

COMMENT LETTER

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Comment Letter on Host Economy Laws and Regulations for ARFP Funds (pdf)

18 SEPTEMBER 2017 BY EMAIL International Capital Markets Regulation Office of International Affairs intl-se@fsa.go.jp Investment Managers and Superannuation Australian Securities and Investment Commission ARFP.Guidance@asic.gov.au Asset Management Supervision Office Financial Supervisory Service fundpassport@fss.or.kr Financial Markets Authority consultation@fma.govt.nz Investment Management Policy Development Department Securities and Exchange Commission, Thailand ARFP@sec.or.th RE: Draft interim guidance on host economy laws and regulations for ARFP funds Dear sir/madam, ICI Global¹ welcomes the opportunity to comment to the Asia Region Funds Passport (ARFP) Joint Committee (JC)² on the draft interim guidance on host economy laws and regulations (“draft interim guidance”), published on 25 July 2017 for public consultation.³ ICI Global has applauded the ARFP initiative from the outset⁴ and commented on the 2014 APEC Consultation Paper: Arrangements for an Asia Region Funds Passport (“First Consultation”),⁵ the Arrangements for an Asia Region Funds Passport: Feedback Statement and Consultation on Draft Rules (“Feedback Statement”)⁶ and associated annexes (“Second Consultation”).⁷ We remain fully supportive of the ARFP which seeks to encourage competition, lower costs and spur fund managers to innovate and find ways to offer superior services and products – all to the benefit of investors. 1 ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI’s membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$27.1 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC. 2 Throughout this letter the term “participant” and “participant economy” refers to an economy that is a party to the ARFP Memorandum of Cooperation (MoC) signed on 28 April 2016 and which came into effect on 30 June 2016. The term “ARFP Joint Committee” refers to the committee of participant economies established under the MoC for the purpose of overseeing the effective implementation and operation of the passport arrangements. Certain non-participant economies are observers at Joint Committee meetings. 3 The Interim Guidance is available at <https://cdn.tspace.gov.au/uploads/sites/20/2017/07/Interim-ARFP-Guidance.docx> and is summarised in a cover note available at <https://cdn.tspace.gov.au/uploads/sites/20/2017/07/ARFP-Guidance-CoverNote.docx> 4 https://www.iciglobal.org/iciglobal/news/news/14_news_icig_arfp 5 The Consultation Paper is available at

Arrangements-FINAL.pdf. 6 The Feedback Statement is available at <http://fundspassport.apec.org/files/2015/03/ARFP-Feedback-statement-UPDATED-for-release.pdf> 7 The Consultation Paper is available at

<http://fundspassport.apec.org/files/2015/03/ARFP-Annex-1-2-and-3-UPDATED-for-release.pdf>

ICI Global | Page 2 of 7 We appreciate the changes that have been made to the ARFP following the prior consultations. We acknowledge the desire, expressed during the conclusion of the MoC,⁸ for activation of the passport this year when at least two participants have implemented the necessary domestic arrangements. Against this backdrop, we offer the following comments, described in more detail in subsequent sections: • Distribution – permit the use of ARFP funds for retirement and long-term savings; • Tax – eliminate tax barriers that erode the benefits of an ARFP fund; • Implementation – enable ARFP funds to develop an early reputation for transparency and strong regulation by providing clarity on implementation in good time before the passport; • ARFP rules – promote regulatory coordination, convergence and harmonisation; • Operations – facilitate cross-border provision of operational functions for ARFP funds; and • Enlargement – support further enlargement of the group of ARFP participants. Substantive Comments Distribution We recommend that ARFP participants permit the use of ARFP funds, including on a cross-border basis, within retirement and long-term savings schemes (e.g., clarifying the eligibility of ARFP funds as investment options within such schemes and identifying and removing any impediments and barriers to investment). Regulated investment funds play a substantial role in providing diversified, long-term investment solutions to retirement savers in many jurisdictions around the world. ARFP funds have similar potential to provide such savers in the region with additional savings vehicles to support retirement and long-term savings goals. Furthermore, retirement savers may benefit from the economies of scale derived by ARFP operators from long-term investment. Tax Tax issues continue to present crucial cross-border challenges for ARFP funds. We believe that ARFP participants' laws must provide for tax neutrality between: (i) resident and non-resident funds; (ii) resident and non-resident investors; and (iii) resident and non-resident ARFP operators. We appreciate that some ARFP participants are revising their domestic tax laws to minimise these tax barriers. The draft interim guidance describing the tax laws expected to apply in host economies on commencement of ARFP is helpful to ARFP operators and potential investors.⁹ We note, however, that the draft interim guidance does not address each tax neutrality principal with respect to each ARFP participant.¹⁰ We urge ARFP participants to continue this effort and to devote the necessary resources to eliminate any tax barriers that erode the benefits of investing in an ARFP fund. Implementation In the last stages of implementation, it is important that ARFP funds are able to develop an early reputation for transparency and strong regulation. While ARFP participants have published some aspects of their approach to implementation, in some areas host economies' legal requirements are not settled. 8

<http://fundspassport.apec.org/2016/04/28/asia-region-funds-passport-memorandum-of-cooperation/> 9 Section 3, draft interim guidance. 10 For example, the tax guidance on Japan and Korea does not describe tax rules for non-resident investors. Likewise, the Australia tax guidance does not address tax rules for non-resident CIS operators, while the New Zealand guidance indicates that the taxation of foreign CIS operators is still an open issue. ICI Global | Page 3 of 7 We urge the ARFP JC to adopt a balanced approach to the activation of the passport – ensuring that: (i) the remaining aspects of implementation are settled and communicated to ARFP operators in good time ahead of activation; and (ii) a sufficient number of ARFP participants – that collectively offer sufficient potential scale for ARFP funds – are ready and able to operate the passport (e.g. authorise and register ARFP funds). ARFP Rules Coordination, convergence and harmonisation of approaches across ARFP participants supports consistency in investors' experience, strengthens investor confidence,

reduces uncertainty and complexity for ARFP operators, and may facilitate the enlargement of the group of participating economies. Such an approach also will support ARFP supervisory authorities in their authorisation and supervisory obligations (e.g. streamlining processes and sharing good and best practice). Leveraging experiences of ARFP supervisory authorities and operators in cross-border business, we recommend that the ARFP JC undertakes the following work: • coordination – compare domestic legal and regulatory approaches (e.g., investor definitions)¹¹, operational and supervisory practice (e.g., multi-share class funds, commission and/or fee based distribution) and capital controls (e.g., multi-currency dominated share classes) to coordinate implementation; • convergence – monitor and analyse ARFP participants' implementation to develop solutions when areas of divergence arise (e.g., host state “gold plated” requirements for ARFP funds); and • harmonisation – seek to develop a common approach across ARFP participants to reduce complexity (e.g., cross-border registrations and marketing, including investor disclosures).¹² We recommend that the ARFP JC prioritises the development of a common approach to fund registration and marketing, including a common investor disclosure document, to avoid the problems posed when an ARFP fund must follow different approaches in each host economy to comply with local laws. A common approach would need to be comparable with host economy requirements so a common experience is shared by investors (e.g. they receive the “same level” of disclosure). To inform the development of a common approach for the ARFP, selected international approaches to fund registration and marketing are briefly described in the annex to this letter. Operations We recommend examining ways in which the provision of operational functions for ARFP funds can be facilitated on a cross-border basis (e.g., back-office functions, administration, custody, valuation, etc.). The introduction of an operational “passport” to enable a service provider in one country to perform activities for an ARFP fund in another, has the potential to enhance efficiency, increase competition, provide ARFP funds with a broader choice of providers and reduce operational costs – all to the benefit of investors. An operational passport is consistent with the ARFP JC's desire to enhance the efficiency and quality of fund back-office processing and consistent with the existing practices of some ARFP participants who permit their local funds to use non-resident providers under certain conditions (e.g., foreign authorised financial institutions acting as custodians). ¹¹ page 55, Part 9 “Dictionary”, Annex 3, Second Consultation, contains a set of definitions and references that could be expanded over time, available from

<http://fundspassport.apec.org/files/2015/03/ARFP-Annex-1-2-and-3-UPDATED-for-release.pdf>

¹² Section 1 and 4 and 5 in the draft interim guidance outlines disclosure, distribution and local agent host state requirements respectively. ICI Global | Page 4 of 7 Enlargement We strongly support enlarging the number of participants¹³ and making ARFP changes that would encourage other economies in the region to join.¹⁴ We encourage the ARFP JC to enable other economies to involve themselves, as appropriate, in the process of developing the ARFP and to consider how differing approaches can meet ARFP regulatory principles and outcomes. Conclusion The ARFP has great potential benefits for investors and regulated fund managers in the participating countries. We appreciate the substantial efforts undertaken to date on the ARFP and welcome the opportunity to provide input. We look forward to continue working with you in developing the ARFP. If you have any questions about our comments or would like additional information please contact Bona Lee, Head of Regulatory Policy and Legal Affairs, Asia-Pacific (bona.lee@iciglobal.org) or Giles Swan, Director of Global Funds Policy (giles.swan@iciglobal.org). Yours faithfully, /s/ Dan Waters Managing Director ¹³ We have welcomed the announcement of additional participant economies, ICI Global Press Release: CI Global Welcomes Announcement of Japan's Intention to Join the Asia Region Funds Passport, available from https://www.iciglobal.org/iciglobal/news/news/ci.15_news_icig_japan_arfp.global ¹⁴

Increasing the number of Participant economies in the ARFP would further support: (i) the development and integration of capital markets across the APEC region; (ii) efforts by ARFP Operators to achieve greater regional scale and efficiencies; and (iii) the goal of broadening the base of investors that can benefit from the ARFP. ICI Global | Page 5 of 7 Annex -

Selected international approaches to fund registration and marketing to inform the potential future development of the ARFP We recommend that ARFP participants work together to develop common approaches to fund registration and marketing. Such approaches can facilitate more efficient distribution of ARFP funds by reducing the substantial burdens and costs that licensing and authorisation in multiple host economies will entail (e.g., “simplified” licensing for entities marketing Passport Funds). In this regard, we recommend that ARFP participants work together on a common disclosure document to avoid the problems posed when the same fund must use different documents in each host economy to comply with local laws. Such a disclosure document also would have to be comparable to host economy disclosure documents so investors receive the “same level” of disclosure. Other regulators in the world have faced similar challenges when distributing funds on a cross- border basis. We briefly describe below approaches to fund registration and marketing in the European Union (EU), Canada and the United States (US). Regulators in those places have, and in some cases continue to grapple, with challenges posed by “cross-border” distribution within their territories. Their experiences may provide valuable insights and lessons for ARFP members.

European Union (EU) In the EU, successive iterations of the UCITS rules have introduced and refined a common obligatory investor disclosure document made available to investors from the point of sale (alongside any supplementary host Member State disclosures). The “Simplified Prospectus” developed in the second completed iteration of UCITS was replaced in a subsequent iteration by a shorter, less technical “Key (Investor) Information Document” (KID) which, following recent reforms, contains information including on product objectives, risk and return characteristics and costs. The KID reflects the style of similar initiatives in other jurisdictions to provide investors with more concise information about a fund. Detailed EU level rules specify the KID’s content and presentation, the timing and method of delivery to the investor and the process for review, revision and republication. Nevertheless, EU Member States have added supplementary disclosure that must accompany the KID. The supplementary disclosure varies among Member States, meaning that funds effectively have the KID plus any distinct supplementary disclosure required by each Member State into which they wish to distribute. These additional requirements have been recognised as hindering cross-border distribution of funds and adding unnecessary cost and complexity. It also is a challenge for investors and funds as it is important that investors in the same fund receive at least similar, if not the same, disclosure. In recognition of this problem, the European Commission is examining reforms, including on marketing communications and obligatory investor disclosures, to reduce and remove barriers to the cross-border distribution of funds in the EU. Reforms are under discussion including the following:

- Adopting a common definition of the activities that constitute “marketing” of a fund (e.g., communication with potential investors prior to a fund’s launch) – thereby triggering a regulatory notification – and “pre-marketing” (which do not trigger notification requirements) to enable a fund to gauge investor or distributor interest prior to its launch, or if the fund is already marketing in other host countries, prior to the submission of an additional marketing notification;
- A harmonised definition of “marketing communications” and a single set of requirements for the content of these communications, including where delivered through digital means (e.g. email, online), would offer better access to information and other advantages for fund investors, such as more consistent information;
- A harmonised approach to the provision and content of any EU Member State supplementary information that must accompany the existing obligatory

investor disclosures (e.g., KID), to improve the consistency of information provided to fund investors. Furthermore, a harmonised approach would reduce the time and complexity of marketing cross-border funds, particularly those distributing into multiple host countries. Requiring multiple versions of fund documents to meet varying rules across the EU is very costly and creates unneeded confusion and complexity. If implemented, it is hoped that such reforms could eliminate or at least lessen the current duplication, divergence and conflict that exists due to the various EU Member State requirements, and thereby strengthen the EU single market, while also resulting in more consistent disclosure for UCITS and their investors.

Canada In Canada, 13 provincial and territorial securities regulators are responsible for the regulation of securities, including mutual funds, within their respective jurisdiction. To facilitate the distribution of funds throughout Canada, all of the provinces and territories have adopted – essentially uniformly – the various Canadian national instruments that govern the regulation and distribution of funds in Canada. In Canada, a fund files its prospectus through the centralised System for Electronic Data Analysis and Retrieval (SEDAR) to become qualified for sale to the public – regardless of the province or territory in which it is domiciled. Through this centralised system the fund indicates the provinces and territories in which it wishes to sell shares of the fund, and the fund’s principal regulator issues a receipt on behalf of all of the covered jurisdictions (referred to as the “passport system”). The registration fee – as determined by each province and territory – is paid through this centralised system rather than directly to each province or territory. A fund is subsequently authorised to sell its shares to the public in the provinces and territories it indicated without further action or approval from each province or territory. The regulation of marketing/sales communications is similarly regulated in an efficient and effective manner. In particular, each province and territory has adopted National Instrument 81-102, which governs the information that can be included in sales communications. However, although the regulations governing sales communications are virtually the same, the provinces and territories retain the jurisdiction to enforce for breach of law within their jurisdiction. In practice, the securities regulators administer the requirements on sales communications consistently, with a certain amount of deference given to the Ontario Securities Commission, in which approximately 70% of funds are domiciled. Further, under the laws adopted by the Canadian securities regulators, marketing/sales communications are not required to be reviewed by the regulator or any self-regulatory organisation. Instead, as mentioned above, action may be taken by the relevant securities regulator for breach of law. We believe that Canada illustrates an approach for efficient and effective “passporting” that should be considered by the ARFP regulators. The concept of a centralised system and a common instrument to govern communications with respect to marketing communications, whereby, all ARFP participating economies would adopt the same rules and requirements regarding marketing communications, but would retain some authority with respect to enforcement, would be highly helpful to facilitating and encouraging use of the ARFP.

ICI Global | Page 7 of 7 United States (US) Prior to 1996, US mutual funds were subject to local state requirements and federal rules. As such, a mutual fund sold throughout the US could be subject to up to 50 sets of state rules. In 1996, to address the inefficiencies inherent in state and federal securities registration schemes, the US Congress passed the National Securities Markets Improvement Act (NSMIA) to pre-empt state “blue sky” laws that required issuers of securities, including funds, to register many securities with state authorities prior to distributing a fund in a state. As a result of NSMIA, securities of companies registered under the Investment Company Act (ICA) of 1940 (commonly referred to as mutual funds), are exempt from state registration and review. NSMIA, somewhat similar to the Canadian approach, however, provides that states retain jurisdiction to investigate fraud. The authorisation or registration process for US mutual funds is therefore now focused at the

federal level, with the US Securities and Exchange Commission which has a centralized system for filing registration materials and other required documents related to mutual funds. The review of fund marketing communications for US mutual funds is also performed at a federal, and not state level. The ICA requires that all fund sales literature be filed with the SEC, or if the material is to be used by a member of FINRA – the securities industry’s self-regulatory organisation – with FINRA. Because most mutual funds are distributed by FINRA member firms, most mutual fund sales literature is filed with and reviewed by FINRA rather than with the SEC. FINRA reviews member communications to the public to ensure that they are fair, balanced, and compliant with FINRA rules and federal regulations. This centralized approach is helpful for both funds and investors.

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