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Manager
Policy Framework Unit, Foreign Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: FIRBStakeholders@treasury.gov.au

Enhancing Australia's foreign investment framework

The Financial Services Council (FSC) is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks.

The financial services industry is responsible for investing almost $3 trillion on behalf of more than 14.8 million Australians.

The FSC welcomes the opportunity to submit proposals to improve the overall design and operation of the foreign investment framework to reduce regulatory burden while ensuring Australia's national security interests are protected.

We submit that the Government should consider providing appropriate objective criteria for fund managers that engage in ordinary low security risk investment activity primarily for the benefit of Australians, and life companies that engage in the investment of the statutory funds they are required to maintain and invest under the *Life Insurance Act 1995* (Life Act). If funds and life companies meet those criteria, they should be expressly excluded from the operation of the *Foreign Acquisition and Takeovers Act 1975* (Act) and regulation, rather than granted relief under various exemptions and via certificates.

Alternatively, our submission proposes amendments to section 36 of the *Foreign Acquisitions and Takeovers Regulation 2015* (Regulations) in order to reduce regulatory burden for foreign investment funds, including superannuation funds and life companies, operating in Australia. Our drafting proposals have the effect of exempting foreign funds that are also Australian Registered Entities, unregistered managed investment schemes, Registered Superannuation Entities and life companies registered under the Life Act, and who carry out investments for the benefit primarily of Australians, from having their ordinary investment activities being subject to the significant actions, notifiable actions or notifiable national security actions obligations.

Tranche 1: Proposed Regulatory Amendments
The FSC supports the proposal to raise the control threshold for unlisted land entities from 5% to 10% for foreign investors who acquire an interest in an unlisted Australian land entity. We agree that this would reduce the regulatory burden for fund managers by aligning with the control threshold for listed Australian land entities and the control threshold that applies to more sensitive investments.

Financial Services Council Ltd
Level 5, 16 Spring Street
Sydney NSW 2000
E. info@fsc.org.au
W. fsc.org.au
ABN 82 080 744 163
@FinServCouncil
@FinServCouncil
@financial-services-council

Tranche 2: Broader Legislative and Regulatory Reforms

> **Consultation Question 1.2: Improving the treatment of passive-style investments and superannuation funds under the framework, including to better accommodate how entities in the financial sector operate and manage their affairs (e.g. interfunding).**

The FSC supports the aim of improving the treatment of passive style investments and superannuation and insurance funds under the framework, particularly in relation to interfunding.

We submit amendments to section 36 of the *Foreign Acquisitions and Takeovers Regulation 2015* to this end (see Appendix A). Section 36 relates to exemptions for certain actions relating to the acquisitions by funds, schemes and life companies of various assets from being significant actions, notifiable actions or notifiable national security actions.

Exemptions for interfunding activities

Exemptions should be provided for interfunding activities as well as the investment of statutory funds by life companies. Interfunding is a common practice in the Australian funds industry, used by investment managers as a mechanism to pool assets from internal funds and external clients to sector funds. This mechanism helps to reduce risk, complexity and costs. An example is where a unit trust that is offered to an institutional client base with institutional fees, terms and conditions is then separately offered to a retail investor base (which is subject to a different set of regulatory obligations and fees etc) through a 'feeder fund', that is, a separate unit trust that invests wholly in the institutional unit trust. The assets of the feeder fund are only comprised of units in the institutional fund.

The foreign investment framework in Australia appears to treat an Australian unit trust managed by a locally licensed and domiciled but ultimately foreign owned, trustee as a "foreign" entity, which causes transfer of assets from one locally registered and domiciled unit trust to another locally registered and domiciled unit trust managed by the same trustee to be treated as a significant or notifiable action. This creates an administrative burden for global fund managers and for the Foreign Investment Review board (FIRB) and an oversight by the FIRB which we do not believe is within the intention of the policy. The application of the rules is broad when the underlying assets of the trust are managed by the same person and there is no significant or notifiable action in respect of the underlying assets. It is further noted for structural reasons highlighted in Treasury's Johnson Report, that the vast majority of investors in Australian unit trusts are Australian residents. We submit that for policy and commercial reasons, this activity should be the subject of an exemption from the regime.

Exemptions for Life companies

Life companies regulated by the Life Act are subject to statutory obligations to hold and invest premiums paid by policy holders in designated statutory funds. Life companies are subject to regulation by both APRA as insurers and by ASIC as holders of Australian financial services licenses. They are required under the Life Act to act in the best interests of their policy holders when investing the statutory funds held to meet the payment of claims.

Investment by a foreign life company of its statutory funds in an Australian asset can amount to a significant action, notifiable action, notifiable national security action or reviewable national security action. Further,

life companies typically engage investment managers to invest the statutory funds on their behalf, which are then invested through multi-fund structures. Where the foreign life company invests the statutory funds through a fund structure, the trustee of each fund in the structure in which the foreign life company's interest is 20% or more also becomes a "foreign person" and subject to the Act in relation to its own investment activities.

This creates a significant administrative burden for life companies, their investment managers and the trustees of the funds through which they invest the statutory funds. This burden is magnified where the life company appoints multiple investment managers, each of which are making investment decisions regarding a portion of the statutory funds. The rules in the Act regarding tracing, associates and aggregation of interests mean that the life company and its investment managers are often unable in practice to ascertain whether a particular investment at a point in time would amount to an action regulated by the Act.
Given that: (i) life companies are already subject to significant oversight by Australian regulators to protect the interests of policy holders; (ii) the Life Act requires that the life company's investment decisions are driven by the best interests of policy holders rather than the interests of the foreign life company itself; and (iii) the fact that managing investments in order to comply with the Act often means that life companies are unable to undertake investments that are in the best interests of policy holders, we submit that the investment of statutory funds by life companies (including via fund structures) should be the subject of an exemption from the regime.

<u>Application of section 18A: increasing percentage of interests without acquiring additional interests in securities</u>

In addition, the operation of section 18A of the Act captures fund managers (including life companies) undertaking the standard activity of acquiring shares in listed entities for the benefit of members in index tracking and actively managed funds. Movements in a relevant share register due to the actions of other investors may increase or decrease the fund manager's interest in the relevant securities. This may result in the fund manager or life company being deemed to have taken a 'notifiable action', 'significant action' or both, or possibly even a 'notifiable national security action'.

We submit s18A of the Act is too broad and should only apply where a fund manager or life company has taken a positive action to increase its holdings in a relevant security. The proposed mechanism for providing this exemption is the expansion of section 36 of the *Foreign Acquisitions and Takeovers Regulation 2015* to cover fund managers and life companies engaging in this activity (see Appendix A).

> **Consultation Question 1.3 Other opportunities to simplify Australia's foreign investment framework or reduce regulatory burden while maintaining appropriate safeguards, in line with the Government's earlier reform packages.**

<u>National security actions:</u>

The definitions of notifiable and reviewable national security action are extremely broad. It is onerous for buyers of securities to consider and confirm. In particular, the scope of reasonable enquiries is not clear. In the ordinary course of its business, a fund manager is not undertaking a one-off transaction where extensive due diligence will be performed. Fund managers often do not have the information nor are they in a position to determine if the national security rules apply. Further, if the security is bought as part of an index strategy, the opportunity to do additional due diligence is limited as the security is bought as part of its inclusion on an index.

It is proposed that clear safe harbours be considered as an alternative. These could be provided to ensure fund managers engaging in business-as-usual activities do not bear an unreasonable compliance burden. This would also relieve the associated burden on FIRB itself to process notifiable and reviewable national security actions that are triggered by a fund manager acquiring interests in securities that may trigger the current very broad definitions, but do not, in practice, pose any credible threat to national security.

New Zealand investors:

New Zealand investors investing in funds under the *Trans-Tasman Mutual Recognition Act 1997* (NZ) should not be considered foreign for the purposes of this regulation.

Currently, Australian investors do not need foreign investment approval to buy investments under UCITS, but foreign investors including those from New Zealand who run into the relevant regulatory thresholds when investing in an Australian fund would need FIRB approval.

Consideration should be given to how investors in foreign passport funds and new CCIV funds are to be treated under the regulations.

Consultation Question 3.1 Whether exemption certificates are striking an appropriate balance between facilitating investment and protecting the national interest, including whether the scope, timeframes and financial limits for exemption certificates are appropriately targeted

Current exclusions under the Act and Regulations provide inadequately for fund managers and life companies, that are deemed to be foreign persons, but carry on the business of investing for the benefit Australian investors or investing statutory funds comprised of Australian policy holder premiums. Exemption certificates provide an opportunity for fund managers and life companies to engage in activities otherwise caught by the regime, but the application of relatively short timeframes, onerous conditions, reporting obligations, caps on expenditure, high fees and long processing time to assess applications illustrate the ineffective application of the regime to fund managers and life companies.

We submit that fund managers and life companies that meet an appropriate criterion and undertake low-risk investment activity in Australia should be expressly excluded from the operation of the Act and Regulations, rather than granted relief under exemption certificates. Below are some examples of the application of exemption certificates which indicate that they are not appropriately targeted for fund managers:

- Applicable exemptions: whilst the application of the regime is broad, the range of available exemptions to the regime for Australian domiciled fund managers and life companies which operate in Australia are limited. For example, under section 36 of the Regulations, there is an exemption for acquisitions by funds, schemes and life companies but only in relation to land or mining tenements. We submit the exemptions under the regime would better serve Australian investors by excluding the activities of appropriately defined fund managers and life companies acting in the ordinary course of their business (see Appendix A).
- Conditions (including reporting): Member experience has indicated that the conditions associated with exemption certificates are becoming longer and sometimes difficult to understand with some noticeable inconsistency in the application of conditions to similar applications. For a fund manager engaging in interfunding activity that is caught by the regime, there is often no single transaction that triggers an approval and/or reporting obligation; there are in fact, multiple, daily transactions.

- This is also applicable for life companies managing investments of the statutory funds, where multiple investment decisions are made on a daily basis. Any requirement to provide reporting on a regular basis on these activities does not necessarily provide meaningful information or insight on a transaction.
- In addition, the reporting obligations that apply to recipients of exemption certificates (including s98D of the Act) are poorly suited to fund managers and life companies who are caught by the regime due to interfunding activities. Production of the data via an excel data file is cumbersome upon business to produce and presumably requires significant effort for FIRB to consume or extract value from the data. As noted above, multiple daily transactions of varying value are not contemplated by the current reporting mechanism.

If you wish to follow up on this submission or have any questions, please contact Chaneg Torres, Policy Manager at ctorres@fsc.org.au.

Kind regards,

Chaneg Torres
Policy Manager
Investments & Global Markets

Appendix A: FSC Proposed Amendments to Section 36 of the *Foreign Acquisitions and Takeovers Regulation 2015*

36 Acquisitions by funds and schemes

The excluded provisions do not apply in relation to an acquisition of:

(a) an interest in Australian land; or

(b) an interest in a tenement; or

(c) an interest in securities including units in a unit trust~~, in a mining, production or exploration entity;~~

by any of the foreign persons mentioned in column 1 of the following table in the circumstances mentioned in column 2 of the table.

Acquisitions by funds and schemes		
Item	**Column 1** **Foreign person**	**Column 2** **Circumstances**
1	A life company operating in Australia or a corporation or trustee of a trust in which the life company has a substantial interest. - ~~subsidiary of such a life company~~ *FSC NOTE: This addition expands the proposed exemption to cover funds in which a foreign life insurance company has an interest over 20% but less than 50%.*	The acquisition is made by way of investment of its statutory funds (within the meaning of the *Life Insurance Act 1995*) primarily for the benefit of owners of policies who are ordinarily resident in: (a) Australia; or (b) a jurisdiction the subject of a mutual recognition law for the purpose of investment in Australia. *FSC NOTE: Similar to the reasons stated below at row 4, allows exemptions for New Zealand policy holder funds invested in a statutory fund.*
2	A body corporate that is: (a) a general insurer (other than a life company) operating in Australia; or (b) a subsidiary of such a general insurer	The acquisition: (a) is made from the reserves of the body corporate; and (b) is consistent with the body corporate's obligations under the *Insurance Act 1973*

Acquisitions by funds and schemes		
Item	**Column 1** **Foreign person**	**Column 2** **Circumstances**
3	A registrable superannuation entity licensee who is the trustee of a registerable superannuation entity ~~a Australian business that maintains a superannuation fund for its employees~~ (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) ~~who is the trustee of a registrable superannuation entity primarily for the benefit of the members of the fund, or their dependants, who are ordinarily resident in Australia~~ (superannuation fund) *FSC NOTE: The effect of this amendment is to expand the exemption to foreign persons who are licenced trustees of all superannuation funds, not just a superannuation fund issues for employees. Together with paragraph (c) above, this would allow superannuation funds to buy Australian assets without being restricted by the Foreign Acquisitions Takeovers Act 1975.*	The acquisition is made as an investment of all or part of the assets of that superannuation fund
4	A responsible entity of a managed investment scheme registered under section 601EB of the *Corporations Act 2001* or the trustee of an unregistered managed investment scheme.	The acquisition is primarily for the benefit of scheme members: (a) ordinarily resident in Australia; and/or (b) Ordinarily resident in a jurisdiction the subject of a mutual recognition law for the purpose of investment in Australia (Mutual Recognition Jurisdiction); *FSC NOTE: The existing paragraph (a) here would work together with paragraph (c) above, to allow managed Investment schemes that Invest primarily for the benefit of Australians to buy Australian assets without being restricted by the Foreign Acquisitions Takeovers Act 1975.* *The addition of (b) would ensure that an Australian fund with New Zealand members investing under mutual recognition benefits would benefit from the exclusion.*

Acquisitions by funds and schemes		
Item	**Column 1** **Foreign person**	**Column 2** **Circumstances**
5	A responsible entity of a managed investment scheme registered under section 601EB of the *Corporations Act 2001* (registered managed investment scheme) or the trustee of an unregistered managed investment scheme engaging in interfunding activities described in column 2	The acquisition is primarily for the benefit of scheme members ordinarily resident in Australia; and/or ordinarily resident in a mutual recognition jurisdiction; and The acquisition is of a unit in an Australian unit trust (the target fund) and the foreign person is both the responsible entity or trustee of the managed investment scheme; and (a) the responsible entity or trustee of the target fund; or (b) a related body corporate of the responsible entity or trustee of the target fund. *FSC NOTE: This amendment allows managed investment schemes that invest primarily for the benefit of Australians to buy both registered and unregistered funds for which it is an RE or trustee.*
6	A registrable superannuation entity licensee (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) who is the trustee of a registrable superannuation entity (superannuation fund) engaging in interfunding activities described in column 2	The acquisition is of a unit in an Australian unit trust (the target fund) and: (a) is made as an investment of all or part of the assets of that superannuation fund; and (b) the foreign person is either: (i) the responsible entity or trustee of the target fund; or (ii) a related body corporate of the responsible entity or trustee of the target fund. *FSC NOTE: This amendment allows a superannuation trustee to buy both registered and unregistered funds (including superannuation funds) for which it is an RE or trustee.*