

# INTERNATIONAL REGULATORY COOPERATION: the case of the Asia Region Funds Passport initiative

## Executive summary

The aim of the Asia Region Funds Passport (ARFP) initiative is to streamline the regulatory processes for cross-border offers by enabling mutual recognition of fund licensing. Once ARFP is operating in early 2019, a fund manager in one of the participating APEC economies in the Asian region will be able to offer their products to retail investors in other passport member economies.

Currently there is limited transferability of funds across borders and Asian funds are largely assembled, distributed and administered within each jurisdiction. Most of the demand for cross-border funds in the region is met from Asian retail funds based in the EU. There are significant economies of scale in funds management so there are large potential benefits to investors from reducing the share of the returns on managed funds absorbed by expenses.

This case study discusses the key events since the announcement in 2010 leading up to the proposed launch in 2019. There were a range of complex technical regulatory challenges to resolve including whether the host or home country law applies, the common regulatory arrangements required and the rules for eligibility of passport funds. There were also tactical challenges about which economies should be involved and the scope of mutual recognition (limited to licensing or including disclosure, distribution and disputes). It highlights the importance of having a small core group of committed countries and the role of key people in getting the initiative over the line.

While every example of IRC is unique, there are a number of lessons to learn from the ARFP that are relevant to other IRC initiatives:

- *IRC like most good things take time* – it took eight years of sustained effort to get the launch in place
- *Start small* – select the least demanding form of IRC (in this case licensing) that gets you over the line rather than shooting for the moon and missing altogether (disclosure, distribution and disputes)
- *Build a coalition of the willing* – plurilateral negotiations amongst diverse economies are difficult to close out. Establishing a small core working group of committed countries meant the initiative got to go forward
- *The key role of a public entrepreneur* – willing to personally champion the initiative and go the extra distance to push it through
- *Have the right people in the room* – keeping the group at the technical expert regulator level meant the parties were able to cut through a host of small prickly issues
- *Political mandate helps but it's not sufficient* – the APEC banner provided legitimacy and a political mandate which was helpful but was never enough on its own
- *Context and capability matters* – IRC between economies at different levels of development can be particularly difficult when mutual recognition of other regimes is required.

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## How it works – mutual recognition of fund licensing

Asian-domiciled managed funds have not been benefiting from the growing demand for cross-border funds in the region and most of this demand is met from funds based in Europe or the US. Currently there is limited transferability of funds management across borders and Asian funds are largely assembled, distributed and administered within each jurisdiction. Each economy has its own regime covering the licensing, distribution, disclosure requirements, and options for redress. ARFP streamlines the regulatory processes for cross-border offers by enabling mutual recognition of fund licensing. When implemented, ARFP will enable operators of collective investment schemes (CIS) such as a fund manager, to offer their products to retail investors in other member economies, without the need to meet different licensing requirements.

## How the Asia Region Funds Passport initiative was developed

The genesis of the ARFP was a study that highlighted the potential for the large Australia fund management industry, which is underpinned by the Australian superannuation regime, to develop financial services exports. The concept was introduced to the APEC Finance Ministers in 2010. Since then, interested Asian APEC economies along with New Zealand and Australia, have been engaged in a series of policy dialogues on the design of the key features of a funds passport scheme, identifying and resolving any technical and policy challenges; and developing options to take the scheme forward.

Box 1 highlights the role of key events in the process since the initiative was launched.

### BOX 1 The journey from concept to launch

2009: The Australian Financial Centre releases a report (the Johnson report) which argued for greater financial services exports of Australian managed funds. The Australian Treasury picks up this recommendation and drives the proposal forward.

2010: APEC Finance Ministers declaration launches ARFP as an exploratory process.

2010: A series of exploratory meetings are held amongst interested economies. This led to the formation of a core working group (with a changing composition) of the most committed economies.

2013: Australia, Korea, New Zealand and Singapore sign a Statement of Intent and Framework, which is an agreement to pilot the arrangement.

2014: APEC Policy Support Unit publishes a cost benefit analysis documenting the business case and showing the potential benefits to be USD20 billion per annum (assuming expense margin savings of 20 basis points).

2016: Memorandum of Cooperation is signed by Australia, Japan, Korea, New Zealand and Thailand.

2017: There is individual country consultation to check if any legal changes are required to give effect to the mutual recognition of licensing under the ARFP.

Early 2019: Planned launch of a pilot ARFP initially involving the licensing regimes for six countries: Australia, Japan, Korea, Malaysia, New Zealand, and Thailand.

There are several features of the brief chronology outlined in Box 1 that particularly deserve comment. The *first was the role of the Australian Treasury*, and one key person in that organisation, who championed the initiative in the region and kept it moving forward. This **highlights how a public entrepreneur is often at the heart of a change process**.

The *second was the impact of establishing a small core working group* from committed economies. The initial stage of the process involved a series of meetings in which economies outlined their positions. This helped to build a shared understanding but did not give the initiative any momentum. The core group was inclusive rather than exclusive. Initially the core was Australia, Korea, New Zealand and Singapore and they were joined later, at various stages, by Malaysia, the Philippines, Thailand and Japan. In the end six countries have agreed to launch the initiative: Australia, Japan, Korea, Malaysia, New Zealand, and Thailand. Singapore and the Philippines decided not to be involved in the initial launch. The experience with ARFP brings out the importance for other IRC initiatives of **building a coalition of the willing** to build up momentum and carry it forward.

The case also highlights the difficulty of IRC between economies at different levels of development because of the **extent of regulatory trust required with mutual recognition** of other economies' regimes and systems. In this case, economies' eligibility to join ARFP was linked to three main criteria:

1. Having a positive financial sector assessment program (FSAP) review by the IMF of the managed fund regulatory system
2. Having a robust information sharing regime in place through the International Organisation of Securities Commissions Multilateral MoU
3. Having a clean bill of health on anti-laundering from the Financial Action Task Force.

The *third key feature was a deliberate choice to focus on mutual recognition of licensing requirements* and to limit the funds it applied to. Coverage was limited initially to 'plain vanilla' funds by eligible fund managers that met specific criteria. These included having a track record of managing assets, having appropriate financial resources, and key personnel with appropriate qualifications. A more ambitious approach would have been to aim for full interoperability which raised a wider range of complex technical legal interface issues such as rules on disclosure, distribution, disputes and redress procedures. This highlights the importance of **starting small rather than shooting for the moon and missing altogether**.

The *fourth key feature was having the right people in the room*. The EU had pioneered the concept of passport funds through a scheme known as Undertakings for Collective Investment in Transferable Securities (UCITS). The UCITS provided a model for the ARFP. Keeping the group at the technical expert regulator to expert regulator level meant the parties could cut through a host of prickly technical issues.

The *fifth key feature was the role of APEC* which provided the umbrella under which the initiative was developed. **APEC provided legitimacy and a political mandate** which was helpful but was never enough on its own.

The last feature was the **length of time** required to get the pilot over the line. It took eight years of sustained effort to get the launch in place and the initial launch will not include either of the two major financial centres in the region: Singapore or Hong Kong. This length of time reflected both technical and other barriers.

The technical barriers arose because there were a range of complex technical regulatory challenges to resolve including whether the host or home country law applies, the common regulatory

arrangements required and the rules for eligibility of passport funds. But with sustained will and determination, most technical barriers can be overcome. A second key barrier was distance, which limited the frequency of the meetings. The project required getting key people with busy day jobs from the five or six economies together for two-day meetings with some people facing a day of travel on either side. This limited the project to a schedule of two to three meetings a year.

The most difficult non-technical barrier was the different regulatory mindsets. Both Australia and New Zealand run more principle-based licensing regimes whereas other jurisdictions (such as Singapore) run more prescriptive regimes.

## **Understanding the context for cooperation**

The funds industry is world-wide business which is characterised by significant economies of scale so there is significant benefit in having a world scale industry. It also an industry where fund management can absorb a significant part of the return. The expense ratio of the EU funds available locally is typically 0.9 percent. By contrast many the funds in Asia are small and are therefore not able to achieve economies of scale. As a result, the costs of managing funds in some of these economies are as high as 2.6 percent on average.

The ARFP, by enabling streamlining the regulatory processes for cross-border offers, is intended to increase the extent of fund management in the region and reduce the share of the returns on managed funds absorbed by expenses. However, ARFP is competing with two other cross border funds initiatives in the region.

The first, the Mutual Fund Recognition Programme between Hong Kong and mainland China, is still under discussion. The second, the ASEAN Collective Investment Schemes Framework, was announced in mid-2014 and includes Singapore, Malaysia and Thailand. The ASEAN CIS Framework is intended to facilitate cross-border offers of CIS to retail investors as part of the ASEAN regional capital market integration plan.

ARFP has attracted six countries some with significant funds management industries. It is hoped that the successful operation of the ARFP will attract others including big financial centres such as Singapore (or Hong Kong) to join.

## **Conclusion – implications for IRC generally**

This case study highlights that IRC, like most good things, take time. It took eight years of sustained effort to get the launch in place. Thus, IRC is a long game: as it requires investment of time and effort to build up trust and networks. The crucial lesson is the role of building and sustaining relationships as the soft stuff is the hard stuff.

This case study is a story of a long march by a small group of economies committed to the concept of passport funds and championed by one agency and one person in particular. The pilot launch in 2019 is the culmination of hard work by a wide range of officials who worked on resolving the highly technical problems posed by the subject matter. Making progress required working through technically complex issues about the which economy's law would apply, the common regulatory arrangements required and the rules for eligibility of passport funds. There were also tactical challenges about scope (limited to licensing or including disclosure and disputes) and which economies should be involved.

So, what are the lessons emerging from this case study that are relevant for IRC initiatives in other jurisdictions?

While every example of IRC is unique, there are a number of lessons that can be learnt from the ARFP that are relevant to other IRC initiatives:

- *IRC like most good things take time:* it took eight years of sustained effort to get the launch in place
- *Start small:* select the least demanding form of IRC (in this case licensing) that gets you over the line rather than shooting for the moon and missing altogether (disclosure and disputes)
- *Build a coalition of the willing:* plurilateral negotiations amongst diverse economies are difficult to close out. Establishing a small core working group of committed economies meant the initiative got go forward
- *The key role of a public entrepreneur:* – willing to personally champion the initiative and go the extra distance to push it through
- *Have the right people in the room:* keeping the group at the technical expert regulator level meant the parties were able to cut through a host of small prickly issues
- *Political mandate helps but it's not sufficient:* the APEC banner provided legitimacy and a political mandate which was helpful but never enough on its own
- *Context and capability matters:* IRC between economies at different stages of development is particularly difficult when mutual recognition of other regimes is required.

## Key references

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