31 May 2024

Foreign Investment Division
Treasury
Langton Cres
Parkes ACT 2600

via email: FIConsultations@treasury.gov.au

Exempting interfunding from mandatory foreign investment notification

We thank Treasury for the opportunity to provide feedback on exposure draft legislation to exempt interfunding transactions from mandatory notification and fees under the Foreign Acquisitions and Takeovers Regulation 2015 (FATR).

The FSC is a peak body which sets mandatory standards and develops policy for more than 100 member companies in the financial services industry. Our full members represent Australia's retail and wholesale funds management businesses, superannuation funds, investment platforms and financial advice licensees. The industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians.

The additional requirements placed on foreign-owned asset managers to comply with the Foreign Investment Review Board (FIRB) regime for passive investments create an unlevel playing field that results in a competitive disadvantage. This leads to lower returns for the majority Australian underlying investors while negatively impacting capital investment in the Australian economy, without producing a benefit to the national interest.

While we are supportive of the intent of the proposed changes, we have concerns about the effectiveness of the measure as expressed in the exposure draft legislation. Considering the current drafting, we do not believe the exemption will be entirely effective in practice as it does not provide a sufficiently clear basis for asset managers to rely upon.

Further technical refinements are required to make the terms workable in the context of asset management practice, ensuring they are clear enough to provide certainty as to which transactions the measure applies. Additionally, the exemption should also no longer require mandatory reporting, in line with other similar exemptions currently in place. Limitations in its scope also prevent the measure from being effective in reducing the additional burden faced by asset managers with foreign parents for low-risk passive investment transactions made in the ordinary course of managing investments.

Foreign investment framework reforms

The FSC notes the Treasurer's recent announcement proposing reforms to the foreign investment framework as part of the Government's *Future Made in Australia* policy agenda. We are encouraged by the Government's focus on attracting foreign capital to invest in Australia, noting its important and beneficial contribution to the Australian economy.

In particular, we welcome and support the statement in the *Australia's Foreign Investment Policy* document that passive or low-risk interfunding transactions should be exempt from mandatory notification requirements and fees to simplify routine transactions and reduce the regulatory burden on institutional investors. This is a positive first step towards reducing the administrative burden on asset managers with foreign parents, creating a more level playing field and competitive market for investment products that will ultimately benefit Australian investors.

The interfunding measure interacts with this broader policy position of the Government, which seeks to make it easier for trusted foreign investors to continue investing in Australia by streamlining the approval process, while adopting a risk-based approach that targets high-risk investments for compliance review.

In order to achieve this policy goal, it is important to lessen reporting obligations and exempt transactions from fees along with streamlining the information required to be reported to FIRB. This will level the playing field by ensuring that administration costs for ordinary business activities undertaken by both domestic and foreign asset managers are equivalent, boosting competition and choice for investors.

Technical refinements

Definition requirement

We have concerns that the drafting will not allow asset managers to rely on this exemption in practice. Interfunding is a mechanism to administer and realise the investment guidelines of a fund and is part of the ordinary course of how responsible entities (REs) and registrable superannuation entity (RSE) licensees operate. As well as being permitted under their inherent powers, it is subject to overriding fiduciary powers and obligations.

Considering its origin as a term of industry practice relating to transactions made in the ordinary course of business, there is no legislative definition or concept of interfunding. As a result, there is significant potential for unintended technical consequences to result.

An example of how this may lead to practical difficulties is proposed section 40A(2)(e). An additional requirement in the draft provision to 'describe' interfunding in disclosure and/or other information documents would unnecessarily require the inclusion of additional content that is not required under the *Corporations Act 2001* or *Superannuation Industry (Supervision) Act 1993*.

To ensure the administrative and reporting burden is reduced by the measure, we recommend that the provision be clarified to indicate that interfunding transactions fall within the 'ordinary course of operation of the acquiring fund' and do not require further specific disclosure. Alternatively, the words in the draft provision after and including 'as described' should be omitted, based on the principle that interfunding is a term of industry practice in the ordinary course of regular business activities.

Reference to 'subsidiary'

The drafting of proposed section 40(2)(f) does not apply in practice, as the RE or RSE licensee is part of a corporate group and are not subsidiaries of the acquiring or target fund. Additionally, interests held in a fiduciary capacity are disregarded when determining a subsidiary under the *Foreign Acquisitions and Takeovers Act 1975*.

We recommend this section be omitted in favour of a clarification that the RE or RSE licensee of both the acquiring and target fund must either be the same entity or related bodies corporate.

Concept of control

The requirement in draft section 40A(3) that a passive holding requires no control over the target fund is potentially rendered inoperable where the RE managing the fund being acquired is the same entity as the RE managing the acquiring fund. In this sense, the same entity can be said to 'control' both funds prior to and subsequent to the transaction taking place.

The draft legislation should be revised to make it clear that each entity can vote its interest as a member. This reflects the fact that one fund is not exercising control over another by the mere fact of voting the units it owns. This would account for the role of the RE/trustee, including where they are the same legal entity.

We would also request clarification on the application of this provision where individual members may direct their investment choice between various products within a superannuation fund.

Mandatory reporting requirements

We note that while the *Australia's Foreign Investment Policy* document states that passive interfunding transactions should be exempt from mandatory notification requirements and fees, this measure as drafted retains the reporting requirements despite providing the exemption.

If the new exemption applies there should no longer be any need for reporting of interfunding trades to the Register of Foreign Ownership of Australian Assets. It is unclear why this notification would be necessary or provide useful information in the context of interfunding activities, considering these are internal transactions between related parties and could number in the thousands of transactions.

Monitoring relevant transactions and collecting the required data for reporting also creates an onerous administrative burden in identifying what information must be captured and provided to the ATO, especially where a high frequency of transactions take place on a daily basis in the course of a fund's ordinary business.

In addition, it is worth noting that there are no other existing exemptions from obligations under the FATR that have similar reporting requirements. Interfunding transactions should not require notification, in line with the obligations for similarly exempt activities.

We recommend that draft section 58GA (Item 5) be omitted from the proposed amendments. Exempt interfunding transactions should not be subject to the regulatory reporting requirements, consistent with the treatment of other exempt activities.

Scope of the exemption

The draft regulation remains a very limited exemption applying to only one example of the passive investing activities by asset managers that should not be caught by the foreign investment framework. Successfully achieving the objective sought by this measure to level the playing field and provide more efficient and competitive investment in Australian markets will be made more likely by broadening its scope.

The measure as drafted does not go far enough to cover the majority of business as usual interfunding transactions undertaken by asset managers with foreign parents. It should not only be expanded to include unregistered managed investment schemes (MIS), which are more likely to be used for interfunding transactions, but ideally extend to all low-risk passive investment that is undertaken by an asset manager acting as a fiduciary on behalf of underlying investors.

Include all Managed Investment Schemes

Acquisitions involving registered MISs are only a subset of interfunding transactions as a term of trade practice. It is essential that unregistered MISs also fall within scope to encompass the majority of interfunding transactions within the exemption measure.

Unregistered schemes should be included as they are the most likely to be subject to interfunding arrangements. If these are not within scope, a fund would require an exemption certificate to permit interfunding transactions to buy interests in, for example, a cash fund where interfunding comprises the vast majority of the investment.

These transactions occur on a daily basis, only involve low-risk assets, and are essential to managing risk on behalf of investors. There is no greater level of risk from foreign investment through unregistered MISs compared with registered ones.

Limited extension to other passive investments

In turn, transactions involving MISs are only a subset of similar challenges faced by foreign investment managers making passive investments as fiduciaries for underlying investors in a fund. The measure is capable of doing more to level the playing field, increasing competitiveness in investment products on offer while reducing administrative costs that are ultimately paid by the predominantly Australian underlying investors.

The FSC strongly recommends that the exemption be broadened to include a greater range of passive investments by foreign asset managers. This would include acquisitions of listed securities and MIS, including the interfunding activities currently captured by the proposed exemption, to ensure similar treatment as would

apply to the same activities when undertaken by local asset managers.

This more comprehensive approach would better address the challenges facing global funds acting as fiduciaries in the implementation of passive investment strategies more generally, and could be achieved by extending the exemption in section 36 FATR to all funds management activities undertaken by fiduciaries such as REs and trustees.

An exemption could also be inserted into FATR for actions that satisfy these requirements:

- The sole purpose of the action is to make a passive investment;
- The person making the action is a regulated entity managing other people's money in line with an investment objective for a given fund or mandate; and
- The action only applies to an interest in listed securities, interest in a managed investment scheme or a superannuation fund.

As a result, ordinary commercial activities of investment funds, such as investment in a non-related MIS or purchase of shares in an Australian listed company as part of a passive investment strategy, would not trigger the referral requirements.

These are highly regulated financial products that are acquired on a fiduciary basis to fulfil investment outcomes on behalf of members. As publicly traded interests, listed securities are subject to a substantial range of disclosure requirements, protections and rules governing market conduct.

Acquiring listed securities and unregistered MIS is not used for corporate restructuring, as interfunding transactions are used to reallocate interests between products at the unit trust level. Any changes in ownership or structure at a high level would remain subject to the foreign investment framework.

We would support actions that would have been significant, notifiable, or notifiable national security actions if not for the exemption continuing to be reviewable national security actions. This means the actions related to a national security business and national security land, even if a passive investment, are not included under the exemption. The Treasurer retains the national security call-in power and last resort power.

Conclusion

The FSC supports an exemption for interfunding activities being implemented, however further technical refinements are required for the provision to operate as intended and provide a reliable legislative basis that asset managers are able to rely upon.

In addition, the proposal would also benefit significantly from further minimising administrative complexity and compliance burden by removing mandatory reporting requirements, consistent with the foreign investment framework policy and current practice for other exemptions to foreign investment referral.

We strongly recommend broadening the scope of the measure to address the issue holistically and remove current differences in regulatory burden faced by different market participants in conducting regular and ordinary transactions in the course of managing investments on behalf of underlying investors. The exemption should cover interfunding transactions involving all MISs (registered and unregistered), and be expanded to passive investments in listed securities.

If you would like to discuss this submission further or require additional information, please contact me at jyoung@fsc.org.au.

Kind regards,

James Young
Policy Manager, Funds Management and Taxation