New City Initiative

Facilitating Connectivity

Strengthening UK-APAC Fund Ties

Introduction

Despite the relentless political uncertainty gripping the UK, the country's position as one of the dominant centres for investment management in the world remains unaffected. Second only to the US by size, the UK's asset management industry is responsible for overseeing £7.7 trillion in capital, of which £3.1 trillion are mandates on behalf of foreign investors, a figure that is largely unchanged since 2017.[1] The European Economic Area (plus Switzerland) accounts for the majority (59%) of the foreign sourced assets controlled by domestic UK fund houses although non-EEA capital comprises a large proportion of that AuM total too.[2]

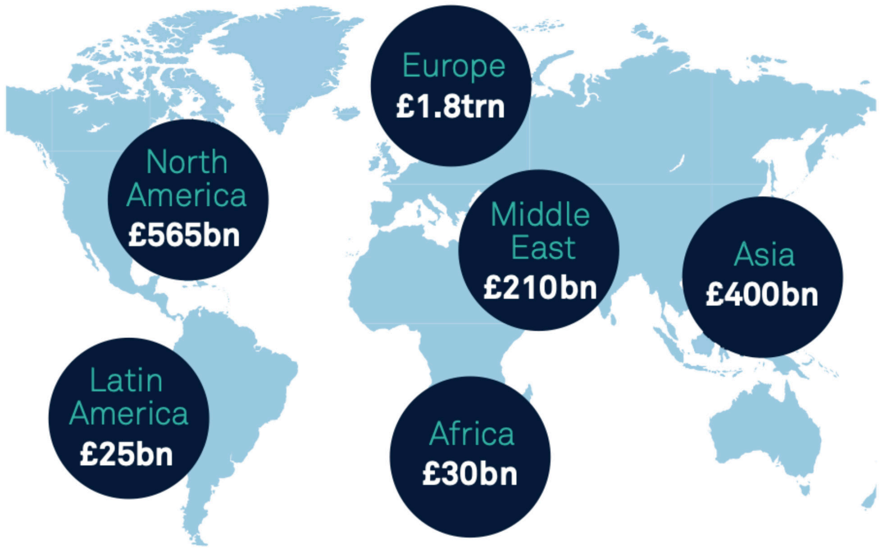


Figure 1: Assets managed by UK firms for overseas clients[3]

Focusing in on APAC

A lot of the UK investment products that are currently sold to institutional and retail clients in Asia-Pacific (APAC) are regulated under EU law, principally either UCITS or the Alternative Investment Fund Managers Directive (AIFMD). Among the primary distribution target markets in APAC for UK UCITS and AIFs are Hong Kong, Singapore and Taiwan, although Korea and Japan have seen demand spike for UCITS recently. Nonetheless, several countries – principally China and Indonesia – remain largely off-bounds either precluding or severely restricting foreign asset managers from freely distributing their funds to local investors.

1 Investment Association (September 2019) Investment management in the UK 2018-2019
2 Investment Association (September 2019) Investment management in the UK 2018-2019
3 Investment Association (September 2019) Investment management in the UK 2018-2019

Brexit fallout does not spare APAC

Initially, there were fears that a Hard Brexit would severely disrupt the global distribution strategies at UK managers, albeit those regulated under UCITS and AIFMD. This was because the status of UCITS/AIFMD's delegation arrangements –which a number of UK and non-EU managers rely on – appeared to be in the balance at one point. Had delegation (i.e. the right for a manager to use an EU ManCo, which outsources risk and portfolio management back to a third country manager) been removed, then third country managers (including those in the UK post-Brexit and APAC) would have had to establish subsidiary branches in the EU at great cost and effort if they were to avail themselves to UCITS/AIFMD distribution benefits.

Not only would the removal of delegation rights have restricted UK managers from selling into the EU, but it could have caused problems for UK UCITS/AIFMs with APAC clients, a number of whom have procured units in such funds because they like the protections which the regulations give them. Elsewhere, it risked unsettling APAC-based managers who leverage the UCITS/AIFMD frameworks via Luxembourg or Ireland-based ManCo structures to sell their products to EU and APAC clients. Given the significantly smaller size of the average APAC asset manager's AuM – relative to firms in North America and Europe - most would have been priced out of launching a UCITS/AIFM altogether had delegation vanished.

While EU regulators will certainly adopt rigid provisions to placate the risk of letterbox entities emerging, the current delegation rules are unlikely to be changed. Even though ultimately the third country fund manager assurances have been forthcoming, the entire incident has damaged the EU's reputation especially in APAC circles. Moreover, the EU's ongoing refusal to extend the much vaunted AIFMD marketing passport to core APAC jurisdictions (namely Hong Kong and Singapore) has done little to help matters either. Some experts see this impasse as an opportunity for the UK to exploit.

Could a UK fund structure break into Asia?

There are several ways in which the UK funds' industry could strengthen its distribution footprint in key APAC markets. The first would be to create a UK-branded fund structure, one that could potentially compete with UCITS or AIFMD on a global scale. The UK is home to a wide range of asset management talent, best in class service providers, a deep pool of legal and accountancy expertise, and an excellent regulatory regime in the form of the FCA (Financial Conduct Authority). Moreover, this fund structure could support the re-onshoring of fund servicing jobs (i.e. accountancy, legal, administration) into the UK away from existing hubs such as Luxembourg and Ireland. One NCI member said special economic zones modelled on Ireland's International Financial Services Centre could be developed in some of the more deprived parts of the UK and could help to stimulate regional economic growth.

If the UK-EU trade negotiations this year succeed in establishing an equivalence deal for managing and distributing funds, the opportunity for creating a new UK branded funds' regime may become more complicated and longer term. But if post-Brexit equivalence falls short, then the opportunity and impetus for the UK to create its own new fund regime and to build in mutual links with APAC, and the rest of the world, becomes greater. The UK undoubtedly has the infrastructure and skills depth to create a funds' regime on its own. But what would such a fund structure look like?

Firstly, any UK fund structure would need to incorporate the investor protections enshrined in UCITS and AIFMD, although there is scope to certainly improve upon them. For instance, the FCA has publicly stated that some of the prescriptive liquidity arrangements mandated under UCITS need some revisions in light of the Woodford episode earlier in 2019. However, one NCI member suggested relaxing a limited number of UCITS/AIFMD provisions, advising that any new UK funds' regime should loosen the tough capital requirements currently imposed on UK asset managers - at least on those not actively selling products into the EU.

In order to make a UK branded fund structure attractive to APAC investors, one lawyer in the region said the UK would need to simplify the existing tax treatment rules for foreign investors. "The UK unit trust and open ended investment company (OEIC) never took off in APAC because the UK tax regime is too complicated whereas Luxembourg and Ireland are more straightforward. If a UK fund structure is to succeed, it must be tax neutral just as it is in the Cayman Islands, Channel Islands, Ireland, or Luxembourg," acknowledged the lawyer.

In time, the UK could forge delegation agreements with different APAC markets enabling local managers to leverage a new well-regulated UK fund structure without having to establish a subsidiary/branch in the UK. This – in effect – mimics the existing EU delegation framework – although it would be a UK ManCo which outsources portfolio and risk management back to the third country manager. Given the UK's reputation for excellent regulation and client protections, this setup should appeal to APAC investors and managers.

Creating a UK funds' regime and successfully marketing it as a global brand will, however, not be an easy-going process. In the context of the fractious EU-UK relationship, it would be politically unpalatable for EU regulators to contemplate equivalence for a UK branded fund structure irrespective of whether it complies with UCITS/AIFMD let-alone competes with them. An NCI member said a UK fund structure would also need to differentiate itself from AIFs and UCITS if it is to find broader appeal. He said efforts by industry bodies such as the Investment Association to create a long-term asset fund were a step in the right direction. The lawyer concurred. "One of the things that AIFMD does not do is it fails to differentiate between hedge funds and private equity. I think any future regulation needs to make sure that there is delineation between liquid, open end funds and close ended funds," he said.

Leveraging existing connectivity channels between Asia and the UK

The UK has deep and historic links with Asia and it should seek to leverage them if it is to enable domestic managers to widen their APAC footprints. Firstly, the UK and Hong Kong are both signatories to a Mutual Recognition of Funds (MRF) scheme, a bilateral regulatory framework which allows mutual funds in the two jurisdictions to be distributed into each other's market through a streamlined authorisation process.[4] While MRF activity to date has been notably slow, the UK's FCA should consider negotiating MRFs with other key markets in the region including Singapore, Taiwan, Japan, Australia, New Zealand and Korea.

4 BNP Paribas Securities Services (April 4, 2019) Hong Kong Mutual Recognition of Funds

And then there is China...

The APAC lawyer conceded that Hong Kong's MRF with EU markets is unlikely to flourish, mainly because there are not enough retail investors in the former whereas potential customers in the latter are more inclined to purchase European versions of Hong Kong funds. That said, an MRF between the UK and China would be an excellent opportunity for asset managers and investors in both markets. UK regulators should nurture their blossoming relationship with China through the roll-out of an MRF scheme to rationalise cross-border distribution, a move which would give UK firms access to one of the world's biggest untapped investor markets.

The UK and Chinese financial systems are already heavily interconnected, evidenced by the fact that London is the leading trading and clearing hub for offshore RMB transactions. Such close collaboration between the two markets could be pivotal if the UK tries to strike an MRF deal with China.

Partaking in regional passporting schemes

Certain markets within APAC are attempting to simplify cross-border fund distribution through harmonisation initiatives such as the ASEAN CIS (Collective Investment Scheme) and ARFP (Asia Region Funds Passport). By optimising the authorisation process, regulators hope to incentivise more local fund managers to sell their investment products on a cross-border basis. Both passporting schemes – which are largely modelled on the UCITS/AIFMD frameworks – could potentially remove a number of the obstacles which have traditionally blocked asset managers from distributing their products outside of their home markets.

Fund passporting scheme	Impacted markets
ASEAN CIS	Malaysia, Singapore, Thailand
ARFP	Australia, Japan, Korea, New Zealand, Thailand

While ASEAN CIS is yet to acquire critical mass even though it launched five years ago, experts are confident ARFP will be a greater success owing to the fact that more countries are participating in it. The UK should not only support these regional fund passporting initiatives, but become a signatory to at least one or both. If the UK were to become an ASEAN CIS/ARFP participant, this could enable its fund managers to target large swathes of investors in fast growing emerging markets and APAC financial hubs. The schemes would also provide UK investors with easier access to a wider range of asset management talent.

It is also important not to underestimate some of the fragilities afflicting the various APAC passporting schemes. Foreign exchange and capital controls in some markets along with arbitrages around taxation and regulation have impeded the development of a number of these APAC cross-border distribution programmes.[5] Just as the framers of the Capital Markets Union (CMU) in the EU are trying to eliminate divergences across AIFMD and UCITS across the EU-27, some believe the legal and cultural differences in APAC are simply too insurmountable for these well-intended passporting schemes to truly take off and flourish.

"When people talk about fund passporting initiatives, they look at UCITS and say how wonderful it is. But UCITS has been around for 30 years and it still faces challenges. There are huge regional differences in terms of corporate governance, currency, language and regulations in APAC. In theory, if the UK were to kickstart ASEAN CIS or ARFP, it could work but it would be very difficult and it is unlikely to take shape overnight," said the lawyer.

A saturated market

While APAC offers enormous potential, it does have an abundance of existing fund structures making it hard for a UK fund brand to compete, especially in such a saturated marketplace. For instance, Singapore's VCC (Variable Capital Company) is a new fund structure being promoted by the Monetary Authority of Singapore and is expected to be launched later this year. The VCC will be available to managers of open ended and closed ended funds and comes as Singapore is positioning itself as a fund domicile. In addition, Hong Kong is developing an open ended fund structure as is Australia, which is set to roll out its Corporate Collective Investment Vehicle, a product that is very similar to the UK OEIC.

Conclusion

For many, UCITS' position is unassailable and it is rightly regarded to be the world's premier mutual fund regulatory wrapper, having accumulated net assets in excess of EUR 10 trillion, a figure which the Association of the Luxembourg Fund Industry (ALFI), an industry group, estimates will reach EUR 42 trillion by 2048. That is not to say a UK fund structure cannot compete with UCITS or AIFMs, but it is an undertaking that will consume enormous amounts of time, investment, patience and effort on the part of regulators and industry. However, NCI believes this is an initiative which is entirely achievable and could be potentially rather lucrative for the UK and Asian economies.

5 Euromoney (June 2017)Fund passporting in Asia-Pacific: A long journey

NCI Proposals

- The UK funds' industry has an excellent opportunity to further cement itself in APAC. UK policymakers/regulators should do this by developing a UK-own fund brand to compete with UCITS and AIFs in the region.
- The establishment of such a UK fund brand will require input from industry and government, and this is something the NCI is willing to facilitate in coalition with other associations and market participants. The process of setting up this new fund structure will not be easy, but NCI believes it is certainly achievable.
- As the representative of leading owner managed firms in the UK and Europe, NCI has already extended the UK fund management community's links with APAC through the 2019 launch of NCI Singapore with 11 founding members.
- The UK should further leverage the MRF scheme with Hong Kong, and regulators ought to negotiate further MRFs with other critical markets, most notably China.
- The UK should become a signatory to a regional fund passporting regime such as the ARFP or ASEAN CIS in order to maximise its APAC distribution footprint.

New City Initiative Members

UK Members

Alvarium Investments	Bentley Reid & Co.	Brown Advisory	Cape Ann Asset Management
Columbus Point LLP	Dalton Strategic Partnership LLP	Edgbaston Investment Partners	Evenlode Investment Management
Findlay Park Partners LLP	Guinness Asset Management	Highclere International Investors	Independent Franchise Partners LLP
Kennox Asset Management Limited	Kiltearn Partners	Latitude Investment Management	LGT Vestra LLP
Longview Partners LLP	Majedie Asset Management Ltd	Marathon Asset Management	Mayfair Capital Investment Management Ltd
Morant Wright Management	Northill Capital LLP	NS Partners Ltd.	Oldfield Partners LLP
Orbis Investments	Phoenix Asset Management Partners Ltd	Polar Capital	Record Currency Management
Revera Asset Management	RWC Partners Ltd.	Sanderson Asset Management	Sanlam Four Investments Ltd
Seilern Investment Management	Silchester International Investors	Somerset Capital Management LLP	Stanhope Capital LLP
Stonehage Fleming Family & Partners	Troy Asset Management Limited	Waverton Investment Management	

Continental Members

Comgest S.A.	Quero Capital	Skagen Funds

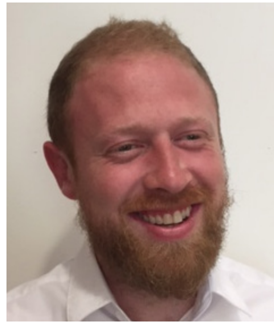
About the New City Initiative

NCI is a think tank that offers an independent, expert voice in the debate over the future of asset management.

Founded in 2010, NCI counts amongst its members some of the leading independent asset management firms in the City and the continent. The NCI gives a voice to independent, owner-managed firms that are entirely focused on and aligned with the interests of their clients and investors.

Over the last decade, a traditional “client-centric” approach has enabled entrepreneurial, owner-managed firms to emerge as an important force in a financial industry dominated by global financial giants. Now, more so than ever, these firms play a key role in preserving the stability and long-term focus of the financial sector, which is of benefit to society at large.

About the Author



Charles Gubert

Charles Gubert is a consultant to the NCI. He is founder of GTL Associates, a research, copy-writing and marketing consultancy to financial services institutions, and a contributing editor at Global Custodian Magazine. Prior to this, he was a research manager at Thomas Murray IDS, a consultancy and editor at COOConnect, an online title aimed at chief operating officers at alternative and long-only fund managers. He started his career as a reporter at Risk Magazine and Hedge Funds Review.

Office

New City Initiative
3rd Floor, Princes Court
7 Princes Street
London
EC2R 8AQ

+44 (0)20 7157 9541
www.newcityinitiative.org
secretariat@newcityinitiative.org
@NCityInitiative

www.newcityinitiative.org
@NCityInitiative

New City Initiative, 16 Babmaes Street, London SW1Y 6AH