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By Email

Dear Alan

Consultation Paper 268 - Proposed repeal of [CO 03/824]

1 Introduction

Allens welcomes the opportunity to provide comment on ASIC's proposed repeal of ASIC Class Order [CO 03/824] (***[CO 03/824]***) and the issues raised in Consultation Paper 268 *Licensing relief for foreign financial services providers with a limited connection to Australia* (***CP 268***) more generally. While we do not ourselves rely on [CO 03/824], we regularly advise foreign financial service providers about the licensing and regulatory issues associated with providing financial services in Australia generally and [CO 03/824] in particular.

2 Summary

In summary, in our view:

- [CO 03/824] provides a very useful regulatory purpose and should be maintained; and
- section 911A(2E) does not adequately cover the same ground.

3 Policy background to [CO 03/824]

Paragraph 9 of CP 268 says:

> The original policy rationale for this relief was to ensure that isolated transactions by a foreign entity with Australian wholesale clients would not require that entity to hold an AFS licence. It was granted in part due to concerns that overseas counterparties to derivatives and foreign exchange transactions may be caught by engaging in inducing conduct under s 911D when issuing financial products to Australian wholesale clients. This would require those overseas counterparties to be licensed for entering into ad-hoc derivative and foreign exchange contracts with Australian wholesale clients.

While concerns about derivatives and forex transactions may no doubt have been an element, we submit that the policy intent was not limited to, or even primarily focused on, this kind of transaction. For example, ASIC Information Release 03-28 (1 October 2003) simply states that the purpose of [CO 03/824] is 'clarification of when the licensing provisions apply to wholesale financial service providers who have only a limited connection to Australia' and 'provides relief from the requirement

to be licensed for foreign providers of financial services to wholesale clients, where the provider would not need to be licensed other than as a result of s 911D of the Corporations Act (ie because otherwise they are not conducting a business in Australia)'. Current Regulatory Guide 121 suggests a similar breadth of purpose.

4 Scope and practical use of [CO 03/824]

As CP 268 notes, section 911A(2E) as inserted by r 7.6.02AG *Corporations Regulations 2001* (Cth) (***s 911A(2E)***), is different from [CO 03/824] in two important respects.

First, and most significantly, s 911A(2E) only applies to a relatively limited range of financial services relating to derivatives, forex and carbon emissions products. In our experience, [CO 03/824] is relied on, or at least considered, by many foreign financial service providers who undertake a broader range of activities than those permitted under s 911A(2E). Based on their recent publications on CP 268, other law firms have a similar experience.

Second, s 911A(2E) is only available in relation to professional investors rather than wholesale clients. The category of professional investor is much narrower and, to some extent, more difficult to establish. Specifically, the price or value of the financial products, their use in connection with a business (that is not a small business) or the person's net assets or gross income are each tests relevant for determining a person's status as a wholesale client. None of these are relevant considerations for determining a person's status as a professional investor.

While for many of our foreign financial service provider clients the narrower requirement is unlikely to be problematic, it is likely to be a more significant restriction for smaller enterprises (those more often likely to need to rely on [CO 03/824] before they decide to increase their engagement with Australia).

5 Policy

5.1 Impact of repeal

In our view, the repeal of [CO 03/824] could adversely affect Australian wholesale investors' access to international investment opportunities by unduly restricting foreign financial service providers' ability to deal with Australia-domiciled wholesale clients.

[CO 03/824] facilitates foreign financial service providers assessing whether to begin operating in Australia in earnest and as such can be a helpful means of establishing whether further activity in Australia is worthwhile and, as such, encourages competition and facilitates innovation in the Australian market.

If [CO 03/824] is repealed, in our view, there is a real risk that some foreign financial service providers will be forced to not engage with Australian investors with a consequent reduction in competition.

Other exemptions available are limited to specific fact scenarios which have limited application or are available only to entities that are subject to equivalent regulation in a number of recognised foreign jurisdictions.

5.2 Policy balance

We submit that, in policy terms, [CO 03/824] strikes an appropriate balance between, on the one hand, facilitating access to the Australian market and encouraging competition and, on the other hand, protecting Australian investors:

- the relief is limited to situations not resulting in a business being carried on in Australia so it is really only available very limited circumstances (such as an offshore fund manager raising capital from Australian wholesale investors without carrying on a business in Australia); and

- the relief only applies when services are being provided to wholesale clients, who are well placed to look after their own interests. In this regard, we observe that, generally, wholesale clients who contemplate opportunities from foreign financial service providers relying upon [CO 03/824]:
  - are advised by financial, legal and asset-specific experts as required;
  - conduct comprehensive due diligence on the background and track record of the financial services provider and the underlying opportunity or investment being offered, rather than simply confirming that the provider is licensed; and
  - document any investment or appointment in a detailed (and heavily negotiated) contract.

6 Consultation process

We have, in part, made this submission because we are concerned that many of those potentially affected will not themselves write to ASIC. This is not due to lack of interest on their part but simply the fact that those most likely to be affected do not, almost by definition, have any substantive connection with Australia. Also, at any given time, the class of people actually relying on [CO 03/824] is likely to change: either their connection to Australia will cease (or never start in any meaningful way) or they will have progressed their business and obtained an AFSL or obtained an exemption under one of the 'equivalent regulation' instruments.

Paragraph 15 of CP 268 suggests that ASIC will repeal [CO 03/824] if only a small number of responses from those relying on the class order are received. Given that those relying upon [CO 03/824] (or who have relied upon it in the past) may not become aware of CP 268, we submit ASIC should not repeal [CO 03/824] based solely upon a small number of responses.

We have set out our responses to CP 268 in the annexed schedule. If you have any questions about our submission or would like to discuss any aspect of it, please contact us.

Yours sincerely

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Schedule 1 – Questions in CP 268

B1Q1. Are you an entity that relies on [CO 03/824] and, if so, for what financial services? Please provide details.

Allens does not rely upon [CO 03/824] but we regularly advise entities who may rely upon [CO 03/824].

B1Q2. Do you consider that [CO 03/824] is currently operating effectively and efficiently? Please give reasons for your view.

Yes.

The breadth of the relief provided by [CO 03/824] is of significant benefit to many of our clients who only undertake very limited and infrequent activities in Australia, and who would not otherwise justify the significant initial and ongoing costs of passporting their foreign licence to Australia or obtaining an Australian financial services licence in their own right.

The scope for misuse of [CO 03/824] is very limited as relief is only provided in respect of financial services provided to wholesale clients and in circumstances where no business is being carried on in Australia. Non-compliance with the instrument is supported by an appropriate penalty as non-compliance with [CO 03/824] amounts to unlicensed conduct in contravention of s 911A *Corporations Act 2001* (Cth).

B1Q3. Do you rely on [CO 03/824] to provide financial services in relation to financial products that are not referred to in s 911A(2E)? If so, please provide details of these services and products.

As noted above, Allens does not provide financial services but we regularly advise entities seeking to rely upon [CO 03/824].

[CO 03/824] applies to all financial services that may be provided by a foreign financial service providers to Australian clients while s 911A(2E) only applies to dealing, providing financial product advice and making a market in respect of derivatives, foreign exchange contracts, carbon units, Australian carbon credit units or eligible international emissions units.

The breadth of relief provided by [CO 03/824] is a unique and significant feature of the relief.

B1Q4. If we repeal [CO 03/824], do you think that one year is an appropriate transitional period to facilitate future compliance with the Corporations Act, including seeking any other relevant exemptions that may be necessary for you to continue providing financial services to Australian wholesale clients? Please give reasons for your view.

No.

Some entities presently relying upon [CO 03/824] will be unaware of the repeal should it occur given their very limited connection with Australia. Although these entities typically maintain internal procedures for regulatory compliance, there is still a risk of inadvertent non-compliance if there is a relatively short transitional period. We submit a longer period (say, two years) should be adopted should ASIC decide to repeal [CO 03/824].

Further, in our view, there is no similar alternative exemption available to entities relying upon [CO 03/824]. Legislative reform would be needed to afford these entities an equivalent level of regulatory exemption.

B1Q5. If we were to continue the relief in [CO 03/824], what would be the costs associated with a requirement to notify ASIC when you are relying on [CO 03/824]? Please give reasons for your view.

It is difficult to estimate total costs for preparing a notification without further details of the information to be provided and the format for providing it. Also, most costs would be internal to users so we are not in a position to estimate this.

Having said this, we think a simple notification requirement may be an appropriate condition for relying upon [CO 03/824]. We would not, however, support giving notification of ceasing to rely. This kind of notification is often overlooked and the consequences of failing to notify may be complex.

B1Q6. If we were to temporarily extend the relief in [CO 03/824] until the expiry of ASIC Corporations (Repeal and Transitional) Instrument 2016/396, what would be the costs associated with a requirement to notify ASIC when you are relying on [CO 03/824] during the extension period? Please give reasons for your view.

See our previous answer.