Dear Sir/Madam

Asia Region Funds Passport

We refer to the "Consultation Paper: Arrangements for an Asia Region Funds Passport" (Consultation Paper) and the request for submissions.

K&L Gates is one of the largest law firms in the world, with more than 2,000 lawyers who practice in 48 fully integrated offices located on five continents. The firm has a strong presence in key capital cities and world commercial and financial centers. Our more than 400 lawyers located in 11 distinct Asia Pacific markets provides us with the largest integrated presence of any law firm in the Asia Pacific region.

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Clients of K&L Gates value the ability of our global investment management practice to advise on work through rapidly evolving regulatory regimes and to deliver clear practical advice that focuses on our clients' strategic and commercial goals.
We congratulate APEC for the significant work undertaken to date in the preparation of the Consultation Paper. We welcome the opportunity to comment on the issues raised in the Consultation Paper and thank APEC for this opportunity. We hope you find our submission helpful in the further development of this important initiative.

We have not made submissions on each issue raised in the Consultation Paper. Rather, we have focussed on issues which we believe are critical to the success of the Asia Region Funds Passport (ARFP). In particular, we are of the view that for the ARFP Initiative to be successful:

1. the ARFP rules will need to extend to the passporting of licenses for passport fund issuing and operation, the issuing of passport fund disclosure documents, distribution of passport funds to wholesale/sophisticated clients and dealing with host economy distributors and fund platforms;

2. portfolio management of part or all of a passport fund will need to be able to be sub-delegated to an entity domiciled outside the passport economies;

3. the ARFP rules will need to facilitate the electronic distribution of passport funds in passport economies;

4. passport economies will need to ensure that other domestic laws and practices do not undermine the ARFP rules; and

5. passport economies will need to ensure that domestic taxation laws do not undermine the policy intent of the ARFP rules by uncertain or unequal taxation treatment of passport funds and domestic funds.

Further details in relation to each of these issues and our responses to the questions set out in the Consultation Paper are attached to this letter.

Yours faithfully

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QUESTIONS ABOUT THE SUBSTANTIVE REQUIREMENTS

Basic eligibility

Types of CIS

Q3.1 Should there be any restrictions on the legal form of passport funds in some or all economies such as for example an exclusion of CIS that are partnerships? If so why?

In our view, passport economies should be given the flexibility to nominate appropriate vehicles that can be offered under the passport. We do not believe there should be any restrictions.

In Australia the form of CIS is a unit trust called a managed investment scheme. We strongly recommend the adoption of alternative forms of CISs in Australia, such as open ended investment companies, variable capital companies and broad based limited liability partnerships.

Q3.2 Would the restriction on naming and promotion in relation to MMFs give rise to any practical problems? If so please explain.

Any restrictions imposed should be consistent across the passport economies to avoid investor confusion. We suggest the term MMF be defined under the passport rules, which we note is consistent with IOSCO’s policy recommendations for regulation of MMFs.1

Offer in the home economy

Q3.5 Would the requirement for an offer in the home economy give rise to any practical problems? If so please explain.

(a) We understand the policy behind the home economy offer requirement is to ensure that, prior to distribution in a host economy, a rigorous system has been applied in the preparation of a fund disclosure document in the home economy. Whilst we are supportive of this policy we have the following comments in relation to a number of aspects of this proposal as articulated in the Consultation Paper:

(i) The requirements set out on pages 12 and 13 of the Consultation Paper, that:

- "the interests may be acquired by any [our emphasis added] member of the public in the home economy on an application under the offer, subject to applicable laws";

- "information about the offer is made available to persons who customarily arrange for investments in regulated CIS operated by the passport fund operator in an equivalent way [our emphasis added] to the way in which information about some or all other regulated CIS of the operator is made available"; and

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1 Recommendation 1, page 11 of the IOSCO Policy Recommendations for Money Market Funds, October 2012
• "if the passport fund operator enters contracts under which persons arrange for investments to be made for most of its other regulated CIS, those contracts or substantially equivalent contracts are entered in relation to the passport fund which is the subject of the offer."

may be problematic. We submit that these aspects of the home economy offer proposal require further consideration and refinement. For example, it is common in making a CIS offer to:

• restrict investments in a CIS only to applicants applying for investments over a stated minimum subscription amount;
• restrict investments in a CIS only to applicants who meet certain age and residency requirements;
• restrict investments in a CIS only to applicants who provide appropriate identification documentation (for example to meet AML/CFT requirements).

A CIS with these types of standard application restrictions may not comply with the home economy offer test as articulated in the Consultation Paper.

These types of standard application restrictions are generally applied for good commercial reasons such as:

• ensuring that a CIS can operated efficiently and administration costs connected with immaterial application sizes are not borne by the CIS operator or the CIS;
• ensuring that a CIS will not bear administration costs associated with non-resident investors where those costs would outweigh scale efficiencies that may otherwise be achievable by allowing such non-residents into the CIS; and
• permitting a CIS operator to apply high internal standards in relation to AML/CFT, where those standards may go beyond strict legal requirements.

(ii) We understand the requirement that "information about the offer is made available to persons who customarily arrange for investments in regulated CIS operated by the passport fund operator in an equivalent way..." and the requirement that "if the passport fund operator enters contracts under which person arrange for investments to be made for most of its other regulated CIS, those contracts or substantially similar contracts are entered into in relation to the passport fund..." includes a requirement to "actively market"/distribute a CIS in the home economy in the same manner that the CIS operator markets and distributes its other products in the home economy.

However, this may be unachievable in respect of many proposed passport funds. In particular, a passport fund may be structured in such a way as to make it commercially inappropriate for the fund operator to attempt to have the passport fund distributed in the usual manner in the home jurisdiction. For example, a Singapore domiciled fund may be established with an AUD currency hedge to make it commercially appropriate for Australian investors. Because of the AUD currency hedge, the Singapore fund
operator may not be commercially able to distribute that fund in the usual manner in Singapore. Its usual fund distributors may not agree to distribute that fund in Singapore (due to it being unlikely to have sufficient acceptance by investors in Singapore).

To require a passport fund to be "actively marketed" and distributed in the home economy may inadvertently restrict the types of CISs that are passported and undermine part of the policy intent of the passport regime being to increase the diversity of CISs available to investors in the passport economies.

(iii) Any conditions imposed should not limit the ability of passport fund operators to target particular investors nor should the conditions require a passport fund operator to offer a passport fund in the same manner as the passport fund operator would offer the passport fund in the home economy. The passport will provide passport fund operators with access to a larger pool of potential investors, increasing diversity, and passport fund operators should be given the opportunity to tailor passport funds to the target investor base.

For these reasons, we submit that the home economy offer requirement be modified to require only:

- the preparation in the home economy of a disclosure document that meets the requirements for a disclosure document for an offer to the public in the home economy; and

- the home economy disclosure document to be accessible by members of the public in the home economy (it should be sufficient that the disclosure document is available on the passport fund operator's website).

We believe that this would achieve the policy objective of ensuring that a rigorous system has been applied in the preparation of a passport fund disclosure document in the home economy.

(b) The home economy offer requirement, as currently drafted, suggests that commission rates should be equivalent across a passport fund operator's suite of products.

It is common for different commission payments to be applied to different CIS funds. For example, commission rates on a product issuer's money market funds may be different than the commission rates on its global growth equities strategies funds. Accordingly, we submit that the 'equivalency' requirement in respect of commissions in the current draft of the home economy offer requirement be amended. We submit that passport fund operators should be free to choose to pay or not pay, commissions in respect of the distribution of its passport funds and to set the rate of commission as commercially appropriate for the particular passport fund and distribution channel concerned.

Q3.6 Would the requirement for an offer in the home economy promote investor confidence in the effectiveness of supervision of passport funds by the home regulator? What other possible measures could be applied?

Subject to the comments we have made at Q3.5 above, yes and in our view, by imposing a condition on the passport fund operator to comply with the home economy offer and disclosure requirements, the passport regime will provide a high degree of
investor protection without restricting the passport operator to distribute the passport fund in the usual manner in the home economy.

Licensing of the passport fund operator

Operational requirements

Q3.7 Is the requirement for an audit of certain home economy laws and regulations related to the passport fund operational requirements sufficient to ensure that passport funds are operated in accordance with the prescribed standards?

Q3.8 Are there any practical problems associated with the compliance audit rule? In particular are there any particular aspects that would be burdensome or inappropriate to audit?

Q3.9 Would it be clearer or more practical to instead require an audit of whether the passport fund operational requirements are being met?

We are supportive of a compliance audit requirement. We submit that the compliance audit requirement should extend to include an audit of compliance with the passport rules and applicable host economy rules.

Track record of operator

Q3.11 Should operators be allowed to count experience operating other types of retail investment schemes (for example, pension funds) as the requirement is currently drafted? Are there other types of experience which should be allowed to be counted?

To encourage global asset managers to domicile their CISs in passport economies, we would encourage each home economy to move quickly to recognise other appropriate non-passport economies for the purposes of the track record requirement.

For example, a large U.S. or London based fund manager may be considering establishing operations in the Asia region for the first time. A sophisticated global asset manager based in the U.S., London or other appropriate jurisdiction should be encouraged to establish its operations in a passport economy and to have its experience counted for the track record requirement of the passporting rules.

One possible alternative way of addressing this issue is for the passport economies to agree up-front a list of other CIS regulatory frameworks that will be recognised for this purpose.

We further suggest the conditions relating to experience for operators be set out under the passport rules as opposed to home economy rules to prevent the possibility of regulatory forum shopping between the home economies for this purpose.

Qualification of officers of the operator

Q3.12 Are the qualification standards appropriate and sufficient to ensure the ability of the passport fund operator to perform its functions?

In our view, the qualifications standards require further clarification and/or modification. In particular:

(a) we suggest that the conditions relating to experience for the CEO and executive directors be clarified to include experience in a jurisdiction whose
securities regulator is an ordinary or associate member of IOSCO. This is consistent with our comment under Q3.11 above;

(b) we suggest clarifying what is meant by experience in an entity that carries on a business in “financial or capital markets”. This phrase has different meanings depending on the jurisdiction in which it is used. We also consider the phrase “financial services” should be included as this is more appropriate for Australian CIS operators;

(c) we suggest removing the requirement to have at least one person responsible for “making” discretionary investment decisions for the passport fund who is an officer or employee of the operator. In Australia, it is very common for a responsible entity/trustee of a CIS to outsource the investment management function to an external service provider, unrelated to the responsible entity/trustee. Under these arrangements, officers and employees of the responsible entity/trustee are ultimately responsible for any investment decisions made but do not “make” discretionary investment decisions. Accordingly, this requirement is problematic in the context of the Australian funds management industry and we query the necessity of this requirement, particularly in light of the proposed delegation requirements.

We also submit that this requirement may be problematic where a funds management business is part of a larger group where all employees are employed through a separate services company subsidiary of the group and office holders are appointed to have corporate governance oversight as opposed to being involved in the day-to-day investment decision making. For these reasons, we submit that this requirement is not necessary and may be problematic for many CIS operators.

Q3.14 Should the proposed requirements for there being a qualified person who is an officer or employee of the operator apply to ensure this important function is done in the organisation directly regulated as a passport fund operator? What if any practical problems would arise?

See our comments at Q3.12 above.

Capital requirements

Q3.16 If professional indemnity insurance is permitted as a substitute what requirements should apply? Should there be minimum requirements concerning the terms and level of coverage of the insurance policy and the insurance provider? For example:

Requirements on the terms and level of coverage:

(a) The policy must have an initial term of no less than one year.

(b) Coverage must include liabilities of the fund’s directors, officers or staff of third parties for whom the fund has vicarious liability.

Requirements concerning insurance provider:

(a) The insurance provider is a third party entity and subject to prudential regulation and ongoing supervision.

(b) The fund manager must assess that the insurance provider has sufficient financial strength with regard to its ability to pay claims.
Are there any other set of requirements that need to be applied?

If professional indemnity insurance cover is permitted as a substitute, it is important that minimum requirements concerning the terms and level of coverage of the insurance are developed. Additional insurance requirements could include:

(a) minimum cover;

(b) maximum excess; and

(c) specified policy terms.

In addition, it may be appropriate to require minimum standards in respect of other types of insurances such as fidelity insurance.

Operation of the passport fund

Independent oversight

Q3.17 Are there other means to ensure the policy objective of independent oversight is met? If so please explain these other means and why they should be permitted.

We agree with the proposals regarding independent oversight as set out in the Consultation Paper.

Compliance audit

Q3.18 Should an independent oversight entity be permitted to conduct a compliance audit?

We submit that the compliance audit should not be able to be conducted by an independent oversight entity. In our view, the compliance audit should be undertaken by an independent auditor or firm of auditors.

Q3.19 Should an independent oversight entity be permitted to self-certify its own compliance in respect of its own obligations under the passport rules instead of arranging its compliance to be audited in any circumstances? If so, under what circumstances should such self-certification be allowed and how can the potential conflict of interests be satisfactorily mitigated?

As a matter of good corporate governance, we are supportive of internal audit processes being undertaken by an independent oversight entity. However, we are of the view that this should not negate the need for an annual compliance audit undertaken by an independent auditor or firm of auditors. We submit that, from a policy perspective, ensuring the integrity of the operation of passport funds is paramount to ensure the successful launch of the ARFP initiative. Requiring an annual compliance audit by an independent auditor or firm of auditors is, in our view, an important pillar in providing investor confidence in passport funds.

Q3.20 Would there be any practical difficulties in an auditor providing the opinion proposed? If so please elaborate and identify any alternative measures or alternative form of report that would sufficiently address the policy objective of ensuring compliance through independent checking where reasonable (for example, a review engagement providing negative assurance or an agreed upon procedures report from the auditor).
We note that, as currently drafted, there is no requirement that the operation of the passport fund be audited as against passport rules or host economy laws which the passport fund is required to comply with. We query whether, without such a requirement, there may be a gap in oversight. Whilst acknowledging that this may raise cross-jurisdictional complexity for compliance audit firms, we submit that the audit requirement should extend to an audit of the passport fund’s compliance not only with home economy laws but also with the passport rules and with applicable host economy rules.

Q3.21 Is this the most appropriate approach to ensure there are adequate standards which are applied consistently?

See our comments at Q3.18 - Q3.20 above.

Investment restrictions

Q3.22 Do any of the permitted assets (for example, depository receipts over gold) lack appropriate qualities of liquidity and reliable valuation and therefore should not be permitted or should be further restricted in keeping with the object of passport funds being relatively non-complex investments while enabling passport funds to be offered that will attract investor interest? If so what should be excluded or what restrictions should apply?

(a) Regulated CISs: We note that passport funds will be permitted to invest in regulated CISs. However, there appears to be no restrictions on the types of regulated CISs that can be invested in. This may permit investment in illiquid CISs which we understand is not intended.

(b) Indexes: We note that one of the requirements in relation to indexes is that "100 per cent of the constituents of the index… are investments that the passport fund would be permitted to hold". We submit that this test is very restrictive and suggest that it be replaced with a test that "a majority of the constituents.....".

(c) Transferable security: We note that, in the end of the second last paragraph at the bottom of page 25 of the Consultation Paper, it states that "passport funds can only hold transferable securities, including interests in investment schemes... where no liability arises from holding the security". This requirement is problematic in the context of Australian managed investment schemes. We strongly encourage the Australian Treasury to facilitate amendments to the Corporations Act 2001 (Cth) to provide statutory protection for members of registered managed investment schemes to clarify that a member can have no liability arising from holding an interest in a registered managed investment scheme. Without this, there is a risk that a passport fund could not, under this test, invest into Australian registered funds.

Financial reporting and audit

Q3.28 Is it appropriate for a host regulator to require financial statements and audit reports to be translated to an official language of the host economy? If not, why not?

Yes, we support the requirement to translate financial statements and audit reports to an official language of the host economy.
General questions about the substantive requirements

For each area of CIS regulation outlined in the framework:

Q3.29 Do you agree with the proposed approach in terms of whether home, host or passport rules apply to this area of CIS regulation?

The Consultation Paper proposes that, in regards to the operation of passport funds, home economy laws and regulations will apply. We submit that many of the aspects of the rules surrounding the operation of passport funds should be passport rules, as opposed to home economy rules to ensure consistency of passport fund regulation across each of the home economies. This is to avoid forum shopping based on regulatory requirements. For example, the rules dealing with minimum risk management requirements, related party transaction requirements, and the rules relating to duties of operators and record keeping should be passport rules.

Q3.30 Do you think that the proposed approach would enable the passport to achieve its key objective of providing a high degree of investor protection? If not, in what way can the approach be enhanced?

We have some concern about the ability of investors to compare passport funds domiciled in different passport economies. In this regard we suggest that:

(a) the passport rules permit a passport fund operator to use the disclosure document used for the passport fund in the home economy in each host economy with an appropriate wrapper;

(b) the passport rules require a key investor information document (KIID) to be prepared for each passport fund; and

(c) the KIID be required to be translated into the language of the host economy.

Q3.31 Where the passport rules apply, do you agree with the proposed content of the passport rules? If you do not agree, please explain why not. In your view, are there better ways to achieve the underlying purpose of the proposed rules?

In addition to the comments made elsewhere in this submission, we have the following comments:

(a) Delegation. In our view, the proposed passport rules in relation to portfolio management delegation are too restrictive and may prevent the success of the passport regime. Under the proposed rules, fund operators may delegate the portfolio management function if (amongst other things):

(i) the delegate is subject to regulation which, to the satisfaction of the home regulator, following consultation with other passport economy regulators provides substantially equivalent regulatory outcomes to that applying in the passport regime; and

(ii) the delegate is regulated by an organisation that, to the satisfaction of the home regulator, following consultation with other passport economy regulators, has cooperation arrangements in place with the home regulator which are comparable to, and as effective as, those in place between the passport economy regulators.

This requirement may significantly restrict the ability of passport fund operators to outsource portfolio management to delegates located in jurisdictions outside
the passport economies. For example, an Australian CIS operator that is a subsidiary of a global asset manager may wish to delegate portfolio management of a passport fund to an asset management subsidiary of the global asset manager, say, in London or the U.S.. There may be good commercial reasons for the global asset manager centralising portfolio management in one location, including to achieve economies of scale, efficiency and consistency in portfolio management, to avoid conflicts that may otherwise arise in operating multiple portfolio management teams in different jurisdictions and to manage risk and compliance.

Similarly, a passport fund operator may wish to sub-delegate the investment management of a segment of the fund’s assets to a specialised asset management company located in a jurisdiction outside the passport economies. For example, an Asian equities fund operator may wish to sub-delegate the Japanese equities segment of the fund to a specialised asset management company located in Japan.

These particular jurisdictions (as examples) may be considered to have robust regulatory frameworks. However as currently drafted, there is great uncertainty as to whether (and how long it will take) the passport economies to recognise the regulations and regulatory system of these jurisdictions for the purposes of this rule.

Given that these commercial issues may well outweigh the potential benefits for fund operators in operating passport compliant funds, it appears to us that there is a real risk that fund operators may choose not to participate in the passport regime unless this rule is amended to enable delegation as described above.

As an alternative, we suggest that it may be more appropriate to allow passport fund operators to delegate the portfolio management function to an entity domiciled outside the passport economies provided that:

- the first 4 points under the heading 'Delegation' on page 36 of the Consultation Paper are complied with;
- the operator remains responsible for determining the investment policy for the passport fund and appoints a 'head manager' in the home economy;
- the delegate is authorised under its national law for the purpose of portfolio management;
- the delegate is subject to supervision and monitoring by the passport fund operator under a written contractual arrangement with the passport fund operator, and
- there are cooperation arrangements in place between the applicable regulators (e.g. IOSCO Multilateral Memorandum of Understanding).

(b) **CIS classes.** In many places throughout the Consultation Paper, references are made to matters by reference to the CIS as a whole. We submit that some of these references should be to the applicable class of the CIS. For example: in the case of a multi-portfolio fund, the investment restrictions should be applied at the level of the particular portfolio class of the fund, as opposed to the fund as a whole.
(c) **Location of the CIS.** Page 12 of the Consultation Paper states that a passport fund must be domiciled in a passport fund economy in which the operator has a principle place of business. We note that this is more restrictive than under the UCITS IV Directive which permits a UCIT fund to be established in a different EU member state to where the management company is based. We submit that consideration should be given to whether it is sufficient for a passport fund operator to have a principle place of business in a passport economy and then to be permitted to establish passport funds in any other passport economy consistent with the approach taken in the UCITs IV Directive.

(d) **Custody.** We agree with the requirement that passport fund assets should be held by a custodian. However, we query the benefit of the requirement that the custodian must be authorised by the home regulator. Page 20 of the Consultation Paper states that a passport fund could also use a custodian authorised by another regulator. However, it is unclear whether this is a reference to another passport economy regulator or any other regulator.

We submit that it should be sufficient that the passport fund operator appoint a custodian that meets certain minimum criteria set by the passport rules. The reason for this alternative proposal is that, in our view, it may not always be appropriate for a passport fund operator to appoint a local custodian to hold fund assets. This is particularly the case where the fund invests in global assets and, therefore, where it may be more appropriate to appoint a global custodian, for example, domiciled in the U.S or Europe, where the majority of fund assets may be held. The requirement to interpose a home economy custodian, if achievable, may be administratively burdensome and costly. This requirement could be a disincentive to fund operators domiciling their funds in any of the home economies.

(e) **Liquidity.** We note under the passport rules (page 38) that a passport fund must pay redemption proceeds in no more than 15 days. In Australia, the redemption period is set out in the constitution for a fund and for new funds from 2013, ASIC will generally require a fund constitution to provide that redemption proceeds be paid within 21 days.

Whilst we do not disagree with the proposed time period of 15 days, we suggest that operators be given the opportunity to comply with this particular passport rule by disclosing this time period under the disclosure document, regardless of the time period that exists under the fund’s constitution.

Q3.32 **What impact would the proposed approach have on competitiveness and investor confidence?**

(a) To ensure competition and investor confidence, we submit that:

(i) passport economies will need to ensure that other domestic laws, such as laws and regulatory practices relating to licensing, fund distribution and marketing, do not undermine the ARFP rules and the ability of passport funds to compete on a level playing field with domestic funds; and

(ii) passport economies will need to ensure that domestic taxation laws do not undermine the policy intent of the ARFP rules by uncertain tax rules or by unequal taxation treatment of passport funds and domestic funds and their underlying investors vis-à-vis their investments.
(b) The Consultation Paper proposes passporting of funds. It does not, however, propose the passporting of licences. We are of the view that without the passporting of licenses, the ARFP proposal will be significantly restricted.

In Australia, the Australian Securities and Investment Commission recognises entities licensed in other jurisdictions under its Foreign Financial Services Providers Policy (See RG 146). We suggest that this type of approach could be adopted by each of the passport economies, in respect of each other passport economy.

Specifically, we submit that the passport rules should be extended to passporting of licenses for passport fund issuing and operation, the issuing of passport fund disclosure documents, distribution of passport funds to wholesale/sophisticated clients and dealing with host economy distributors and fund platforms. A simple registration process in the host economy for a licenced passport fund operator could then be applied.

Other:

Q3.35 Are there any additional requirements you would suggest? If so, what are the rules and why?

See comments at Q3.30.

In addition, we submit that it is essential to enhancing competition and investor confidence, that the passport rules and applicable home and host economy rules provide for electronic, web based fund registration, distribution, disclosure and application, management and redemption procedures. Accordingly, we submit that passport rules should be adopted to facilitate this. This may also require consideration of AML and privacy laws in each jurisdiction.

QUESTIONS ABOUT REGULATORY FUNCTIONS

Registration and assessment

Q4.1 Is the proposed registration and assessment process operationally practicable?

We submit that any passport fund registration or "entry" requirements should be electronically based. We also submit that greater clarity around the host economy "entry" criteria is required to ensure this process does not, inadvertently undermine the passport regime.