CHAPTER 7

Issues affecting Australia as an international financial centre

Introduction

7.1 Corporations regulation 7.6.10(n) provides for a licensing exemption to offshore providers of financial services under specified conditions. The regulation has attracted criticism from a number of submitters on the basis that the restriction of the exemption to 'dealing' only is neither workable nor appropriate.

7.2 With regard to the second issue, concerns have been raised about how ASIC will exercise its discretion to approve overseas regulatory authorities under paragraph 911A(2)(h) of the *Corporations Act 2001* (the Act).

Exemption from licensing—offshore service providers

7.3 Section 911A of the Act provides that a person who carries on a financial services business in the jurisdiction covered by the Act must hold an Australian financial services licence. Exemptions from the licensing requirement may be specified in the regulations.

7.4 Regulation 7.6.01(n) provides a licensing exemption for persons outside the jurisdiction covered by the Act ('offshore providers') who 'deal' in financial products under certain circumstances. Specifically, the regulation states that offshore providers will not have to be licensed to provide financial services consisting of dealing in a financial product to a person within the Act's jurisdiction on condition that the service is arranged by a licensee whose licence covers the particular service provided.

7.5 Offshore providers wishing to provide financial services other than dealing will be required to obtain a financial services licence.

7.6 The International Banks and Securities Association of Australia (IBSA), Goldman Sachs Australia Pty Ltd (Goldman Sachs), Morgan Stanley Dean Witter Australia Securities Limited and Morgan Stanley Dean Witter Australia Limited (Morgan Stanley) raised concerns about regulation 7.6.01(n).[1]

7.7 The submitters said that they supported the original draft regulation released for consultation and noted that it applied to the provision of financial services generally and was not restricted merely to dealing. They also said it was similar to repealed subsection 93(5) of the Corporations Law and that this provision had worked well.

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1 Submissions 19, 26 and 30 respectively.

7.8 Their major concern was with the amendment of the regulation to restrict the licence exemption to dealing only. However, they were also critical of the consultation process for the regulation and claimed they were not given the opportunity to comment on the change, nor were they aware that such a change would be made.

7.9 IBSA commented that the Department of the Treasury was concerned that the regulation, as originally drafted, would provide a means for financial services providers to move offshore and avoid FSR regulation.

7.10 The submitters claimed that the narrowing of the regulation's coverage had resulted in difficulties of application. Goldman Sachs provided the following examples:

> …the activity of issuing OTC derivative products is 'dealing'. However, there is a point in the development of a successful business of dealing in OTC derivative products at which clients start to have an expectation that, should they call, they will be quoted a price. At that point, the activity may be 'market making' to which regulation 7.6.01(n), in its final form, does not apply. The point at which 'dealing' becomes sufficiently successful to be 'market making' is indistinct, which is problematic in relation to the operation of Regulation 7.6.01(n). A similar problem may also exist in relation to the indistinct point at which 'arranging' (which is categorised by the Act as 'dealing' and is therefore covered by Regulation 7.6.01(n)) becomes 'advising', which is not covered by Regulation 7.6.01(n).[2]

7.11 In the same vein, Morgan Stanley commented that:

> There appears to be no logical explanation for this limitation considering that advice and dealing services are often intertwined, and the difficulty in differentiating between dealing and market making activities. In addition, custodial services will often be provided as part of the suite of services to the client.[3]

7.12 More generally, IBSA claimed that the limitations in the regulation would adversely affect the delivery of financial services to the Australian market by offshore service providers. In this regard, IBSA said that:

> It is often found that those most familiar with local market conditions and regulatory requirements are qualified persons located in the jurisdiction in which the investment is undertaken.
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> In the event that correspondent offshore providers must be licensed in Australia, Australian investors may be disadvantaged, as these providers are unlikely to continue to offer their services. One reason for this is the unfavourable balance between the compliance cost of regulation for a global

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2 Submission 26, p. 2.

3 Submission 30, p. 6.

> bank and the benefit from servicing Australian clients, who as a group are relatively small in global business terms. This in part reflects the practical difficulty of having to comply with Australian regulation, as well as their home regulation given the scope and complexity of their overall business.[4]

The Committee's views

7.13 The Committee notes IBSA's comments about the Department of the Treasury's possible reasons for limiting the regulation to 'dealing', namely, that a more widely framed provision might prompt institutions to move their financial services businesses offshore and so avoid FSR regulation. Although IBSA has argued that the Australian-based licensee arranging the provision of the offshore services would still have to satisfy the requirements of FSR regulation, the Committee has concerns that retail consumers could be disadvantaged, particularly in the area of financial advisory services.

7.14 Notwithstanding the Committee's concerns, the Committee accepts that there may be practical difficulties in the application of regulation 7.6.01(1)(n) because of the potential for overlap between 'dealing' and 'market making' and 'arranging' and 'advising'.

Recommendation

The Committee consequently recommends that regulation 7.6.01(1)(n) be reviewed as soon as possible with the objective of resolving the difficulties involved in its practical application and so make it consistent with the regulatory objective of enhancing efficiency in the provision of financial products.

7.15 As far as widening the scope of the regulation is concerned, the Committee notes that subsection 93(5) of the repealed Corporations Law (on which the submitters suggested regulation 7.6.01(1)(n) should be modelled) only applied in the context of a securities business. It further notes that regulation 7.6.01(1)(n) provides for dealing in financial products which has a wider scope than the notion entailed in a securities business. The Committee consequently considers that, assuming the practical difficulties in the regulation are resolved, the regulation represents an acceptable regulatory compromise between the old and the new FSR regimes.

Cross-border financial services

7.16 Paragraph 911A(2)(h) of the Act provides that a person regulated by an overseas regulatory authority that is approved by ASIC in writing may provide those regulated financial services to wholesale clients without having to obtain an Australian financial services licence.

7.17 At the hearing on 11 July 2002, Dr David Lynch, Director of Policy at IBSA, said that ASIC had held a round-table meeting with industry in early June to discuss

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4 Submission 19, p. 3.

proposals raised in ASIC's consultation paper on cross-border financial services which had been released in May 2002. Dr Lynch referred to the following as the key issues that emerged at the meeting and were still awaiting resolution:

- who would ASIC recognise as an approved overseas regulator?
- what range of activities would ASIC recognise as being regulated?
- ASIC's timeliness in finalising its conclusions on the previous two issues.[5]

7.18 IBSA, Goldman Sachs and Morgan Stanley raised concerns that ASIC would adopt what they regarded as too narrow an approach in the assessment of overseas regulation with the emphasis being on identifying symmetries in regulatory approaches rather than looking at their substance.

7.19 On this point, Goldman Sachs said it raised issues with ASIC about its consultation paper that related to, among other things:

> …the potential imposition by ASIC of a requirement for overseas providers to disclose differences between the overseas regulatory regime and the Australian regime, which would entail a very substantive comparative analysis of two (probably sophisticated) legal systems.[6]

7.20 Also on this point, IBSA commented at the hearing that:

> One of the difficulties with looking at the detail of the law is that the regulatory system here is quite different to those in other jurisdictions, so you are not going to get symmetry or a mirror effect. I will give an example. The insider trading laws in Australia, as introduced through the act, cover all OTC transactions. That is typically not the case in most other jurisdictions. So if the expectation in looking at similar regulatory regimes was that you would have precisely the same outcomes, you would never get anybody to recognise that. There needs to be a pragmatic approach which looks at the substance of the regulation and, to some degree, the quality of the regulation as well as the specific design of it.[7]

7.21 Timeliness was another issue raised in the submissions. All argued that it was important for ASIC to progress its assessments of overseas regulators as soon as possible to enable financial services groups to complete their transition planning. It was suggested that it might be most efficient for ASIC to conduct its initial assessment on regulators from the major financial centres such as the United Kingdom, the United States, Japan, Hong Kong and Singapore.

7.22 Referring to these issues, Morgan Stanley commented that:

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5 *Committee Hansard,* 11 July 2002, p. 209.

6 Submission 26, p. 2.

7 *Committee Hansard*, 11 July 2002, p. 212.

> Whilst ASIC is encouraging financial service providers to transition early, groups such as Morgan Stanley are experiencing difficulties in completing their transition planning, even before beginning to transition to the new regime, until ASIC identifies which overseas regulators will be approved for the purposes of section 911A(2)(h). This is an even greater problem for suitably regulated foreign entities which do not have the benefit of the transition period for all or part of their business because they wish to either expand their activities or commence business in Australia.
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> Accordingly, regulators should be approved under the exemption as a matter of urgency. Morgan Stanley endorses (and contributed to) the IBSA recommendation of 10 May 2002 that ASIC initially focuses on the major global financial centres (e.g. the United Kingdom, the United States, Hong Kong, Singapore and Japan).
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> ASIC has previously stated that it will consider individual applications for ASIC to approve foreign regulators in respect of specific services. Morgan Stanley submits that a far more effective approach in light of the urgency of the matter would be for ASIC to approve at least some of the major foreign regulators, including the United States Securities and Exchange Commission and the United Kingdom Financial Services Authority.[8]

The Committee's views

7.23 ASIC has advised the Committee that it has not yet developed any definite policies for the regulation of cross-border financial services. However, it has indicated that the consultation paper discussed by the submitters was comprehensively circulated and discussed with all stakeholders and foreign regulators in Hong Kong, Singapore, New Zealand and the United Kingdom.

7.24 The Committee notes ASIC's advice that:

> …ASIC is currently in the process of taking all comments received into account before issuing a final document version of the 'Principles of cross-border regulation', sometime next month. The principles will be high-level and intended to guide ASIC's decision making and policy making processes before progressing to develop relevant and more specific policy on cross border situations.[9]

7.25 The Committee also notes that ASIC recently advised in its 'Frequently Asked Questions' segment on its website that it plans to release its final policy on overseas regulators as well as overseas regulated financial services providers generally in the second quarter of 2003, with policy proposal papers scheduled for release in the last quarter of this year.

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8 Submission 30, p. 2.

9 Letter dated 16 August 2002 to the Committee from Mr Andrew Larcos, Government Relations Adviser, ASIC.

7.26 The Committee draws some comfort from the fact that ASIC will consider applications for interim relief:

> We recognise that some financial service providers may not be able to take advantage of the two-year transition period; such as providers wishing to commence business in Australia for the first time after 11 March 2002 or established providers wishing to undertake new classes of activities after 11 March 2002. Further, we also recognise some established providers may wish to rely on some form of exemption for overseas financial service providers during the transition period.
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> Until our final policy is released we are prepared to give interim relief on a case-by-case basis to such financial service providers.[10]

7.27 However, the Committee is concerned that ASIC's timetable for formulation of its policy regarding overseas regulators may not be in keeping with industry's expectations or needs, notwithstanding the availability of interim relief.

Recommendation

The Committee urges ASIC to reconsider its timetable with a view to expediting its policy formulation for the regulation of cross-border financial services following the consultation process.

7.28 In terms of the actual content of ASIC's policy statement and the approach it adopts in assessing overseas regulators, the Committee is not persuaded on the evidence that the Committee's intervention at this early stage would be appropriate.

10 *Frequently Asked Questions*, ASIC website, www.asic.gov.au, 29 August 2002.