ARFP SET TO TURBOCHARGE ASIA-PACIFIC ASSET MANAGEMENT

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Research by BNP Paribas shows that the Asia Region Funds Passport (ARFP) will boost growth in retail assets under management (AUM) among signatories to the scheme. Although issues such as tax neutrality need to be resolved before launch, it has the potential to be a game changer for the fund industry in the region.

Though planning for the ARFP began as early as September 2013, the starting gun for implementation was fired in April this year, when Australia, Japan, South Korea and New Zealand signed a memorandum of co-operation (MOC) on the scheme that came into effect on 30 June. Thailand also confirmed its participation in June, while the Philippines has committed to adopt IOSCO principles in order to be compliant so that it may join the ARFP scheme in future. Singapore, which was an original member of the ARFP working group, has deferred its participation over taxation concerns.

The five committed signatories have 18 months to take the necessary domestic steps in order to comply with the terms of the agreement. Activation of the ARFP will happen as soon as any two of these economies implements the MOC arrangements, meaning it is likely to launch sometime next year.

Enhancing growth in AUM

The launch of the ARFP has the potential to give the asset management industry in Asia-Pacific a rapid and significant boost. Research and analysis by BNP Paribas shows that when implemented, the ARFP will boost growth in retail AUM among signatories by more than 10 percentage points over five years.

Regional AUM growth analysis by BNP Paribas used two scenarios:

- First, a control scenario excluding any ARFP impact: our forecasts indicate that retail AUM across the five ARFP markets will grow from US$1,602bn in 2017 to US$2,245bn in 2022, or by 40% over the period. This "organic" growth is based on individual market characteristics and potential, consistent with past performance[1].
- Second, the ARFP scenario: when factoring in expected changes in investor behaviour owing to the launch of the ARFP, we anticipate combined retail AUM across the five markets has the potential to grow to US$2,435bn by 2022 – or an additional US$190bn over the baseline forecast (Figure 1). This equates to growth of 52% over five years.

> "In summary, our analysis suggests the successful implementation of the ARFP has the potential to boost retail AUM by 12 percentage points over a five year period, a significant and appealing gain."

Furthermore, the potential size of the ARFP market offers a compelling case for regional and global asset managers to pursue opportunities in participating jurisdictions. Driven by regional regulators and industry participants to promote a unique regional funds framework, asset managers will look to swiftly adapt their business models and capitalise on the potential generated by the ARFP.

> **"Today, fund managers sell their funds to individual and limited markets in Asia. Tomorrow, with fund passporting schemes like the ARFP, they will sell their funds to the whole Asian market."**

Remi Toucheboeuf, Head of Asset and Fund Services Product, Asia BNP Paribas Securities Services

[1] BNP Paribas analysis based on data and CAGR projections from Cerulli Associates: The Cerulli Report, Asset Management in SEA 2015, Asian Distribution Dynamics 2015 and Cerulli Edge Global 2016

How will the ARFP affect investor behaviour and boost AUM?

Adding to organic growth expected in retail assets under management, we expect the introduction of the ARFP to impact investor behaviour in a number of ways and provide an AUM boost across the region.

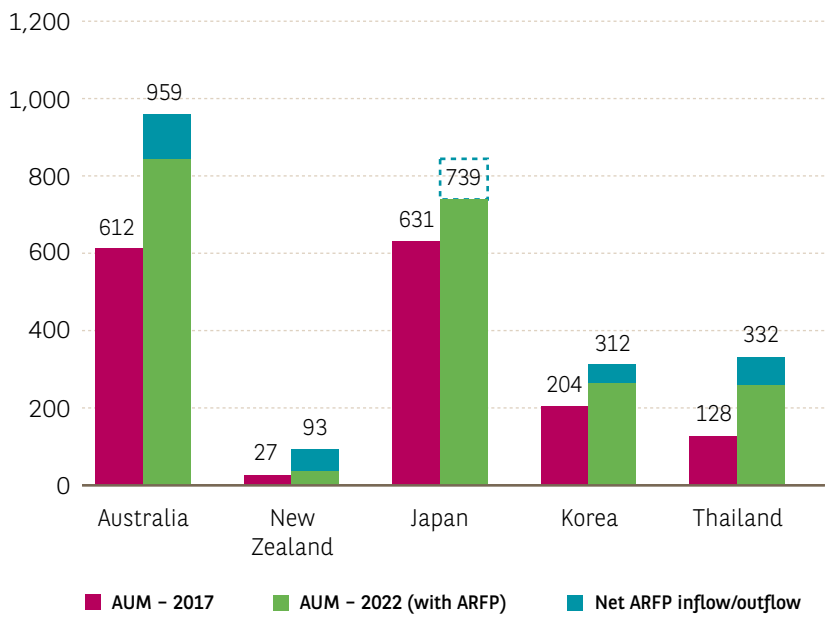
The introduction of the scheme means retail investors will have greater choice of investment options and strategies. Increasing investor education and sophistication, in addition to growth in the advice industry, will also drive asset managers to innovate and enhance their services to remain competitive. Over time, investors will also become more investment savvy and will have access to a much greater variety of investment vehicles, increasingly available through mobile digital channels. Additionally, as developing markets in the region mature, we are likely to see an increase in compulsory savings initiatives, further driving growth in AUM and cross border investment allocations.

The end result will be a shift in investor behaviour from a typically strong bias to domestic equities, bonds and cash towards more sophisticated ARFP investment options. In addition, as the universe of fund choices expands, retail investors in these countries are likely to increase the amount of money they put into foreign-domiciled ARFP funds (that is, "imported funds") at the expense of locally domiciled funds.

Of course, these effects will not be equal across each of the countries in the ARFP scheme. Their impact will vary depending on the maturity of the domestic asset management industry, the regulatory landscape, the size of the market, the sophistication of investors and their existing exposure to foreign funds, as well as the macroeconomic environment.

Taking these factors into consideration, our analysis indicates that Japan is likely to see the highest ARFP-related net outflows, totalling US$105bn in the period 2017-22, supplying a large proportion of the aggregate "cross-border" effect. Meanwhile, Australia is anticipated to see net inflows following the introduction of the ARFP of US$117bn over the same five year time period. The other participating markets are projected to experience varying net inflows and boosts to AUM (Figure 1).

Figures 1: Impact of the ARFP



Digital technology: enabler and disruptor

While evolving investor behaviour is expected to boost AUM in ARFP signatory markets, another major force is also likely to drive growth in regional assets under management: digital disruption in fund distribution.

The two forces are interlinked, since digital disruption is rapidly decreasing the costs of investment to end consumers. Online fund platforms typically have little to no sales fees and marginal management fees. Fee-conscious retail investors in ARFP markets will increasingly rely on such platforms to access the wide variety of products that will proliferate once the ARFP takes off. Already, some Asian asset managers are launching online-only funds.

For asset managers, digital distribution also makes market entry much easier. Traditionally, Asian markets have been difficult for foreign fund managers to penetrate due to high barriers to entry and a heavy domestic bias. Global managers looking to distribute products typically require a local distribution partner. Yet the challenge with this model is that local banks typically distribute their own locally manufactured products from their related asset management divisions through their retail branch networks.

An alternative model requires the fund manager to establish operations on the ground in the target market. This can be a costly and lengthy process before any momentum and results are achieved. But with the rapid development of mobile platform technology, disruption to traditional channels for fund distribution, particularly amongst younger generations, is expected to be exponential.

Firms that adopt digital technology as both an enabler and a disruptor can challenge existing barriers to entry and develop new distribution models through mobile platforms. Successful firms will need to embrace this technology to capture the growing young middle class in key Asia-Pacific markets. We expect the larger established asset managers to eventually adopt hybrid distribution models that combine traditional distribution channels with developing digital options.

A done deal?

Our analysis assumes a successful rollout of the ARFP, but that is not yet assured. Several important issues still need to be resolved, including the tax treatment of participating funds in the scheme. Recent analysis conducted by EY cites the diversity of local tax rules as a challenge to reaching agreement between ARFP participants.[2] To be successful, the ARFP will need to remove any uncertainty around taxation, and ensure a level playing field for participating countries.

Further, the success of the scheme depends on practical and operational issues facing participants, such as the level of familiarity investors have with the ARFP, the operating costs for fund managers, the involvement of fund distributors and the degree of regulatory support available. In addition, the existence of local currency controls, as in Thailand and Korea, remain a key challenge to cross-border investment. A supportive foreign exchange policy will need to be implemented in all ARFP participants to reassure investors.

For the ARFP to reach its maximum potential in each market these operational details must be resolved. For Australia, to take one example, "the ARFP offers local asset managers access to the increasing demand from Asian investors for competitive cross-border investment options," says Adam Halvorson, Product Manager at BNP Paribas Securities Services. "But it's critical that industry and government get the framework right."

[2] EY, "Asia region funds passport – the state of tax", August 2016

The best game in town

None of the challenges are insurmountable. Given the participation of global giants like Australia and Japan (the world's third- and fourth-largest pension markets by AUM[3]), the ARFP is shaping up to be the most promising fund passporting scheme in the Asian region. The inclusion of Singapore, a key regional player, and the emerging economies of the Philippines, Thailand and, further downstream, Indonesia, Malaysia and others, has the potential to greatly expand the size of the market.

Asset managers and regulators in emerging jurisdictions will need to adopt best practices to participate and become competitive, suggesting an exciting opportunity for the growth and development of the industry in these markets. In addition, as asset managers seek to enter new markets quickly, they are likely to be forced to innovate both in terms of product development and digital distribution, broadening the potential pool of investors.

"A successful ARFP provides the region with extraordinary opportunities. The strengthening of cross-border ties, market development and product innovation offers investors and industry players alike a challenging but exciting new landscape ahead."

Adam Halvorson, Product Manager, Asset and Fund Services, BNP Paribas Securities Services

Taking these factors into account, support for the ARFP is rising among market participants. In a recent survey by Asian Investor of senior executives from asset owners, distributors and asset management firms, 36% picked the ARFP as the passport regime likely to create the best platform for business growth, up from 24% in 2015. By contrast, the survey showed confidence in the ASEAN Collective Investment Scheme (CIS), launched in 2014 with Thailand, Malaysia and Singapore as signatories, and the Mutual Recognition of Funds (MRF) programme between Hong Kong and mainland China, fell from last year.[4]

Ultimately, it seems likely that the passporting initiatives in the region will be consolidated, with the ARFP playing a key role. In the meantime, the growth in the region's retail mutual fund AUM as a result of the ARFP means regional investors will benefit from greater investment choice and product innovation. Additionally, fund managers and distributors in the region will need to innovate to be competitive and generate new business. Finally, regulators will oversee the development of the regional financial markets, ultimately leading to a stronger, more sophisticated funds management infrastructure servicing the world's most dynamic economic region.

[3] OECD Pension Funds in Figures, June 2016

[4] Asian Investor, "Confidence wanes on cross-border schemes", 26 July 2016

BNP Paribas: The Asia fund passporting experts

BNP Paribas Securities Services has significant experience helping clients seize the opportunities presented by fund passporting schemes in the Asia-Pacific region, including the ASEAN Collective Investment Scheme (CIS) and the Hong Kong-China Mutual Recognition of Funds (MRF) initiative.

Since the launch of the ASEAN CIS, BNP Paribas has taken a leading role exploring the initiative with our clients, setting up operations and meeting with regulators to clarify guidelines. In fact, all six Singapore-domiciled funds authorised by regulators under the scheme (out of 11 CIS funds authorised to date) are offered by clients of BNP Paribas Securities Services.

BNP Paribas Securities Services will support participants in the MRF scheme with flexible and automated solutions for northbound funds. Our operating model takes benefits of market utilities and facilitates the management of the cross border flows. We offer end-to-end fund services in Hong Kong for funds domiciled seeking to access the burgeoning mainland market.

Contact

Australia
Adam Halvorson
Product Manager, Asset and Fund Services,
BNP Paribas Securities Services
adam.halvorson@au.bnpparibas.com

Asia
Remi Toucheboeuf
Head of Asset and Fund Services Product, Asia
BNP Paribas Securities Services
remi.toucheboeuf@asia.bnpparibas.com

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