26 June 2014

Ms Trudie Wykes
Senior Adviser
The Treasury
Langton Crescent
PARKES ACT 2600

CC: ASIC, Department of Foreign Affairs and Trade, APEC Secretariat

Dear Ms Wykes

RE: ARRANGEMENTS FOR THE ASIA REGION FUNDS PASSPORT

The Financial Services Council represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The Council has over 125 members who are responsible for investing more than $2.3 trillion on behalf of 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Should you wish to discuss this submission further please do not hesitate to contact me on +61 418 420 949.

Yours sincerely

ANDREW BRAGG
Director of Policy & Global Markets

Financial Services Council Ltd
ABN 82 080 744 163
Level 24, 44 Market St
Sydney NSW 2000
T. +61 2 9299 3022
F. +61 2 9299 3198
E. info@fsc.org.au
W. fsc.org.au

INTRODUCTION

Background

The FSC has long supported the establishment of an Asia-regional platform where investment funds can be bought and sold across national borders without any impediment.

The Asia Region Funds Passport (ARFP) will not only increase choice for investors but will increase regional cross-border capital flows, trade and investment.

We therefore commend and urge APEC and regional governments to continue the pursuit of multilateral free trade for investment funds in our region.

The objectives of the ARFP are:

- increased services exports, economic activity, employment and taxation collection within the Asian region;
- increased consumer choice;
- removal of barriers to cross border capital flows;
- deeper regional capital markets; and
- reduced cost and inefficiency in the financial services industry in the Asian region.

At the APEC Finance Ministers meeting in September 2013, the governments of Australia, Korea, New Zealand and Singapore agreed to establish a pilot of the ARFP.

Subsequently, the Philippines and Thailand have joined the consultation model of the ARFP which was released in April 2014.

The FSC remains hopeful that these six APEC economies will be joined by other nations as the model is developed throughout 2014 and 2015.

The ARFP model for our region

We consider this draft ARFP model whilst balancing two key competing commercial and regional public policy / economic objectives. We understand that both objectives must be weighed appropriately in the final model.

Firstly, this model must present a commercially attractive case for regional and global investment managers when considering vehicles for collective investments. That is, this model must develop as a commercially viable structure for all investment managers with operations in this region.

If the model is too restrictive or not competitive with vehicles such as UCITS, the ARFP will never be commercially viable. For instance, given the penetration of UCITS in Asia, if investment managers regard UCITS as a superior vehicle, the ARFP will not be used. With €6 trillion under management in UCITS products, it has significant scale, efficiency and familiarity advantages over the yet-to-be developed ARFP.

Investment management is an industry where scale is important. Without economies of scale, the ARFP will be unable to deliver lower fees and innovative products to investors in our region.

Secondly, the FSC understands that this commercial reality needs to be balanced against the public / economic policy objectives of regional governments. We understand governments are working to ensure that the ARFP increases economic activity and taxation collection in our region (rather than Europe, for instance).

We too believe this is a critical public policy goal for our region. We should derive the maximum benefit of managing investments and savings in the Asian region in this century as our population ages and the middle classes grow.

In weighing these considerations, we have proposed recommendations which seek to establish an ARFP which will be commercially viable but also maximises regional economic benefit.

In developing this model, the core design principle of competitive neutrality must be adopted.

Accordingly, the passport model should provide competitive neutrality on:

- Tax;
- Legal investment vehicles; and
- Distribution.

Regulatory arbitrage must always be avoided and should be specifically targeted in any future public commitments between APEC and / or regional governments. We elaborate on tax in appendix A.

The passport arrangements should provide the ability for both funds and licensed entities to utilise the multilateral mutual recognition in an efficient manner. The ARFP must deliver true, unencumbered mutual recognition between the economies.

RECOMMENDATION: Regulatory arbitrage must be eliminated in all passport economies.

Australian demand

In Australia's case, there are many reforms which are required if the ARFP is to deliver for Australia and for investors in our region. Taxation and regulatory structure reforms will be required in the next 18 months.

The FSC understands and respects that taxation and regulatory structure reforms are not in scope for this consultation. We have documented (below) the necessary reforms for the benefit of Australian Treasury and other APEC economies.

Australia will be a strong contributor to the passport. Australian citizens will invest offshore and Australian domiciled managers will be utilised by foreign investors in a range of asset classes and investment styles.

For example, there is strong demand from Australian investors for exposure to offshore assets, however, typically retail investors are unable to meet this demand due to structural barriers. The ARFP will help to meet this demand.

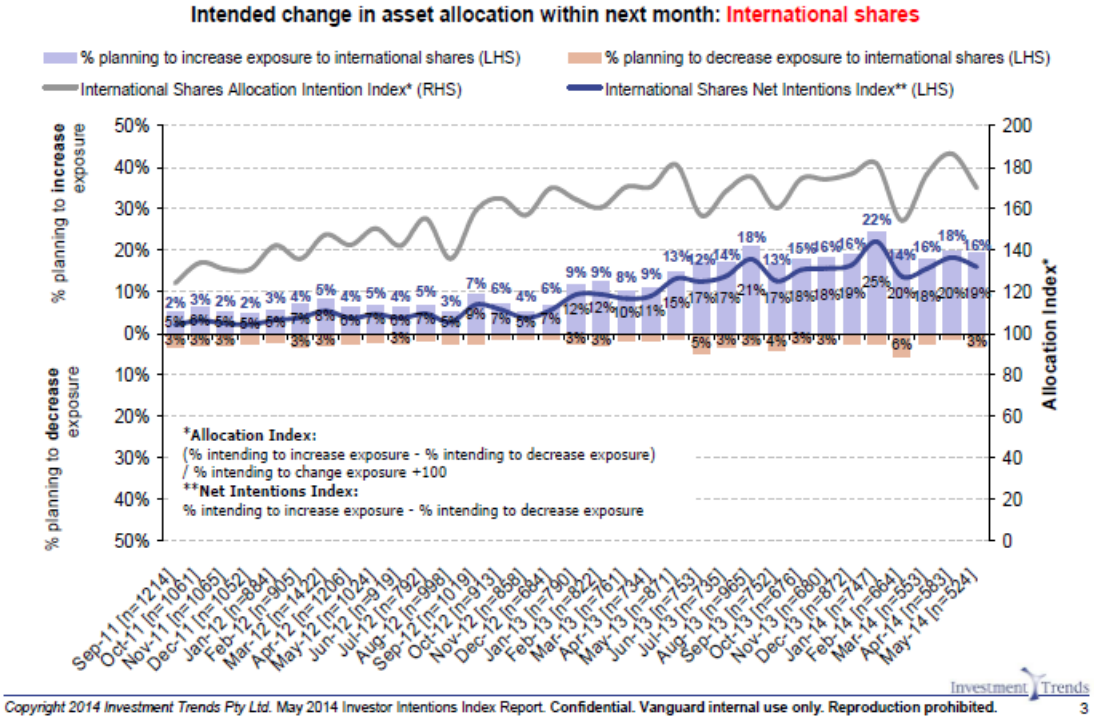
For example, research from Investment Trends demonstrates Australian investors have growing intentions to invest in international shares.

The past 12 months show that the proportion of Australian investors who plan to increase their international share exposure in the next 12 months outnumber those who plan to decrease their exposure by 15-20% points.

Other findings from Investment Trends show that Australian investors' preferred vehicle for gaining exposure to offshore assets varies by region. Their most common preference for global (multi-region) and Asian exposure are through investment funds.

The past 12 months show that 15-22% of Australians plan to increase their international share exposure in the next 12 months, versus a comparably low proportion who plan to decrease their exposure.

Allocation intentions: International shares



This provides a strong indication of demand for offshore investment within the Australian retail investment market.

ARFP – Australian legal and tax structure

The Australian Government needs to specifically establish an ARFP structure in the *Corporations Act 2001* which is clearly demarcated from other legal vehicles.

It must have a tax rate which is applicable solely to ARFP products.

A specific legal and taxation structure which is clear and unambiguous will provide the necessary certainty for foreign investors seeking to invest in Australian domiciled ARFP funds.

An ARFP structure would show our region that Australia is serious about addressing the widely held perception that Australia does not provide a level playing field for foreign investors and regularly changes the rules without warning.

RECOMMENDATION: Create an ARFP structure in the Corporations Act for legal and taxation certainty.

Collective investment vehicles reform

To improve Australian competitiveness, it is necessary to be aware of the preferences of international investors.

Many foreign investors (even though they may reside in a Double Tax Treaty country) do not come from a common law jurisdiction.

Consequently, these investors are not familiar with trusts and often prefer to invest in a Collective Investment Vehicle (CIV) which has either a contractual basis (e.g. an Irish common contractual fund) or is a corporate entity (e.g. a Luxembourg SICAV).

Establishment of alternative flow through vehicles, particularly for non-resident investors is necessary for Australian based fund managers to service these clients from Australia, as opposed to them establishing an off shore CIV for these clients in a competing jurisdiction.

The FSC suggests that the elective approach available to Managed Investment Trusts (MITs) should not be limited to unit trusts. Instead any legal entity that meets the prescribed prerequisite conditions could be eligible to elect, irrevocably, into the new regime. Once such an entity has elected into the regime the features normally associated with MITs such as transparency, flow through, deemed capital status would apply, regardless of how that type of entity might normally be treated for tax purposes.

By allowing such flexibility, Australian managers would be able to develop products that suited particular overseas jurisdictions. This flexibility will be essential for Australian managers to fully capitalise on the opportunities which will arise through the ARFP.

To be clear, the FSC believes that a wider range of collective investment vehicles should be made available in Australia. This reform is necessary alongside creating an ARFP legal structure (as mentioned above) which could then leverage a wider range of investment vehicles such as companies and partnerships.

RECOMMENDATION: Introduce a CIV regime comprising a broader range of tax flow-through CIVs to allow Australian based fund managers to compete more effectively internationally.

Australian taxation

Australia should introduce an Investment Manager Regime (IMR) for non-resident investors to facilitate greater use of Australian investment managers. Fundamentally, the IMR seeks to ensure internationally consistent and unambiguous investment outcomes for non-resident investors who use Australian investment managers through adherence to the following key principles:

- non resident investors should not be subject to Australian tax on non Australian source income;

- non resident investors should be exempt from Australian tax on profits on marketable securities whether dealing on capital or revenue account and whether they use an Australian manager or not; and
- investors should face the same tax outcomes for indirect investment through a collective investment vehicle as for direct investment.

The FSC recommends the government continue the commitment to deliver a world class IMR with wide application to a variety of offshore investor types. The regime must strive for equality of taxation outcomes for foreign investors so that investors using an Australian intermediary receive the same treatment as those investing directly.

We also support a reduction of the Managed Investment Trust withholding tax rate. Whilst the rate was reduced to 7.5 per cent in 2009, it was subsequently increased to 15 per cent in 2012. This rate is inconsistent with interest withholding tax rate of 10 per cent and is encouraging investment to be structured as debt instead of equity.

Australian ARFP roadmap

This roadmap sets out the critical path for domestic changes that Australia must make for fund managers to utilise the ARFP from 1 January 2016:

Deadline	**Item**
September 2014	**Investment Manager Regime** - final policy and legislative design is announced
December 2014	**Final Passport Model** - Confirmation of regional passport model by APEC **Tax treatment of Passport investors** – policy statement is required on whether competitive withholding tax treatment will be provided for foreign investors accessing Australian funds
January - March 2015	**Multi-currency classes** – required so that additional classes can be offered within existing funds from Day 1. Sufficient time must be allowed so that new classes can be set up and relevant product disclosure information can be provided to existing investors **Collective investment vehicles** - confirmation from government that additional vehicle structures will be available in 2016, including which types will be allowed **Investment Manager Regime** legislated to provide tax certainty for Passport investors using Australian managers
February 2015	**Australian domestic legislation** – legislative process commences

May 2015	**Commonwealth Budget** – delivery of final budget before the Passport goes live **Withholding taxation** - changes required to commence from 1 July 2015 contained in the 2015-16 Budget papers
July 2015	First financial year in which the Passport will be operational
September 2015	**Collective investment vehicles** – ability to set up new funds using new vehicle structures must be available within 6 months of Passport commencing, to allow managers to set up products with competitive vehicles
January 2016	Passport goes live

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?

No, we do not support restrictions on the legal form of passport funds. As discussed above, legal form is largely determined by investor appetite and familiarity. Managers should be free to determine an appropriate legal structure without restriction.

Australian CIS

Australian managers can currently only offer unit trust structures domestically, which will severely limit the ability to offer competitive products into the passport regime.

The FSC has long advocated for Australia to broaden the allowable collective investment vehicle types and this is the subject of a Board of Taxation Report into Collective Investment Vehicles, which was delivered to the government in December 2011 but remains unreleased.

The UCITS structure allows for different sub-funds to be contained within an umbrella corporate or trust structure. Within those sub-funds are different hedged or unhedged currency classes, accumulation or distribution share classes and retail or institutional share classes.

The unit trust structure in Australia does not allow for this and this will put Australian unit trusts at disadvantage in comparison to other participating countries in the Asia passport as well as UCITS funds.

We submit that the government must provide the ability to offer multi-currency class funds well in advance of the passport regime commencing, so that managers can take advantage of existing funds from Day 1 of the regime.

If Australian unit trusts are not permitted to offer multi-currency class funds this will present a serious impediment to Australian fund managers and may impact the likelihood of the successful operation of the Asia Passport.

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

The proposed model states a passport fund must not be called a MMF or otherwise promoted as a MMF in a host economy unless it complies with any specific additional requirements for a MMF in the host economy.

This may lead to a MMF fund in Australia being marketed as such whereas it may not be able to be marketed as a MMF in Singapore or South Korea. This will give rise to the Product Operator ensuring the same fund is marketed differently in different jurisdictions and in the event Australian investors suffer losses in a MMF they may claim against the Product Operator and in their claim ask why was the same fund marketed to one group of investors as a MMF whereas it was not marketed to another group of investors as a MMF.

As a consequence, we recommend there is a consistent naming convention for all fund types.

Q3.3 To what extent are offers likely to be made of interests in a passport fund that is an ETF in its home economy but not able to be traded on a financial market in the host economy?

Dual listings, secondary listings or the ability to list depositary interests on a second exchange are options that are generally already available in Asia, however these options have some disadvantages in relation to the cost and compliance requirements with maintaining dual listings.

We see the purpose of passporting relief to enable an ETF issuer to offer a security traded on one exchange into another country without also separately listing it on the local exchange. For example, passporting could allow an ETF listed on the ASX to be offered to Singaporean investors without also separately listing on the SGX.

Currently an ETF issuer cannot stop an investor in Singapore from buying an ETF listed on the ASX, however, the passporting relief could potentially allow the ETF issuer to actively offer the ETF to the investor in Singapore (subject to potential local requirements) and therefore provide more information about the product. The investor in Singapore could also be confident that the ETF met the requirements for passporting.

Note: We would also suggest that any final rules that refer to ETF units being traded on-market refer to the ETF units being "sold" rather than "redeemed" as redemption implies that the securities are being redeemed off market directly with the issuer and may cause confusion.

Q3.4 There is a risk of retail investors misunderstanding how they can realise their investment in an ETF where the interests are not traded on a local financial market. Is there reason for concern that this risk is not sufficiently addressed by host economy laws and regulations about disclosure and distribution? If so please explain.

We do not consider this to be a significant issue from an investor protection perspective. As already mentioned, the primary purpose of passporting is mutual recognition of the regulatory regimes of other passport countries. Any requirement which essentially required dual-listing would practically mean that ETFs are not catered for under the passport regime.

We do not think there is any need for additional disclosure on how a host country investor would sell the securities on a home country exchange such as the ASX, as we would expect that they would instruct a broker to do this. We think it would need to be clear to the investor that the ETF was a passport fund, but it would already be clear to the investor that the ETF is traded on a foreign exchange and not on the local exchange as they would have needed to engage a broker who is able to trade securities on this exchange in order to buy the ETF in the first place.

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.

The FSC understands the proposed requirement for an entity to offer each of their passport products in the home economy has been included as an integrity measure.

In some cases, passport products will be specifically tailored for investors in host economies and therefore the product may be not be supported by the necessary marketing and distribution support in the home country. For example, a Korean scheme operator may choose to target a Korean bond fund, issued in Australian dollars to Australian investors. This product may not have been designed for "domestic" or home investors as the product class is issued in Australian dollars and the marketing materials are printed in Australian English.

Likewise, it is unlikely a product issued in Singapore Dollar or Korean Won product issued by an Australian manager will be attractive to Australian retail investors.

Although this requirement could be somewhat cumbersome, we believe it could be implemented in a manner which minimises compliance costs for scheme operators.

RECOMMENDATION - we believe the requirement should be met by making an offer document available in the home economy. Website delivery should be sufficient for this purpose.

<u>Commissions</u>

Australian operators are prohibited from paying commissions in Australia. This is not applied consistently across APEC member countries where commissions can be paid to distributors.

This will put Australian funds at disadvantage when distributing into APEC countries. ASIC indicated commission arrangements could be put in place by Australian operators, however, this may impact on the requirement to treat unitholders in the same manner.

As currently drafted, there are 6 conditions that must be met if interests in a passport fund are to be offered in a host economy. One of these conditions relates to commissions paid by the passport fund operator. This condition, the "equivalency requirement", suggests that commission rates should be equivalent across a passport fund operator's suite of products.

In our view, the "equivalency requirement" is uncommercial and inappropriate for a large number of fund operators. It is common for a fund operator to pay different commission rates across its suite of products and across its various distribution channels.

RECOMMENDATION – we believe passport fund operators should be free to:

- choose whether to pay commissions in respect of the distribution of its CIS funds; and
- negotiate the rate of commission for the particular CIS 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?
As outlined in Q3.5 above, we do not believe that a home economy offer provides an additional investor confidence because the nature of products targeted at investors in different economies is likely to be very different.

This difference should not be seen as managers offering sub-standard products to offshore investors. The tailoring of products for specific markets should increase investor confidence as it is a reflection of the increased suitability of the product for the particular risk/return profile and asset class appetite of investors in that economy.

Q. 3.10

The relevant Track Record differs according to the various capacities which may be undertaken by different sections of a business and/or by delegates. The roles of the Responsible Entity/governance body, Investment Manager, Administrator, Distributor/Promoter and Depository should each have appropriate track records but may have achieved by organisations independently of one another.

To fulfil the objectives of the Passport the Regulator should be satisfied that the Operator has brought these together sufficiently in aggregate to meet the requirements. For example, the Investment Manager and governance body may not have previously had experience in retail activities but provided the Administrator and Distributor have done so then this element of the Passport's requirements should be able to be accepted.

Licensing of the passport fund operator

Qualification of officers of the operator

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?

The rules must not restrict managers from sub-delegating investment management to non-passport suppliers. Such suppliers could be related parties or other managers within a manager of managers' structure and should not be ruled out of the passport structure.

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 note that the independent oversight entity role would be expanded to consider compliance with offer documents. In Australia, a compliance committee is responsible for compliance with constitution, Corporations Act and a scheme compliance plan.

Each member economy will have existing requirements to ensure that key risks of the scheme are mitigated and monitored accordingly. The expansion of the independent oversight entity role should be clearly limited to the additional requirements as set out in the ARFP.

We note that compliance audit requirements are restricted to compliance with the ARFP rules and a defined set of obligations under home economy laws & regulations that help ensure the Passport fund's operational requirements are in place.

RECOMMENDATION - point 2 be amended to reflect the compliance audit requirements.

Compliance audit

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

We agree that the independent entity should be permitted to conduct a compliance audit. However these should be restricted where conflicts can be appropriately managed and the independence of the compliance monitoring can be demonstrated.

RECOMMENDATION - the independent entity should be able to conduct a compliance audit in the following situations:

1. Where independent oversight is through a separate and independent entity (Trustee model) which is unrelated to the operator of the Fund and any party delegated a function of the passporting fund;

2. Independent oversight is provided by independent Board or Compliance Committee and those responsible for the monitoring of the compliance framework have a direct reporting line to the independent board / compliance committee and the functions being monitored relate to those delegated to a third party that is unrelated to the operator of the fund. The operator of the fund is ultimately responsible and liable for the actions of third parties. If functions are delegated to a third party that is not related to the operator of the Scheme, the operator will have in place controls and monitoring measures to ensure those functions delegated to the third party comply with the passport rules. An additional requirement to engage a compliance auditor would be duplicating a function already completed by the operator. The direct reporting line by those employed to complete the monitoring function mitigates risk of conflict within the operator.

We also note that in terms of Australia's approach, the operational requirements audit should be added to the current AFSL audit requirement where the AFSL holder is approved to be an operator of a passport fund in order to ensure efficiencies in audit are gained and costs of audits are reduced.

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?

See response to Q3.18 above.

Investment restrictions

The current rules would allow master feeder structures but only where both the master and the feeder are passport funds, for example current Australian trust structures investing 100% in SICAV structures would not be allowed.

RECOMMENDATION - the master feeder rule be extended to allow a ***limited*** allocation to UCITS funds.

Securities Lending

The proposed restrictions on securities lending and repurchase arrangements appear to be relatively prescriptive. Aside from the restriction on such arrangements being used to leverage the fund (which on face value is a prudent and appropriate proposal), we would caution against imposing additional restrictions which will potentially dissuade quality funds from participating.

One of the stated aims of the passport is to enable consumers within the region to access quality funds and for the benefits of large funds with scale to be shared across passport countries.

We note that the very funds that are ideal candidates to participate in the passport (large, cost-effective funds that are fully invested in the market have a long track record of performance), will be reluctant to participate if it means restricting or altering the way the underlying portfolios of funds are managed.

Delegation

Q3.26 Are these eligibility requirements sufficient to ensure that the delegates have the necessary experience to perform the delegated functions and are subject to appropriate regulatory oversight? If not, what other measures should apply?

The FSC does not support a rule which compels scheme operators to undertake certain delegated activities solely in the passport economies. The proposal is inconsistent with commercial realties of international asset management.

Setting aside the point that the proposed delegation rule may fall foul of World Trade Organisation (WTO) rules, the rule would seemingly preclude a scheme operator from delegating a proportion of a product's portfolio management to a non member-economy.

This design feature presents a serious risk to the passport's viability. Scheme operators managing products such as global equity or global bonds would be unable to use the passport as the necessary component of the management to Europe or the Americas would be banned.

As UCITS does not impose such restrictions, this design feature could hobble the passport's prospects for scale and wide adoption by scheme operators. This is particularly the case when considering that one of the most attractive products for distribution through the ARFP would be global equity funds. This is because portfolio management of such funds occurs across the globe.

Scheme operators commonly utilise portfolio management capability "on the ground" in the region in which the assets are managed. There is often no substitute for managing the assets from close proximity.

The following provision is most problematic:

> …the delegate is regulated by an organisation that to the satisfaction of the home regulator, following consultation with other passport economy regulators, has co-operation arrangements in place with the home regulator which are comparable to, and as effective as, those in place between the passport economy regulators;

It is virtually impossible to imagine that the same level of multilateral mutual recognition could be achieved beyond the ARFP signatories. The ARFP will deliver an unprecedented agreement between our regulators to work together on this project. We have not seen any intention for this level of cooperation to be shared more broadly with the United States or European Union; which we expect to be highly unlikely.

Accordingly, we believe this proposed design feature would make it impossible for certain products such as global equity funds to fit within the ARFP.

If a delegation rule is required, we believe that the first four bullet points on page 36 of the model would be sufficient as they largely mimic the delegation rules imposed on the domestic funds industries in Australia and Singapore.

However, the FSC is cognisant of the desire to include passport rules which ensure that the benefits of the passport accrue to the Asia Pacific region though increased direct and indirect economic activity, employment and taxation growth.

We believe that the best way to deliver a stronger economic benefit to the region would be to create a viable ARFP which also includes distribution in the model.

By building scalable products which are domiciled in our region and capturing the second layer of the value chain (after manufacturing or scheme operators), the passport would deliver increased economic activity in this region.

Expanding the passport rules to distribution also has the benefit of removing inconsistency, ambiguity and removing any perception of protectionism within the region.

RECOMMENDATION – remove the proposed delegation rule; expand the passport rules into distribution.

<u>Obligations of independent RE where management functions are delegation</u>

It is proposed that where the term “operator” is used, in the context of its application to an independent Responsible Entity (RE) that the obligation is on the independent RE or its “agents”.

RECOMMENDATION - the definition of “operator” which “means a person who operates a passport fund under an authorisation of the home regulator and such a person includes both the trustee and manager, if applicable” – be amended to also include the independent RE or its agents, as applicable (or be interpreted to include that concept).

Q3.27 Is it appropriate to apply the same requirements as apply to an operator to a delegate in relation to the experience of its chief executive officer and executive directors? If not, why not?

Exchange traded passport fund classes

The FSC does not support the proposal in the discussion paper requiring exchange trade passport fund classes to have in place a direct redemption facility for members in certain circumstances.

The discussion paper proposes that if the interests in a passport ETF are suspended on the relevant financial market for five consecutive trading days, the passport fund must take reasonable steps to ensure interests in the fund are able to be redeemed by members that submit a redemption request.

In Australia, ASIC Class Order 13/721 imposes a similar direct redemption requirement as a condition of standard relief that ETF issuers require in order to offer ETF products by restricting withdrawals to authorised participants that are Australian tax residents.

However, this applies to some newly listed products only, and under Australian domestic law there is no general requirement for the majority of existing ETFs to have a direct redemption facility in place. As such, we do not believe the passport rules are an appropriate vehicle in which to introduce new costly obligations on ETF issuers, which should be focused on making the passport as facilitative as possible.

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?

We believe it is appropriate to issue financial statements and audit reports in the official language of the host economy on the basis investors will want to understand the information being presented to them in those documents.

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 requirements in relation to custody arrangements may require further clarification. These requirements are discussed on pages 19-20 of the model. We agree that a passport fund must ensure there is a custodian for the assets. We also agree that the activities that relate to the asset holding must be performed by officers who are separate from, and able to act independently from, people involved in investment or trading decisions.

However, we query the benefit of the requirement that the custodian must be authorised by the home regulator. In our view, it may not always be appropriate for a passport fund operator to appoint a local custodian to hold fund assets, particularly where the fund invests in global assets. The "authorisation" requirement may deter passport operators from domiciling their CIS funds in a passport economy.

In our view the custody arrangements should be clarified so that passport fund operators are free to appoint a custodian that meets the operation requirements of the passport rules, but without a requirement that the custodian be domiciled in a passport economy.

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?

Investment Performance

Comparability and presentation of investment performance of passport funds across economies will be an important underpinning factor to ensure that a high degree of investor protection is achieved.

The Global Investment Performance Standards (GIPS) is a single global investment performance presentation standard which provides a common method for calculating and presenting investment performance.

We strongly believe that adoption of the GIPS across relevant jurisdictions would be complimentary to the success of the passport.

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?

Custody/home economy

See our response to Q3.29 above.

Classes

Throughout the model, references are made to matters concerning the CIS as a whole. In our view, it is becoming increasingly more common for global fund operators to establish a fund with multiple investment strategies.

In principle, these funds allow operators to create segregated portfolios to cater for different investors and investment strategies. In order to facilitate support from global fund operators, we submit that the passport rules allow passporting of the applicable class rather than limiting this to the CIS as a whole.

More specifically, we submit that the passport rules should:

- clearly state that CIS funds can have multiple investment strategies and classes;
- acknowledge that CIS funds may offer segregated portfolios that are not open for offer under the passporting regime; and
- amend references to CIS to references to the applicable class of the CIS.

For example, references in relation to custody arrangements (pages 19-20) should be amended so that custody requirements apply to the applicable class of the passport fund. Similarly references in relation to investment restrictions and portfolio allocation (pages 23-30) should be amended so that these restrictions apply to the applicable class of the passport fund.

Q3.33 For prospective passport fund operators or current and prospective fund managers, what impact would the proposed approach have on your business? If the proposed approach would result in an increase or reduction in compliance or other costs, please quantify.

The FSC is working with A.T. Kearney to determine the cost and efficiency savings which would accrue to the investment industry if a successful ARFP is established. We expect to have this information by the third quarter of 2014.

Q3.34 Do you require more information about the proposed approach? If so, what?

Passport restrictions to apply at class level

For managers to be able to take full advantage of the passport it is necessary to allow as many pre-existing funds to meet the eligibility requirements as possible.
Setting up new funds is a costly process and the greatest economies of scale will be gained when managers can set up a new passport class within an existing fund structure, instead of establishing a brand new fund. If passport criteria apply at the fund level instead of the class level, economies of scale will be difficult to achieve.

We understand that there is no policy objection to passport investment criteria applying at the class level, as opposed to the fund level. We request that this position is clarified in either the passport rules or the Australian based rules.

RECOMMENDATION – the passport rules, in their final form, must ensure that existing products can utilise the passport regime.

Other:

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

Maximising eligibility of existing funds

Multi-currency classes

This issue has been outlined in Q3.1 above.

Redemption timeframes

We note under the passport rules that the passport fund must (subject to a suspension permitted by the passport rules) pay redemption proceeds in no more than 15 days from the time the request for redemption is received.

In Australia, the redemption period is set out in the constitution for the fund and for new funds, ASIC will generally require the responsible entity (fund operator) to pay redemption proceeds within 21 days. This is consistent with ASIC policy outlined in ASIC Regulatory Guide 134.

Whilst we do not disagree with the proposed time period of 15 days, in Australia, many funds will have a liquidity period of in excess of 21 days which would make them ineligible for the passport regime.

We suggest that work be undertaken to ensure that the passport rules, in their final form allow existing products to utilise the passport regime. In the context of this example, this may be achieved by allowing Australian fund operators to comply with the passport rules by disclosing

payment of redemption proceeds under the disclosure document, regardless of what is written in the fund's constitution.

Q3.36 Do you have questions about how the passport will work that are not addressed in the proposed framework? What are they?

Distribution in host economy

It is critical that symmetry is achieved between passport economies in the mutual recognition of distribution licensing. The regulatory elements that comprise the distribution function must be understood so that equivalence is achieved.
The further the passport rules go in allowing distribution of funds, the greater profit will be made in the region. Currently there is significant mismatch of distribution licensing rules within the region, with a broad range of contexts for what is allowable activity for fund manufacturers. This will lead to regulatory arbitrage.

The following bullet points highlight the differences:

- In the Australian context, distribution of retail funds is tied to the concept of providing "financial product advice", and fund distributors must hold an Australian Financial Service Licence that authorises them to provide financial product advice. Offshore funds must register locally to access local retail investors directly, unless going through certain third party platform arrangements.
- Singapore has a broadly similar framework to Australia, where fund managers that produce retail funds must hold a capital market services licence, and distributors must be licenced under the Financial Advisers Act. However offshore funds can be sold directly to retail investors in certain circumstances, such as with UCITS.
- Funds in Korea are governed by the Financial Service and Capital Markets Act, which dictates that all funds must be sold through a local distributor or brokerage which is licenced as an investment broker/dealer.
- The Securities and Exchange Commission of Thailand also stipulates that offshore funds must be sold through local feeder fund structures.

The varying requirements of distributing and marketing the funds will be a significant hindrance and cost burden over and above meeting the passport requirements, and take-up of the passport would be low where marketing under the mutual recognition does not add any benefits over setting up a normal distribution arrangement outside the passport.

RECOMMENDATION – harmonise distribution arrangements and eliminate regulatory arbitrage.

Taxation arrangements

The taxation arrangements for foreign investors investing into domestic managed fund products vary across the passport economies.

There are also differences between jurisdictions in the tax treatment of managed funds depending on asset type. For the passport to be successful in the Australian context it will be necessary to provide specific taxation relief to ensure Australian managers are not at a disadvantage compared to managers in other Passport economies.

As noted above, we recommend the Australian government provide specific legal and taxation arrangements for foreign investors investing into Passport products. These arrangements would ensure that foreign investors investing directly and through passport vehicles would receive an equivalent tax outcome.

We note Australia has double tax treaties will each of the passport pilot countries, however it is a requirement that an effective exchange of information arrangement is in place for the reduced rate of withholding on fund payments to apply.

Currently the Philippines is not listed in the relevant regulation. We seek clarity as to when the regulation will be updated to include the Philippines. Should additional economies join the passport it will be necessary to ensure that withholding tax can be treated at the treaty rate.
See appendix A for more information on taxation arrangements in the economies.

Transitional relief for constitution changes

Some existing funds may need to change their constitution to be able to conform with the passport rules. To the extent that there are no detrimental changes to investor's rights we would like the opportunity to discuss with ASIC the suitability of class order relief for certain changes.

AML/KYC and Privacy issues

The passport rules should clarify the economies' agreement on how AML/KYC rules and FATCA/CRS are to be applied, including what reporting is required.

QUESTIONS ABOUT REGULATORY FUNCTIONS

Registration and assessment

Q4.2 If not, what changes would you propose? What impact would the proposed approach have on competitiveness and ensuring investor confidence?

To avoid the same mistakes of the UCITS which ultimately led to UCITS IV, it is important that once a fund has been approved as a ARFP fund by the home regulator there is a streamlined process for the registration in the host economy with limited restriction on the host economy's ability to review the application.

The purpose of the application is to notify the host economy of the intention to distribute the product. Until a universal offer document is created under the Passport, the main risk is compliance with the host economy's distribution rules and any other requirements.

To ensure such applications can be treated as notifications rather than applications to be reviewed it is proposed that with each application, a legal sign off within the host economy is provided with the application to confirm compliance.

Provided the required documents are lodged to the host with the external legal sign off, the host should register the fund within 21 days unless it can be refused on public interest grounds.

It will be very important to establish minimum requirements for regulators to approve funds.

For example, host regulators need to provide approval (or otherwise) quickly. And it should be clear how often the clock can be restarted if the host regulator asks for more information or requests a change to the detail of an application.

SUPERVISION AND ENFORCEMENT

Other

Q4.5 Please detail any other matters you consider relevant to the supervision and enforcement arrangements that need to be reflected in the passport arrangements.

FATCA

The Foreign Account Tax Compliance Act (FATCA) was enacted by the United States Congress in March 2010 to improve compliance with US tax laws. FATCA will impose certain due diligence and reporting obligations on foreign (non-US) financial institutions, including Australian institutions. These institutions will be required to report to the US Internal Revenue Service (IRS) information on US citizens with financial accounts.

On 28 April 2014, Australia and the US signed an intergovernmental agreement to assist in the facilitation of FATCA for Australian financial institutions. A key objective of the intergovernmental agreement is to support Australian compliance with FATCA in a way that reduces its overall burden on Australian business. This includes reporting the information via the Australian Taxation Office (ATO) under the existing Australia–US tax treaty arrangements.

We seek clarity that FATCA reporting by Australian financial institutions on Australian domiciled passport funds would follow the same rules as those for investors into non-passport funds.

Other Reporting

It is currently unclear whether there will be additional disclosure requirements expected of the fund manager by the home economy for the manager to report the host economy in regards to investors in their funds. The extent of reporting requirement needed may influence fund managers decision and readiness to participate in the Passport when ready.

Regulatory Reporting – Efficiencies would be gained if the home regulator shared regulatory reporting requirements with other regulators in the region so that duplicate submissions are not required.

Current Focus on Retail Offers – Efficiencies and cost savings would be gained if institutional offers could be subject to a similar notification/proposed Country Supplement process in place of registration drawing upon the processes envisioned for the Passport.

SUMMARY OF RECOMMENDATIONS

1. *Regulatory arbitrage must be eliminated in all passport economies.*

2. *Create an ARFP structure in the Corporations Act for legal and taxation certainty.*

3. *Introduce a CIV regime comprising a broader range of tax flow-through CIVs to allow Australian based fund managers to compete more effectively internationally.*

4. *We believe the requirement should be met by making an offer document available in the home economy. Website delivery should be sufficient for this purpose.*

5. *We believe passport fund operators should be free to:*

    - *choose whether to pay commissions in respect of the distribution of its CIS funds; and*
    - *negotiate the rate of commission for the particular CIS fund and distribution channel concerned.*

6. *Point 2 be amended to reflect the compliance audit requirements.*

7. *The independent entity should be able to conduct a compliance audit in the certain situations.*

8. *The master feeder rule be extended to allow a **limited** allocation to UCITS funds.*

9. *Remove the proposed delegation rule; expand the passport rules into distribution.*

10. *The definition of "operator" which "means a person who operates a passport fund under an authorisation of the home regulator and such a person includes both the trustee and manager, if applicable" – be amended to also include the independent RE or its agents, as applicable (or be interpreted to include that concept).*

11. *The passport rules, in their final form, must ensure that existing products can utilise the passport regime.*

12. *Harmonise distribution arrangements and eliminate regulatory arbitrage.*