Accelerating funds' growth in Asia-Pacific

HSBC

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Asia-Pacific (APAC) is undergoing economic expansion, making the region's investors a core distribution target for asset managers globally. Private wealth has increased dramatically, with APAC's high-net-worth-investor (HNWI) population now overseeing more assets than anywhere else in the world, having accumulated around $21.6 trillion in disposable capital.[1] In China, investable assets are expected to reach $31.8 trillion by 2021[2],although only 5% of the country's domestic household savings are currently held in mutual funds.[3] For asset managers, the opportunities in APAC markets are enormous.

[1] Capgemini (March 20, 2018) – World Wealth Report 2018
[2] Boston Consulting Group (December 2017) China Wealth 2017: The way ahead after a golden decade
[3] Financial Times (April 9, 2018) China's fund industry predicted to grow fivefold by 2025

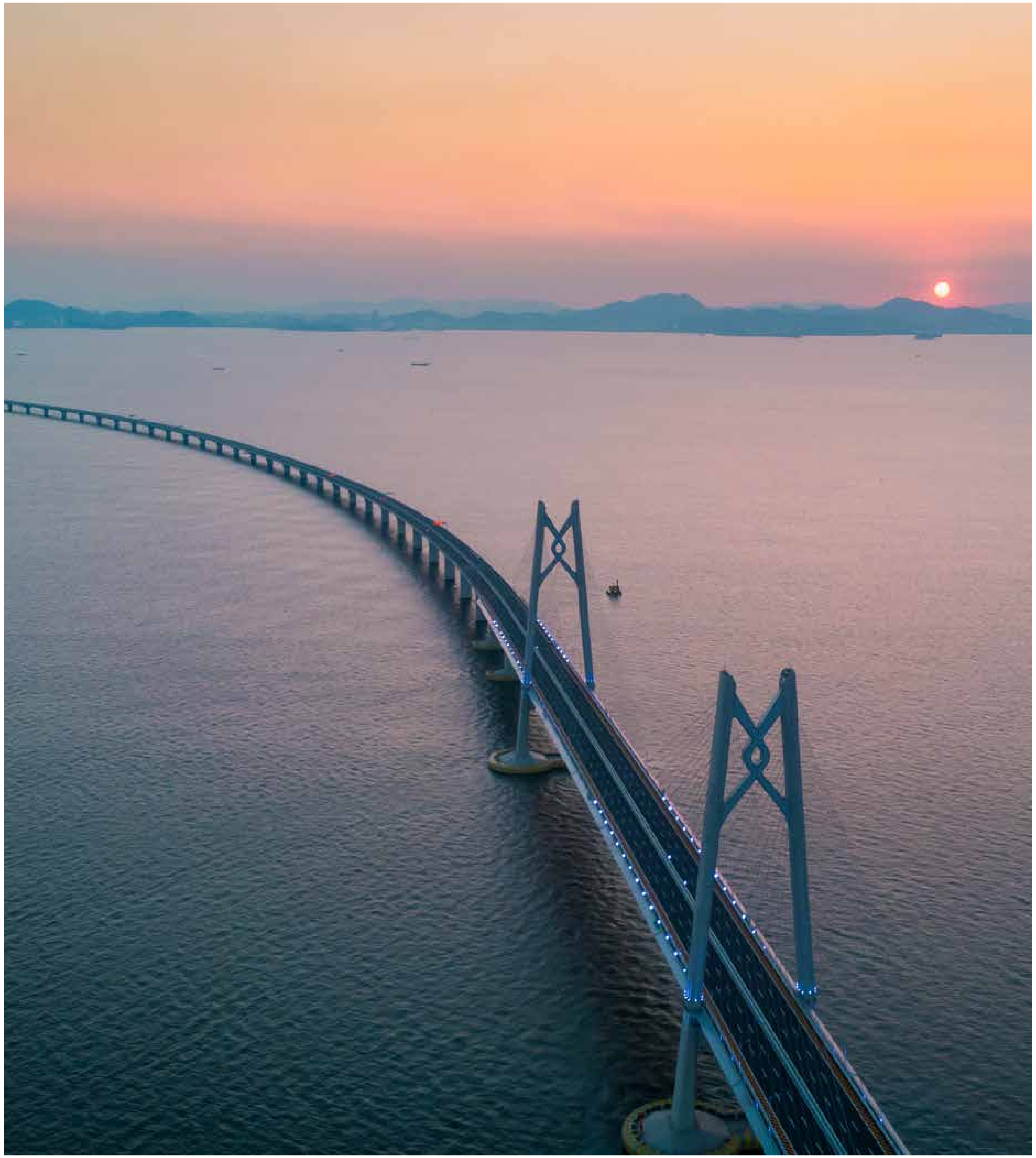
Developing a distribution strategy for China

Despite the sheer volume of wealth in APAC, the distribution channels available to overseas fund managers in key markets are either subject to prescriptive quotas – as they are in China and India – or closed entirely to foreigners as is the case in Indonesia. Nonetheless, China did reopen its Qualified Domestic Institutional Investor (QDII) programme following a three year interval, allowing eligible local investors to allocate cash to foreign managers.[4]

China is also approving private fund manager (PFM) licenses for investment firms operating WFOEs (wholly foreign owned enterprises) enabling foreign managers to invest in onshore assets and distribute to a maximum of 200 domestic qualified investors.[5] Unlike previous mainland access schemes, managers leveraging the WFOE structure do not need to enter into a joint venture or equity arrangement with a local, onshore financial institution.

However, reports have surfaced recently suggesting foreign fund manager authorisations under the QDLP (Qualified Domestic Limited Partnership), an outbound investment scheme available to affluent citizens in Shanghai, have been suspended despite the programme only resuming again in February 2018 after a two year pause.[6]

[4] Reuters (April 12, 2018) China revives QDII outbound investment scheme
[5] Boston Fund Selector Asia (December 17, 2018) SSGA granted WFOE license
[6] Reuters (October 10, 2018) China taps brakes on outbound investment, betrays capital flow fears



The early beginnings of regional distribution initiatives

UCITS and more recently the Alternative Investment Fund Managers Directive (AIFMD) have both created a degree of regulatory homogenisation inside the EU making it easier for firms to sell their products cross-border and globally without too many impediments.

Having witnessed the global success enjoyed by well-regulated EU fund wrappers such as UCITS and AIFMD, some of the more mature APAC markets are attempting to mirror the European approach by implementing their own Asia-centric funds' regimes designed implicitly to break-down the cross-border regulatory barriers obstructing fund distribution.

The ASEAN CIS, which encompasses Singapore, Malaysia and Thailand, is an example of one of these regional cross-border initiatives which launched in 2014. Adoption has so far been limited with only a handful of funds being fully authorised in this time.[7] Attempts to loosen some of the eligibility criteria under the ASEAN CIS[8] have not yet led to a groundswell in investor support. Nonetheless, ASEAN CIS' slow start has not prevented other APAC markets from pursuing their own cross-border fund distribution programmes.

The Asia Region Funds Passport (ARPF) covers Australia, Japan, South Korea, New Zealand and Thailand, and went live in February 2019 after many years of negotiations.[9] It will be interesting to see how ARFP develops given the experience to date with the ASEAN CIS. That said, it is still early days for these new schemes. UCITS, which is now the world's most recognisable mutual fund wrapper has been around for three decades, but the brand still took several years to cement itself. For these APAC initiatives to be successful and attractive to regional investors, they need to deliver economies of scale across a broad product range.

[7] International Adviser (September 19, 2018) Schroders and UOB AM join fund passport scheme
[8] Simmons & Simmons (March 6, 2018) Singapore: ASEAN CIS framework enhancements
[9] International Adviser (October 31, 2018) Asia region funds passport finally set to launch

MRF enters its fourth year

Mutual Recognition of Funds (MRF) between Hong Kong and China launched in 2015, enabling Hong Kong and Chinese asset managers operating vanilla strategies to distribute into each other's markets. Again, the level of investment since its inception has been relatively low, with few funds having been fully authorised for sale.[10,11] This has not deterred regulators in Singapore and China from trying to establish their own MRF access channel, [12]in effect replicating the Hong Kong-China fund distribution setup.

Most global asset managers will find it hard to ignore China as a long term market for distribution and MRF represents a relatively straightforward stepping stone towards achieving that objective. Since MRF went live with China, Hong Kong has extended it to a handful of European markets including Switzerland, France, the UK and most recently Luxembourg. While the schemes will ultimately provide allocators with more investment options, asset managers have yet to materially explore the benefits on offer.

[10] Fund Selector Asia (June 4, 2018) Outflows continue for northbound MRF products
[11] Ignites Asia (February 12, 2019) HSBC Global AM debuts first northbound MRF fund
[12] PwC (January 2019) Asset and Wealth Management Research Digest

APAC pivots towards new fund structures

Authorised funds in Hong Kong and Singapore have historically been set up as unit trusts, but efforts are being made by regulators in both jurisdictions to expand the number of available fund structures in order to win greater domiciliation share. Hong Kong's Securities and Futures Commission (SFC) introduced its own open ended fund structure (OFC) giving managers the option to establish a local fund in the form of a company in addition to a unit trust.[13] The number of SFC-authorised funds in Hong Kong has enjoyed steady growth, and the OFC's architects believe the new fund structure will help accelerate that even further.[14]

The Monetary Authority of Singapore (MAS) is pushing through with its own unique fund structure in the guise of the S-VCC (Singapore Variable Capital Company), which is due to be launched some time in 2019.[15] The S-VCC structure, which is able to avail itself to US "check the box" election, can be used by an array of open-ended and closed-ended traditional and alternative asset management strategies including hedge funds, private equity and real estate.[16] Many experts are confident the fruition of a flexible S-VCC structure will help elevate Singapore into a globally competitive fund domicile.[17]

Coinciding with the roll-out of the ARFP, Australia is launching its Corporate Collective Investment Vehicle (CCIV), a product which is modelled on the UK's Open Ended Investment Company (OEIC).[18] The CCIV's proponents believe the new vehicle could dramatically enhance the competitiveness of Australia's funds' industry at home and abroad.[19]

[13, 14] Clifford Chance (May 31, 2018) Hong Kong new open-ended company structure goes live in July 2018
[15] Asia Asset Management (June 7, 2018) Singapore to unveil new corporate structure for investment funds next year
[16, 17] PwC (2018) – Understanding the Singapore Variable Capital Company
[18, 19] K&L Gates (July 16, 2018) CCIV Regulatory Framework Revised for Consultation

Strengthening governance in Asian funds

Having seen the UK Financial Conduct Authority (FCA) push through with its Senior Managers and Certification Regime and launch a wholesale conduct study into the practices at asset managers, Asian regulators have begun to take similar steps. In 2016, Hong Kong's SFC unveiled its Manager-in-Charge regime, which introduced heightened accountability requirements for senior managers at licensed corporations. Following this, the SFC issued its Fund Manager Code of Conduct (FMCC) in 2018, outlining the responsibilities which asset managers should assume in the day to day management of their investment funds.[20]

FMCC demands firms adopt market misconduct and risk management policies and procedures, enhanced investor disclosures,[21] and exercise due skill, care and diligence during the selection and ongoing monitoring of their custodians.[22] It also tightens up on securities lending and repo transactions, leverage and liquidity risk management processes, insisting managers establish and document their policies on these activities, and disclose more information about them to clients[23] in what will align local rules with international practice.

The SFC is also revising key provisions contained in the Hong Kong Unit Trust Code, namely increasing the minimum capital requirements for management companies of authorised funds, codifying diversification rules and easing restrictions on investing in derivatives that are not futures, options or warrants.[24] The proposals also clarify the eligibility requirements for custodians and trustees, and further harmonises local rules governing these entities with the best practices outlined by the International Organisation of Securities Commissions.[25]

In Singapore MAS has introduced changes to its Securities and Futures Act (SFA), revising the definition of accredited investor and expanding the scope of what qualifies as an institutional investor to include sovereign wealth funds, supranational government organisations and central government agencies.[26] In addition, MAS is imposing new licensing requirements for entities dealing in OTC contracts[27] along with tighter oversight of financial benchmarks.[28] Finally, MAS issued guidelines which became effective in February 2019 on liquidity risk management practices at asset managers and[29] it is presently consulting with the industry about enhancing best execution rules for investment firms.[30]

[20, 21] RNorton Rose Fulbright (January 2018) Five things to know about the new Fund Manager Code of Conduct

[22, 23] AIMA (January 21, 2018) Hong Kong SFC amendments to fund manager code of conducts

[24, 25] Charltons (January 2019) Amendment to Hong Kong Code on Unit Trusts and Mutual Funds effective 1 January

[26, 27] Simmons & Simmons (November 15, 2018) Significant changes to the Capital Markets Regulatory Framework in Singapore: Pointers for the AMIF sector

[28] Linklaters (October 26, 2018) – Significant amendments to the Securities and Futures Act takes effect – what are the implications for your business?

[29] AIMA (January 21, 2018) Hong Kong SFC amendments to fund manager code of conduct

[30] KPMG (June 2018) Parting of the ways: Evolving asset management regulation report

An ESG regime for APAC

As the European Commission (EC) continues in its efforts to formalise guidance for ESG (environment, social, governance) investing and disclosures at asset managers, the SFC is pushing through with its own green finance initiative. In September 2018, the SFC announced it was looking to establish processes by which asset managers can make clear to investors how and to what extent they factor environmental criteria into their investment processes and risk assessments,[31] emulating the EC's Sustainable Finance Initiative.

With more investors asking asset managers to incorporate sustainability metrics into their portfolios, Hong Kong's efforts will put it on a solid footing to meet this emerging demand. ESG is certainly attracting greater regulatory interest in APAC more broadly, with Singapore and Malaysia becoming the latest markets in the region to introduce similar reforms.

[31] SFC (September 21, 2018) SFC announces green finance strategic framework

APAC's bright future

APAC regulators are actively observing and adopting the latest relevant international practices thereby helping to improve the competitiveness and global reach of their domestic asset management businesses. With an increasing investor focus on sustainability for instance, APAC regulators are responding quickly, introducing sensible, pragmatic policies to facilitate growth in these areas. Finally, APAC is taking a lead on augmenting cross-border distribution through its exciting new fund passporting initiatives, in what should help boost regional flows even further. In short, the future continues to look bright for APAC.

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