12 August 2019

Alan Worsley, Senior Specialist
Strategic Policy
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001

By email: policy.submissions@asic.gov.au

Re: ASIC Consultation Paper 315 – Foreign financial services providers: Further consultation

Dear Mr Worsley,

The Australian Investment Council welcomes the opportunity to contribute our feedback in response to ASIC Consultation Paper 315 (the consultation paper) and ASIC's proposal to introduce 'funds management' licensing relief for foreign financial services providers (FFSPs) and repeal the 'limited connection' relief, released in July 2019. We previously provided feedback to ASIC's earlier *Consultation Paper 301: Foreign financial services providers* as the Australian Private Equity and Venture Capital Association Limited (AVCAL).

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses, which when combined represents a multi-billion dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity, venture capital and private credit funds, alongside institutional investors as well as leading financial, legal and operational advisers. Amongst our members are the key institutional investors in the asset class, including Australian superannuation funds.

We remain concerned that the proposed changes to exemptions for foreign financial services providers (FFSPs) will deter them from offering their products and services to Australian wholesale investors such as domestic superannuation funds, thereby limiting the scope of investment opportunities for superannuation funds to the detriment of their members. In particular, we believe that the proposed changes will deter offshore alternative asset managers, such as PE and VC funds, from seeking capital commitments from Australian superannuation funds. This is likely to restrict the ability of super funds to deploy capital overseas, and could have an impact on the returns that these funds generate for their members.

While the introduction of funds management relief is welcome, we believe that ASIC's proposals are contrary to the interests of Australian wholesale investors and create uncertainty for FFSPs and their existing and potential clients in Australia. More detailed feedback on the proposals in the consultation paper are further outlined below.

We look forward to participating in any future discussions about the issues set out in this submission. If you would like to discuss further, please do not hesitate to contact me on 02 8243 7000.

Yours sincerely,

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Chief Executive

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Response to consultation paper

1. Funds management relief

The AIC is broadly supportive of the introduction of funds management relief (proposal B3), bearing in mind the views that we express in other parts of this submission and our earlier submission in response to ASIC CP 301. It is vitally important that Australia's wholesale investors continue to have ease of access to international markets, and the FFSPs are not discouraged from providing fund management services to Australia-based wholesale clients – in particular the superannuation sector.

Australia has accumulated the fourth largest pool of retirement savings in the world through the superannuation system.[1] In the last 20 years, the superannuation system has seen the highest growth in assets out of all other developed markets, at 12.1% per annum.[2] Australia recorded the second-highest pension asset-to-GDP ratio in the world in 2017, at 138%. This was far higher than that of the UK (121%), Canada (108%), Japan (63%), and South Korea (47%).[3] This high pace of growth in assets must be accompanied by policy settings that enable superannuation funds to invest the accumulated capital across a range of asset classes and geographies.

A report issued in May 2014 by Rice Warner,[4] commissioned by the Actuaries Institute for the Financial System Inquiry, stated: "As the [super] industry grows it is possible that allocations to overseas investments may be driven higher due to reduced capacity in the Australian market for funds to invest the assets." Undoubtedly, this need for super funds to allocate capital to overseas investment is even more likely now given the substantial growth in super assets since 2014.

The sheer size and significant role that super funds play within Australia's financial system suggests that domestic capital markets across many asset classes are less able to absorb the ever-increasing levels of super fund savings than ever before, and that this trend will continue both over the near- and long-term.

In this context, the ability for Australia's superannuation funds to access investment options through a funds management relief provision is imperative. While the Australian Investment Council supports the relief in principle, we are concerned about the conditions that have been framed around the relief provision. These are discussed further below.

(a) Imposing a cap on the scale of activities

The consultation paper proposed that the funds management relief may only be relied upon by an FFSP if less than 10% of its annual aggregated consolidated gross revenue, including the aggregated consolidated gross revenue of entities within its corporate group (for each of the previous and current financial years), is generated from the provision of funds management financial services in Australia.

We believe that the 10% threshold is far too low and would exclude a significant number of FFSPs that could otherwise provide their services with relative ease to the Australian wholesale market. This is particularly the case for private capital fund managers, including managers of private equity, venture capital and private credit assets.

Private capital funds are typically structured as limited partnerships, whereby investors in those funds (as 'limited partners') are essentially passive investors without active management rights. A limited partner's

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[1] *Global pension assets study 2018*, Willis Towers Watson

[2] Ibid.

[3] Ibid.

[4] *Ageing and Capital Flows*, Rice Warner, May 2014

liability to the partnership and its creditors is generally limited to the amount of capital that it agrees to contribute to the partnership.

The overwhelming majority of capital raised by private capital fund managers comes from institutional and wholesale investors. The institutional investors that deploy capital into the private capital asset class tend to be large and sophisticated, managing tens of billions of dollars across their investment portfolios.

A single investor could therefore be contributing as much as 10% of the total capital raised within one fund structure. Management fees, as one of the key forms of revenue for fund managers, are drawn from investors in proportion to the amount of capital that each investor has committed to the fund. As a result, if a single Australian superannuation fund were to contribute to 10% of the aggregate amount raised by an offshore private capital fund, that offshore fund manager would not be eligible for the funds management relief.

According to the ABS, superannuation fund assets held overseas totalled $463 billion as of March 2019, having increased annually by an average of 19% over the last three years.[5] As the extent of Australia's wholesale investor appetite for international investment opportunities continues to grow, we are more likely to see two or more Australian investors committing capital to the same funds, or requiring the portfolio management services of a particular company. We believe that a 10% revenue cap would restrict a significant number of FFSPs from relying on the funds management relief, thereby discouraging them to take on Australian wholesale clients. This would be especially felt by offshore fund managers that operate in a niche part of their respective market (for example, small or mid-market specialist PE funds, or US-based tech VC funds), that may not have large legal or compliance teams at their disposal, but that often generate above-average returns for investors.

We therefore recommend that the 10% cap be lifted to 25% to enable a greater pool of FFSPs being afforded eligibility to funds management relief.

(b) <u>Condition of not carrying on a business in Australia</u>

ASIC proposes that FFSPs seeking to have the benefit of the funds management relief will be subject to a number of additional conditions (apart from the 10% revenue cap), including that the FFSP must not be carrying on a business in Australia.

It is often the case that FFSPs that enter into investment mandates with Australian wholesale investors are registered in Australia as foreign companies. If that is one test in determining whether an FFSP is 'carrying on business in Australia', then this could unnecessarily include a large number of FFSPs with an otherwise minimal presence in or connection to Australia, especially for FFSPs that enter into separately managed account agreements with Australian wholesale clients.

One could therefore interpret the new regulations as precluding those entities registered in Australia as foreign companies not being able to rely on the funds management relief, even though the relief appears to be intended to operate for their benefit. We believe that this could be an unintended outcome of how Regulatory Guide 176 has been drafted as part of the current consultation, and would urge ASIC to reconsider the inclusion of this condition in the draft Regulatory Guide.

2. Repeal of limited connection relief

The AIC doesn't support the repeal of the limited connection relief. Our previous submission discussed the importance of limited connection relief in ensuring that conduct that may be deemed as 'inducing' an Australian client to use the products or services of the FFSP (which is standard industry practice globally in

[5] ABS 5655.0 Managed Funds, Australia, March 2019

how an FFSP and a wholesale client establish a relationship) is carved out from requirements to obtain an AFSL. We still believe that to be the case.

However, should ASIC proceed with the repeal of this form of relief, then we would be supportive of extending the repeal date until 31 March 2020 at the earliest. The need for FFSPs and their Australia-based wholesale clients to adjust to the newly proposed regulations within an appropriate timeframe is critical in ensuring that existing agreements (and agreements that are currently being negotiated) between parties are not negatively impacted by the changes. This would provide for an orderly transition and ensure that Australia's strong reputation for policy certainty – a critical part of creating and strengthening commercial links internationally – is maintained.

3. Reverse solicitation relief

The AIC is generally supportive of the provision of reverse solicitation relief for FFSPs as proposed in the appendix to the consultation paper. However, it remains unclear to us how and in what instances the reverse solicitation relief would operate (acknowledging the guidance provided in paragraphs 106-107 of the consultation paper).

For example, an Australian wholesale investor may be subscribed to the free and publicly-available 'market updates' newsletter of an overseas fund manager. Such activities in assessing information regarding market developments are important for large sophisticated investors with global portfolios of assets to undertake as part of their fiduciary duties. In our view, it would be reasonable in this instance for the fund manager to rely on the reverse solicitation relief if they were to, at some point after that subscription is made, provide a paid service to the wholesale investor.

We would like to see more clarity provided by ASIC in how certain types of communications, as well as other activity or conduct, would be determined to be entitled to this relief. Greater clarity can be provided by way of further examples being given to illustrate how reverse solicitation relief would operate (similar to the examples provided in Table 4 (p. 36) of the consultation paper).