association of the luxembourg fund industry

To Mr Alan Worsley
Senior Specialist, Strategic Policy
Australian Securities and Investments Commission
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31 July 2018

Dear Mr Worsley

RESPONSE TO ASIC CONSULTATION PAPER 301: FOREIGN FINANCIAL SERVICES PROVIDERS

1 Introduction

The Association of the Luxembourg Fund Industry (**ALFI**) appreciates the opportunity to comment on the proposed changes regarding the regulation of foreign financial services providers in ASIC Consultation Paper 301: *Foreign financial services providers* (**CP 301**).

ALFI is the representative body of the Luxembourg investment fund community. Created in 1988, ALFI today represents over 1,400 Luxembourg domiciled investment funds, asset management companies and a wide range of service providers such as depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax experts, auditors and accountants, specialist IT providers and communication companies. Luxembourg is the largest fund domicile in Europe and the Luxembourg funds industry is a worldwide leader in cross-border fund distribution. Luxembourg domiciled investment structures are distributed in more than 70 countries around the world.

2 General comments regarding CP 301

In 2013, ALFI applied for class order relief from the requirement for CSSF-regulated financial services providers[1] to hold an AFS licence in respect of financial services provided to wholesale clients only in Australia. AFS licensing relief was granted by ASIC on 8 November 2016 under *ASIC Corporations (CSSF-Regulated Financial Services Providers) Instrument 2016/1109* (**Instrument 2016/1109**).

We regret that ASIC is now proposing to repeal the sufficient equivalence relief. We believe that the current licensing relief regime provides an appropriate way to facilitate cross-border investment while ensuring investor protection, as it offers Australian wholesale clients efficient access to financial products from jurisdictions that have been assessed as having regulatory frameworks that are sufficiently equivalent to the framework in Australia. Instrument 2016/1109

[1] As defined in *ASIC Corporations (CSSF-Regulated Financial Services Providers) Instrument 2016/1109*.

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has enabled significantly easier access to UCITS[2] initiated by fund managers regulated by the CSSF in Luxembourg.

3 Background in relation to UCITS in Luxembourg

The UCITS concept is originally derived from the European Directive 85/611/EC, replaced by European Directive 2009/65/EC (the **Directive**), which provides a single regulatory regime across the European Union for open-ended funds investing in transferable securities such as shares and bonds.

One of the primary objectives of the UCITS regime is to harmonise collective investment schemes in the EU through the introduction of a common investment vehicle which can be established and regulated in one EU Member State and marketed across the EU without the need for further authorisation (i.e. the so-called "passport"). With a view to defining the highest levels of investor protection and in recognition of the UCITS' retail nature, the Directive regulates the organisation, management and oversight (including conduct of business rules) of such funds, while imposing rules concerning diversification, liquidity and use of leverage, among other items. More recently, as from March 2016, the Directive also sought to harmonise further the provisions in respect of UCITS fund depositaries, specifying safe-keeping duties, asset protection standards via appropriate segregation requirements, as well as a strong liability regime in the event such rules were to be breached.

The UCITS brand is recognized as the only true globally distributed investment fund product, and a growing number of countries in Asia and Latin America have accepted UCITS as providing a stable, high quality, well-regulated investment product with significant levels of investor protection. Given such guarantees, local authorities have been traditionally comfortable in permitting the sale of UCITS to retail investors in their respective jurisdictions outside the EU. Today, UCITS are marketed on a global basis in more than 70 countries with a particular focus on Europe, Asia, Latin America and the Middle East. As a result, many asset managers are establishing UCITS funds with a clearly defined global distribution strategy.

4 Specific issues in relation to the regime proposed under CP301

In our view, some significant concerns raised by the proposed foreign Australian financial services (**FAFS**) licencing regime described in CP 301 and we recommend that an alternative approach to regulating FFSPs should be explored by ASIC. Further detail is set out below.

4.1 Practicability and increased regulatory cost burden

We welcome ASIC's position that it does not intend to undertake a further sufficient equivalence assessment of the financial services regulatory regime in respect of Luxembourg.

However, the FAFS licencing regime described in CP 301 will increase regulatory costs, which is ultimately not in the interest of Australian investors. Increased regulatory burden and fees may

[2] "UCITS" means Undertakings for Collective Investment in Transferable Securities.

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lead some asset management groups to reconsider offering their UCITS to Australian wholesale investors if the time, cost and resources required to apply for and hold a FAFS licence, and the obligations that this would entail, cannot not be commercially justified. This would reduce the investment horizon available to Australian wholesale investors. This is particularly the case for FFSPs with little or no presence in Australia and a limited proportion of their global business in Australia. Unless other exemptions are available, there is a real risk that those FFSPs will refuse to service Australian wholesale clients going forward.

The requirement to hold a foreign AFS licence could therefore significantly limit the ability of Australian wholesale investors to access foreign financial services and products from Luxembourg.

We would **recommend** that ASIC consider an alternative, middle ground approach to regulating FFSPs going forward (see section 4.3 below for one possible alternative which in our view would address this concern).

4.2 Perceived lack of reciprocal exemptions – registration in Luxembourg

We would like to address ASIC's concern that Australian financial service providers have not been granted reciprocal passport exemptions in foreign markets. In the case of Luxembourg, it is, in fact, very simple for Australian financial service providers to distribute products to clients. There are currently four different options available:

(1) Marketing of AIFs[3] to professional investors in Luxembourg without passport by non-EU AIFMs on the basis of article 45 of the Law of 2013[4]

(2) Marketing of non-EU AIFs to professional investors in Luxembourg without passport by EU AIFMs on the basis of article 37 of the Law of 2013

(3) Australian open end domiciled funds as target funds of Luxembourg UCITS

(4) Australian closed end, listed domiciled funds as transferable securities for a Luxembourg UCITS

The four options are detailed in the appendix.

[3] AIF: Alternative Investment Funds

[4] Law of 2013: Law of 12 July 2013 regarding alternative investment fund managers, transposing Directive 2011/61/EU of the European Parliament and of Council of 8 June 2011 on Alternative Investment Fund Managers, as amended.

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In addition, on 18 July 2016, ESMA released its advice to the European Parliament, the Council and the Commission on the extension of the AIFMD[5] passport to non-EU AIFMs and AIFs in 12 non-EU countries, including Australia [ESMA/2016/1140] as detailed here:

ESMA: general advice on the potential extension of the passport to Australia (page 67)

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding the monitoring of systemic risk impeding the application of the AIFMD passport to Australia. With respect to investor protection, ESMA is of the view that there are differences between the Australian regulatory framework and the AIFMD. However, given the general requirements mentioned above in paragraph 19 applicable to all non-EU AIFMs wishing to make use of the AIFMD passport, these differences are not seen as a significant obstacle impeding the application of the AIFMD passport to Australia.

Having regard to the above assessment ESMA is of the view that there are no significant obstacles regarding market disruption and obstacles to competition impeding the application of the AIFMD passport to Australia, provided the abovementioned class order reliefs are extended to all EU Member States.

As set out in section 1.1. of its advice, "*Within three months of receipt of positive advice and an opinion from ESMA, and taking into account the criteria of Article 67 (2) and the objectives of the AIFMD, the Commission should adopt a delegated act specifying the date when the rules set out in Article 35 and 37 to 41 of the AIFMD become applicable in all Member States. As a consequence, the EU passport would be extended to non-EU AIFs and non-EU AIFMs*".

As a result of the decision of the United Kingdom to leave the European Union, this process has temporarily been put on hold until the future relationship between the United Kingdom and the European Union has been clarified. It is however expected that the process will resume when an agreement has been found.

Articles 37 and 45 of the Law of 2013[6] will cease to be applicable once the European Commission has adopted the delegated act referred to under Article 68(6) of Directive 2011/61/EU, and from the date disclosed therein.

From that date on, the passport regime provided for in Article 35 and 37 to 41 of the AIFMD shall become the sole and mandatory regime applicable in all EU Member States, including Luxembourg

Consequently, at least in the case of Luxembourg, we submit that express reciprocal exemptions are not required where the Australian provider complies with the reasonable rules or guidelines

[5] AIFMD: Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

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limiting its operations in, or connection to, Luxembourg. The lack of expressly reciprocal exemptions is not the result of any unwillingness to grant equal treatment to Australian financial service providers by the CSSF.

4.3 How will FFSPs relying on Instrument 2016/1011 be affected?

Given the very significant impact the proposals will have on our members relying on Instrument 2016/1011, and their Australian clients, we believe that it is critical that appropriate transitional arrangements are implemented.

In particular, we would welcome further detail and clarity regarding how ASIC intends to deal with FFSPs that have (i) already implemented AFS licensing relief under Instrument 2016/1011 and (ii) issued interests in their UCITS to wholesale investors in Australia in reliance on that relief, but ultimately determine that becoming an FAFS licensee is not commercially justifiable (see section 4.1 for further detail). In these cases, there is a risk that Australian investors may be subject to compulsory redemptions of their investments. We submit that it would be an undesirable outcome for Australian clients to merely be subject to compulsory redemptions from investments, as it is possible that this will result in adverse outcomes for those clients.

We would **recommend** that (i) greater detail be provided in relation to any proposed transitional arrangements and (ii) industry is consulted in relation to those proposed transitional arrangements.

Further, and in addition to our recommendation in section 4.1, we would **recommend** that an alternative, more efficient, approach to regulating FFSPs currently relying on sufficient equivalence relief would be to extend the AFS licensing relief currently provided by section 911A(2E) of the Corporations Act[7], to cover other financial products together with custodial or depository services. We submit that the "professional investor" and "not in this jurisdiction" conditions of this relief would ensure that this broader exemption would be subject to appropriate limits, which are comparable to those that are currently in place under the FFSP relief regime. For completeness, we note that the definition of professional investor is narrower than wholesale client, and so this modification of section 911A(2E) would exclude high net wealth individuals holding qualified accountant certificates.

4.4 Alignment with ASIC's regulatory objectives

Finally, it is not apparent to us that issuing a foreign AFS licence places ASIC in a significantly better positon to regulate and supervise FFSPs than it is in under the current relief framework.

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[7] As inserted by Corporations Regulation 7.6.02AG. Section 911A(2E) currently provides an exemption where:

- the service provider is "not in this jurisdiction";
- the client is a "professional investor"; and
- the services are limited to dealing, advice and market making in relation to derivatives, FX and certain carbon credits.

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We are concerned that the current proposal under CP 301 does not demonstrate, based on substantive evidence, that the proposed FAFS licensing framework will improve matters relating to ASIC's fundamental concern that the current relief framework for FFSPs no longer strikes the appropriate balance between cross-border investment facilitation, market integrity and investor protection. In particular we would like emphasise that:

(a) as noted in section 4.1, we are concerned that the changes proposed under CP 301 will practically hinder cross-border investment and significantly limit the ability of Australian wholesale investors to access financial services and products from Luxembourg; and
(b) in practice, CSSF-regulated financial services providers relying on Instrument 2016/1011 will often have little or no presence in Australia. These businesses operate on a remote cross border basis, with all staff (including those with "responsible manager" roles), compliance, business support, infrastructure and other resources located outside Australia. The result could therefore be that ASIC would be responsible for licensing and regulating a group of AFS licence holders with no meaningful presence in Australia, and it is not clear that this will solve the administrative and jurisdictional difficulties identified CP 301.

In this regard, we repeat our recommendation in section 4.1.

5 Recommendations in relation to the FAFS licence framework proposed under CP 301

We are mindful that, despite the significant concerns noted in section 4, ASIC may ultimately determine to proceed with the FAFS licensing framework proposed under CP 301. If this is the case, we would **recommend**:

(a) that further detail be provided in relation to the express requirements of the proposed FAFS licence application and variation processes, including the number and type of documents and the nature of any information that must be lodged with ASIC to apply for, or vary, a FAFS licence;
(b) that if a FFSP with multiple affiliates wishes to have those affiliates licensed to provide financial services in Australia, whether or not a more streamlined regulatory process can be implemented, or if specific exemptions will be available for affiliates of FAFS licensees;
(c) further to recommendation 5(b) above, that ASIC consider:
    (i) designating a dedicated ASIC contact to an FFSP group who can actively engage with that FFSP group's financial services business in Australia, its FAFS licence applications and any regulatory queries or correspondence;
    (ii) establishing a dedicated ASIC FAFS licence query mailbox & contact person or team, which is capable of providing reliable regulatory assistance to FAFS licence holders, noting that FAFS licence applicants will be foreign entities; and
    (iii) publishing a FAFS licence application kit similar to the AFS licensing kit under ASIC Regulatory Guides RG 1, RG 2 and RG 3, together with pro-forma FAFS licence authorisations similar to those under ASIC Pro-forma 209 and a sample FAFS licence application summary, similar to the ASIC Sample eLicensing Application. We submit that drafts of these materials should also subject to industry consultation before being finalised;

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(d) that in the absence of appropriate transitional provisions, it is likely that Australian wholesale clients may be subject to compulsory redemptions of their investments. Consequently, FFSPs currently relying on sufficient equivalence relief should have the benefit of (i) an appropriate grandfathering regime and (ii) a streamlined FAFS licensing process or alternative AFS licensing exemptions (see section 4.3 above) that replace the sufficient equivalence relief instruments. In particular:
    (i) in respect of a possible grandfathering regime, we submit that such a regime would be justifiable on the basis that the home jurisdiction, in our case Luxembourg, has been previously recognized as sufficiently equivalent to that in Australia; and
    (ii) in respect of a streamlined FAFS licensing process, we suggest that FFSPs already relying on sufficient equivalence relief, eg under Instrument 2016/1011, be eligible for a streamlined FAFS licence application process. A streamlined application could, for example, comprise an application form and a single business description proof document. A streamlined application would result in a FAFS licence with the same authorisations as covered by the relevant passport exemption;
(e) that, if FAFS licences are to be generally available to FFSPs, ASIC will need to clarify what (if any) level of presence in Australia will be required to enable ASIC to achieve it's oversight and enforcement goals, and also ensure that the proposed regulatory framework is commercially viable; and
(f) that the FAFS licence application process must take into account the limited connection relevant FFSPs will necessarily have to Australia. At a minimum, it will need to:
    (i) permit applications by FFSPs that operate from outside Australia, whose resources (including human and technology resources) are not located in Australia; and
    (ii) permit persons to be nominated a responsible managers who will necessarily have limited, or no, experience operating in the Australian market under an AFS licence.

We trust this submission is useful for ASIC's policy formulation. Please do not hesitate to contact Pierre Oberlé, Senior Business Development Manager at ALFI [redacted] should you wish to discuss it.

Yours sincerely

Pierre Oberlé
Senior Business
Development Manager

Camille Thommes
Director General

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<u>Appendix:</u> 4 options for Australian financial service providers to distribute products to clients in Luxembourg

In the case of Luxembourg, it is very simple for Australian financial service providers to distribute products to clients. There are currently four different options available:

(1) Marketing of AIFs to professional investors in Luxembourg without passport by non-EU AIFMs on the basis of article 45 of the Law of 2013

Without prejudice to Articles 37, 39 and 40 of the AIFMD[8], non-EU AIFMs are authorised to market to *professional investors*, in the territory of Luxembourg, units or shares of AIFs they manage, subject at least to complying with the conditions set out in article 25 of the Law of 2013, *irrespective of the nationality of the relevant AIF(s)* (Luxembourg, EU or *non-EU*) or whether the AIF(s) is/are regulated or not in the country it is/they are established.

As such, an Australian manager is allowed to market an Australian domiciled fund to *professional investors* in Luxembourg without passport.

Relevant legal texts and documents

a) Article 45 of the Law of 2013[9];

b) Application form and information notice at http://www.cssf.lu/en/supervision/ivm/aifm/forms/;

c) CSSF Frequently Asked Questions (Version 11, 7 July 2017) concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers, questions 18 a) – 18 j) page 38/ 39.

(2) Marketing of non-EU AIFs to professional investors in Luxembourg without passport by EU AIFMs on the basis of article 37 of the Law of 2013

Without prejudice to Article 35 of the AIFMD, an authorised AIFM established in Luxembourg or in another Member State is allowed to market to *professional investors*, in the territory of Luxembourg only, units or shares of *non-EU AIFs* it manages and of EU feeder AIFs whose master AIF(s) is/are not (an) EU AIF or whose master AIF(s) is/are not managed by an authorised EU AIFM.

Relevant legal texts and documents

a) Article 37 of the Law of 2013;

[8] AIFMD: Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

[9] Law of 2013: Law of 12 July 2013 regarding alternative investment fund managers, transposing Directive 2011/61/EU of the European Parliament and of Council of 8 June 2011 on Alternative Investment Fund Managers, as amended.

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b) Application form and information notice at
http://www.cssf.lu/en/supervision/ivm/aifm/forms/

c) CSSF Frequently Asked Questions (Version 11, 6 July 2017) concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers, questions 19 a) – 19 k) page 40/ 41.

As such, a European manager is allowed to market an Australian domiciled fund to *professional investors* in Luxembourg without passport.

(3) Australian open end domiciled funds as target funds of Luxembourg UCITS

A less known, but probably more significant route from a volume perspective for an *indirect* marketing of Australian domiciled funds in Luxembourg is the possibility for a Luxembourg UCITS to invest in Australian domiciled funds.

Other Luxembourg non-UCITS investment funds may invest in target funds as well.

Other UCITS and AIFs which are not established as funds of funds also invest in target funds on an ancillary basis, which significantly adds to the above figure.

An investment by a UCITS in a target fund that is not itself a UCITS is however subject to the conditions set out in article 41 1 e) of the Law of 2010[10], which can be summarised as follows:

(i) Such other target funds (UCIs) must be authorised under laws which provide that they are subject to supervision considered by the CSSF to be equivalent to that laid down in "EU law" and that cooperation between authorities is sufficiently ensured;

(ii) Equivalent level of investor protection, in particular with regards to rules on the segregation of assets, borrowing, lending, and uncovered sales of securities;

(iii) Target funds publish half-yearly and annual reports;

(iv) Target funds do not in turn invest more than 10% of their assets in other funds (prohibition of the "cascade mechanism").

(4) Australian closed end, listed domiciled funds as transferable securities for a Luxembourg UCITS

To the extent that a closed end fund is listed and regularly traded on a stock exchange, and that it meets the criteria to be considered as a transferable security, it can be acquired by a UCITS.

[10] Law of 2010: Law of 17 December 2010 relating to undertakings for collective investment (« UCIs ») transposing Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS); As amended by the Law of 10 May 2016, transposing Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

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This is explicitly provided for in article 2/ 2. (a) and (b) of Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions. There is also a reference thereto in recital (7)

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