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12 August 2019

Alan Worsley, Senior Specialist
Strategic Policy
Australian Securities and Investments Commission
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Email: policy.submissions@asic.gov.au

Dear Mr Worsley

Submissions in response to Consultation Paper 315: Funds management relief

We refer to Consultation Paper 315 "*Foreign financial services providers: Further consultation*" dated July 2019 (**CP315**). We appreciate the opportunity to make submissions and provide feedback in response to the proposals as they relate to the "funds management relief" set out in the paper. Terms not defined in this submission have the same meanings given to them in CP315.

Ashurst is a global law firm with offices in most of the world's leading financial centres (including London, Hong Kong, Tokyo, Singapore, Frankfurt, Paris, New York, Sydney and Melbourne among others). We are commonly asked to advise foreign financial services providers, and in particular, foreign fund managers, on matters relating to compliance with Australian financial services laws, licensing arrangements and their provision of financial services to Australian clients.

Accordingly, these submissions relate specifically to ASIC's proposed "funds management relief" as contemplated in the draft ASIC Corporations (Foreign Financial Services Providers—Funds Management Financial Services) Instrument 2019/XXX (the **ASIC Instrument**) which forms Attachment 2 to CP315.

B1Q1: ***Do you agree with our proposal to provide AFS licensing relief to permit FFSPs to provide funds management financial services to professional investors (subject to the cap in proposal B3 and the conditions in proposal B4)? If not, why not? Please be specific in your response.***

Yes, we agree with your proposal to provide AFS licensing relief to permit FFSPs to provide funds management financial services to professional investors without the need to procure an AFSL. We have in our practice seen numerous instances of foreign fund managers bringing investment opportunities to Australian professional investors which would not otherwise be available.

In turn, these professional investors have used their investments with the foreign fund managers to offer strategies to Australian retail clients, through regulated structures such as superannuation trusts and managed investment schemes. The establishment of these regulated structures has resulted in opportunities for Australian companies to provide related fund services (such as custody, administration and unit registry), which are of significant value to the Australian economy.

In our view, many of the proposed conditions that would apply to the operation of the relief as discussed further below are, in principle, acceptable. However we are concerned that some of the proposals, primarily

(a) the concept of an 'eligible Australian user' to whom a foreign fund manager can provide portfolio management services, and

(b) the proposed revenue cap,

are not necessary as a means of protecting Australian consumers of these services and could produce outcomes which would not be favourable to Australian investors. We consider that the current proposals could be improved in a number of respects in order to enhance their effectiveness and to remove anomalies in their outcomes, while continuing to facilitate a result which is consistent with ASIC's policy objectives in developing a new approach to the regulation of foreign financial services providers in Australia.

As stated by ASIC in paragraph [33] of CP315, the purpose of this relief is to "*[preserve] competition by ensuring that a diversified range of investment managers and investment products may be made available to professional investors in Australia, which will ultimately benefit investors in Australia investing through these institutions.*"

B1Q2: *Do you agree with our proposal to not provide relief in relation to the provision of a custodial or depository service on the basis that it is covered by reg 7.6.01(1)(k)? If not, why? Please be specific in your response.*

We do not agree with the proposal to not provide relief in relation to the provision of custodial or depository services, and we do not consider that all circumstances are covered by regulation 7.6.01(1)(k) of the *Corporations Act 2001* (Cth). While we accept that regulation 7.6.01(1)(k) will apply in many circumstances, this exemption only covers sub-custodian relationships. It follows that we consider that the relief should be made available to FFSPs providing custodial or depository services to professional investors.

For example, there may be circumstances in which Australian professional investors wish to invest in global securities but there is limited value to them in appointing an Australian licensed custodian, only for the purposes of accessing the services of an offshore company that does not hold an AFSL which is able to provide custodial services for financial products which are not in this jurisdiction. The Australian licensed custodian will only provide limited services as all of the activities of safekeeping and administration of the relevant securities will be performed offshore. Often this situation arises in the context of global trading platforms under which a client seeks access to trading facilities for foreign financial markets but needs to have their financial products held by an entity which is located in the relevant jurisdiction.

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? If not, why not? Please be specific in your response.*

No, we do not agree with the inclusion of 'portfolio management services' as a discrete type of funds management financial services that FFSPs can provide under the relief.

This is because there is no relevant distinction to be drawn between the two services which ASIC is seeking to cover under the relief, being:

(c) the provision of certain financial services to professional investors; and

(d) 'portfolio management services'.

The only difference between these two services is that one is essentially 'wrapped' in an offshore fund structure and the other is not. However in each case, the FFSP is, at its heart, providing 'portfolio management services' – that is, in "licensing terms", dealing in financial products on behalf of another person.

In the case of 'portfolio management services', the client is the superannuation trustee or responsible entity of a registered managed investment scheme which has engaged the fund manager to provide the services. In the other case, the client is the offshore fund structure or the operator of the fund structure – but the Australian investor is the recipient of the benefit of the 'portfolio management services' as an investor in the offshore fund structure. The logic of creating different categories of clients who can receive these services within the scope of the relief is not immediately apparent.

Given the monetary thresholds in the definition of 'portfolio management services', these services are generally only made available to Australian clients who are able to invest significant amounts of money - these clients will fall within the definition of 'professional investor' as it currently stands in the *Corporations Act 2001* (Cth). We are not suggesting that the relief be extended to capture the provision of financial services to 'wholesale clients' generally, but we consider there is limited utility in narrowing the provision services to a limited category professional investors (being the 'eligible Australian users'). This is because we consider that the definition of 'professional investor' is sufficiently tight as to only capture those who are genuinely sophisticated enough to understand the decisions which they are taking in engaging a portfolio manager which is not subject to Australian financial services licensing requirements and is located outside of the jurisdiction.

B2Q2: *Do you agree with our proposed definition of 'portfolio management services'? If not, why not? Please be specific in your response.*

For the reasons given above, we do not agree with the separating out of 'portfolio management services' from other financial services that may be provided by a foreign fund manager.

'Portfolio management services' essentially entail dealing in a financial product on behalf of another person, arranging the issue of certain financial products (such as OTC derivatives and foreign exchange contracts), making a market in financial products (although this is not common) and providing financial product advice. These all currently exist in the law, and are well defined - we do not see the value in creating another financial services definition which essentially captures certain types of already existing financial services.

B2Q3: *Do you agree with our proposed definition of 'eligible Australian users' of portfolio management services? If not, why not? Please be specific in your response.*

As noted above, we do not consider that there should be a different, narrower, suite of clients that can receive 'portfolio management services' under the relief, from those that are able to be offered and issued interests in offshore funds. We also consider that there are other difficulties with the definition of 'eligible Australian users' as proposed in CP315.

We set out below some examples of the limitations of the proposed definition.

Example 1

An offshore fund manager has a unique investment strategy focusing on Government and corporate bonds and other fixed income financial products located outside of the jurisdiction. The offshore fund manager agrees with an Australian responsible entity that the responsible entity will establish an Australian registered managed investment scheme, and will engage the offshore fund manager to manage the money in accordance with the investment strategy. The responsible entity operates a large number of registered and unregistered managed investment schemes, with net assets totalling in excess of $600

million.

However, the responsible entity will not meet the 'eligible Australian user' definition because on commencement, the scheme has less than $10 million invested.

The effect of the net asset threshold means that many funds or schemes which do not have a minimum of $10 million at the initial closing would be excluded from being provided such services as they do not fall within the definition of 'eligible Australian user'.

Example 2

An offshore fund manager invests in global infrastructure opportunities. An Australian listed investment company with a market capitalisation of $400 million wishes to gain exposure to these investments.

However, the listed investment company will not meet the 'eligible Australian user' definition because it is not captured.

It is not apparent why a distinction is made between financial services being provided to a listed investment company and a listed managed investment scheme – in the case of Example 2, the responsible entity of a listed managed investment scheme falls within the definition of 'eligible Australian user', whereas the listed investment company clearly does not. There is no public purpose for distinguishing between a listed investment company and a listed managed investment scheme because the nature of the underlying investors will be similar.

Example 3

An offshore fund manager has been engaged prior to the implementation of the new foreign financial services licensing regime to be the sole investment manager to a registered managed investment scheme, relying on the former foreign financial services provider relief. The offshore fund manager operates a quant strategy which aims to make money from market volatility, which is not capable of being replicated by any other manager in the market.

The scheme has less than $10 million in net assets by the time the new regime commences. The responsible entity will not meet the definition of 'eligible Australian user'.

The foreign fund manager may need to retire as manager as the relief will be unavailable to it for the provision of financial services to this fund, although it is involved in providing 'portfolio management services' to other funds operated by the same responsible entity. If it retires the fund will need to be wound up. Investors will suffer the adverse tax consequences of realising capital gains in the year of wind up and will no longer have access to the strategy.

As noted in *Example 1*, the net assets threshold would operate to exclude a number of funds or schemes – the consequence of this in *Example 3* clearly indicates that the narrow ambit of the relief does not achieve the purposes of preserving competition and benefiting Australian investors.

Example 4

An Australian family office wishes to engage an offshore fund manager for its global emerging markets strategy. The Australian family office controls in excess of $150 million and invests the money of one family and does not operate managed investment schemes.

The Australian family office and its investment vehicles will not meet the 'eligible Australian

user' definition.

Again, *Example 4* shows that there is limited utility in the relief being provided only to the provision of financial services to a narrow category of professional investors.

Example 5

A corporate group which includes a life insurance company and a general insurance company wishes to engage a foreign fund manager to provide portfolio management services. The foreign fund manager relies on the foreign fund manager relief.

The life insurance company will meet the definition of 'eligible Australian user' but the general insurance company will not. The life insurance company can engage the foreign fund manager for portfolio management services but the general insurance company can not.

B3Q1: ***Do you agree with our proposal to apply an aggregated revenue cap to ensure that the financial services provided by FFSPs under the funds management relief are provided on a limited basis? If not, why not?***

We recognise ASIC's desire to approach the availability of the relief on the basis that there is a cost benefit analysis to be undertaken by a manager in respect of the cost of obtaining and maintaining an Australian financial services licence in Australia, as against the value of the revenue to be obtained by the foreign fund manager in question.

ASIC has proposed a 10% revenue cap, being the threshold that represents the level of services by reference to the revenue generated from professional investors in Australia that it is comfortable to allow an FFSP to provide without needing to obtain an AFS licence. The implementation of this approach is on the basis of ASIC's concern that the costs of obtaining and maintaining an AFS licence when an insignificant proportion of revenue is generated from professional investors in Australia may mean that such services may cease to be available in Australia if the FFSP is required to obtain an AFS licence.

We recognise, as does ASIC, that the threshold for the proposed revenue cap, and the manner in which this cap is executed, are arbitrary. We do not consider that the proposed revenue cap contributes to either market integrity or consumer protection, as the services provided by the foreign fund manager will be able to be provided under the relief but only in circumstances where the cap is not exceeded.

In fact, a revenue cap will prejudice smaller foreign fund managers who will reach the cap much faster than larger, global fund managers. It seems illogical that the conditions of the relief would operate to benefit a large fund manager (which would be able to operate a much larger Australian business) than a smaller fund manager (which would only be able to operate a much smaller Australian business). We note also that a larger fund manager may be able to spread its business over more foreign jurisdictions such that it is less likely to have a concentration of business in Australia.

We note that ASIC considers that "*if the FFSP forms a view that it will or may breach the aggregated revenue cap in the financial year that it provides the services, the FFSP should not provide the service*". In our view, this is highly impractical for fund managers as it requires them to determine the level of business activity with professional investors in Australia on a forward looking basis, and to cease the provision of financial services if the estimate does not satisfy the cap or it would otherwise be at risk of losing the benefit of the relief. We note that many of these managers will charge for their services based on the value of the portfolio that they are investing –

which means that the revenue cap may be breached as a result of matters which are not within the foreign managers control.

We also note that if a fund manager were to terminate a professional investor mandate on the basis that it would fail to comply with the revenue cap, there could be adverse outcomes for retail clients who are invested with the professional investor, including capital gains tax realisation where assets purchased in pursuance of the mandate must be sold.

We are also concerned that the revenue cap could drive FFSPs to 'cherry pick' mandates on the basis of which client offers the best fee for the FFSPs services. This could mean that an FFSP would prefer to terminate an existing mandate in order to allow for it to enter another mandate that is on more favourable terms.

The revenue cap also creates an issue where additional fees are earned by managers as a result of growth in the portfolios that they manage, or as a result of outperformance of benchmarks or hurdles. Most managers are remunerated on the basis of portfolio value and may also receive additional revenue in the form of performance fees. It is entirely possible that the manager may, at the end of a financial year, find that it has exceeded its previous year's estimates because of the impact of these changes in anticipated revenue outcomes. However, we note that the relief is lost as soon as the FFSP determines in the subsequent financial year that it did not satisfy the revenue cap for the preceding financial year. As soon as the relief ceases to be available, the FFSP would have to terminate its mandates which would give rise to adverse outcomes for retail clients as described above.

Under the proposed relief, a foreign fund manager must consider terminating existing client mandates in order to remain under the revenue cap. The foreign fund manager could choose to seek a licence but there will be a significant time lag between making that decision and obtaining a licence. However the relief does not contain any provisions which allow for a period of the revenue exceeding the cap, or the cap being exceeded as a result of market movements, or for the relief to continue while an application for a licence is pending. The relief automatically ceases to apply if the conditions are not met.

In short we do not support a revenue cap. However, if there is to be a cap, we would propose that it be increased to 20% to allow appropriate head room having regard to some of the difficulties in applying a revenue cap which we have outlined above.

We also consider that accommodation needs to be made for circumstances where the 'look back' shows the revenue cap was exceeded in the previous financial year in circumstances where the FFSP had reasonably estimated that its revenues would fall within the cap. We would propose that the 'look back' test in paragraph 6(c) of the draft ASIC Instrument be removed all together.

B3Q2 What systems and processes will you need to implement to monitor your compliance with the aggregated revenue cap? Please be specific in your response.

As lawyers to clients who will likely seek to rely on this relief, we do not propose to respond to this question.

B3Q3: ***What are the costs associated with implementing the systems and processes to monitor compliance with the aggregated revenue cap? Please be specific in your response.***

As lawyers to clients who will likely seek to rely on this relief, we do not propose to respond to this question.

B3Q4: ***Are there any other caps that we should consider as an alternative (see Table 3 for other caps we have considered)? What are the costs associated with monitoring compliance with your alternative cap? Please be specific in your response.***

A "number-of-clients" test may be a suitable alternative, and would be particularly beneficial to smaller foreign fund managers who may be offering more unique strategies. We propose that the relief be available if either test (ie "number-of-clients" or a revenue cap with an appropriate threshold) is satisfied. We would consider that a 10 client cap would be an appropriate alternative threshold.

B3Q5: ***Is the proposed aggregated revenue cap able to be applied to all the types of financial services that you may provide to professional investors in Australia (eg providing financial product advice)? Please be specific in your response.***

To our knowledge, most of our fund manager clients do not provide financial product advice separately from either the offer of interests in offshore funds, or the provision of portfolio management services. The revenue cap should only apply to fees generated from the provision of financial services to Australian clients.

We agree with ASIC's approach that there is no requirement to attribute fees generated from 'portfolio management services' provided to offshore funds with Australian client investors to the calculation of their Australian revenue. We note that this is consistent with the approach taken by the Canadian regulator which is referred to in CP315.

B3Q6: ***If you currently have the benefit of the limited connection relief and intend to reduce the size of your activities in Australia to have the benefit of the proposed funds management relief, how long would it take to do so? What are the costs associated with this? Please be specific in your response.***

As lawyers to clients who will likely seek to rely on this relief, we do not propose to respond to this question.

B4Q1: ***Do you agree with our proposal to impose these conditions on the funds management relief? If not, why not? Please be specific in your response.***

Generally the conditions are suitable subject to our comments above on the revenue cap.

B4Q2: ***Are there any other conditions that you think we should impose on FFSPs? Please be specific in your response.***

No, these appear to be comprehensive.

B4Q3: ***Are there any conditions that you think we should not impose on FFSPs? Please be specific in your response.***

No, these appear to be suitable, subject to our comments above on the revenue cap.

B4Q4: ***Should the provider of the funds management financial services be subject to an additional condition that it be regulated by a regulatory authority that is a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMOU) or the IOSCO Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO Enhanced MMOU)? How would this additional condition affect the provision of funds management financial services to professional investors in Australia? Please be specific in your response.***

Yes, we consider this to be an appropriate additional condition. In practice, our sophisticated professional investor clients will only contract with fund managers who are subject to satisfactory regulation, and it seems suitable that this be part of ASIC's expectation of FFSPs relying on the 'fund manager relief'.

B4Q5: ***What are the costs associated with complying with these conditions? Please be specific in your response.***

As lawyers to clients who will likely seek to rely on this relief, we do not propose to respond to this question.

B4Q6: ***Do you agree with our proposal to use our powers to require an FFSP to provide information about the services the FFSP provides to professional investors in Australia, as well as its compliance with the proposed aggregated revenue cap? Please be specific in your response.***

We consider that it is appropriate that ASIC should have the power to request information about the services which an FFSP provides to professional investors in Australia, as well as information about its compliance with the proposed aggregated revenue cap, provided that this information is kept confidential by ASIC and underlying clients are not required to be identified by name i.e. any reports or calculations can be desensitised.

B4Q7: ***If you disagree with the proposal to use our powers, would you prefer that we impose the requirement to provide an annual declaration about the activities the FFSP conducts in Australia as an explicit condition on the relief? Please be specific in your response.***

We do not favour a requirement that there be an annual declaration by fund managers who rely on the relief.

B5Q1: ***Do you agree with the proposed transitional period? If not, do you think it should be longer or shorter?***

We are concerned about the impact on Australian clients (retail and wholesale) if there is no grandfathering of arrangements which are in place for existing portfolio management agreements where the relevant manager has been relying on the 'limited connection' relief. It is not an insignificant exercise to wind up a fund, or for an Australian client to terminate a mandate and find a new portfolio manager with a similar strategy. The existing proposal is that the 'limited connection relief' will end on 30 September 2020 – which may allow sufficient time for a manager to transition to the fund manager relief (assuming this proposal proceeds). However, if the foreign fund manager does not qualify for the fund manager relief, then this would not allow sufficient time for the foreign fund manager to obtain a limited licence.

Consideration should therefore be given to longer grandfathering for existing mandates. Further, in circumstances where an Australian client is already invested in an offshore fund, any financial services provided in connection with that existing investment should also be subject to grandfathering.

Other comments

ASIC has not specifically sought input on its definition of "offshore fund". We wished to comment particularly on one aspect of this definition which appears to be problematic, namely, paragraph (a)(ii) which requires that an "offshore fund":

"is operated on the basis that the assets of the scheme are to include investments in securities, interests in land, interests in, or securities issued by, other offshore funds or other investments; and"

This definition does not appear to cover the field of investments that could be offered through an offshore fund and it is not immediately apparent why there should be any qualification on what assets or exposures can be obtained through an offshore fund.

For example, we are from time to time instructed to act in relation to offshore funds which gain their exposures through the use of derivatives, or which invest in debt, which is either entered into directly by the fund, or acquired on the secondary market. We note these are merely common examples of asset classes which would not fit within this paragraph – it is not difficult to conceive of other assets which would not fit the criteria quoted above, for example, direct infrastructure or life insurance policies.

We note to highlight the point, ASIC's own guidance about the scope of investment business which would cause an entity to fall within the definition of "dealing in a financial product" under Section 766C(5) – see https://asic.gov.au/for-finance-professionals/afs-licensees/do-you-need-an-afs-licence/is-there-a-licensing-exemption-available-for-the-issue-of-debentures/. The guidance indicates that making loans would not fall within the scope of 'investment business'.

Please contact Lisa Simmons on +61 2 9258 6595 or [redacted] if you have any questions about this submission.

Yours faithfully

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