

Asia Region Funds Passport – MAS seeks feedback on proposed arrangements

A joint consultation paper (**Paper**) has been published by Australia, Korea, New Zealand, the Philippines, Singapore and Thailand on the proposed rules and arrangements that will govern the operation of the Asia Region Funds Passport (**ARFP**). The ARFP will allow fund managers operating in a passport member economy to offer collective investment schemes (**CIS**) in other passport member economies under a streamlined authorisation process.

The Paper sets out the proposed:

- substantive rules applicable to passport CIS and participating CIS operators;
- procedural requirements for passport CIS;
- supervision approach for passport CIS; and
- enforcement approach for passport arrangements.

The Paper seeks the views of the funds industry on the practical operation of the proposed passport arrangements. The Paper includes over 40 consultation questions covering substantive requirements, regulatory functions as well as supervision and enforcement. The Paper may be accessed via this [link](#).

The proposed ARFP arrangements adopt a partial approach to mutual recognition by applying a mix of home economy laws and regulations, host economy laws and regulations and specific passport rules. Full mutual recognition is not envisaged in the initial phase, as economies in the region are at different stages of development and have diverse regulatory regimes.

The interaction between home economy laws, host economy laws and passport rules would be subject to the following fundamental principles:

- the basic eligibility criteria applicable to a passport CIS

would be set out in the passport rules;

- home economy laws and regulations would be supplemented with passport rules to ensure a common minimum standard;
- home economy laws and regulations that go beyond the passport rules would continue to apply; and
- compliance with certain areas in which the host economy laws and regulations apply – primarily related to the interaction of passport CIS with investors.

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Eligibility

There are three basic eligibility criteria:

Type

Only eligible CIS (including money market funds and exchange traded funds) which invest predominantly in transferable securities and permissible investments¹ fall within the scope of the ARFP arrangements.

Location

A CIS may be offered as a passport CIS only if:

- the CIS is constituted or established, and authorised, in a passport member economy; and
- the CIS operator² is authorised and has a principal place of business in that same economy.

Public offer

Interests in a passport CIS may be offered in a host economy only if:

- there is an ongoing offer of the interests in the home economy;
- the offer is subject to the requirements applicable to a public offer in the home economy;
- the interests may be acquired by any member of the public in the home economy; and
- the passport CIS operator satisfies other requirements in relation to providing information in relation to the offer and

¹ Permissible investments would include regulated CIS, deposits, currency, derivatives, transferable securities, money market instruments and depository receipts over gold.

² "CIS operator" means a person who operates a regulated CIS under an authorisation of the passport economy regulator, whether as a responsible entity, trustee, management company or otherwise.

commissions and contracts pertaining to the passport CIS.

Licensing

CIS operators authorised under the home economy laws and regulations would be able to operate passport CIS, subject to a number of additional requirements, including the following:

Operational

A compliance audit would be required to ensure compliance with obligations under the home economy laws and regulations (to the extent that these laws and regulations ensure the passport CIS operational requirements are in place).

Experience

The CIS operator or a related party would need to have at least five years' experience as the operator of CIS or other investment schemes that predominantly invest in transferable securities or money market instruments and are offered to retail investors in a jurisdiction which has a CIS regulatory framework that is comparable to that of the home economy.

Certain qualification requirements would also apply to the officers of the CIS operator. For example, the CEO would need a minimum of 10 years' experience, at least two executive directors would need a minimum of five years' experience and persons responsible for discretionary investment decisions for the passport CIS would need a minimum of five years' experience in financial or capital markets.

Capital adequacy

The CIS operator would be required to maintain equity (or shareholders' equity for a body corporate) of at least

US\$1 million. Where the CIS operator's assets under management (AUM) exceed US\$500 million, it would need to maintain additional capital equivalent to 0.1% of the AUM in excess of US\$500 million, up to a maximum of US\$20 million of additional capital.

Good standing

The CIS operator, its directors and senior managers and persons having control or significant influence over the CIS operator, would need to be of sufficient good standing to be permitted to operate a passport CIS.

AUM

At the time the CIS operator seeks to establish a regulated CIS authorised as a passport CIS, the CIS operator and its related parties would be required to have AUM in investment schemes of at least US\$500 million. This amount may only include assets in investment schemes that invest at least 50% of their assets in permissible investments.

Operation

Home economy laws and regulations would serve as a baseline to the operation of passport CIS. In addition, the following passport rules would apply:

Custody arrangements

There would be minimum standards for the safekeeping of the assets of the passport CIS relating to the use of a custodian, its independence, separation of assets and their identification.

Independent oversight

There would also need to be independent oversight of the performance of a CIS operator's duties.

Compliance audit

In addition, the passport CIS would be required to appoint an auditor to conduct an annual compliance audit in relation to compliance with passport rules and operational requirements.

Investment restrictions – asset classes

For the passport to ensure liquidity and valuation, passport CIS would only be allowed to hold permissible investments. Certain permissible investments such as deposits, derivatives, transferable securities and money market instruments would have to meet certain additional requirements.

Investment restrictions – portfolio allocation

In order to promote investor confidence, passport CIS would need to be well-diversified between issuers and fungible assets, and only invest in permissible investments. There would be seven broad limits (based on those applicable to UCITS (undertakings for collective investment in transferable securities) in Europe):

- a single entity limit;
- a group limit;
- a CIS limit;
- a limit on unquoted shares, stocks and interests in investment schemes other than regulated CIS;
- a limit on investments conferring significant management influence;
- a limit on the share of securities or money market interests on issue; and
- a limit on depository receipts over gold.

Proposed exceptions to some of the limits are described in the Paper.

Derivatives

The passport rules would require passport CIS to limit their exposure to derivatives and include four key requirements:

- rules to ensure that the requirements relating to portfolio allocation are not avoided by use of derivatives investments in regulated CIS;
- a limit on the global exposure to derivatives by the passport CIS;
- a requirement that exposures are covered by assets available to perform obligations; and
- requirements to manage counterparty risk.

Securities lending

A passport CIS would not be able to:

- engage in securities lending to generate leverage;
- reinvest any collateral it obtains or any income earned on that collateral, except in the event of counterparty default; and
- transfer more than 50% of the value of its assets in securities lending transactions, excluding assets transferred where the obligations of the transferee have been terminated (including by performance).

Additional requirements would also be imposed on counterparties to securities lending transactions and related collateral.

The proposed passport rules would:

- prohibit money lending, the provision of guarantees and underwriting by passport funds;
- limit the circumstances in which a passport CIS may borrow money

or other assets or obtain finance; and

- prohibit the acquisition of partly paid securities.

Delegation

A CIS operator would be able to delegate any function, as allowed under its home economy laws and regulations, but would need to meet certain requirements set out in the Paper.

Valuation

Issue and redemption of interests in the passport CIS would be based on its net asset value. The proposed valuation methodologies used to value assets held by the passport CIS are included in the Paper.

Redemption

The redemption rules would ensure that each passport CIS provides reasonable redemption rights to its members.

Investors

In general, the host economy laws and regulations would apply in relation to a passport CIS's interaction with investors. A host economy may impose rules on passport CIS in relation to their dealings with investors in addition to the host economy laws and regulations that apply to regulated CIS generally. However, any additional rules are not to be unduly burdensome for the passport CIS in comparison to regulated CIS in the host economy. Any additional rules would also need to be reasonable to promote the confidence of retail investors in passport CIS.

Distribution and intermediaries

The passport arrangements do not have any effect on host economy laws and regulations relating to

intermediaries or the distribution of CIS in the host economy. This means that passport CIS may only be distributed in a host economy in accordance with the laws and regulations of the host economy. In this respect, passport CIS are to be treated the same as local regulated CIS in the host economy.

Disclosure

When offering interests in a CIS in a host economy, the host economy laws and regulations would apply to the disclosures required to be given to investors, except with respect to financial statements and audit reports.

Marketing

Similar to disclosure, it is proposed that the host economy laws and regulations would apply to the marketing of CIS.

Complaints

Host economy laws and regulations would also apply to the handling of complaints, including both internal dispute resolution and external dispute resolution.

Applications

Application to be a passport CIS in the home economy

The application form would have two parts:

- Part 1: General information about the CIS and the CIS operator required by the passport rules

and all passport member economies; and

- Part 2: Specific information required by the home economy.

Once the home regulator registers a passport CIS, the home regulator would publish Part 1 of the CIS's application for registration on the home regulator's website or another single website approved by the home regulator.

The home regulator may register a passport CIS only if, having considered the application for registration, it is of the opinion that the passport CIS is eligible to be a passport CIS and is likely to comply with the home economy's laws and regulations and the passport rules on an ongoing basis.

Application for entry into the host economy

A passport member economy may elect either of two processes for its host regulator assessment:

- streamlined authorisation by the host regulator. The passport CIS may be offered only after the host regulator has authorised the CIS. The host regulator would be required to assess the application within 21 days after receipt, but either the host regulator or the passport CIS may extend this period by an additional seven days; or
- notification process. The passport CIS may be offered in

the host economy after 21 days if not otherwise notified in writing by the host economy.

In assessing an application under either process, the host regulator would not generally reassess the passport CIS's compliance with the home economy's laws or the passport rules. Rather, the host regulator would focus on assessing the documents required to be lodged with the application by the host economy's laws and regulations (for example, disclosure documents).

Ongoing obligations

A passport CIS would need to comply, on an ongoing basis, with:

- the passport rules, both in the home economy and in each host economy;
- the home economy's laws and regulations applying in relation to the CIS; and
- the host economy's laws and regulations applying in relation to the CIS.

Comments

The consultation period ends on **11 July 2014**. Economies that decide to participate in the ARFP will work together towards its launch in 2016. We will be submitting comments to the Monetary Authority of Singapore (**MAS**). If you have any comments to include in our submission, please contact us before **13 June 2014**.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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