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Dear Mr Worsley

Submission in relation to Consultation Paper 315

Thank you for the opportunity of making a submission in relation to Consultation Paper 315.

This submission does not purport to completely cover all the undoubtedly complex issues relating to the matters raised in Consultation Paper 315. It is an attempt to tease out some of the practical problems and concerns relating to those issues, in the time available.

This submission is more concerned with drawing attention to relevant concerns rather than proposing systemic solutions. It is submitted that appropriate amendments are still required in order to achieve the appropriate balance between cross-border facilitation, market integrity and investor protection.

We endorse the concerns noted in AFMA's submission of 3 August 2018 in relation to these same matters as to the unintended adverse consequences to Australian financial markets which may occur if the relevant proposals are effected without amendment.

Summary of concerns – likely impacts

1. **Likely effects on competition:** The proposals contained in CP 315 (the 'proposals') will effectively put Australian managed investment schemes (MISs) and trustees of pooled superannuation trusts (PSTs) at a comparative international disadvantage in terms of the investments they can acquire and the relevant foreign-based advice they can receive. The proposals could thus disadvantage Australian investors.

   In particular, the proposals as currently drafted will result in inconsistent standards applying in relation to product acquisition depending upon whether an offshore fund offers securities through a trust or a company, potentially making securities offered through incorporated entities largely impossible for Australian MISs to access. We note that the drafting on this point may change (par 35 of CP 315).

2. **Likely compliance costs:** Similarly, the restrictions that the proposals would require in relation to foreign financial service providers (FFSPs) - under either the Funds Management Relief or Foreign AFSL options - are so onerous that they are likely to result in FFSPs refusing to provide services or offshore funds to Australian investors. It is submitted that in an interconnected commercial world, it is unreasonable for issuers of securities in offshore funds and foreign investment managers to need to be registered (for Funds Management Relief) or licenced (as a foreign AFSL holder) in Australia if they are issuing products, or giving general product advice, to Australian AFSL holders which are professional investors.
3. **Reducing red tape for Australian entities:** Given their level of expertise, assessed as part of the AFSL application process, responsible entities (REs) of Australian MISs, trustees of PSTs and investment managers appointed under mandates by superannuation funds should be able to acquire interests in offshore funds and obtain advice from foreign investment managers without restriction. This is particularly the case where the customers of the REs or trustees are themselves wholesale clients or professional or sophisticated investors.

Specific recommendations

(not all of these will be relevant depending which of the recommendations is/are adopted)

1. That the limited connection relief be maintained, including for the reasons set out in par 15 of CP 315 (and noting that a majority of respondents to CP 301 disagreed with the concept of a complete repeal of the limited connection relief, as per par 29 of CP 315).
2. That inverse solicitation relief be made available.
3. That the proposed Funds Management Relief for FFSPs not be limited in any way where the financial services are provided to wholesale or professional investors and/or that **Section 911A as modified by Reg 7.6.02AG be amended** as set out in the attached schedule to permit responsible entities of Australian MISs and trustees of PSTs to acquire units in offshore funds and obtain advice from foreign investment managers without restriction.
4. That the changes contemplated in par 35 of CP 315 be made so as to result in a more even-handed regulation of the various different types of offshore fund structures and that the existing exemption where the foreign person or company provides the service only to related bodies corporate – s 911A(2)(i)) – similarly be amended consistently with the changes contemplated in par 35 of CP 315.
5. That the legislation be amended to clarify when products or services are located outside Australia.
6. That the legislation be amended to clarify whether Foreign AFSL holders necessarily need to register as foreign companies.
7. That the transitional period be extended.

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1. Background – types of activity that will be caught

It would be normal for an Australian MIS/master trust/PST (as applicable) to wish to undertake the following activities in relation to FFSPs:

- Invest in offshore funds (whether established as trusts, limited partnerships or corporate vehicles managed by third parties and, where applicable, funds managed by related parties; and
- Recommend or arrange for investments in the same offshore funds to Investment Management Agreement (IMA) clients who are professional investors (where there is no corresponding Australian fund available); and
- Appoint FFSPs as investment managers or advisers to advise (a) Australian MISs/master trusts/PSTs and (b) the appointer's IMA clients, on securities issued by offshore entities.

2. Proposed Principles

It is submitted that there are certain principles which should underlie appropriate regulation of FFSPs under Australian law:

(1) the issue of interests in offshore funds should not necessarily be regulated in the same way as the provision of financial services such as advice or portfolio management;

(2) wholesale Australian investors - or at the very least the subset of wholesale Australian investors being Professional Investors - should not be restricted in investing in offshore funds or obtaining services from foreign financial service providers; and

(3) professional Australian investors should not be restricted from recommending or arranging investment in offshore funds to their wholesale clients.

We consider the second and third principles first.

2.1 Wholesale and Professional Investors

When a professional investor such as an Australian MIS/master trust/PST makes an investment decision to invest in an offshore fund, or appoints an FFSP to provide advice, it is not clear that there is any overall benefit to the ultimate Australian investors in requiring the offshore fund or FFSP to either register with ASIC for the purposes of obtaining relief, or to obtain a foreign AFSL, as would seem to be the intention underlying CP 315.

Given the extensive requirements that must be met and expertise that must be demonstrated in order for an Australian entity to obtain an AFSL, it is unreasonable to assume – as both the present legislation and the propsed changes seem to assume – that an investor which is an AFSL holder is incapable of forming its own opinion as to the utility of the advice it receives from either local or overseas investment managers, or as to the desirability of investing in certain foreign securities such as offshore funds, equities and bonds. We can see no justification for these restrictions.

It is, in our submission, unreasonable that responsible entities of Australian MISs or trustees of PSTs which wish to invest in offshore funds should be restricted by Australian law from being readily able to invest or to obtain advice about those investments from local experts in the relevant jurisdictions.

2.2 Products and services should not necessarily be treated in the same way

Some of the restrictions which relate to the proposed FFSP Funds Management Relief and to the proposed Foreign AFSL conditions are more relevant to services, and some are more relevant to the issuing of interests in offshore funds .

ASIC appears to take the view that even if an Australian AFSL holder is itself acquiring interests in offshore funds, or is making the arrangements for interests in offshore funds to be issued to Australian investors, strictly the issuing of the foreign security to an Australian investor (even if an AFSL holder) still amounts to the foreign issuer providing financial services (see RG 121.43 and ff as well as CP 315 par 37, and see the caps proposed in B3).

We do not agree that this is an appropriate view.

Recommendation: It is recommended that the issue of foreign-based securities such as offshore fund securities (whether offered through a trust or a company), **should not be treated on the same basis as the provision of advice and similar services by FFSPs based offshore.** It is submitted that many of the proposed tests for both:

(1) FFSP Funds Management Relief, and

(2) Foreign AFSL requirements

are not appropriate for product issuers.

The following provides an example of the difficulties that the proposals would cause in relation to investment by an Australian superannuation trust, master fund or MIS in the interests in an Irish collective investment scheme , even if the Australian AFSL holder were related to the manager/operator of the Irish product issuer (in which case a separate exemption could be available, depending on the structure of the issuer). We note that Ireland is a highly regulated jurisdiction.

In a typical Irish corporate fund structure the corporate fund, the fund operator (UCITS or AIF manager) and the investment manager are all different legal entities. The following structure is common:

(a) An Irish corporate fund with various sub-funds (which are not separate legal entities) in which an Australian AFSL holder and/or its clients wish to invest. The Irish fund is regulated as a fund, not an investment manager.
(b) The Irish fund operator (who could be a related body corporate of an AFSL holder) is appointed by the Fund. The operator is regulated as a UCITS/AIF manager and does not enter into Investment Management Agreements (IMAs) with clients.
(c) A UK investment manager is appointed by the fund operator. This is the only entity in the structure that could qualify for sufficient equivalence relief.
Note however that the UK investment manager does not provide a financial service to the Australian AFSL holder/client. It provides a financial service only to the Irish fund operator.

ASIC notes in paragraph 35 of CP 315 that:

> [it is] proposing to include in our funds management relief those investment management structures that are commonly employed in offshore jurisdictions, such as body corporates limited by shares that operate in a similar way to an investment fund.

We submit that similar inclusions should be made in the Corporations Regulations and not only in the Funds Management Relief, to ensure that overseas fund structure does not dictate whether or not relevant existing exemptions apply and to ensure a level playing field.

However even if further amendments to the proposed Funds Management Relief and Foreign AFSL requirements are made, which entity does ASIC expect will register for the proposed Funds Management Relief in the above scenario? Would both the fund entity and the fund operator need to register for Funds Management Relief?

Also in the case described, neither the Irish corporate fund, nor the fund operator will qualify as an entity regulated in a sufficiently equivalent jurisdiction and so neither entity would be able to obtain a Foreign AFSL, even should it wish to do so.

3. Issues arising

There are a number of questions that arise in relation to the proposed restrictions in relation to both the proposed Funds Management relief and the proposed Foreign AFSL.

3.1 When are products or services located outside Australia?

For the purposes of the "portfolio management services" aspect of the proposed Funds Management Relief, it is not necessarily clear when assets are *"located outside this jurisdiction"* (that is, outside Australia). More clarity is required here.

3.2 Issues relating to registration as a foreign company

Does a foreign AFSL holder need to be registered as a foreign company? Impact on exemption

If an overseas entity needs to register as a foreign AFSL holder, it would seem likely that they would also be regarded as carrying on a business in Australia and need to be registered as a foreign company. Certainly most lawyers would so advise, for an abundance of caution. However it is not clear that this is the case and indeed the proposals will have the effect of penalising entities which have relied on such conservative advice, in that Fund Management Relief is not available to companies which have registered in Australia as foreign companies. This seems counter-productive and it suggested that this restriction on the exemption be removed.

Given that the tests as to "*carrying out financial services for Australian investors*" (for licensing purposes) and "*carrying on business in Australia"* for foreign company registration purposes are not necessarily identical, it is recommended that the differences between the tests be clarified or that clearer tests be established.

If foreign company registration is indeed required for the foreign AFSL holder, this may deter some foreign entities from applying for a foreign AFSL in the first place, because of concerns about tax consequences and the like.

What is property in Australia?

The draft RG 176 contained in Attachment 1 to CP 315 contains a decision tree and a brief section which describes who should register as a foreign company; however the description raises a number of questions. The draft RG provides as follows:

> ***Register as a foreign company (if required)***
>
> *RG 176.47 Generally, an FFSP must register as a foreign company under Div 2 of Pt 5B.2 if, among other things, it:*
>
> *(a) has a place of business in Australia (e.g. a branch office);*
>
> *(b) establishes or uses a share transfer office or share registration office in Australia; or*
>
> *(c) administers, manages or deals with property in Australia as an agent, legal personal representative, or otherwise.*

Is the test of what is "property in Australia" the same test as to whether assets are located outside Australia?

3.3 Problems with conditions of proposed relief – cap on operations

In relation to the proposed revenue cap we submit that:

(a) The 10% threshold is much too low. As illustrated by many of the queries above, in respect of offshore funds the revenue cap is an arbitrary measure with the results differing depending on factors such as structure of offshore fund (trust versus corporate entity, individual funds versus umbrellas with multiple sub-funds) and the size of a FGFSP's corporate group; and

(b) The calculations are overly complex.

The concern is that many offshore fund managers would not agree to comply with the proposed restrictions but would instead refuse to transact, where possible, with Australian investors, which is an undesirable outcome for Australian investors.

Again we take the example of Australian investor in an Irish Fund which is a corporate vehicle, and which has sub-funds. The following questions arise in relation to the calculation:

(1) In relation to the requirement to calculate the annual aggregated consolidated gross revenue, does this mean of the corporate fund as a separate entity or of a sub-fund(s) (not themselves separate legal entities) in which the Australian entity has invested? Or does this mean the consolidated gross revenue of the fund operator? Note the fund operator is not considered to be in the same corporate group as the corporate collective investment schemes that they operate.

(2) It is also submitted that this test would give completely different results depending upon whether the offshore fund is structured as a corporate vehicle or a trust or limited partnership. This is unreasonable.

(3) It is not clear what a FFSP would need to do if it exceeds the revenue cap if the FFSP will not qualify for the foreign AFSL (for example not a sufficiently equivalent jurisdiction). Will individual relief be possible? Will the FFSP need to compulsorily redeem the Australian investor from the offshore fund (if that is possible)?

3.4 Problems with conditions of transitional period

The transitional period for the limited connection relief is relatively short. It is not clear whether it is in Australian clients' interests for FFSPs to *"reduce their activities in Australia within six months"* when this apparently means either redeeming Australian investors out of their funds and/or terminating Investment Management Agreements? This may not even be possible with investments in closed-end funds.

4. The existing situation – s911A

Reg 7.6.02AG of the Corporations Regulations amends s 911A to provide a number of possible exemptions, none of which unfortunately provide an appropriately tailored solution for the situation of a responsible entity wishing to obtain overseas investment advice or invest in offshore funds .

Section 911A(2E) provides that a person (person 1) is exempt from the requirement to hold an AFS licence for a financial service they provide to a person (person 2) in the following circumstances:

(a) person 1 is not in this jurisdiction;

(b) person 2 is a professional investor; and

(c) the service consists of any or all of the following:

(i) dealing in derivatives, foreign exchange contracts, carbon units, Australian carbon credit units or eligible international emissions units;

(ii) providing advice on derivatives, foreign exchange contracts, carbon units, Australian carbon credit units or eligible international emissions units;

(iii) making a market in derivatives, foreign exchange contracts, carbon units, Australian carbon credit units or eligible international emissions units.

Most responsible entities of managed investment schemes would not be able to rely on this section in relation to obtaining investment advice from overseas investment managers because the range of services mentioned is very narrow and reflects only a small subset of the securities in relation to which overseas investment managers advise.

We suggest deleting the restrictions in sections 911A(2C) and 911A(4) on overseas advisers giving advice to AFSL holders which are operators of registered MISs or PSTs. Indeed, we would support deleting s 911A(4) entirely, but at the very least the reference to registered managed schemes should be deleted.

In the interests of clarity and consistency, we suggest that it also be made clear in 911A(2C) that overseas advisers can give advice to AFSL holders who operate **wholesale managed investment schemes** (particularly given that section 911A(4) does not place an overriding limit on the ability of these schemes to access overseas advice from a non-AFSL holder in the way that it does in relation to registered schemes).

We attach a schedule showing the suggested changes to the legislation.

Please let us know if you require any further information or would like to discuss the contents of this submission further.

Yours faithfully,

Suggested Amendments

Section 911A as modified by Reg 7.6.02AG

S 911A (2C) Also, a person (***person 1***) is exempt from the requirement to hold an Australian financial services licence for a financial service they provide to a person (***person 2***) in the following circumstances:

(a) person 1 is not in this jurisdiction;

(b) person 2 is:

(i) the holder of an Australian financial services licence; or

(ii) exempt from the requirement to hold an Australian financial services licence under paragraph 911A(2)(h);

(c) person 2 is ~~not~~, in relation to the service:

(i) acting as a trustee or investment manager of a superannuation trust, wholesale trust or managed investment scheme; or

(ii) acting as a responsible entity of a registered managed investment scheme; or

(iii) except as provided in (i) and (ii), not acting as a trustee, nor otherwise acting on someone else's behalf.

S 911A (4) A person is not exempt under any paragraph of subsection (2) for a financial service they provide if the service is:

~~(a) the operation of a registered scheme, or~~

~~(b)~~ a traditional trustee company service.