



Law Council
OF AUSTRALIA

Business Law Section

4 September 2023

Legislative Framework Unit
Foreign Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Stefan.Olofsson@TREASURY.GOV.AU

Dear Mr Olofsson,

Interfunding Transactions Exemption

1. This submission is made by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia (**Committee**). It concerns the draft policy specifications (**Draft Specifications**) circulated following the 2023–24 Federal Budget announcement that *'[t]he Government will exempt passive or low-risk interfunding transactions from mandatory notification requirements and fees under the Foreign Acquisitions and Takeovers Act 1975 [(FATA)]'* (**Interfunding Exemption**).¹

Key Points

2. The Committee broadly supports the introduction of the Interfunding Exemption proposed in the Draft Specifications. The Committee understands that the underlying intention of the Interfunding Exemption is to:
 - (a) recognise that there are significant administrative and regulatory burdens for internal fund management steps that make up interfunding; and
 - (b) to provide relief from those burdens for such low risk interfunding steps.
3. However, the Committee recommends that the following key matters be addressed:
 - (a) that the persons covered by the Interfunding Exemption include all parties involved in interfunding so that the underlying policy rationale of providing an exemption for interfunding steps can be realised;
 - (b) that no reporting requirements are imposed for interfunding steps given the significant administrative burden associated with the Register of Foreign Ownership of Australian Assets (**ROFOA**);
 - (c) that sub-custodian arrangements be covered; and
 - (d) as the Draft Specifications are not yet reflected in a draft regulation, that the consultation process allows relevant stakeholders and the public to comment on a draft regulation when issued, and to provide feedback on any further proposed changes to the draft regulation before that regulation is tabled.

¹ Australian Government, *Budget 2023-23* (Budget Measures, Budget Paper No 2, 9 May 2023) 18.

Specific Submissions

1. Acquirers and interests

- (a) The Draft Specifications propose that the exemption is limited to:
 - (i) acquisitions by responsible entities of a registered managed investment scheme or an RSE licensee holder of a superannuation fund; and
 - (ii) acquisitions of interests in a managed investment scheme or a superannuation fund with the same ultimate controlling entity.
- (b) The Committee notes that this does not cover the following scenarios under which low risk interfunding activities may also occur:
 - (i) trustees of unregistered managed investment schemes;
 - (ii) alternative structures, including acquisitions by or in a corporate collective investment vehicle established under the Corporations Act 2001 (Cth) (**CCIV**);
 - (iii) life funds and general insurers (as already covered at section 36 of the *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) (**FATR**)); or
 - (iv) offshore fund of fund transactions or feeder funds, which are a feature of investments in the financial services industry.

Recommendation: The Committee proposes that the Draft Specifications should cover all scenarios for low risk interfunding activities, including managed investment schemes, and to the greatest extent be future-proofed for emerging structures, including CCIVs. Further, the Draft Specifications should clearly extend to other activities such as offshore fund of fund transactions, and feeder fund activities where feeder funds are deemed to be foreign government investors.

2. Register of Foreign Ownership of Australian Assets

- (a) The Draft Specifications state that interfunding transactions require notification to the ROFOA. While the Committee recognises the intent behind the introduction of the ROFOA, the requirement to report interfunding transactions under the current framework is onerous, given the volume of transactions requiring notification. This is particularly the case as we understand that those conducting interfunding activities currently benefit from exemption certificates with bespoke reporting to accommodate the unique nature and volume of low-risk interfunding activities.
- (b) The Committee submits that, as the interfunding activities remain reviewable national security actions, there should instead be a record-keeping obligation by those seeking to rely on the exemption, noting that the Treasurer already has the ability to request that information (for example, under section 133 of the FATA).

Recommendation: That the Draft Specifications (and consequently the Interfunding Exemption) are amended so that no reporting is required under the ROFOA, and a record-keeping obligation in the style of section 117 of the FATA is added for those seeking to rely on the Interfunding Exemption.

3. IDPS

- (a) The Draft Specifications do not extend to sub-custodian arrangements, including where an investor-directed portfolio service (**IDPS**) applies. Although foreign custodians benefit from an exemption under section 30 of the FATR, this exemption applies only to acquisitions of legal interests (section 30(c) of the FATR). IDPSs and sub-custodian arrangements are a common feature of the financial services industry. The current exemption under section 30 of the FATR creates a challenge where, under the terms of the IDPS, a fund manager is the custodian for each customer's separate assets which it manages but appoints a sub-custodian to hold on behalf of the investors the legal title to each client's underlying direct shares and ETFs. The Committee submits that including IDPS activities within the Interfunding Exemption is consistent with the purpose and policy of the Interfunding Exemption.
- (b) IDPSs are a common feature of the Australian funds management regime where, instead of pooling the underlying assets, the client, for administrative efficiency (eg, reporting), will require the IDPS operator to hold their assets as custodian and act in accordance with their directions regarding the underlying assets. Section 30 of the FATR is intended to provide a broad exception for foreign custodians. However, the reference in section 30(c) of the FATR is to the subject interest being a legal interest. This creates a challenge where, under the terms of the IDPS, a fund manager is the custodian for each customer's separate assets which it manages but appoints a sub-custodian to hold on behalf of the investors the legal title to each client's underlying direct shares and ETFs. Accordingly, the nature of the interest that the fund manager holds as custodian for its clients is the client's beneficial interest in the underlying direct shares and ETFs as the custodian holds the legal interest. A sub-custodian would benefit from the foreign custodian exception in section 30(c) of the FATR as it would be the registered holder of the legal interest in the underlying assets, but the fund manager is not the registered holder. This produces an anomalous result. The Committee submits that including IDPS activities and sub-custodian arrangements within the exemption is consistent with the purpose and policy of the Interfunding Exemption.

Recommendation: That the Draft Specifications (and consequently the Interfunding Exemption) are amended to include IDPS sub-custodians.

4. Consultation process

The Committee appreciates the opportunity to have commented on the Draft Specifications. Acknowledging that the specific draft regulations are yet to be provided for comment and the technical nature of interfunding, the Committee submits that there should be multiple rounds of consultation on the drafting of the

regulations before they are tabled in Parliament, so that industry-specific and technical terms can be appropriately reflected, and unintended consequences are avoided.

Recommendation: At least one further round of consultation is conducted after initial feedback is provided on draft regulations.

Conclusion and further contact

5. The Committee would be pleased to discuss any aspect of this submission.
6. Please contact the chair or deputy chair of the Committee, Wendy Rae at Wendy.Rae@allens.com.au or Marcus Clark at Marcus.Clark@jws.com.au, if you would like to do so.

Yours faithfully

A handwritten signature in black ink, appearing to read 'P. Argy', with a long, sweeping flourish extending to the right.

Philip Argy
Chairman
Business Law Section