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**By Email**

Dear Alan

**Consultation Paper 315 - Foreign financial service providers: further consultation**

## 1 Introduction

Allens welcomes the opportunity to comment on the Australian Securities and Investments Commission's (***ASIC***) Consultation Paper 315 – *Foreign financial service providers: Further consultation* (***CP 315***), which proposes to:

(a) repeal the Limited Connection Relief[1] and Sufficient Equivalence Relief[2] which are currently available for eligible foreign financial service providers (***FFSP***);

(b) introduce a new form of licensing relief for certain funds management services provided by FFSPs (as set out in the draft ASIC Corporations (Foreign Financial Services Providers – Funds Management Financial Services) Instrument 2019/XXX (***Funds Management Relief***)); and

(c) introduce a foreign Australian financial services (***AFS***) licensing regime and ASIC Corporations (Foreign Financial Service Providers – Foreign AFS Licensees) Instrument 2019/XXX which sets out the requirements to determine whether an FFSP is eligible to apply for a foreign AFS licence (***Foreign AFS Licensee Instrument***)

Our submissions below are set out as responses to particular feedback questions raised by ASIC in CP 315. Where we have not provided a response to a feedback question, that is because we do not wish to make a submission in relation to that question.

[1] 'Limited Connection Relief' means the relief currently provided under *ASIC Corporations (Foreign Financial Service Providers – Limited Connection) Instrument 2017/182* (***Limited Connection Relief***).
[2] 'Sufficient Equivalence Relief' means the relief currently provided to FFSPs regulated by an overseas regulatory regime that is sufficiently equivalent to the Australian regulatory regime and who are providing certain financial services to wholesale clients only (***Sufficient Equivalence Relief***).

## 2 Funds Management Relief

### 2.1 B1Q1 – Do you agree with our proposal to provide AFS licensing relief to permit FFSPs to provide funds management financial services to professional investors?

Yes. Allens is supportive of the proposed introduction of the Funds Management Relief for FFSPs. We consider the Funds Management Relief addresses the concerns we had raised in our previous submission on Consultation Paper 301 – *Foreign financial service providers*. In particular, we had submitted that some form of 'limited connection' relief is required to enable FFSPs to undertake fundraising activities in Australia as part of a global capital raising, and to provide Australian institutional investors with access to offshore investments and investment managers.

In our responses to the more specific questions below regarding the Funds Management Relief, we have identified some aspects of the relief that we think are unnecessary or overly restrictive and, if retained, would significantly limit the benefits provided by the relief.

As a general observation, in our view, one of the limitations of the Funds Management Relief is that it appears to have been drafted as a 'blend' of the current Limited Connection Relief and Sufficient Equivalence Relief, but with more conditions added to define the nature of the services captured and the extent of the permitted connection with Australia. As a result, the conditions are complex, at times overlapping and internally inconsistent and difficult to satisfy other than in the most extreme situations (e.g. an offshore fund 'accidentally' offering a small proportion of securities to Australian institutional investors).

The condition that the FFSP must not be carrying on business in Australia (which derives from the Limited Connection Relief) is a clear example of this and we discuss this in more detail in section 2.7 below. To illustrate this point, an FFSP that is currently relying on the Sufficient Equivalence Relief to provide investment management services to an Australian institutional client should, in our view, be eligible to qualify under the Funds Management Relief if it satisfies the conditions of the relief, rather than needing to apply for a Foreign AFS licence. As currently drafted, the Funds Management Relief is unlikely to apply to such an FFSP because the FFSP would, in our experience, typically be registered in Australia as a foreign company. Its only realistic options would be to apply for a foreign AFS licence or withdraw from the Australian market, which we think would be contrary to the policy objective of the Funds Management Relief.

### 2.2 B1Q2 – Do you agree with our proposal to not provide relief in relation to the provision of a custodial and depository service?

We agree that it is not necessary to provide relief for an FFSP to provide standalone custody services to Australian institutional clients. As ASIC notes in CP 315 (at paragraphs 38 – 39), regulation 7.6.01(1)(k) would allow an FFSP to act as a sub-custodian without an AFS licence, provided that an AFS licensee acted as master custodian (which is a typical custodial arrangement for global securities).

However, as a technical matter, we think that paragraph (a) of the definition of 'funds management financial services' should include a fourth limb, as follows:

*'(iv) providing a custodial or depository service in relation to financial products that form part of the assets of the offshore fund".*

This is because the operator of an offshore fund (like the trustee of a trust in Australia) may be taken to provide a custodial or depository service (within the meaning of section 766E) to the investors in the fund by holding the assets, or a beneficial interest in the assets, of the fund. (Any associated dealing services provided by the operator of an offshore fund would be captured under the definition of 'portfolio management services' in paragraph (b) of the definition of 'funds management financial services'.)

### 2.3 B2Q1 – Do you agree with our proposed inclusion of 'portfolio management services' as a discrete type of funds management financial service that FFSPs can provide under the relief?

Yes, we agree with the proposed inclusion of 'portfolio management services' as a discrete type of funds management financial service that FFSPs can provide under the relief.

In this way, FFSPs that operate offshore funds (under paragraph (a) of the definition of 'funds management financial service') can rely on the 'portfolio management services' relief in respect of the management of the assets of the offshore fund. Separately, an FFSP that provides investment management services to an Australian institutional client under a separate mandate, or 'fund-of-one' structure, can also rely on the 'portfolio management services' limb of the relief (provided our comments below regarding the concept of 'eligible Australian users' and the jurisdictional limitation are addressed).

### 2.4 B2Q2 – Do you agree with our proposed definition of 'portfolio management services'?

We have a small number of concerns with the proposed definition of 'portfolio management services', which we have outlined below:

- (**management of assets**) it would be preferable to use the existing terminology in the Corporations Act of 'dealing' and 'providing financial product advice', rather than the imprecise term 'management of assets'. If 'dealing' and 'providing financial product advice' were instead used, it would be clear that this would capture all forms of investment management (including discretionary and non-discretionary portfolio management services and advisory / emulation portfolio management services[3]), as well as both actively and passively managed portfolios;
- (**assets**) the use of the undefined term 'assets' could possibly exclude rights (such as those relating to derivatives), thereby making the definition too narrow; and
- (**located outside of Australia**) we submit this is an unnecessary jurisdictional limitation which would exclude, among other things, global equity mandates that may be awarded to offshore operators which could include a small Australian component (eg the inclusion of a listed (or dual listed) entity). We think that this should be broadened to require at least 50% by value of the assets to be located outside of Australia. Otherwise, the 'offshore fund' limb of the relief (in paragraph (a) of the definition of 'funds management financial service') would be of limited utility because there would be no corresponding 'dealing' exemption to cover the trading of the assets of the offshore fund where (as is permitted) less than half of the assets (by value) of the offshore fund were located in Australia.

### 2.5 B2Q3 – Do you agree with our proposed definition of 'eligible Australian users' of portfolio management services?

No. The 'portfolio management services' limb of the Funds Management Relief is proposed to be limited to circumstances where those services are provided to a sub-set of professional investors (whereas the 'offshore fund' limb of the relief applies in relation to all professional investors). We submit that both limbs of the relief should apply where the relevant services are provided to professional investors (and their related bodies corporate – see below).

The proposed client categories for portfolio management services is too narrow as it fails to capture a number of important types of professional investors that would benefit from having access to

[3] 'Emulation portfolio management services' are services where a manager provides a list of securities held within a specific type of investment strategy, and the client assesses that list and then acquires/disposes of any or all of the securities included (or no longer included) on that list.

FFSPs, including listed investment companies, AFS licensees and authorised deposit-taking institutions.

We also note that the proposed categories would not accommodate arrangements where the FFSP provides services to locally licenced intermediaries (eg via a sub-delegation arrangement), or provides access to its portfolio management services by being appointed as the exclusive manager of an Australian registered managed investment scheme (which would have net assets of less than $10 million upon establishment).

In light of the above, we recommend that instead of introducing a new sub-set of professional investors, the relief should be available where the relevant financial services are provided to any 'professional investors' (as defined in the Corporations Act) which would capture the additional investor groups referred to above and would make the second limb of the Funds Management Relief consistent with the first limb.

In addition, for both limbs of the Funds Management Relief, the concept of 'professional investor' should extend to a related body corporate of the professional investor. This is a technical issue because the term 'professional investor', rather than 'wholesale client' has been used in the relevant definitions. If the term 'wholesale client' had instead been used, it would have extended to related bodies corporate of a wholesale client (by operation of reg 7.6.02AD). However, that regulation does not apply to 'professional investors' and therefore the instrument will need to expressly provide for this. This extended meaning is important because it is typical for Australian institutional investors to make investments using wholly-owned special purpose vehicles or other investment entities.

## 2.6 B3Q1 – Do you agree with our proposal to apply an aggregated revenue cap to ensure that financial services provided by FFSPs under the funds management relief are provided on a limited basis?

(a) **Calculation of revenue cap**

We appreciate ASIC's concern that some form of quantitative measure is required to ensure that the funds management financial services provided by the FFSP under the Funds Management Relief do not form a substantial part of its business, and broadly speaking, agree that an aggregate 10% revenue cap is a reasonable measure.

However, we submit that some of the details of the proposed 10% revenue cap may require further consideration for the following reasons:

(i) (**calculation methodology**) The proposed methodology, which is partly based on revenues in the previous financial year (paragraphs 6(1)(c) and 6(2) of the draft relief instrument) and also on a forward looking basis every 6 months for the current financial year (paragraphs 6(1)(d) – (f) of the draft relief instrument), is likely to be difficult to apply, particularly if the FFSP's growth is fluctuating. For example, an FFSP, particularly one that is in a start-up phase or is only beginning its cross-border activities in Australia, may find itself in breach of the Funds Management Relief (for the previous financial year) if it discovers after the end of the that financial year that it had unexpectedly performed above the 10% cap in the last 6 months, despite having complied with the revenue projection requirements of the relief. One method of addressing this could be by taking an average of gross revenues over the last 3 years (instead of only the previous year), as this would give the FFSP more time to manage any unexpected fluctuations.

As another example, an FFSP may have satisfied the test for the previous financial year but may experience difficulty in accurately determining the forward-looking estimates where the FFSP's growth fluctuates. We note that the analogous cap

applied to international advisers by the Ontario Securities Commission (***OSC***), which is referred to in CP 315, does not impose an additional forward-looking estimate requirement. We would submit that this additional requirement should be removed as any regulatory benefit obtained from it would be outweighed by the difficulty in managing and preparing the estimate where there are fluctuations in growth, and the compliance costs and risks that it would impose on FFSPs seeking to rely on the relief.

(ii) (**buffer or transition period for unanticipated temporary breaches**) Similarly, there may be revenue fluctuations that are outside of the FFSP's control and that the FFSP may consider to be temporary or abnormal (eg market movements or an unexpected reduction in local / home business) and not a true reflection of the extent of the FFSP's activities in Australia. In those circumstances, we submit that some form of 'buffer' or transitional period should be included in the Funds Management Relief to accommodate for such fluctuations. We note that in CP 315 (para 50), ASIC suggests that if a FFSP finds itself in a position that it is close to exceeding the proposed aggregated revenue cap, the FFSP should consider whether it should, among other things, apply for a foreign or standard AFS licence or reduce its activities so that it can maintain the benefit of the Funds Management Relief. In our view, these options would be impracticable for temporary periods of revenue fluctuations that are outside of the FFSP's control, and do not contemplate the possibility that a fluctuation could be sudden, giving the FFSP little or no time to rectify the breach or find an alternative method of providing the services. In our view, to retain this aggregated revenue cap, without a buffer or transitional period, would present significant compliance risks for FFSPs, which may dissuade them from electing to rely on the relief.

As such, we submit that the Funds Management Relief should provide for a transitional period where an FFSP may exceed the cap without automatically being in breach of the relief. The time period should be of sufficient duration to allow the FFSP to determine whether the fluctuation is temporary and if not, to prepare and apply for a foreign AFS licence or cease providing the relevant services (where possible).

In addition, it is unclear how ASIC intends to monitor the cap or what assurances ASIC will provide to ensure that the revenue data supplied to ASIC will be kept confidential. We would be grateful if ASIC could confirm these points.

(iii) (**exclusion of revenue of Australian regulated affiliates**) The proposed revenue cap will be applied both on the basis of the consolidated gross revenue of the FFSP and its related entities, and on the basis of the gross revenue of the FFSP itself. The OSC measure is applied only on a consolidated gross revenue basis. More importantly, however, the OSC methodology expressly excludes from gross revenue any revenue of an affiliate of the foreign adviser that is registered in a jurisdiction of Canada. We think this is an important feature of the calculation, as a global financial services group may have locally licensed entities in Australia, and the revenue of those entities should be disregarded when calculating the consolidated gross revenue of the group for the purposes of the cap. If it were not disregarded, this could distort the calculation and may indicate that the cross-border activities of the group in Australia are more extensive than what they, in fact, are. Accordingly, we would submit that the definition of 'consolidated gross revenue' in the draft relief

instrument should similarly exclude the gross revenue of any members of the FFSP's group that are registered in Australia.

## 2.7 B4Q3 – Are there any conditions that you think we should not impose on FFSPs?

There are a number of conditions, and other aspects of the proposed Funds Management Relief, that we submit should not be imposed on FFSPs. We have set these out below:

(a) **Operation of section 911D**

The Funds Management Relief is only available for foreign companies that are carrying on a financial services business in Australia only because of the operation of section 911D of the Corporations Act (that is, the FFSP is engaging in conduct that is likely to induce people in Australia to use the funds management financial services provided by the FFSP). This reference appears to have been carried over from the Limited Connection Relief. Given the number of other conditions to the relief which already ensure a limited connection to Australia, we submit that the relief should not be restricted in this manner so as to enable a broader group of FFSPs to benefit from this relief.

(b) **Registered as a foreign company**

The Funds Management Relief also provides that a FFSP must not be registered as a foreign company (paragraph 6(1)(a)). In our experience, many FFSPs are registered as foreign companies because of the uncertainty in respect of the carrying on business test. Whether a FFSP is 'carrying on business' can often be factually uncertain and requires an extensive analysis of the circumstances. While section 21 of the Corporations Act sets out various matters for consideration in determining whether a company is 'carrying on business in Australia', Courts have held that section 21 does not provide an exhaustive definition of what constitutes carrying on business in Australia, and that this is a question of fact that needs to be assessed in all the circumstances having regard to the common law. As a result of this complexity, many FFSPs have, out of caution, registered as foreign companies. This means that these FFSPs will need to deregister as foreign companies or otherwise be excluded from the Funds Management Relief, which we consider is an unreasonable outcome. We are of the view that the other conditions of the Funds Management Relief in aggregate (even as amended as we have proposed) should be sufficient for ASIC to be comfortable that any FFSPs relying on the Funds Management Relief will have a limited connection to Australia, and accordingly, recommend that this condition should be removed.

(c) **Definition of 'offshore fund'**

(i) **established and operated outside of Australia**

We consider the definition of 'offshore fund' may potentially be too limiting as it requires, in the case of a managed investment scheme (***MIS***), for the scheme to be established and operated outside of this jurisdiction. Depending on the nature of the offshore fund offered by the FFSP to an Australian professional investor, investments may be structured to allow the Australian client(s) to invest into a locally domiciled vehicle (such as an unregistered MIS). This may be for a number of reasons, including the comfort and ease of investing in a familiar Australian structure from a governance perspective, the ability to obtain unit values and fees in Australian currency and simpler application and redemption mechanisms. In such circumstances (which in our experience are not uncommon), the FFSP would fall outside of the relief as it would not be dealing in the interests of an MIS that was established and operated outside of Australia (as required by paragraph (a)(i) of the

definition of 'offshore fund'). Accordingly, ASIC might consider broadening the definition of 'offshore fund' to accommodate a local feeder fund structure.

(ii) **carrying on business in Australia**

The Funds Management Relief proposes that to qualify as an offshore fund, a foreign company that is not a MIS must not be carrying on a business in this jurisdiction (paragraph (b)(i) of the definition of 'offshore fund'). As noted in paragraph (b) above, this test can be very difficult to apply. Consequently, we consider that to include this as a condition of the relief will only add a further layer of complexity and uncertainty, and is unnecessary given that the other conditions to the relief limit the FFSP's connection to Australia. We submit that the carrying on business test should be a separate consideration for FFSPs which sits outside of the Funds Management Relief.

(iii) **tax residency condition**

Paragraph (d) of the definition of 'offshore fund' provides that to qualify as an offshore fund for the purposes of the relief, among other requirements, the scheme or foreign company must not be any of the following (within the meaning of the *Income Tax Assessment Act 1997* (***Income Tax Act***)):

(A) an Australia trust;

(B) a resident trust for capital gains tax purposes;

(C) a resident unit trust,

(the ***Tax Condition***).

To determine whether a trust falls within any of the categories of the Tax Condition requires, among other things, an assessment of whether 'the central management and control of the trust was in Australia'. In addition, in respect of unit trusts, sub-paragraphs (ii) and (iii) impose additional tests, including whether any property of the trust is situated in Australia, and whether one or more Australian residents hold more than 50% of the beneficial interests of the income or property of the trust. We submit that the Tax Condition should be removed from the Funds Management Relief as it indirectly imposes additional thresholds that must be satisfied by an FFSP which otherwise may qualify as an offshore fund for the purposes of the relief. For example, an Irish unit trust may satisfy paragraphs (a) and (c) of the 'offshore fund' definition, but fail to qualify for the relief on the basis that it holds 1% of its assets in Australian listed shares and has a large professional investor (such as an Australian superannuation fund) as a cornerstone investor which holds more than 50% of the units in the trust. Further, because the Funds Management Relief permits up to 50% by value of the assets of the scheme or foreign company to be located within Australia (see paragraph (c) of the definition of 'offshore fund'), the Tax Condition is inconsistent with this condition.

We assume that ASIC has proposed the Tax Condition to support the limited connection rationale underpinning the Funds Management Relief. However, we consider that this condition would impose an unreasonable compliance monitoring obligation on FFSPs, which would limit its appeal, and that the existing conditions of the Funds Management Relief should be sufficient to satisfy ASIC's intention.

# 3 Foreign AFS licence

## 3.1 Sufficiently equivalent jurisdictions under individual relief instruments

It is proposed in CP 315 that FFSPs that are from specified sufficiently equivalent jurisdictions which are set out in the Foreign AFS Licensee Instrument (namely Germany, Hong Kong, Luxembourg, UK, Singapore and the US) will be eligible to apply for a foreign AFS licence.

While the draft Regulatory Guide 176: *Foreign financial service providers* (***RG 176***) annexed to CP 315 provides that FFSPs subject to individual relief instruments may also apply for a foreign AFS licence, it does not appear to be proposed that jurisdictions previously assessed as being sufficiently equivalent under individual instruments (being Brazil, Denmark, France and Sweden)[4] will be captured as being sufficiently equivalent jurisdictions under these arrangements.

To clarify this point, we recommend that these jurisdictions be included in the list of sufficiently equivalent regimes in Table 2 of the draft RG 176 and in the Foreign AFS Licensee Instrument. We further recommend that all FFSPs from the same jurisdictions as the entity relying on the individual relief should be entitled to benefit from this prior assessment of those regimes (as is currently proposed in draft RG 176 as the general position for the extension of the Foreign AFS Licensee Instrument when new overseas regulatory regimes are assessed as being sufficiently equivalent regimes (RG 176.93)). This would make the application of past relief consistent with the proposed approach for new individual relief granted under the draft RG 176.

We also suggest that ASIC contact each entity currently operating under an individual instrument that grants relief which is substantially similar to the Sufficient Equivalence Relief to verify how that individual relief will continue to operate and the applicable time extensions for the relief, in light of the various considerations in CP 315.

# 4 Other

## 4.1 Transitional arrangements and grandfathering for Limited Connection Relief

(a) (**transitional arrangements**) CP 315 proposes that the Limited Connection Relief will be repealed on 31 March 2020, with the transitional period to end on 30 September 2020. This means that a FFSP currently relying on the Limited Connection Relief will have 6 months to become eligible for the Funds Management Relief, or to obtain a foreign (or standard) AFS licence.

Should a FFSP relying on the Limited Connection Relief seek to obtain a foreign or standard AFS licence, we submit that ideally a transitional period of 18 months (so that the end of the transition periods for both the Limited Connection Relief and Sufficient Equivalence Relief align to 31 March 2022) is necessary to prepare the requisite proof documents and lodge the licence application with ASIC – particularly as it is currently unclear what the application time frames will be for a foreign AFS licence.

The additional 18 month period would also provide an appropriate amount of time for a FFSP relying on the Limited Connection Relief which is from a jurisdiction that is outside of those listed in the Foreign AFS Licence Instrument as being sufficiently equivalent, to seek an assessment of its regulatory regime to determine whether it would satisfy the conditions of the Foreign AFS Licence Instrument.

(b) (**grandfathering provisions**) We further submit that a number of FFSPs currently relying on the Limited Connection Relief may not wish to obtain a foreign AFS licence and may not be eligible for the Funds Management Relief. This means that once the transitional

[4] See page 36 of CP 301.

arrangements have ceased, such FFSPs will need to withdraw from the Australian market by terminating the financial services being provided to Australian clients. In our view, this could result in significant financial harm to Australian clients – for example, if the FFSP was forced to compulsorily redeem all of the units for Australian clients, leaving no ability for Australian clients to determine the timing for exiting their investment. We submit that to address this possibility, ASIC should consider grandfathering provisions to allow the existing Limited Connection Relief to remain in force in respect of existing financial products and services, for the benefit of both FFSPs currently relying on the relief and their Australian clients.

We would welcome the opportunity to discuss any aspect of our submissions with you. If you have any questions, please do not hesitate to contact Penny Nikoloudis, Jo Ottaway or any other member of our team (see contact details on the following page).

Yours sincerely

**ALLENS**

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