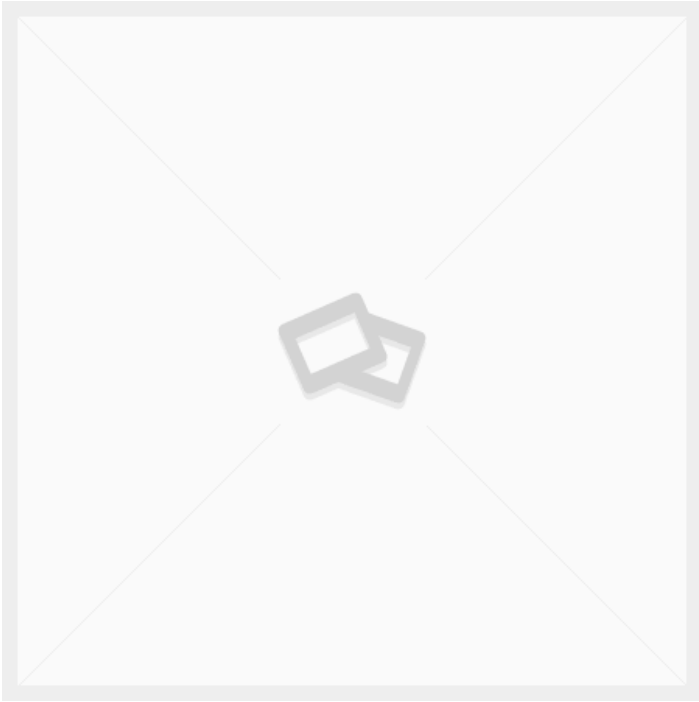


ASIA REGION FUNDS PASSPORT

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Author: Bill Jamieson.

Introduction

On April 16, 2014, Singapore, Australia, Korea, New Zealand, the Philippines and Thailand released a Consultation Paper ("**Consultation Paper**") to seek views from the public on the implementation of the Asia Region Funds Passport ("**ARPF**"), inviting interested parties to make their submissions by 11 July 2014. This update takes a look at the ARPF and some of the regulations outlined in the Consultation Paper.

Background

The ARFP is a proposed regulatory arrangement for the cross-border offer of collective investment schemes ("**CIS**") in participating Asia-Pacific Economic Co-operation ("**APEC**") economies (i.e. Australia, Chinese Taipei, Hong Kong, Indonesia, Japan, Korea, Malaysia New Zealand, the Philippines, Singapore, Thailand and Vietnam). The ARFP is expected to commence in 2016 and will allow a fund manager operating an eligible fund regulated by one passport member economy to offer the fund to investors in other passport member economies under a streamlined regulatory framework.

It is hoped that, by facilitating the cross-border distribution of fund products, the ARFP, once implemented, would increase fund activity in the Asia-Pacific region and would ultimately benefit the funds' industry, as well as each participating economy.

The Consultation Paper sets out the substantive rules that apply to passport funds and fund managers, including the regulation of licensing and reporting as well as the restrictions on investments.

Substantive Requirements

The Consultation Paper outlines some of the rules that fund managers will have to comply with should they wish to apply for a passport. Fund managers will have to comply not only with fund management rules in their own home jurisdictions but also with certain rules in the foreign jurisdiction in which the fund is being offered (host jurisdiction), as well as the applicable rules under the ARFP regime.

The ARFP has several criteria which a collective investment scheme ("**CIS**") has to fulfil before it can be eligible for passport application as follows:

- The type of CIS has to be a regulated fund structure. Each jurisdiction nominates

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different types of CIS that are available to operate under the ARFP scheme – the proposed rules require that the CIS invests predominantly in transferable securities and certain other liquid assets.

- The CIS has to be constituted or established in a home jurisdiction that allows the ARFP to operate, and the operator must be authorised and operate primarily out of the home jurisdiction.
- Interests in a passport fund may be offered only if there is an ongoing offer of the interests in the home jurisdiction that it is subject to the offering and disclosure requirements that apply to public offerings in that home jurisdiction (i.e. a retail fund).

The ARFP framework also sets out some other key requirements in the following fields:

- Licensing of the passport operator (fund manager).
- Qualifications and experience requirements of operators and executives, including directors and Chief Executive Officers.
- Capital adequacy requirements - for instance, it is a requirement for operators to maintain equity balances of at least USD 1 million, and managers with assets under management ("**AUM**") in excess of USD 500 million must maintain at least additional capital equivalent to 0.1% of the excess, up to a maximum USD 20 million of additional capital.
- The operator and its related parties must have USD500million of AUM in investment schemes with at least 50% of their assets in permissible investments. Safekeeping of fund assets, including the appointment of a custodian that is independent of the CIS operator.
- Governance of the CIS by a trustee, a board of directors or compliance committee of which at least half the members are independent.
- Annual compliance audits and audit of the fund in accordance with IFRS or equivalent standards.
- Restrictions on investments - the Consultation Paper proposes limits as to the type of assets that a passport fund may hold, as well as the quantities of each specific asset, in particular, a limit of 10% on unlisted securities.
- Securities lending - one key restriction proposed by the Consultation Paper is that the fund must not engage in securities lending to generate leverage and must not, at any point in time, have transferred more than 50% of the value of its assets in securities lending transactions.
- Prohibitions on money lending.
- Restrictions on borrowing, including purpose, nature and timing of repayment.
- Delegation of functions.
- Valuations.
- Host jurisdiction rules will apply in areas such as interaction with investors, disclosure,

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advertisement of the fund and handling of complaints, as well as general administrative issues. This could operate as a limitation on the value of the passport, as host regulators could require operators to establish a significant presence in the host jurisdiction and licensing for the marketing of the fund in that country.

- Enforcement - the Consultation Paper suggests that both home and foreign jurisdictions be given the power to issue stop orders and that each jurisdiction is to ensure that passport regulators in their own jurisdiction are allowed to use their powers with respect to matters that are governed by their own rules and regulations, passport rules and also in supervising rules and regulations of the foreign jurisdiction.

Conclusion

The Consultation Paper presented a detailed proposal as to the workings of the ARFP, but it is generally recognised that there are significant challenges to introducing the ARFP to the CIS market and fund management industry, largely attributed to the gaps in legislation between members of the APEC region.

In addition, while the ARFP seems to be largely based off the European UCITS framework, the key difference between the UCITS framework and the ARFP is that the UCITS contains an overarching regulatory and governance framework. Arguably, the passport rules intend to bridge between the gap between the current state of Asia's fund management landscape and a UCITS type regime, which can be considered to be an end-point. As the consultation period has recently concluded, the results of the consultation will be key in refining and fine-tuning the implementation and the direction of the ARFP.

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