation for the application to become a registered Passport fund in the Home Economy may be provided in the local language.

For Thailand, we note that the documents required for the Passport application process can be in English language. This includes an application form, supporting documents and fund fact sheet.

We also note that the participating economies have agreed on the common fields that must be addressed in a Part A of the application to become a registered Passport fund in the Home Economy. We agree with the respondent that there are benefits in having consistent forms of applications and disclosure. As the Passport progresses, we are thinking of looking at whether the adoption of consistent forms of applications and disclosure will be workable with a view to reducing complexity and cost.

## Approval of Passport funds

38. One respondent submitted that it would be prudent to set time limits for each regulator to approve Passport fund applications. Alternatively, reciprocity in application approvals by participating markets could be used. This way, when a regulator in one jurisdiction approves a fund from a second jurisdiction, the second jurisdiction's regulator should approve a fund from the first jurisdiction.

JC response:

We note that there is a time limit imposed on deciding applications by Host Regulators.

While there is no time limit prescribed in the Passport rules, we are committed to deciding applications to register Passport funds in the Home Economy quickly and efficiently. We look forward to testing the length of time to decide an application in the pilot. We will use the findings of the pilot to improve our efficiency in deciding applications for registration as a Passport fund in the Home Economy.

## Guidance to support understanding of key documents

39. One respondent noted that the MoC was a complex document, and industry would benefit from some clear navigational tools such as charts, for example flow charts of the approval process in each participating economy, the money flow per location (for deals in ARFP funds) and formal comparison charts of each participating economy, for each of the aspects relating to local approval processes

JC response:

The JC acknowledges the complexity of the MoC. Participating economies will continue to engage with industry during implementation of the ARFP to improve communication of regulatory requirements as much as possible.

At the last JC meeting, we identified a number of enhancements to the MoC to provide flexibility to meet the future growth and development of the passport and improve its usability which will be progressed and information will be published at the appropriate time.

## Dispute resolution

40. One respondent observed that, in the European funds passport arrangement – UCITS – mechanisms exist for the European Securities and Markets Authority (ESMA) to resolve disputes over issues such as the interpretation of UCITS directives and disputes arising between home and host regulators or regulators and investors. There is a strong case for the creation of a resolution mechanism to help address uncertainties, disputes or issues of misinterpretation that may arise in the course of operations of the ARFP.

JC response:

We note that the MoC provides a dispute resolution mechanism. We will continue to identify and deal with any issues which arise during the implementation and administration of the Passport regime in accordance with the MoC. While we note that a dispute resolution mechanism exists, we remain committed to discussing and resolving any differences amicably.

## References and text in the interim Guidance in relation to Thailand

41. One respondent suggested additional references relating to Thailand which could be included in the Guidance.

JC response:

The SEC Thailand points out that as new regulations are currently being prepared (and would soon be issued) for the implementation of the Passport regime, such regulations will cause changes in names of the SEC current Notifications relating to cross-border offering of ASEAN CIS. As a result, the Guidance in relation to Thailand will need to be updated and revised to reflect such changes.