

Regulation impact statement – Asia Region Funds Passport

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Background

The idea of an Asia Region Funds Passport (the Passport) was first put forward in a submission by the Investment and Financial Services Association (IFSA) (now the Financial Services Council) to the *Australia as a Financial Centre Forum* in March 2009.¹

IFSA proposed that a common framework be developed in the Asia-Pacific region to allow a higher level of cross-border trade in collective investment schemes.

The objective was to develop an arrangement, based on a mutual recognition,² that would allow collective investment schemes based and regulated in one economy (the home economy) to be 'passport' or sold to investors in other economies in the region (host economies). This would occur without the collective investment scheme and its operator having to meet all the host economy requirements applying to the operation and sale of interests in such a scheme.

The Australian Financial Centre Forum's 2009 report, *Australia as a Financial Centre – Building on our Strengths* (the Johnson Report),³ supported the idea and recommended that the Passport scheme be developed.

The Australian Government supported the recommendation and, to determine whether there was sufficient interest in the concept of a Passport scheme, introduced it as an exploratory policy initiative within the Asia-Pacific Economic Cooperation (APEC) Finance Ministers' Process. This provided a region-wide platform to collaborate with finance policy makers, regulators, industry participants, and technical experts to examine how a passport scheme could be developed.

1. The problem

Australia has a well-developed, high-quality financial system. It ranked fifth in the World Economic Forum's Financial Development Index (2012).⁴ The Australian fund management industry (excluding superannuation) is made up of around 306 businesses, employing approximately 20,000 Australians.⁵

In Deloitte's 2014 report *Building the Lucky Country #3 – Business imperatives for a prosperous Australia*, Australia's fund management industry is identified as having a high comparative advantage due to:

- Australian industry's experience and skills developed with managing funds associated with Australia's compulsory superannuation system;

¹ Investment and Financial Services Association, *Submission to the Australian Financial Centre Forum* (4 March 2009), available at: http://cache.treasury.gov.au/treasury/afcf/content/submissions/download/second_round/IFSA.pdf.

² 'Mutual recognition' involves two sufficiently equivalent jurisdictions agreeing to recognise aspects of each other's regulatory systems and therefore not impose their own requirements in those areas.

³ Available at:

http://cache.treasury.gov.au/treasury/afcf/content/final_report/downloads/AFCF_Building_on_Our_Strengths_Report.pdf.

⁴ Available at: <http://www.weforum.org/reports/financial-development-report-2012>.

⁵ IBISWorld Industry Report K6419a *Funds Management Services in Australia*, January 2017

- Australia's reputation as a safe investment location with solid financial institutions; and
- Australia's ties with Asia.⁶

However, this comparative advantage in fund management has not translated into strong exports of fund management services. Australia has the third largest pool of financial assets under management in the world at over \$3 trillion.

The Johnson Report identified a number of reasons why Australia has been unable to translate this advantage into higher international trade.

A key issue raised was Australia's taxation of foreign funds. Aspects of the issues identified in the Johnson Report have been addressed through the implementation of an Investment Manager Regime (IMR). The IMR provides tax certainty to foreign investors investing in Australian and offshore assets by providing clear rules to exempt particular types of investments from being taxed. The first two elements were introduced in the *Tax Laws Amendment (Investment Manager Regime) Act 2012*, and the third and final element was introduced in the *Tax and Superannuation Laws Amendment (2015 Measures No. 1) Act 2015*.

Regulatory barriers also restrict trade in financial services. Differences and duplication in regulatory requirements across economies can add significantly to the difficulties and costs faced by fund operators attempting to sell collective investment schemes across borders (and in this way export their fund management services to foreign residents).

In some economies, foreign collective investment schemes are not allowed to be sold at all or only to institutional or professional investors. To access these economies, a fund operator would have to set up a subsidiary that is locally licensed to manage collective investment schemes. In other economies, such as New Zealand, Australian collective investment schemes enjoy relatively easy market access.

Thailand

Until the recent introduction of the Association of Southeast Asian Nations (ASEAN) mutual recognition scheme, Thailand did not allow foreign collective investment schemes to be sold to retail investors. An Australian fund operator would have to register a subsidiary (as a company) and have that subsidiary licensed (as an operator) in Thailand or enter into a joint venture with a local firm to offer a collective investment scheme to Thai retail investors. The collective investment scheme itself would also have to be constituted and authorised under Thai law.

Korea

Foreign collective investment scheme can be sold in Korea only after the scheme has been registered with the Financial Services Commission, having met the registration requirements (for example, capital and good standing requirements). Approval can take three to four months. In Korea, domestic domiciled collective investments constitute approximately 90 percent of the market (by assets under management).

⁶ ***Building the Lucky Country: Positioning for prosperity? Catching the next wave***, Deloitte, 2014, available from: http://www.deloitte.com/view/en_AU/au/news-research/luckycountry/prosperity-next-wave/index.htm;

New Zealand

Australian managed investment schemes can be offered to retail clients in New Zealand under the Australia New Zealand Mutual Recognition of Securities Offerings scheme (the trans-Tasman scheme). This is a full mutual recognition scheme and only minimal restrictions and process requirements apply.

Japan

Japan has a similar model to Korea, but imposes a greater number of ongoing obligations on foreign collective investment schemes, which necessitates changes to fund documentation (offering documents and constituent documents) which then also need to be approved in the home economy.⁷

2. Case for government action/objective of reform

In September 2013, a Statement of Intent was presented at the APEC Finance Ministers' Meeting for signing. The purpose of this statement was to agree to a broad set of principles that would be used to develop the Passport and a commitment to public industry consultation on the arrangements.

Prior to the signing, an options regulation impact statement was prepared (under the regulation impact statement rules applying at the time), to consider the merits of Australia signing the Statement of Intent against two other alternatives for the Government:

- Option 1 – do not engage in Passport negotiations (status quo);
- Option 2 – pursue a full mutual recognition scheme (push for an alternative arrangement to be entered into by regulators); or
- Option 3 – pursue a negotiated partial mutual recognition scheme (sign the Statement of Intent).

The Australian Government proceeded with option 3 and signed the Statement of Intent, along with Korea, New Zealand and Singapore. The Statement of Intent saw these economies, in addition to the Philippines and Thailand, seek to negotiate a Passport scheme.

Subsequently, a further options regulation impact statement was prepared in 2014, to consider whether Australia should become a party to the MOU. Three options were considered:

- Option 1 – do not sign the Passport MOU and withdraw from the Passport process (status quo);
- Option 2 – become a party to the Passport MOU; or
- Option 3 – pursue a full mutual recognition scheme.

The Australian Government proceeded with option 2 and signed the MOU in September 2015, along with Japan, Korea, New Zealand, the Philippines and Thailand. The MOU signalled Australia's commitment to join the Passport ahead of its commencement in 2016.

⁷ BNP Paribas Securities Services and Knadel, *Distribution of UCITS in Asia*, (May 2012), available at: <http://securities.bnpparibas.pl/files/live/sites/web/files/medias/documents/research-paper/Ucits-cross-border-distribution-asia.pdf>

The Australian Government signed the ARFP MOC, along with Japan, Korea, New Zealand and Thailand, which took effect on 30 June 2016. The MOC is a commitment to implement arrangements in domestic law to facilitate the operation of the Passport.

3. Policy options

Options for consideration

Australia has signed the MOC. Therefore the decision facing the Government is whether or not to implement the Passport provisions in domestic law.

Option 1 Status quo

Under this option, Australia would not implement the Passport provisions. Australian fund operators would continue to face the regulatory barriers described earlier.

Option 2 Legislate the arrangements of the MOC

Under this option, Australia would implement and participate in the ARFP. Under the MOC, the following arrangements would apply.

- To be eligible, a fund must already be regulated in its home economy as a collective investment scheme (a regulated CIS). For example, for an Australian fund to be eligible, it will need to be a “registered scheme” under the *Corporations Act 2001* (Corporations Act). This will mean a Passport fund is subject to a similar suite of rules in its home economy as a domestic fund.
- A standard set of rules (the Passport Rules) will be applied to Passport fund operators in addition to the home economy laws and regulations that apply. The Passport rules cover areas such as the experience and financial resources of the fund operator, custody of assets, investment restrictions, asset valuation and redemption. The rules effectively restrict the use of the Passport to liquid, well-diversified collective investment schemes operated by experienced and well-capitalised fund operators.
- To be registered as a Passport fund by its home regulator, a regulated CIS must be likely to comply with the Passport Rules. In Australia’s case the home regulator would be ASIC.
- Once a Passport fund is registered by its home regulator, it can apply for entry into other participating economies under a streamlined entry process. The host regulator has 15 business days to approve or reject the fund. The host regulator will rely on the home regulator’s assessment with respect to the Passport rules, although there will be circumstances where the host regulator can reject the fund.
- A Passport fund will not be subject to substantive additional regulation in host economies. For example, operators of Passport funds will not be required to be licensed in the host economy to offer the Passport fund there. Nor will the fund have to comply with any requirements in the host economy that relate to the internal operation of the fund (this will be covered by the Passport rules). However, host economies will impose obligations in some key areas, namely: disclosure, marketing and complaints handling.

The ways in which legislating the Passport arrangements would change the status quo for Australian fund operators will depend on where they seek to offer their products. For example, in Thailand it would mean there is no need to establish a locally licensed subsidiary or enter into a joint venture.

Importantly, it also allows a fund to be offered across multiple economies under the common Passport Rules, using one legal vehicle. Previously, fund operators would likely offer very similar products through different legal vehicles registered in different jurisdictions, with slight changes to reflect local requirements.

Given that the objective of the Passport arrangements is to implement a negotiated partial mutual recognition outcome, in combination with a package of special Passport rules that align differing regulatory arrangements, this option is deregulatory.

4. Cost benefit analysis of each option/Impact analysis

Implementing the Passport arrangements can have benefits for industry, the economy and investors. These benefits are discussed below in relation to each option.

Option 1 – Status quo

<u>Summary of the indicative deregulatory impact – Option 1</u>	
Net deregulatory savings (averaged over 10-year period)	\$0

Industry net benefits

The Passport can commence after any two participating economies complete the implementation. If Australia were not to implement the Passport arrangements Australian industry would be at a disadvantage as other economies' managed funds industries would have preferential access to each other's markets but the Australian industry would not.

Economy net benefits

It is uncertain as to what the level of funds managed on behalf of overseas investors would be if Australia were to not implement the Passport arrangements. Growth from a low base has been relatively consistent and discussions with industry indicate that this would likely continue on trend. As such, there would continue to be an increase in positive flow on effects to the broader economy (jobs, government revenue and gross domestic product) but not to the same extent as Option 2.

Investor net benefits

If Australia were to not participate in the Passport, Australian retail investors' access to the foreign fund management industry would likely remain at around current levels. The number of current retail offerings of foreign collective investments schemes in Australia is low.

Option 2 – Legislate the arrangements of the MOC

<u>Summary of the indicative deregulatory impact – Option 2</u>	
Gross deregulatory benefits (averaged over 10-year period)	\$6,253,011
<i>Less activity from funds not currently offering in participating economies</i>	(\$3,429,869)
New gross regulatory benefits	\$2,823,142
<i>Less new upfront regulatory costs</i>	(\$222,880)
<i>Less new ongoing regulatory costs</i>	(\$1,823,795)
Net deregulatory savings (averaged over 10-year period)	<u>\$776,467*</u>

* This calculation does not capture the deregulatory benefits accrued from offerings into new markets that are likely to result from removing regulatory barriers.

Industry net benefits

The Passport is likely to create opportunities for the Australian funds management industry to increase revenue by gaining access to new markets, or faster, less costly, access to existing markets. By reducing the barriers in this way, the Passport may make offering Australian collective investment schemes overseas profitable where it otherwise may not have been. By increasing the commerciality of offshore offerings, the Passport is likely to increase the volume of foreign collective investment schemes being managed in Australia and the size and profitability of the industry.

Based on industry estimates provided by the Financial Services Council there could be approximately \$12.6 billion in funds under management in Passport funds managed by the Australian industry by 2020, translating to approximately \$100 million per year in revenue.⁸ Over the same period, it is estimated that there could be up to \$50 billion in funds under management in Passport funds across the region.

Having a larger pool of investor assets under management also provides greater scope for efficiencies of scale benefits to arise.

Removing local licensing and registration requirements is likely to generate its own benefits by reducing the costs associated with repacking and tailoring investment products to meet differences in regulatory frameworks (discussed further below under regulatory impact).

The Government continues to engage regularly with industry, consumer groups and academics to ensure the design of the Passport arrangements provides a useable and effective framework to offer collective investment schemes across borders.

⁸ Assuming an average funds under management fee of 0.8 per cent.

Overall regulatory impact

All up, the Passport is expected to reduce regulatory barriers associated with cross-border trade of collective investment schemes, and is anticipated to bring approximate ongoing savings per year of \$776,467.

This costing is based on broader indications from industry about assumed activity savings – see appendix B for a breakdown of this activity.

Regulatory benefits– average ongoing deregulatory savings

The main regulatory saving captured is reduced compliance costs by not having to meet multiple sets of regulatory arrangements. Instead, firms will only need to comply with a streamlined set of arrangements.

Based on feedback received from industry, the Passport is anticipated to allow some firms to rationalise their current regional presences, and allow firms to designate more of their portfolio and support services to one particular economy. This reduces duplication.

Best estimates obtained indicate that gross regulatory costs of one full-time equivalent employee will be saved for every \$275 million of assets under management in Passport funds.⁹ This reflects reduced compliance costs relating to portfolio management activity, research and analysis, accounting, legal and compliance, and other support functions.

It is expected that there will be approximately \$14 billion of assets under management in Passport funds over a 10-year average, which translates to an average gross regulatory benefit of \$6,253,011 per year. However, more than half of this comes from activity from collective investment schemes not currently offered in participating economies. Excluding these collective investment schemes reduces gross regulatory benefits to \$2,823,142 per year.

Industry has noted that further work to clarify and streamline the process for distributing collective investment schemes in the region may create further efficiencies and opportunities for industry. Both now and under the Passport, foreign collective investment schemes may only be distributed through a locally licensed distributor (i.e., a bank or financial services firm).

New ongoing regulatory costs

Given that the Passport is anticipated to increase the access retail investors have to foreign collective investment schemes, the Passport rules have been designed to provide a strong standard of protection for investors. As such, a number of the requirements will be new for Australian fund operators. For example, the Passport rules contain detailed requirements on the portfolio allocation. There is currently no equivalent in Australian regulation.

As such, there will be a greater ongoing compliance burden associated with operating an Australian Passport fund than there is operating a registered scheme which is not registered as a Passport fund.

It is expected that approximately 30 per cent of the full-time equivalent staff saved from streamlined regulatory arrangements will be required for compliance with new arrangements. These additional

⁹ This is before consideration of total regulatory impacts; see page 14 - *new regulatory impacts*.

activities include time spent meeting and maintaining the portfolio and asset restrictions, completing annual compliance reviews, and providing timely advice to regulators when requested.

It is anticipated that there will be approximately \$14 billion in Passport funds over a 10-year average. New regulatory costs will equate to a yearly average of \$1,823,795 over the first 10 years, which includes new Passport funds from entities already offering in participating economies as well as entities not currently offering in participating economies.

One off, upfront regulatory costs

According to industry estimates, approximately one full time equivalent employee will require between six weeks and six months to set up a Passport fund in compliance with the Passport arrangements. This timeframe could decrease as industry becomes more familiar with the Passport arrangements and efficiencies are created.

It is anticipated that these upfront regulatory costs will equate to a yearly average of \$222,880 over the first 10 years of the Passport scheme. Upfront regulatory impacts relate to portfolio management activities, research and analysis, accounting, legal and compliance, and other support functions.

Economy net benefits

There are also likely to be positive flow-on benefits from increasing Australia's export of fund management services. This was the subject of a report by Deloitte Access Economics (commissioned by the Financial Services Council) which found that increasing the export of fund management services would have benefits for the broader economy, adding to jobs, government revenue bases and aggregate gross domestic product. Such flow-on effects are estimated to be considerable in size.¹⁰

Looking at the region more broadly, a 2014 economic study conducted by the APEC Policy Support Unit found that

*by providing more opportunities for funds managers to assemble locally domiciled funds, the ARFP could potentially bring about 170,000 new jobs in the region. Efficient funds industries will also be critical for channelling funds from surplus markets to those where there are shortages. Together, this will bolster the capital formation of the Asia region and maintain the region's position of being the key engine of global growth.*¹¹

There are difficulties in estimating long-term regional impacts. However, there is a range of research from commercial and non-commercial sources indicating that the Passport will have a positive impact on job and wealth creation in the region.

¹⁰ Deloitte Access Economics/Financial Services Council, *The economic impact of increasing Australian funds management exports, 2014*, available at: <https://fsc.org.au/entity/annotation/7b809d3e-bfc6-e611-80d2-00155dea4d00>

¹¹ Asia-Pacific Economic Cooperation Policy Support Unit, *Asia Region Funds Passport – A study of Potential Economic Benefits* (July 2014), available at: http://publications.apec.org/publication-detail.php?pub_id=1535

Investor net benefits

Benefits

The Passport is expected to result in greater competition in the market for collective investment schemes in participating economies. The extent to which this may translate into greater range of product offerings (for example, products focused on domestic Asian markets) or lower fees, is difficult to assess.

In its 2014 interim report to APEC Finance Ministers, the Asia Pacific Financial Forum found that

*'if successful [the Passport] can offer investors more investment choices at reasonable costs while helping them achieve greater diversification and higher return on their investments.'*¹²

In the long-term, Australia could experience a 10 basis point reduction in fees associated with the Passport – largely stemming from scale benefits associated with increases in potential markets and exports.¹³

A 10 basis point reduction in funds management services could translate to close to \$2 billion in savings, which, in a competitive environment, a large proportion would likely flow to investors.¹⁴

Increased foreign offerings will give Australian investors increased choice and access to investments that are focused on foreign (particularly Asian) assets. Improving choice and access gives an investor more options to manage risk through investment diversification.

Potential risks

Increased access to foreign collective investment vehicles brings potential risks for Australian retail investors as outlined by the International Organization of Securities Commission (IOSCO) *Objectives and Principles of Securities Regulation*.¹⁵ The key risks to consumers of collective investment products include: risks around governance, inadequate segregation of client assets, valuation of fund assets and inadequate disclosure of all material risks.

If a Passport investor loses money as a result of operator misconduct, there are also additional difficulties associated with taking legal action against a foreign Passport fund operator and enforcing any judgement made in the investor's favour.

However, a number of arrangements have been put in place to provide a certain level of consumer protection under the Passport scheme.

Only countries meeting certain specified membership requirements will be permitted to become Passport member economies.

¹² Asia Pacific Financial Forum 2014 Interim Report to APEC Finance Ministers, page 47, available at: <http://www.ncapec.org/events/APFF/APFF%20Interim%20Report%202014-06-30%20clean.pdf>

¹³ Asia-Pacific Economic Cooperation Policy Support Unit, *Asia Region Funds Passport – A study of Potential Economic Benefits* (July 2014).

¹⁴ Ibid.

¹⁵ IOSCO *Objectives and Principles of Securities Regulation*, available from <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>

The eligibility requirements focus primarily on demonstrated adherence to relevant IOSCO principles which represent a standard set by an international body that is followed by a majority of economies in the world. IOSCO has assessed each Passport economy as having appropriately addressed each of the risks facing these consumers.

As industry practice and regulatory arrangements may differ in each Passport economy, the Passport rules ensure there is a degree of uniformity in the structure of passport funds and in how risks are addressed by regulation. The Passport rules have also been designed with a strong consumer protection focus. Only liquid, well-diversified collective investment schemes with limited exposure to derivatives are 'passportable'. This is to ensure that Passport funds gain an early reputation for being simple, liquid, and well-regulated investments.

Under the MOC, each economy will be allowed to impose obligations on foreign collective investment schemes in relation to their dealings with investors in its economy (for example, rules around disclosure, misleading communications and complaint handling). This means investors will be able to compare disclosure documents, will be provided with warnings about the specific risks associated with foreign collective investment schemes and have access to Australian dispute resolution mechanisms.

While the Passport will rely on a large degree of cooperation between regulators, the Passport arrangements will allow host regulators some control over foreign Passport funds being offered in their economies. For example, host regulators will have the opportunity to assess foreign collective investment schemes under either a streamlined entry or notification process. They will also have the ability to take action against a foreign Passport fund for breaches of the Passport rules, which they may consider should the home regulator fail to do so.

In relation to enforcement of actions against a foreign Passport fund operator, arrangements have been negotiated to address potential gaps in the system. There are provisions in the Passport rules to ensure a Passport investor may take an action in their home economy.

5. Consultation plan

The Passport scheme has been developed multilaterally from the outset. This has involved close consultation and collaboration by Australian officials with representatives of securities regulators and finance ministries from across the region.

The Passport MOC was developed through a series of ten Working Group meetings which included all current Passport economies and a number of potential Passport economies.

As part of the process for developing and negotiating the Passport arrangements, Treasury sought nominations for an 'industry champions' group that has been meeting since November 2013. Industry champions include Australian fund operators committed to exploring the cross-border issuance of collective investment schemes under the Passport and other firms that are willing to lend their expertise to development of the Passport. More than 30 firms have participated.

Treasury and ASIC officials meet regularly with the industry champions and will continue to do so through to finalisation of the Passport legislation and potentially beyond.

As set out in the Passport Statement of Intent, a commitment was made by participating economies to formally consult publicly on the arrangements of the Passport. In 2014 a consultation paper,

*Arrangements for an Asia Region Funds Passport*¹⁶ was negotiated and agreed by all parties and was the principal document used for consultations. This consultation received 28 submissions, a number of which were from Australian financial institutions. Further details are provided at [Appendix C](#).

Following the 2014 consultation, the Working Group refined the Passport rules and the Passport MOC through a process of multilateral negotiation. These close consultations with officials from across the region were intended to ensure that the Passport arrangements were acceptable to relevant regulators and governments. In doing so, they were intended to assist to facilitate the participation of a broad range of regional economies in the Passport, from its commencement or soon thereafter.

In 2015, Australia, other working group economies and some other regional economies consulted on the Passport rules. Australia encouraged active participation in these public consultations by relevant economies.

The purposes of these consultations, which were the first public consultations on the text of the Passport rules, are to ensure the rules are commercially viable and competitive (including by providing appropriate investor protections) and therefore attractive to industry stakeholders and consumers from across the region.

The outcomes of public consultations informed further refinements to the Passport rules at the final three Working Group meetings and were considered at the final Policy and Technical Workshop.

The Government also publicly consulted on an exposure draft of the core chapter for the ARFP regulatory framework from 25 August to 25 September 2017. As part of this round of consultation, stakeholders were asked about the estimated regulatory costs for complying with the ARFP regulatory framework. Eighteen submissions were received, which expressed support for the legislation but no submissions responded on the request for specific regulatory cost information.

This initial consultation was followed by consultation on revisions to the core elements and other required legislative changes from 20 December 2017 to 25 January 2018. One submission was received, which expressed support for the legislation.

Complementary consultation was also undertaken on the proposed regulatory guidance to be issued by ASIC and the other Passport economy regulators. The consultation closed on 19 September 2017. In addition, ASIC consulted on proposed guidance in relation to Passport funds (Consultation Paper 296). This consultation closed on 8 December 2017.

The MOC also established a Joint Committee with representatives from each of the Passport economies. One of the purposes of the Joint Committee is to monitor the Passport arrangements including ensuring that their application remains consistent with the objectives of the Passport. This will ensure that each Passport economy implements the Passport arrangements in a consistent way and that the implementation is conducive to supervisory co-operation.

¹⁶ *Arrangements for an Asia Region Funds Passport*, available at: <http://fundspassport.apec.org/consultation-paper>

6. Option selection/Conclusion

Option 2 is preferred because it will likely have net benefits for investors, and strengthen regional cooperation and trust amongst regulatory authorities involved. It has strong support within industry, and more broadly in the region.

Implementing the Passport provisions will give Australia access to a partial mutual recognition scheme that leaves a degree of control with the host regulators, ensuring consumer protection and financial stability. The application of the Passport rules will also promote regulatory equivalence in some areas.

7. Implementation and evaluation/review

Following the signing of the MOC it is necessary to reflect the Passport arrangements in Australian law through a package of amendments to the Corporations Act, the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) and related legislation. These amendments will make the following changes.

- Establish a mechanism for incorporating the Passport Rules in Annex 3 of the MOC into Australian law, and imposes an obligation on Passport funds and operators registered in Australia as well as foreign Passport funds and operators offering interests in Australia to comply with the Passport Rules.
- Establish a new Chapter 8A in the Corporations Act which mainly implements the common regulatory arrangements in Annex 2 of the MOC. Chapter 8A among other things sets out the process whereby Australian managed investment schemes may be registered by the Australian Securities and Investments Commission (ASIC) as Passport funds. It also sets out the process whereby foreign Passport funds may notify ASIC of their intention to offer interests in the fund to Australian investors and the circumstances in which ASIC may reject such notifications.
- Makes amendment to other parts of the Corporations Act to amend how the obligations in those parts apply to foreign Passport funds. Annex 1 of the MOC sets out the main areas where host economies may apply their own regulation, including financial reporting, licensing and disclosure.

Passport Joint Committee

The outcome of the new Passporting arrangements can be reviewed by the Joint Committee, which has been established under Paragraph 6 of the MOC. The main functions of the Joint Committee are to:

- monitor the Passport arrangements and its operation, which includes ensuring that the application of the Passport arrangements remains consistent with the objectives of the Passport;
- maintain an official Passport website, where it will publish the text of the MOC and any amendments to it, and a list of participants that have implemented the Passport arrangements;

- publish annual progress reports on the operation of the Passport;
- commence a review of the Passport arrangements two years after the date on which the Passport first becomes operational, or at a time determined by the Joint Committee, and publish the report of the review on the official Passport website;
- facilitate the resolution of differences as set out in Paragraph 8 of the MOC;
- recommend amendments to the MOC where appropriate, and when the amendment should take effect in accordance with Paragraph 9 of the MOC;
- assess nominations from prospective subsequent participants and make recommendations to the participants based on the procedures set out in Paragraph 11;
- where considered appropriate, develop and publish information that serves as general guidelines to operators, investors and Passport regulators on the operation of the Passport including processes for registration of Passport funds, the admission of Passport funds in each host economy and the interpretation of the Passport Rules for CIS operators and investors; and
- consider and, if agreed, make recommendations to the participants about aspects for the form or content of the application for registration of a Passport fund or entry to a host economy that are to apply.

The Joint Committee will consist of one representative from each of the participating economies. Since the MOC was established, the Joint Committee has convened in-person on three occasions, in Kuala Lumpur (November 2016), Tokyo (April 2017) and Bangkok (October 2017).

APPENDIX A: Asia Region Funds Passport – Key milestones

The milestones below represent the path taken by Australia and other participating economies to develop the Passport.

October 2010	Workshop
November 2010	Passport introduced at APEC Finance Ministers
2011	Three workshops
November 2011	Mandate for further progress at APEC Finance Ministers
2012	Two workshops
August 2012	APEC Finance Ministers agree to further development of a partial mutual recognition model, governing arrangements and policies for a pilot Passport
December 2012	Formation of Asia Region Funds Passport working group
2013	Two working group meetings
May 2013	Workshop
September 2013	Signing of the Passport statement of intent
2014	Three workshops
April 2014	Passport consultation paper released
February 2015	Release of the Asia Region Funds Passport rules and operational arrangements
September 2015	Signing of the Statement of Understanding
June 2016	The Memorandum of Cooperation takes effect
November 2016	Joint Committee Meeting 1 – Kuala Lumpur
April 2017	Joint Committee Meeting 2 – Tokyo
October 2017	Joint Committee Meeting 3 - Bangkok

APPENDIX B: Estimated net impact of option 2 on funds management activities

Based on arrangements detailed in the consultation paper released in April 2014 proposing arrangements for the Passport, it is expected that the following overall deregulatory savings would be distributed amongst the following categories.

Activity	Examples of activity	Indicative saving per \$275 million of funds under management
Portfolio management	Investment management, asset allocation and acquisition/disposal decisions	Anticipated to provide 15 weeks of a single employee per year – 44 percent of total net regulatory savings
Compliance and legal	Oversight of fund's activities to ensure adherence to differing regulatory and legal requirements are met	Anticipated to provide 13 weeks of a single employee per year – 38 percent of total net regulatory savings
Accounting	Fund accounting – pricing of investor interests, calculation of differing taxation and distribution calculations	Anticipated to provide 3 weeks of a single employee per year – 9 percent of total net regulatory savings
Research and analysis	Fundamental assessments of assets quantitative assessments of return and risk	Anticipated to provide 3 weeks of a single employee per year – 9 percent of total net regulatory savings

Methodology

Industry data

Over August to October 2014, the Australian industry was consulted about the design of the Passport. Industry was also asked to describe how the Passport might change the regulatory costs associated with offering products in the region. The Financial Services Council surveyed its membership and 21 industry participants provided estimates on the number of collective investment schemes they may offer under the Passport in aggregate form.

Some within industry also provided confidential information direct to Treasury estimating how the Passport may lead to changes in the regulatory costs associated with their overseas product offerings including impacts on portfolio management and support functions.

Industry participants were advised of the regulatory burden measurement framework, and the types of costs that are considered as part of measuring regulatory impacts.

In addition, stakeholders were asked about their estimated regulatory costs as part of the Government's public consultation on the exposure draft of the core chapter for the ARFP regulatory framework, conducted between 25 August 2017 and 25 September 2017. However, there were no comments provided on the estimated regulatory costs.

Average labour costs per hour

A default hourly labour cost has been used based on Australian average weekly earnings, but adjusted to include income tax. This provides an economy-wide value for employees of \$39.31 per hour. This value is scaled up using a multiplier of 1.75 to account for the non-wage labour on-costs (for example, payroll tax and superannuation) and overhead costs (for example, rent, telephone, electricity and information technology equipment expenses). This results in a scaled up rate of \$68.79 per hour.

10 year time frame

Industry participants were asked to provide information based on a 10-year horizon, and to provide estimates as to how regulatory costs might change over this period.

All industry participants indicated that fund offerings via the Passport would increase gradually over time as industry became more familiar with the arrangements and tested investor awareness and demand for Passport products with limited offerings.

Participating economies

Industry provided estimates on the basis that the economies of Australia, Korea, the Philippines, New Zealand, Singapore and Thailand were anticipated to be participating upon the Passport's commencement. To date, Australia, Japan, Korea, New Zealand and Thailand have joined the Passport. Other economies are considering whether to join.

Estimated average participating Passport fund

Based on the industry responses received, averaged over a 10-year period from the commencement of the Passport, a typical Australian Passport fund is likely to have funds under management of close to \$275 million. The Passport is likely to be used by larger fund operators that have the ability to meet track record and minimum capital requirements.

APPENDIX C: Working group response to public submissions to consultation paper: *Arrangements for an Asia Region Funds Passport*

A consultation paper, *Arrangements for an Asia Region Funds Passport*¹⁷ was negotiated and agreed by the Passport working group. This document was used to support formal public consultations on the proposed passport arrangements, which were held in all working group economies over the period April to July 2014.

Submissions received demonstrated strong support for the passport, although a small number of rules attracted criticism. Comments were received on many aspects of the proposed arrangements. The following summarises feedback on key aspects of the arrangements and the working group's treatment of that feedback.

More broadly, consultations revealed a diverse range of views on numerous specific issues, which the working group considered and made judgments on. This meant that a number of suggested changes to the passport arrangements were not accepted by the working group. It is intended that the passport provide strong investor protections, including by restricting the range of fund managers that may participate and the types of funds that may be designated as passport funds. These goals guided the working group in considering the comments received.

For example, it was suggested that a broader range of experience be accepted in determining whether a fund manager meets the 'track record' requirements, including experience managing assets other than collectively (for example, individual discretionary mandates). Broadening measures of experience in this way is not considered appropriate given the importance not just in managing money but more specifically with the operational and legal frameworks associated with managing collective investment schemes.

It was also suggested that property funds be permitted to be passport funds, noting that in Australia there are a range of property funds on offer to the public and Australian fund managers have considerable experience in the management of property funds. However, this would conflict with the requirement that passport funds invest only in highly liquid assets, noting that property is not a type of liquid asset. This requirement is important in ensuring investors can redeem their passport fund interests promptly and is expected to contribute to generating a strong reputation for investor protection. For this reason, it is not considered appropriate for property funds.

One submitter proposed that the proposed liability of a master custodian for sub custodians be removed. However, this liability for the sub custodian encourages appropriate due diligence and oversight of the sub custodian and contributes to investor protection. It was not, therefore, considered appropriate to waive this liability.

There was broad support for the absence in the passport arrangements of any restrictions on the legal structure of passport funds. This means that, for example, trust, contractual and corporate investment structures are able to be utilised under the passport. Some submissions did note however, that their economies do not permit the use of all of these fund structures, irrespective of

¹⁷ *Arrangements for an Asia Region Funds Passport*, available at: <http://fundspassport.apec.org/consultation-paper/>

whether the passport permits their use. This is a matter for those economies to address, rather than for consideration in developing the passport arrangements.

Industry expressed the view that the proposed passport arrangements needed to be modified to permit the use of so-called 'umbrella' fund structures which would permit operators to register sub funds. In response, the passport rules have been amended to provide for the use of sub funds.

It was proposed that host economy laws and regulations concerning the labelling of exchange traded funds and money market funds would apply to passport funds and that additional disclosure may be required if an exchange traded fund is sold in an economy in which it is not listed. (An exchange traded fund is a security that tracks an index and whose interests trade on an exchange. A money market fund is a fund that invests in short-term debt securities.)

Under the requirements, a passport fund must not be called an exchange traded fund in a host economy unless it complies with any specific additional requirements for an exchange traded fund in the host economy. Similarly, a passport fund must not be called a money market fund or otherwise promoted as a money market fund in a host economy unless it complies with any specific additional requirements for a money market fund in the host economy.

A range of views were provided on offering exchange traded funds and money market funds under the passport arrangements. Some submitters argued for consistent naming conventions across the participating economies. Others were more ambivalent about whether this was necessary. A number of submitters argued against additional disclosure. Some questioned whether exchange traded funds and money market funds were likely to be sold cross border.

The working group considered these widely divergent views and decided against amending the proposed requirements. In so deciding, the working group concluded that it is appropriate to allow host economies to impose rules on naming conventions and disclosure relating to exchange traded funds. For example, it is important that where interests in an exchange traded fund are offered in a host economy, that investors in the host economy not be under the false impression that they can sell their interests in the fund on a market in the host economy where that is not the case.

A large number of submissions commented on the proposed home economy public offer rule. Under this proposed rule, interests in a passport fund could only be offered in a host economy if a number of conditions were met. Conditions included that the fund be offered and actively marketed in the home economy. The purpose of this proposed rule was to ensure the home regulator has a stake in monitoring the compliance of the passport fund with the passport arrangements. This stake is achieved because a requirement for a public offer in the home economy creates the possibility that investors in the home economy may acquire interests in the passport fund.

Some submissions opposed the rule on the basis of the regulatory burden it would create. Others raised issues with the conditions, expressing concern about what would be required to prove compliance.

Following discussion, the working group remained of the view that the benefits deriving from a public offer in the home economy in safeguarding investors outweigh the associated regulatory burden imposed by it. However, in light of comments received and on further consideration, the working group concluded that there were a number of different ways in which the outcomes sought could be achieved. In response, the passport arrangements were amended to enable passport funds to comply with this requirement by meeting one of three alternative tests. This provides considerable flexibility in meeting the requirement.