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Dear Ms Wykes

Consultation Paper: Arrangements for an Asia Region Funds Passport

Thank you for the opportunity to comment on the arrangements for an Asia Region Funds Passport.

The Property Council is the peak body for owners and investors in Australia's \$670 billion property investment industry. The Property Council represents members across all four quadrants of property investment, debt, equity, public and private.

The Property Council supports streamlining regulations to make it easier for fund operators in Passport member economies to offer collective investment schemes to retail investors.

Reducing the regulatory differences between Passport member economies will lead to deeper and more efficient financial markets as well as boost regional economic growth.

However, the Passport proposals as currently drafted will not achieve the policy objective to increase investment in managed funds in the Asia region.

Originally, the Passport was intended as a "one stop shop" ie. simple managed investments would be able to market their products quickly and efficiently by cutting red tape.

Given the majority of complex issues (eg. disclosure, distribution, licensing of distributors, marketing and complaints) have been left to a host member economy to resolve, there is now no substantial reason to exclude investment in property from the Passport.

Property investment will not create any additional material complexity or barrier to the Passport's success.

However, if the complex issues will be resolved before the Passport commences, we recommend developing a timetable for including property in the second stage reforms.

The Voice of Leadership

Currently, international investors are channelling capital into property as a primary investment. Excluding property from the Passport is a missed opportunity to leverage funds into the Australian economy.

Unless amended, the proposals will:

- bar investment in real property ie. property funds are not eligible collective investment schemes.

This will block the property industry's access to regional investors and unnecessarily restrict retail investors' participation in an important asset. Investment in property provides regular income and capital growth for investors;

- fail to provide a uniform set of rules across the Passport member countries to simplify the licensing and marketing of managed funds.

This will force eligible investment vehicles to waste considerable time and cost to meet additional host country requirements eg. applying for a fund operator's license in another Passport member country;

- constrain the ability of collective investment vehicles to achieve a diversified investment portfolio.

This is because the rules cap investment at 5% for each responsible entity/trustee, rather than 5% for each investment fund; and

- preclude many Australian responsible entities and trustees from establishing a Passport fund due to the minimum USD1 million capital adequacy requirement.

Many small to mid-size funds will be prevented from offering Passport funds.

These problems can be easily fixed by:

- including property funds as eligible collective investment schemes (or, alternatively, implementing a timetable to include property funds if the complex issues will be resolved before the Passport commences);
- developing and implementing mutual recognition arrangements for critical Passport rules, including local licensing and disclosure requirements;
- adopting less restrictive portfolio allocation limits for fund operators ie. a 5% limit on investments in a single Australian trust or scheme; and
- adopting the same capital adequacy requirements that exist for Australian registered scheme operators (which start at \$150,000 and increase according to scheme assets).

As the proposals currently stand:

- the property industry's access to regional investors will be unfairly restricted and property funds will be competitively disadvantaged compared to other schemes;
- there will be higher compliance costs for industry which will impede fund operators offering the Passport; and
- investors will be blocked from achieving a diversified investment portfolio.

Our detailed comments on the proposals are contained in the attached submission.

Please do not hesitate to contact Darren Davis on 0400 929 817 or myself if you have any queries.

Yours sincerely

A handwritten signature in black ink, appearing to read 'AM', with a horizontal line underneath.

Andrew Mihno

Executive Director International & Capital Markets

Property Council of Australia

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***Consultation Paper:
Arrangements for Asia Region
Funds Passport***

*Property Council of Australia
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Comments on the Consultation Paper

Set out below are comments on the following aspects of the Consultation Paper:

- basic eligibility and licensing;
- investment restrictions – asset classes;
- investment restrictions – portfolio allocation;
- capital adequacy requirements; and
- interaction with investors.

Basic eligibility and licensing

The Consultation Paper (the Paper) proposes a “partial approach” to mutual recognition of operational and regulatory arrangements of Passport member economies.

The Paper states that “full mutual recognition is not seen as possible” in the initial phase of the Passport due to the different stages of development of Passport member economies.

Industry’s concerned that without full or near full mutual recognition across all of the relevant areas of operation of the Passport, the Passport will not deliver the consumer, industry and economic benefits outlined in the Paper.

For example, the rules relating to licensing a Passport fund operator and operation of the Passport fund will be largely based on Passport rules.

However, the rules that apply to disclosure, distribution, licensing of distributors and complaints will be dealt with by host economy rules.

If a fund operator is required to apply for local licensing and comply with the conditions attaching to that local licensing requirement in each host economy, the compliance burden and costs will be prohibitive.

This will severely limit the value of the Passport.

Industry is also concerned that anti-competitive practices will emerge between participating economies where the requirements to achieve local licensing are the most difficult.

Australia offers generous recognition of licensing regimes compared to other jurisdictions.

For example, ASIC allows certain regulated foreign financial services providers to notify ASIC of their intention to rely on ASIC Class Order relief and then provide financial services in Australia without requiring an Australian financial services licence.

This level of facilitation is not offered by other regulators in the region.

There is an urgent need for discussion between the participating economies about mutual recognition of licensing to:

- reduce compliance costs;
- streamline regulatory requirements; and
- prevent anti-competitive practices.

The costs and time required to establish separate and distinct disclosure documents for each jurisdiction in which a Passport fund is to be marketed will be a significant impediment to the success of the Passport regime.

Australia and New Zealand operate a mutual recognition regime for retail securities disclosure documents.

This regime is simple to use and has facilitated capital flows between the two jurisdictions. The regime could be extended to Passport member countries.

Given the majority of complex issues (eg. disclosure, distribution, licensing of distributors, marketing and complaints) have been left to a host member economy to resolve, there is now no substantial reason to exclude investment in property from the Passport.

Property investment will not create any additional material complexity or barrier to the Passport's success.

However, if the complex issues will be resolved before the Passport commences, we recommend developing a timetable for including property in the second stage reforms.

Currently, international investors are channelling capital into property as a primary investment. Excluding property from the Passport is a missed opportunity to leverage funds into the Australian economy.

Investment restrictions – asset classes

Investment restrictions will apply to the types of collective investment schemes (CIS) eligible for the Passport regime.

Eligible CIS (including Money Market Funds and exchange traded funds) which invest predominantly in transferrable securities and certain other liquid assets will fall within the scope of the Passport arrangements.

This means that registered schemes which invest in other asset classes such as property, infrastructure and corporate debt will fall outside the Passport arrangements.

The investment restrictions should be altered to allow Passport funds to invest in direct real property.

Real property is a well understood asset class which offers investors both capital returns and consistent distributions from rental income.

Investment restrictions – portfolio allocation

The Property Council is concerned that the proposed portfolio allocation limits will make it difficult for a regulated CIS to allocate reasonable funds to real property investments.

(a) Single entity limit

The single entity limit is too low.

Under the proposals (subject to exemptions outlined¹), a Passport fund must not acquire an asset if it results in the Passport fund holding more than 5 per cent of the value of its assets in transferable securities and money market instruments.

This proposal will constrain the ability of collective investment vehicles to achieve a diversified investment portfolio.

This is because the rule caps investment at 5% per responsible entity/trustee, rather than 5% per investment vehicle.

We recommend adopting less restrictive allocation limits for fund operators ie. a 5% limit on investments in a single Australian trust or scheme.

(b) Unquoted securities

The Paper proposes that a Passport fund must not acquire a share, stock or interests in investment schemes, other than regulated CIS, if it results in the Passport fund holding, or holding to a greater extent, more than 10 per cent of the value of its assets in shares, stock or interests that are not:

- quoted on a financial market regulated by an ordinary or associate member of IOSCO; or
- approved for quotation on such a regulated financial market.

As many property funds are unlisted, this proposal will restrict a Passport fund operator's ability to obtain exposure to Australian property.

The proposal will unfairly restrict the range of assets that investors can gain exposure to via the Passport.

The proposal should be amended to include unlisted property funds as an investment class.

Capital adequacy requirements

The paper proposes that an operator must maintain equity of at least USD1 million. Where the operator has assets under management exceeding US500 million, it must maintain additional capital equivalent to 0.1% of the AUM in excess of USD500 million, up to a maximum USD20 million of additional capital.

We consider that a minimum equity requirement to operate a Passport fund of USD1 million is excessive and will preclude a large number of Australian responsible entities and trustees from establishing a Passport fund.

¹ One such exemption involves a credit check which, if undertaken, increases the single entity limit to 10 per cent – however this does not address the Australian situation that an investment in securities of an Australian fund gives a credit exposure to the trust and its assets, and not strictly to its trustee or responsible entity.

We recommend that the capital requirements that currently exist for an Australian registered scheme operator - which start with a minimum of \$150,000 and increase by reference generally to scheme assets - is an appropriate capital measure. This will permit smaller and mid- size fund managers to participate in the Passport.

Interaction with investors

The Paper proposes that the host economy rules and regulations will apply in relation to a Passport fund's interaction with investors. A host economy could require a fund operator to appoint a local representative to interface with investors in the host economy. As such, this proposal will impede the Passport regime as host regulators could require the establishment of significant infrastructure by CIS operators in their own countries.

The Passport arrangements will not affect host economy rules and regulations relating to intermediaries or the distribution of CIS in the host economy. This will hamper the marketing of Passport funds in host economies as the host economies could require separate licensing for the marketing of the fund in that country.

To ensure the Passport regime is workable and create a level playing field across the region, it is essential that new rules are developed immediately so that a Passport fund operator does not need to establish additional infrastructure in a host jurisdiction.

The rules for marketing/distribution of CIS and local licensing to market a fund in a host jurisdiction need to be harmonised as a priority. If this is not actioned, there will be a regime which recognises funds, but the products cannot be distributed across the region.