

Allens

101 Collins Street
Melbourne VIC 3000 Australia

GPO Box 1776
Melbourne VIC 3001 Australia

T +61 3 9614 1011
F +61 3 9614 4661
www.allens.com.au

ABN 47 702 595 758

Allens > < Linklaters

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Alan Worsley
Senior Specialist, Strategic Policy
Australian Securities and Investments Commission
Level 5
100 Market Street
Sydney NSW 2000

Dear Alan

Consultation Paper 301 - Foreign financial services providers

1 Introduction

Allens welcomes the opportunity to comment on the Australian Securities and Investments Commission's (**ASIC**) proposed introduction of a Foreign Australian financial services (**AFS**) licence as raised in Consultation Paper 301 – *Foreign financial services providers (CP 301)*. In particular, we intend to comment on the proposed repeal of the 'limited connection relief' that has previously been provided under ASIC Class Order [CO 03/824] – *Licensing relief for financial services providers with limited connection to Australia dealing with wholesale clients (CO 03/824)* (and more recently under *ASIC Corporations (Foreign Financial Service Providers – Limited Connection) Instrument 2017/182 (Limited Connection Relief)*).

Allens regularly advises foreign financial services providers (**FFSPs**) in relation to the licensing and regulatory compliance obligations associated with providing financial services from offshore into Australia, including on the availability of Limited Connection Relief. Further, we are aware that the continued ability for FFSPs to rely on a form of Limited Connection Relief is of great importance to our Australian institutional clients seeking to access offshore investments and the services (including investment management services) of FFSPs.

We have, in part, made this submission because we are concerned that many of those potentially affected by the removal of Limited Connection Relief will not themselves write to ASIC. This is not due to lack of interest on their part, but simply due to 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 Limited Connection Relief 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 AFS licence (or relied on relief under a different exemption).

We note that Allens made similar submissions to ASIC on the repeal of Limited Connection Relief in 2016, when ASIC was considering whether to repeal CO 03/824. That submission was made in a letter addressed to you dated 2 December 2016.

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2 Summary

In summary, while we acknowledge ASIC's stated concerns in relation to Limited Connection Relief in CP 301, in our view (and the view of a number of our Australian institutional clients):

- A form of Limited Connection Relief is of critical importance to FFSPs seeking to raise capital / offer investments in Australia (but not to otherwise carry on a financial services business here), or to take preparatory steps towards operating in this jurisdiction, as existing licensing relief is of limited application in these cases.

Please see section 3 below for details.

- The removal of Limited Connection Relief is likely to result in a number of unintended consequences to the detriment of wholesale (including institutional) clients in Australia, including reduced access to offshore investments and the services of FFSPs by Australian wholesale (in particular, institutional) investors and an increasing need for Australian wholesale clients to deal with onshore SPVs of FFSPs with minimal capitalisation.

See section 4 below for details.

- We consider that a modified form of Limited Connection Relief could address ASIC's concerns, while at the same time continue to be available to those FFSPs who need to rely on such relief (and of those Australian institutional clients who rely on the services of FFSPs and seek continued access to offshore investments).

See section 5 below for details.

3 The continued need for Limited Connection Relief

While we acknowledge ASIC's concerns that some FFSPs may have given Limited Connection Relief a broader interpretation than was originally intended, we submit that Limited Connection Relief is of critical importance to FFSPs seeking to:

- (a) raise capital / offer investments in Australia (but not to otherwise carry on a financial services business here); or
- (b) take preparatory steps towards operating in this jurisdiction.

Further, we consider that this need **cannot** be met through other existing AFS licensing exemptions or the 'modified form' of AFS licence for FFSPs proposed in CP 301 (**Foreign AFS Licence**) and accordingly, there is a continued need for a form of Limited Connection Relief.

3.1 Circumstances in which Limited Connection Relief is still required

We consider that a form of Limited Connection Relief should continue to be available to FFSPs, who are not carrying on a financial services business in Australia, to enable them to undertake the following two limited financial services, to wholesale clients only, without the need to apply for a Foreign AFS Licence (which is a time-consuming and costly exercise).

(a) **Global investment offerings or capital raising**

In our experience, Limited Connection Relief is often used in the context of global capital raisings or investment offers by foreign entities into Australia. In addition to seeking investments from foreign investors, such foreign entities may also seek to raise funds from Australian wholesale investors. Such transactions are often time critical and global in nature, and applying for a Foreign AFS Licence would simply not be an option for such entities (or if it were an option, we consider it is unlikely that such entities would be willing to apply for and maintain an AFS licence or Foreign AFS Licence for an activity with such limited connection to Australia). The consequence is likely to be that such foreign entities would instead simply

exclude Australian wholesale investors from their offerings to the detriment of those Australian investors.

(b) Preparatory steps

Limited Connection Relief also assists FFSPs who are taking preparatory steps in the Australian market. This is because it enables them to assess whether to begin operating in Australia in earnest and as such can be a helpful means of establishing whether further activity and investment in Australia is worthwhile. It therefore encourages competition and facilitates innovation in the Australian market.

3.2 Availability of other licensing exemptions

Although other licensing exemptions are available to FFSPs under the *Corporations Act 2001* (Cth) (**Corporations Act**), these other exemptions are specific to certain fact scenarios which have limited application in the context of a global capital raising / investment offer or where a FFSP is seeking to take preparatory steps.

In CP 301 (para 95), ASIC has noted that the Limited Connection Relief was introduced to address a concern about the operation of s911D of the Corporations Act, which widens the jurisdictional reach of our licensing regime to capture conduct that is intended to induce people in Australia to use the financial services provided by a person from outside Australia. ASIC goes on to say that the Government has limited the breadth of the operation of section 911D by amending section 911A, as inserted by regulation 7.6.02AG – the implication being that Limited Connection Relief is no longer required.

Table 1 in CP 301 sets out the specific licensing exemptions introduced by regulation 7.6.02AG. Those exemptions do not apply to the scenarios described in section 3.1 above, where Limited Connection Relief is relied upon. In particular:

- section 911A(2A) (introduced by reg 7.6.02AG) applies only where the FFSP does *not induce* people in Australia to use its services and other conditions apply;
- section 911A(2B) (introduced by reg 7.6.02AG) applies only in specific circumstances where a FFSP is trading on a licensed Australian financial market for a client and other conditions apply;
- section 911A(2C) (introduced by reg 7.6.02AG) applies only where a FFSP provides financial services to an AFS licensee and other conditions apply;
- section 911A(2D) (introduced by reg 7.6.02AG) applies only in certain reverse solicitation situations, where other conditions also apply; and
- section 911A(2E) (introduced by reg 7.6.02AG) applies only to dealing, advice and making a market in relation to derivatives, foreign exchange contracts and certain carbon emission products, where those services are provided to professional investors and other conditions also apply.

None of these exemptions would apply to the scenarios described in section 3.1 above, which rely on the Limited Connection Relief.

ASIC Regulatory Guide 121 *Doing financial services business in Australia* (**RG 121**) includes as an annexure a comprehensive table setting out these and other licensing exemptions that may be available to FFSPs (including the Limited Connection Relief). Again, none of those exemptions would apply to the scenarios described in section 3.1 unless the FFSP involved an Australian AFS licensee in the activity, or the FFSP relied on the relief which applies where an FFSP provides certain financial services to wholesale clients only and is regulated by an overseas regulatory regime that is sufficiently equivalent to the Australian regulatory regime (**Sufficient Equivalence Relief**).

3.3 Conclusion

If Limited Connection Relief is repealed, in our view, there is a real risk that some FFSPs will cease to engage with Australian investors with a consequent reduction in competition and investment opportunities.

4 Unintended consequences of repealing Limited Connection Relief

Having spoken to several wholesale clients (including Australian institutional clients) in relation to the proposals in CP 301, we consider that the removal of Limited Connection Relief would result in a number of unintended consequences. These include a lessening of competition and a reduction in opportunities for Australian wholesale (and in particular, institutional) investors to access foreign markets, as well as the services provided by such FFSPs (including investment management services). We provide further details regarding these unintended consequences below.

4.1 Reduced access to foreign investments and the services of FFSPs

Our Australian institutional clients have expressed concern that the removal of Limited Connection Relief will reduce their access to offshore investments, as Australia is unlikely to be viewed as a key market for investors and, therefore, in the absence of Limited Connection Relief, the cost, expense and time required to obtain a Foreign AFS Licence (or a general AFS licence), especially where an offer has a compressed timeline, is likely to deter offshore FFSPs (including offshore funds) from seeking to offer investments into Australia to the great detriment of Australian wholesale investors, and the Australian economy more generally.

In addition, Australian institutional investors are concerned that the removal of Limited Connection Relief will restrict their access to the services of offshore managers, again to their detriment. For example, one institutional investor¹ has indicated that they prefer to have their international equities portfolios managed by offshore managers, given that such managers generally possess a greater level of expertise and knowledge of offshore equities markets. However, if such managers are required to obtain a Foreign AFS Licence (or an AFS licence) then they may reassess their willingness to provide such services to Australian institutional investors.

Similarly, we are aware that FFSPs provide ad hoc (infrequent) presentations to institutional investors in Australia in reliance on Limited Connection Relief, which provides useful information and insights to Australian investors. If these presentations were to cease due to the repeal of Limited Connection Relief, again this would disadvantage Australian wholesale (and, in particular, institutional) investors and in our view, would not be in the best interests of Australian wholesale investors.

4.2 Australian wholesale (including institutional) clients may be forced to engage with onshore SPV with minimal capitalisation

We understand that in anticipation of the proposals outlined in CP 301, some FFSPs (and in particular, offshore investment managers) have already set up special purpose vehicles (**SPVs**) in Australia and have obtained AFS licences to enable them to operate without the benefit of the Sufficient Equivalence Relief or the Limited Connection Relief. While ASIC may view this as a good outcome from an AFS licensing perspective, the unintended consequence of this restructuring, which has been driven by anticipated regulatory change, is that Australian institutional investors who previously contracted with well-resourced FFSPs are now being forced to contract with onshore SPVs, which, while meeting the minimum financial requirements, have a fraction of the capital of the FFSP. This is detrimental to Australian institutional investors, as they are now dealing with onshore

¹ Section 911A(2C) would not be available because the exclusion for acting as a trustee etc would apply.

SPVs against whom they can recover little in the event of a dispute, rather than well-resourced overseas managers who could be pursued for significant amounts of compensation in their home jurisdictions (especially as our Australian institutional clients have informed us that they have the resources to undertake cross-border litigation).

4.3 Unintended authorised intermediary market

Finally, in the absence of another viable licensing exemption for FFSPs, we anticipate that some FFSPs may seek to rely on the intermediary authorisation licensing exemption set out in section 911A(2)(b) of the Corporations Act, and some of the other licensing exemptions that apply where a third party AFS licensee is involved in the activity. As a consequence of this, we anticipate that an unintended market for 'licensed intermediaries' willing to provide intermediary authorisation, and similar, services to FFSPs wanting to offer financial products into Australia may develop in the absence of the Limited Connection Relief, which we assume is not intended by ASIC.

Given the clear need for a form of Limited Connection Relief and the potential unintended consequences of removing the relief as outlined above, in our view, it would seem preferable to address ASIC's concerns with Limited Connection Relief, as outlined in section 5 below, rather than simply remove the relief in its entirety.

5 Addressing the issues raised in CP 301 in relation to Limited Connection Relief

5.1 Limited Connection Relief no longer strikes an 'appropriate balance'

The principal aim of CP 301 is to develop an 'appropriate balance between cross-border investment facilitation, market integrity and investor protection'. CP 301 notes several issues with the current FFSP exemptions which mean that the regime is not currently achieving this balance:

- there have been a number of incidents of non-compliance under the current regime;
- ASIC has found it difficult to administer the supervision and enforcement of FFSPs under the current system;
- there has been little-to-no mutual recognition of Australian entities by foreign regulators. ASIC notes that compared to other, similar jurisdictions, Australia's exemptions for FFSPs are particularly broad; and
- recently, global standard setters such as IOSCO have suggested that greater supervision and enforcement is required from regulators to minimise misconduct in wholesale markets.

We submit that Limited Connection Relief could achieve an appropriate balance, if some minor amendments were made to the relief, as we have outlined below.

5.2 FFSPs could notify ASIC of their reliance on the relief

ASIC raises a legitimate concern in noting that it is currently unaware which FFSPs are using Limited Connection Relief and as such, has 'little to no visibility' of the entities relying on the relief.

However, as ASIC noted at paragraph [96] of CP 301, a FFSP could be required to notify the regulator (in the form of a letter) of an entity's activities, which could include the following:

- a detailed description of the intended business activity (i.e. an account of specific transaction procedures, intended market presence in the country, and client groups targeted);
- a copy of the FFSP's constitution or articles of association; and
- an executed agreement with a local agent.

We consider this to be a suitable and proportionate solution to this concern, which could be achieved through an amendment to the current Limited Connection Relief.

5.3 ASIC could obtain greater control and supervision

As is noted in CP 301 at paragraph [17], FFSPs are not required to:

- submit to the non-exclusive jurisdiction of the Australian courts in legal proceedings; or
- comply with a written notice from ASIC directing the FFSP to provide ASIC with specific information about the financial services business operated by the FFSP in Australia.

Furthermore, paragraph [97] of CP 301 notes that ASIC currently has only 'very limited powers to adequately supervise the activities of such persons when engaging with clients in Australia'.

We consider that Limited Connection Relief could be amended to include a requirement to submit to the Australian courts and to comply with a written notice from ASIC. A failure to meet either of these requirements could be resolved by revoking that particular entity's entitlement to Limited Connection Relief. This would provide ASIC with significantly increased supervisory powers, without unduly burdening FFSPs.

Additionally, the issues of 'visibility' noted in CP 301 could be addressed by the notification requirement suggested in section 5.2 of this letter.

5.4 The relief could be limited to 'professional investors'

In light of the types of activities by FFSPs that, in our experience, currently have the benefit of the Limited Connection Relief (see section 3.1 above), another amendment may be to limit the relief so that it applies only to the extent that financial services are provided to 'professional investors' as defined in section 9 of the Corporations Act. Currently, the Limited Connection Relief applies to financial services provided to 'wholesale clients', which, as you know, is a broader concept that includes 'professional investors' as well as other 'smaller' wholesale clients, including high net worth individuals, self-managed superannuation funds, etc. This may help address the concerns that ASIC has raised in CP 301 regarding investor protection.

5.5 Broad interpretation of the Limited Connection Relief

Paragraph [98] of CP 301 reads:

Another concern we have with the current limited connection relief is that we have seen some entities that purport to rely on the limited connection relief do so based on a broad interpretation of the operation of the relief, particularly in circumstances where other exemptions from the AFS licensing requirements (e.g. under s911A(2A), 911A(2B), 911A(2C), 911A(2D) and 911A(2E)) were unavailable to them.

We submit that if entities were required to notify ASIC of their reliance on the relief and meet some basic disclosure requirements, as has been recommended in section 5.2 of this letter, then ASIC would be far better placed to evaluate which entities were taking an unduly broad interpretation of the relief and take action accordingly.

In addition, ASIC might consider offering further clarification, or guidance, in relation to the scope of a Limited Connection Relief, to avoid such issues in the future. Alternatively, an amendment could be made to the current Limited Connection Relief to limit it to certain factual scenarios, including the scenarios described in section 3.1 above.

6 Submissions if ASIC decides to repeal Limited Connection Relief

While we submit that a form of modified Limited Connection Relief, along the lines of that outlined in section 5 is appropriate and should address ASIC's concerns, if ASIC decides to proceed with the repeal of Limited Connection relief, we make the following additional submissions.

6.1 Grandfathering relief should be provided

We submit that any financial services that have been provided **prior to** the repeal of Limited Connection Relief and any transaction structures that have been set up in reliance on Limited Connection Relief should be 'grandfathered'. This would mean that any transaction or other arrangement between a FFSP and an Australian wholesale investor entered into prior to the repeal of the Limited Connection Relief could proceed, or remain on foot, as though that relief had not been repealed. In other words, the repeal should not have retrospective effect. We consider this to be a fair and reasonable approach given that many such arrangements have been entered into on the basis that Limited Connection Relief would continue to be available.

6.2 Representatives

ASIC notes in CP 301 that Foreign AFS Licences may be subject to additional tailored conditions, including in relation to the appointment of 'representatives' (see Proposal C8(a) in CP 301). We submit that ASIC should be careful not to limit the categories of 'representatives' to natural persons and bodies corporate, as a FFSP may have representatives that are not natural persons or bodies corporate, but rather other legal entity types, such as limited partnerships. Accordingly, we recommend that if such a licence condition is imposed, then it should be flexible enough to accommodate different types of legal entities.

6.3 Need for further guidance for FFSPs

We submit that, in the event that Limited Connection Relief is repealed, ASIC should consider providing further guidance regarding the extent to which a FFSP can provide financial services into Australia without needing to obtain a Foreign AFS Licence (or an AFS Licence), or meet the conditions of a relevant exemption (e.g. further guidance in relation to when a FFSP could be regarded as carrying on a financial services business in Australia would be helpful). In particular, guidance on what form of marketing can be undertaken in Australia without a licence (or the benefit of a licensing exemption) would be useful.

7 Conclusion

For completeness, we have set out our responses to the specific questions raised in CP 301 relating to the repeal of Limited Connection Relief in the annexed schedule.

If you have any questions about our submission or would like to discuss any aspect of it, please do not hesitate to contact us.

Yours sincerely



Penny Nikoloudis
Partner
Allens

T +61 3 9613 8816



Jo Ottaway
Financial Services Counsel
Allens

T +61 3 9613 8163

For more information, please also feel free to contact:

Geoff Sanders

Partner
Allens

[REDACTED]
T +61 3 9613 8673

Derek Heath

Consultant
Allens

[REDACTED]
T +61 2 9230 4233

Marc Kemp

Partner
Allens

[REDACTED]
T +61 2 9230 4991

Penelope Barclay

Consultant
Allens

[REDACTED]
T +61 2 9230 4322

Schedule 1 – Questions in CP 301

D1. We propose to repeal the limited connection relief on 30 September 2019.

D1Q1. Do you agree with our proposal to repeal the limited connection relief? If not, why not? Please be specific in your response.

No, for the reasons outlined above in our submission (see, in particular, sections 3-5), we believe a form of modified Limited Connection Relief is of critical importance to the Australian financial services sector (and especially to Australian institutional investors seeking to access offshore investments and the services of FFSPs) and the economy more generally. As such, we consider that the relief should therefore continue, subject to certain amendments.

We have outlined our response to this point in the letter above.

D1Q2. If we repeal the limited connection relief, what would be the compliance costs associated with applying for an ordinary AFS licence, or a foreign AFS licence, and maintaining your entity's compliance with the Corporations Act? Please provide an itemised breakdown of:

- (a) your entity's projected costs to apply for and maintain an ordinary AFS licence;**
- (b) your entity's projected costs to apply for and maintain the proposed foreign AFS licence; and**
- (c) any other relevant costs.**

Although we regularly advise FFSPs who may seek to rely upon Limited Connection Relief, Allens does not itself rely upon Limited Connection Relief. Accordingly, we are unable to provide comment on this question.

D1Q3. D1Q3 We understand from the limited engagement by service providers with CP 268 that a number of wholesale fund operators rely on the limited connection relief. If we repeal the limited connection relief:

- (a) What would be the impact on your business or your client's business? Please provide data on the types of activities for which you rely on the relief, and the volume and value of business you conduct under the relief.**
- (b) How does your entity address this issue with respect to activities that you conduct in jurisdictions other than your home jurisdiction? Please be specific in your response.**

As noted above, Allens does not itself rely upon Limited Connection Relief and has not obtained the relevant data from affected clients. That said, if Limited Connection Relief were repealed, we consider it would have a significant impact on the business of both:

- FFSPs (including those currently relying on Limited Connection Relief, as well as those who would seek to rely on it in the future); and
- Australian institutional investors seeking to access offshore investments and the services of FFSPs.

In addition, we anticipate that the removal of Limited Connection Relief would have significant unintended consequences.

See, in particular, sections 3-4 above for details.

D1Q4. If you rely on our limited connection relief, do you rely on licences or exemptions relating to your activities that affect places other than your home jurisdiction? Please be specific in your response.

Allens does not itself rely upon Limited Connection Relief.

D1Q5. If you disagree with our proposal to repeal the limited connection relief, what (if any) enhanced conditions should be introduced to better facilitate supervision by ASIC? For example, what would be your view on the introduction of:

- (a) a requirement on FFSPs to notify ASIC of reliance on the limited connection relief at the outset and a further notification when the FFSP ceases to rely on that relief (the notification would be through an online form requesting a detailed description of the intended business activity (i.e. account of specific transaction procedures, intended market presence in Australia and client groups targeted), a copy of the FFSP's constitution or articles of association, and an executed agreement with an Australian local agent);**
- (b) an express information-gathering power for ASIC; and**
- (c) a mechanism for ASIC to monitor and take action in relation to your activities?**

We have outlined our suggested enhanced conditions in our submission (above), please see section 5 for details.

D1Q6. If we repeal the limited connection relief, do you expect to apply to rely on another exemption to continue to provide financial services? If not, why not? Please be specific in your response.

Allens does not itself rely upon Limited Connection Relief.

We anticipate that some clients would seek to rely on other licensing exemptions, if available, but as outlined in section 3.2 above, for FFSPs seeking to do undertake a global investment offering or to take preparatory steps into the Australian market, there is limited relief available.