Regulatory Impact Statement – Joining the Asia Region Funds Passport

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment.

It provides an analysis of the impacts of joining the Asia Region Funds Passport. The analysis is in part, based on research carried out by third parties and sets out the expected outcomes at a high level. It is not straightforward to quantify the impacts of joining the Funds Passport, beyond the high level assumptions.

The scale and timeliness of the costs and benefits are sensitive to the level of uptake by Asia Pacific Economic Cooperation forum economies and by domestic fund managers and investors.

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Executive summary

1. This Regulatory Impact Statement considers whether New Zealand should join the Asia Region Funds Passport (the Funds Passport).

2. The Funds Passport is a non-binding mutual recognition arrangement between the financial markets regulators of cooperating Asia Pacific Economic Cooperation forum economies. It allows fund managers in one jurisdiction who wish to do so, an easier and less costly path to offer a managed fund to retail investors[1] in other participating jurisdictions.

3. The Funds Passport cuts down on incompatible or overlapping regulatory requirements for managed funds (known in New Zealand as managed investment schemes) [2].

4. This Regulatory Impact Statement concludes that New Zealand should join the Funds Passport as the potential benefits are considered to outweigh the potential costs and risks.

5. In addition to wider benefits to the Asia Pacific region of a successful Funds Passport, and assuming uptake over time, joining the Funds Passport should result in the following potential benefits:
    a. for New Zealand investors/savers - a greater range of investment opportunities for investors from a better developed domestic funds sector due to increased competition between fund managers;
    b. for New Zealand fund managers – an increased ability to access much larger markets to offer their managed funds to;
    c. for New Zealand as a whole - increased capital flows into New Zealand from better developed and integrated regional managed fund markets.

6. This Regulatory Impact Statement also outlines impacts of joining. The main risk to success of the Funds Passport is that the expected quantum of benefits will only eventuate if there is a critical mass of Asia Pacific Economic Cooperation forum economies joining, fund managers opting to use the process and investors choosing to invest. It is likely that momentum will slowly gather behind the Funds Passport over time and it will not be an overnight success. It is not straightforward to quantify the impacts of joining the Funds Passport, beyond the high level assumptions.

7. Overall, the Funds Passport is expected to bring potentially significant benefits to the Asia Pacific region and is more likely than the status quo to meet the objectives of regional integration, development of domestic funds industries and increased capital flows.

[1] There are two categories of investors in financial markets: *retail investors* and *institutional investors*. A retail investor is, in general, an individual who invests relatively small amounts of money for himself/herself rather than on behalf of anyone else. Retail investors are considered to have less financial literacy and be poorly informed compared to other investors. Fund managers offering a managed investment scheme to retail investors have higher disclosure requirements and the managed investment scheme will often be of lower risk. Retail investors are the opposite of institutional investors, which are large and experienced institutions, such as banks, insurance companies and pension funds that buy and sell high volume, high value financial products as part of their investment portfolios.

[2] A managed fund is a pool of money contributed by a number of different people for investment. The money is invested on behalf of investors by a fund manager and according to a disclosed investment strategy. The aim is to increase the financial return to those investors on a proportional basis.

Background

8. The Funds Passport is an initiative being pursued by a number of countries under the Asia Pacific Economic Cooperation Forum Finance Ministers Process.

9. The development has been guided by the following objectives:
   - providing investors with a more diverse range of investment opportunities, enabling them to better manage their portfolio, and meet their investment objectives;
   - deepening the region's capital markets to attract finance for growth in the region;
   - facilitating the recycling of the region's savings locally, growing the pool of funds available for investment in the region;
   - strengthening the capacity, expertise and international competitiveness of financial markets in the Asia Pacific region and the fund management industry with a view to supporting sound economic development; and
   - maintaining legal and regulatory frameworks which promote investor protection, fair, efficient and transparent markets for financial services, supporting financial stability, and providing high standards in the management and distribution of managed funds.

Key Features of the Funds Passport

10. The Funds passport is a non-binding arrangement between financial markets regulators of cooperating Asia Pacific Economic Cooperation forum economies countries that cuts down on incompatible or overlapping regulatory requirements.

11. The Funds Passport will enable managers of managed funds based in one Fund Passport economy to offer their products to investors in other Fund Passport economies using a streamlined regulatory process. The Funds Passport is an opt-in opportunity for fund managers.

12. The intention is that if a financial markets regulator in one country has assessed that (1) a fund manager meets the stated criteria, and (2) the managed fund proposed to be offered meets the stated criteria, then the managed fund can be offered in other countries without being reassessed by other financial market regulators. Funds will still need to comply with some domestic requirements in each country, including disclosure rules.

13. There are strict rules concerning the types of investments that passport funds may invest in. Funds must be well diversified and invest in liquid assets. These restrictions were put in place in order to provide investors with confidence in the operation of the funds.

14. The Funds Passport is the third initiative of this type across the Asia Pacific. It is the only one open to economies that are not members of the Association of Southeast Asian Nations[3].

[3] There are other 'funds passports' in the region. The first local funds passport arrangement became operational in 2014 and is between three members of the Association of Southeast Asian Nations, Singapore, Malaysia and Thailand. New Zealand cannot be a member of the Association of Southeast Asian Nations and cannot participate in this initiative. The second initiative is a bilateral Mutual Recognition agreement between Hong Kong and Mainland China, finalised in 2015. Prior to these initiatives, the only platform for widespread distribution of off-shore funds into the Asia Pacific region was by the European Union based Undertakings for Collective Investment in Transferable Securities.

15. The Funds Passport represents a practical step towards better-integrated financial markets across the Asia Pacific region, and is expected to bring important benefits to the region, including New Zealand.

Status quo and problem definition

16. Currently, a managed fund that wishes to offer across borders in Asia (this may be a New Zealand managed fund into Asia, or vice versa) faces significant barriers. In most cases, it must comply with all local regulatory requirements in each country that it wishes to offer in.[4]

17. These regulatory requirements are such measures as:
    a. re-licensing of fund managers in the host economy that are already licensed in the home economy;
    b. additional entry requirements such as increased equity, capital or professional indemnity insurance;
    c. re-assessment of investment parameters.

18. Given these regulatory impediments, cross-border offerings in Asia are very limited. This means that capital is moved to out of the region to developed markets rather than remaining in the region as stable and productive investment funds. Financial markets within the Asia Pacific remain underdeveloped.

Objectives

19. The objectives to be met are:
    - better developed and integrated regional integration of managed fund markets;
    - development of the domestic funds sector from increased competition and opportunities for investors; and
    - increased capital flows into New Zealand..

20. We have identified two options, the status quo and joining the Funds Passport.

21. One other option was considered but rejected as not being realistic and has not been assessed. This option would be to negotiate separate mutual recognition agreements with each of the five other Funds Passport economies[5]. Apart from there being no intention to do this, negotiations are invariably resource intensive with no guarantee of reaching agreement. An agreement would not necessarily contain benefits for New Zealand that are equivalent to the Funds Passport and, in any case, a bilateral agreement would not capture the wider multilateral and therefore regional benefits.

Option 1: Retain the status quo

22. None of the problems identified above would be addressed by retaining the status quo and none of the objectives would be achieved.

[4] Unless a specific mutual recognition agreement is in place.
[5] Mutual recognition of financial product offerings was agreed with Australia in 2006.

23. Not joining the Funds Passport will avoid the costs and risks identified below. However, under this option, the growth potential of the New Zealand fund management sector and New Zealand's current level of financial regional integration will remain unchanged. New Zealand's access to capital and foreign investment products will continue to face barriers. It will remain difficult for fund managers and investors to access foreign markets. Additionally as Funds Passport participants are able to offer more easily in each other's economies, the incentive to incur the costs of negotiating New Zealand's financial regulatory environment is decreased even further.

24. The opportunity to join the Funds Passport in the future is not time limited. However, in respect of New Zealand's involvement in negotiating the Funds Passport arrangements, choosing to not join would reflect poorly on the initiative and New Zealand's commitment to regional integration. If New Zealand did not join the Funds Passport, it would not be able to influence any improvements to the regime.

Option 2: Join the Funds Passport (preferred option)

25. In this option, New Zealand would join the Funds Passport.

26. The costs to New Zealand to join are minimal:

    a. There will be administrative costs to government of implementing the Funds Passport through new regulations, exemptions and guidance documents and ongoing monitoring of the regime.

    b. There will be costs to fund managers who choose to opt-in. Whether or not a fund manager chooses to incur these costs will be based on a commercial decision taking into account the costs and benefits to them. These costs could include:

        i. costs of developing a fund that meets the Funds Passport requirements if the fund manager does not already have a suitable product;

        ii. a registration cost in the overseas jurisdiction (which should be lower than the licensing cost the fund manager would otherwise pay);

        iii. costs of arranging distribution channels in the overseas jurisdiction if the fund manager does not already have them;

        iv. costs of the disclosure documents for the overseas jurisdiction.

27. The following section sets out the impacts of joining the Funds Passport.

Impacts

28. The immediate benefit of the Funds Passport will be to reduce some of the current barriers to offering managed funds across jurisdictions in the Asia Pacific region. In particular, it will remove the requirement to be licensed in each participating jurisdiction. It will also provide a pathway to address other barriers in the future.

29. The expected benefits from the Funds Passport will only eventuate if a critical mass of Asia Pacific Economic Cooperation forum economies join, fund manager's start offering across jurisdictions and investors choose to invest. The intention is to create a credible Funds Passport 'brand' that can be built on over time. While it is likely that momentum will gather behind the passport over time, there is some risk that uptake will be slow, at least in the short term.

Investors

30. Assuming uptake by fund managers, it is expected the Funds Passport will lead to a better developed domestic funds sector due to increased competition between fund managers. This may in turn mean a greater range of investment opportunities for investors, potentially with an increased number of more diverse region-specific products;

31. Given the ability for fund managers to access a much larger customer base, this may lead to economies of scales for those funds, which could result in fee reductions for the investors.

32. Uptake by investors may be influenced by different tax treatment between domestic and foreign funds in each jurisdiction i.e. tax discrimination against foreign investors. This could impede uptake of passport funds. Information on tax issues is being collated by Asia Pacific Economic Cooperation forum economies outside of the Funds Passport process to assess if there is an issue and, if so, whether it can be resolved.

Fund managers

33. The Funds Passport opens up the ability for New Zealand fund managers to access much larger retail markets to offer their funds into.

34. Around twenty-four fund managers currently meet a minimum requirement to participate which is responsibility for funds under management of at least USD 500 million. There are other criteria that we are unable to assess eligibility against, but the funds under management threshold is considered a reasonable indicator that thresholds such as staff qualifications, financial resources and organisational arrangements would also be met.

35. We expect an increasing number of New Zealand fund managers to qualify over time as the industry develops here, particularly with the growth of Kiwisaver. However, we do not have an indication from the market about how many fund managers will opt to use the Funds Passport and in what timeline.

36. The rules about the kinds of managed funds that can be offered are very prescriptive. Some eligible fund managers may still decide that the expected returns are not sufficient to justify the time to involved to offer them, or that investors may not be interested.

37. Becoming a Funds Passport participant may result in domestic fund managers having to compete with foreign funds for domestic investors. Domestic fund managers will be able to rely on a tendency towards ‘home bias’ where investors prefer to invest more in their home country than overseas.

38. Smaller New Zealand fund managers who will not qualify to use the Funds Passport also tend to focus on New Zealand and Australian equity markets, where they have a competitive advantage in research and knowledge. It is unlikely that a foreign passport fund would be competing directly in this market with New Zealand investors.

New Zealand

39. Many of the advantages for New Zealand will arise from more integrated managed fund markets in the region as a whole.

40. This is reflected in the New Zealand Government's Business Growth Agenda (BGA). The delivery of the Funds Passport is a current project within the Building Investment chapter of the BGA. The Funds Passport will provide an opportunity to attract investment into New Zealand. The BGA sets out that this is critical to strengthening economic growth and lifting productivity, and building an innovative and internationally-connected economy. The BGA recognises that investment brings the financial capital that firms need, for example to establish new operations, expand their operations or meet the costs of accessing foreign markets.

41. There are additional advantages for New Zealand joining the Funds Passport as a foundation participant. One is that there are opportunities for larger benefits as more Asia Pacific Economic Cooperation forum economies join. New Zealand will also be able to directly contribute to improving the Funds Passport, for example negotiating to reduce other barriers for our domestic regime such as disclosure and reporting, direct distribution and the provision of financial services.

Asia Pacific region

42. The Funds Passport represents a practical step towards better-integrated financial markets across the Asia Pacific region. Regional financial integration is being pursued because it is expected to bring important benefits.

43. In 2014, the Asia Pacific Economic Cooperation forum Business Advisory Council produced an interim report to Finance Ministers on a Public Private Collaboration for Regional Financial Market Development. The report found that regional integration will contribute to the development of financial markets and services that will in turn increase economic growth and provide capital to address priority issues in the region such as poverty and environmental remediation[6]. The Funds Passport could provide a mechanism to unlock stable and long-term capital and channel capital from markets that are in surplus to markets that are in short supply.

Conclusions and Recommendations

44. Overall it is considered that the potential advantages and benefits of New Zealand joining the Funds Passport outweigh the disadvantages and risks. Funds Passport is expected to bring potentially significant benefits to the Asia Pacific region and is more likely than the status quo to meet the objectives of regional integration, development of domestic funds industries and increased capital flows.

45. It is therefore recommended that New Zealand joins the Funds Passport.

Consultation

46. The Working Group undertook two public consultations:

Summary of feedback

47. The majority of submitters were generally supportive of the initiative and proposed amendments while raising some questions and concerns about various details.

[6] Asia Pacific Economic Cooperation forum economies Business Advisory Council (2014). Public Private Collaboration for Regional Financial Market Development: the way forward for the Asia-Pacific Financial Forum. Retrieved on 12 January 2016 from: http://mddb.apec.org/Documents/2014/MM/FMM/14_fmm_008.pdf

Consultation 1

48. A document on policy options and an overall framework for the passport rules was consulted on over April-June 2014. Several economies also held workshops with their fund management industries. In New Zealand a total of 40 fund managers and sector representatives in total attended workshops in Auckland and Wellington. In response to the consultation, 28 submissions were received from across the Asia Pacific region.

49. Support for the Funds Passport was widely conveyed however, the degree of support varied, and some submitters expressed concern about foreign competition.

50. Many submissions emphasised the importance of achieving greater scale and ensuring the arrangements do not prohibit the participation of a broader group of economies. Some submissions also urged the Working Group to consider linkages with the other mutual recognition schemes in the region.

51. A key theme of submissions was a desire to achieve greater harmonisation in regulatory and institutional quality by moving more obligations into the Funds Passport rules rather than being governed by the laws of each Funds Passport economy.

52. A large number of submissions urged the Working Group to consider the implications of domestic tax arrangements and advocated for the neutral tax treatment of Passport Funds i.e that domestic and foreign funds are treated the same within a jurisdiction.

New Zealand Specific

Two New Zealand firms, Amanah Trust Management (NZ) Ltd and ANZ provided submissions. The key themes to come out of these submissions were the importance of developing New Zealand as a financial hub and ensuring the Funds Passport is commercially attractive by appropriately balancing of commercial and policy objectives.

Consultation 2

53. Draft Passport rules and operational arrangements were then released for public comment over February-April 2015 and 23 submissions were received from across the region.

54. Overall the feedback was largely positive and submissions tended to seek clarification or highlight concerns relating to a specific issue. There were no submissions made by New Zealand companies in the second stage of consultation.

55. Where possible the Funds Passport rules and arrangements have been refined, taking submissions into account.

Departmental consultation

56. MBIE have worked closely with the regulator in New Zealand, the Financial Markets Authority (FMA), to ensure the Funds Passport is workable within New Zealand's regulatory regime. Additionally, Treasury and the Ministry of Foreign Affairs and Trade have been kept informed throughout the process. Inland Revenue has been consulted on tax issues.

Implementation

57. There will be administrative costs to government to implement the changes required by the Funds Passport as the negotiated requirements are not always the same as the regime under current financial markets law in New Zealand.

58. This will require new regulations to be made under the Financial Markets Conduct Act 2013. Implementation will also require the FMA to make a number of exemptions and produce new guidance for managers and supervisors of Funds Passport funds.

59. From that point on, the new regulations and processes will provide a Funds Passport option for fund managers to engage in if they so desire.

60. MBIE will work with the FMA to implement the Funds Passport. This is likely to take up to 18 months to complete.

Monitoring, evaluation and review

61. A commitment of joining the Funds Passport is that each economy will provide to other participants an annual progress report on the operation of the Funds Passport with a view to improving its operation and resolving any issues which may arise. The reports are reviewed by a Joint Committee where each economy will have a representative.

62. Such progress reports will include the following information:

    - Use of the Funds Passport including any data available on number and size of funds in operation; and
    - Performance of regulatory functions including:
        - data on the number of applications received;
        - data on the number of admissions of a Funds Passport fund to an economy;
        - the number of registrations or admissions and de-registrations and refusals respectively; and
        - timeliness in performing the regulatory functions.

63. Funds Passport participants may recommend that additional information be included in the progress reports.

64. A combined report will be published annually on the official Funds Passport website.

65. Following New Zealand's decision to join the Funds Passport, MBIE will work the FMA to ensure monitoring and evaluation processes are in place prior to commencement of the Funds Passport arrangements. This is likely to include developing measures that indicate whether the Funds Passport is achieving its objectives in the New Zealand context.

66. Similarly, the Joint Committee will undertake a review the Passport Fund arrangements two years after commencement.

67. If at any stage it no longer suits New Zealand's interests, New Zealand is able to cease participation in the Funds Passport by giving 28 days written notice to the other participants. New Zealand must still ensure that existing members, Passport Funds and fund managers are not unduly affected by the withdrawal.