3 August 2018

Mr Alan Worsley
Senior Specialist, Strategic Policy
Australian Securities and Investments Commission
Level 5, 100 Market Street
SYDNEY NSW 2000

Dear Alan

## ASIC Consultation Paper 301 – Foreign Financial Service Providers

Thank you for the opportunity to provide comments on ASIC Consultation Paper 301 (the consultation paper).

### Overall recommendation

Our overall recommendation is that ASIC should retain both the sufficient equivalence relief and the limited connection relief. In our view nothing material has changed in the regulatory frameworks of the jurisdictions that are currently the subject of the sufficient equivalence relief that should give ASIC cause to withdraw the relief. If anything, regulatory regimes in these jurisdictions are continuously being enhanced and made more robust. The limited connection relief also continues to serve a useful regulatory purpose by reducing cost and burden for foreign financial service providers (FFSPs) with limited activity in the wholesale market in Australia. The class order promotes certainty for offshore entities that have a limited connection with Australia and facilitates efficient operations in a global market environment. The class order also allows Australian companies, wholesale clients and other sophisticated investors to efficiently access global capital.

AFMA agrees with the importance attached to the objectives of market regulation and investor protection, and believes ASIC can meet its objectives in this area while also serving the equally important objective of open and competitive financial markets. This understanding is consistent with the announcement by the Minister of Financial Services at the ASIC Forum in March that ASIC's new Statement of Expectations will reflect a new competition mandate for ASIC. This new mandate will require ASIC to consider the effect that its work and the exercise of its powers will have on competition in the financial system. Many of the issues we raise below are pertinent to this policy setting.

It may be the case that it is appropriate and less disruptive to impose additional conditions on the relief, and/or narrow the scope of the available relief in order for ASIC to achieve its regulatory objectives, including to strive to maintain, facilitate and improve the performance of the financial

**Australian Financial Markets Association**
ABN 69 793 968 987
Level 25, Angel Place, 123 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7907 Email: secretariat@afma.com.au Web: www.afma.com.au

system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy.

AFMA is strongly of the view that if the foreign AFSL regime is introduced, the licensing process needs to be streamlined and simple for entities that are already licensed in equivalent jurisdictions. An overly onerous application process is likely to be a significant disincentive to offshore entities obtaining a licence and providing services to Australian clients. The consultation paper indicates that the limited connection relief would cease in September 2019, which is 12 months earlier than the sufficient equivalence exemptions. There is uncertainty about the transition period for entities relying on the limited connection relief and we suggest that both exemptions should be extended until at least September 2020.

## Summary

As ASIC is aware, AFMA's financial market members are predominantly institutions with a local presence that are fully regulated by ASIC under the Corporations Act, by APRA under the Banking Act, and under other relevant Australian financial services legislation. The positions set out in this submission represent the concerns of our membership as corporate and intermediary participants in global financial markets.

Australia is a sophisticated financial marketplace but is not in a dominant position from either a global or regional perspective. Accordingly, it is imperative that decisions affecting the openness of the Australian market and access by Australian investors to products and services appropriately balance the equally important objectives of consumer and investor protection with the development of the financial sector given its important contribution to the Australian economy. The fact that other jurisdictions may or may not provide similar recognition or reciprocal arrangements to Australian financial services licensees is not a reason in and of itself to terminate the class orders, particularly where the current arrangements generate significant beneficial outcomes for Australians.

Prior to the release of this consultation paper, ASIC most recently consulted on the foreign financial service providers' regime over the period September to December 2016. Apart from the decision, welcomed by industry, to extend the class order regime for a further period, there has been no further consultation by ASIC or any indication of the likely direction that ASIC would take in relation to the regime. The proposals to remove the class orders and institute a licensing regime are therefore somewhat of a surprise to industry, and represent a very substantial shift in long-established arrangements that have by and large served Australian investors and the economy well.

The complete removal of the class order regime is, we believe, a disproportionate response to ASIC's concerns about a minority of entities and events in an environment where the inbound and outbound flow of products and services since the class orders were implemented has been of overall benefit to the Australian market. AFMA's position is that the regulatory regime should accommodate in a more proportionate way what can be highly bespoke and unique services provided to Australian customers in circumstances where a product or service is not otherwise available in Australia, and particularly where the entity providing the service is closely regulated in its home jurisdiction.

The proposals set out in the consultation paper reflect decisions of a regulatory policy nature that may in fact have significant economic policy consequences. We urge ASIC in the strongest terms not to proceed with the proposals set out in the consultation paper until these economic and other possible unintended consequences have been fully considered and understood. The removal of the existing reliefs, to be replaced by licensing requirements, risks a reduction in competition in financial services and a reduction in access to products and services available to Australian customers, including corporates who require access to offshore wholesale funding markets.

Similarly, the consultation paper does not address how these proposals will impact Australian licensed financial markets. Offshore entities who are market makers provide a significant proportion of liquidity in certain products traded on Australian markets. In some cases, because of the nature of their business activities those entities are not required to be licensed in their home jurisdiction and may not be willing to obtain a foreign AFSL in order to continue their trading activity in Australia.

## Capital flows – contextual setting

It is important to acknowledge the context in which this consultation is occurring in order to better understand the concerns around the proposed removal of the class order regime. Australia is a small open economy in global terms. It has a large international sector with substantial trade and investment flows that can only occur with the support of the financial services sector. Australia is generally a price taker in global markets and its cross border financial services business must operate within the regulatory settings of the more dominant global jurisdictions. It is in Australia's economic interest to reduce regulatory and policy frictions that could impede the efficient conduct of international business.

In its Bulletin June Quarter 2017, the Reserve Bank stated that "over a long period of time, investment in the Australian economy has been greater than domestic saving. The difference has been made up by net capital inflows from abroad. Cross-border investment has played an important role in expanding the economy's productive capacity to meet growing demand for Australia's goods and services, such as during the recent mining investment boom. Australia's history of capital inflows reflects the net outcome of saving and investment decisions taken across all sectors of the Australian economy – by households, corporations and the general government sector – with these decision affected by various domestic and international policy settings."[1]

Of course, AFMA does not contend that capital inflows occur principally because of the existing FFSP class order regime, but the regime does facilitate access to the Australian market by offshore arrangers and providers of capital, and facilitates Australian investor access to those offshore providers and markets. Table 1 sets out net capital inflows as a percentage of gross domestic product.

[1] Reserve Bank of Australia, Bulletin June Quarter 2017, page 23

**Table 1**

**Net Capital Inflows**[a]

Per cent of GDP

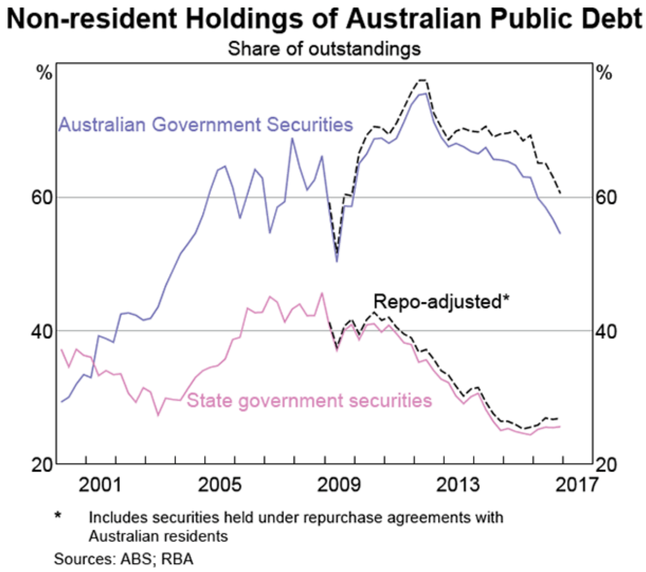
| | Average over: | | |
|---|---|---|---|
| | **1998–2007** | **2008–13** | **2014–16** |
| **Private sector** | 5.0 | 2.3 | 2.3 |
| Banks[b] | 5.4 | −0.2 | −0.5 |
| Other financials | −2.6 | −1. 2 | −0.4 |
| Other corporates | 2.2 | 3.4 | 3.0 |
| *Mining sector* | *na* | *1.7* | *2.4* |
| **Public sector** | −0.1 | 2.1 | 1.2 |
| **Total** | **5.0** | **4.4** | **3.5** |

(a) Excludes households and the RBA
(b) Adjusted for the US dollar swap facility in 2008 and 2009; includes securitisers
Source: RBA

The Australian bond market provides an example of both the importance and nature of capital flows.

It is notable that in the public sector, foreigners have continued to increase their holdings of Australian government debt over the last few years. The RBA goes on to state that flows into government bonds by foreign investors have moderated recently and have not kept pace with the issuance of these bonds by the Australian government. Correspondingly the share of Australian government debt held by residents – specifically local banks – has increased. The increase in domestic holdings of Australian government debt is almost entirely attributable to meeting prudential requirements – in particular the Liquidity Coverage Ratio, which requires banks to hold sufficient high quality liquid assets to withstand a 30 day period of stress.[2] Graph 1 shows non-resident holdings of Australian public debt.

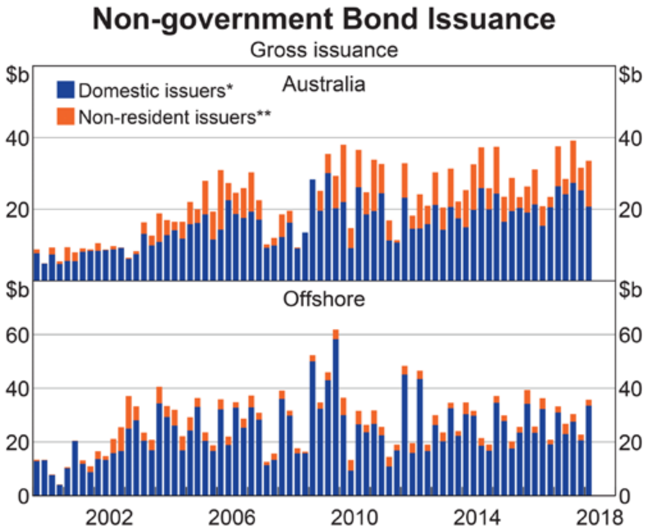
**Graph 1**




[2] Ibid, page 26

International capital flows typically move in both directions, in part reflecting the benefits of diversification of investment and funding for businesses and also the different characteristics of markets across jurisdictions and the opportunities they present. Graph 2 below illustrates this by demonstrating the significant reliance by Australian corporates on overseas debt funding but also the significant presence of foreign issuers in the Australian bond market.

**Graph 2**



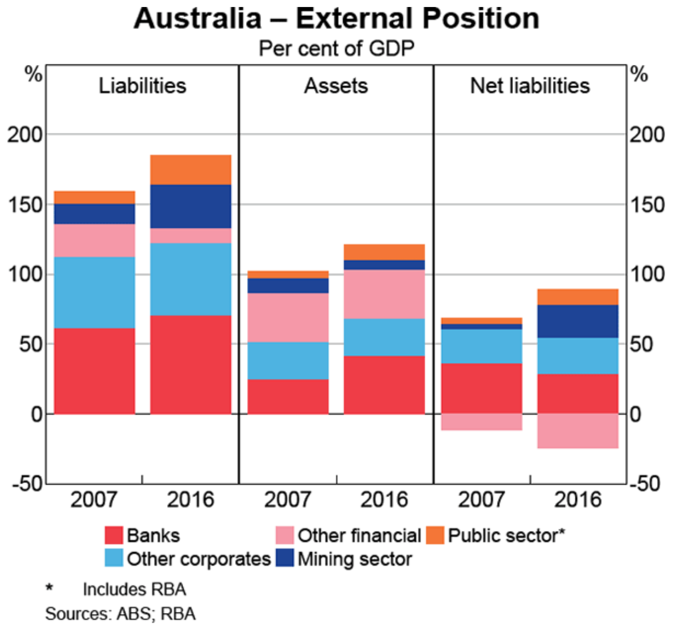

* Excludes ADIs' self-securitisations
** Offshore non-resident issuance includes Australian dollar-denominated bonds only
Source: RBA

Finally, it is also important to note that Australian net foreign liability position has been relatively stable for more than a decade to 2015, before increasing slightly more recently to be around 60% of GDP. The net foreign liability position measures the stock of Australia's foreign liabilities relative to the stock of Australian's holdings of foreign assets. Despite the relative stability in the aggregate position, there have been changes in the sectoral net liability positions, which largely mirror the trends in capital flows (see Graph 3).

Over the past decade or so, the public sector's gross foreign liabilities have increased (by the equivalent of 14 percentage points of GDP to around 20% of GDP) as has the stock of mining sector liabilities (by the equivalent of 20 percentage points of GDP over this period to be currently equivalent to about 25% of GDP). For the banking sector, an increase in foreign liabilities has been offset by an increase in the stock of foreign assets held by banks, such that the net liability position has declined a little. In contrast to the other sectors, other financial corporations have a net foreign asset position, reflecting Australian superannuation funds' large holdings of foreign assets.[3]

[3] Ibid, page 29

**Graph 3**




## Background to class order relief

We take this opportunity to revisit the background to the establishment of the class order regime. The International Banks and Securities Association of Australia (IBSA at the time, and now AFMA following a merger of the associations in 2006) was a key proponent of the relief. The class order regime was essentially the mechanism to address the exceptionally wide jurisdictional nexus provision in section 911D of the Corporations Act, in circumstances where it was practically very difficult to make further changes to the FSR legislation immediately after its commencement.

### *Sufficient equivalence relief*

At the time of commencement of the FSR Act, section 911A(2) of the FSR Act detailed the circumstances under which a person may be exempt from the requirement to hold an Australian financial services licence. This includes circumstances where the provision of the service is covered by an exemption prescribed in regulations [paragraph 911A(2)(k)].

The draft second stage regulations at the beginning of 2002 included the exemption under paragraph 911A(2)(k) which facilitated the provision of financial services by offshore providers through local licensees. The draft stage regulations applied to arranging financial services, including advice, market making and other services as well as dealing.

However the scope of the exemption included in the final regulations (Corporations Regulation 7.6.01(1)(n) made on 28 February 2002) was narrower as it specified that the service provided could only consist of a dealing in a financial product or class of financial products.

Subsequently, the Regulations were amended to introduce Corporations Regulation 7.6.01(1)(na) which says that a financial service provided by a person (*person 1*) to another person (*person 2*) is exempt in the following circumstances:

- (i) person 1 is not in this jurisdiction;
- (ii) person 2 is in this jurisdiction;
- (iii) the service consists only of 1 or more of:
  - (A) the provision of financial product advice to person 2; and
  - (B) person 1 making a market; and
  - (C) the provision of a custodial or depositary service to person 2;
- (iv) person 1 is:
  - (A) a related body corporate of a financial services licensee whose financial services licence covers the provision of the service; or
  - (B) a party to a business joint venture with a financial services licensee whose financial services licence covers the provision of the service;
- (v) the financial services licensee arranges for person 1 to provide the service;
- (vi) the financial service licensee's licence is subject to a condition requiring it to assume responsibility for the conduct of person 1 in the provision of the financial service mentioned in this paragraph.

This exemption is restrictive, given the requirement in paragraph (vi) for the Australian licensee to be responsible for the conduct of the offshore provider. The other limitation on the use of Corporations Regulation 7.6.01(1)(na) is that it relies on the local licensee being authorised to perform the relevant activities, unlike the sufficient equivalence exemptions.

Section 911A(2) also provides at paragraph (h) that a person can be exempt from the requirement to hold an AFSL where the person is regulated by an overseas regulatory authority; the provision of the service by the person is covered by an exemption specified by ASIC in writing under this subparagraph and published in the Gazette; and the service is provided only to wholesale clients.

Furthermore, section 911A(2)(l) says that where the provision of the service is covered by an exemption specified by ASIC in writing and published in the Gazette, a person is exempt from the requirement to hold an AFSL for that service.

It is therefore clear that Parliament contemplated that ASIC would be able to grant exemptions for FFSPs, and in doing so, did not anticipate that wholesale clients would require all of the protections afforded by the AFSL regime in Chapter 7, nor that ASIC would require the full suite of regulatory powers in relation to those entities.

ASIC issued a policy proposal paper in December 2002 about the use of its discretionary powers in s911A(2)(h) and s911A(2)(l) in relation to FFSPs. The proposals were guided by the *Principles for cross border financial services regulation* – in particular that an FFSP should be exempt from the requirement to hold an AFSL if:

- (a) regulation of the FFSP by their overseas regulatory authority is sufficiently equivalent to regulation by ASIC; and

(b) there are effective co-operation arrangements between the FFSP's overseas regulatory authority and ASIC.

The proposals paper said that regulation by an overseas regulatory authority is "sufficiently equivalent" to regulation by ASIC if the regulatory regime under which the authority operates is:

(a) clear, transparent and certain;
(b) is consistent with the IOSCO Principles and Objectives of Securities Regulation;
(c) is adequately enforced in the home jurisdiction; and
(d) achieves the same outcomes as the Australian regime achieves in relation to the regulation of wholesale financial services.

The paper went on to say an overseas regulatory regime will achieve the same outcomes as the Australian regime achieves, in relation to the regulation of wholesale financial services if it promotes the provision of efficient, honest and fair financial services by ensuring that financial services are provided by persons who:

(a) are fair and honest;
(b) are competent to provide the financial services;
(c) have adequate resources; and
(d) have adequate risk management processes including in relation to the maintenance of financial records.

In our view, these principles remain valid and appropriate in the context of services provided by offshore providers to Australian wholesale clients. In CP 301, ASIC has detailed its concerns that other regulators in other major jurisdictions take a narrower approach to licensing relief, including the UK, the USA, Germany, Hong Kong, Singapore, New Zealand and Japan, and that none of the regulators in these jurisdictions would appear to offer Australian entities licensing relief that is as broad as the sufficient equivalence relief or the limited connection relief.

We do not agree that the existence of reciprocal arrangements with, or quid pro quo treatment by, other jurisdictions should be a primary consideration in the decision whether to continue the class order regime. The value and benefit to the Australian economy and to Australian investors of the services provided under the existing arrangements is an equally important if not more important consideration. Furthermore, it may be the case that because other jurisdictions do not have the equivalent of section 911D, no reciprocal relief is needed.

We do acknowledge ASIC's concerns in relation to restricted monitoring and supervision arrangements, the limitations on supervisory and enforcement powers, and the limitations on the capacity of other regulators to take enforcement action against entities regulated in their jurisdictions in relation to activities that occur elsewhere, including in relation to dealings with Australian clients.

The December 2002 ASIC policy proposal paper did articulate that effective co-operation arrangements with other regulators could include asking the overseas regulatory authority to take enforcement action in relation to FFSPs in their jurisdiction. In hindsight, the expectation that another regulator could or would take enforcement action may have been unrealistic for a variety of reasons including but not limited to the extent of that regulator's powers to take action in relation to events that occur outside of their jurisdiction.

If ASIC's primary concern is its regulatory reach over FFSPs and ability to take action including enforcement if needed, then we suggest there may be other mechanisms to deal with this including a condition in the exemption requiring an FFSP to submit to the jurisdiction of ASIC in relation to the financial services provided.

***Limited connection relief***

As outlined in CP 301, the limited connection relief in CO 03/824 (extended by Instrument 2017/1820) was granted in response to concerns that overseas counterparties may technically engage in conduct that is intended to induce people in this jurisdiction to use a financial service or is likely to have that effect [see s911D(1)], thereby triggering the requirement to hold an AFSL even when they are not carrying on a financial services business in Australia.

If the limited connection relief is withdrawn, this problem will persist and is not resolved by section 911A(2E) as inserted by Corporations Regulation 7.6.02AG as the services can only be provided to professional investors and are limited to dealing in, providing advice on, and/or making a market in derivatives, foreign exchange contracts, carbon units, Australian carbon credit units or eligible international emissions units.

As indicated in our December 2016 submission, AFMA's preferred outcome is that the exemption in s911A(2E) is broadened so that it is not limited to this small range of financial products. At the time the exemption was granted, part of the rationale was to recognise the global nature of derivatives and foreign exchange markets. We would argue that other financial products are now similarly global in nature given technological advancements in markets and the trans-national nature of many corporations. Any such amendments should not result in this exemption being the sole exemption available, as that would exclude the ability of offshore providers to provide financial services to non-professional wholesale investors which would otherwise be available under the ASIC class order regime.

We strongly recommend that ASIC maintains the limited connection relief, albeit with additional conditions if required, if and until the legislative exemption is reviewed.

## Use of current exemption

AFMA acknowledges ASIC's concerns that it does not have sufficient information about the current use of both the sufficient equivalence relief and the limited connection exemption. Our members are willing to assist in the provision of more detailed and specific information in order to create the level of comfort needed to retain the class order regime. Some of this information is set out in the attached responses to the consultation questions, but some information is subject to commercial sensitivities as you will appreciate, or could not be gathered in the time available to respond to the consultation. AFMA can facilitate direct provision of information to you if needed. It may also be the case that additional conditions should form part of the exemption, requiring the provision of information to ASIC either on a recurring basis or in response to a written notice.

Please contact me on 9776 7997 or tlyons@afma.com.au if you have any questions about this submission or would like further information on any points.

Yours sincerely

**Tracey Lyons**
**Head of Policy**

## AFMA responses to ASIC Consultation Paper 301 proposals and questions

***C1Q1 Do you agree with our proposal to repeal the sufficient equivalence relief and individual relief for FFSPs? If not, why not? Please be specific in your response.***

No, AFMA does not agree with the proposals in their current form.

Key points:

- The current exemption model can be enhanced without the need to require entities to obtain an Australian financial services licence (AFSL) – for example by adding additional conditions, enhanced breach reporting obligations, further requirements to comply with ASIC directions, and audit requirements.

- Requiring an offshore entity, in a jurisdiction deemed to be equivalent, to comply with an additional separate and distinct regulatory regime is likely to lead to confusion (particularly if individual jurisdictions are subject to divergent requirements), duplication and / or conflict in respect of technical regulatory issues which from a policy perspective are not material, and potentially increased levels of inadvertent non-compliance. Compliance costs are likely to be significant as additional resources will be required to ensure adequate oversight.

- The process of obtaining an AFSL will be difficult and potentially costly for entities outside the jurisdiction. There is unlikely to be a good understanding of the ASIC licensing process meaning most entities seeking an AFSL will need to engage local lawyers and licensing application experts, with associated costs.

- Access limitations to global products and services will ultimately be detrimental to capital markets in Australia.

- The proposals may trigger unintended Banking Act consequences and tax implications for FFSPs.

As providers of financial services both within Australia through AFS licensed entities and cross border into Australia relying on the sufficient equivalence class orders and the limited connection class order, AFMA members believe that the current regime strikes an appropriate balance between ASIC's regulatory objectives and commercial considerations. As large global organisations, AFMA members have many global organisations as part of their client base. An efficient way to enable clients to transact in multiple jurisdictions is to paper global clients to a single entity and have that entity provide financial services in various jurisdictions, such as in Australia through the use of the class orders. Changes to this regime will reduce the efficiency with which large financial institutions operate by creating an administrative and financial burden, resulting in increased costs and friction in the market place.

There will be a significant impact across firms in relation to the way they provide financial services to Australian clients if the class orders are repealed, resulting in increased costs of doing business cross-border into Australia, and risks to long-term existing client relationships where reliance is placed on the class orders on an ongoing basis.

For some AFMA members, in several parts of their business, the entire structure and provision of financial services into Australia is reliant on the class order exemptions. Removal of these exemptions, without some other form of exemption for the offshore entities to provide services into Australia, will have a significant negative impact on the ability to service Australian clients. In some instances it would preclude firms from being able to service Australian clients, given they do not have the required infrastructure or processes to perform many financial services solely from Australia through locally licenced entities. For firms who are not able to establish locally, or are not able book through locally established entities, where the services being provided into Australia are only incidental or minimal to their primary business lines, these costs may become marginal for the third country entity, which may then decide to cease providing the services, to the detriment of Australian clients and liquidity in the underlying markets.

Removal of the current exemptions and the requirement to obtain a foreign AFSL, which may not be used by foreign firms who choose instead to exit the market or may only be used with significant additional compliance costs, would also impact the ability of Australian institutional clients and investors to access the full range of international products and services that global organisations are able to otherwise offer to their global institutional client base. We believe that Australian institutional clients and investors will lose access to opportunities they may otherwise have been able to have, leaving them with restricted access, or increased costs of access – for example, through a requirement to acquire the services through some other form of structuring. We can also envisage a situation where Australian issuers accessing foreign currency debt markets in the US or European markets would face increased access restrictions. Access limitations to global products and services will ultimately be detrimental to capital markets in Australia and to the underlying corporates in Australia who may need to access these markets for hedging and capital raising purposes.

We recommend that the sufficient equivalence relief is retained but amended and made more robust, with greater transparency for ASIC in relation to business being undertaken with Australian clients, as well as reporting and access to information directly from the legal entities, rather than relying on MOUs with the home regulators. ASIC has also demonstrated its ability to obtain information from users of the class orders through the issuance of ASIC Act s33 notices to the FFSP operating under the class orders.

We also recommend that the scope of the sufficient equivalence relief is reviewed in terms of products and services currently permitted under the class order to ensure it reflects the contemporary needs of wholesale investors.

It is also open to ASIC to amend the sufficient equivalence relief to include a requirement to comply with some or all of the provisions in Appendix 2 to the consultation paper.

There are also concerns, which are not taken into account in the consultation paper, about the potential implications under the *Banking Act 1959* for some bank FFSPs who may be held to be carrying on banking activities in Australia – specifically:

1. If FFSPs have to register in Australia with ASIC (either as an AFSL or a foreign AFSL holder), it may mean that the firm also has to obtain a banking licence from APRA, particularly if the FFSP has the word "Bank" in its name. It is suggested that ASIC does not intend this consequence for those FFSPs that are carrying on banking activity from offshore pursuant to APRA's letters to foreign banks. However, the requirement to register with ASIC may have Banking Act implications that have not yet been fully explored.

2. In some situations, a subsidiary may be a derivatives exchange member locally. However if a FFSP is required to obtain authorisation from APRA, then that FFSP may be required to establish a bank branch locally. APRA currently considers a third party clearing guarantee on the derivatives exchange to be an unlimited risk, and therefore it would not allow the FFSP (that is, the banking entity being the entity that is currently exempt from ASIC and APRA licensing requirements) to perform clearing services on the derivatives market. This will have an impact on third party clearers in the derivatives markets.

3. These FFSPs may be required to apply for a banking licence, which will involve a significant amount of documentation, cost, process and resources. These outcomes are avoidable if the class order regime is maintained.

The above comments about Banking Act implications should also be read as applying to the limited connection relief.

***C2Q1 Do you agree with our proposal to implement a modified AFS licensing regime by modifying the application of certain legislative requirements to sufficient equivalence FFSPs? If not, why not? Please be specific in your response.***

No, AFMA does not agree with this proposal, for the reasons set out above.

We acknowledge that as a regulator, a significant part of ASIC's role is to regulate Australian markets and protect Australian investors. We believe that these aims can be achieved without a new foreign licensing regime. We also believe that removal of the sufficient equivalence class orders would bring about a significant economic impact on both providers of services and clients.

Given that the financial services global entities provide to Australian clients are only provided to wholesale clients, and for the most part, professional investors, we believe that a form of regulation that is more proportionate to the risk presented is sufficient to achieve an appropriate level of investor protection for wholesale clients. This is commensurate with the current framework of Australian financial services laws which recognise the distinction between wholesale and retail clients, and set obligations on providers of financial services accordingly. The distinction is also recurrently recognised in relation to the provision of certain services from offshore into Australia. For example, legislation (eg. s911A(2E)) provides a clear exemption for the issuance of derivatives from offshore into Australia to professional investors – in large part in recognition of the sophistication of the relevant players in that market. Where the provision of other financial services or products is made to only wholesale clients in Australia, and those services and/or products are provided by entities that are regulated by established and sophisticated regulators (including but not limited to the regulators of regimes that are currently recognised as sufficiently equivalent for the purposes of the FFSP class orders), ASIC's objectives relating to investor protection are sufficiently met.

If necessary, the current exemption regime based on equivalence can be enhanced to resolve some of the issues noted by ASIC while maintaining the simplicity and lack of regulatory duplication in the current model by, for example:

- adding additional conditions;
- enhancing breach reporting obligations;
- including further requirements to comply with ASIC directions; and
- audit and reporting requirements.

Requiring an offshore entity, in a jurisdiction deemed to be equivalent, to comply with an additional separate and distinct regulatory regime is likely to lead to confusion, duplication and/or conflict in respect of technical regulatory issues which from a policy perspective are not material, and potentially increased levels of inadvertent non-compliance. Compliance costs are likely to be significant as additional resources will be needed to ensure adequate oversight.

The process of obtaining an AFSL will be difficult and potentially costly for entities outside the jurisdiction. There is unlikely to be a good understanding of the ASIC licensing process meaning that most entities seeking an AFSL will need to engage local legal counsel, with associated costs.

AFMA members and their related parties operate different types of businesses. Some members report they have up to twelve entities in their global structure that currently utilise and rely on the sufficient equivalence class orders, who are located in and regulated by regulators in multiple countries. The services provided by these offshore entities into Australia cover a full spectrum of financial services, including:

- clearing, execution, custody and ancillary services;
- wealth management, brokerage and discretionary advisory services;
- debt capital markets activities, including EMTN programs;
- dealing/execution services across a broad range of securities and derivatives including electronic platform execution services;
- general and personal financial advisory services;
- provision and distribution of research;
- issuance of interests in managed/collective investment schemes;
- discretionary investment management services;
- the offering of non-cash payment facilities;
- services relating to the arranging for offers of securities and third party funds.

These activities are limited to wholesale clients, and a number of providers have been relying on the sufficient equivalence class order continuously for almost 15 years.

Our members are willing to assist in the provision of more detailed and specific information in order to create the level of comfort needed to retain the class order regime. Some of this information subject to commercial sensitivities, or could not be gathered in the time available to respond to the consultation. AFMA can facilitate direct provision of information by members to you if needed.

In the event that a foreign AFSL is introduced, where providers have existing Australian clients who have invested into financial products (for example, foreign issued and regulated managed investment schemes) under either the sufficient equivalence class order and/or the limited connection class order, there should also be some grandfathering relief provided to such persons for the ongoing provision of financial services related to the foreign product they are invested in. This is on the basis that:

(a) FFSPs should not be forced to opt into an FFSP licensing regime merely because they have clients to whom they have legitimately issued interests under prior regulation or exemption instruments; and

(b) in some instances, depending on the terms of the product issued, ceasing to provide financial services to the Australian investor may cause a breach of contract, a breach of relevant foreign regulation, and potentially cause losses to the Australian investor (eg. if the investor is forcibly redeemed from a product) or to remaining investors in the product (eg. investors in a limited liquidity product, such as a private equity collective investment scheme).

***C2Q2 If you are a sufficient equivalence FFSP, what would be the impact of introducing this modified AFS licensing regime on your business activities in Australia? Please be specific in your response, and include an itemised breakdown of:***

***(a) projected costs (per annum) for applying for and maintaining an ordinary AFS licence;***
***(b) projected costs (per annum) for applying for and maintaining the proposed foreign AFS licence; and***
***(c) any relevant costs at the entity-specific level.***

It is difficult to accurately project the business impacts and costs associated with the implementation of, and compliance with, a modified AFSL regime without a finalised framework. Nevertheless, we outline below broad estimates of the types and amount of projected costs. We note that this does not include the costs to the broader economy, which are factors that should be considered in a policy change exercise of this nature. Further, it does not consider the costs that would be incurred by ASIC in implementing a more restrictive regulatory regime, which would also likely be passed on to industry participants.

Business impacts are likely to be broad, particularly if, as a result of the changes, there is a requirement to re-contract (or repaper) existing clients, or rebuild technology and human infrastructure. Costs associated with doing so are not only economic in the sense of conducting a repapering exercise, but could also result in loss of clients to the firm because a client may not wish to execute amended agreements, thereby forcing termination of existing client contracts; a loss of direct revenues as a result of opening up existing client contracts to negotiation which have long been settled (placing providers at a commercial disadvantage given the ‘forced’ requirement to re-contract); and losses flowing from potential reputational damage as a result of required changes to the way clients have previously been serviced - for example, changes to relationship managers, and potential reductions in the scope and level of services able to be provided. In some cases, revenue losses associated with no longer being able to service Australian clients from offshore or from potential contractual renegotiations could run into tens of millions of dollars.

Member estimates vary, but an initial application for a foreign AFSL could cost, in external fees (not including a fully costed internal allocation model) in the range of A$200,000 - 300,000 per entity, depending on the licensing authorisations required for that entity, the level of proofs required to be submitted, and the length of time the application process takes with ASIC. These estimates are based on external spend for license variation applications made by local Australian licensed entities, which have taken as long as 18 months to complete for a single variation.

Ongoing costs with respect to maintaining a foreign AFSL will in large part depend on the specific licensing requirements and obligations, reporting obligations, and conduct standards. As global organisations seek to standardise processes globally wherever possible in order to reduce risks, incremental regulatory obligations can require significant lifts in implementation, training, and institutionalisation. Costs associated with such implementation, training and institutionalisation are difficult to gauge but costs are estimated to be in the range of $600,000 – 800,000 per annum per entity[4]. The reason for this is that it is expected there would need to be:

- operational system builds;
- ongoing compliance expertise (often dedicated and potentially onshore) for each entity (at least one head count);
- ongoing maintenance of responsible managers for each entity (which could number several for each entity depending on the license authorisations applied for);
- ongoing associated training for those persons locally and internationally for anyone with responsibility for functions performed by the entity;
- procedures put in place and maintained for each entity in relation to breach reporting;
- continual monitoring processes for regulatory reform that may impact the entity; and
- gap analysis against AFSL requirements versus the relevant current international licensing regime the entity operates under.

These ongoing costs would include external legal fees, internal legal, compliance monitoring, control function, training (both onshore and offshore) and incremental audit costs associated with Australian licensing compared to international licensing.

As noted above, these costs may cause product issuers and service providers to stop offering certain services to Australian institutional clients, or charge more for access to the products or services in order to cover the additional costs associated with compliance. This is likely to have an impact particularly for products and services that are only currently manufactured or supported from outside Australia and cannot be replicated by local Australian licensees in Australia. The loss of opportunity

[4] Does not include any potential ADI authorisation costs

for Australian institutional clients to access these products and services could result in lower returns and reduced access to international services.

It is currently unclear if the proposed regime would trigger contractual obligations between any local entity and foreign entities which previously did not exist. Such contractual obligations may in turn create a tax burden, reducing the ability for firms which operate on a global basis to effectively compete with domestic only firms due to increased administrative and financial costs.

One significant impact could be the application of a tax burden for clients with offshore banking units (OBUs). For example, Australian clients of local financial institutions that also have an account with a foreign related entity of that local financial institution, frequently establish an OBU which, from an Australian tax perspective, requires all transactions to be offshore. These clients will be disadvantaged if the FFSP is required to obtain an AFSL or foreign AFSL in Australia, especially if this also requires the foreign entity to obtain a banking licence. In that case, the account can be considered an account with an Australian entity and will be taxed as a local account. The implication of this is that Australian clients will only enter into relationships with those FFSPs who are able to remain fully offshore and fall within the Corporations Act exemptions, which are limited. This will have flow on implications for those entities establishing business in Australia. It should also be noted that most of the Australian clients with an OBU also have an AFSL for their onshore business with a subsidiary of the FFSP (and that subsidiary has an AFSL). Accordingly, ASIC is regulating local activity by those OBU clients.

These comments should also be read in the context of the limited connection relief.

***C2Q3 If you are a sufficient equivalence FFSP, how does your entity conduct its cross-border activities in other jurisdictions? Does your entity hold licences in jurisdictions other than your home jurisdiction? Please be specific in your response.***

Members report that their FFSPs operate on a cross border basis through a number of mechanisms including licensing exemptions.

There are differing requirements globally in relation to requirements for licensing. Where internal infrastructure permits, providers do have the ability to provide some financial services through, or in a manner that in part relies on, locally licensed entities. There are, however, jurisdictions services are provided entirely on a cross-border basis.

As a snapshot, in Asia Pacific and the UK:

- **Singapore:** Section 339 of the Securities and Futures Act sets out the extraterritorial application of the general licensing restriction for key financial service activities. MAS Guidance on this section states that the licencing regime only applies where an act has a substantial and reasonably foreseeable effect in Singapore. The MAS also clarifies that it does not have a policy intent of regulating business resulting from unsolicited enquiries, legacy relationships with clients who are now in Singapore or business with regulated entities in Singapore. This would mean that offshore banks would be able to provide services to a regulated person (e.g. any other bank or broker) in Singapore in respect of an activity for which the client is regulated.

Even where the licensing obligation would apply, various exemptions are available to a foreign financial service provider when dealing with accredited investors and institutional investors (i.e. wholesale business). One example for instance is that under the Securities and Futures Regulations (SFR) there is an exemption for the requirement to hold a licence for "dealing in securities" for dealing in bonds with an "Accredited Investor". Similarly, there is a licensing exemption in respect of the otherwise licensed activity of providing financial advisory services where these are only provided to "Institutional Investors".

- **South Korea:** A foreign financial service provider must register with the Korean regulator as a cross-border investment advisory company or a discretionary investment management company in order to provide investment advisory or discretionary investment management services to Korean clients. A foreign financial service provider is exempt from this requirement if it:

    1. Provides investment advisory or discretionary investment management services outside Korea to the Korean government, the Bank of Korea, the Korea Investment Corporation, certain funds established pursuant to special laws and their asset managers; and
    2. Does not make any investment solicitation (ie. soliciting a specific investor to enter into an investment advisory agreement or a discretionary investment management agreement) or advertisement (ie. advertising the financial investment products of, or business conducted by, a foreign investment advisory company or discretionary investment management company) targeted to the aforementioned Korean entities.

- **New Zealand**: There are several safe harbours available to foreign financial service providers under the Financial Markets Conduct Act 2013 (FMC Act). A licensing requirement will not be triggered when providing certain financial services if the client falls into one of the categories or criteria listed under these safe harbours, including but not limited to the following: investment business, large person or government agency, in each case as defined under Schedule 1 of the FMC Act.

- **United Kingdom**: Offshore providers may rely on the overseas persons exclusion set out in Article 72 of the Regulated Activities Order. This permits persons with no permanent place of business in the UK to enter into deals with or on behalf of UK persons or advise on investments in the UK as a result of a legitimate approach. This covers unsolicited enquiries as well any other form of contact which is permitted under the financial promotion rules. The financial promotion rules contain broad exemptions for communications intended to induce financial services activities in the context of wholesale business, high net worth individuals, professional investors, mergers and acquisitions, employee credit or share schemes, as well as a range of other exemptions.

Members also provide financial services on a cross border basis to professional/institutional investors/clients in numerous other Asian countries, using international entities, without the need for a license. Examples include Hong Kong, Indonesia, India, China, Taiwan, Thailand, and Japan.

Within the EU, passporting regimes assist with the ability to provide services cross border into many EU countries without specific country by country licensing requirements.

Within some organisations, limited financial services are provided cross border from outside of the USA into the USA, but members do have a number of international entities that are able to provide services to affiliates and directly to institutional clients thorough leveraging locally SEC licensed and regulated entities. In the context of providing access to futures exchanges, foreign firms may provide intermediated access to third country exchanges to US clients where a Part 30 exemption has been granted to the third country exchange or jurisdiction. The Part 30 exemption essentially recognises that US clients will be subject to an equivalent regime when compared to how they would be treated if they were a client to a US regulated Futures Commission Merchant.

***C2Q4 If you are a domestic AFS licensee, what would be the impact of introducing this modified AFS licensing regime on your business activities in Australia? Please be specific in your response, and include an itemised breakdown of costs and/or savings.***

Many AFMA members hold one or more AFSLs in their company groups. For some FFSPs who engage in trading, execution and clearing activities from overseas there may be implications for memberships on the local exchange, particularly where the FFSP's related entity has a membership on the exchange.

If the sufficient equivalence class order were to be repealed, theoretically it is possible that those holders, where current infrastructure permits, could provide services to Australian end investors, and effectively outsource aspects of the provision of those services to its foreign affiliates. This is not a model that has previously been widely adopted, as it places additional risk burdens on the local Australian licensee for the activities conducted by its affiliates. A number of members have indicated this would not be a viable option for their business.

We refer you to our comments regarding grandfathering of existing clients (to avoid forced recontracting) and the ability to continue to service clients that invested in products or signed up to terms under the current sufficient equivalence class order exceptions. Without grandfathering, compliance costs associated with re-routing financial services through Australian AFSL holders could run into several million dollars.

***C2Q5 If you are a wholesale client of a sufficient equivalence FFSP in Australia, what impact would the repeal of the relief have on your business? Please give reasons for your preference.***

Given the compliance costs and regulatory risks arising, we believe that removal of the sufficient equivalence exemption is likely to lead a significant reduction in the number of offshore financial service providers offering services to Australian clients. We do not believe that all current FFSP entities will apply for a foreign AFSL should that requirement be introduced. Therefore, AFMA members who are also wholesale clients in Australia of various FFSP entities believe the change is likely to limit the ability of local clients to conduct their business outside Australia and will materially impact competition.

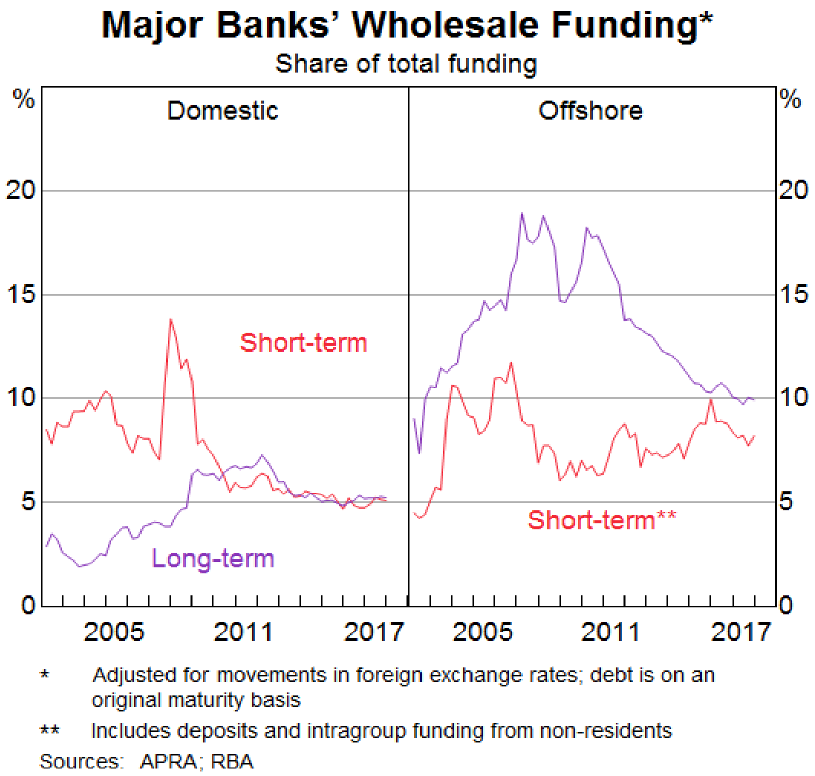
To explain this in a little more detail, many global banks have one or two main broker/dealer-type entities located in Europe or the US through which they offer a diverse suite of global products to international clients including in Australia under the class order regime. If this regime is repealed it is extremely likely that the global firms would not build out the required complex and costly infrastructure in their locally incorporated broker/dealer as it would not be commercially viable, and the global firms will not subject their main European or US broker/dealer legal entities to AFSL conditions given the burden in managing both the cost and complexity versus its home jurisdiction.

The net result would be both a reduction in competition and the range of financial products being made available to Australian investors, including the most vanilla products such as European or US listed equities.

Another very important issue for Australian wholesale clients that does not appear to have been considered in the consultation paper is the importance of access to offshore wholesale funding markets for Australian ADIs and other corporates.

In its Bulletin – March 2018 *Financial Institutions Developments in Banks' Funding Costs and Lending Rates,* the Reserve Bank reports that the major banks obtain a larger share of funding from offshore wholesale markets compared with other Australian-owned banks (see Graphs 4 and 5 below). Recently, smaller Australian-owned banks have further reduced their use of domestic short-term debt and funding from offshore debt markets as they have shifted toward more deposit funding. Changes in the composition of banks' funding can affect their overall funding costs as long-term debt is typically more costly than short-term debt and deposits.

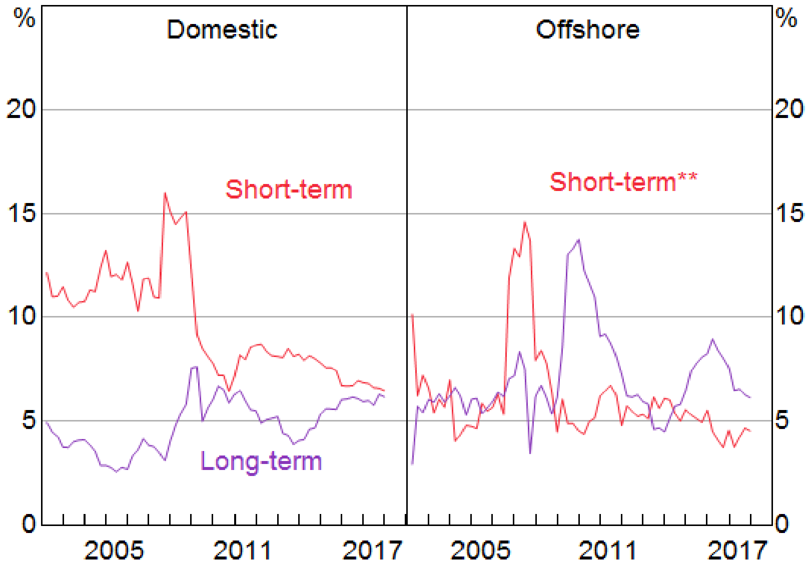
**Graph 4**




**Graph 5**

**Other Australian Banks' Wholesale Funding***

Share of total funding




* Adjusted for movements in foreign exchange rates; debt is on an original maturity basis

** Includes deposits and intragroup funding from non-residents

Sources: APRA; RBA

As an example, a large ADI member has advised that approximately 23% of its core assets are funded by term funding issuance and around 70% of this term funding is sourced offshore. It is a structural feature of the Australian economy that fixed income does not form a sizable allocation of a superannuation fund's investments, and that they tend to favour equities. This results in a lower appetite for fixed income products compared with offshore jurisdictions such as Europe and the US, compelling Australian issuers to source funding offshore.

Offshore markets provide greater diversity in terms of the bond tenors available to issuers as well as the types of funding products that can be issued. For example, it is difficult to issue a sizeable volume of long-dated bonds in Australia compared with the US or Europe. Any regulatory changes that have the potential to impact on access to and cost of funding are issues that need to be carefully weighed and considered.

***C3Q1 Do you agree with our proposal that general obligations under s912A(1)(a)–(ca) and (h) should apply to sufficient equivalence FFSPs applying for a foreign AFS licence? If not, why not? Please be specific in your response.***

The complicated proposed framework of applicable and non-applicable provisions will be difficult to understand for offshore entities and likely to lead to inadvertent non-compliance.

While we do not agree that an AFSL regime is an appropriate solution, we would potentially support the introduction of certain of the general licensing obligations that can be truly deemed fundamental conduct obligations as additional conditions on the class orders, including:

- s912A(1)(a): "*do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly"*;
- s912A(1)(b): "*have in place adequate arrangements for the management of conflicts of interest"*.
- S912A(1) "*have adequate risk management systems"*.

We do not support the inclusion of other obligations under s912A which have broad application and are likely to duplicate existing requirements in financial institutions home jurisdictions. This includes paragraphs 912A(c) & (ca) "*comply with/ensure representatives comply with the financial services laws".* Given the wide definition of "financial services laws" and the broad range of requirements captured by these provisions, their inclusion is likely to create a significant compliance burden on foreign AFSL holders where similar requirements in equivalent jurisdictions should already exist.

FFSPs should be able to rely on the rules of their home jurisdiction where the jurisdiction has been deemed sufficiently equivalent. We believe that ASIC may be able to achieve the objectives set out in CP 301 through the strengthening of class order regime.

***C4Q1 Do you agree with our proposal to exempt sufficient equivalence FFSPs from the general obligations in s912A(1)(d)–(f) and (j)? If not, why not? Please be specific in your response.***

We support the maintenance of the sufficient equivalence class orders, in a modified form if necessary to achieve ASIC's objectives, rather than a foreign licensing regime. However, in the event a foreign AFSL is introduced, we would support the dis-application of these provisions for foreign AFSL holders.

***C5Q1 Do you agree with our proposal to exempt sufficient equivalence FFSPs from the application of certain provisions of the Corporations Act and Corporations Regulations where the overseas regulatory regime achieves similar regulatory outcomes to the Corporations Act? Please be specific in your response.***

We agree that these provisions should be excluded if an AFSL regime is adopted. However, we note again that a complicated framework of applicable and non-applicable provisions (particularly if individual jurisdictions are subject to divergent requirements) will be difficult to understand for offshore entities and likely to lead to inadvertent non-compliance.

***C6Q1 Do you agree with the considerations we should have regard to when determining which Corporations Act and Corporations Regulations provisions should not apply to sufficient equivalence FFSPs? If not, why not? Please be specific in your response.***
and
***C6Q2 Do you think we should include any other considerations when determining which provisions should not apply to sufficient equivalence FFSPs? Please specify which other considerations in your response.***
and

***C6Q3 Do you think there are other Australian requirements that should be included in Appendix 1 (i.e. requirements that should not apply to foreign AFS licensees)? If so, why should those additional requirements not apply to foreign AFS licensees? Please be specific in your response.***
and
***C6Q4 Do you think there are provisions in the Corporations Act or Corporations Regulations that we have included in Appendix 1 that should apply to foreign AFS licensees? If so, why should those requirements apply to foreign AFS licensees? Please be specific in your response.***

There is concern that the proposed process is too granular and likely to lead to confusion – that is, a range of applicable and non-applicable regulations depending on the home jurisdiction of the financial institution and the level of equivalence that is granted, as the consultation paper seems to suggest each obligation will be assessed on a case by case basis. This is likely to lead to confusion and inadvertent non-compliance. It is also the case that many of the obligations that are included have detailed provisions for compliance (eg. short selling) that are likely to make the framework too complex for an offshore entity to comply with.

AFMA recommends that the exemption framework is retained, with the inclusion of high level conduct obligations, enhanced requirements to cooperate with ASIC and notification requirements.

***C7Q1 Do you agree with our proposal and the proposed conditions of exemption? If not, why not?***

If the foreign AFSL is introduced, yes we agree that client money provisions should be excluded as applying them is likely to lead to potentially conflicting obligations. For example, the UK Bankers exemption under the CASS rules can conflict with Australian client money obligations but provides equivalent protection. A similar view may also be taken in respect of Singapore client money rules.

The Corporations Act client money provisions are very Australian centric (eg. the requirement for money to be held in an ADI trust account). An obligation to comply with these requirements would result in substantial implementation costs, and result in inefficient flows of money. In the wholesale client context when dealing with what can be very large amounts of money, this can be financially detrimental to both the client and to the financial services provider, and in fact increase the risks associated with client money flows by increasing the number of accounts/touchpoints required in a transaction flow.

***C7Q2 Are there any provisions of Divs 2 and 3 of Pt 7.8 from which you consider an FFSP should not be exempted? If so, please be specific in your response.***

No comments.

***C7Q3 Are there any sufficiently equivalent jurisdictions in relation to which proposal C7 should not apply? Please be specific in your response.***

No comments.

***C8Q1 Do you agree with the conditions we are proposing to impose on foreign AFS licensees? If not, why not? Please be specific in your response.***

It has been noted that application of the standard licence conditions is confusing as certain provisions of the Corporations Act appear to have been excluded under section C6. Appendix 1 excludes for example s912A(1)(d) relating to adequate resources but the standard conditions of a licence includes financial requirements for a licensee. Many other conditions are retail focused so there appears to be little value in applying PF209 as a general rule.

For some organisations, the restriction in relation to only being permitted to appoint 'wholly owned' bodies corporate of the foreign AFS license would be problematic. For various structural and regulatory reasons, entities within some groups of companies are typically not 'wholly owned', although all entities in the group are ultimately owned by the head company. Some foreign AFS licensees may also have parent or sibling bodies corporate already operating in Australia, rather than wholly owned bodies corporate. A more appropriate and commercial construction would be to permit 'related bodies corporate', or affiliates, to be appointed as authorised representatives and in turn, their employees and directors – to the extent that a licence would be required. In the event that a service is being provided by a related body corporate to another related body corporate and not directly to an Australian client, then in line with current laws we do not believe a licence would be required solely for that service.

***C8Q2 Would you prefer to have the option of allowing sufficient equivalence FFSPs to appoint any person as a representative? Note that in this case the general obligation under s912A(1)(f) of the Corporations Act would apply to the foreign AFS licensee.***

Generally, yes.

***C8Q3 Are there any other conditions that you think we should impose on foreign AFS licensees, and why? Please be specific in your response.***

No comments.

***C9Q1 Do you agree with our proposal that core and additional proofs must be provided to support an application for a foreign AFS licence?***

AFMA is strongly of the view that if the foreign AFSL regime is introduced, the licensing process needs to be streamlined and simple for entities that are already licensed in equivalent jurisdictions. An overly onerous application process is likely to be a significant disincentive to offshore entities obtaining a licence and providing services to Australian clients.

Where entities are licensed by an equivalent regulator, a licence (or exemption) should be granted with minimal core proofs. There appears to be limited benefit in requesting documentation that will have already been assessed by the foreign regulator.

We recommend that an enhanced sufficient equivalence relief could incorporate the proposals for the below core and additional proofs (or schedule documents) where applicable under a relief arrangement:

A5 - Business description
B3 – Compliance Arrangements / Managing Conflicts of Interest
B5 – Financial Statements and Financial Resources
B7 – Risk Management System Statement

There are concerns about ASIC's capacity to process a large number of applications from current FFSP class order entities. Given the current backlog of domestic AFSL applications, there is likely to be a significant delay in offshore entities obtaining a foreign AFSL. We note that the current ASIC service charter for applying for or varying an AFS licence is 150 days from receipt of a complete application (with a target of 70%) and 90% of complete applications within 240 days.

***C9Q2 In addition to the requirements specified in RGs 1–3, what information do you believe you can and should provide to us to demonstrate that you are not likely to contravene the obligation under s912A(1)(c) to comply with the additional conditions on a foreign AFS licensee (see proposal C8)? Please be specific in your response.***

While we agree that no entity should operate in Australia without adherence to principles such operating in a fair and efficient manner, the application of adherence to simply 'financial services laws' under s912A(1)(c) is too broad to be adequately demonstrated at the time of application. This is also likely to create a heavy administrative burden for both ASIC and the applicant.

***C9Q3 In addition to the requirements specified in RGs 1–3, what information do you believe you can and should provide to us to demonstrate that you are not likely to contravene the obligation under s912A(1)(c) to comply with financial services laws subject to the modifications proposed in proposal C5? Please be specific in your response.***

See above re C9Q2.

***D1Q1 Do you agree with our proposal to repeal the limited connection relief? If not, why not? Please be specific in your response.***

AFMA is strongly of the view the limited connection relief should retained but placed in legislation/regulations with the wording clarified to make it clear when it should apply. It has been noted the current wording is ambiguous and potentially open to abuse but could be clarified to limit its scope.

For some members, the limited connection relief is predominantly used in situations where they are dealing with a single client or a small number of clients, where that service would not warrant obtaining a licence. These clients are generally Australian clients seeking services from a related entity in a foreign jurisdiction, with no solicitation or marketing occurring in Australia, although the client may be introduced to the offshore entity by a local AFSL holder. Many of those clients may be trading in markets where they must face a local broker, and it is therefore not possible to facilitate the execution of their trades through an Australian AFSL holder directly.

Examples of the many situations in which the limited connection relief is used include:

- Distribution of global research into Australia where the local licensed entity does not have a research presence or there is no local licensed entity and where the Australian recipients are a small group of the global distribution list from a particular entity, and Australian investors are not specifically targeted.

- An Australian client seeking cash equities execution in respect of Japanese equities, where trades are executed for a very small number of wholesale clients through the related Japanese securities broker;

- Cash equities execution services in India provided to Australian funds - all trades are settled through custodians that are local Indian intermediaries registered with SEBI. The Indian entity has no presence in Australia and does not actively market into Australia.

- A deposit or superannuation product is provided to a UK citizen who then moves to Australia. The entity may have no presence in Australia and does not actively market to Australia, yet it will be providing a service to an Australian client.

As such, any blanket removal of the exemption with an expectation that an offshore provider would seek a foreign AFSL would be a significant burden. For services provided to a small number of clients, obtaining a foreign AFSL would not be warranted given the compliance costs of maintaining the licence – it is likely that FFSPs would cease providing financial services to these clients. This is likely to lead to Australian clients being unable to access certain offshore markets, products and services.

AFMA is supportive of additional conditions being applied to the limited connection relief including notification of use, express information gathering powers for ASIC and a mechanism for ASIC to monitor and take action concerning activities conducted under the relief.

FFSPs will continue to rely on a number of other exemptions that are available including Corporations Regulation 7.6.02AG although there are limitations associated with these provisions (eg. limited application to derivatives transactions).

There are some unique aspects to the financial services laws promulgated under the Corporations Act as they apply to financial services providers who have limited connections with Australia or Australian wholesale clients. These unique aspects create anomalies that are not always covered by exemptions currently contained in the Corporation Act and Regulations.

As an example, some entities in a group act as a general partner (typically a special purpose Country A entity which is ultimately owned by the group of companies) to Country A limited partnerships (managed investment schemes) which are offered to profession/institutional type investors globally.

The limited partnership will typically appoint an external (third party) custodian. Where one single investor in the limited partnership is an Australian domiciled professional/institutional entity (these products are not available to retail or high net worth clients), Australian licensing requirements can be enlivened. Because the fund is structured as a limited partnership, under Australian law, the view is that:

1. The custodian is ‘inducing’ Australian clients (the Australian limited partners); and
2. The general partner is ‘arranging’ custodial services to be provided to each limited partner by the custodian.

Where the custodian is not licensed or exempt from AFS licencing requirements, then the ‘arranging’ of these custody services through the general partner may attract a licensing requirement. There is often an anomaly in the ability to find an exemption in relation to the general partner ‘arranging’ for the provision of the custodian services to the Australian client (the Australian limited partners).
In relation to section 911D, this view is a conservative view on what behaviour may amount to ‘inducing’ Australian clients. Nevertheless, the service of arranging for a third party custodian – often for a single Australian professional investor in a product sold to many – with no Australian touch point other than a single Australian investor in the product, should not attract a requirement for AFS (or foreign AFS) licensing in Australia, particularly as in many instances the general partner will be a single purpose entity.

An additional example of where anomalies can occur from carve outs to certain exemptions is in section 766C(5) from ‘dealing’. A body corporate or an unincorporated body is not seen as conducting a dealing activity (issuing a financial product) under section 766C(4) where it issues interests in itself. With the carve out contained in 766C(5) for entities carrying on a business of investment in securities, interests in land, or other investments, an issue of equity in a principal capacity will be a dealing activity requiring licensing.

Listed investment companies (LIC) are often caught in this – and an issue of shares in the LIC by an Australian institutional investor, will, without some form of relief trigger an AFS licensing requirement for the LIC. This is particularly difficult to structure around without a license requirement, considering the breadth of scope of section 911D. As an aside, we would submit that the concept of ‘inducing’ continues to get broader, and captures unintended situations as technology advances. Seventeen years ago, when the concept was introduced, ‘inducing’ people in Australia typically involved some need and/or positive act to set up some infrastructure within Australia, or at least with Australian investors in mind. In 2018 it is nearly impossible to block a person located in Australia from viewing materials which are accessible online, even with the use of jurisdictional blocking technology. ASIC Regulatory Guide 121 states “Conduct that amounts to inducing includes attempts to persuade, influence or encourage a particular person to become a client. It could, for example, include mass marketing campaigns.”

Accordingly we see that there is an increasing need to provide some form of relief to entities that are accidentally or tangentially providing a non-systemic product or service to an Australian client – but which is unable to categorically say that it did not conduct an activity that was likely to induce an Australian client to request the product or service.

Without some form of relief, it is likely that offers of these Country A limited partnerships, or transactions involving LICs would be restricted to non-Australian investors. This may adversely impact the investment strategies and portfolios of some of our members' largest clients (which include statutory bodies), and restrict access to foreign markets and services unnecessarily.

We agree that ASIC has a valid concern about more oversight as to who relies on the limited connection relief. However as we understand it, this relief is used by a range of entities and the full impact of removing this exemption needs to be properly assessed especially given that such entities may not be aware of this consultation.

***D1Q2 If we repeal the limited connection relief, what would be the compliance costs associated with applying for an ordinary AFS licence, or a foreign AFS licence, and maintaining your entity's compliance with the Corporations Act? Please provide an itemised breakdown of:***

***(a) your entity's projected costs to apply for and maintain an ordinary AFS licence;***
***(b) your entity's projected costs to apply for and maintain the proposed foreign AFS licence; and***
***(c) any other relevant costs.***

See responses to C2Q2.

***D1Q3 We understand from the limited engagement by service providers with CP 268 that a number of wholesale fund operators rely on the limited connection relief. If we repeal the limited connection relief:***

***(a) What would be the impact on your business or your client's business? Please provide data on the types of activities for which you rely on the relief, and the volume and value of business you conduct under the relief.***
***(b) How does your entity address this issue with respect to activities that you conduct in jurisdictions other than your home jurisdiction? Please be specific in your response.***

From a funds management perspective (including traditional and alternatives) both the sufficient equivalence relief (for example, the *ASIC Corporations (CSSF-Regulated Financial Services Providers) Instrument 2016/1109*) and the limited connection relief are used to provide services such as issuance, arranging and general advice.

These services are not conducted through companies registered as foreign companies in Australia and often the services are provided in conjunction with an Australian licensee, which may promote the funds.

For example, an Australian regulated entity that holds an AFSL may distribute group and non-group products to large institutional clients, including superannuation funds and semi-government bodies, but does not manufacture any products in Australia. The Australian AFSL holder seeks out best of class products for its clients and has, in some cases, exclusive distribution arrangements with offshore non-group fund managers and investment managers, which Australian clients cannot otherwise access. The fund manager or investment manager in these cases will be covered by the sufficient equivalence class orders, or can obtain an individual relief instrument depending on their home jurisdiction. Under these arrangements, the Australian AFSL holder is not responsible for the conduct of the offshore provider, who is highly regulated in their home jurisdiction.

Members report that significant amounts of assets under management are raised from categories of clients including superannuation fund trustees, responsible entities and trustees of Australian funds and other financial services licensees, high net worth individuals and family offices in Australia. Assets raised via private placements from Australian limited partners (via institutional clients indicated above) are also significant. More specific information can be provided if required.

It is unlikely that many of the offshore providers in these scenarios would obtain a foreign AFSL if the class order regime was to be terminated. Much of the amount that is actually sold into Australia by the third party fund managers would not warrant licensing. Business may be conducted on a fly in/fly out basis including roadshows and investor relations. The offshore entities providing the services do not have physical offices in Australia or Australian based employees. Overall, if the licensing regime were to be introduced, Australia would be seen as increasing hurdles to carry on business activities here. Institutional clients in Australia, and superannuation funds in particular, will normally only deal with an entity that is licensed or exempt from licensing. If the class order regime was withdrawn, the offshore fund manager would no longer be able to deal directly with the institutional client unless a local licensee appointed the offshore provider as an authorised representative, which is unlikely given the liability issues that would arise, or unless the offshore provider obtained a foreign AFSL as proposed. The worst possible outcome is that the Australian institutional client would have to divest its holdings in the managed fund.

Our members report that their institutional clients in these scenarios do not require the type of protection that might be afforded to them under a foreign AFSL. Rather, it is already the case that clients build contractual protections into their agreements with the offshore provider that are as strong, if not stronger, than that proposed under the foreign AFSL regime.

However, in recognition of ASIC's concerns about limited access to information about activity occurring under the class orders, a suggested compromise is to maintain the current class orders with additional reporting points. In other jurisdictions, such as in Canada, South Africa and Singapore (via the CISNet platform), funds (or their fund managers/sponsors) are required to provide certain data points on an annual basis to provide visibility to the regulator. These include:

**For funds:**

- AUM of Australian investors in funds;
- increase/decrease in AUM from Australian investors from prior reporting period;
- Confirmation that only wholesale clients are targeted;
- Number of Australian domiciled clients;
- Name of foreign legal entity adviser promoting fund(s) in Australia, including name of onshore Australian licensee where relevant;
- Type of fund – PE, hedge etc;
- Investment strategy;

- Liquidity terms of the fund; and
- For funds that offer liquidity, redemption information from the prior reporting period.

Where the funds are distributed in Australia by locally licensed distributors, the appropriate party to be able to provide the above information to the regulator will be the locally licensed entity. For private placements by Australian limited partnerships into offshore private funds, the general partner/offshore fund sponsor of the offshore private fund will be the appropriate party to be able to provide the required information to the regulator.

Other options include requiring the offshore funds (where offered only to qualified investors) to be registered with the local regulator before the local investor makes the investment decision (ie. prior to signing the subscription agreement), such as in South Korea.

**For mandates/separately managed accounts:**

- AUM of Australian investors;
- Increase/decrease in AUM from Australian investors from prior reporting period;
- Confirmation that only wholesale clients are targeted;
- Number of Australian domiciled clients;
- Name of foreign legal entity adviser providing the mandate service in Australia, including name of onshore Australian licensee where relevant; and
- Type of investment strategy.

Where offshore foreign financial service providers have sub-discretionary or advisory investment management relationships with Australian wholesale clients (eg. local asset managers), the above information can be provided by the local entity as necessary.

***D1Q4 If you rely on our limited connection relief, do you rely on licences or exemptions relating to your activities that affect places other than your home jurisdiction? Please be specific in your response.***

No comments.

***D1Q5 If you disagree with our proposal to repeal the limited connection relief, what (if any) enhanced conditions should be introduced to better facilitate supervision by ASIC? For example, what would be your view on the introduction of:***

***(a) a requirement on FFSPs to notify ASIC of reliance on the limited connection relief at the outset and a further notification when the FFSP ceases to rely on that relief (the notification would be through an online form requesting a detailed description of the intended business activity (i.e. account of specific transaction procedures, intended market presence in Australia and client groups targeted), a copy of the FFSP's constitution or articles of association, and an executed agreement with an Australian local agent);***
***(b) an express information-gathering power for ASIC; and***
***(c) a mechanism for ASIC to monitor and take action in relation to your activities?***

Yes, AFMA would potentially support all of the above.

***D1Q6 If we repeal the limited connection relief, do you expect to apply to rely on another exemption to continue to provide financial services? If not, why not? Please be specific in your response.***

As outlined in CP 301, the limited connection relief in CO 03/824 (extended by Instrument 2017/1820) was granted in response to concerns that overseas counterparties may technically engage in conduct that is intended to induce people in this jurisdiction to use a financial service or is likely to have that effect [see s991D(1)], thereby triggering the requirement to hold an AFSL even when they are not carrying on a financial services business in Australia.

If the limited connection relief is withdrawn, this problem will persist and is not resolved by section 911A(2E) as inserted by Regulation 7.6.02AG as the services that may be provided are limited to dealing in, providing advice on, and/or making a market in derivatives, foreign exchange contracts, carbon units, Australian carbon credit units or eligible international emissions units.

As indicated in our December 2016 submission, AFMA's preferred outcome is that the exemption in s911A(2E) is broadened so that it is not limited to this small range of financial products. At the time the exemption was granted, part of the rationale was to recognise the global nature of derivatives and foreign exchange markets. We would argue that other financial products are now similarly global in nature given technological advancements in markets and the trans-national nature of many corporations.

We strongly recommend that ASIC maintains the limited connection relief, albeit with additional conditions if required, if and until the legislative exemption is reviewed.

***E1Q1 If we repeal the sufficient equivalence relief and individual relief, do you think that a 12-month transitional period gives sufficient time to comply with the applicable Corporations Act requirements and foreign AFS licence conditions? Please give reasons for your view.***

Given the potentially large number of entities that may seek a foreign AFSL, the general lack of understanding of the licensing process and current back logs in domestic AFSL applications, a 12 month transition period is not likely to be adequate. We note that the current ASIC service charter for applying for or varying an AFS licence is 150 days from receipt of a complete application (with a target of 70%) and 90% of complete applications within 240 days which suggests that a 12 month transition period is unrealistic.

Significant structural changes to businesses may be required. Given the compliance costs associated with the proposed regime it is likely that organisations will need to review business sales and booking models and implement changes that may include consolidating entities dealing with Australian clients, all of which is likely to take some time. It will be a complex process for global organisations to map every financial service they provide globally, and to determine whether there is any Australian touch point for that service and then which category of licensing that may fall under.

Similarly, the finalised requirements, including the specific licensing requirements and obligations, reporting obligations, and conduct standards will impact on the timing for implementation, training, and institutionalisation. Therefore, a period of 24 months may be more appropriate. Alternatively, ASIC could consider a grandfathering period being the longer of (a) 24 months; or (b) for a particular entity currently relying on a class order, where an application is submitted within that 24 month period, a period of 6 months from the date upon which it is approved or rejected by ASIC (with contractual issues to be addressed separately). This would provide market participants sufficient time to make an application if they choose to do so, as well as providing ASIC enough time to process these (with sufficient market clarity should an application remain pending).

AFMA suggests that additional consultation on implementation is needed once the regulatory framework is settled.

***E2Q1 Do you agree with our approach (not to undertake a further sufficient equivalence assessment of jurisdictions in Table 3)? Please give reasons for your view.***

We agree. However, where individual relief has been granted for a specific FFSP for a jurisdiction we believe that ASIC should consider extending that equivalence for all entities seeking a licence/relief for that jurisdiction.

***E3Q1 Do you agree with the proposed transitional period? If not, do you think it should be longer or shorter?***

See comments re E1Q1.

***E4Q1 Do you agree with our approach? Please give reasons for your view.***

The process of obtaining equivalence for a jurisdiction is likely to be lengthy and we note that very few jurisdictions have been added to the list since the original class orders were issued – this is likely to be especially so if ASIC intends to review each obligation noted in Appendix 1 independently when assessing equivalence and granting relief for a jurisdiction. We expect that the equivalence application process itself is likely to take in excess of 12 months.

AFMA members have noted that whether ASIC intends to treat the European Union (EU) as sufficiently equivalent is a matter that needs to be resolved. The current country based approach is problematic.

ASIC should consider pro-actively conducting an equivalence assessment of the EU as a single jurisdiction given the increasing harmonisation in financial services regulation in the EU as a result of MiFID II, EMIR and the role of the EU supervisory authorities. This will create market certainty in the event that business lines from a jurisdiction which is currently equivalent, such as the UK, must migrate at short notice to the EU into one of several likely jurisdictions (e.g. the Netherlands, Germany, France, Ireland). Treating the EU as a single jurisdiction will reduce duplication of effort and the resulting market certainty will ensure Australian clients can continue to access all relevant investments and financial instruments (including vanilla products such as European equities) without any unnecessary interruption.

The jurisdictions that are considered sufficiently equivalent should extend to European countries that fall under European law and ECB supervision. ASIC has already recognised (to differing degrees) the UK, Germany, France, and Luxembourg which all fall under European law and ECB supervision. ASIC should consider individual relief for EU countries not listed in the proposal (eg. Netherlands, Ireland, Belgium and others) on a priority basis, particularly where FFSPs in those countries are currently relying on the limited connection relief or may need to in the short term as a result of Brexit.

On that basis, we strongly urge ASIC to extend the time for the limited connection to be withdrawn given the likely timeframes required to establish equivalence.

While the proposed exit of Britain from EU is clearly a matter beyond ASIC's control and outside the direct scope of this consultation paper, there are significant issues to be addressed in terms of how Australian entities will gain access to EU markets if access from the UK is curtailed.

A major challenge facing Australian banks at present and by extension their clients operating and seeking to invest abroad, is access to EU markets in the light of Brexit. Industry is keen to support ASIC and APRA in engagement with the European Commission to gain equivalence status for Australia (where not already obtained), which will allow Australian banks and other financial institutions access to all EU States and therefore assist their and their clients' overseas activities.

The regulators may already be in negotiations with the EU for equivalency arrangements. However, we would caution that if ASIC pursues the removal of the sufficient equivalence and limited connection reliefs, this may signal to the European Commission that Australia is not prepared to offer reciprocal access to EU financial institutions and therefore diminish Australia's chances of being declared equivalent under various EU rules. This will damage the business prospects of Australian financial institutions and clients relying on their assistance.

AFMA members also seek clarity that for some large financial institutions with global reach, Australian clients may not be papered to the "home" jurisdiction but may instead be papered to a branch for regional coverage. Provided that the branch is also in a jurisdiction which benefits from an equivalence assessment AFMA members assume that it is permissible for branches to provide such services to Australian customers in accordance with the regime applicable to the branch.

***E4Q2 Do you think that the proposed 12-month transitional period is sufficient for FFSPs to engage with ASIC for us to undertake a sufficient equivalence assessment of their home regulatory regime and apply for a foreign AFS licence? If not, do you think it should be longer or shorter? Please give reasons for your view.***

We think it is unlikely that 12 months will be a sufficient period.

***E5Q1 Do you agree with our proposal of a scaled-back assessment of sufficient equivalence for the new foreign AFS licensing regime? Please give reasons for your view.***

Given the wide range of jurisdictions that may have institutions currently operating under the limited connection relief a large number of equivalence assessments may be required in a short timeframe. Any equivalence assessment will need to be streamlined. While it will be a simpler process to conduct a line-by-line assessment of obligations where a fewer number of obligations are to apply, it is still likely to be a time consuming process.

***E5Q2 Do you think other questions should be excluded on the scaled-back assessment? Please be specific in your response.***

No comments.

***E5Q3 Are there any measures relevant to ASIC's assessment of sufficient equivalence that you think we could adopt to assist FFSPs to obtain such an assessment without creating significant burdens for them arising from such an assessment? Please be specific in your response.***

Guidance from ASIC will assist participants to provide fully informed responses. For example it is not clear how ASIC would treat the impact of extraterritoriality of RG264 when balanced against foreign requirements.

****