
The Asia Region Funds Passport

Kota Okada
Financial Industry Analyst
Nomura Institute of Capital Markets Research

I. Establishment of pilot program

In September 2013 Australia, Korea, New Zealand, and Singapore signed a *Statement of Intent on the Establishment of the Asia Region Funds Passport*¹. This marked the start by the four countries of a pilot program for the scheme.

The passport scheme is intended to enable collective investment schemes (CIS) that have been approved in one (“home”) country to be sold in other (“host”) countries that belong to the scheme without having to go through a complicated registration and approval process. It is therefore similar to the UCITS (Undertakings for Collective Investment in Transferable Securities) scheme in the EU².

In November 2009 the Australian government, which was in the process of trying to establish Australia as an international financial center, floated the idea of an Asia Region Funds Passport. Then, in 2010, APEC (Asia-Pacific Economic Cooperation) became a forum for discussion of the concept of an Asia Region Funds Passport, and in October the first capacity-building workshop was held with the aim of supporting several APEC developing economies in improving their technical skills in cross-border trading of financial products. Altogether seven such workshops were held, leading, in September 2013, to the start of a pilot program based on the aforementioned *Statement of Intent*.

This report deals with APEC’s development of an Asia Region Funds Passport (“ARFP”). Countries wishing to become members of ARFP do so by amending their legislation so that it complies with the ARFP rules set out in the *Statement of Intent*. We therefore explain these rules.

¹ APEC, “*Statement of Intent on the establishment of the Asia Region Funds Passport*,” Sep. 2013.

² UCITS is regulated by an EU directive. UCITS is undertakings with the sole purpose of investing funds raised from the general public in transferable securities or liquid financial assets, according to the principle of risk diversification, that allow the owner to request, directly or indirectly, that investment units be redeemed using the UCITS assets.

II. ARFP framework and rules

1. ARFP Framework Document rules

The *Statement of Intent* was published together with a *Framework Document*. This document sets out the initial guiding principles and basic arrangements for the Passport, and consists of three sections: a definition of the Passport; its scope; and the applicable rules (Figure 1).

The Passport is defined as “an arrangement for the cross-border offers of eligible CIS in Passport member economies.” Its scope is defined as retail offers of CIS that are well diversified in terms of the exposure of a fund to issuers of financial products, are liquid and do not have complex features that may increase risk, and that have interests which are redeemable on request except in specified circumstances. Furthermore, CIS operators based primarily in non-member economies cannot use the Passport, and Passport member economies will recognize and respect the integrity of each other’s regulation of CIS, while recognizing the need for a stepped approach in which differences between national regulations are gradually eliminated.

The section on applicable rules covers host economy laws and regulations, home economy laws and regulations, and special Passport rules. A host economy is a jurisdiction (other than the home economy) in which a Passport fund is offered to the public in that jurisdiction. In general, host economy laws and regulations will apply where they relate to the direct interaction between investors and a Passport fund, including matters such as disclosure and marketing. A home economy is a jurisdiction in which a Passport fund is constituted or established, and authorized, registered, approved or licensed under the laws and regulation of that jurisdiction for offer to the public in that jurisdiction. In general, home economy laws and regulations will apply to the authorization of the CIS operator, and the authorization and operation of the CIS. Furthermore, special Passport rules apply in 16 different areas, including types of legal vehicles, regulatory control, custody of assets, valuation, and short selling.

2. Rules governing Passport members

The *Statement of Intent* also contains rules governing Passport members. The Passport will first be established with a limited number of Passport member economies which will form a Pilot Group. The purpose of commencing with a Pilot Group is to launch the operation of the Passport initially with a limited number of economies to establish a strong and efficient framework that can then be expanded to create a wider, more inclusive regional Passport.

An economy that wishes to become a Passport member economy must obtain the consent of each existing Passport member economy. Passport member economies will make a decision within a reasonable time. If the nomination is declined, the economy will be provided with recommendations to assist it to become a Passport member economy at a later stage.

Figure 1: ARFP Framework Document rules

| | Overview |
|------------------------|---|
| Passport | The Passport is defined as “an arrangement for the cross-border offers of eligible CIS in Passport member economies.” Its aim is to foster the growth and competitiveness of the Asia region and its fund management industry. |
| Scope | Its scope is defined as retail offers of CIS that satisfy the following criteria: <ul style="list-style-type: none"> • funds that are well diversified in terms of their exposure to issuers of financial products, are liquid and do not have complex features that may increase risk; • funds that have interests which are redeemable on request except in specified circumstances. Eligibility is restricted to CIS established and approved in member economies. CIS operators based primarily in non-member economies cannot use the Passport. |
| Applicable rules | Passport member economies will recognize and respect the integrity of each other’s regulation of CIS, while recognizing the need for a stepped approach in which differences between national regulations are gradually eliminated. |
| Host country rules | A host economy is a jurisdiction (other than the home economy) in which a Passport fund is offered to the public in that jurisdiction. Host economy laws and regulations will apply where they relate to the direct interaction between investors and a Passport fund, including matters such as the following: <ul style="list-style-type: none"> • sales • disclosure • dealing with investor complaints • marketing |
| Home country rules | A home economy is a jurisdiction in which a Passport fund is constituted or established, and authorized, registered, approved or licensed under the laws and regulation of that jurisdiction for offer to the public in that jurisdiction. In general, home economy laws and regulations will apply to the authorization of the following aspects of operating a CIS: <ul style="list-style-type: none"> • the authorization, registration, approval and licensing of CIS operators • general duties of the CIS operator and its directors and officers • outsourcing and service providers • risk management requirements • meetings of Passport fund members. |
| Special Passport rules | Special Passport rules will apply in the following areas: <ul style="list-style-type: none"> • Streamlined Authorization Process (for Passport funds to be offered in a host economy) • types of vehicles (to ensure there are no restrictions on the type of legal vehicle a CIS uses) • advanced qualifications and experience (of CIS operators of Passport funds) • regulatory control (to ensure Passport regulators are able to appropriately oversee Passport funds offered in their economy) • delegation (to ensure that a significant proportion of Passport fund activities are undertaken by entities within the region, consistent with the aims of the Passport to develop the region’s fund management industry) • custody of assets (to ensure there is separation between the assets of the CIS and the assets of the CIS operator and other CIS) • valuation (to ensure CIS assets are valued on an appropriate basis) • independent oversight • investment and portfolio allocation restrictions (to ensure only CIS using a restricted range of issuer-diversified and liquid investments can be offered under the Passport) • derivatives (to limit the use of derivatives) • lending (to prohibit money lending, underwriting and the provision of guarantees by Passport funds, except in limited circumstances) • borrowing (to provide that Passport funds may only borrow or obtain finance in limited circumstances and limited amounts) • short selling (to prohibit short selling by Passport funds) • redemption and suspension (to ensure each Passport fund provides reasonable redemption rights and to specify when redemptions may be suspended) • distribution of audited accounts (to ensure audited accounts are prepared in accordance with international standards or prevailing national standards that are substantially converged with international standards) • regulatory powers (to provide that the regulatory powers of the host regulator in the host economy apply to a Passport fund) |

Source: Nomura Institute of Capital Markets Research, based on *Statement of Intent on the Establishment of the Asia Region Funds Passport*

III. What each Passport member economy hopes to gain

The ARFP concept originated in November 2009 with the publication by the Australian Financial Centre Forum of “Australia as a Financial Centre: Building on our Strengths.”³ This report identified ARFP as one way of establishing Australia as an international financial center.

Australia subsequently took part in all the ARFP workshops and took the initiative in developing the Passport concept from the outset. We attribute this to a desire by Australia to export to the rest of Asia the products, infrastructure, and know-how developed by its fund management industry for the country’s superannuation system.

Then, in December 2013, it was reported that 68% of the inflows to Australian fund management companies came from the Asia-Pacific region—an indication of the extent to which Australia stands to benefit from ARFP⁴.

Other economies besides Australia that are seeking to become Asian financial centers are Hong Kong and Singapore. Both have attended all the above workshops since the second, and Singapore is a member of the ARFP Pilot Group. It is worth mentioning that, like Singapore, Korea has attended all the workshops since the second and is a member of the ARFP Pilot Group. In a report published in August 2013 (“Funds Passport – International Discussions and Implication”) the Korea Capital Market Institute, one of the country’s leading think tanks, took the view that, while membership of ARFP might have a negative impact on the demand for the services of Korean fund management companies in the short term, it would probably increase their international competitiveness in the long term.

Actually, APEC’s ARFP is not the only fund passport concept that has been proposed for the region: ASEAN also has one⁵. In October 2013 three members of the ASEAN Capital Markets Forum (Singapore, Malaysia, and Thailand) agreed on an ASEAN CIS Framework. With this framework, Singapore-based fund management companies will be able to offer CIS to retail investors in Malaysia and Thailand without having to make any legal changes or adjustments.

Singapore has been the main driving force behind the framework, which is due to be implemented by the first half of 2014.

³ The Australian Financial Centre Forum, “*Australia as a Financial Centre: Building on our Strengths*,” Nov. 2009.

⁴ Financial Services Council and the Trust Company, “*Australian Investment Managers Cross-Border Flows Report*,” Dec. 2013. The Financial Services Council (FSC) is a trade body representing Australian fund management companies.

⁵ One example is an initiative, announced in January 2013, for mutual recognition of mutual funds by Hong Kong and mainland China. See Kamiyama, Tetsuya, “*ASEAN’s Investment Trust Markets: Current Conditions and Challenges*,” *Nomura Journal of Capital Markets*, Summer 2013, Vol. 5, No. 1.

IV. Future developments

The ARFP *Statement of Intent* contains a timetable. Public consultations on the *Framework Document* by the members of the Pilot Group are due to be held in January–June 2014. This is part of the process of devising detailed rules for the Passport’s guiding principles and basic arrangements. Then, in June–December 2014, technical and procedural rules will be refined to take account of the public consultations and prepared for finalization through an arrangement document, which, in February 2015, will be signed by those economies that wish to become members of the Pilot Group. The Pilot Group economies will then implement legislation and measures, where necessary, to give effect to the arrangement document. In January 2016, eligible CIS in passport member economies will be able to access the Passport, and the scheme will come into operation (Figure 2).

Figure 2: Timetable for implementation of ARFP

| Date | Milestone |
|-------------------------|--|
| September 2013 | Interested Finance Ministers express their intention to consult on detailed rules based on the <i>Framework Document</i> by signing the <i>Statement of Intent</i> . |
| September–December 2013 | Technical and procedural rules and other elements of the Passport prepared for consultation. |
| January–June 2014 | Public consultations conducted. |
| June–December 2014 | Technical and procedural rules refined to take account of public consultations and prepared for finalization through an arrangement document. |
| February 2015 | Economies which wish to become members of the Passport when it is launched (the Pilot Group) sign the arrangement document. |
| February–December 2015 | Pilot Group economies implement legislation and measures where necessary to give effect to the arrangement document. |
| January 2016 | Eligible CIS in passport member economies can access the Passport. |

Source: Nomura Institute of Capital Markets Research, based on *Statement of Intent on the Establishment of the Asia Region Funds Passport*

Despite this timetable, many think that ARFP will have to surmount a number of obstacles before it can become as widespread as UCITS. These obstacles include differences in the stage of development and legal form of mutual funds in each country; a tendency for retail channels to be dominated by domestic banks; and obstacles to the entry of foreign financial products that may remain even once the Passport is operating. Nevertheless, ARFP’s pilot program is under way in the four members of the Pilot Group, and the number of members may increase.

As a member of APEC, Japan also has the option to declare at any time its intention to join the Passport. As ARFP’s framework is still, as we have explained, being worked out, some take the view that there is not enough evidence to judge the scheme’s advantages and disadvantages. However, it is also possible to argue that, by being involved in laying the groundwork, Japan would have an opportunity to put its own views. It will therefore be interesting to see how the pilot program progresses and whether Japan decides to become a member.