Comments on Detailed Rules and Operational Arrangements for the Asia Region Funds Passport (ARFP)

Prepared by
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Sub-Stream on Regulatory Mutual Recognition / ARFP, Capital Markets Work Stream

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ASIA-PACIFIC FINANCIAL FORUM

SUB-STREAM ON REGULATORY MUTUAL RECOGNITION/ARFP
CAPITAL MARKETS WORK STREAM

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A. COMMENTS: RULES AND OPERATIONAL ARRANGEMENTS

1. ENLARGEMENT OF THE ASIA REGION FUNDS PASSPORT (ARFP)

We refer to the letter of the APEC Business Advisory Council (**ABAC**) to the Asia-Pacific Economic Cooperation (**APEC**) Working Group in response to the first consultation paper issued on the ARFP, in which ABAC submitted that the flexibility of the ARFP to enlarge is critical to its impact and success. We echo ABAC's view that the ARFP should work towards the inclusion of other economies such as Hong Kong, Japan and Chinese Taipei. The participation of as many economies as possible in the ARFP, particularly at the outset, and the opportunity for future enlargement would incentivise active participation by financial service providers in the ARFP, increasing the ARFP's coverage and thereby increasing intra-regional capital market integration, and allowing its benefits to be more widely enjoyed. We respectfully emphasise that ARFP's enlargement will increase investors' investment options and reduce cross-border investment costs through economies of scale.

Reciprocity

We respectfully suggest that the spirit of reciprocity should be expressed as part of the purpose of the ARFP in order that member economies will accord "equivalent priority" to promoting Passport Funds as they do to domestic funds. We respectfully suggest that the memorandum of understanding (the "**MOU**") should set out that member economies will demonstrate commitment towards promoting ARFP and Passport Funds in their jurisdiction (in equal measure with domestic funds).

Interoperability with other regional frameworks

It is important that the ARFP is flexible enough to interoperate with other regional investment schemes, such as the Hong Kong-China mutual recognition regime and the ASEAN CIS Framework to facilitate the future convergence of the various initiatives and structures. We would respectfully suggest that the investment restrictions of the ARFP be closely aligned with other regional fund management schemes, including for example the ASEAN CIS Framework, thus paving the way for funds that previously qualified for either one of the schemes to qualify for the other, thereby achieving greater efficiency and helping to reduce costs. Interoperability with other regional schemes would, as with the introduction of more economies into the ARFP, create greater economies of scale, reduce market fragmentation and improve financial market integration, while ensuring that alternatives continue to be available to retail investors.

We note that the draft Passport Rules impose restrictions on the portfolio allocation of Passport Funds in other collective investment schemes, unlike the ASEAN CIS Framework, which allows funds to invest in units of other collective investment schemes without restrictions. We respectfully suggest that the Working Group consider removing the restrictions on a Passport Fund's investment in units of other collective investment schemes. Otherwise, the investment restrictions would be more restrictive than those applicable to authorised funds in Singapore and funds approved under other frameworks.

Inclusiveness of the ARFP

We note that the Working Group has retained the requirement for independent oversight but has provided flexibility in the mechanism for independent oversight, with a different independent oversight entity for each Home Economy as set out in Section 14 of Annex 3. We also note that the Working Group has indicated that the table will be updated to include additional mechanisms when other economies join the ARFP.

We respectfully request that the Working Group consider waiving the independent oversight and compliance review requirements for jurisdictions where management companies are periodically and robustly inspected by a Home Regulator or other self-regulatory organisation. For example, in Japan, most funds are organised as a trust-type investment vehicle, for which the management company acts as a settlor sponsor. There is no requirement for an external compliance committee or independent custodian (since affiliated trustees are permitted). Nonetheless, the fund management industry in Japan is subject to a stringent regulatory regime, which has assisted the industry to ensure sound management and operation of trust vehicles.

We view the insufficient flexibility in applying these independent oversight and compliance review requirements as a significant obstacle to the enlargement and attractiveness of the ARFP. In this regard, we note that the UCITS regime does not have equivalent restrictions so as to avoid excluding jurisdictions with civil law traditions such as Germany that rely on similar systems used in Northeast Asia to ensure investor protection.

We note that currently, some of the requirements under the Passport Rules are linked to International Organization of Securities Commissions (**IOSCO**) standards. This can be helpful for facilitating consistency across participating jurisdictions, however care must be taken such that this sort of link does not create barriers to entry where economies are not yet party to the IOSCO MoU, or have been signed up for less than five years. Similar references to IOSCO standards in the Standards of Qualifying CIS under the ASEAN CIS Framework have made it more difficult for economies such as the Philippines to participate in the scheme.

2. PASSPORT RULES

Taxation

We note that there are still no Passport Rules in relation to taxation at a fund level and the taxation of distributions, despite an acknowledgement of the seriousness of the implications that domestic tax issues may have on the ARFP scheme.

Different tax regimes in participating jurisdictions can significantly impact a fund's performance and returns earned by retail investors, creating incentives or disincentives for participation. Of particular relevance are taxes related to the fund's structure, for example, unit trust and open-ended investment company and their distribution mechanisms. There are also further considerations on applicable double taxation treaties in cross-border flows.

To that end, we continue to urge the Working Group to clarify the ARFP arrangements in relation to taxation, including taxation at the fund level, taxation of distributions in each participating economy and the use of different structures to invest into an ARFP fund (which could pose transparency issues for the ultimate beneficiaries if taxation necessitated their identification and reporting). We also believe that the ARFP could benefit from a streamlining of tax treatment of eligible funds in participating jurisdictions that would promote a level playing field. The Passport Rules should also address issues related to transparency and how differences in capital gains and withholding taxes will be dealt with.

We are of the view that certainty in the tax treatment of Passport Funds will facilitate the efficient expansion of the ARFP, since member and non-member economies (contemplating joining the ARFP) may then adjust their tax laws to conform to the ARFP tax regime (if necessary). In this regard, we respectfully submit that Australia should eliminate the negative tax treatment of non-domestic funds.

Dispute Resolution

In the UCITS regime, the European Securities and Markets Authority (**ESMA**) resolves disputes over, *inter alia*, the interpretation of UCITS directives and any disputes arising between home and host regulators or regulators and investors. We believe that 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 the operation of the ARFP. For instance, in Section 3(a) of Annex 1, it is mentioned that additional requirements may be imposed by each Participant on a Passport Fund or its Operator in its capacity as Host Economy, so long as the additional requirements are not "unduly burdensome". There is currently no guidance on what type of requirements would be "unduly burdensome" and there may be differences in the interpretation of "unduly burdensome" between the member economies. As such, it would be beneficial to have an arbiter on the interpretation of Passport Rules and a dispute resolution mechanism which will, inter alia, adjudicate on repercussions for any breach of the Passport Rules.

Standardisation of fees and performance figures

We respectfully suggest that the Working Group establish Passport Rules on the method of calculation of and disclosure of performance figures and fees in the prospectus of

Passport Funds in order to ensure investors are able to conduct a fair comparison of the available Passport Funds.

3. LAUNCH OF THE ARFP

We note that according to the scheduled timetable, willing and ready economies will become party to the MOU in September 2015. This envisages that it is sufficient for only two economies to sign the MOU in order to launch the ARFP. We believe that launching with this minimal requirement would damage the credibility and momentum of the ARFP scheme and that securing a critical mass of participants representing a high proportion of interested economies is very important to maximise the scheme's appeal. We respectfully submit that best efforts be undertaken, including through the above proposals related to enlargement, to increase the number of prospective participants prior to the launch of the ARFP; and that the other economies should commit to continuing discussions with a view to joining the ARFP within the next year.

4. INTERNATIONAL RECOGNITION OF PASSPORT FUNDS

We would also suggest that the Working Group begin engaging with non-member regulators with a view to facilitating the cross-border distribution of Passport Funds beyond the member economies. Passport Funds should eventually be permitted to be offered into non-member economies the same way UCITS funds may be distributed in non-EU jurisdictions such as Singapore and Hong Kong.

We are of the opinion that the successful launch of the ARFP will significantly depend on investors and other market participants having clarity and certainty of the tax treatment of Passport Funds. We respectfully note that, in the context of other regional cross-border investment schemes (such as the Hong Kong-Shanghai Stock Connect), investors have welcomed and benefitted from a greater degree of clarity in respect of the applicable tax policy. We firmly believe that further information on these issues will greatly assist regulators in delivering on the Government-level commitments to making the ARFP a success within and beyond the member economies.

In this connection, we urge the Working Group to establish Passport Rules in relation to distribution restrictions, compliance and reporting or data privacy and protection. We recommend that the Passport Rules be clarified on whether Home Economy Laws and Regulations relating to distribution, compliance and reporting, marketing restrictions and data privacy or protection apply. For example, under the ARFP, it is likely that investor information will need to be made available among participating jurisdictions. As such, ARFP-related considerations would need to incorporate or take into consideration domestic requirements governing data confidentiality and sovereignty.

B. COMMENTS: THE WORKING GROUP FEEDBACK STATEMENT

Paragraph reference	Feedback Statement	APFF Comment
Paragraph 15	A large number of submissions urged the Working Group to consider the implications of domestic taxation arrangements and advocated for the neutral tax treatment of Passport Funds.	We note the lack of clarity provided on these matters in the Feedback Statement or in the Passport Rules. We respectfully suggest that Australia eliminate the negative tax treatment of non-domestic funds.
Paragraph 16	Each Working Group member has agreed to share with other Working Group members, information about their taxation and capital controls settings in their respective economies to provide further clarity and identify potential issues that could impede use of the Passport.	We would be grateful for further information on the capital controls which may potentially impede the success of the ARFP and would suggest that the Working Group iron out any potential issues prior to the launch of the ARFP.
Outcome to Paragraph 21	Requiring compliance with rules about labelling would likely mean meeting the most stringent requirement in any Participant. Because the requirements apply only to labels rather than descriptions about the fund, compliance can be achieved by simply avoiding the usage of the terms such as ‘money market fund’ or ‘exchange traded fund’.	We respectfully submit that this could result in significant misrepresentation, especially in the case of exchange traded funds (**ETFs**). We recommend that an explanation of what is termed a money market fund (**MMF**) and an ETF be included in the disclosure document of a passport fund to reduce risks of misunderstanding.
Outcome to Paragraph 27	To provide certainty, Passport Regulators consider for example France, Germany, Ireland, Luxembourg, the United Kingdom and United States of America as economies that currently have sufficiently broadly similar regulatory frameworks for the purposes of delegation of functions by a fund operator under section 11(3) of the Annex 3 unless some adverse change occurs.	We would recommend adding Hong Kong and Japan to this list of "economies with a comparable regulatory framework" as these economies have equally robust regulatory frameworks and the Working Group should work towards the inclusion of these economies into the ARFP.

Paragraph reference	Feedback Statement	APFF Comment
Outcome to Paragraph 47	To provide certainty, the Working Group considers for example that the regulation of licensed investment managers in France, Germany, Ireland Luxembourg, the United Kingdom and United States of America are broadly similar for the purposes of this provision.	
Paragraph 50	There was broad support for the list of permitted asset classes in the consultation paper. Most comments focused on the portfolio allocation restrictions. Common themes included: • that the single entity limit is too restrictive given the concentration in local markets; • that Passport Funds should be allowed to invest in UCITS in the same manner as Regulated CIS; and • that the derivative and securities lending arrangement requirements were too restrictive.	We note from Passport Rule 34 that the permissible level of investment of assets in UCITS funds is restricted to 10% to 30%. This is arguably relatively restrictive compared to other regional schemes and restrictions imposed on domestic funds.
Outcome to Paragraph 58	With respect to standardised disclosure and key investor information, the Working Group is open to considering this as a potential future development.	We note the difficulties in achieving a standardised disclosure document between regional and domestic regimes. Nonetheless, we urge the Working Group to work towards a standardised disclosure and key investor information document and such standardised disclosure should distinguish the fund as a Passport Fund.

ABOUT ABAC AND APFF

The **APEC Business Advisory Council (ABAC)** was created by the APEC Economic Leaders in November 1995 to provide advice on the implementation of the Osaka Action Agenda and on other specific business sector priorities, and to respond when the various APEC fora request information about business-related issues or to provide the business perspective on specific areas of cooperation. In 2012, ABAC proposed the **Asia-Pacific Financial Forum (APFF)**, a platform for regional public-private collaboration to help accelerate the development of integrated financial markets and services in the region. In 2013, the APEC Finance Ministers adopted the APFF as one of their official policy initiatives and entrusted its management to ABAC. In 2014, the Ministers endorsed the APFF's Interim Report, which drew from the work of more than 270 senior representatives and experts from 137 major private and public institutions.

The Interim Report recommended concrete undertakings across the broad financial sector that can yield tangible results within two or three years. These undertakings, encapsulated in 12 action plans, are clustered around two major issues: (a) the development of deep, liquid and integrated capital markets and the region's long-term investor base; and (b) expanded access of enterprises and individuals to financial services. These action plans are as follows:

- ☐ a pathfinder initiative to develop credit information sharing systems;
- ☐ a pathfinder initiative to improve the legal and institutional architecture for security interest creation, perfection and enforcement and related workshops;
- ☐ dialogues on regulatory issues in trade and supply chain finance;
- ☐ workshops on emerging facilitators of trade and supply chain finance;
- ☐ a pathfinder initiative to develop classic repo markets;
- ☐ workshops to develop strategies to improve legal and documentation infrastructure for the development of OTC derivatives markets;
- ☐ self-assessment templates on information for capital market investors: development and workshop series;
- ☐ ARFP Support Initiative;
- ☐ workshop series to develop an enabling Asia-Pacific securities investment ecosystem;
- ☐ dialogue series on regulation and accounting issues impacting the long-term business of the insurance industry in Asia-Pacific economies and longevity solutions;
- ☐ collaboration with APEC Finance Ministers' Process in promoting long-term investment, including infrastructure; and
- ☐ conference and workshop series on linkages and structural issues.