



Australian Private Equity & Venture Capital Association Limited

3 August 2018

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

Email: policy.submissions@asic.gov.au

Dear Mr Worsley,

ASIC Consultation Paper 301: Foreign financial services providers

Thank you for providing the Australian Private Equity and Venture Capital Association Limited (AVCAL) with the opportunity to comment on the Australian Securities and Investments Commission's Consultation Paper 301 (the paper) regarding foreign financial service providers (FFSPs), released on 1 June 2018.

AVCAL is a national association which represents the private equity (PE) and venture capital (VC) industry. AVCAL's members comprise most of the active PE and VC firms in Australia, who together manage around \$30 billion on behalf of Australian and offshore superannuation and pension funds, sovereign wealth funds, family offices, and other investors. Amongst AVCAL's members are the key institutional investors in the asset class, including Australian superannuation funds.

We are concerned that the proposal in the paper of a licensing regime for overseas providers of financial services will deter them from offering their products and services to Australian wholesale investors such as domestic superannuation funds, thereby limiting the scope of investment opportunities for superannuation funds to the detriment of super fund members. In particular, we believe that the proposed changes will deter offshore alternative asset managers, such as PE and VC funds, from seeking the capital commitments of Australian superannuation funds. This is likely to restrict the ability of super funds to deploy capital overseas, and could have an impact on the returns that these funds generate for their members. Our views are detailed below.

1. Australia's growing superannuation assets

Australia has accumulated the fourth largest pool of retirement savings in the world.¹ In the last 20 years, the superannuation system has seen the highest growth in assets out of all other developed markets, at 12.1% per annum.² This high pace of growth must be accompanied by policy settings that enable superannuation funds to invest in a range of asset classes and geographies.

¹ *Global pension assets study 2018*, Willis Towers Watson

² *Ibid.*

A report issued in May 2014 by Rice Warner,³ commissioned by the Actuaries Institute for the Financial System Inquiry, stated: “As the [super] industry grows it is possible that allocations to overseas investments may be driven higher due to reduced capacity in the Australian market for funds to invest the assets.”

Undoubtedly, this need for super funds to allocate capital to overseas investment is even more likely now given the substantial growth in super assets since 2014.

Australia recorded the second-highest pension asset-to-GDP ratio in the world in 2017, at 138%.⁴ This was far higher than that of the UK (121%), Canada (108%), Japan (63%), and South Korea (47%). The sheer size and significant role that super funds play within Australia’s financial system raises the question of whether domestic capital markets across all asset classes are able to absorb the ever-increasing levels of super fund savings, both over the near- and long-term.

By way of example, exposure to the Australian listed equities market has been a key investment strategy for Australian-based superannuation funds. It is estimated that super funds own close to half of all shares on issue in the domestic listed market.⁵

2. Comments on ASIC CP 301

As the growth of super assets continues to outpace Australian GDP growth year-on-year, the opportunity set for super funds to invest and allocate assets should be expanding. Instead, the proposed changes outlined in the paper regarding foreign financial service providers would likely result in a shrinking of that opportunity set, in our view.

Offshore fund managers, including those managing PE and VC funds, normally rely on both types of relief provisions that are currently available. The ‘limited connection’ relief is relied on for the fund (most often a limited partnership) entity, and the ‘sufficient equivalence’ relief is used by the fund manager or general partner (GP) entity, as these fund managers are usually headquartered in countries such as the US or the UK and hence are subject to regulation by the Securities and Exchange Commission (in the US) or the Financial Conduct Authority (in the UK).

AVCAL believes that repealing the sufficient equivalence relief and the limited connection relief – and substituting the relief provisions with a licensing regime similar to that of AFSL holders – will likely discourage offshore fund managers from taking on super funds as investors.

The ‘limited connection’ relief is especially important in ensuring that conduct that may be deemed as ‘inducing’ an Australian client to use the products or services of the FFSP (which is standard industry practice globally in how an FFSP and a wholesale client establish a relationship) is carved out from requirements to obtain an AFSL.

We believe that offshore fund managers that operate in a niche part of their respective market (for example, small or mid-market specialist PE funds, or US-based tech VC funds), that may not have large legal or compliance teams at their disposal, would be unwilling to take on the compliance and regulatory burdens presented by having to apply for, and comply with, a set of onerous regulations such as what is proposed. It will often be the case that these specialist fund managers will only have one or two Australian wholesale investors in their fund, and therefore they

³ *Ageing and Capital Flows*, Rice Warner, May 2014

⁴ *Global pension assets study 2018*, Willis Towers Watson

⁵ Credit Suisse research, as cited at: <https://www.businessinsider.com.au/australian-super-funds-now-own-almost-half-of-the-australian-stock-market-2018-3>

will have reservations about dedicating time and resources to accommodating extensive compliance obligations associated with one or two investors only.

If the fund manager does decide to accommodate the Australian investor and apply for and comply with the proposed licensing arrangements, it may be the case that any associated compliance costs will be passed on to that investor. At a time when super funds in particular are facing fee and cost pressures (including through regulations such as ASIC RG 97), we believe it would be highly detrimental to fund members if more potential sources of fee and cost increases for domestic super funds are created.

Meanwhile, larger global fund managers – with enough resources to comply with multiple regulatory and licensing regimes – would often already have a presence in Australia and be operating under an AFSL.

Looking to other asset classes, Australia often lacks the depth or sophistication that wholesale investors would need in certain aspects of a truly diversified portfolio. For example, the ASX is heavily skewed towards the financial and resources sectors but is limited in the number and scale of listed tech companies. As another example, domestic investors have traditionally had to look overseas to access developed high-yield credit markets. While it may be possible for investments to be made directly into those asset classes offshore, a more prudent approach may require engaging the services of a wholesale fund manager to gain exposure to a particular asset class for the fund.

Sophisticated institutional investors in Australia already operate under a number of statutory and regulatory frameworks. Most large super funds operate under regulations issued by ASIC and the APRA, with strict guidelines that govern what kind of oversight and governance mechanisms are implemented, including oversight of where and how capital is invested by the fund. Adding further regulatory burdens diminishes their ability to deploy capital efficiently and cost-effectively.

Ultimately, ASIC's proposed change creates a regulatory burden that makes it more difficult for a domestic wholesale investor to invest in a wide variety of offshore funds and markets, potentially diluting the expected returns of Australia's large institutional investors such as super funds.

3. About AVCAL and Australia's private equity and venture capital industry

AVCAL represents the PE and VC industry in Australia, which has a combined total of around \$30 billion in funds under management on behalf of domestic and overseas investors including Australian and offshore superannuation and pension funds, sovereign wealth funds, and family offices. VC and PE firms invest billions of dollars in early stage and established businesses spanning across almost every sector of our national economy. In the financial year ending 30 June 2017 alone, PE and VC invested around \$3.6 billion into Australian businesses.

An April 2018 study by Deloitte Access Economics provides some deeper insights into the economic contribution of PE including:

- In FY2016, private-equity backed businesses contributed \$43 billion in total value added to the Australian economy – equal to 2.6% of Australian GDP;
- PE-backed businesses supported 327,000 FTE jobs (172,000 directly, and 155,000 indirectly);
- In FY2016, private equity-backed businesses added almost 20,000 FTE jobs, accounting for 11% of total Australian employment growth in FY2016;
- PE-backed businesses typically delivered annual revenue growth of 20%, while boosting the size of their workforce by 24%;
- More than 85% of private-equity businesses introduced some type of process or product innovation in FY2016, far greater than the average profile of non-PE backed businesses.

4. Next steps

We would like to thank you for the opportunity to make a submission to ASIC in response to the paper. Please do not hesitate to contact either me or Kosta Sinelnikov, Policy & Research Manager, on 02 8243 7000, if you would like to discuss any aspect of this submission further.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Yasser El-Ansary', written over a horizontal line.

Yasser El-Ansary
Chief Executive, AVCAL