



11 July 2014

fundspassport@treasury.gov.au

Dear Sir/Madam,

Deutsche Bank's response to the Asia Region Funds Passport consultation

Deutsche Bank (DB) welcomes the opportunity to comment on the Asia-Pacific Economic Cooperation's (APEC) proposal for an Asia Region Funds Passport (ARFP) scheme. We strongly support the goal of a fund passport scheme: pooling investment opportunities across the region would lower the cost for retail investors and make it easier to save for the future. The ARFP will increase the choice of products available to investors, promote competition in industry and improve regional liquidity.

We also recognise and welcome the regulatory cooperation which has gone into making the scheme a realistic proposition.

We believe the consultation paper sets out a good framework for how the scheme could work and support its direction. Our comments are attached to this letter. There are three overarching principles we would like to emphasise at this stage:

- The benefits of the ARFP will increase significantly the greater the number of countries participating and therefore avoiding the creation of barriers to entry should be a guiding principle for the scheme's design;
- Every effort should be made to harmonise and simplify regulations to avoid potential arbitrage and unnecessary complexity; and
- The ARFP should minimise costs for investors to increase the scheme's appeal and maximise participation.

In addition, we have identified some issues which we believe would benefit from more detailed consideration. As the policy-making process becomes more focused on implementation, we would be happy to meet with any of the authorities involved to discuss the points raised in our response or to offer technical and commercial insight. Please do not hesitate to contact us should you have questions.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Daniel Trinder', written in a cursive style.

Daniel Trinder
Managing Director,
Government and Regulatory Affairs



Membership of the ARFP

The success of the scheme will ultimately be determined by its scale. Increasing the number of APEC member jurisdictions involved will lead to increased participation by providers and investors, more choice for investors and an improvement in regional liquidity. As such, it is of paramount importance that the ARFP is designed in such a way that new members are incentivised to participate and we would support other APEC members signing up to the ARFP as soon as possible in order to maximise its collective benefits.

The scheme's framework must avoid the creation of direct or indirect barriers to entry for those economies not yet involved. For example, there should be a clear process for new members joining the scheme. Page 2 of the consultation paper states that eligible economies who want to become passport member economies would "mutually [decide] to adopt those arrangements". This implies any prospective member would need to conduct a series of bilateral discussions with each existing member to facilitate joining. This would be unnecessarily onerous compared to a process which would allow the prospective member to engage collectively with those already involved. It may also increase the possibility of regulatory 'blind-spots' between jurisdictions, which could inadvertently create further barriers to joining and the possible politicisation of the ARFP. Any or all of these factors could lead to the scheme's sub-optimal adoption.

Harmonisation and limiting arbitrage

The consultation recognises the need for harmonisation across jurisdictions and we welcome the emphasis placed on this in the consultation. We recommend that it remains a primary objective as the scheme's design is finalised, because the harmonisation of regulations across jurisdictions – along with consistent implementation standards and transparency – is absolutely fundamental to creating both a framework for recognition and a level playing field.

Relevant rules should be consistent as far as possible and need to be coherently interpreted by regulators to prevent divergence: differences in either implementation or interpretation across jurisdictions will result in the uneven application of standards and quickly reduce incentives for investors, industry and APEC members to participate. In other words, making it simpler and more predictable to passport into another market will offer certainty for industry and a greater choice for investors, maximising the overall success of the scheme.

We acknowledge that some examples of regulatory differences may become apparent at a later stage. However, at this nascent phase, it is clear that continuous engagement between authorities and industry is necessary to discuss how the scheme can maximise participation and set sufficiently high standards to ensure its credibility. We therefore believe the following proposals would be valuable as momentum for the scheme grows:

- **Regular supervisory meetings:** A large number of points raised in this submission relate to the interpretation of supervisory standards. Not only should the relevant rules be considered across jurisdictions with regard to different national markets and corresponding legal regimes, but just as important they should be consistently interpreted to prevent supervisory arbitrage. Regular meetings between all the supervisory authorities as the ARFP's regulations are drafted would provide an effective forum for standards to be shaped, or



‘baselined’. Once the ARFP is established, the continuation of such meetings would help supervisors agree common understanding and interpretation of the passport rules and the authorisation process. The decisions and regulations of such a committee may not necessarily be binding, but should to be adopted by each supervisory authority to help provide a level playing field and predictability.

- **A public-private forum:** We consider there is significant value in creating a "public-private forum" that will bring together core stakeholders from industry, supervisors and Government to better assess the impacts, implications and possible actions on each constituency. The group should discuss the issues raised in this submission and other feedback, providing expertise across a range of relevant issues as required. For example, its focus could include impact assessments on how proposed ARFP rules would work and offer expertise on topics related to efficiency, reducing administrative costs and investor protection. This body can also in effect support the supervisory meetings by identifying risks, analysing consistency and monitoring progress towards the ARFP’s stated benefits. This will also enhance transparency which will likely support industry participation in the ARFP.
- **Guidelines:** We anticipate that other responses from industry and inter-regulator discussions are likely to highlight areas where further information and clarity would be helpful to avoid differential treatment or potential for arbitrage. We therefore propose that supervisors consider the publication of guidelines which expand on how some issues will be interpreted across supervisory authorities – for example covering important legal terms set out below, such as ‘reasonable’, or offering further guidance on what products are prohibited. These standards could also cover those issues not included in regulation but that which would impact on day-to-day fund management operations. These guidelines should be updated or added to over time.

Potential issues of disagreement between participating members

The following points are examples of issues where inconsistencies could arise and we recommend further consideration be given to minimise potential discrepancies, including taking into account the suggestions above:

- **Definition of ‘reasonable’:** Page 37 of the consultation paper states that all passport funds must offer a “reasonable opportunity” to members to redeem their interest. Page 38 also considers the possibility of allowing redemption in the currency of any economies, based on “a reasonable” estimate of the market exchange rate. Agreeing coherent interpretations of legal terms is essential to ensuring that products can be appropriately provided to customers in different jurisdictions and that there is a level playing field. Various parties involved in fund management – operators, supervisors, trustees or legal counsel – could interpret this term differently according to market practices in the jurisdictions in which they operate.
- **Embedded derivatives:** Page 33 of the Consultation Paper states that when a transferable security or money market instrument embeds a derivative, the requirements for derivatives “generally apply to the embedded derivative”. It is important to therefore agree what constitutes an “embedded derivative”. While of course recognising the intentions of this proposal, we recommend a pragmatic interpretation of these terms based on the risk profile of the instrument, which should



be applied consistently by all ARFP regulators. This would maximise choice for investors as much as possible.

It seems the criteria set out for an embedded derivative 'test' closely replicates Art. 10 of the so-called UCITS Eligible Assets Directive ("Directive 2007/16/EC"). The German Supervisory Authority ('BaFin') has published interpretive guidance clarifying, for example, that it treats a security which tracks the gold price 1:1 differently to a security with leverage on the gold price. The latter would be treated as embedding a derivative whereas the former's risk and economic characteristics are essentially the same as an equivalent non-derivative based product. As such, the BaFin does not require the security to be treated as an embedded derivative. Other European regulators take a similar approach, which offers commonality across jurisdictions and ensures a risk-based approach.

Home-host harmonisation

The successful functioning of the ARFP will rely on common understanding between the relevant authorities across different jurisdictions of their role as both a home and a host authority. We welcome the consultation's guidance on the interaction between the home and host regulators, and support the model of home/host/passport regulations as set out on page 10. However, we believe there is a need for further consideration of:

- ***Home-host approval:*** We recognise that in practice both the home and the host regulatory authorities will retain the ultimate right to decide whether a product can be offered to retail investors. However, as far as is possible, the principle of full acceptance of home country approval needs to be made explicit: that is, if a home authority approves a fund for passporting then the default approach of the host regulatory authority should be to accept this subject to the fulfilment of necessary legal criteria. Such an approach will help to harmonise standards between members, avoid delays and remove regulatory uncertainty about the mechanics of passporting.
- ***Investor protection:*** We fully recognise the importance of high standards of investor protection and the benefits strong standards will bring to the ARFP brand. However, home and host regulators may need to consider how to achieve this given potential variation in the way in which investor protection regimes are implemented between countries taking part. For example:
 - It will be necessary to reconcile views on investor protection regarding segregation or separation of assets. This needs to be clarified on the basis that assets can be transferred or maintained in different ways across borders.
 - Investors from a host country should have at least the same rights as the investors from the home country, including access to the same basic information in identical and equivalent manners and within similar time frames. As such, it is important that investor protection standards are proportionate and consistently applied, so that there is not asymmetric treatment undermining the principle of equal rights. Allocation of responsibilities for the protection of investors should be relevant and proportionate to the risks that are within the remit of service providers to manage – e.g. appropriate for the role of structurers, fund managers, distributors. Requirements in any jurisdiction on service providers to assume strict and onerous responsibility that is outside of their effective risk management



control will introduce moral hazard, lowering of risk management standards in other parts of the industry and additional costs.

- **Legal compatibility:** The ARFP clearly needs to avoid any situation whereby a fund that has fulfilled all passport regulations is prevented from distribution because certain fund characteristics are not compliant with specific aspects of local law – for instance, compliance or marketing regulations. We agree that a high level of investor protection is absolutely essential (discussed above), however, for the success of the ARFP, there is clearly a need to remain pragmatic in how this is delivered. This will become more relevant as specific details of the scheme become agreed but it is important that such regulatory gaps are identified as quickly as possible.
- **Notifications:** Given the number of legal systems covered by the ARFP, it is important that the notification process and finality of regulatory decisions are clearly communicated to prevent misunderstanding.
- **Parity of treatment:** Just as the regulatory framework for the scheme seeks to create a level playing field across jurisdictions, it is equally important that investors are offered the freedom of choice in the market between local firms and those offering on a cross-border basis. Preferential treatment for local firms will create disincentives to participation and could deprive investors of cross-border expertise.

Tax

It is recommended that tax requirements are clear, simple to comply with and avoid duplication: such principles will avoid either the creation of unnecessary barriers to entry for new participants or the levying of additional costs to retail investors. However, we recognise that compliance with cross-border tax requirements is inherently complex – for example, regarding different international account structures. While it is unrealistic to expect detailed proposals to be agreed multi-laterally at this early stage, we recommend that tax is considered in more detail by the necessary authorities. This is an aspect of the proposal which would benefit from consideration in a public-private working group.

It should also be noted that the OECD's Common Reporting Standards (CRS) on the automated exchange of tax information are likely to come into force within the ARFP's pilot timeline of 2016. The CRS includes economies looking to take part in the ARFP at its inception as well as those not yet involved. It is important that the ARFP's framework is compatible with the OECD's new standards to avoid distorting or complicating the structure of the ARFP in such a way that could prevent new member states from joining or increase costs for retail investors.

Minimising the cost to investors

We believe it is in the interests of all ARFP participants, particularly investors, to minimise the costs associated with the scheme. Maximising the scheme's efficiency will increase competition, maximise the benefits for retail investors and increase take up. As such, we welcome the proposed streamlined authorisation process in host economies, as set out on page 47, "to avoid creating unnecessary additional costs for passport funds". Central to this goal is reducing the time it takes to bring a fund to market as much as possible, so we welcome the ambition that the host authority should assess a fund's application within 21 days, as noted on page 48.



To help minimise costs, we suggest that the following issues merit further consideration:

- **Cost objective:** We support the objectives of the ARFP as detailed on page one of the consultation paper. However, as the framework for the operation of the ARFP is finalised over the coming eighteen months, we believe that the need to minimise costs (in order to maximise the benefits of the scheme) should be explicitly recognised in the ARFP’s objectives.
- **Language:** As the ARFP involves multiple jurisdictions with numerous reporting and transparency requirements, translation costs have the potential to be a significant factor. We suggest further discussion and agreement across jurisdictions on the adoption of a “recognised financial language” such as English for the majority of documentation, supplemented by key investor information published in the host language(s) (as retail investor understanding is a key element of investor protection). Such an approach would avoid all documents being translated into all relevant languages.
- **Disclosure requirements and investor protection:** We anticipate that a standardised ARFP investor disclosure pack containing basic information about the fund would be available to all host-country investors. By this being uniform and standardised, formatting and language translation costs would be minimised. It would also maximise accessibility for investors, minimise potential for mis-selling, promote trust and confidence, and as such enhance the ARFP brand.
- **Data privacy and protection:** With the introduction of the ARFP, there are increased possibilities of data needing to be made available across jurisdictional boundaries. A balance therefore needs to be struck between meeting local data confidentiality requirements and the practical cross-border sharing of fund information with authorities. We recommend further discussion with the relevant authorities on this subject.
- **Audit requirements:** The consultation paper indicates that passport funds will be required to appoint “an auditor to conduct an annual compliance audit in relation to the passport rules and the passport fund operational requirements”. This raises two issues: firstly, the consultation paper does not clarify whether this relates to an internal or external auditor and, secondly, that an audit must be carried out every year. We are concerned that the implied requirement for an external auditor to be appointed on an annual basis is excessive and would place an unnecessary cost on funds. We strongly recommend a risk-based and proportionate approach to all auditing requirements which takes into account factors including the size of the investor base and/or the complexity of funds under management. Consideration should also be given to allowing firms to ‘self-certify’ compliance with passporting regulations.
- **Compliance challenges:** As the ARFP involves multiple jurisdictions, there is a possibility of overlapping reporting requirements to multiple authorities including tax, central banks and securities regulators for every participating jurisdiction, with potential differences in specific requirements introducing complexity and operational challenges.

Additionally, variations in specific requirements relating to legal relationships, ‘Know Your Customer’ and anti-money laundering requirements – potentially in



different languages – may result in significant cross-border hurdles towards the establishment of a fund.

Taking steps to streamline and harmonise compliance requirements across jurisdictions aligned with global standards where applicable will help to minimise the need for duplicative systems and processes, therefore saving investors' administration costs and reducing delays. Similarly, further consideration should be given to ensuring that transparency requirements do not raise the cost of retail investors' participation, nor excessive documentation requirements reduce incentives to take part.