INSIDE VIEW: Pilot passport scheme mooted

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Asia is made up of 48 different countries, many of which are keen to emulate the Ucits brand. **Angelyn Lim** and **Kylee Zhu**, of Dechert, discuss the feasibility.

The finance ministers of the Asia Pacific Economic Cooperation countries recently issued a joint announcement supporting the establishment of a pilot Asia region funds passport scheme (ARFP).

This pilot scheme may be launched as early as the second half of this year. Participant jurisdictions Hong Kong, Singapore and Australia are likely to form the core common regulatory framework and determine the initial list of eligible investment products.

After years of talk and lobbying by certain countries and sectors, notably the Australia and New Zealand asset managers, this is a significant step towards the establishment of an ARFP framework. But how realistic is it?

The proposal is modelled after its famous European cousin, Ucits, which the Asian funds industry has been keen to emulate. Such a scheme would allow fund managers in participating Asian countries to promote their products to investors in other participating Asian countries, although the existing impediments of different local regulatory, legal and tax requirements would still need to be overcome.

These different local regulatory, legal and tax requirements currently already impact on the reach of Ucits in Asia.

China and India, the two largest retail markets in Asia, as well as Indonesia and Australia, do not recognise Ucits. In Taiwan, Ucits can be registered for retail investment only if they do not utilise derivatives at all and the registration process is a lengthy one. In Japan, Ucits registration is also a notoriously slow and expensive process. In Malaysia and Thailand, a locally registered feeder fund is required to invest into a Ucits. The situation is similar in South Korea, although it has also introduced tax disincentives for foreign funds. As it stands, Ucits are not truly pan-Asian passport-able.

In the absence of an ARFP, individual countries in Asia have already taken steps to advance market access with bilateral or multi-lateral reciprocity appearing to be the next best alternatives.
• Australia has entered into bilateral mutual recognition agreements with New Zealand and Hong Kong, whereby funds, which have been authorised in one country, can be distributed to retail investors in the other country. They do not have to comply with the full range of the other country's authorisation requirements.
• Hong Kong and Taiwan have put in place reciprocal cross-listing of exchange-traded funds (ETFs). An approved ETF that is licensed by the Securities and Futures Commission in Hong Kong or the Financial Supervisory Commission in Taiwan will be mutually recognised by the other jurisdiction.
• Members of the Association of Southeast Asian Nations (Asean) have also undertaken tangible efforts to create a single integrated marketplace for listed securities by adopting the Asean and Plus Standards Scheme in 2008, which facilitates multi-jurisdictional share or debt offerings.

The advantages of an ARFP are obvious: potentially enhanced portfolio management by promoting access to larger pools of funds. This would encourage better diversified portfolios at lower transaction costs, improved internal management, greater investor choice, economies of scale resulting from registering funds across different jurisdictions and a common offering mechanism. Smaller managers would have the opportunity to tap into new markets for their products.

Asia is made up of 48 countries with differences not only in their local regulatory and taxation requirements but also in their stage of economic development and evolution. While the benefits of an ARFP may be evident, the task of reconciling such differences across the region is surely much easier said than done.

Liberal markets, such as Hong Kong and Singapore, generally encourage, or at least facilitate, local market access by offshore investors. Whereas India and China only offer restricted access to foreigners.

Some jurisdictions, like Australia, may have inherently prohibitive local tax treatments of foreign investors, which do not lend it or its products to being attractive investments to offshore investors. However, Australia is currently making significant strides in amending its domestic tax legislation to address this issue.

Political agenda

Although differences in tax treatment and national political and regulatory agendas continue to exist in Europe, the Ucits regime has the advantage of being enacted and implemented by a single supranational body. Asia, on the other hand, does not have such a body and it is not anticipated that it will establish one soon.

Participating Asian countries would also need to agree on common product licensing, monitoring, disclosure, sales practices and enforcement. Consequently, an ARFP would be dependent on the initiative of individual countries in Asia to pass identical – or at least substantially similar – laws and regulations to make the ARFP happen. Such an initiative is surely likely to be hampered by differing political agenda, not least some degree of protectionism and the rivalry to become Asia's pre-eminent financial services hub.

The fact that Asia does not have a common currency is not an insurmountable hurdle. The de facto common currency for most funds, including Ucits, is the dollar.

It is entirely possible it may be the renminbi for ARFP.

The Alternative Investment Fund Managers Directive means a real possibility of Asian managers being left out of the European fund-raising market. And the looming prospects of the Foreign Account Tax Compliance Act now lend added impetus for the establishment of an ARFP.

An ARFP also likely has the support of some Asian regulators, who prefer an Asia-centric approach to the regulation of funds available in Asian jurisdictions.

With the hindsight of Europe's Ucits experience, it is theoretically feasible for an ARFP to begin with a core group of countries that are already on a par in their development and prepared to agree a common set of regulations. Candidates are Hong Kong, Singapore and Australia, which have developed mature markets with comparable regulatory systems.

It may also be more palatable to local regulators if the first step in the foundation of an ARFP is the establishment of a passporting system extended at the outset to only non-retail funds, so as to achieve the harmonisation of private placement regimes Asia-wide.
Once the regulation of asset managers is finessed in this manner and that project is successfully off the ground, it may be easier to transpose or extend the ARFP to apply to retail products as well.

In the post-global financial crisis investment and regulatory landscape, the time is now ripe for a real, sustained effort at establishing an ARFP – whether for retail or private funds, or both.

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