17 February 2021

The Director, Skills and Innovation Policy Section
Migration Planning and Visa Policy Branch
Department of Home Affairs

Via email: ICAP@homeaffairs.gov.au

Re: Discussion Paper on the Complying Investment Framework (CIF) for the Business Innovation and Investment Program (BIIP)

Dear Director,

The Financial Services Council (FSC) thanks Department of Home Affairs for the opportunity to provide a submission on the Complying Investment Framework for the Business Innovation and Investment Program.

The FSC commends the government for its commitment to the Business Innovation and Investment Program and the Significant Investor Visa. In particular, we commend the government for its decision to double visas under the BIIP to 13 500 places, and to devote more resources to the processing of visa applications under the program. Quicker processing of applications will help deliver greater capital inflow needed for Australia's economic recovery.

Member feedback received indicates that the SIV program has led to greater investment from high value overseas investors wanting to come to Australia. Since the program began, over $11.7 billion has been invested into Australia. This investment has helped local companies like Mort & Co in Toowoomba, an independent cattle feedlot business that has been enabled to expand and grow jobs in regional NSW and QLD.

The FSC is strongly supportive of the continuation of the scheme and any measures that will strengthen its integrity. In this context we encourage the Government to take a cautious approach to changes that would deter applicants as, whilst industry feedback varies on various design features, the underlying policy objective of maximising capital inflows into the Australian economy should continue to be the priority. Strong capital inflows will support domestic economic growth as Australia continues to emerge from the COVID-19 induced downturn and capitalise on our relative strong performance compared to the rest of the world in managing the health impacts of COVID-19.

About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the

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capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

Our members include funds that comply with the Significant Investor Visa and the Investor Visa.

FSC response to the Discussion Paper

1. Should the ratios currently applied by the CIF to the Significant Investor visa remain?

It should be noted that there was no consensus view from FSC members as to the appropriate ratio for the current CIF. Members agreed that the SIV needs to be globally competitive for foreign investors whilst balancing the need for the Australian Government to achieve their policy intent in getting the best possible deal for Australia.

There was generally acceptance that investment into VCPE will direct capital into small and medium (SME) Australian businesses and help Australia's post-COVID economic recovery through jobs growth, business expansion, commercialisation of Australian ideas and R&D, and expansion to foreign markets.

Members did raise concerns that investors are often concerned about the risk associated with a mandated VCPE component. Home Affairs data shows that the number of SIV applications and grants have halved since the start of the tighter rules in 2015. We submit there is a risk that increasing the VCPE component will dampen applications and capital inflow, which would be contrary to Australia's interests.

The FSC submits that maintaining the status quo is preferable to raising the VCPE component as the market has adjusted to this current arrangement and a higher VCPE component may disincentivise potential investors.

2. How should the CIF be applied to the Investor Visa?

Members of the FSC welcome the decision of the Government to direct investment under the Investor Visa (IV) into managed funds as opposed to state government bonds. As with the CIF for the SIV, among FSC members there is no single consensus as to how the CIF should be applied to the investor visa.

It was considered that there were benefits of mirroring the final CIF for the SIV so that both visa subclasses were consistent which would be simple and easy to understand for applicants. It would also reduce the cost and complexity of administering and monitoring the CIF for both programs. The current CIF is well known and understood by most in the migration and funds industry.

3. Changes to the types of funds eligible to offer complying investments

a. Should all eligible funds be limited to ASIC registered funds only?

FSC members do not generally support limiting funds to those that are ASIC registered (and typically retail) funds only, as this would limit market competition. This is because SIV funds typically target high net worth individuals who are eligible to invest in wholesale funds. The majority of SIV funds are not registered with ASIC, and therefore a requirement to register with ASIC would create an immediate barrier to entry into the market due to the costs and timeframe for registration. Alternative oversight measures such as annual audits for SIV funds would be preferable.

b. Should the threshold of funds under management be increased to further improve the integrity and function of the CIF?

i. If so, what amount should the threshold be increased to and what is the evidence supporting your proposed threshold

FSC members include a range of funds under management. We submit the threshold should not be so high as to unduly exclude competition.

The current threshold could be extended to the fund manager as well as the trustee or responsible entity in order to avoid a 'trustee for hire' being appointed by a 'start-up' fund manager or sole operator to circumvent threshold requirements.

There was also support for ensuring that the trustee or manager of an SIV fund be 'of substance', to avoid the situation where a trustee can be hired to circumvent the regulations and in the event of fraud there is no entity for investors to pursue (this was seen most recently in the case of the iProsperity scandal). This could be achieved for example by requiring minimum net assets.

The fund manager of the SIV compliant investment fund should always be independent of the SIV applicant, and of sufficient scale.

4. What are your views on the following options to address potential integrity concerns, provide greater clarity in the CIF and to ensure the benefits to the Australian economy are realised?

Possible amendments to the Complying Investments Instrument (IMMI 15/100)

a. Provide a clear definition of Fund of Funds (FoF). Currently FoFs is referred to in the general requirements of the instrument but is not defined. This is open to interpretation and potential misuse.

- Fund of funds could be defined as:
  - i. A 'fund of funds' is generally a managed investment fund that invests in other funds.
  - ii. an investor is permitted to invest in managed investment funds through a fund of funds or investor directed portfolio service provided the managed investment fund(s) in which the a fund of funds or investor directed portfolio service invests comply with the other requirements of the complying investment framework.
  - iii. the fund of fund structure cannot be solely vertically integrated.
- Would this definition be clearer and mitigate potential risks?

Members agree with the definition in i) and ii) as this is well understood by stakeholders. Currently, any sub fund of a fund of funds must be disclosed on the form 1413D and the investment manager must warrant that the sub fund is a complying investment.

There was no industry consensus around the language in (iii) and the policy intent behind this provision was not understood. It should be noted that funds of funds allow more diversified exposure and lower volatility, whether the underlying funds are run by one manager or a range of managers.

b. Can the 12 month option for Venture Capital funds investments be removed or reduced as the market is now more mature? (section 8(2) of IMMI 15/100)

Whilst there was some divergence on whether or not to remove the 12 month option for people to invest in VCPE, most members support removing the 12 month period due to the size and number of SIV funds now involved in the VCPE space.

c. Under the Balancing Investment component should investments be limited to bonds or notes issued by a company that is quoted on the Australian securities exchange?

- This could include removing items (ii) and (iii) from the following (section 10(3)(b) of IMMI 15/100):

  i. a company that is quoted on an Australian securities exchange

  ii. a wholly-owned subsidiary of a company mentioned in subparagraph (i), if the subsidiary is incorporated in Australia; or

  iii. a company incorporated in Australia, or a registered foreign company, if the bonds or notes are rated as investment grade by a credit rating agency that holds an Australian financial services licence;

Members do not see any integrity concerns from the purchase of bonds under section 10(3)(b). We submit therefore that no change is necessary.

It should be noted that the majority of bonds issued by ASX listed companies are issued via wholly owned subsidiaries. This is a long standing market convention. Investment in these bonds should be allowed. Limiting investments in subsidiaries would significantly reduce the number of companies that complying bond funds would invest in with SIV capital, as well as increase investment risk due to lack of diversification. We recommend retaining the ability to invest in bonds or notes issued by subsidiaries of ASX listed companies or investment grade bonds issued by Australian companies.

The Government could consider removing bonds or notes by foreign companies as an investment option to maximise the benefits to Australia and ensure that SIV money is invested in Australian companies to ensure the best possible deal for Australia.

d. Ensure the emerging companies investment is made into securities that properly meet the market capitalisation requirements for the emerging companies component of the CIF.

- This could include adding item (iii) to the following (section 9(5) of IMMI 15/100): The

  investment must not be made in:

  i. securities issued or proposed to be issued by a government; or

  ii. debentures; or

  iii. securities that otherwise meet the requirements under this section but where the issuer of those securities invests the proceeds of the issue of those securities in securities that do not meet the market capitalisation requirements under subsection six.

Members support the intention behind these changes to prevent investment into securities which do not invest in underlying emerging companies. The Government should consider the use of Exchange Traded Funds (ETFs) which can be used to circumvent the SIV regulations, as these securities are listed and generally have a market cap of less than $500 million, but investment in them does not necessarily result in direct investment into emerging companies.

We submit that iii) should be drafted carefully so that investment can be made directly in a compliant company that decides in term to invest the share sale proceeds into bonds of large cap listed ASX companies to earn interest on these funds for a period of time.

e. Clarify the use of derivatives for risk management and ensure hedging is only used to manage currency and interest rate movements and not used to guarantee investment value.

- Specify that complying investments may only be made in a derivative if the investment is not designed to substantially reduce or completely eliminate the exposure of an investor to the risk of loss from changes in the market price of an investment. Furthermore, allow hedging of currency and interest rate risks, however capital guarantee products should no longer be considered as complying investments.
- To achieve this, section 11(9) in the current instrument (IMMI 15/100) could be amended to the following:

Derivatives

i. An investment may be made in a derivative, other than an option mentioned in paragraph (e) of the definition of securities in section 4, only if:

a. the investment is made for risk management purposes; and

b. the investment is not a speculative investment; and

c. the investment is not designed to materially reduce or completely eliminate the exposure of an investor to the risk of loss from changes in the market price of an emerging companies investment.

Note: Hedging of currency and interest rate risks will be permitted under subsection (9), however capital guarantee products will be prohibited.

Members agree that the use of derivatives for capital protection is contrary to the intent of the scheme in incentivising the provision of risk capital. The use of such derivatives in this context cannot be said to be for 'risk management purposes' as specified in the current regulations. The current CIF wording which permits the use of derivatives for "risk management purposes" is not clear enough and is open to exploitation. Complex derivatives have been used by SIV funds to offer 'capital guarantees', particularly to meet the emerging companies component. This undermines the integrity of the SIV regime. As a consequence, money invested becomes passive and investment is not made into the intended underlying emerging companies. The use of derivatives for capital protection should be excluded.

We agree with the proposed wording. We submit that derivatives should be allowed for general risk management of interest rates and currency only as proposed.

f. Clarify that venture capital investments (in addition to emerging and balancing investments) may be made through a fund of fund structure.

- "Venture capital fund" could be added to the following (section 11(11) of IMMI 15/100):

> Managed investment fund and venture capital fund investment —fund of funds or investor directed portfolio services
>
> - An investment in a managed investment fund or venture capital fund may be:
>
> a. made through a fund of funds or an investor directed portfolio service, if the investment is otherwise in accordance with the requirements of this Part; and
>
> b. held in cash in the fund of funds, or investor directed portfolio service:
>
> (i) for a period of up to 30 days after the time the funds are first made available for investment; and
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> (ii) during any switching period mentioned in subregulation 5.19C(7) of the Regulations.

FSC members agree with this proposal.

5. Should fund managers be required to provide annual independent audit reports to show their compliance with the CIF legislative instrument?

There was broad agreement amongst our members that it was critical for the ongoing success of the SIV program that the integrity of SIV funds and fund managers was not in question. Recent high profile scandals such as the case of iProsperity (IPG) have damaged the reputation of the SIV program and the Australian funds management industry.

FSC members broadly agree with the intent of the proposal. It could increase confidence from stakeholders that their capital has been invested in compliance with the SIV requirements.

However, the Government should consider how this can be practically implemented. For instance, who would be appointed as the auditor and how will audit outcomes be administered under this program? Any auditor would also need to possess requisite levels of knowledge to be able to perform an audit effectively.

A requirement for annual independent audits may increase the cost of providing SIV investment services and could impact the market of managers offering SIV compliant investments, but this should not override integrity considerations.

If you wish to follow up on this submission or have any questions, please contact Chaneg Torres, Policy Manager at ctorres@fsc.org.au.

Yours sincerely,

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