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August 8, 2019

Via Email to policy.submissions@asic.gov.au

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

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

Dear Mr. Worsley:

ICI Global[1] and the Investment Adviser Association (IAA)[2] appreciate the opportunity to comment on Consultation Paper 315 (CP 315), which is intended to ensure that the Australian Securities and Investments Commission (ASIC) has sufficient supervisory and enforcement powers over foreign financial services providers (FFSPs) that provide financial services to Australian wholesale clients or professional investors in Australia.[3] ASIC's revised regulatory framework for FFSPs is of great interest to our members that currently offer interests or securities in offshore funds and/or provide portfolio management services to wholesale clients and professional investors in Australia.

In its proposal to revise the framework for FFSPs, we generally believe that ASIC strikes the right balance between its regulatory and supervisory needs to protect investors with the importance of not

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$30.2 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] The IAA is a not-for-profit U.S. association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission (SEC). Our membership consists of investment adviser firms that manage assets for a wide variety of individual and institutional clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations. For more information about the IAA, please visit www.investmentadviser.org.

[3] *See* CP 315, Foreign financial services providers: Further consultation (July 3, 2019), available at https://download.asic.gov.au/media/5191721/cp315-published-3-july-2019.pdf. ICI Global and IAA each commented in 2018 to ASIC on Consultation Paper 301: Foreign Financial Services Providers.

unduly reducing the benefits that FFSPs can provide to their clients. Specifically, we agree with ASIC's proposal to grant FFSPs relief to provide funds management financial services to professional investors in Australia. We believe it is for the benefit of Australian professional investors, including superannuation funds, to have access to a broad range of funds management expertise and to diversified portfolios. As ASIC notes, absent this proposed relief, many FFSPs that provide funds management services (even if they are part of a global group with affiliates that have Australian operations) would not be able to provide services to Australian professional investors.

To ensure that ASIC can achieve its objectives, we set forth below our suggestions to improve the proposed licensing framework for FFSPs. These recommendations are premised on our understanding that the existing licensing framework (including relevant exemptions) under the *Corporations Act 2001* (Cth) (Corporations Act) and *Corporations Regulations 2001* (Cth) (Corporations Regulations) will remain unchanged. We also request clarification or guidance where we believe it could be helpful for FFSPs to comply with the new framework.

I. Funds Management Relief

<u>Scope of the Relief</u>

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?

The exemption for funds management financial services is proposed to apply to a "foreign company that is carrying on a financial services business in this jurisdiction *only because of the operation of section 911D of the Act* (emphasis added) in relation to funds management financial services provided by the foreign company" (911D Condition).

Under section 911D of the Corporations Act, an FFSP is considered to be carrying on a financial services business (and therefore must be licensed) if the FFSP engages in conduct that induces, or is likely to induce, persons in Australia to use its services. We understand that the intention and effect of the 911D Condition in the draft instrument is that an FFSP could *only* rely on the relief if the only reason the FFSP is brought into the Australian regulatory regime is due to the deeming provision in section 911D. FFSPs would not be able to rely on the relief in other circumstances, such as if they are otherwise engaging in activities that would amount to carrying on a financial services business in Australia (for example if the deeming provision is not triggered or relied upon).

We believe that this limitation is unduly restrictive, will greatly reduce the ability of FFSPs to rely on the relief, and is inconsistent with ASIC's stated policy rationale for the relief - namely, to preserve "competition by ensuring that a diversified range of investment managers and investment products may be available to professional investors in Australia" (paragraph 33, CP 315).

Accordingly, we request that ASIC consider replacing "only" from the 911D Condition with "including."

Request for Relief on a Group Level

Under the current proposal, it appears that each FFSP must separately notify ASIC of its reliance on the funds management relief.[4] We request that ASIC permit FFSPs to notify ASIC of their reliance on the relief on a corporate group level rather than at a specific entity level (at their discretion). This approach would be administratively more efficient for ASIC, Australian professional investors, and FFSPs and would reduce costs.

If relief is permitted to be notified on the corporate group level, the undertakings by the signatory to the deed could extend to procuring other entities within the corporate group that rely on the relief to comply with the same undertakings as if they were party to the deed.[5]

Exception for Application to Current Clients

We submit that there should be grandfathering for an FFSP relying on existing relief if the FFSP does not otherwise qualify for the funds management relief and does not otherwise obtain a foreign Australian financial services license (AFSL).[6] Grandfathering is needed because existing Australian clients of FFSPs may be receiving ongoing financial services under contracts that have fixed terms or have a termination notice period that is longer than the compliance date.

Under the proposal, in these circumstances, if the FFSP does not apply for a license and does not otherwise qualify for relief, the FFSP may be in breach of, or forced to terminate, contracts with existing Australian clients or may be required to redeem existing Australian clients' interests in a fund, which could be to the detriment of those Australian clients or their underlying investors.[7]

Application of Cap on Scale of Activities

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

ASIC is proposing that an FFSP may have the benefit of the funds management relief only 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

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[4] We are not aware of any other key global jurisdiction that requires an individual fund (whether it is structured as a corporation, limited partnership, trust or other vehicle) to hold an individual financial services license to allow clients to invest into it (as opposed to requiring the fund to register in that jurisdiction, which is common).

[5] Entities not relying on the relief would not need to comply with the undertakings.

[6] An FFSP may not obtain a foreign ASFL if it is not from a jurisdiction that is found to be sufficiently equivalent, or if the amount of its Australian sourced revenue is too small to justify the expense of applying for and complying with the foreign ASFL.

[7] Forced termination could be particularly detrimental in the context of closed-end private equity funds, where it is difficult to unwind investments before the end of the life of the fund.

generated from the provision of funds management financial services in Australia. We recognize that the funds management relief must operate subject to certain conditions to address ASIC's policy objective of ensuring that the funds management financial services do not form a substantial part of the FFSP's business. We believe, however, that the proposed revenue cap in its current formulation (10% cap on both the entity and group level) and the calculation period are overly complex and impractical, and may, in practice, impede the effectiveness and objective of the relief.

For the relief framework to be effective, the conditions with which an FFSP must comply – including a cap on the scale of activities – need to (1) be workable from an operational and compliance perspective, (2) refrain from favoring certain managers, and (3) give certainty to Australian professional investors as well as the FFSP itself. We are concerned that the proposed calculation of the cap fails to satisfy all three of these important criteria.

First, ASIC's cap, as proposed, is challenging from an operational and compliance perspective. The 10% trigger at the entity and group level is complex and difficult to calculate. Entities within the same group may be in different jurisdictions with different laws and accounting standards, and they may not have information-sharing protocols in place that are adequate to facilitate the necessary group revenue calculations on a rolling basis. Further, in particular group structures, an entity may operate autonomously and independently from the parent company and/or sibling companies making such calculations nearly impossible and potentially misleading, which is not in furtherance of ASIC's objective.

In addition, how the calculation methodology should be applied in certain scenarios is not entirely clear. For example, if an offshore fund is required to hold a license, should the calculation for such fund be made at the umbrella fund or sub-fund level? Further, how should the fund account for its fund management company, which may not be legally part of the same corporate group as the fund?

Second, the 10% cap as formulated would, in practice, favor managers that are part of a large global network operating in many jurisdictions. These managers could generate significant revenue under the proposal without triggering the cap, but a smaller manager operating in fewer jurisdictions would trigger the cap after generating a much smaller amount of revenue from Australia. If the practical effect of the proposal would be to favor large global fund managers over smaller but equally-qualified operators, that would be inconsistent with ASIC's stated policy rationale for the relief (as extracted from CP 315 in our response to question B1Q1 above).

Third, Australian professional investors typically seek to obtain a portfolio management service or invest in an investment vehicle for the long term following extensive and time consuming due diligence processes and so would want certainty in the licensing or relief/exemption status of the provider and its ability to provide continuous service and information. Similarly, an FFSP needs certainty of its regulatory status and compliance with regulatory requirements to enter into an agreement with an Australian professional investor. Because ASIC's proposal would depend on the percentage of revenue generated from the provision of funds management financial services in Australia (which would likely fluctuate year to year), both the investor and the FFSP would not have any certainty of whether the FFSP would continue to be eligible for the relief on an ongoing basis.

Due to circumstances outside of its control, an FFSP may unexpectedly find itself no longer eligible for the funds management relief. The proposed cap could, for example, be exceeded as a result of market movements (*e.g.*, fees based on assets under management), by a reduction in the FFSP's business outside Australia, (or as a result of external factors affecting revenue in other parts of a global group. For example, if there was a large redemption from a fund or the termination of a significant mandate, the proportion of revenue from Australian investors may increase without any increase in activity or business in Australia. Alternatively, the cap could be triggered by a performance fee in a particularly good year or an FFSP may be part of a corporate group that has broader operations in Australia that may trigger the cap on the basis of their activities and clients. Under these circumstances, the FFSP may then be forced to terminate or restructure its arrangements with its Australian investor(s), resulting in Australian clients having to find another arrangement.

For these reasons, we urge ASIC to reconsider conditioning the funds management relief on a cap and consider whether its policy objectives can be met in another manner.

Additionally, we do not understand ASIC's rationale for applying a cap on the scale of activities of an FFSP, which is described as "ensuring that those services do not form a substantial part of their business." Restricting offshore funds management activities in this way has the potential to undermine ASIC's stated policy rationale of preserving competition and "ensuring that a diversified range of investment managers and investment products may be available to professional investors in Australia."

If ASIC determines to proceed with imposing a revenue cap despite our concerns, we strongly recommend that the methodology for calculating and testing for the cap be significantly simplified. Specifically, we recommend that the cap (1) be assessed at the time that an offer is first made to an investor for a portfolio management service, at the first offer to a new investor in an investment vehicle, and at the first offer of a new investment vehicle to an existing investor, (2) is assessed on *either* the revenue of the entity or corporate group (at the discretion of the FFSP, as notified to ASIC), and (3) exclude any services provided by a related body corporate operating under an AFSL.

In addition, we urge ASIC to raise the cap substantially to reduce the likelihood of the cap being breached due to market movement and/or episodic revenue-generating events. Further, we request that, depending on how the cap will need to be calculated, ASIC consider providing a grace period for FFSPs to come into compliance with the cap if it is breached.

Moreover, we recommend that ASIC permit the FFSP to determine whether the cap should be applied at either the entity level or the corporate group level and notify ASIC of its determination. In certain circumstances, applying the cap at the entity level may make the relief unavailable and limit the ability of Australian professional investors to invest in a diverse range of smaller investment vehicles. For example, if a relatively small offshore fund is an FFSP that needs to be separately licensed, it would be

unable to rely on the funds management relief if it triggered the 10% cap at entity level even if the revenue amount at the corporate group level was significantly below the cap.[8]

Conversely, there are certain foreign fund management companies in which there is a parent company and multiple affiliated fund managers that operate autonomously from the parent company and/or sibling companies. These management companies should not be required to apply a cap at the corporate group level because the businesses of the affiliated companies are wholly unrelated to one another and they do not have access to each other's revenue information.

If the revenue cap were to be applied in the manner proposed in CP 315, in our view the cap would significantly undermine the utility of the relief and run counter to ASIC's stated goals.

<u>Custodial and Depository Services</u>

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?

ASIC is proposing not to extend the relief to cover the provision of custodial and depository services for the interests or securities of the scheme under the rationale that an existing AFS licensing exemption is available (Reg. 7.6.01(1)(k)). We do not agree.

The basis for ASIC's decision to exclude custodial and depository services from the relief is not evident from a policy perspective. The provision of such services is an important part of an offering for a fund formed in a non-corporate structure. Where an offshore fund does not adopt a corporate structure (*e.g.*, trusts, limited partnerships in certain jurisdictions, etc.) or does not appoint an external custodian (*e.g.*, because it provides self-custody), the operator of the fund (*e.g.*, trustee, general partner, etc.) would hold the offshore fund's assets on trust for, or on behalf of, investors in the fund. In such a case, the operator of the offshore fund may be providing a custodial or depository service in Australia, and we believe Reg 7.6.01(1)(k) would not be sufficient to provide relief for such operators, given it only applies in the specific circumstance where an FFSP is acting as sub-custodian to a master custodian that holds an AFSL.

We note that the passporting class order exemptions (*e.g.*, Class Order 03/1100 as extended by ASIC Corporations (Repeal and Transitional) Instrument 2016/396) currently provide for an exemption in relation to the financial service of 'providing a custodial or depository service' which is consistent with the need for this exemption.

If custodial or depository services are not covered by the draft instrument, then non-corporate offshore funds will be at a competitive disadvantage (compared to corporate offshore funds). For non-corporate offshore funds, the exemption is necessary for operating a fund, and the lack of an exemption for these

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[8] This would also disqualify "fund-of-one" structures from relying on the funds management relief.

services would undermine the policy aim of preserving competition and making a diversified range of investment managers and investment products available for Australian investors.

For these reasons, we request that the relief instrument include custodial and depositary services.

II. Funds Management Relief: Portfolio Management Services

Definition of "Portfolio Management Services"

B2Q2: Do you agree with our proposed definition of "portfolio management services"? If not, why not?

ASIC proposes to define "portfolio management service" as "a financial service provided by a person that is the management of assets *located outside this jurisdiction…*" on behalf of certain persons. We do not agree with the limitation of the scope of portfolio management services to "assets located outside [Australia]" and request that ASIC delete the italicized words in this provision.

CP 315 refers to the relief being intended to cover the situation "where funds management services are *primarily* concerned with financial service in relation to offshore interests and securities." The current drafting, however, could be interpreted to mean that a global equities portfolio would not be within the scope of the relief if it included one or more Australian equities. It does not seem appropriate to deprive FFSPs of the ability to rely on the relief on this basis and, in turn, to limit Australian investors' access to the expertise of global asset managers.

We recommend that the relief allow for portfolio management services or investments in Australian securities if they are an incidental part of the overall portfolio (for example, in a global mandate).

To the extent that ASIC determines to keep the requirement that the assets be located outside Australia, we request that ASIC provide clarification or guidance regarding (1) a de minimis amount of assets that are located in Australia that are permitted to be managed, (2) what assets, specifically, are considered to be located in Australia (*e.g.*, where are OTC derivatives "located"), and (3) the meaning of "located outside" Australia.[9] A reasonable minimum value or percent of offshore assets in the portfolio would be consistent with the definition of an offshore fund for purposes of the funds management relief, which imposes a 50% minimum in relation to non-cash offshore assets. Similar to the offshore fund definition, we suggest that this minimum be measured at the "point-of-sale."

In addition, we request that the definition should be amended to read "management of assets *(including general financial product advice and related dealing services)*" because portfolio managers generally provide reporting and commentary, which may be general financial product advice, and dealing services related to their portfolio management services.

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[9] Similar questions regarding what assets or property ASIC considers to be located "in Australia" arise with respect to the foreign ASFL application, which require the applicant to be registered as a foreign company if required to do so under the Corporations Act. Under Div 2 of Part 5B.2, section 21(1), an FFSP must register as a foreign company if, among other things, it "administers, manages or deals with property in Australia as an agent, legal personal representative, or otherwise."

Eligible Australian Users

B2Q3: Do you agree with our proposed definition of "eligible Australian users" of portfolio management services? If not, why not?

We do not agree with ASIC's proposal to introduce a newly defined category of investor called "eligible Australian users" of portfolio management services. Instead, we recommend that portfolio management services should be able to be provided to existing categories of "professional investors" rather than creating a new category of "eligible Australian users."

In proposing to limit the relief in this manner, ASIC states that it believes that portfolio management services should only be available to a limited category of professional investors that may use such services, namely users that are in the business of funds management or have a portfolio of assets that requires investment management to meet specific investment objectives or goals of the portfolio. The rationale for ASIC's limitation remains unclear. First, we do not believe that there is a greater consumer protection concern for portfolio management services provided to professional investors compared to dealing in the interests of a managed investment scheme or securities of a body that carries on a business of investment. Second, there are other categories of professional investors that are in the business of funds management or have a portfolio of assets that requires investment management to meet specific investment objectives or goals of the portfolio that are not within ASIC's definition. For example, ASIC's proposed definition of "eligible Australian user" does not include a family office (*e.g.*, a private wealth management advisory firm that serves ultra-high net worth investors) or a listed investment company. These types of investors should benefit from being able to access a diverse range of investment managers for the same reasons as the proposed eligible Australian users.

In addition, we understand that institutional investors (*e.g.*, large superannuation funds and sovereign wealth funds) may commonly establish subsidiaries or other vehicles (such as feeder funds) to hold their investments, for example, to quarantine potential liability or preserve their regulatory and tax status. These vehicles are not included within the proposed new category of "eligible Australian users."

Further, in keeping with Recommendation 7.3 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services (that financial services regulation should be kept as simple as possible), we would suggest that a simpler, less complicated relief would be more effective and easier to implement. Creating a new category of investors increases the complexity and compliance burden on ASIC to monitor the use of this relief as well as to the users of the relief and the eligible Australian users. A single category of investors that are qualified and eligible to receive services from an FFSP is much more straight-forward and will better achieve ASIC's objectives.

III. Carrying on a Business in Australia

B4Q3: Are there any conditions that you think we should not impose on FFSPs?

ASIC proposes that, to rely on the funds management relief, an FFSP "is not a registered foreign company." Given that Australian courts have been taking a more flexible approach to how, and an increasingly broad view of when, a foreign entity's offshore activities may amount to carrying on

business in Australia, some FFSPs have erred on the side of caution and taken the conservative approach to register early under the Corporations Act to conduct regular visits to Australia and to maintain business relationships. Under ASIC's proposal, those early mover FFSPs would be ineligible for the funds management relief, unfairly penalizing them for their conservative approach and voluntary registration. We therefore recommend that ASIC remove this condition.[10]

IV. Transition Period

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

ASIC proposes that the funds management relief will be available to eligible FFSPs beginning April 1, 2020, with a six-month transition period permitted until September 30, 2020, to allow FFSPs time to come into compliance with the conditions of the funds management relief. We request that ASIC provide a two-year transition period for compliance with the funds management relief. This longer transition period is necessary for FFSPs that currently rely on the "limited connection" to determine how best to proceed and to ensure compliance with the requirements, and it would align the transition period for both the funds management relief and the foreign AFSL. We do not see a policy rationale to require entities seeking to rely on the funds management relief to have less time to transition to the new regime than entities seeking to rely on the foreign ASFL.

V. Reverse Solicitation

C1Q1: Are there any significant reasons why ASIC should provide an AFS licensing exemption based on reverse solicitation, given our proposed funds management relief in Section B and the licensing exemptions available in Reg. 7.602AG?

ASIC has determined not to provide an AFS licensing exemption for reverse solicitation in the current proposal but has stated that it is open to reconsidering this decision based on information and data about activities conducted in Australia that would not be covered by the proposed funds management relief and the existing statutory licensing exemptions. ASIC further requested detailed information about the mechanisms that industry would suggest ASIC adopt to address its concerns about the ability to monitor the activities of an FFSP providing financial services on a reverse solicitation basis from outside Australia.

Our members believe that a reverse solicitation exemption for professional investors with proper systems, controls, and procedures would be beneficial to both Australian investors and FFSPs. We respectfully request that ASIC either separately consult on this matter at a later date or permit interested parties to make supplemental submissions on this issue. The changes that ASIC has proposed in CP 315 to the FFSP regulatory framework are substantial. More time is needed to evaluate

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[10] If this condition remains, we request that ASIC clarify whether a foreign company with an Australian Resident Business Number would be considered a registered foreign company.

fully the impact of these changes, gather the information that ASIC has requested, and consider the potential scope and operation of a reverse solicitation exemption.

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We appreciate your consideration of our comments on this important consultation. Please contact Eva M. Mykolenko, ICI Global Associate Chief Counsel – Securities Regulation, at [redacted] or Monique Botkin, IAA Associate General Counsel, at [redacted] if we can provide any additional information.

Respectfully submitted,

/s/ Jennifer S. Choi
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