

14 July 2020

Roger Brake
Division Head, Foreign Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email only:
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Dear Mr Brake

Foreign investment reforms

On behalf of the Financial Services Council (FSC), I am writing to you to provide the views of the FSC members on the foreign investment reforms paper published by the Treasury on 5 June 2020. The paper outlines comprehensive reforms to Australia's foreign investment review framework. However, the proposal paper lacks detail in some areas and the FSC looks forward to further engagement with Treasury. This submission recommends some changes to the framework to reduce unnecessary red tape on investors and providers of capital to the Australian economy while ensuring outcomes for our national interest are maintained.

About the Financial Services Council

The FSC is a leading 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, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing \$3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

The FSC's Overall Position

These reforms will have a significant impact on the financial services sector, including fund managers and the FSC is the peak body representing the funds management industry. The proposal that will have a particular impact on fund managers is the new "national security" test. Fund managers require certainty around what they can and cannot invest in. Based on the 5 June 2020 paper, fund managers will face significant operational issues for the following reasons:

- i. any acquisition of 10% or more in any Australian entity could potentially trigger mandatory notification under the new test and a fund manager would ordinarily not know (given the breadth of the definition) whether or not an entity is a "sensitive national security business"; and
- ii. it is not clear from the paper whether the tracing rules will apply for the purposes of determining whether an acquirer of an offshore entity has acquired a direct interest in an Australian "sensitive national security business". If the tracing rules do apply, the mandatory notification could be triggered by an overseas entity acquiring 20% of more in another overseas entity which has an Australian "sensitive national security business" within its controlled group structure. This should be made clear in the proposed legislation.

The FSC notes the important role that our fund manager members play in providing capital into the Australian economy. This proposal will discourage investment in Australia. As the Productivity Commission has shown in a

recently released paper,¹ tightening of the foreign investment rules is likely to lead to reductions in investment, GDP, wages and national incomes.²

As such, the FSC requests the ability for fund managers to obtain a suitable exemption to permit the legitimate investment activities of its members.

The FSC advocates for investor certainty. As an example of a potential exemption, investor specific exemption certificates (EC) along the lines of the proposal on page 11 of the Treasury paper could be facilitated by the Government at minimal cost.

Recommendations

The FSC recommends that fund managers should have the ability to obtain a suitable exemption to permit legitimate investment activities, such as a broad EC for the portfolios they manage (as envisaged on page 11) for a broad range of sectors and that conditions for receiving an EC be publicly available to help fund managers determine whether they are eligible. Under the current regime, large global fund managers that are investing in hundreds of Australian companies on behalf of Australian and international investors, need to apply on a company by company or sector by sector basis to maintain their exposure to Australian equities in line with the stated investment objectives of their portfolios. This regime is resulting in significant red tape and compliance costs to monitor and manage.

The FSC's proposed certificate should operate at the fund manager level, rather than at a portfolio by portfolio or security by security level, so that the managers may operate with minimal cost and regulatory burden. The EC should be granted on a case by case basis to a regulated fund manager making portfolio investments once the Treasurer (on the advice of FIRB) is satisfied that the organisation does not pose a national security risk.

In relation to any exception or exemption, the following factors would indicate that fund managers do not pose a national security risk:

- i. Fund managers that are portfolio investors and do not seek to control the day to day management of the company or the composition of the board. In this case, fund managers are including Australian companies in a diversified portfolio of assets to seek to deliver investment returns to their underlying investors. This is particularly the case for indexing strategies, where a fund manager is investing in an Australian company in line with an index and not proactively picking companies.
- ii. Fund managers headquartered in a country for which Australia has a strong relationship with and for which there is a comprehensive and robust regulatory regime governing funds management activities.
- iii. Fund managers act as fiduciaries that have a broad and wide client base. This includes Australian funds managed by foreign fund managers, which often have most of the investment into the fund from Australian investors such as retail investors or superannuation funds who allocate capital to the fund manager to invest on behalf of Australians.

Conditions of eligibility for an EC should be clearly disclosed. Inconsistent grants of ECs can bring significant disruption and uncertainty to the Australian market and existing foreign investors. Therefore, to the extent that any conditions to exemption apply to fund managers that receive an EC, the FSC recommends that FIRB clearly state any and all applicable conditions.

The FSC also recommends that FIRB publish a list of national security sensitive sectors that are excluded from the EC and welcomes further consultation from Treasury on what is defined as a national security related business.

¹ Productivity Commission (2020) *Foreign Investment in Australia*, Commission Research Paper.

² See Table A.4.

We also recommend that any exemption certificates should be offered under a streamlined application process for minimal cost without a dollar cap on investment. Alternatively, if ECs do have dollar caps on investment, the caps should apply on a basis that is net of sales. As an example, suppose a fund manager's EC has a cap of \$100m, and the manager has invested up to the cap (that is, the manager has \$100m invested in assets subject to the certificate). Then if the manager sells an asset subject to the certificate, then the value of that sale becomes available to make into other assets subject to the certificate. It may also be more appropriate to consider any caps based on a percentage of the shares in any issuer.

Finally, the FSC supports in principle the proposal in the paper that fees will be reformed to make the fees fairer and simpler, while ensuring they cover the administration costs of the scheme. We note a recent paper by the Productivity Commission³ demonstrates that current fees are much higher than costs. On this basis, the FSC recommends moving to a cost recovery approach would mean a substantial reduction in fees for many applicants.

The FSC would welcome the opportunity to discuss this submission and the broader policy matter further. For further discussions please feel free to contact us on (02) 9299 3022.

Kind regards,

A handwritten signature in blue ink that reads "Vincent So". The signature is written in a cursive style and is positioned above a horizontal blue line.

Vincent So
Policy Manager, Investments & Global Markets

³ Productivity Commission (2020) *Foreign Investment in Australia*, Commission Research Paper.