



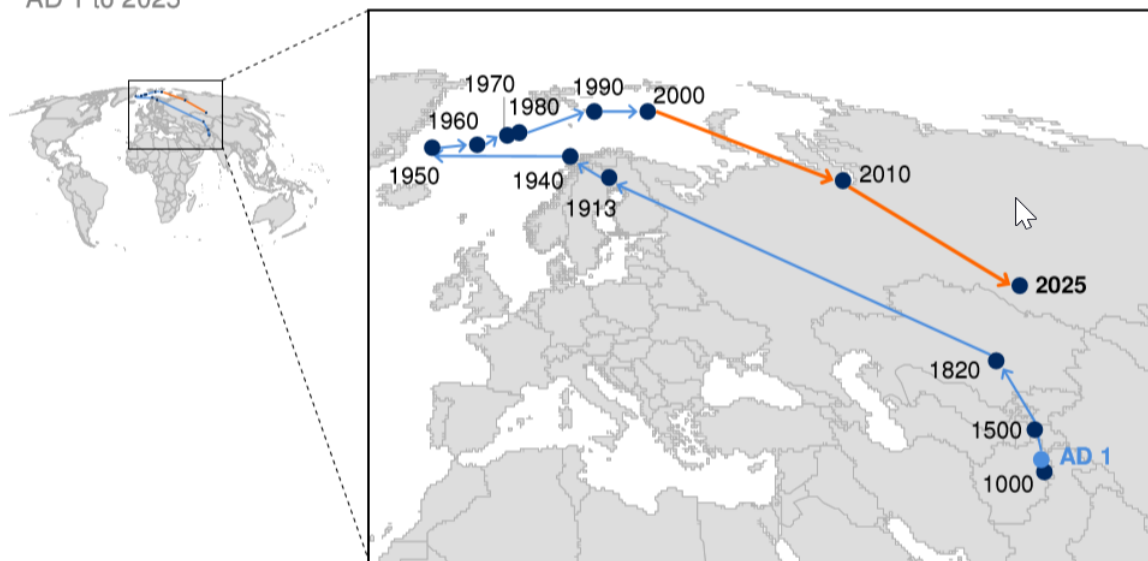
## Wealth, Investments and Evolving Regulation

You probably already familiar with the striking Global Economic centre of gravity [map](#) released in 2012 by McKinsey analysts:

## By far the most rapid shift in the world's economic center of gravity happened in 2000–10, reversing previous decades of development

Evolution of the earth's economic center of gravity<sup>1</sup>

AD 1 to 2025



<sup>1</sup> Economic center of gravity is calculated by weighting locations by GDP in three dimensions and projected to the nearest point on the earth's surface. The surface projection of the center of gravity shifts north over the course of the century, reflecting the fact that in three-dimensional space America and Asia are not only "next" to each other, but also "across" from each other.

SOURCE: McKinsey Global Institute analysis using data from Angus Maddison; University of Groningen

It took one century, from 1820 to 1913, for the centre of gravity (as measured by "weighing" locations' GDP) to move from Asia to Europe. After the second world war, that point moved across the Atlantic to the United States. In the 1960s, 70s, 80s and 90s, it remained in the western part of the northern hemisphere. Then a dizzying acceleration occurred. In just one decade, from 2000 to 2010, the centre swept back to Asia, reversing almost all the trends of the previous 2,000 years.

**Singapore** is one of the top power countries evolving at an unprecedented speed, rated as most likely destination to "park" the private wealth. According to [WealthInsight](#), one in 34 people in Singapore are millionaires. That makes it the sixth most millionaire-dense country in the world and the top across Asia.

The investment industry is a natural beneficiary of the growth in wealth and savings among the middle classes in Asean emerging markets. Assets of world's largest fund managers in Asia Pacific rose by 17%, higher than other regions in 2018, according to [press release](#) by Willis Towers Watson. Singapore's assets under management (AUM) expanded by 19% to US\$2.4 trillion in [2017](#). Alternative sector AUM increased by 17%, led by private equity (PE) and hedge fund managers.

Another critical economic and social factor contributing to the above engine of growth is the size of the "global middle class" which will increase from 1.8 billion in 2009 to 3.2 billion by 2020 and 4.9 billion by 2030. The bulk of this growth will come from Asia: by 2030 Asia will represent 66% of the global middle-class population and 59% of middle-class consumption, compared to 28% and 23%, respectively in 2009.<sup>1</sup>

[McKinsey](#) have reported in 2018 that there is a considerable shift from deposit to investment solutions, supported by instrumental regulatory regimes in Asia. It is expected that the 2017 revenue pool of \$66 billion of traditional assets, excluding alternatives, will almost double to \$112 billion over the next five years.

Asian investors are comfortable with active products, accustomed to high returns, and thus less sensitive to active fees, while in Europe and US passives are gaining significant share. Nearly 90 percent of total financial assets in Asia—or about \$110 trillion—are outside the asset management industry (compared to about 60 percent in the US and about 70 percent in Europe), presenting an obvious opportunity for the asset managers or third-party professional managers, using the Asian investment platform to go global and notably, capturing the rise of middle class and fintech savvy millennials.

In mature markets, like Japan, Australia, Taiwan, where rapidly aging societies and aggressive pension reforms create significant opportunity for third-party asset managers. According to McKenzie's predictions, in the next two years alone, its expect at least \$1.2 trillion of new inflows will become available to Asia's managers.

There are currently three schemes that have been introduced into the region but arguably the most ambitious is the Asia Region Funds Passport (ARFP) which contains the greatest number of markets and many in the industry have drawn parallels with the European UCITS regime.

The ASEAN Collective Investment Scheme (ASEAN CIS), Asia Region Funds Passport (ARFP) and Mutual Recognition of Funds (MRF) will not become brands in the short-term, but over the course of many years – as was the experience with the Undertakings for Collective Investment in Transferable Securities (UCITS), a cross-border mutual fund based in the European Union (EU), in its formative years from 1985 to 1992 (Full article can be found [here](#)).

The ASEAN CIS covering Singapore, Malaysia and Thailand is into its 4<sup>th</sup> year of operation however, reports suggest only 13 funds have launched under the scheme.<sup>2</sup> The Mutual Recognition of Funds (MRF) passport providing cross-border mobility between asset managers in Hong Kong and Mainland China has existed for almost two years, and there is some limited momentum behind it. Data from December 2016 revealed 47 southbound (Mainland China domiciled) funds, and six northbound (Hong Kong domiciled) funds are using MRF.<sup>3</sup>

Total of [13](#) participating APEC Members were invited to join Asia Region Funds Passport (ARFP) regime: Australia, Singapore, Hong Kong, Japan, Republic of Korea, Thailand, Malaysia, Indonesia, Vietnam, the Philippines, United States, Chinese Taipei and New Zealand.<sup>4</sup> The ARFP commenced on [1 February 2019](#) with Japan, Thailand and Australia able to receive and process registration applications from local prospective Passport funds and entry applications from foreign Passport funds from this date.

In June 2016, Australia, Japan, the Republic of Korea, New Zealand and Thailand entered a memorandum of co-operation ("MoC"). New Zealand has consulted on draft regulations required to implement the rules into New Zealand law. It anticipates that it will complete preparations for implementation and be ready to receive registration applications under the ARFP by the end of July 2019. Singapore's asset managers with sufficient critical capital will be able to apply, most likely at the end of this or next year.

We agree with [Deloitte's assertion](#) that the ARFP framework would surely place Singapore on the map for asset managers willing to distribute to the greater APAC region, similarly of the business case of Luxembourg within European context.

The ARFP emphasises investor protection by ensuring that participating countries must meet international [IOSCO](#) standards. The ARFP will complement the existing cross-border distribution schemes in the region such as the UCITS and master-feeder fund structures.

In the longer term, the passport could also facilitate funds from the Asia region being marketed in Europe through an Asian/European mutual recognition agreement.

**To qualify for the ARFP, the fund must:**

- a) Be constituted or established as a regulated Collective Investment Scheme (CIS) or a sub-fund of a regulated CIS in one of the participating ARFP jurisdictions
- b) Be distributed in its home jurisdiction
- c) Have financial asset in CISs of at least USD 500m in total net asset value.
- d) Only invest in specific asset classes: transferable securities, money market instruments, deposits, depositary receipts over gold, derivatives, units of other funds. Further details are in the ARFP rules document

The fund's operator must have a minimum capital of USD 1m, plus 0.1% of Assets under Management (AuM) above USD 500m of AuM, up to USD 20m. Passport Funds will only be able to invest in liquid assets, to allow investors to redeem interests as and when required. The ARFP commits to a 21-day application review timeline for ARFP eligibility.

### **Industry implications**

Funds in most Asian economies are largely domestic strategy funds. The ARFP will be an excellent opportunity for asset managers to distribute their unique strategies to new markets. Local asset managers will face increased competition from foreign asset managers, likely leading to a downward pressure on fees. Retail investors will benefit from a wider range of fund investment products to choose from.

Main takeaways of published APEC Guidance on passporting rules, Host Economy Obligations, [Annex 1](#), Passport Funds will not be required to be licensed in order to approach a qualified distributor where retail investors are not involved. **For Singapore**, a qualified distributor may be restricted to certain entities such as banks and holders of a capital markets service licence. **For Australia**, a qualified distributor would be the holder of an Australian financial services licence authorised to deal in interests in managed investment schemes.

### **Challenges for asset managers**

Currently, host jurisdictions' rules significantly differ in areas such as disclosure requirements. In addition, unequal tax treatments between local and foreign funds also hamper foreign fund attractiveness and comparability.

Asset managers also face challenges in managing an effective distribution model such as:

- Currency restrictions in South Korea and Thailand: onshore FX requirements, overall foreign investment quota, foreign currency transaction restrictions
- Fund operator responsibility for appointing suitable local representative, distributor and transfer agent in host jurisdiction(s)

They also must choose the most suitable product for the target market(s), avoiding aggressive sales of local distributor partners and offering competitive fees against local funds.

The next face-to-face meeting of the JC is planned to take place in Singapore in October 2019.

According to a research commissioned by Calastone, titled '[The Impact of Technology and Regulation for Funds](#)', only 7% of surveyed participants considered ARFP to have the best chance of success relative to other cross-border fund distribution schemes. Comparatively, 29% of participants are confident in the Mutual Recognition of Funds (MRF) between Hong Kong and mainland China, which was first implemented in 2015.

The research highlights that:

- 93% of respondents say the amount of effort required to comply with regulations in the funds industry has increased. The second version of the Markets in Financial Instruments Directive (MiFID II) has created the most work

- 72% say a side-effect of regulatory compliance is underinvestment in other parts of the business
- 79% say the cost of regulation will ultimately be borne by the end investor
- 80% say legacy technology is a problem for the funds industry, especially in the back office
- 19% say asset managers are good at adopting new technology (down from 21% in last year's survey)
- Out of a list of emerging technologies, blockchain is expected to have the biggest impact.

Interestingly, the answer to the question why the asset managers weren't good at adopting new technology was overwhelming towards cost considerations and lack of focus on internal operations efficiency and "innate conservatism of the industry". One of the respondents gave a strong answer: "It's because you have a bunch of old people at the C-levels of asset management who have allergic reactions to the thought of change or evolution". In our opinion, an arguable statement, there are plenty of seasoned "old People" with a proclivity to innovate and strong digital footprint, driving the priority of implementing technology for a strong processes and internal requirements, investing in their own "end-user experience", ultimately seeing the big picture of driving up the firms' competitive market positioning. Especially if you consider that the composition of investors in the funds industry is changing, with millennials poised to become an increasingly important client target for asset managers in the next 5 to 10 years, the culture of asset managers ought to adapt to a digitally astute demographic, without significant sums of money to invest.

We can help with directing you to relevant well positioned FinTech and Regtech solution providers, offering compatible tools to automate your operations within your regulatory mandate.

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<sup>1</sup> [http://oecdobserver.org/news/fullstory.php/aid/3681/An\\_emerging\\_middle\\_class.html](http://oecdobserver.org/news/fullstory.php/aid/3681/An_emerging_middle_class.html)

<sup>2</sup> Chris Wright. "Asia: Malaysia's IOSCO coup might kick-start Asean progress," euromoney.com, 20 March 2017, <http://www.euromoney.com/Article/3670244/Asia-Malysias-IOSCO-coup-might-kick-start-Asean-progress.html>

<sup>3</sup> Paul Treanor. "HK-China Mutual Recognition of Funds – Slow start belies market potential," bravurasolutions.com, 20 January 2017, <https://bravurasolutions.com/blog/2017/01/hk-china-mutual-recognition-of-funds-slow-start-belies-market-potential/>

<sup>4</sup> Key reference documents: [Consultation on rules and operational arrangements](#); [Consultation on ARFP Guidance on host economy laws and regulations](#)