

An ASEAN Funds Passport?

Background

In a previous article,¹ we touched upon the tangible efforts undertaken by members of the Association of Southeast Asian Nations (ASEAN)² to create a single integrated marketplace for listed securities. More recently, two ASEAN jurisdictions have taken tentative steps towards the mutual recognition of ASEAN funds. This *DechertOnPoint* examines recent developments in Southeast Asia that may bring us closer to an ASEAN-centric approach to the distribution of funds in Asia.

By way of background, in November 2007, ASEAN member states adopted the ASEAN Economic Community Blueprint 2015 (AEC Blueprint), which outlines the goals and timelines of implementing the ASEAN Economic Community (AEC) by 2015. The AEC is anticipated to establish ASEAN as a single market and production base in order to increase ASEAN's dynamism and competitiveness, with the end goal of economic integration into the global economy. To implement the objectives of the AEC Blueprint, on 9 April 2009, the ASEAN Capital Markets Forum (ACMF) created a framework for the mutual recognition of cross-border offerings of collective investment scheme products (CIS) within ASEAN to non-retail investors, with the intention of making such products available to retail investors once adequate protective measures have been established.

¹ *Financial Services Quarterly Report*, Second Quarter 2012, "[The Asia Region Funds Passport: Myth or \(Almost\) Reality?](#)".

² As at 31 July 2012, ASEAN comprised Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. Potential new entrants to ASEAN are East Timor and Papua New Guinea, which have each been granted observer status.

Developments in Thailand

The Thai Securities and Exchange Commission (SEC) announced on 27 June 2012 that it would allow ASEAN CIS to be offered to accredited investors³ by July 2012, with the goal of extending the initiative to retail investors in the later part of 2012. This move, which stems from the ACMF initiative, is intended to promote the cross-border offering of securities in the ASEAN region by allowing products that have been authorized in one ASEAN jurisdiction to be offered in another

³ An "accredited investor" is defined to include all 18 categories of institutional investors and high-net-worth investors. For completeness, the 18 categories of institutional investors are: (1) Bank of Thailand; (2) commercial banks/specialized banks; (3) finance/credit foncier/securities companies; (4) insurance companies; (5) asset management companies; (6) provident funds; (7) private funds; (8) organizations or specialized juristic entities, like Government Pension Fund and Social Security Fund; (9) futures brokerage companies; (10) foreign financial institutions; (11) Deposit Protection Agency; (12) Financial Institutions Development Fund; (13) Stock Exchange of Thailand; (14) corporations; (15) companies owned more than 75% per investors in categories 1-14; (16) foreign investors sharing characteristics of the investors in categories 1-15; (17) individual licensees for fund management and futures brokering; and (18) other investors as are specified by the SEC. High-net-worth investors are (i) individuals with (a) at least THB 50 million (approximately US\$1.5 million) in total assets; (b) an annual income of THB 4 million (approximately US\$125,500) or higher; or (c) those with equity portfolios worth more than THB 10 million (approximately US\$313,600); and (ii) juristic persons having (a) shareholders' equity at the minimum of THB 100 million; or (b) securities investment of at least THB 20 million (approximately US\$627,300).

ASEAN jurisdiction (i.e., Thailand) without the need to apply to the regulator of the second jurisdiction (in this case, the SEC) for approval. The advantages of such a scheme are expected to be two-fold: (i) on the ASEAN-level, driving the ACMF initiative forward; while (ii) locally, providing Thai investors with an alternative to investing in foreign markets, and concurrently developing the Thai mutual fund industry.

The SEC announcement indicates that, in order to qualify, ASEAN CIS offered in Thailand must have similar characteristics to mutual funds which are Thai-domiciled. Qualifying ASEAN CIS could only be offered in Thailand via a selling agent that is a Thai-licensed securities broker that complies with certain specified criteria.⁴

Has the SEC, with its announcement, now forged ahead of the other ASEAN regulators? In terms of exercising its initiative and putting a framework in place, this would certainly appear to be the case. However, as at the date of this *DechertOnPoint*, there has been no further clarity as to the SEC's requirements in relation to such ASEAN CIS, nor have there appeared to be any further developments in establishing the practical arrangements that need to be in place. For instance, it seems that the SEC is agreeable to recognizing other ASEAN members, but whether such jurisdictions will be equally willing to recognize SEC-authorized funds in the absence of a mutual recognition arrangement is uncertain. For true ASEAN economic integration, other ASEAN members will need to be on board in rolling out their own initiatives. Thailand's fund industry cannot benefit until the rest of ASEAN (or at least the members who are able to participate and contribute) is in agreement with this initiative. Until these issues are addressed, the SEC's head start might not take Thailand very far ahead of the rest of ASEAN.

⁴ The selling agent will need to (i) verify that investors are, in fact, institutional investors or high-net-worth individuals before offering the securities for sale; (ii) disclose on the SEC website the investment units offered for sale; (iii) ensure that securities offered for sale are traded at the same time and on the same day as executed in the home jurisdiction unless such day is a Thai national holiday; (iv) disclose service information to investors in advance if it exercises its own discretion whether or not to trade investment units; and (v) provide a summary in the form of a fact sheet (in the Thai language) of the significant features of the relevant securities.

Developments in Singapore

Another ASEAN member state, Singapore, has drafted a proposal to develop a mutual recognition framework for retail CIS. In April 2012, the Monetary Authority of Singapore (MAS) circulated the "*Consultation on Draft Standard Requirements and Product Restrictions for Mutual Recognition of CIS under ASEAN Capital Markets Reform*". This draft proposal was reviewed by ASEAN capital market regulators and consultation closed on 11 May 2012. There was no period of public consultation.

The draft proposal envisages that qualified CIS authorized and managed in participating ASEAN member jurisdictions may be offered in other participating host jurisdictions by taking advantage of a fast-track process. Nevertheless, such qualified CIS will still need to apply to the regulator of the relevant host jurisdiction for recognition and ASEAN jurisdictions will be required to satisfy certain pre-conditions (these pre-conditions were not elaborated on in the draft proposal) in order to enter into the mutual recognition agreement. The relevant CIS and its operators must also comply with certain proposed requirements.

To be eligible to become a qualified CIS, the MAS has suggested that the requirements set forth in the chart below should apply.⁵

CIS Operator Requirements	
Licensing	The CIS Operator must be (i) licensed by its home regulator; and (ii) subject to ongoing supervision in its home jurisdiction.
Experience	The CIS Operator must possess at least five years' prior experience in managing CIS.
Minimum Assets Under Management	The CIS Operator, together with its related corporations, must have at least US\$500 million of assets under management globally.

⁵ The information is extracted from the MAS draft proposal "[Consultation on Draft Standard Requirements and Product Restrictions for Mutual Recognition of CIS under ASEAN Capital Markets Reform](#)".

Capital Adequacy	The CIS Operator must have a minimum shareholders' equity of US\$1 million and additional capital must be at least 0.1% of assets under management in excess of US\$500 million.
Compliance Audit	An external auditor is required to complete an annual compliance audit on the CIS.
Personnel	<p>Industry experience requirements are set out for the CIS' directors, CEO, Key Executive Officers (e.g., Heads of Departments) and Fund Managers.</p> <p>For example, Key Executive Officers must have at least three years' experience (in the preceding five years) in financial/capital markets (if they have a university degree); and at least five years' experience (in the preceding seven years) in financial/capital markets (if they do not have a university degree).</p> <p>Fund Managers must show at least three years' experience (in the preceding five years) in fund management (if they have a university degree) and at least five years' experience (in the preceding seven years) in fund management (if they do not have a university degree).</p>

Delegation	For a sub-manager domiciled in an ASEAN member jurisdiction that is a signatory to the mutual recognition agreement, there will be no limit on the net asset value (NAV) of the CIS that may be delegated by the CIS Operator. Conversely, delegation to other sub-managers will be limited to an aggregate of 20% of the NAV and such sub-managers must nevertheless be domiciled in a jurisdiction that is a signatory to the International Organization of Securities Commissions' Multilateral Memorandum of Understanding Appendix A and must be acceptable to the home regulator of the CIS (although the mechanisms for defining acceptability were not detailed in the draft proposal).
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CIS Operational Requirements	
Authorization	The qualified CIS must be authorized by its home regulator and the CIS Operator must be able to demonstrate that the qualified CIS is offered in the home jurisdiction.
Disclosure	Disclosure must comply with the requirements of the host jurisdiction.
Marketing/Distribution	The marketing/distribution of the CIS is subject to the requirements of the host jurisdiction.
Financial Statements	International Financial Reporting Standards must be applied in preparing the CIS' accounts from 2015.

Valuation	An independent party must be responsible for calculating or cross-checking the NAV on each dealing day.
Redemption	Redemption payments should be received by investors within seven business days and “business days” must be as defined under host jurisdiction laws. CIS Operators must also deal in units at least once a month.
Local Representative	Regulators in the host jurisdictions may require a local representative that is a regulated entity to be responsible for administrative duties.
Alternative Dispute Resolution	Alternative dispute resolution mechanisms of host jurisdictions may be applicable.
Jurisdiction	The CIS Operator must undertake to submit to the non-exclusive jurisdiction of the courts of the host jurisdiction.

The MAS draft proposal also deals with the eligibility requirements of the trustee/custodian of the qualified CIS, which include, amongst other provisions: the requirements for the licensing and capital adequacy of the trustee/custodian, its independence from the CIS Operator, the segregation of assets and the delegation of custody functions. Further, the permissible eligible assets in which investments may be made are also stipulated in the draft proposal, as are various limitations to investment. Eligible assets include transferable securities, money market instruments, deposits, units in other CIS and financial derivatives. Securities lending, repurchase transactions and direct lending of monies are activities that are expressly prohibited.

Although the MAS draft proposal goes into greater detail (as compared with the Thai initiative), certain aspects of the draft proposal still beg clarification. For example, while it is understood that such CIS

must be *authorized* and *managed* in an ASEAN jurisdiction in order to qualify for the distribution scheme, it is not clear whether the qualified CIS must also be *domiciled* in an ASEAN member state. The MAS draft proposal also suggests that certain pre-conditions will be imposed on ASEAN participants willing to enter into mutual recognition agreements with Singapore; however, the details of such pre-conditions have not yet been furnished. More fundamentally, unlike its Thai counterpart, the MAS has not offered any specific timeline as to the implementation of this draft proposal. Apart from the draft proposal, nothing further has been issued by the MAS. It is not clear, at this stage, how (if at all) non-ASEAN domiciled CIS and non-retail CIS may benefit from this proposal for an ASEAN funds passport.

An ASEAN Funds Passport

It would appear that the development of an ASEAN funds passport still has some way to go. Thailand and Singapore, who have clearly taken the lead thus far, still need to iron out the exact details and mechanisms of their respective initiatives over the coming months. There is currently (as at the time of publication) nothing publicly available on the websites of other ASEAN regulators regarding an ASEAN funds passport. For a truly ASEAN funds passport to become a reality, more concerted effort is required from the rest of ASEAN. Nonetheless, given the different stages of economic and political development among different ASEAN member states, it is unlikely that all of ASEAN will be prepared to take the initial big leap. Aside from Thailand and Singapore, other potential pioneering participants in such a passporting arrangement may include Indonesia and Malaysia.

Asia-Pacific nations such as Hong Kong, Taiwan and Australia, which are outside ASEAN, are likely to monitor these developments with much interest, especially given the recent discussions about establishing a separate Asia Region Funds Passport. From a global perspective, the ASEAN region represents a significant trading bloc with much potential for investment. Given ASEAN’s history of regional cooperation, there is every possibility that an ASEAN funds passport may come to pass. Based on the current two proposals from each of Thailand and Singapore, it appears that non-ASEAN CIS Operators may need to consider establishing a presence within ASEAN, and/or registering the relevant CIS for local distribution in an ASEAN jurisdiction in order to benefit from the accessibility afforded by an ASEAN funds passport.

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