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Licensing exemptions for foreign financial services providers (FFSPs)

The Australian Financial Markets Association (**AFMA**) is providing comments on the exposure draft of the *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Licensing exemptions for foreign financial services providers* (**Draft Bill**).

1. Introduction

The Draft Bill is based on the *Treasury Laws Amendment (Streamlining and Improving Economic Outcomes for Australians) Bill 2022* (**2022 Bill**), which was introduced to Parliament in February 2022 but lapsed at dissolution. AFMA made submissions to Treasury on the 2022 Bill and the need to introduce exemptions to reduce barriers of entry and encourage greater engagement by foreign financial service providers in the Australian market, for the benefit of the Australian economy. We appreciate the time and effort which Treasury has afforded AFMA to discuss the exemption framework, and it is apparent that Treasury has taken on board many of the comments AFMA has made in this process.

As a general comment, AFMA supports the introduction of the three proposed exemptions. They would cover, to a large extent, the financial services which AFMA's members have traditionally provided under ASIC exemptions which are scheduled to cease with effect from 31 March 2025.

You will see that our submissions below relate not so much to the coverage of the exemptions, but rather to the proposed conditions attached to those exemptions. AFMA's members are concerned to ensure that they are able to comply in a practical sense with the conditions of the exemptions in a way which will ensure they can continue to provide their services in an effective way for the benefit of their Australian clients.

2. Context

Australia has a developed and open economy which is significantly integrated with global markets. Businesses in Australia are sophisticated and have a need to deal in financial markets offshore and with foreign financial institutions to be able to diversify their investment and access to funding and new business opportunities. This is possible through the integrated services that foreign financial services providers with significant global operations are able to offer. It is important that the ease of access for Australian businesses to these services is facilitated, not hindered, by the new exemptions.

Where the conditions of the exemptions are onerous or complex from a compliance controls perspective, this will necessarily impact on the cost or availability of services. This would have harmful economic impacts and feed a growing perception that Australia is not an easy place to do business.

Institutional markets are globally integrated and are easily the largest and most competitive segment of international financial markets. For instance, Australian financial institutions and corporates raise substantial funding on the overseas markets, while Australian superannuation and managed funds are large net equity investors in foreign companies. Similarly, foreign investors hold a large part of Australian government debt and are significant shareholders in many ASX listed companies.

The steady increase of impediments to doing business with Australia at some point means that global firms in Australia providing services to wholesale investors decide cease and limit access of Australian investors to offshore markets. Businesses participating in global markets may cease trading in Australian markets as a hedge to those global positions with a flow on effect on the Australian economy by reducing offshore investment in Australian financial markets, such as those conducted by the ASX. Such changes are not immediate and often hard to directly correlate to particular regulatory developments. Often there will be a combination of reasons which accumulate to a tipping point leading to a business to discontinue a service because it is no longer commercially viable. The impact of this discontinuance of services may be discounted by the authorities while the economy continues to grow and there is sufficient domestic activity, but the downside becomes much more evident during periods of lower economic growth when the availability of counterparties to hedge with is greatly diminished.

Maintaining global networks to access services is of great importance to a trading nation like Australia. A key goal of nation developmental economics is to build cross-border connectivity through the establishment of resilient financial services networks to assist economic growth. These networks take years to build and need to be cultivated and kept active, especially for recessionary times to keep commercial life going. Australia has been resilient in the past partly due to such networks. They should not be diminished and impeded.

To be successful as a financial centre, Australia must be able to attract and retain the businesses that operate in this segment. If the law presents a significant barrier to the conduct of cross-border business with Australian wholesale clients (including large companies and financial institutions), Australian generated business will be by-passed as not worth the effort because it is a legally complex and expensive task for overseas providers to deal with the regulatory barriers placed between them and Australian wholesale clients. The exemptions go some way to achieving the reduction of such

barriers, but there are specific conditions proposed which we are concerned means that the exemptions will not achieve the objectives of ensuring Australian businesses are able to gain the benefits of the services of foreign financial services providers.

3. Comments on Exemption Conditions

3.1. Efficiently, honestly and fairly condition (section 911N)

Under the Draft Bill it is a condition of each of the proposed exemptions that the FFSP must comply with the obligation to do all things necessary to ensure financial services are provided efficiently, honestly and fairly (the **EHF standard**).

We appreciate that the EHF standard is one of the conduct standards which applies to the holder of an Australian financial services licence (**AFSL**). However, we do not think it is appropriate to extend this obligation to FFSPs relying on the proposed exemptions.

In our view, the new exemptions, should properly exempt the FFSP from *all of* the Australian licensing requirements, and not adopt a piecemeal approach of adopting only certain conditions. The piecemeal approach raises two general questions of broader policy:

a) Why single out one particular obligation which is applicable to licensees and make it a condition of the exemptions and re-attach that obligation as a condition?

b) Why single out these three new exemptions for special application of the efficient honest and fair obligation, but not apply it to all the other exemptions which appear in section 911A(2), Regulation 7.6.01 and elsewhere?

We envisage there would be significant challenges for the FFSPs if they were required to apply this standard, with no or limited benefit in this standard being applied to them. Relevantly:

a) For FFSPs relying on the comparable regulator exemption, the provider is already subject to standards of conduct in the comparable jurisdiction. These offshore standards may be expressed in different terms to the EHF obligation, but nevertheless impose conduct rules to protect clients and the financial system and in the general sense would be considered to have fair, honest and efficient regulatory regimes. It is not the case that members are concerned with not being able to provide services to a high standard. The issue is that the two standards may be different, even if only subtly different. Requiring the FFSP to rationalise the different standards and build governance and compliance frameworks to ensure compliance with both would present a real and material issue for FFSPs. This is particularly the case where the Australian courts have not yet settled or agreed on the application of the EHF standard, and case law continues to evolve on this point.

b) For FFSPs relying on the professional investor exemption, they too are often subject to standards of conduct in an offshore jurisdiction. However, there is an additional consideration here – their only Australian clients would be

professional investors. Professional investors do not need the protection of the EHF standard and are commonly well placed to go to another provider should they be unsatisfied with the service they get from their FFSP.

c) For FFSPs relying on the market making exemption, they are subject to the relevant Market Integrity Rules and the rules of the relevant market operator, which will impose standards of conduct which must be applied. There seems limited, if any, benefit in applying the EHF standard as well.

Section 911N(3) sets out a number of circumstances where the EHF standard obligation does not apply. This creates a further degree of difficulty for compliance teams to build a compliance framework around conduct. Further, the basis for this distinction is not clear, particularly given that the holder of an AFSL is subject to the standard for all financial services it provides.

Proposal to address concern with the efficiently, honestly and fairly condition (section 911N) condition

We want to see section 911N removed for the reasons discussed above.

3.2. The requirement to notify ASIC of any contravention (section 911R) – the need for a materiality threshold

Section 911R of the Draft Bill provides that the FFSP must notify ASIC of any contravention of a condition.

It is critical that there be a materiality threshold applied to this. It would be very unusual for there not to be a threshold. By way of comparison under the current ASIC sufficient equivalence exemption, failure to comply with a condition of that exemption is reportable only where it is not "in an immaterial respect".

As presently drafted, if an FFSP fails to provide one client with the required disclosure of the FFSP's exempt status (under section 911L), the FFSP would be required to notify ASIC of this. Having a materiality or significance threshold is important to ensure that ASIC is informed of matters which are of consequence.

Proposal to address concern with Section 911R materiality threshold.

We suggest that the introduction to section 911R could be amended to read as follows (new text underlined):

If a person contravenes a condition for an exemption under paragraph 911A(2)(eo), (ep) or (eq) that applies to the person, <u>and the contravention is significant</u>, the person must provide ASIC with full particulars of the contravention.

3.3. Professional investor exemption (sections 911A(2)(eo)(iii))

3.3.1. Marketing visits (section 911E)

AFMA appreciates that section 911E has been included to address previous concerns to the effect that marketing visits ought to be permitted for a FFSP relying on the professional investor exemption. Although a small firm might be able to manage marketing visits within the proposed parameters, in the context of the global firms dealing with professional investors it is completely unworkable. There are a number of major concerns with the application of the "marketing visits" tests. Relevantly:

a) "Marketing visits" is not defined, and this is needed. For example, it is not clear whether the following would be included in the 28 day calculation:

   (i) client relationship management visits (which do not involve the promotion or solicitation of new products or services);

   (ii) attendance at conferences (as a speaker or as an attendee); or

   (iii) internal management visits which involve no or limited external client facing activity.

   It is not clear what the trigger is for a visit to be construed as a "marketing visit" and the EM does not elaborate on this at 1.66 or in Examples 1.1 and 1.2. For example 1.66 provides *"The 28 day limit for marketing visits includes each full or partial day on which the person is in Australia for a marketing visit, whether or not a financial service is provided on that day"*, however if a representative came to Australia and only engaged provided a financial service on one day of a 21 day trip, would this be a "marketing visit" taking up 21 days?

b) The calculation includes visits by "representatives" of an entity. The term "representative" is defined in section 910A of the Corporations Act to include (in the context of an FFSP) an employee of a related body corporate. This is problematic for FFSPs that are part of a global group which has branches or entities in Australia and around the world. Visits by an employee of one entity to discuss any financial service would count towards the calculation for another entity in the group (even though there is no connection with the FFSP's services).

c) The calculation would require the FFSP to count weekends, any annual leave taken in the same visit, and other days regardless of whether that day involved client-facing activities or not. Given Australia's geographic location (and the time it takes to get here), it is common for visitors to spend more days in Australia in addition to the days they may visit clients.

d) It is not clear how the calculation would work where an FFSP relies on both the professional investor exemption and comparable regulator exemption, (which enables services to be provided from Australia) for different scenarios. For example, an FFSP may have representatives in a non-comparable jurisdiction conducting marketing visits, whilst representatives from the

comparable jurisdiction may visit to provide services in Australia under the comparable regulator exemption.

Overall, limiting marketing visits in this way provides no regulatory benefit and creates an unworkable bureaucratic burden and compliance headache that would prove too complex in practice to monitor. This is just another factor in militating against global financial market participation.

Proposal to address concerns with marketing visits (section 911E)

It is our view that there should be no restrictions on the number of marketing visits which might be undertaken; particularly given that the relevant clients and prospective clients are all professional investors. Section 911E should be amended to make it clear that that financial services provided by a person visiting Australia during marketing visits are permitted.

3.3.2. Professional investor exemption not available for dealings in products tradeable on prescribed licensed markets (section 911F)

The Draft Bill provides that an FFSP cannot rely on the professional investor exemption for a financial service which is a dealing which involves one or more trades in a prescribed financial product on a prescribed licensed market. There is no indication as to what markets will be prescribed, but we assume that it is likely proposed that ASX and Cboe would be prescribed licensed markets and cash equities would be the prescribed financial products.

The draft EM suggests that this exclusion has been included to ensure adequate regulatory supervision, maintain domestic market integrity and protect retail investors from potential harm (as expressed in the Draft EM). We query the basis for the exclusion, for the following reasons:

a) Market integrity of the licensed market ought not be a concern. This is adequately addressed already because whether the FFSP is or is not a trading participant of the licensed market, the ASIC Market Integrity Rules will apply. Those rules ensure adequate regulatory supervision by ASIC and adequate protections to ensure market integrity. Relevantly:

    (i) Where the FFSP is a trading participant of the licensed market, then the FFSP and its trading will be subject to the ASIC Market Integrity Rules;

    (ii) Where the FFSP is not a trading participant of the licensed market, then it would need to execute through a trading participant. That trading participant would be subject to the ASIC Market Integrity Rules.

b) There is no need for additional protections for retail clients to apply; given this exemption only applies to dealings on behalf of Australian professional investors.

We cannot identify the regulatory benefit in excluding FFSPs from the benefit of the professional investor exemption simply because the service involves the execution of trades on a prescribed licensed market (or the arranging of such trades).

To the extent there is a perceived regulatory benefit, that is more than offset by cost – that being the loss of liquidity to the Australian market if FFSPs are not reasonably able to facilitate trading for professional investor clients on Australian licensed market.

If, despite our submissions, Treasury decides to retain section 911F, then we ask that section 911F at least be amended to make it clear that the professional investor exemption would be available to the extent that the FFSP's "dealing" was merely "arranging for a participant of the licensed market to deal"". In other words, the exemption would only not be available to a participant of the licensed market. This amendment is necessary because section 766C(2) treats "arranging a dealing" as "dealing". Making this amendment would mean that the market participant could not rely on the exemption, but a FFSP who merely receives or handles orders to deal, and passes those orders to a market participant, would be able to rely on the professional investor exemption. Such an amendment would be appropriate to maximise liquidity and order flow to the Australian markets.

Proposal to address concerns with trading on prescribed licensed markets section 911F

We suggest that section 911F be deleted.

To the extent that, in time, concerns emerge with respect to the trading on licensed markets (directly or indirectly) by FFSPs under the professional investor exemption creates regulatory concern, then an appropriate condition could be introduce by Regulation under section 911G. This section provides that the regulations may prescribe circumstances in which the professional investor exemption does not apply.

If it is decided to retail section 911F, then it should be amended to make it clear it only applies to participants of the licensed market, so as to not impact dealing by arranging.

3.4. Comparable regulator exemption (section 911A(2)(ep))

3.4.1. The list of comparable regulators

AFMA's members include global banks and financial institutions which are regulated in a raft of global jurisdictions (often in more than one). Many have offshore regulated institutions which are regulated in jurisdictions presently assessed by ASIC as being subject to sufficiently equivalent regulations.

Our members trust that, at the outset, the list of comparable regulators would include the regulators in jurisdictions presently covered by ASIC's foreign AFSL

regime. It would assist greatly if Treasury could confirm that those jurisdictions will be considered to be covered by the comparable regulator exemption.

Separately, it would assist if Treasury could confirm whether regulators in jurisdictions such as Japan, New Zealand, Switzerland, and particularly the European Union in respect of ESMA supervision around laws like the Markets in Financial Instruments Directive and Regulation, would also be considered for near term inclusion as comparable regulators. In the case of New Zealand, AFMA notes that the 'Australian majors' provide the majority of banking services in New Zealand (Westpac, ANZ, ASB and BNZ) are all wholly owned subsidiaries of AFS Licensed Australian firms (Westpac, ANZ, CBA and NAB respectively). At the wholesale level there are well established links between the subsidiaries and parent banks to provide services to customers in both Australia and New Zealand, many of whom have longstanding trans-Tasman operations, with policies and procedures that are generally aligned to their Australian parent entity.

This should provide comfort to ASIC that activities conducted from a New Zealand based subsidiary would be of generally comparable standard to those provided by the Australian parent, and thus able to benefit from a Comparable Regulator Exemption.

We note that section 911X(2)(a) requires the Minister, before determining comparable regulators, to consider whether the relevant regulatory outcomes are comparable in "regulating and ***improving*** the performance of financial services system and financial services providers in that system". It is unclear what is intended by the inclusion of the criteria that outcomes would be "improved" and what baseline this would be assessed against. It would assist if the process for determination could be made clear (particularly if it is intended that the Minister's power might be delegated to ASIC).

A further note is that the current sufficient equivalence determinations refer to particular regulatory statuses under supervision of the referenced regulators (eg CFTC registered FCM or CPO, as opposed to CFTC registered swap dealer). A clarification on the point of whether the regulator itself will be considered 'comparable' or a particularly regulatory status granted by a comparable regulator will be the determining factor. In our view it should be the regulator itself.

As currently drafted only Professional Investor clients will be able to access financial services and products that they are able to access currently from FFSPs under the present 'limited connection' relief. As a consequence, the broader Australian wholesale client base will be unable to access to financial services and products that they are able to access currently from FFSPs under 'limited connection'. For example, access to offshore funds such as hedge funds, and communication with research analysts from non-comparable jurisdictions for further research distribution or onshore marketing. The exemptions as drafted do not appear to assist Australian wholesale clients who want access to offshore funds and communications with research analysts from non-comparable jurisdictions that they currently have access to where 'limited connection relief is relied on.

Proposal regarding comparable jurisdictions determinations

It would be helpful if Treasury could confirm (and, if possible, reference in the Explanatory Memorandum) that the current sufficient equivalence determinations of ASIC will be carried over to comparable regulator determinations or, if not, what more might be required to support the latter determination.

It would be helpful if the EM could provide guidance as to what might be required to demonstrate "improving" the financial services system and providers in the system. Alternatively, the "improving" standard should be removed if it has no clearly identifiable substance.

3.4.2. The requirement that the services be provided from the comparable jurisdiction or Australia

A condition of the comparable regulator exemption is that the FFSP provides the financial service from Australia or from the relevant comparable jurisdiction (subparagraph 911A(2)(ep)(v)).

We are concerned as to how this might apply where there is a global institution (such as a global bank) which provides financial services from more than one comparable jurisdiction. For example, ASIC's sufficient equivalence is presently relied on by a global bank, which has branches in London, Singapore, Hong Kong and New York, all of which are (presently) assessed as sufficiently equivalent. The global bank also has a branch in Japan, which is not presently assessed as sufficiently equivalent.

It is not clear from the Draft Bill:

a) whether it would be open to such an institution to make separate notifications to ASIC with respect to more than one comparable regulator, or whether it would be limited to relying on one comparable regulator exemption – if the latter, then the proposed comparable regulator exemption would not work, because it would limit the FFSP to providing services from only the one offshore jurisdiction; or

b) Whether an institution which is regulated by a comparable regulator (eg. Hong Kong) could rely on the exemption for services provided from another jurisdiction (eg. Japan), even though those services were subject to the supervision of the comparable regulator; or

c) whether an institution which is regulated by a comparable regulator (eg. Hong Kong) could rely on the exemption for services provided on its behalf from another jurisdiction by another group entity (but subject to the supervision of the first entity.

Proposal to address concern about from which comparable jurisdiction

To address the concerns raised above it would be helpful if:

- Subparagraph 911A(2)(eo)(v) could be amended to read:

  (v) the person provides the financial service from this jurisdiction or from <u>either (A)</u> ~~the~~ <u>a</u> comparable jurisdiction<u>; or (B) another jurisdiction in circumstances where the provision of the financial service is subject to the supervision of the comparable regulator.</u>

- The EM could clarify the approach where a FFSP is regulated by more than one comparable regulator or provides a financial service from multiple jurisdictions.

3.4.3. The suggestion that the FFSP is registered as a foreign company under Part 5B.2 of the Corporations Act (section 911Q)

Section 911Q(3)(a) seems to assume that a FFSP which relies on the comparable regulator exemption will be registered as a foreign company under Part 5B.2 of the Corporations Act, as it requires the agent to be appointed under Division 2 of that Part.

Many FFSPs which presently rely on the ASIC sufficient equivalence exemptions are not registered in Australia as a foreign companies, as they do not carry on business in Australia within the meaning of Part 1.2 Division 3 of the Corporations Act. For example, many FFSPs relying on these exemptions service Australian wholesale clients from their offshore offices and have no Australian presence which would trigger the requirement to register as a foreign company.

AFMA has no concern with the requirement under proposed paragraph 911Q(2) that a FFSP should be required to appoint an agent for service in Australia (as this is presently a condition of the sufficient equivalence exemptions). However, there should be no requirement that the FFSP register as a foreign company in Australia, which has additional serious consequential flow effects regarding tax and other reporting requirements.

Where a foreign company has registered as a foreign company under Part 5B.2, the foreign company will have appointed an agent for service under Division 2 of that Part. Accordingly, there is no need to prescribe additional formalities regarding the appointment by such companies of an agent.

Proposal to address concern around foreign company requirement (section 911Q

Sub-paragraph (3)(a) should be amended to remove any suggestion that a foreign company relying on the comparable regulator exemption is required to register as a foreign company. This can be achieved through the following amendment to sub-paragraph (a):

a) If the person is a foreign company not registered under Division 2 of Part 5B.2 – the person's agent is appointed under a document which satisfies with the requirements of section 601CG ~~Division 2 of Part 5B.2 as the person's local agent~~;

911Q Exemption for comparably regulated providers—agents to ensure training of representatives.

Subsection 911Q(4)(b) requires that a person that uses the comparable regulator exemption must comply with certain conditions including ensuring that its representatives are adequately trained and competent to provide the financial services. It should be made clear that this training should be in accordance with the requirements of the comparable jurisdiction. Training requirements of representatives may be in accordance with 'local' regulatory requirements depending on where the representative is based. For example, a Hong Kong based representative of United Kingdom booking entity complies with HK requirements which UK comparable jurisdiction entity considers sufficient. Many jurisdictions may be relying on substituted compliance in this respect so need for some flexibility on 'whose' training requirements must be complied with is sought.

Clarification of training and competence requirement (section 911Q)

The EM should make clear that the obligation to ensure adequate training and competence of representatives is in accordance with the local regulatory requirements permitted by the comparable jurisdiction.

911P Exemption for comparably regulated providers— significant investigations notification

Subsection 911P (4) requires that a person must notify ASIC of any 'significant' enforcement action taken, any significant disciplinary action taken, or any significant investigation undertaken against the person. The term 'significant' has long caused uncertainty in compliance circles with regard to notification to ASIC and is the subject of nuanced and peculiar understanding of Australian case law and ASIC statements. Such nuanced understanding it outside the scope of compliance systems which are directed to flowing a comparable jurisdiction's requirements. The historical experience is that "significance" is quite subjective and there is little guidance for offshore entities to make such a determination. A more objective notification threshold would be a way to address this concern.

Guidance on what is a 'significant' enforcement action for notification (section 911P)

We request consideration be given to a more objective notification threshold.

4. Other observations

The following are other observations in respect of the Draft Bill:

4.1. ASIC should maintain register of reliance on exemptions

Section 911J(2) of the Draft Bill requires FFSPs to notify ASIC of their intended reliance on the exemptions. In the interests of transparency, we consider that ASIC should be required to maintain a public register of FFSPs who have filed for reliance on the relevant exemptions.

This level of transparency would ensure that the regulatory status of the FFSP from which they may seek services is available to clients. This would also lessen the need for specific client disclosure, although it is accepted that such disclosure has been a long-standing feature of the sufficient equivalence exemption and FFSPs generally provide such disclosure as a matter of course.

This proposal is similar to the existing Financial Advisers Register already managed by ASIC which is a public record of financial advisers who are authorised to provide personal advice on relevant financial products to retail consumers.

Proposal for ASIC to maintain a register

ASIC should be required to maintain a register of entities which have notified it of their intention to rely on one or more of the proposed exemptions.

4.2. Nature of notifications of reliance on exemptions – section 911L

If our submission in 4.1 above is accepted (which is that ASIC would maintain a register of entities which have filed to rely on the exemptions), then we consider there is a strong basis for the removal of the notification requirement under section 911L altogether. That is because professional investors and wholesale clients receiving services from the FFSPs would be able to view the register (as they can do should they wish to view the licensing status of a financial services provider, by viewing the ASIC professional register).

4.2.1. If this primary submission with respect to section 911L is not accepted, then we have the following comments on section 911L(3):

a) Paragraph 911L(3) requires that the notice specify which particular exemption the FFSP relies on. As Treasury is aware, the licensing exemptions under the Corporations Act and Regulations are cumulative – a provider may rely on one or more exemptions for different services. We anticipate that this will be the case going forward. This means, for example, that for one service the FFSP may rely on the professional investor exemption, and for another the comparable regulator exemption or, potentially another exemption not impacted by the Draft Bill.

b) For this reason, and to simplify the disclosures which a FFSP must make to clients when relying on one of the new exemptions, we consider it ought be sufficient for the FFSP to disclose that they (i) do not have an AFSL and; (ii) instead rely on an exemption. Given the clients will be either wholesale clients or professional investors, we consider that disclosure to be sufficient.

Proposal to address concern with section 911L

Section 911L should be deleted.

If, despite this primary submission, section 911L(3) is retained, then subparagraph (b) of paragraph 911L(3) should be deleted. The notification would simply include a statement to the effect of that set out in subparagraph (a).

Please contact David Love either on 02 9776 7995 or by email at dlove@afma.com.au in regard to this comment letter.

Yours sincerely

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