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Investment Management Business in Australia

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Foreign investment managers and other financial service providers are increasingly looking to the opportunities provided by the significant pool of investable funds in the Australian market and to the possibilities that Australia provides as a gateway to the Asia-Pacific region. Australia has a sophisticated investment management regulatory regime and the purpose of this article is to highlight the regulatory alternatives open to foreign investment managers and hopefully assist such entities in choosing the option that is most appropriate to their needs.

This article commences with a discussion of the licensing requirements for investment managers and looks at the application of relevant exemptions. We then go on to look briefly at a number of other fundamental regulatory issues associated with doing investment management business in Australia.

1. Financial Services Licensing

1.1 The Australian Licensing Regime

The Australian Securities and Investments Commission (ASIC) is Australia's corporate, markets and financial services regulator and administers a licensing regime for "financial services" providers. An entity will be providing a financial service if it:

- provides financial product advice to clients.
- deals in a financial product;
- makes a market for a financial product (there is a separate licensing regime for operating a market in Australia);
- operates a registered scheme;
- provides a custodial or depository service; or
- provides traditional trustee company services.[1]

Under the Australian licensing regime, entities which provide financial services in Australia generally must hold an Australian Financial Services License (AFSL), which carries with it a range of conventional compliance, conduct and disclosure obligations.

Although providing financial services in Australia generally requires an AFSL, there are a number of exemptions and alternatives which may be applicable to foreign managers depending on the particular entity and the nature of the financial services it intends to provide.

1.2 Carrying on a Financial Services Business in Australia

As noted above the licensing regime applies to entities, including those domiciled outside Australia, that are "carrying on a financial services business in Australia."

Whether a foreign entity is carrying on a financial services business in Australia depends on a range of factual circumstances. An entity will be deemed to

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be carrying on a financial services business in Australia if it:

- has a place of business in Australia;
- establishes or uses a share transfer office or share registration office in Australia; or
- administers, manages or otherwise deals with property situated in Australia as an agent, legal personal representative or trustee.[2]

Outside of these deeming provisions, a number of other factors need to be examined to determine whether an entity is carrying on a financial services business including the following:

- Whether the financial services are provided to Australian investors with system, regularity, and continuity and involve a series or repetition of acts. A limited scope "one-off" transaction with one Australian customer may not be enough to constitute carrying on a financial services business.

  In this regard, the significance of the transaction(s) connected with Australia is however relevant. It is possible for a "one-off" transaction, if substantial enough, to constitute the carrying on of a financial services business in Australia. For instance a large active investment management mandate may have all the indicia of system, regularity, and continuity.

  However, a foreign entity will not be considered to be carrying on a business in Australia where it only provides a "one-off" service which is completed within 31 days (not being one of a number of similar transactions repeated from time to time).

  For example, a foreign entity seeking to issue interests in an offshore fund to a small number of Australian investors may not be considered to be carrying on a financial services business where it issues interests to all Australian investors on a single issue date, or on a series of dates which are within a 31 day period of each other.[3]
- Whether the activity is intended or likely to induce people in Australia to use the financial services provided.[4]

Accordingly, foreign entities that do any of the following are likely to be considered to be carrying on a financial services business:

- establishing, managing or acting as trustee of a collective investment vehicle in Australia, such as a managed fund, limited partnership, investment company, mortgage trust or property trust;
- operating, managing or acting as trustee of a collective investment vehicle outside Australia which systemically invites Australian clients to invest;
- entering individual investment mandates with Australian clients;
- offering securities to Australian investors even on a one-off basis if the number of investors who receive the offer is numerous;
- promoting and distributing collective investment vehicles or other financial products to Australian clients;
- giving Australian clients advice about securities, collective investment vehicles, government and corporate bonds, derivatives, foreign exchange, general insurance, life insurance, superannuation or other financial products; or
- trading in or having custody of financial products on behalf of Australian clients.[5]

1.3 Foreign Entities Carrying on a Business

Foreign entities that are considered to be carrying on a financial services business in Australia have a number of options available in respect of the licensing regime. These options include:

- relying on an exemption from the requirement to obtain a financial services license;
- entering into an agreement with an existing AFSL holder under which the foreign entity may provide financial services on behalf of the AFSL holder; or
- obtaining an AFSL.

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Each of these options is explored further below. Whichever option is chosen, a foreign company carrying on a financial services business in Australia will also be required to register with ASIC as a foreign company (this requirement is addressed below).

2. Licensing Options for Foreign Firms

2.1 Possible Exemption for Foreign Entities

Services Provided to Wholesale Clients

Foreign entities that provide financial services in Australia to wholesale customers can be exempted by ASIC from the obligation to hold an AFSL where ASIC is satisfied that the foreign entity is regulated by an overseas authority under a regime that is broadly equivalent to the Australian requirements.

There are two broad categories of relief available to foreign entities under this exemption. Class Order relief potentially is available in a range of circumstances discussed below while individual relief for a specific foreign entity may be available where Class Order relief is not appropriate.

The circumstances applicable to Class Order relief are as follows:

- Class Order relief may be available as of right to those entities which meet the eligibility criteria specified in a Class Order issued by ASIC. Such Class Orders are issued in a range of circumstances including where ASIC has received a number of similar applications or in response to an application through an industry association in respect of foreign entities which are regulated by the same overseas authority and offer particular financial services.[6]
- Where a foreign entity is seeking to rely on a Class Order exemption it will need to notify ASIC and provide supporting documentation demonstrating that the Class Order applies to it. ASIC will then assess the information and confirm whether the entity is eligible for the relief.[7]

There are, for example, two Class Orders that apply to US entities. Class Order [CO 03/1100] provides relief to certain US SEC regulated financial service providers. This Class Order applies to a foreign company, which is a body corporate incorporated, or a partnership formed, in the US or a state of the US and is:

- a registered broker dealer that is a member of the Securities Investor Protection Corporation established under the Securities Investor Protection Act of 1970 and that is a member of the Financial Industry Regulatory Authority (FINRA) and of which FINRA is the examining authority;
- a registered broker dealer that is an over-the-counter (OTC) derivatives dealer within the meaning of Rule 3b-12 promulgated under the Securities Exchange Act of 1934 and who is affiliated with a registered broker dealer who is a member of FINRA; or
- a registered investment adviser.[8]

Class Order [CO 03/1101] provides relief to US Federal Reserve and Office of the Comptroller of the Currency (OCC) regulated financial service providers. This Class Order applies to a body that is, other than for Edge corporations (see below), a body corporate incorporated, or a partnership formed, in the US or a state of the US and is:

- a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act or a subsidiary or such a company where all of the entity's activities are subject to a determination under particular sections of that Act;
- an entity which is the subject of a certificate of the OCC under section 27 of Title 12 of the United States Code, or a subsidiary of such an entity;
- a corporation established and approved as an Edge corporation under section 211(5) of

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Title 12 of the Code of Federal Regulations of the US, or a subsidiary of such a corporation.[9]

The eligibility criteria will be specified in the relevant Class Order or relief instrument and may vary. However, common criteria include that:

- the foreign entity is and remains authorized to provide the financial services under the regime in its home jurisdiction;
- the financial services are provided in Australia in a manner that complies with the requirements of the home jurisdiction;
- the foreign entity has executed a deed in which the entity agrees to submit to the jurisdiction of Australian courts;
- the foreign entity notifies ASIC of any changes to its regulated status in the US and any significant regulatory actions or investigations; and
- the foreign entity uses an appropriate disclaimer in materials presented to Australian clients notifying them that the entity is exempt from the requirement to hold an AFSL and is regulated by the SEC under US laws which differ from Australian laws.[10]

Any relief granted (either under Class Order or individual relief) will continue to apply only as long as the regime in the home jurisdiction remains sufficiently equivalent to the Australian regime.

Foreign entities relying on relief from ASIC must notify ASIC of the following:

- an intention to no longer rely on the relief (such as if the entity intends to apply for an AFSL or cease doing business in Australia); and
- significant investigation, enforcement or disciplinary action against the entity or a breach of the requirements of any Class Order being relied on.[11]

Each of the notification requirements has associated timeframes during which the event must be reported.

Services Provided to Retail Clients

As noted above, the exemption for foreign financial service providers subject to an equivalent regulatory regime is only available in respect of financial services provided to wholesale customers.

Accordingly, where a foreign entity wishes to provide services to retail investors, it will need to consider other options.

For instance a foreign entity wishing to establish and manage an investment fund in Australia which is to be offered to retail investors may still be able to rely on Class Order relief if an AFSL holder is appointed as the trustee of the fund and the foreign entity acts as the investment manager. In these circumstances, the AFSL holder is responsible for the obligations under the licensing regime in respect of the fund and its investors. As the investment manager's client will be the trustee of the fund, the investment manager will be providing services to the trustee only which is designated as a wholesale client.

In other circumstances, where the foreign entity wishes to provide services direct to retail customers, or where it is not subject to a regulatory regime for which ASIC has provided relief (for example if it is a Cayman regulated entity), it will need to consider either entering into an arrangement with an existing AFSL holder or obtaining an AFSL itself.

2.2 Arrangement with an Existing AFSL Holder

Where the above relief as a foreign regulated entity is not available, a foreign entity may enter into an arrangement with an existing AFSL holder.

Intermediary Authorization

A foreign entity which is a financial product issuer may rely on an exemption from the requirement to obtain an AFSL in circumstances where the entity enters into an arrangement with an AFSL holder under which:

- the AFSL holder agrees to make offers to potential customers to arrange for the entity

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to issue a financial product to the potential customers; and

- the entity issues the financial product to such customers.[12]

In making offers to arrange for a financial product to be issued to potential customers, the AFSL holder will be performing a financial service and must do so in a manner that is consistent with its obligations as an AFSL holder. However, the unlicensed entity will be regarded as the "issuer" of the financial product and will bear primary responsibility for all obligations to customers of the product. The foreign entity also will be carrying on a business in Australia in these circumstances and will be required to register with ASIC as a foreign company (which is discussed further below).

This exemption is commonly used by issuers of a financial product, such as interests in a wholesale managed fund, which are not subject to a regulatory regime for which ASIC has provided Class Order relief. It allows the trustee of a fund to solicit Australian investors through the AFSL holder intermediary, without the need to obtain an AFSL itself.

Authorized Representatives

Foreign entities wishing to provide financial services advice and dealing services pursuant to a conventional individual mandate with Australian customers may seek to be authorized by an AFSL holder to do so. The authorization must be in writing and may only authorize the foreign entity to provide services which are covered by the scope of the AFSL.

This arrangement would require the AFSL holder to perform certain oversight and supervisory functions in respect of the foreign entity's activities, which is sometimes not acceptable to foreign investment managers.

2.3 Obtaining an AFSL

Should the foreign entity not be eligible for the above relief or choose not to enter into an arrangement with an AFSL holder then if it is carrying on a financial services business it will need to apply to ASIC for an AFSL. As part of the application, the entity will need to demonstrate to ASIC's satisfaction that it has the necessary human, technical and financial resources to provide the services authorized under the AFSL.

In planning an application for an AFSL, careful consideration needs to be given to what financial services will be provided (which will inform the required authorizations) and whether these services will be provided to retail or wholesale customers. This pre-application scoping is extremely important in order to ensure that the only authorizations sought under the AFSL application are those that are actually needed. Applicants, which seek additional non-relevant authorizations, run the risk of adding significant complication to the process and the need to demonstrate to ASIC higher levels of human, technical and financial resources than is actually needed.

The application process can take anywhere between four to six months and involves providing ASIC with an application form together with extensive supporting documentation, which sets out amongst other things, the foreign entity's written policies and procedures designed to ensure compliance with an AFS licensee's regulatory obligations as discussed further below.

2.4 Obligations for All AFSL Holders

AFSL holders must comply with a sophisticated range of compliance, conduct and disclosure obligations. Foreign entities intending to provide financial services in Australia should consider the range of obligations associated with holding an AFSL compared with being a foreign regulated financial services provider subject to relief from ASIC or pursuant to one of the arrangements with an AFSL holder discussed above.

Some of the key obligations AFSL holders face include:

- conducting its business honestly, efficiently and fairly and having processes in place to demonstrate that this will be the case;
- having adequate arrangements in place to manage conflicts of interest;

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- complying with financial services laws and any AFSL conditions;
- maintaining sufficient financial resources and human resources;
- holding client money on trust for clients in a separate bank account and segregating client assets from their own assets;
- implementing an anti-money laundering program; and
- keeping records of its compliance with the regulatory regime and reporting any significant breaches to ASIC.[13]

Where an AFSL holder provides services to retail customers, significant additional obligations apply. In particular, entities providing financial services to retail clients will be subject to much more onerous disclosure obligations than when providing services to wholesale clients only.

For product issuers, this is comprised of both point of sale and ongoing disclosure requirements. Point of sale documents include product disclosure statements and financial services guides that are given to prospective investors and include certain prescribed information, such as details of the benefits, risks, fees, terms and conditions, and tax implications of investing in the product.

Ongoing disclosure also must be provided to retail investors where certain events occur, such as an increase in fees or other material changes to the investment. In addition, issuers of certain products are required to provide periodic reports to investors in respect of their investment.

Entities that provide financial product advice which considers a retail customer's personal circumstances must provide the client with a formal statement (Statement of Advice) detailing the advice. The Statement of Advice also must include certain other information prescribed by regulation.

In addition to the disclosure requirements, other obligations on an AFSL holder providing financial services to retail clients include:

- a requirement for registration of collective investment vehicles with ASIC and implement a range of safeguards to protect the interests of investors (this is discussed further below);
- establish internal and external dispute resolution procedures; and
- ensuring it has implemented adequate compensation arrangements, including holding adequate professional indemnity insurance.[14]

3. Specific Product Considerations

3.1 Collective Investment Vehicles

Collective investment vehicles offered to retail clients in Australia must generally be registered with ASIC. A range of prescribed obligations apply to a fund that is registered, many of which are designed to provide additional protection to investors in the fund.

The trustee of a registered fund must be a public company that holds an AFSL and the governing rules of the fund must be contained in a constitution that meets particular content requirements.

In addition, a registered fund must have a compliance plan which sets out the measures in place to ensure that in operating the fund, the trustee complies with the relevant law and the fund constitution. The compliance plan must be lodged with ASIC and ASIC may direct the trustee to provide additional information about the arrangements detailed in the plan. Any modification to or replacement of the compliance plan must also be lodged with ASIC.

3.2 Derivatives Trade Reporting

New reporting requirements with respect to over-the-counter derivatives trade reporting recently have been introduced in Australia (although the obligations have not yet commenced for a number of entities).

Under these new requirements, entities (including foreign entities captured by the regulations) will be required to report where they enter into a derivatives transaction. Foreign entities may be captured by this requirement where there is a sufficient connection

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to Australia, which may be the case where the entity is carrying on a financial services business in Australia.

While some aspects of the regulations have not yet been finalized (specifically, in relation to single side reporting of a transaction) foreign entities entering into derivatives transactions should be aware of the reporting requirements.

4. Foreign Company Registration

4.1 Foreign Companies Doing Business in Australia

A foreign company wishing to carry on a financial services business in Australia will be required to register with ASIC as a foreign company. In order to register, certain information must be provided to ASIC, including:

- a current certificate of registration (or similar) confirming registration in the home jurisdiction;
- a certified copy of the company's Constitution;
- a memorandum of appointment of a local agent or power of attorney in favour of a local agent (see below); and
- a memorandum stating the powers of certain directors.[15]

4.2 Appointing a Local Agent

Registered foreign companies must appoint a local agent who is a natural person or company that is resident in Australia.

The local agent is responsible for doing everything that the foreign company is required to do under the Australian Corporations Act 2001. The obligations of a local agent really are focussed on reporting and continuous disclosure obligations pursuant to the notification requirements where the foreign entity is relying on relief from ASIC from the obligation to obtain an AFSL.

A foreign company may have more than one local agent at the same time, but must have at least one.

4.3 Reporting to ASIC

For the period during which it remains a foreign registered company, a foreign entity will have obligations to report certain information to ASIC. This information includes annual reporting of financial statements and changes to any of the following:

- company name;
- registered office address and opening hours;
- directors;
- local agent; and
- cessation of business.

5. Taxation

5.1 Australian Taxation Regime

Australia's taxation regime is obviously relevant to the outcomes for foreign investment managers and their customers and while we are not providing a detailed analysis of Australian tax issues, the following observations concern some recent developments in the Australian tax treatment of foreign managed funds with an Australian connection.

5.2 Double Tax Treaties

Australian tax is generally levied on the worldwide income of its residents and on any Australian sourced income of non-residents. However, Australia has entered a number of double tax treaties which modify this position. Typically, an entity that is resident in a country with which Australia has a double tax treaty will only be subject to Australian tax with respect to income which is attributable to a "permanent establishment" in Australia. Detailed rules govern when income will be attributable to a permanent establishment.

5.3 Investment Manager Regime

In recent years, the Australian Government has introduced the Investment Manager Regime (IMR) to reduce uncertainty in respect of foreign funds' exposure to Australian tax when investing in Australia as this was considered to be an impediment to them doing so. The Australian Government is currently consulting

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on the final element of the IMR, having released draft legislation for consultation earlier this year.[16]

The proposed changes will address circumstances where certain foreign investors derive Australian sourced income on revenue account. There are two broad exemptions being suggested:

- An exemption which applies where a foreign investor invests directly without engaging a local manager and the foreign investor meets certain widely held tests and other criteria.
- An exemption which applies where the investment is made on the foreign investor's behalf by an independent Australian fund manager and certain other criteria are satisfied.

Foreign funds looking to invest in Australia should be aware of the proposed changes in order to be in a position to take advantage of the tax concessions if eligible.

5.4 Foreign Account Tax Compliance Act (FATCA)

The US Government enacted the Foreign Account Tax Compliance Act (FATCA) in 2010.[17] FATCA will impose due diligence and reporting obligations on certain non-US financial institutions. Certain Australian entities (such as Australian superannuation funds) are likely to be exempt from FATCA. In addition, as with many other countries, Australia has entered into an agreement with the US to minimize the FATCA compliance costs for Australian entities.

6. Conclusion

Foreign entities intending to provide financial services in Australia or to Australian clients need to have an adequate understanding of the Australian regulatory regime and the regulatory options available prior to commencing a financial services business here.

Choosing the right regulatory option is a function of the financial products or services intended to be offered in Australia, the regulatory regime in the home jurisdiction of the foreign entity and the extent to which the foreign entity wishes to control the regulated functions (rather than conducting those functions on behalf of a locally regulated entity).

We obviously have not been able in this article to discuss all the implications associated with each of the more significant regulatory options available to foreign investment managers in Australia. We consider that the right choice for each foreign investment manager is a nuanced process which takes account of not only all the current circumstances, but also the projected circumstances for the manager's business in the Australian market.

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NOTES

1 Section 766A of the Corporations Act 2001 (Cth).

2 Sections 21 and 761C of the Corporations Act 2001 (Cth).

3 Paragraphs 47-50 of *Regulatory Guide 121* "Doing Financial Services Business in Australia," Australian Securities and Investments Commission, July 2013.

4 Section 911D of the Corporations Act 2001 (Cth).

5 Regulatory Guide 121 "Doing Financial Services Business in Australia," Australian Securities and Investments Commission, July 2013.

6 Paragraphs 50-53 of Regulatory Guide 176 "Foreign Financial Services Providers." Australian Securities and Investments Commission, June 2012.

7 Paragraphs 56-69 of Regulatory Guide 176 "Foreign Financial Services Providers," Australian Securities and Investments Commission, June 2012.

8 Class Order 03/1100, Australian Securities and Investments Commission.

9 Class Order 03/1101, Australian Securities and Investments Commission.

10 *See, e.g.,* Class Order 03/1100, Australian Securities and Investments Commission.

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[11] *See, e.g.,* Class Order 03/1100, Australian Securities and Investments Commission.

[12] Section 911A(2)(b) of the Corporations Act 2001 (Cth).

[13] Section 912A of the Corporations Act 2001 (Cth) and Regulatory Guide 104 "Licensing: Meeting the general obligations," Australian Securities and Investments Commission, July 2015.

[14] Section 912A and Chapter 5C of the Corporations Act 2001 (Cth).

[15] Information Sheet 32 "Foreign Companies," Australian Securities and Investments Commission, April 2012.

[16] "Implementing Element 3 of the Investment Manager Regime," Department of Treasury, Australian Government, March 12, 2015, *http://treasury.gov.au/ConsultationsandReviews/Consultations/2015/Implementing-Element-3-of-the-Investment-Manager-Regime.*

[17] Foreign Account Tax Compliance Act of 2009 (H.R. 3933).

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