Law Council
OF AUSTRALIA

Business Law Section

31 May 2024

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

By email: FIConsultations@treasury.gov.au

Dear Sir/Madam

Exempting interfunding from mandatory foreign investment notification

1. This submission concerns the Exposure Draft "Foreign Acquisitions and Takeovers Amendment (Interfunding Exemption) Regulations 2024" dated 2 April 2024 (**Draft Regulation**). The submission is made by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia (**Committee**).

2. The proposed Draft Regulation inserts new section 40A into the *Foreign Acquisitions and Takeovers Regulation 2015* (**Principal Regulations**).

3. Life Funds utilising interfunding may not be adequately covered by the proposed new section 40A. The application to Life Funds is presumably uncontroversial so the application should be expressly covered.

4. Life Funds utilising interfunding will not be covered by the proposed new section 40A as they do not utilise registered managed investment schemes or registered superannuation funds in their funding structure. As matter of policy, the application to Life Funds should be uncontroversial. However, as Life Funds are statutory funds for the benefit of owners of policies (and not trusts) we suggest this be done by way of an expansion to section 36 of the Principal Regulations, which already deals with Life Funds.

5. Interfunding can also involve transactions effected by (and in relation to the acquisition of interests in) unregistered managed investment schemes, corporate collective investment vehicles (**CCIVs**) and notified foreign passport funds, which should also be covered by the exemption. Current interfunding exemption certificates, including those for superannuation funds, cover such schemes. Without this exemption for unregistered managed investment schemes, CCIVs and notified foreign passport funds—i.e. without an expansion of sections 40A(2)(b) and

40A(2)(c)—the Draft Regulation will not actually achieve the policy objective of providing regulatory relief for interfunding structures. Fund managers will still need to engage in costly (and confusing) application processes to cover some aspects of their interfunding structures.

6. By way of consequential amendments, on the categories of the disclosure document that describe the 'ordinary course' operation of the acquiring fund:

   (a) section 40A(2)(e)(i) should be expanded to refer to registered schemes, CCIVs and notified foreign passport funds; and

   (b) section 40A(2)(e)(ii) can be expanded to refer to the governing rules of a registerable superannuation entity or a product disclosure statement issued in connection with the registerable superannuation entity.

7. Section 40A(2)(f) sets out a condition of the exemption that cannot be met due to the use of the defined term 'subsidiary'. Paragraph (f) refers to REs and RSE licensees being targets rather than the registered schemes and registrable superannuation entities themselves being the targets (this could be clarified at section 40A(2)(d)). However, even if this issue were addressed at paragraph (f), there remains an issue with the balance of paragraph (f) when using 'subsidiary':

   (a) an RE or RSE licensee (when acting in that capacity) will not have any subsidiaries (as section 21(2)(a) *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**) disregards interests held in a fiduciary capacity when considering the concept of a 'subsidiary');

   (b) an RE or RSE licensee (when acting in that capacity) will not be a subsidiary of a foreign person seeking to invest in it because the foreign person must be an RE or RSE licensee (acting in that capacity); and

   (c) the acquirer and target would not be subsidiaries of each other under the FATA as defined due to the RE and RSE licensee acting in a fiduciary capacity.

8. Rather, the entities in an interfunding structure (typically unit trusts) would have a responsible entity or trustee that is the RE, RSE or a subsidiary of the RE or RSE. The unitholders of that unit trust would then be another RE, RSE or subsidiary of the RE or RSE acting as responsible entity or trustee of another entity (again, typically a unit trust). From the interfunding exemption certificates that have been issued, a clearer approach may be to exempt the acquisitions of securities in entities (typically units in unit trusts) where:

   (a) the acquirer is the RE, RSE or a subsidiary of the RE or RSE; and

   (b) the responsible entity or trustee of the target fund is also the RE, RSE or a subsidiary of the RE or RSE.

9. Section 40A(3) describes the 'passively held' test. Under section 40A(3)(a)(iii), one of the qualifications to being a 'passive' fund is that an individual member is not able to influence any individual investment decisions, or the management of any individual investments, of the person operating the scheme or entity. Some managed investment and superannuation fund products may allow the member to select (via a product menu) the investments they wish to hold in their account. The 'influence' test may be unintentionally broad and uncertain to apply and not achieve the policy objective of providing regulatory relief for interfunding structures for such

products. A more appropriate test may be to focus on whether or not members have day-to-day control over the operation of the relevant scheme or entity i.e. analogous to limb (a)(iii) of the definition of "management investment scheme" in the Corporations Act.

Recommendation:

Expressly cover Life Funds utilising the definitions and structure already available in section 36 of the Principal Regulations.

Expressly include unregistered managed investment schemes, CCIVs and notified foreign passport funds.

Remove 'subsidiary' as used in section 40A(2)(f) and replace it with a description of the acquisition that more closely reflects existing interfunding exemption certificates.

Modify section 40A(3)(a)(iii) to focus on whether members have day-to-day control over the operation of the relevant scheme or entity (and remove the influence test).

10. The proposed regulations also insert new subsection 58GA into Subdivision C of Division 2 of Part 5B of the FATA to provide register notice obligations for interfunding transactions covered by the new section 40A.

11. Subsection 58GA(1) provides that, if a foreign person takes an action that is an interfunding transaction covered by regulation 40A and is therefore exempt from being a notifiable or significant action under the Act, the foreign person must give a register notice to the Registrar.

12. Requiring registration of what can amount to many inconsequential and daily transactions defeats the purpose of the exemption.

13. Ultimately these transactions are in respect of Australian beneficiaries / members' interests; requiring registration does not provide any additional foreign holding information to the Government, and only serves to add to the cost burden on Australian members and to the Government in respect of its administration of the Register of Foreign Ownership of Australian Assets (**Register**).

14. Consequently, the exemption should be a complete exemption from the reporting obligations and not just from the action provisions.

15. The exemption should logically sit in Division 3 of Part 3 of the Principal Regulations (Exemptions for certain actions) where the excluded provisions do not apply.

16. As Treasury would be aware, there is already confusion about sections 41 and 41A of the Principal Regulations regarding the operation of the Register provisions, for which the proposed Draft Regulation provides a tidy up. However, adding section 40A without a Register exclusion will simply preserve the confusion (particularly as there is then an interpretive difference).

17. Further, once the acquirer's interest in the relevant target is registered on the Register, any percentage increase to its holding needs to be updated on an ongoing basis, not just changes that reach the 5 per cent threshold or that are otherwise material. This is because each acquisition above the relevant percentage threshold is an action relying on the proposed Draft Regulation 40A exemption and is therefore captured by section 58GA(1)(a).

18. This is an inherent, but perhaps little appreciated, complication across the board for all registration obligations, not just due to the interfunding exemption provisions. The impracticality of this is exacerbated in an interfunding situation because of the high volume involved. There would be a high level of non-compliance with this obligation and it (and the new issues from the proposed Draft Regulation 40A exemption) should be remediated now.

19. That continues the unnecessary burden of FIRB assessment on the interfunder, particularly where the transaction is only occurring within the matrix and potentially, as recognised by the EM, as part of activities that "generally consist of high-volume and low-value transactions, which can occur multiple times per day". Again, it is not clear what possible benefit there is to the Register to have this information recorded. Cost will still be incurred that will simply be borne by the Australian members/beneficiaries of the relevant scheme / superannuation fund.

20. In the alternative—although not as a preferred solution, but only if essential to remain within determined core policy settings—timing relief (e.g. annual update) or record keeping relief (e.g. the interfunder to retain specific internal records that must be submitted upon request by Treasury) should be provided.

Recommendation:

Eliminate the unnecessary stakeholder cost required to submit reporting of little or no screening value.

Include the exemption in Division 2 of the Principal Regulations.

21. The Draft Regulation also clarifies an outstanding anomaly identified in respect of the application of the pro rata rights issue exemption—as relevant to any actions undertaken in respect of any capital call by a relevant entity or its portfolio companies.

22. The identified anomaly relates to the (recently updated and clarified) "rights issue" / "maintaining same interest" exemption in section 41(2) of the Principal Regulations. The relevant exemption provides that certain provisions of FATA relating to mandatory notification requirements do not apply to an acquisition of an interest in securities in an entity (including securities in a land entity) under a rights issue or similar offering where the relevant acquirer's interest will not exceed its "allowable percentage". In the context of an acquisition of an interest in securities in an Australian land corporation, the legislation currently gives rise to a potential circumstance where no notification to FIRB is required and no approval from the Treasurer is required, but a notification on the Register under Part 7A of the FATA

(specifically section 130ZA) would be required as there would still be an acquisition of an interest in Australian land (being the acquisition of a share in an Australian land company) and section 130ZA does not make the requirement to notify subject to the acquirer having received a no-objection notification.

23. In effect, if the proposed Draft Regulation is made (including the noted clarifications to section 41(a) and section 41A(1) and new sections 58GA, 58KA and 58KB), any action taken in respect of a capital call in respect of any Australian company (whether this is an Australian land company or non-Australian land company) that is captured within the existing 'rights issue exemption' will be exempt from all mandatory notification requirements under the FATA and Regulations, including all requirements to lodge notifications on the Register under Part 7A of the FATA.

24. Most significantly, there remains an outstanding question as to the correct approach to compliance in respect of any actions taken in respect of capital calls from 1 July 2023 until the commencement of the Proposed Regulation. This is because the exposure draft of the Proposed Regulation does not currently contemplate retrospective application to any transactions that occurred prior to the commencement of the proposed Draft Regulation.

25. A similar issue arises in relation to section 41A of the Principal Regulations, which is particularly relevant to listed Australian entities. Our review of the 2023 annual reports of S&P/ASX 20 entities revealed that 19 out of 20 were foreign persons by virtue of shares held by foreign custodian corporations. When concerns were raised by Committee members about the application of Register notice obligations on affected companies with Australian Taxation Office and Treasury officials, the feedback we received was that the issue would be addressed. However, this will not be the case if proposed section 58KB does not have effect from 1 July 2023 as there will be a large and permanent category of actions that have occurred for almost a year that will remain subject to register notice obligations.

Recommendation:

Proposed sections 58KA and 58KB should have effect from 1 July 2023.

Other matters

26. We have assumed that the 'core policy settings' of the Regulations are determined. However, matters for subsequent reform—consistent with the stated ambition to simplify the framework to ensure that uncomplicated notifications are cleared on a timely basis—so that screening resources are best focused on matters where there may be a substantive question, include:

    (a) Expanding the ambit of section 36 of the Principal Regulations to cover all acquisitions and not just land (including tenements) and mining, production, or exploration entities.

    (b) A general review of matters for which notification to the Register is required, to eliminate totally the reporting for which there is not tangible regulatory

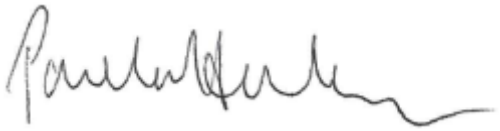
benefit. As one example (and a matter that could be easily addressed via the Draft Regulation), Australian citizens not ordinarily resident in Australia are exempted by section 35 of the Principal Regulations from the obligation to lodge register notices in respect of interests in Australian land, but are required to lodge register notices in respect of interests in exploration tenements and registerable water interests. Committee members struggle to explain the rationale for this to affected clients.

27. The Committee encourages Treasury to develop a comprehensive set of guidance notes to assist investors in the range of reporting requirements, and to take an educational approach to reporting.

Conclusion and further contact

The Committee would be pleased to discuss any aspects of this submission. Please contact the chair of the Committee, Wendy Rae, at Wendy.Rae@allens.com.au, or Bruce Macdonald at Bruce.Macdonald@ashurst.com, if you would like to do so.

Yours faithfully



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