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Irish Funds Asia Pacific Roadshow
August 2016

Funds Industry Leader Insights on Market Developments

Introduction

Our Irish Funds summer roadshow in Singapore, Hong Kong and Tokyo coincided with significant announcements in Asia, most notably the timeline for Shenzhen to be included in the Stock Connect scheme. We held 3 successful seminars, with large attendances in each city and featuring panelists from the Hong Kong Exchanges and Clearing, MSCI, Neuberger Berman, Henderson Global Investors, SPARX and a wide range of fund industry service providers. All the seminars were made possible through the support of our hosts: HSBC Securities Services, PwC and SuMi Trust. The presentations and panel discussions were enhanced by lively Q&A and covered a wide range of industry trends with insights that may prove useful to fund managers and service providers alike. Highlights and key take-aways from the seminars are as follows:

- A primary discussion topic in Singapore focused on the development of **Asian passport programmes** with panelists saying more work needs to be done over time to make these effective, especially on the tax side. There is still a market consensus of the passport potential success being "when" and not "if". Southeast Asia based fund managers are also focused on the new **MAS Outsourcing Guidelines** which included deep discussion centering on the interaction of the requirements with global business models and the way in which managers of differing sizes will adapt.

- Our panel discussions on **Brexit in Hong Kong and Singapore** suggested fund managers have trepidation about the effect on their business, with the impact varying based on the product, marketing and management passports they currently utilize across UCITS, AIFMD and MiFID. Given deep pools of capital and talent the UK remains an attractive, primary market within which to do business. Ireland maintains its position as a highly effective partner for both UK and Asian managers, as it will be the only English speaking country within the EU with a highly sophisticated fund services industry. Irish domiciled funds continue to provide highly effective distribution access for both UK and European markets.

- The announcement of **Shenzhen Connect** is creating positive sentiment amongst HK and multi-national fund managers. This panel featured a significant volume of questions from the audience around the topics of taxation, RDVP, the definition of professional institutional investors for ChiNext as well as the removal of the aggregate quota and potential for that to pave a way to MSCI Inclusion. However, MSCI highlighted a few more issues that need to be resolved, suggesting there is no clear timetable to MSCI inclusion, while Shenzhen Connect now has a firm deadline of 4 months.

In Tokyo, the combination of the widening of access to defined contribution pension scheme accounts locally and the continuing search for yield is presenting opportunities both for local Japanese managers developing cross border strategies and managers looking to distribute into Japan. Irish UCITS are acknowledged as an important part of the solution set given their global reach and established track record.

Singapore Friday August 19th - ASEAN and ARFP Passports are a Work in Progress

Our seminar in Singapore was well attended with the Deputy Head of Mission of the Embassy of Ireland, Ross Church, and Pat Lardner CEO of Irish Funds giving the welcome introductions. Our panel discussions focused on Brexit, the Asian Passports and MAS outsourcing risk management requirements.

Irish Funds CEO Pat Lardner opened the funds industry portion of the programme with a keynote presentation on the potential impact of Brexit. This was followed by a panel discussion with Yoon Ng of Spence Johnson moderating a panel of experts comprising Paul Moloney, Consultant at Eversheds, Tony Lewis, Asia Head of HSBC Securities Services and Bill Jamieson, Partner at Colin Ng & Partners. Core takeaways are as follows:

- Much of the focus of the panel was on Brexit and the potential impact this could have on distribution in Europe for ASEAN fund managers. **The panel believed the impact would be limited as long as funds were already structured as UCITS in Ireland, meaning they would retain access to the European distribution passport.**

- For those fund managers with only a UK fund range, **the panel examined the option of establishing UCITS and alternative fund ranges in Ireland to ensure that distribution of product remains unaffected** regardless of the final form of relationship that Britain has with the EU. The panel also considered the implications for managers who wish to continue to access the UK, which will remain an extremely important market for people seeking to raise money

- The surprise immediately following the initial decision is being replaced by a more targeted analysis of impacts. Given the lack of clarity around end outcome and time-frame the emphasis is on looking at those specific elements of a firms' product, target client and business model mix which require more immediate focus in what looks like a lengthy post-vote/pre-exit period.

Asian Passports: Work In Progress

Armin Choksey, Director of PwC Singapore, gave a presentation on the coming of age of Asian passports with an ARFP Working Group comprising Australia, Korea, New Zealand, the Philippines, Singapore and Thailand releasing 2 working papers on the framework and progress. The main takeaway from the presentation and Q&A was that the take-up to date has been low and the hurdle of addressing tax issues is a crucial one. A significant number of submissions received during the consultation process strongly urged for the consideration of domestic tax implications and advocated for the neutral tax treatment of the passport funds, suggesting the ARFP can succeed if tax neutrality is achieved.

As outlined by PwC in their document "*Funds passport regimes in Asia Pacific*", there are key tax principles which should be incorporated in the ARFP:

- Create a level playing field in respect of returns to the investor
- Remove tax barriers in respect of distribution cross border
- Preserve tax neutrality through collective investment schemes
- Preserve integrity by mitigating tax evasion

Questions still remain which will need to be addressed.

The investor level

- How is the investor taxed if investing in a foreign fund versus a local fund?
- Are there any withholding taxes that apply?
- Are there any concessions that apply to local investors versus foreign investors?
- Are there any integrity measures that apply?

The fund level

- Is there any tax at the fund level?
- How is the fund taxed on its local investments versus foreign investments?
- Do the tax attributes of the investment flow to investors (i.e. transparent treatment of funds)?

Under the current tax regimes for each participating country there are significant differences in tax outcomes to investors. Ultimately there remains quite a bit of work to do to get the passports to a point where they could be as effective as UCITS.

Outsourcing Risk Management: Insights on the latest Monetary Authority of Singapore Guidance

Philippa Allen, CEO of Compliance Asia, hosted a panel of Scott McClaren, Head of Hong Kong at Brown Brothers Harriman, Michelle Lloyd, Head of the Irish desk at Maples and Calder and Ken Forbes, Head of Asia Operations for Henderson Global Investors. MAS issued new guidelines on the 27th of July 2016 after a long consultation beginning in 2004. The guidance addresses regulatory insights on the risk of the failure of a service provider to financial institutions in Singapore.

MAS outsourcing guidelines apply to all financial institutions that are licensed, approved, registered or regulated by the MAS. The guidance is broad in scope, and the same rules apply for the asset management industry as all other industries MAS regulates to include commercial banks, insurance companies and brokers. Market participants have until the 27th of October, 2016 to carry out GAP analysis on outsourcing arrangements and all deficiencies must be rectified by 27th of July 2017.

Asset managers have expressed concern that a strict interpretation may be adopted by MAS, rather than basing a review on current market practices. MAS itself says the extent and the degree to which firms follow the Guidelines will depend on the risks and materiality of their own outsourcing arrangements. However, based on past experience, the concern is that auditors signing off on outsourcing arrangements in the annual audit will take a strict approach to compliance. Fund managers may need to maintain a register of all outsourcing arrangements and provide this annually to MAS, which may require Right of Access and Inspection to all books and records involved in these outsourcing arrangements. Where the fund manager is not a direct party to the outsourcing arrangement, this could ultimately result in additional complexity as well as extra time and costs for compliance.

Philippa Allen said the definition of outsourcing has not changed drastically, but the definition of material outsourcing has changed. Material outsourcing arrangements are arrangements where a failure or security breach would have potential impact on the financial institution's business operations, reputation or profitability; would impact the financial institution's ability to manage risk and comply with applicable laws and regulations; or which involves customer information and, in the event of any unauthorized access or disclosure, loss or theft of customer information would have a material impact on the financial institution's customers. Examples of material outsourcing may include:

- Application processing (e.g. loan origination, credit cards);
- White-labeling arrangements such as for trading and hedging facilities;
- Middle and back office operations (e.g. electronic funds transfer, payroll processing, custody operations, quality control, purchasing, maintaining the register of participants of fund and sending of accounts and reports to investors, order processing, trade settlement and risk management);
- Business continuity and disaster recovery functions and activities;
- Claims administration (e.g. loan negotiations, loan processing, collateral management, collection of bad loans);
- Document processing (e.g. cheques, credit card and bill payments, bank statements, other corporate payments, customer statement printing)
- Information systems hosting (e.g. software-as-a-service, platform-as-a-service, infrastructure-as-a-service);
- Information systems management and maintenance (e.g. data entry and processing, data centres, data centre facilities management, end-user support, local area networks management, help desks, information technology security operations);
- Investment management (e.g. discretionary portfolio management, cash management);
- Management of policy issuance and claims operations by managing agents;
- Manpower management (e.g. benefits and compensation administration, staff appointment, training and development);
- Marketing and research (e.g. product development, data warehousing and mining, media relations, call centres, telemarketing);
- Professional services related to the business activities of the institution (e.g. accounting, internal audit, actuarial, compliance) and;
- Support services related to archival and storage of data and records

Scott McLaren from BBH articulated that custody and large operations is primarily about skill and scale and that only specialist service providers should be considered when making outsourcing decisions - where the outsourcing delivers a measurably superior solution to running these processes in house. In that context, outsourcing decisions should raise the bar and not seen as increasing the risk profile of the outsourced activity. All outsourcing activities still require active and frequent monitoring between the parties to ensure obligations and standards are being met consistently.

Hong Kong Monday August 21st - Shenzhen Connect and Brexit Impact

The Hong Kong seminar focused on 2 key areas, the potential impact of Brexit on the fund management industry and Stock Connect. The Irish Funds HK event featured MSCI and the HKEx, both invited to participate in advance of the announcement of the Shenzhen addition to Stock Connect, and the two panels stimulated interest and feedback among the audience. Pat Lardner made the welcome speech and within the perspective on Brexit he highlighted that Ireland remains a fully committed member of the EU and will help fund managers ensure any transition that is required will be as smooth as possible. It was reiterated that UCITS and AIFMD passport schemes are still open.

Brexit: Impact Depends On European Structure

The panel was moderated by Paul Moloney of Eversheds with Brad Okita, Managing Director of Greater China for Neuberger Berman, David McEvoy, Vice President at BlackRock, Eleanor Wan CEO of BEA Union and Keith Chau, partner at PwC participating.

The main takeaways from the discussion are as follows:

- Many fund managers view Brexit as a challenge, but a delayed challenge given it will take time for Britain to negotiate new terms with the EU. There is also sentiment that Brexit could actually be an opportunity for Asian managers to expand.

- For Asian asset managers, the impact of Brexit will depend on what operations they have in Europe and how they are structured. Within firms that have an Irish fund range with an Irish ManCo, (or self-managed), there may be very little impact. Within firms having a UK UCITS range they may have to look at whether to establish an Irish range, that decision being partially dependent on the negotiated UK exit end point.

- Managers think that while the uncertainty Brexit creates will affect business, the UK remains an attractive place for asset managers to establish their offices given a large pool of capital and a large ecosystem of consultants and other funds professionals.

- The panel believes Ireland, given our well-established fund industry, is positioned to benefit from managers looking to establish operations in the UK. Key contributing factors being that Ireland is a committed EU member as well as the only English speaking member of the EU.

Shenzhen (SZ) Connect Announced, Similar Structure to Shanghai, With Some Changes

Tae Yoo, Managing Director in the Market Development Division of HK Exchange, presented on Stock Connect. The details of Shenzhen Connect, as announced in HK Exchange's public documents are as follows:

Shenzhen (SZ) Northbound Connect:

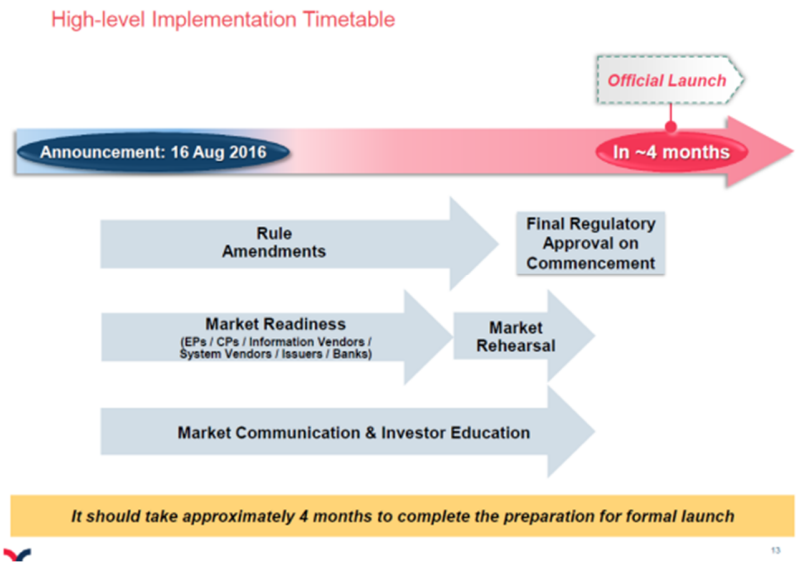
- Eligible Stocks (estimated data as of end July 2016), 880 stocks for SZ Northbound covering:
- Constituents of SZSE Component & SZSE Small/Mid Cap Innovation indexes with a market capitalization of at least RMB 6 bn, and SZSE-SEHK A+H shares
- Main board: ~270, SME board: ~410, ChiNext board: ~200
  ChiNext open to institutional professional investors initially
- Daily Quota: RMB 13 bn.
- Aggregate Quota: None

Shenzhen Southbound Connect:

- Eligible Stocks (estimated data as of end July 2016). 417 stocks (vs. 318 stocks for SH Southbound) for SZ Southbound, adding:
- Constituents of Hang Seng SmallCap Index with a market capitalization of at least HKD 5 bn1 and SZSE-SEHK A+H shares to the existing eligible stocks
- Daily Quota: RMB 10.5 bn
- Aggregate Quota: None

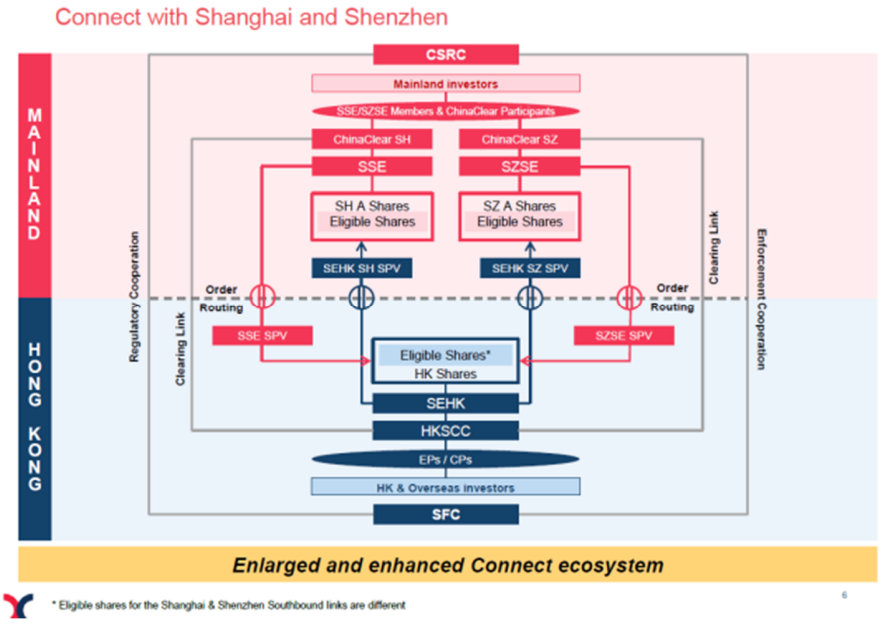
Shanghai (SH) & Shenzhen (SZ) Combined:

- Launch expected in 4 months, see slide on implementation
- Aggregate Quota abolished
- ETFs to be included but roll-out planned in 2017
- SH Connect otherwise remains unchanged



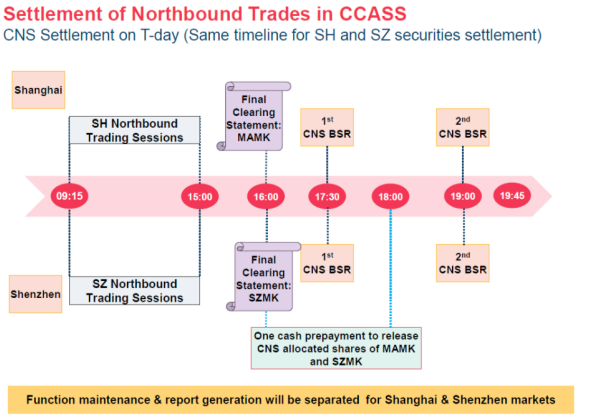
Operational & Trading

- As you can see in the slide below, the same processes will be used for Shenzhen as with Shanghai, with SEHK SPV and China Clear involved.



- Trading and Clearing links will remain the same and investors will trade through local brokers with orders routed through subsidiaries set up by local exchanges to opposite markets. HKSCC is a participant in ChinaClear. It clears and settles cross border trades with ChinaClear for HK and international investors. Participants' CNS money obligation in Shanghai and Shenzhen markets will be netted as HKSCC will arrange fund transfer between ChinaClear SH and SZ. Function maintenance and report generation will be separated for Shanghai and Shenzhen markets. The slides below show the settlement

process for SZ and SH combined. Function maintenance and report generation will be separated for each respective market.



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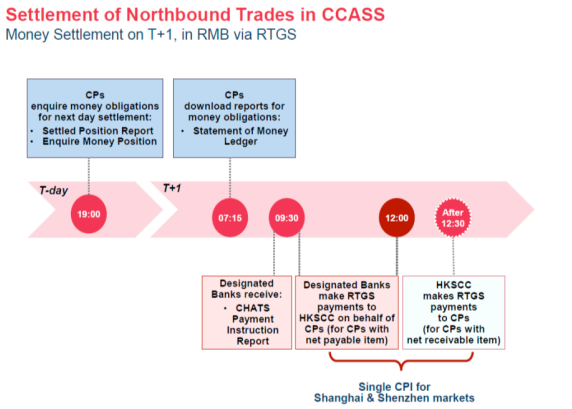

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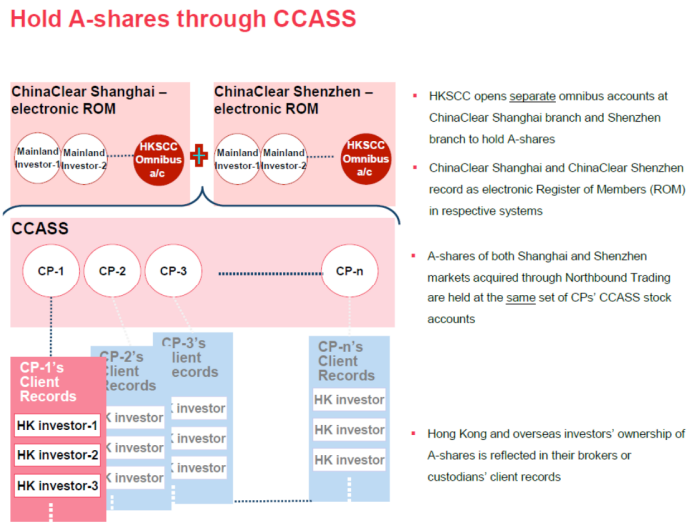
- As outlined in the slide below, HKSCC will open separate omnibus accounts at Chinaclear's SH and SZ branches to hold A shares. But A shares acquired in both stock markets through the Northbound Connect process are held at the same set of CP CCASS stock accounts.



- Risk management measures of ChinaClear SZ branch applicable to HKSCC will be imposed on HKSCC participants. Collateral will be separately calculated for Shanghai and Shenzhen Northbound trades. The security deposit rate for SH is 16.4%, while it is 18.5% in SH. The following proposed principal agreements to be entered into between relevant parties: 1) A Four-Party Agreement between SZSE, SEHK, ChinaClear and HKSCC. 2) Trading Links Agreement between SZSE, SEHK, the SEHK order-routing Subsidiary and the SZSE order-routing Subsidiary and 3) Amended and Restated CSD and Clearing Links Agreement between HKSCC.

- Fees will remain the same. Shanghai and Shenzhen will have the same Northbound and Southbound trading fees. The current PRC policies applicable to Shanghai including stamp duty, capital gains tax, dividend tax, VAT, will also apply to Shenzhen.

Differences Compared to Shanghai Connect

There are some Shenzhen A share specific items. These are:

- Trading hours with closing auction session. Unlike Shanghai, Shenzhen has a closing call auction from 14.57-15.00. From 09.20-09.25 in the opening call auction and from 14.57-15.00 in the closing auction, SZSE will not accept order cancellation.
- Listing date of bonus shares – on the following day of the record date.
- Mainland Security Deposit Rate ("MSCD") – 18.5%.

Shenzhen Connect has a two market approach on risk management measures. An aggregate amount of RMB 5 mn tolerance limit covers both the shortfalls in Shanghai and Shenzhen Northbound trades for intra-day Mainland Settlement Deposit ("MSTD"). One minimum RMB 200,000 MSCD if participating in both Connect markets.

The active Q&A session featured discussion on the following set of important topics:

- The question regarding the definition of "**professional institutional investors**" for ChiNext access. Tae Yoo indicated this will be announced in the SFC's approval/guideline under definition of professional investors.

- **Investors want more information on Exchange rules** which will also be confirmed after SFC approval.

- It was indicated that fund managers are pleased with the **removal of aggregate quota** and believe it could attract more flow. When discussing **daily quota considerations,** it was indicated that fund managers didn't see the daily quote as an issue as long as it is adjustable.

- **Taxation**. The same tax policies will be applied to Shanghai Connect as Shenzhen. Tae Yoo from HKEx confirmed it is working with authorities to address the expiry of exemption in November prior to the announced launch time line subject to regulatory approval.

- **Real DVP**. HKEX were asked if we will ultimately get to true DVP compared to the current, already improved, situation where DVP happens on the same day, but with a time delay of a few hours. Tae said HKEx is not able to answer this at this time, but they are reviewing the issue and welcome feedback from fund managers. He also said post-trade interaction on Shenzhen Connect will remain the same as per SH Connect and the chain of custody remains the same. Also, SEHK order-routing subsidiary has been established in Qianhai to foster greater Guangdong-Hong Kong cooperation and it will not impact changes to post trade processing. This is despite the establishment of a new subsidiary being set up for settlement purposes, which may require further details.

China: Onward and Upward - Mainland Insights and Hong Kong Regulatory Developments

This panel presentation was moderated by Michelle Lloyd, Maples and Calder, with Chin Ping Chia, Managing Director and Head of Applied Research at MSCI, Patrick Wong, Head of China Sales and Business Development at HSBC Securities Services, Sandra Lu Partner at LLinks and Alvin Li, ETF Specialist at CSOP, participating. A series of key topics were addressed in detail:

- **MSCI Inclusion**. Chin Ping from MSCI explained its assessment announcement. The audience questioned the timing, as expectation is building now that Shenzhen Connect has been announced, and the removal of an aggregate quota across all Connect programmes removes concerns around capacity. However, Chin Ping outlined some other areas where MSCI would like to see further developments, meaning there is still no clear timing as to when MSCI will include A shares in the index. The remaining issues centre on:

    - A relaxation of the repatriation limit,
    - Full implementation of the new suspension rules and
    - The resolution of pre-approval requirements.

- **Research**. The panel discussed what the next steps are ahead of the Shenzhen Connect and the panel all agreed more information on Shenzhen listed stocks is key to fund managers being able to make good investment decisions.

- **RQFII**. Michelle Lloyd asked the panel whether there is any need for QFII or RQFII when Stock Connect is fully implemented. Patrick Wong from HSBC noted each fund manager has different needs and the different access schemes meet the needs of different managers. For example, RQFII allows access to additional asset classes such as bonds that currently are not covered under the Connect scheme. CSOP noted that location of RQFII was key to them in terms of structuring their products. The lack of RQFII quota in HK (as it has been used up) has made them look overseas. This has made the logistics of managing their A share access programmes more complex, but not much more expensive in terms of costs.

- **Mutual Fund Recognition**. The panel noted that so far, the MFR scheme has been a disappointment with only 6 funds approved for Northbound distribution. HSBC, who act for 4 of the 6, noted that distribution is the main hurdle to overcome, given banks have control of distribution at present, making it hard to find the necessary mainland agents and distributors.

Ireland and the Asia Financial Community

Peter Ryan, Consul General of Ireland to Hong Kong and Macau, gave an overview of Ireland's strong links with the Asian Financial Community. Emphasized was the importance of the multi-faceted business relationship with China (e.g. the successful trade agreements within the aviation industry) as that helps drive financial sector initiatives and progress.

Irish Funds Ahead – Asia Pacific in 2016-2017

At the Hong Kong and Singapore events, the Chair of the Irish Funds Asia group, Tony Riha, outlined organizational plans for the region. Our daily goal is to have Irish Funds be a multi-faceted resource for Hong Kong, mainland China and Southeast Asia. This extends beyond the hosting of events and includes committee contribution on funds industry initiatives, Working Groups and consultation publications.

The importance of partnership with the Asia-based funds community was emphasized as the contributions of our membership and participants drive the high-quality of content that is delivered.

Irish Funds continue to enhance its role as voice of and resource to the funds community. Please contact Asia Representative Tony Riha at hongkong@irishfunds.ie or on +852 6686 3861 with questions, comments and requests.

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