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Bimonthly Report

3W Tax Regulatory Fund Distribution
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September/October 2013

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What's new?

Editorial

Wim Piot

Partner, Tax Leader

Operational taxes and tax transparency are reshaping the AM industry

In the wake of the financial crisis we have seen a number of developments which are reshaping the tax environment in which the asset management industry operates. An increased focus on tax transparency, enhanced cooperation between governments and additional tax obligations are forcing AM players to adapt to the new globalised business context.

In addition, as countries across the globe seek to reduce their public deficits, the AM sector is increasingly seen as an additional source of revenue. This has resulted in a wide array of measures and actions taken by the governments of many different countries with a view to making the industry contribute.

One of the main disadvantages of these unilateral national initiatives is the lack of harmonisation of the corporate and individual taxation framework. Which kind of information seems to be ultimately the most important for investors? It is paramount for investors to have a clear and detailed understanding of the composition of their revenue – including investment fund income – so that they can make the most of the tax advantages available in their country of residence.

Tax reporting processes are already in place in some European countries (Austria, Belgium, Germany, Sweden and the UK). While complying with those processes is not a legal obligation, the tax rate applicable if a company does not comply with those countries' tax reporting requirements is so high that it effectively forces fund managers to provide the tax reporting information.

These tax reporting initiatives combined with the recently introduced OECD Base Erosion Profit Shifting ("BEPS") report, the implementation of the Foreign Account Tax Compliance Act ("FATCA") in the US and the move towards an automatic exchange of information are shaping the industry's future. The introduction of national financial transaction taxes in countries such as Italy and France and the fact that the idea of a European financial transaction tax is still on the horizon will also have a significant impact on the industry.

The increased level of complexity in taxes and the much broader range of tax obligations and risks in more jurisdictions and at all levels of the fund business model require appropriate responses.

In this context, more and more major investors, looking to limit those risks, require detailed product and market information before they commit capital.

Consequently, the drive towards transparency and information exchange (e.g. FATCA and the EU Savings Directive), needs to be addressed by the AM industry with a more strategic review of the data requirements to reduce future implementation costs.

In addition, the introduction of financial transaction taxes in certain European countries and, possibly, at European level, and the plans for the automatic exchange of information mean that industry players should expect to significantly invest in IT and other infrastructure. This will increase operational pressure and drive up costs.

Increased withholding taxes and capital gain taxes will result in lower returns on investment as well. Therefore, this requires careful management of the risks associated with these taxes, together with diligent compliance work in order to obtain refunds or exemptions.

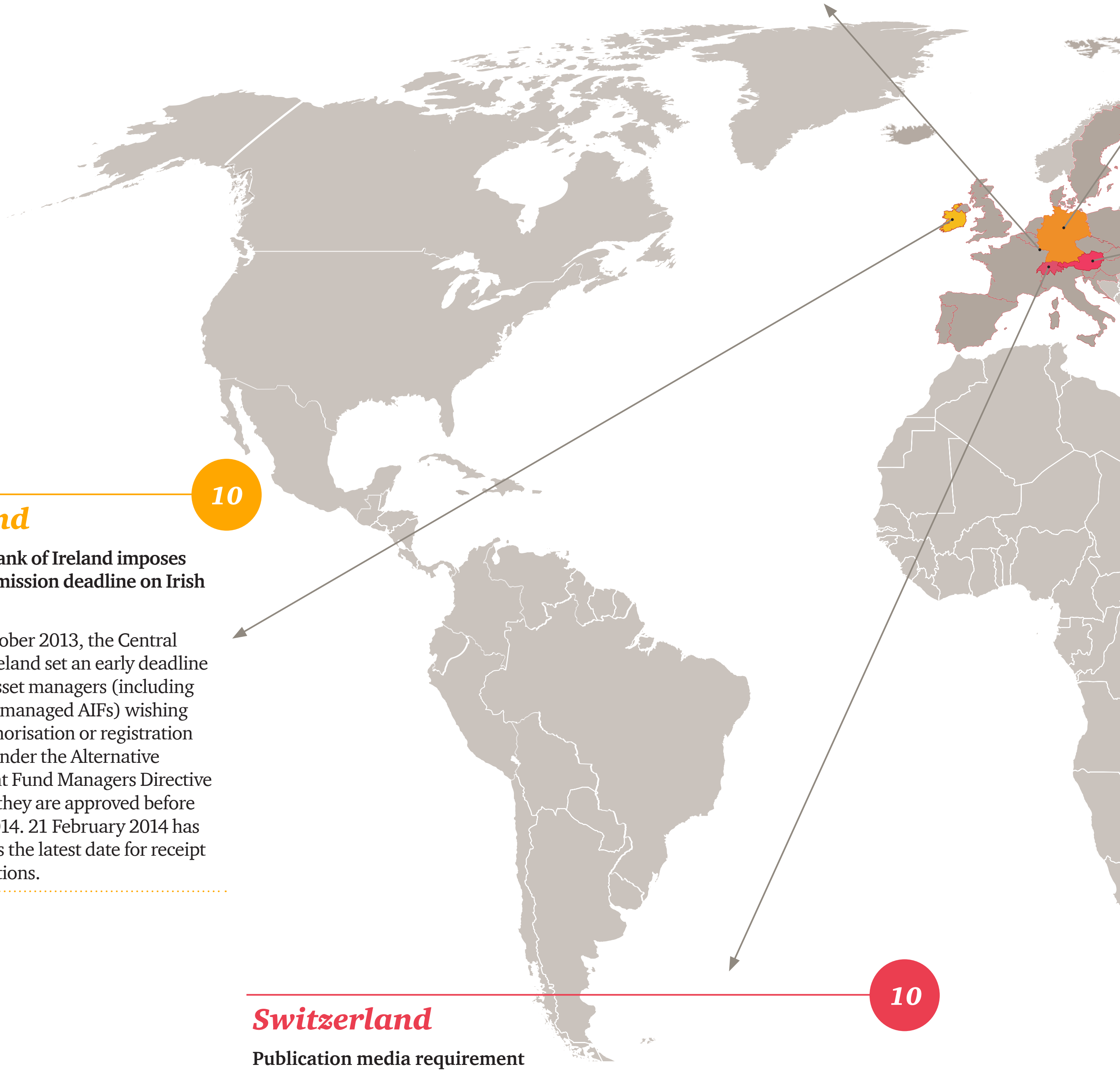
Despite these changes and the need for the AM industry to adjust its strategy, a recent survey led by PwC UK[1] shows that two thirds of industry players have no strategic policy to manage operational taxes, one quarter of asset managers have no internal operational tax resource and one third of industry respondents have no operational tax risk controls.

In this changed landscape, asset managers must comply with greater tax transparency requirements while they are faced with continuing uncertainty and greater tax complexity.

Being successful will depend on recognising these taxes as a critical business risk and taking appropriate measures to anticipate the impact on profitability.

[1] The asset manager's new normal. http://www.pwc.co.uk/asset-management/publications/the-asset-managers-new-normal-preparing-your-fund-for-tax-reporting-and-transparency.jhtml

Hot topics



Europe

8

Timing questions remain for AIFMD reporting

ESMA published its Final guidelines on reporting obligations under Articles 3(3)(d) and 21(1), (2) and (4) of the AIFMD on 1 October 2013. The guidelines are the final clarification on how firms should operate in practice under the AIFMD requirements.

Ireland

10

Central Bank of Ireland imposes early submission deadline on Irish AIFMs

On 21 October 2013, the Central Bank of Ireland set an early deadline for Irish asset managers (including internally managed AIFs) wishing to file authorisation or registration requests under the Alternative Investment Fund Managers Directive to ensure they are approved before 22 July 2014. 21 February 2014 has been set as the latest date for receipt of applications.

Switzerland

10

Publication media requirement

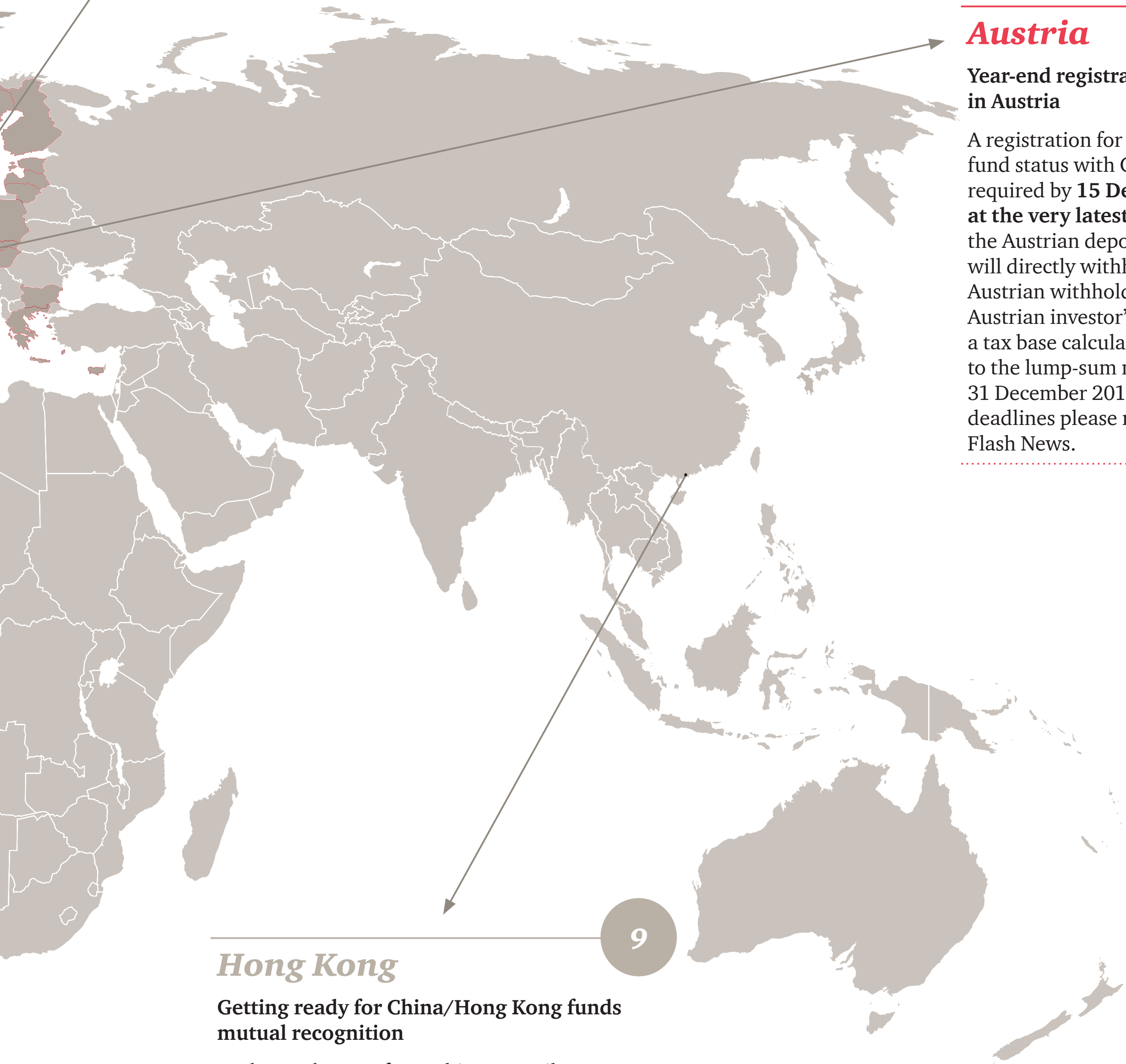
According to the partially revised ordinance on collective investment schemes (Art. 39 of CISO), foreign collective investment schemes must specify in the prospectus for Switzerland, in the specific information for Swiss investors, **one or more media of publication** in which the information required by Swiss law shall be made available to investors.

9

Germany

Payment of 2014 annual fees to BaFin – Important change

From 2014, foreign investment funds authorised for distribution to the public in Germany are no longer required to pay the annual fee by 1 January of each year of their own accord. BaFin will send an invoice to each ManCo/Fund concerned, stating the exact amount to be paid and the new payment ID.



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Austria

Year-end registration deadlines in Austria

A registration for the reporting fund status with OeKB is required by **15 December 2013 at the very latest.** Otherwise, the Austrian depository bank will directly withhold the 25% Austrian withholding tax on the Austrian investor's deposit, using a tax base calculated according to the lump-sum method as at 31 December 2013. For other deadlines please refer to the Flash News.

9

Hong Kong

Getting ready for China/Hong Kong funds mutual recognition

As demand grows from Chinese retail investors for mutual funds, Hong Kong will become the gateway for asset managers to mainland China. This presents significant opportunities, since Chinese savers have more than USD 6.5 trillion in bank deposits to invest.

Austria

25 October 2013

Year-end registration deadlines in Austria

This Newsflash is to remind you of the year-end registration deadlines for Austrian reporting funds with OeKB. These registration deadlines are important in order to avoid the deduction of a lump-sum tax on the deposits of Austrian private investors at calendar year-end.

Please note that the lump-sum withholding tax deduction generally applies to Austrian private investors only.

Are you affected?

- If your range of share classes subject to Austrian tax reporting has remained unchanged since the last annual tax reporting, no action is required on your part.
- If you already have a process in place which ensures that all required share classes are registered with OeKB or if you have agreed on a separate registration process with us, no action is required on your part.

In these two cases, please only consider this Newsflash for information purposes for upcoming years.

Action on your part is only required if any new or existing non-reporting share classes were sold to Austrian investors during this calendar year.

Legal framework

With respect to OeKB registration of share classes for the year 2013, the following deadlines apply:

- 15 November 2013:
  - o For share classes which were newly registered for public distribution with the Austrian Financial Market Authority (FMA) before 15 November 2013.
  - o For share classes which are not registered with the Austrian FMA for public distribution, but were sold on a private placement basis in Austria before 15 November 2013.
- 15 December 2013:
  - o For share classes which are registered with the Austrian FMA for public distribution or are sold on a private placement basis in Austria after 15 November 2013.

A registration for the reporting fund status with OeKB is required by **15 December 2013 at the very latest.** Otherwise, the Austrian depository bank will directly withhold the 25% Austrian withholding tax on the Austrian investor's deposit, using a tax base calculated according to the lump-sum method as at 31 December 2013.

What does it mean for you? Please compare the share classes currently listed as reporting funds on the website of OeKB (see our guide in ***Appendix p.14***) with your records of share classes in which Austrian investors are invested.

If the registration of additional share classes as reporting funds is required within this calendar year, please contact your Austrian tax representative.

Cyprus

28 October 2013

Update on legislation governing Alternative Investment Funds ("AIFs") and Collective Investment Schemes having a limited number of investors

The proposed legislation is currently being reviewed by Cyprus's Attorney General.

However, CySEC has issued a Consultation Paper regarding the issuance of several Directives which will govern the implementation of the AIF legislation. Such Directives relate to AIF restrictions on investments as well as the terms governing the marketing of AIF units in Cyprus, the structuring of the marketing network and the obligations of a person that is part of the units' marketing network.

The main provisions of the proposed legislation include the following:

	Mutual Fund	Variable or Fixed Capital Investment Company	Limited Partnership
Manager	External manager	• Internally or externally managed • Requirements for self-management: the BoD should appoint at least one person responsible for management who should be licensed and on the CySEC register of approved persons	• Manager is General Partner • External manager
Legal Structure	No legal structure	Limited liability Company	Partnership
Relevant Laws	• AIF Law	• AIF • Company Law	• AIF • Company Law
Initial Capital requirements	>EUR 125,000	• Self-managed: EUR 300,000 • Externally-managed: EUR 125,000	N/A

Information to investors

The information CySEC should be provided with includes:

- prospectus (according to the requirements of the AIFM Directive and including additional requirements for retail investors), and
- annual and half-yearly reports.

Annual and half-yearly reports should be made available to investors six months following year-end and two months following the half-year end, respectively.

Marketing of AIF units of other member states or third countries in Cyprus

- AIFs managed by AIFMs which are governed by the AIFM Law registered in other member states or third countries can distribute their units within the Republic of Cyprus according to the AIFM Law.
- Non-EU AIFs can market their units in the Republic of Cyprus only if they are under constant supervision in their home country and comply with relevant local regulations. They are required to obtain a license from CySEC (CySEC is in the process of drafting and issuing a Directive governing the marketing of AIF units in Cyprus).

Collective investment schemes having a limited number of investors

The main characteristics of such schemes are:

- They are not considered to be AIFs.
- Their legal structure can take the form of a limited liability company or a limited partnership.
- There are no requirements for the appointment of an Investment Manager.
- There is a requirement for a custodian which has a registered office in Cyprus, or in another member state or in a third country but has a permanent establishment in Cyprus. The custodian could be a credit institution or investment firm or other regulated entity.
    - o The following are exempt from the requirement of having a custodian:
        - AIFs whose assets are less than EUR 1.5m, and
        - AIFs whose assets are not subject to safekeeping requirements (i.e. property).
- Statutory documents or partnership agreement should include the following provisions:
    - o restrict the number of investors,
    - o restrict the right to transfer shares,
    - o prohibit any public offerings for the purchasing of units (public means retail and professional investors), and
    - o prohibit issue of bearer shares.

What does it mean for you? For your information only.

29 October 2013

Update on AIFMD implementation

Following the implementation of the AIFM Law, the Cyprus Securities and Exchange Commission ("CySEC") has issued a Directive and two Circulars governing the distribution of AIFMs and requirements to be met by them. The provisions of the Directives govern a number of areas. They include:

- the procedure and conditions for granting a licence to operate as an AIFM as well as the procedure to apply for such a licence. More specifically, the Directive provides the applicants with the required forms as well as specific information and documents that should be submitted as part of the licence application.
- the determination of the registration fees and annual contributions payable to the Commission by AIFMs.

CySEC also issued a Circular governing the registration process for AIFMs who do not exceed certain threshold. The circular sets out the procedure for registration, explaining that this can be done through the submission of a specific form which should be accompanied by specific information and documents. It further sets out the requirements for registration, as well as continuous obligations of AIFMs with regard to monitoring and reporting on their total value of assets under management.

CySEC is in the process of drafting and issuing a Directive regulating the provisions regarding the marketing of AIF units in Cyprus.

What does it mean for you? For your information only.

Europe

10 October 2013

Timing questions remain for AIFMD reporting

ESMA published its Final guidelines on reporting obligations under Articles 3(3)(d) and 21(1), (2) and (4) of the AIFMD on 1 October 2013. The guidelines are the final clarification on how firms should operate in practice under the AIFMD requirements.

The AIFMD Level 2 Regulation included the reporting template for firms (in Annex IV) but ESMA has now clarified how AIFMs should complete each field in the template.

ESMA has clarified the frequency with which AIFMs should report if their assets under management change during the year but the overall reporting periods remain unclear. The original guidelines suggested AIFMs authorised from 22 July 2013 should report for the period 22 July 2013 – 31 December 2013; the AIFM would then follow the official reporting timelines (reporting, as necessary depending on their size, for quarterly periods ending from March each year). However following responses to the original consultation, ESMA now suggests AIFMs should consider a number of factors when deciding when they first need to report:

- AIFMD's transitional provisions in Article 61,
- the EC's Questions & Answers on Article 61 which in particular suggest firms should comply with AIFMD between July 2013 – July 2014 on a "best efforts" basis, and
- their authorisation status.

For some AIFMs the flexibility in approach provided by the guidance may be welcome. However, we must wait and see whether individual regulators provide their own guidance or expectations on when AIFMs should report to them for the first time.

ESMA did not materially amend the guidelines elsewhere, except where the responses suggested it was overstepping the requirements laid out in the Level 2 Regulation. Addressing this, ESMA issued an opinion on the same date, where it suggests regulators across the EU should adopt a common approach to collecting additional information for the purpose of monitoring systemic risk. ESMA suggests particular focus on firms using high frequency trading, "hedge fund strategies" and short selling through derivatives.

ESMA also issued technical IT guidelines, XML documents and a consolidated reporting template to help firms. AIFMs now have all the assistance they are likely to receive for reporting under AIFMD, and their implementation plans should now be well-developed to meet the new obligations.

HTML documents:
http://www.esma.europa.eu/content/AIFMD-Reporting-XML-documents-V10

Technical guidelines :
http://www.esma.europa.eu/content/AIFMD-reporting-IT-technical-guidance

Document details:
http://www.esma.europa.eu/content/Consolidated-AIFMD-reporting-template

What does it mean for you? For your information only.

21 October 2013

ESMA published status on MoU on 18 October 2013

The European Securities and Markets Authority ("ESMA") has published a table showing the state of play of Memoranda of Understanding ("MoUs") signed by EU national supervisors. ESMA had negotiated the template MoUs regarding the Alternative Investment Fund Directive ("AIFMD") with non-EU regulators around the globe. The AIFMD MoUs allow the exchange of information between EU and non-EU supervisors thus enabling non-EU fund managers to market alternative funds within the European Union. The AIFMD covers hedge funds, private equity and real estate funds.

Here is the link to the document:

http://www.esma.europa.eu/system/files/2013-1339_final_report_on_esma_guidelines_on_aifmd_reporting_for_publication_clean.pdf

What does it mean for you? For your information only.

Germany

22 October 2013

Payment of 2014 annual fees to BaFin – Important change

From 2014, foreign investment funds authorised for distribution to the public in Germany are no longer required to pay the annual fee by 1 January of each year of their own accord. BaFin will send an invoice to each ManCo/Fund concerned, stating the exact amount to be paid and the new payment ID.

With the implementation of the AIFMD, the Investment Code (“Kapitalanlagegesetzbuch – KAGB”) replaced the Investment Act (“Investmentgesetz – InvG”) from 22 July 2013.

Because of this change, the Regulation on the Imposition of Fees and Allocation of Costs (“FinDAG-Kostenverordnung- FinDAGKostV”) has been amended accordingly and BaFin has changed its payment procedures.

Now, foreign investment funds authorised for distribution in Germany are no longer required to pay the annual fee by 1 January of each year. Additionally, BaFin has decreased the annual fee from EUR 500 to EUR 115 per fund/sub-fund.

Germany: as from 1 January 2014, BaFin fee will not become due and payable until you receive the fee notice.

Moreover, starting in 2014, the annual fee will be charged in accordance with the new FinDAGKostV and BaFin will send an invoice to each ManCo/Fund concerned stating the exact amount to be paid and the new payment ID. The fee will not become due and payable until you receive the fee notice.

On 17 October 2013, BaFin sent a letter explaining the changes to all foreign Management Companies/Funds, which are impacted by this new regulation.

According to the BaFin statement, the first invoices should be sent until 1 June 2014. The exact date of the fee notice has not been set by BaFin yet. Any payment settled before the official BaFin invoice is issued will be paid back to the applicant.

What does it mean for you? You are no longer required to pay the BaFin fee by 1 January of each year, but are required to wait until you receive the BaFin notice fee to pay the annual fee.

Hong Kong

17 September 2013

Memoranda of Understanding with EU and EEA countries regarding AIFMD

The Securities and Futures Commission has entered into Memoranda of Understanding concerning consultation, cooperation and the exchange of information related to the supervision of AIFMD entities (AIFMD MoU) with competent authorities of 28 European Union or European Economic Area countries.

For further details please follow this link:

http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=13PR94

What does it mean for you? For your information only.

27 September 2013

Getting ready for China/Hong Kong funds mutual recognition

As demand grows from Chinese retail investors for mutual funds, Hong Kong will become the gateway for asset managers to mainland China. This presents significant opportunities, since Chinese savers have more than USD 6.5 trillion in bank deposits to invest. China also has a pressing need to grow its pool of savings to meet the needs of its ageing population. Furthermore, China’s rising middle class and its growing wealth will create further avenues of opportunity for asset managers.

For further details, please read the capability statement drafted by our Hong Kong firm, in ***Appendix p.18.***

What does it mean for you? For your information only.

Ireland

24 October 2013

Central Bank of Ireland imposes early submission deadline on Irish AIFMs

On 21 October 2013, the Central Bank of Ireland ("CBI") set an early deadline for Irish asset managers (including internally managed AIFs) wishing to file authorisation or registration requests under the Alternative Investment Fund Managers Directive to ensure they are approved before 22 July 2014. 21 February 2014 has been set as the latest date for receipt of applications.

By doing so, the Irish regulator would like to avoid any late submissions and also given the expected volumes of applications, the CBI would like to ensure that it has enough time to review all applications. The CBI specifies that "applicants are advised to submit completed applications at the earliest opportunity". Moreover, the CBI insists on the quality of the submissions and "applicants should take care to ensure their applications are of the highest standard as incomplete or insubstantial applications will be returned."

The CBI communication is available here:

http://www.centralbank.ie/regulation/marketsupdate/Documents/Note%20for%20Markets%20Update%20Oct%202013_FINAL.pdf

What does it mean for you? If you are an Irish AIFM and would like to file an authorisation or registration request under the AIFMD, you are required to submit your application to the CBI no later than 21 February 2014.

Irish AIFM are required to submit their AIFM application(s) to the CBI no later than 21 February 2014.

Singapore

17 October 2013

Latest developments regarding regional passports in Asia

Asian countries are working hard to develop the cross-border distribution of funds in the region. On the one hand, following the signature of an MoU on 1 October 2013, the Asean CIS Framework is expected to be implemented in the first half of 2014. On the other hand, the Asia Region Fund Passport is intended to be put in place by 2016 following a Statement of Intent signed on 20 September 2013.

On 1 October 2013, the Monetary Authority of Singapore ("MAS"), the Securities Commission of Malaysia ("SC") and the Securities and Exchange Commission of Thailand ("SEC-T") signed an MoU to set up the Asean CIS framework. This framework will allow the cross-border offering of collective investment schemes ("CIS") and it is expected to be implemented in the first half of 2014.

On 20 September 2013, Singapore, Australia, New Zealand and South Korea signed a Statement of Intent to establish a process to see the passport implemented by 2016. A consultation process for the passport arrangement is expected to commence in 2014.

Singapore is therefore at the heart of two major fund passport initiatives in the region.

For an overview of the key features and next steps of both initiatives, please refer to ***Appendix p.25***.

What does it mean for you? For your information only.

Switzerland

19 September 2013

FINMA Circular on "Distribution of collective investment schemes" enters into force

FINMA, the Swiss Financial Market Supervisory Authority, has fully revised its Circular regarding "Public advertising – collective investment schemes". The main aim of this revision is to provide a detailed definition of the term "distribution of collective investment schemes". The Circular has thus been adapted to match the terms of the revised Collective Investment Schemes Act and Collective Investment Schemes Ordinance, which became law on 1 March 2013. The Circular enters into force on 1 October 2013 and supersedes the existing Circular (FINMA-Circ. 2008/8).

For further details please refer to FINMA's press release:

http://www.finma.ch/e/aktuell/Documents/mm-rs-vertrieb-kka-13-9-20130910-e.pdf

The Circular is currently available in French and in German on FINMA's website:

http://www.finma.ch/f/regulierung/Documents/finma-rs-13-09-f.pdf

http://www.finma.ch/d/regulierung/Documents/finma-rs-13-09-d.pdf

27 September 2013

Publication media requirement

According to the partially revised ordinance on collective investment schemes (Art. 39 of CISO), foreign collective investment schemes must specify in the prospectus for Switzerland, in the specific information for Swiss investors, one or more media of publication in which the information required by Swiss law shall be made available to investors.

FINMA confirmed that the mention of one medium of publication is now sufficient. However, selecting additional media of publication is left at the funds' discretion.

What does it mean for you? Starting now, foreign funds can work with only one publication medium in Switzerland.

New CISO allows foreign funds to work with only one publication medium in Switzerland.

UK

29 October 2013

Buffering money market funds

The EC published a proposed Regulation on money market funds ("MMFs") on 4 September 2013, which forms part of the EC's response to the on-going global debate on shadow banking.

In May 2010, CESR (ESMA's predecessor) introduced guidelines for a common definition of MMFs within the context of the UCITS regime: these guidelines were applied alongside the UCITS IV amendments from 1 July 2011. The new Regulation will introduce many additional requirements, ranging from risk management to data collection and capital buffers.

The EC wants MMFs to be able to better withstand redemption pressure in stressed market conditions, through enhancing their liquidity profile and stability. According to the proposal, MMFs will be obliged to hold at least 10% of their assets in instruments that mature within a day, and an additional 20% of assets that mature within a week. The most controversial proposal impacts constant net asset value (CNAV) funds which aim to keep a constant share price of GBP 1/EUR 1.

An ESRB Recommendation of 20 December 2012 advocated the transformation of CNAV funds into variable NAV ("VNAV") funds. The ESRB sees CNAV funds as a threat to financial stability through volume redemptions in stressed markets. But in its UCITS VI consultation, the EC proposed an alternative approach, saying that CNAV funds would only be forced to become VNAVs if they did not hold a prescribed capital buffer. Not surprisingly, it is the latter position that the EC has adopted in its proposal. CNAV funds will need to maintain a capital buffer of 3% (cash only) of the total value of assets under management. The NAV buffer will only be used to compensate for the difference in value between the CNAV per unit or share and the "real" value of a unit or share. The proposals will also change MMFs' eligible assets requirements, restricting investments to four categories of financial assets:

- money market instruments,
- deposits with credit institutions,
- financial derivatives (largely only for hedging purposes and provided strict conditions are met), and
- reverse repurchase agreements.

MMFs will not be able to invest in any other assets, engage in short-selling of money market instruments, gain exposure to equities or commodities, enter into securities lending or securities borrowing agreements, enter into repurchase agreements, or borrow or lend cash.

The proposals also include detailed rules on the diversification of assets that MMFs are required to comply with, such as upper limits on exposure to a single issuer. Rules on an internal assessment of the credit quality of MMF investment instruments are also included.

Alongside the proposals on MMFs, the EC also published a Communication on Shadow Banking, demonstrating its willingness to implement the FBS's wider policy frameworks for regulating shadow banks.

Communication on Shadow Banking:

http://ec.europa.eu/internal_market/finances/docs/shadow-banking/130904_communication_en.pdf

What does it mean for you? For your information only.

29 October 2013

FCA guidance on post-RDR switching

The FCA published GC13/7: changing customers to post-RDR unit classes on 23 October 2013.

Since the implementation of RDR at the end of 2012, fund managers have been banned from paying new rebates to financial advisers. To meet this obligation, most fund managers have switched their investors into "clean" unit classes, which charge a lower annual management charge (because the rebate has been removed). The FCA expects fund managers to make greater use of clean unit classes over the coming years, and to switch their investors into them, due to the new rules on platforms which will be effective from 6 April 2016 (which ban payments to platform providers).

GC13/7 provides fund managers with some assistance in dealing with mass switches. The FCA notes that any switch should benefit investors due to the lower annual management charge. Any other differences between the new unit class and existing unit class should be minimal – and the FCA expects no switches where an investor will be disadvantaged.

For nominees, they have the right to switch their underlying investors into a new unit class, although the FCA suggests they notify the underlying investors about the switch in good time before it takes place. For direct investors, any switch will need the unitholder's permission – the FCA suggests fund managers may want to inform their investors about the new unit classes and highlight its benefits. Additionally, any advice to switch units will not be considered new advice under RDR, so will not impact existing legacy rebates to advisers.

The Guidance Consultation GC13/7 closes to comments on **23 November 2013.**

GC13/7:

http://www.fca.org.uk/static/documents/guidance-consultations/gc13-7.pdf

What does it mean for you? For your information only

UK: FCA guidance consultation GC13/7 on post-RDR switching is open until 23 November 2013.

Lets' go deeper

www.pwc.at

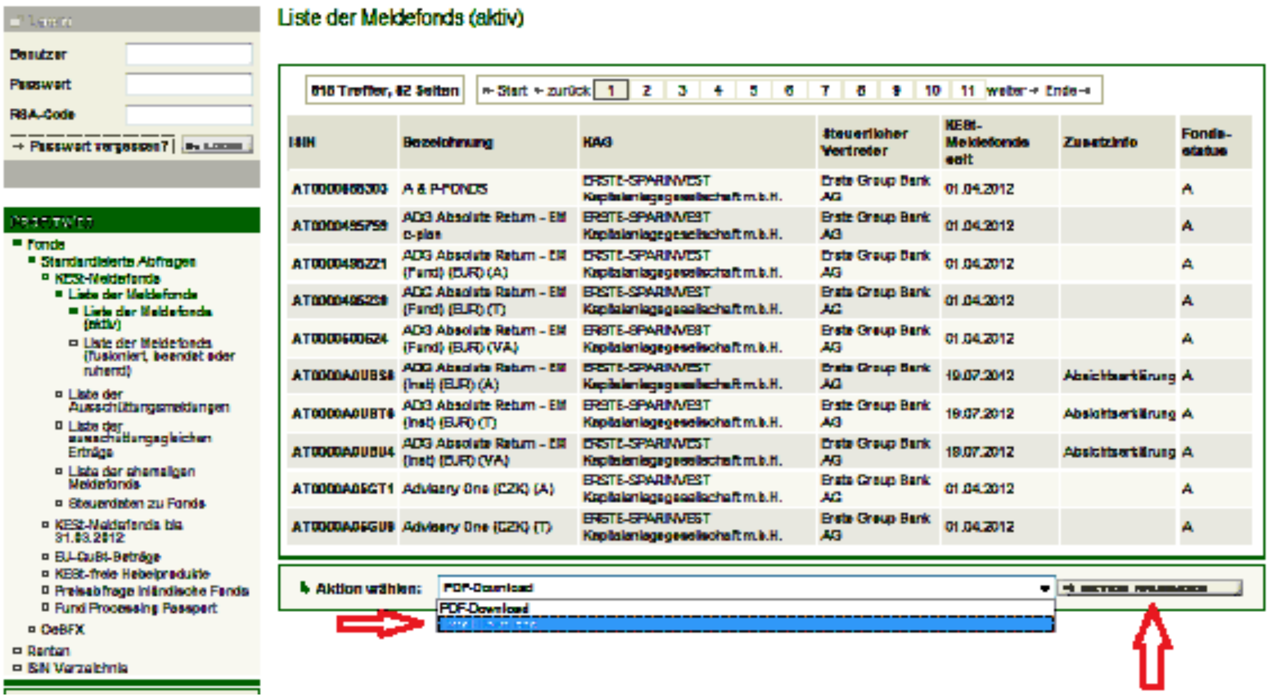
Guide: How to download the current list of reporting funds from the OeKB

Step 1: Go to the website www.profitweb.at

Step 2: Click the link "KEST-Meldefonds" in the middle of the start page as you can see below

Step 3: In the drop-down-list please choose your company or fund and click the button "ERGEBNIS ANZEIGEN" on the left.

Step 4: You will be able to download the list in pdf- or in xls-format by choosing the preferred format and clicking the button "AKTION ANWENDEN" on the left.



What you should do

Please compare the share classes currently listed as reporting funds on the website of with your records of share classes in which Austrian investors are invested.

If the registration of additional share classes as reporting funds is required within this calendar year, please contact your Austrian Tax representative.

For insight and support, please feel free to contact the following subject matter experts, or your usual PwC contact persons.

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Getting ready for China/Hong Kong funds mutual recognition

Preparing to access China's fast-opening asset management market through Hong Kong

pwc

Being prepared for growth

When Hong Kong and China's financial regulators recognise each other's mutual funds, Hong Kong will become the gateway for asset managers to China. Mutual recognition will be a watershed moment for international asset managers, making China's rapidly expanding population of investors directly accessible to foreign funds for the first time.

The opportunity is substantial. With US$6.5 trillion in bank deposits,[1] Chinese savers have considerable sums to invest in mutual funds. And investable assets are growing fast. By 2020, China's newly affluent middle classes will account for two out of every five citizens.[2] What's more, China accounts for about a third of SAAME[3] insurance premiums,[4] with insurance spending still far lower than in neighbouring countries. Finally, pension reforms are also likely to increase the pool of assets.

We anticipate that initially only Hong Kong-licensed asset managers with Hong Kong-domiciled funds will be able to sell into China. So in order to be ready, international asset managers without a Hong Kong presence need to establish one. What's more, asset management companies already in Hong Kong need to review their fund platform and client strategies.

Quickening pace of change

Mutual recognition is happening at the same time as a number of other changes aimed at encouraging asset managers to set up in Hong Kong and distribute into China. The Hong Kong government is reviewing its regulatory and tax regime, aiming to attract more international asset managers and establish a major global funds centre. Its 2014/15 budget, for example, revealed plans for Open Ended Investment Companies (OEICs) and other reforms are likely to follow.

What's more, in Mainland China new fund distribution channels are beginning to emerge, offering an alternative to distributing through the banks. In July 2013, China's largest e-commerce website announced plans to open a channel for marketing mutual funds. Other e-commerce sites may also follow.

Finally, the Chinese government has announced it will allow Hong Kong-funded asset managers to set up Mainland joint ventures, holding stakes of up to 51%.

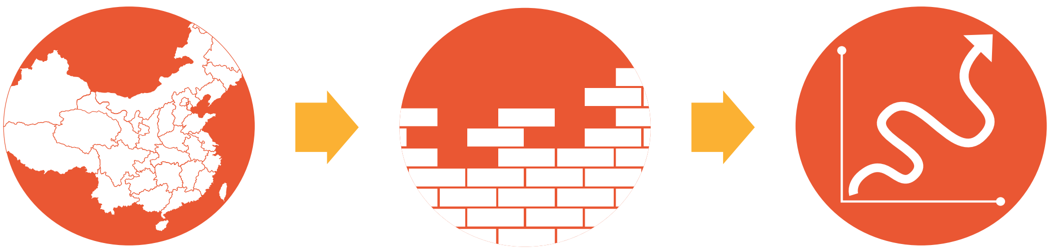
Preparing for market

Mutual recognition will open the China market for international asset managers. As Hong Kong's leading professional services firm for the asset management industry, we have insight into how you can prepare your China strategy. Over the following pages, we outline some of the issues you will face as you build a platform for marketing and selling into China.

Marie-Anne Kong
Asset Management Industry Group Leader
PwC Hong Kong

1 Source: Peoples Bank of China, PwC calculations. As at end 2012.
2 Shanghai Academy of Social Sciences.
3 SAAME: A PwC Project Blue acronym for South America, Africa, Asia & the Middle East.
4 Swiss Re Sigma, World Insurance in 2010/PwC Project Blue, Capitalising on the 5 growth and global interconnectivity of the emerging markets: Financial Services in China (2012).

Three stages to readiness



Entry and planning

- Market assessment and analysis
- Entry strategy
- Business planning
  - Licensing
  - Regulatory requirements
  - Product strategy
  - Operational model
  - Organisational structure

Foundation building

- Incorporation
- Licensing
- Define product / service strategy
- Business infrastructure
  - People
  - Processes
  - Systems
  - Funds platform

Market ready

- Sales and distribution channel
- Branding / marketing activities
- Product launch
- Governance / compliance / reporting
- Operating model

What are the opportunities and the challenges?

There's growing demand from Chinese retail investors for mutual funds. In 2012, retail investor holdings in mutual funds grew 27.7 per cent.

Mutual recognition will provide the opportunity to sell investment funds into China that international asset management companies have been long waiting for. Yet whether you're setting up in Hong Kong, or adapting existing operations, you'll need to plan for and manage a range of complex issues.

The China opportunity

With much of the increasingly affluent Chinese middle classes' wealth still held in bank deposits, there's significant potential for distributing Hong Kong-domiciled funds. Further into the future, offshore funds might also be marketed on the Mainland, but initially recognition will likely only extend to Hong Kong-domiciled funds.

China's burgeoning middle classes want to diversify beyond bank accounts. What's more, they're seeking more international investments and value good governance, especially trustworthy investor protection. So there's likely to be strong demand for Hong Kong-domiciled funds.

Setting up a funds business in Hong Kong is relatively simple, making it a natural platform for distributing into China. Hong Kong is a widely recognised asset management centre, with strong regulatory and legal systems and established asset management infrastructure.

Further into the future, as the China funds industry evolves, there will be demand for further wealth products including insurance and pension funds.

The challenges

The China Securities Regulatory Commission (CSRC) and Hong Kong's Securities & Futures Commission (SFC) formed a working group to plan the terms of mutual recognition in November 2012, although the timing and details are still being developed. For example, investor protection, eligibility criteria and capital requirements, tax treatments and eligibility to treaty benefits are still uncertain, meaning that asset management companies will need to remain flexible and develop views on the range of possible outcomes.

International asset management companies without a local presence, or those with only a distribution team in Hong Kong, will need to establish a strategy for entering the Hong Kong and China fund market. This would include determining:

- Business model (products, services, clients, distribution channels)
- Legal/entity structure
- Operating model, human-capital planning and infrastructure requirements
- Regulatory licenses
- Hong Kong-domiciled fund set up requirements
- HK and China tax , accounting and audit requirements.

Even asset management companies already established in Hong Kong will need to re-examine their strategies and fund operations, as well as a range of other issues. How, for example, can you build a strong brand presence in China? What stakeholders will you need to build relationships with? How dynamic is the Mainland's regulatory environment? And what are the options and opportunities for funds distribution?

Supporting your expansion into China

Whether you're setting up in Hong Kong for the first time or already established, you need a strategy for entering the China market. Depending on your size and existing operations, you'll face a range of challenges.

How we help you succeed

Below we illustrate how you can use our services to help you prepare for mutual recognition – whether you're a new entrant to Hong Kong and China, or an established firm looking to prepare for mutual recognition's opportunities.

Service areas	New entrant to HK and China	Established in HK but HK fund platform requires optimisation
Market entry strategy	• Conduct market research of the HK and China fund industry to provide overview Offshore of key players, products and distribution channels • Assist with development of business case • Define market entry strategy including investment vehicle and capital requirements • Define business model (customer segments, product strategies) • Define distribution strategy • Define client relationship strategy and implementation • Develop distribution channel	• Conduct market research of the China fund industry to provide overview of key players, products and distribution channels • Assess the key challenges of distributing in China e.g. branding • Validate and optimise business model (customer segments, product strategies, distribution channels) • Assess eligibility criteria and capital requirements
Regulatory, governance and compliance	• Provide overview of regulatory landscape, compliance and tax requirements in HK and China • Develop governance framework and compliance processes • Provide advice and assistance on the relevant licensing application and fund authorisation procedures. • Provide on-going regulatory compliance supports • Provide statutory audit service	• Provide overview of regulatory landscape, compliance and tax requirements • Provide advice on the gap difference of the regulatory and compliance requirements between HK and China mutual fund platform • Assessment of current governance framework and regulatory compliance program • Provide statutory audit service
Tax	• Explore domestic tax incentives and pursuing tax treaty benefits • Identify and assess potential transfer pricing implications and opportunities for optimising cost structures	• Explore domestic tax incentives and pursuing tax treaty benefits • Operational readiness - review and revise transfer pricing as appropriate
Operating model and infrastructure	• Design/validate operating model and infrastructure requirements to support the business strategy/model covering the following areas: – Assess operating model options for build out of HK funds platform including in-house build or outsourcing to third party providers – Assess potential third-party vendors and service providers in HK/China including development of vendor evaluation programs and RFP processes – Design end-to-end business processes for key functions including Transfer Agency, Fund administration and custody – Define interactions with head office/overseas entities	• Assessment of current operating model and HK fund platform to identify areas for operational efficiency and flexibility, to support HK and China mutual fund initiative. This could include benchmarking against industry peers and/or process re-engineering • Assess additional operational or reporting requirements for the HK and China initiative • Provide independent validation for operational readiness of HK fund platform • Readiness review for internal control infrastructure
Organisation structure and Human Resources	• Design organisation structure including key roles and responsibilities • Assessment of capability requirements and skills gap e.g. language, experience • Assessment of compensation structures, individual tax planning and compliance and talent management processes	• Assess current workforce capabilities and skills • Assess compensation structures , individual tax planning and compliance and talent management processes
Technology	• Develop IT strategy, including IT organisation and enterprise architecture for HK/China fund platform • Assess potential third-party system vendors including development of vendor evaluation programs and RFP processes. • Develop IT roadmap	• Assess current technology strategy and alignment with business and operating model

Use our unrivalled network in Hong Kong and China

In Hong Kong and China, we're the leading professional services firm and are best placed to give you the insights and connections you need to capitalise on China's exceptional market opportunity. We've invested heavily to attract the most talented individuals, to deepen our expertise and to increase our strengths.

As of 30 June 2013, PwC's network of firms audited approximately 65% of the unit trusts and mutual funds authorised by the Securities and Futures Commision in Hong Kong. In China, PwC provided professional services to more than half (57%) of the funds authorised by the China Securities Regulatory Authority in 2012.

We work closely with PwC's global asset management network, providing access to industry best practice all over the world. In Asia, rankings and awards regularly show the quality of our work. Recent accolades have included:

On a global basis, PwC has a corporate and/or fund audit relationship with each of the top 10 global asset managers.

"Best Auditor – Funds Advice" and/or "Best Auditor – Tax Advice" by Asian Investor for five consecutive years since 2008.

2012 Corporate International Magazine Global Award – Transfer Pricing Advisory Firm of the Year

China Venture Capital Forum CVCA Outstanding Achievement Award 2012; Gold Award in the Excellent PE/VC Service Provider 2011

Contacts

After many years of gradual progress, China's asset management market further opening to international asset managers. For insight and support, please contact one of our specialists listed below:

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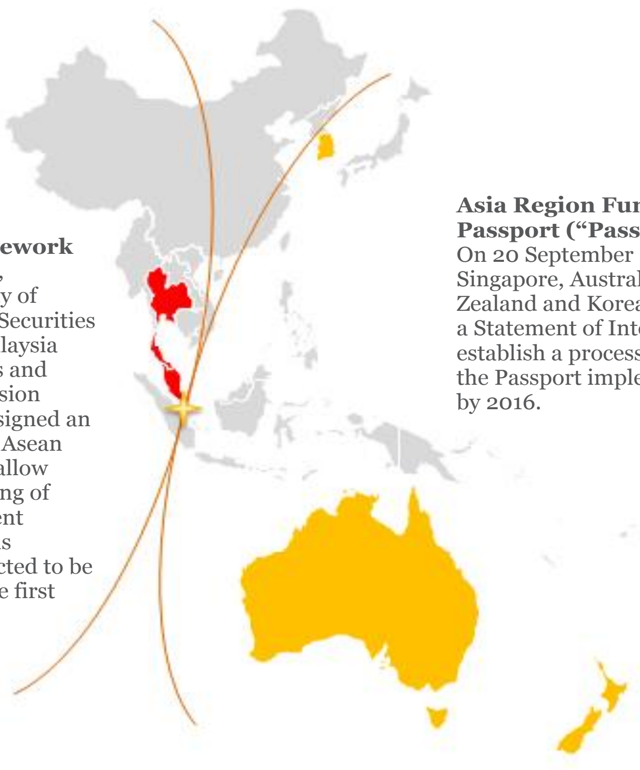
Singapore at the centre of Regional Fund Pass-portability

"With its strategic placement, Singapore has much to benefit from both initiatives and can move forward to lead the development of a true cross-border fund platform"- Justin Ong

11 October 2013

Asean CIS Framework
On 1 October 2013, Monetary Authority of Singapore (MAS), Securities Commission of Malaysia (SC) and Securities and Exchange Commission Thailand (SEC-T) signed an MOU to set up the Asean CIS framework to allow cross-border offering of collective investment schemes (CIS). This framework is expected to be implemented in the first half of 2014.



Asia Region Fund Passport ("Passport")
On 20 September 2013, Singapore, Australia, New Zealand and Korea signed a Statement of Intent to establish a process to see the Passport implemented by 2016.

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ASEAN CIS Framework

Singapore-based fund managers will be allowed to offer their existing retail funds to investors in Malaysia and Thailand. Their counterparts in Malaysia and Thailand would equally have access to the Singapore retail market.
To qualify for the framework all retail funds will need to follow a set of common standards.

Some key features of the framework for the CIS operator are:

- *Licensing/Registration Requirement* –must be licensed and registered by its Home Regulator (MAS in the case of Singapore based funds)
- *Experience of CIS Operator* – A minimum track record of 5 years and AUM of USD 500million globally
- *Capital Adequacy* – Shareholders' equity of at least USD 1 million and additional 0.1% for every AUM in excess of USD500million
- *Roles and Responsibilities / Legal liabilities* – comply with constitutive documents of the Qualifying CIS, Standards of Qualifying CIS and laws and requirement of Home Jurisdiction.
- *Qualification of Personnel of the CIS Operator* –CEO must have a minimum 10 years experience in financial and capital markets; BOD must have a minimum of 5 years of experience in financial or capital markets (for Non-executive Directors experience could be in any other field)
- *Delegation/Outsourcing* - CIS operator may delegate functions subject to CIS operator taking responsibility, ensuring quality , sufficient monitoring and excess to Home Regulator
- *Supervision of CIS Operator* – CIS will be subject to Home Regulator supervision.

Other requirements under the framework are on qualification, custody of fund assets, assessment of qualifying CIS, valuation, redemption of units, investor protection and cross-border aspects.

Next steps

CIS Operators interested to capitalise on the new framework should:

- Analyse the incremental requirement of the Asean CIS Framework versus their existing framework
- Monitor further development in this area for details of licensing /registration which is in the first half of 2014
- Monitor development for non-retail funds where MAS, SC and SEC, has also agreed to work towards having an arrangement to provide mutual supervision assistance for CIS offered to non-retail investors in Singapore, Malaysia and Thailand.

Asia Region Fund Passport

The Asia Region Fund Passport initiative is aimed at creating a more inclusive regional scheme to better integrate financial markets in the APEC region. It is envisaged that CIS Operators in passport member economies will be able to offer their fund to investor in another passport member economies based on an agreed regulatory framework.

Next steps

CIS Operators should participate in the consultation process for the passport arrangement which is expected to commence in 2014.

If you require help, please contact the following subject matter experts, or your usual PwC contact persons

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Why PwC?

The PwC network is the largest global professional services network with 184,000 people working in 157 countries. PwC is the brand under which each member firm operates and provides audit, tax and advisory services including management consulting, transaction, financing and regulatory advice to a wide variety of clients. It helps its clients create value by giving comfort to the capital markets and providing advice through an industry focused approach.

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