



Law Council
OF AUSTRALIA

Business Law Section

Executive Member
Foreign Investment Review Board
The Treasury
Langton Crescent
PARKES ACT 2600
Via email:

19 June 2014

Attention: Jonathan Rollings

Dear Sir or Madam,

Submission for a reform of Australia's foreign investment regime

We refer to the meeting between representatives of the Business Law Section of the Law Council of Australia (BLS) and your colleagues Jonathan Rollings, Paul Flanagan, Andrew Deitz and David Earl from the Foreign Investment Review Board at Treasury in Canberra on 1 May 2014 to discuss possible reform of Australia's foreign investment regime.

As discussed at that meeting, please find enclosed a submission from the BLS on possible amendments to Australia's foreign investment regime. The submission identifies a number of:

- "quick fixes" at section 1 and Schedule 1 which could be quickly and non-controversially introduced; and
- more substantive issues and broader root and branch review for further discussions.

We would be pleased to meet with you to discuss any aspect of our submission. If you have any queries concerning the submission please contact Malcolm Brennan or myself as follows:

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Yours faithfully,

John Keeves
Chairman, Business Law Section

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Amendments to Australia's Foreign Investment Regime

The Business Law Section of the Law Council of Australia (**BLS**) supports amendments to the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**), the associated regulations (**FATR**) and the Australian Government's Foreign Investment Policy (**Policy**). The BLS submits that it is timely to consider making non-controversial amendments in 2014 at the same time as any amendments concerning rural land.

Foreign investment is critical to Australia. Australia's success has been built on its access to foreign direct investment from a variety of capital rich countries over time. An ongoing welcoming attitude to foreign direct investment is critical for the development of Australian infrastructure and competitiveness over the next decades.

There have been concerns raised over the last few years about the transparency and clarity of Australia's foreign investment rules. Thresholds for foreign investment approvals have also been a key feature of the recent free trade agreements (**FTAs**) negotiated by Australia (and of the Australia/China FTA currently under discussion).

There is much that can be done to improve the perceived transparency of the process by updating it for current practices (many of which have moved on considerably since 1975), simplifying the language of the legislation and policy, removing inconsistencies and red tape and reducing processes which are currently conducted outside the legislation itself.

The BLS makes the following suggestions to achieve the objectives of effective regulation, minimising red tape and increasing transparency. Over the longer term, we would strongly support a broader root and branch modernisation of the foreign investment regulatory regime. We would be pleased to meet with you to discuss with you any aspect of our submissions below.

1 Some quick fixes could be easily introduced

BLS members have identified a number of areas where fixes to the regime could be quickly and non-controversially introduced. Those "quick fix" changes are identified in Schedule 1.

The BLS submits that these areas cause unnecessary cost and inefficiency to the operation of the regime that could be relatively easily corrected.

BLS Recommendations:

- include red tape amendments in the next amending bill; and
- allow for public consultation on red tape amendments.

2 Regulate investments by sovereign wealth funds (SWF) and state owned enterprises (SOE) more effectively to meet policy objectives

The BLS considers that the manner in which SWF and SOE investment is regulated is a pressing area for reform given how important investment by these types of investors has become.¹

The BLS understands public concern that the Australian Government should be aware of what foreign governments are doing in Australia and government policy concerns that there is a risk SWF and SOE investments might not be commercial in nature or could be undertaken in pursuit of political or strategic objectives that may be contrary to Australia's national interest.

¹ As at the end of 2013 it has been estimated that SWFs held assets of at least US\$6.2 trillion. Some of the largest commercial enterprises in the world are SOEs.

However, the BLS is concerned that the current regulation of SWF and SOE investments is not targeted to address these policy concerns. In addition, despite the large investment by SWFs and SOEs in Australia over recent years there is no evidence that these concerns are justified in respect of most SWFs and SOEs.

Under the Policy all foreign government investors must notify and get prior approval before making a direct investment in Australia, regardless of the value of the investment. However, a foreign government investor is defined broadly and simplistically to include entities in which governments, their agencies or related entities have an interest above a prescribed threshold (15% from a single country or 40% from more than one country).

Such a definition ignores significant differences in the types of entities that have a degree of government ownership.

The A\$0 threshold for direct investment by foreign government investors is also extremely low by international standards.² As such, even routine or immaterial activities are technically subject to formal review.³

The fact that other countries do not have such controls or have higher review thresholds suggests that the current approach imposes unnecessary costs for SWFs and SOEs undertaking foreign direct investment in Australia.

There is a significant difference between an investment by a foreign government or its instrumentalities and most investments by SWFs or SOEs. That difference should be recognised in Australia's regulatory regime.

Sovereign Wealth Funds (SWFs)

SWFs are a heterogeneous group and the influence of government is always present, as it is in SOEs. Nevertheless, SWFs may be more readily distinguishable from SOEs as special purpose funds or arrangements owned by the general government.⁴ They are commonly established from balance of payments surpluses, official foreign currency operations, the processes of privatisations, fiscal surpluses and/or receipts from commodity exports.

The influence of government ownership upon SWFs and their investment strategies may be less direct than it is for SOEs and more predictable. SWFs hold, manage or administer assets to achieve financial objectives and they employ a set of investment strategies that include investing in foreign financial assets.⁵ For these reasons, the International Working Group of SWFs has been able to establish 24 generally accepted principles and practice (**GAPP**) for SWFs (**the Santiago Principles**).⁶

More generally, SWFs have been perceived as valuable sources of long term institutional capital and as an important force for market stabilisation. For these reasons, a more express welcoming attitude to SWF foreign direct investment would benefit Australia's national interests having regard to the ongoing importance of SWFs in areas such as the development and operation of infrastructure.

Over the last decade significant supranational work has been undertaken to advance transparency and independence of SWFs through the development of the Santiago principles. Australia was at the forefront of those efforts. Australia's regulatory regime should recognise and encourage adherence to the Santiago principles.

² For example, in Canada, SOE investments are subject to a monetary threshold of a book value of assets of C\$354 million in 2014.

³ A good example would be the purchase of an Australian incorporated shelf company.

⁴ *Sovereign Wealth Funds: Generally Accepted Principles and Practices (the Santiago Principles)*, International Working Group of Sovereign Wealth Funds, 2008 at 3.

⁵ See note 4.

⁶ See note 4.

State Owned Enterprises (SOEs)

An SOE is a commercial enterprise where the state has significant control through full, majority or significant minority ownership.⁷ We are not aware of any evidence of SOEs pursuing investment activities for political purposes.

BLS members advising SWFs and SOEs have first-hand experience as to the significant cost and red tape compliance issues experienced by SWFs and SOEs in complying with the Australian regime. Further, BLS members have first hand experience with the delays and red tape issues experienced by Australian business in interacting with SOE's and SWF's in commercial dealings.

The BLS makes the following draft recommendations for change to the general regime. In addition, BLS members have experience of a further subset of technical issues that should be unobjectionable from a policy perspective. Those technical issues are dealt with in Schedule 2 to this submission.

BLS Draft Recommendations:

- distinguish foreign direct investment by governments and their instrumentalities from that of SWFs and SOEs;
- continue to apply existing policy to foreign direct investment by governments and their instrumentalities;
- establish a separate category for SWFs that adhere to the Santiago principles (**recognised SWF investors**);
- provide a mechanism for an SWF to be certified as a recognised SWF investor following an initial screening by FIRB of its governance structure and investment mandate. That certification may be general or for certain categories of investment that accord with the investment mandate of the SWF investor;
- apply the general review threshold to a recognised SWF investor;
- provide that a recognised SWF investor must provide annual reports to FIRB of their foreign direct investment activities in Australia and notify any changes relevant to its certification as a recognised SWF investor;
- establish a separate category for certain SOEs (**recognised SOE investors**);
- provide a mechanism for an SOE to be certified as a recognised SOE investor following an initial screening by FIRB of its governance structure and commercial objectives;
- apply an increased approval threshold to a recognised SOE investor to facilitate immaterial or ordinary course investment activities in Australia (say \$50 million); and
- provide that a recognised SOE investor must provide annual reports to FIRB of its foreign direct investment activities in Australia and notify any changes relevant to its certification as a recognised SOE investor.

⁷ Definition taken from *OECD Guidelines on the Corporate Governance of State Owned Enterprises*.

3 Streamline submission and review process to reduce red tape

The BLS is concerned that the current 30 day and 90 day review processes (plus 10 day notice periods) and gazetting of interim orders leads to the current practice of withdrawing and resubmitting applications when the 30 day time period cannot be achieved. This has resulted in unnecessary red tape and cost and leads to perceptions of a lack of transparency as a process outside the statutory framework.

The BLS is also concerned that in practice, no time frames surround decisions made under the Policy. The lack of time frames is not conducive to discipline around responsiveness on such applications, particularly where they relate to relatively routine matters.

According to ITS Global, the delay on all inwards foreign investment subjected to review represents a permanent and ongoing cost to the domestic economy, being the return foregone on the investment approved by the Government over the period of the delay. Based on 2006-07 data, ITS Global estimate the economic cost of the delayed investment is around \$4 billion a year.⁸

BLS Recommendations:

- remove or shorten the 10 days' notice periods for decisions made;
- remove the requirement to gazette interim orders if the applicant agrees to a confidential extension;
- provide the Treasurer the ability to issue an extension of up to 30 days in the rare instances more time is required; and
- apply the same statutory timeframe to reviews under the Policy.

4 Simplify the general thresholds for review

The BLS is concerned that there are too many thresholds for review, which levels are not proportionate to the level of sensitivity associated with the investments.

The current threshold for review of A\$248 million for general investments (A\$1,078 million for US, New Zealand (NZ) and (shortly) Korea and Japan) is low by international standards.⁹ As noted before, the A\$0 threshold for direct investment by SOEs is extremely low by international standards. The myriad of thresholds for real estate could also benefit from a review. By way of example, the threshold for interests in Australian urban land (which can cover mining projects) is effectively zero.

⁸ 'Foreign Direct Investment in Australia — The Increasing Cost of Regulation' (Report, ITS Global, 2008), 21. This estimate is based on inwards approved investment of \$156.4 billion in 2006-07 and an assumed weighted average delay of three months for each approval, weighted by the value of the proposed investment. The Social Opportunity Cost of the capital foregone by the delay is assumed to be 10 per cent a year. The cost of withdrawal is estimated to be at approximately \$1.5 billion a year.

⁹ For example, in Canada, the general threshold for a World Trade Organization (WTO) member is C\$354 million in 2014. Under the amendments to the Investment Canada Act as proposed in the Economic Action Plan 2013 Act (which will commence upon an order of the Governor in Council), this threshold is to be increased substantially to an enterprise value of C\$600 million, rising to C\$1 billion over four years. The general threshold in Canada for a non-WTO member is C\$5 million for direct investments and C\$50 million for indirect transactions.

The BLS considers that the appropriateness of the thresholds should be assessed against a risks and benefits framework based on policy concerns, so that only high risk investments are subject to review, but not otherwise. The great majority of transactions submitted for review are approved,¹⁰ suggesting that most of the transactions may be low risk.

BLS Recommendations:

- simplify the general review thresholds so there are fewer thresholds proportionate to the level of risks associated with the transactions;
- tie the general review thresholds to 50% of the thresholds under the FTAs; and
- ensure the proposed agriculture investment review thresholds are not disproportionate in light of the general review thresholds.

5 **Move to a broader root and branch modernisation of the foreign investment regulatory regime**

The BLS is concerned with the complexity of the FATA legislation and the foreign investment regulatory regime more generally. The regime is further complicated by the separate Policy. The complexity contributes to the concerns with transparency of the process. A simpler and more accessible presentation of the legislation and regulatory requirements would assist in promoting Australia as an investment destination to investors especially as many foreign investors may have English as a second language.

For example:

- the FATA has not been modernised for modern corporate finance concepts and practices. Any requirement for approval should apply equally to the form of the investment e.g. direct, trust, company, partnership, limited partnership etc;
- the Policy contains substantive regulation that is not contemplated by FATA (e.g. in relation to media or SOEs);
- changes to the Policy are not subject to public consultation;
- the FATA makes no reference to FIRB, its composition or its role;
- an expansion of the sanctions available for enforcement of the legislation; and
- review of the appropriateness of the “aggregate substantial interest” concept whereby a foreign person acquiring even a single share in a company which has greater than 40% foreign ownership may be potentially subject to divestiture if the acquisition is contrary to the national interest (even if the acquired stake is small enough as to not require prior notification and approval).

¹⁰ In 2012-13, a total of 13,322 applications for foreign investment approval were considered, with 12,731 approved, none rejected, 446 withdrawn and 145 exempt as not subject to the Policy or the Act: Foreign Investment Review Board Annual Report 2012-13 (2014), 9.

BLS Recommendations:

- update the FATA to reflect modern business practice, and regulatory concepts and terminology used in the Corporations Act;
- incorporate substantive regulation into the FATA with the Policy restricted to guidance as to how the substantive regulation is reviewed and implemented;
- subject material changes to the Policy to public consultation;
- recognise the FIRB's composition and role formally in legislation to improve transparency and accountability;
- review sanctions and administration of FATA; and
- consider operation of definitions of "aggregate substantial interest" and "aggregate controlling interest".

SCHEDULE 1 QUICK FIX CHANGES

1. Obviously outdated and otiose exemptions – moneylending agreement

There are a number of obviously outdated and otiose exemptions in the FATA and FATR. For example, the exemption for moneylending agreements (FATA s5) needs to be updated to deal with the proliferation of different kinds of lender/arrangements.

BLS Recommendations:

- amend definition for moneylending agreement in FATA to conform to section 609(1) of the Corporations Act as modified by ASIC class order 13/520.

2. Obviously outdated and otiose exemptions – real estate sector

Also, relevant to the real estate sector, there are a number of outdated and ineffectual exemptions:

- the exemption at FATR 3(o) refers to an acquisition of units in a unit trust that accepts funds from the public on the basis of a prospectus approved by the Corporate Affairs Commission of a State or Territory which no longer applies; and
- the exemption at FATR 3(p) refers to an acquisition of land which is entered in the Register of the National Estate which no longer exists.

As an interim measure to provide some relief to the real estate sector, before the regulation is formally put through Parliament, FIRB has announced that no action will be taken when a foreign person does not notify and seek prior approval in relation to an acquisition of a passive interest in a listed or unlisted Australian urban land trust estate, by acquiring an interest in units that result in a holding (alone or with associates) of less than:

- 10% in a listed trust, with a predominantly non-residential property portfolio of office, retail, industrial, or specialised properties, or a mix of these; or
- 5% in other public trusts with at least 100 unit holders and whose developed residential real estate assets that have been acquired from non-associates are less than 10% of the target trust's real estate assets.

In legislating the interim measures as amendments to the FATR, we suggest each interim exemption be lifted to 15% to be consistent with the "substantial interest" threshold throughout the regime.

BLS Recommendations:

- amend FATR 3(o) to exempt acquisition of interest of less than 15% in managed investment schemes regulated by Chapter 5C of the Corporations Act (or alternatively listed or other widely held managed investment schemes);
- amend FATR 3(p)(B) to clarify that the reference to "Register of National Estate" is to all heritage listings; and

- amend FATR 3(p)(ii) to clarify that the valuation threshold applies to the "interest in Australian urban land" rather than the "land" as it is more appropriate to refer to the value of the interest rather than the entire property where a person is seeking to acquire less than a 100% interest in a property. Or create an exception for less than 15% interests in land that meets the threshold.

3. Add exemptions for uncontroversial transactions to remove red tape

There are a number of uncontroversial transactions currently subject to approval, where there are no discernible policy concerns. If FIRB has concerns as to some aspects of the transactions listed the obligation could be changed to an undertaking to report the transaction to FIRB rather than a requirement for approval. For example, review is required for:

- acquisitions pursuant to pro rata offers of shares in companies (under Policy) and units in trusts (FATA and Policy), such as through rights issues or dividend/distribution reinvestment plans;
- acquisitions of shares in listed companies and listed trusts by underwriters who are investment banks provided those securities are sold down to third party investors within a short period (say 30 days) and no voting rights are exercised by the underwriters;
- intragroup transfers where the ultimate controller or the net foreign investment does not change (i.e. there is no "new" foreign person other than an interposed subsidiary of the foreign controller) or where the transaction is tax neutral as it involves a tax consolidated group; and
- acquisitions of additional shares by a foreign person who already holds a substantial interest in a company, even if the acquisition does not result in an increase in the foreign person's shareholding percentage (see FATA ss26(6)(b)(ii) and (iii)).

BLS Recommendations:

- amend the Policy to exempt all acquisitions pursuant to a pro rata offer of interests in shares in companies and units in trusts. For this purpose, an offer will still be considered to be pro-rata if there is a separation between the institutional and retail offer and the offer is not made in certain jurisdictions due to illegality or cost;
- amend the Policy to exempt all acquisitions by underwriters who are investment banks provided these securities are sold down to third party investors within 30 days and no voting rights are exercised by the underwriters;
- exempt all intragroup transfers from FATA ss18 and 26 where the ultimate controller or the net foreign investment does not change. This exemption could be limited to transfers between an entity and a wholly-owned entity or between wholly-owned entities within a corporate group or transfers within a tax consolidated group; and
- limit FATA ss26(6)(b)(ii) and (iii) to circumstances where a foreign person acquires additional shares (or securities convertible into shares) in a company which results in an increase in the person's shareholding percentage (or shareholding percentage assuming conversion of securities convertible into shares).

4. The troublesome “Associate” reference

The term “associate” as defined in FATA is anomalous and should be replaced with a more customary definition.

The concept is inherently ambiguous, not linked to action in concert that is normally the hallmark of association and does not sit well with determining association within and across corporate groups. In particular, there are three principal concerns with the definition.

First the infinite repetition under paragraph (l) of the associate test means that people can be associates of each other without even having the vaguest idea that this may be the case.

Second the automatic deeming of relationships as giving rise to an association is out of date and ill conceived. By way of example:

- why is a person’s employer or employee considered to be an associate (eg a company such as BHP Billiton would have over 100,000 employees to make inquiries of even before considering any other limbs of the associate test).
- the notion of partners being associated would mean that limited partners would be associated for all purposes merely because of their common investment in a small unrelated venture. This would have significant impacts for financial sponsors and their investors.
- even vigorous competitors having a substantial interest in a single joint venture company would be deemed to be associates for all purposes and not just the joint venture. This would have significant implications for the energy and resources sector where joint ventures are a common funding and operating structure and also a means for them to obtain portfolio exposure. It would also have implications for consortium bids which are becoming far more prevalent).

Lastly, unlike the Corporations Act acting in concert test, there is no requirement for any of these deemed relationships to have any connection with the underlying investment.

A well known aphorism used by advisors who deal in this area is that taken to its logical conclusion all members of the human race are associates of each other (section 6(l) definition).¹¹ At a practical level it makes the prudent task of seeking to identify one’s associates impossible in practice.

BLS Recommendation:

- replace FATA s6 with the definition of “associate” taken from the Broadcasting Services Act with appropriate changes (see Schedule 3).

5. Allow use of more recent auditor-reviewed financial accounts

Various provisions in the FATA provide that the value of a company’s assets is the value shown in the company’s most recently audited balance sheet (FATA ss13(4), 13B(1)(a)(i),

¹¹ Another example is the technical concern that all SOEs of a particular country are associates of each other.

13B(5)(a) and 13C(2)). Such a balance sheet can be up to 12 to 16 months old. Where a more recent auditor-reviewed (as opposed to audited) balance sheet is available, it would be more appropriate to use the more recent balance sheet.

BLS Recommendations:

- extend FATA ss13(4), 13B(1)(a)(i), 13B(5)(a) and 13C(2) to allow the use of an auditor-reviewed balance sheet for a half-year period where it is more recent than the audited balance sheet; and
- amend definition of “last accounting date” in FATA s13(3) to refer to the date of the latest audited financial accounts or auditor-reviewed financial accounts, whichever is more recent.

6. Allow independent valuation of land

In determining whether a company is an Australian urban land corporation, FATA s13C(2) provides that if a reasonable value of a company's land assets is not shown in its last audited balance sheet, the reasonable value shown in the company's accounting records is used. It is unclear how this reasonable value is determined.

In contrast, in determining whether a trust estate is an Australian urban land trust estate, FATA s13D(2) provides for the use of a valuation by a suitably qualified valuer not more than 12 months before the particular time.

BLS Recommendations:

- replace FATA s13C(2)(b) with a valuation by a suitably qualified valuer acting at arm's length in relation to the valuation, not more than 12 months before the particular time, where the value of the assets had not increased significantly between the time of the valuation and the particular time.

7. Remove potential double counting of subsidiary assets

FATA ss13(2) and 13C(3) both provide that, for the purposes of determining asset values under those sections, assets comprising shares in a subsidiary are excluded. This is to avoid a double counting of asset values in circumstances where the assets of a corporation and its subsidiaries are aggregated.

In contrast, FATA s13B does not include an equivalent exclusion with the result that it technically appears to require a double counting of assets – namely the value of the assets of a subsidiary and the value of the shares in that subsidiary (which would already reflect the value of the subsidiary's assets).

BLS Recommendations:

- insert into FATA s13B a paragraph similar to FATA ss13(2) and 13C(3) to exclude assets comprising shares in a subsidiary from the calculation.

8. Remove distinction between substantial interest and controlling interest

Given that, as a result of FATA s9(2), a “substantial interest” or “aggregate substantial interest” in a corporation would only not be a “controlling interest” or “aggregate controlling interest” upon an application being made to the Treasurer for a determination, there seems to be little need to distinguish the two concepts.

BLS Recommendations:

- replace references throughout the FATA to “controlling interest” and “aggregate controlling interest” with references to “substantial interest” and “aggregate substantial interest”.

9. Consistent use of references to interest in shares or units

The “substantial interest” concept at FATA ss9 and 9A is defined with respect to “interest in issued shares” (further defined at FATA s11) and “interest in trust estate” (further defined at FATA s12B).

However, other terminology is used elsewhere in the FATA and FATR. For example:

- “interest in a unit” at FATA s12A(f), currently not defined in the FATA;
- “acquisition is of shares” at FATR 3(i) and 3(j); and
- “acquisition is of units” at FATR 3(o).

For clarity of drafting, we consider it desirable that “interest in shares” or “interest in units” be used consistently throughout to line up with the FATA’s definition of “substantial interest”.

This consistency should be extended to Policy. The Policy uses:

- “direct investment” for foreign government investor acquisitions (which is defined to include a 10% interest);
- “investment” in the media sector requirement;
- “interest” in the real estate requirements.

“Interest in” should be a consistent term.

BLS Recommendations:

- extend FATA s12B to specifically include “interest in a unit” in the definition of “interest in trust estate”;
- replace the words “acquisition is of shares” at FATR 3(i) and 3(j) with “acquisition is of interests in shares”;
- replace the words “acquisition is of units” at FATR 3(o) with “acquisition is of interests in units”; and
- use “interest” consistently in the Policy.

10. Update Form 1 (Notice under section 25) and Form 2 (Notice under section 26)

The versions of these forms available from the FIRB website are not consistent with the versions set out in the schedule to the Foreign Acquisitions and Takeovers (Notices) Regulations 1975 (Cth) (**FATNR**). Their formatting also makes them difficult to complete.

The forms are also out-of-date in that they request telex numbers but not email addresses and do not reflect legislative changes (e.g. references to “substantial shareholding” instead of “substantial interest”, reference to Australian corporations being “incorporated” in a State, Territory instead of “registered” and no request for ACNs or ABNs).

These forms should be revised to bring them up-to-date and to better collect data of relevance to FIRB's consideration of an application. We have been made aware of a new online portal that is being trialled that will effectively replace the notices. However, these forms will still need to be updated in the FATNR.

BLS Recommendations:

- revise Forms 1 and 2 in the FATNR to bring them up-to-date and to better collect data of relevance to FIRB's consideration of an application.

11. 12 months approvals

The Policy states that “applications to acquire interests that will not be substantially completed within 12 months will generally not be accepted”.

It would be helpful if the Policy could specify in general terms the circumstances in which FIRB may be prepared to give approvals which last for more than 12 months.

BLS Recommendations:

- provide in the Policy examples of circumstances in which FIRB may be prepared to give approvals which last for more than 12 months (e.g. exercise of share options).

SCHEDULE 2

FURTHER TECHNICAL ISSUES INVOLVING SWF's AND SOE's

1. *Exclude financial sponsors from the definition of foreign government investors*

The broad definition of foreign government investors inadvertently captures domestic and offshore private equity funds whose investors include SWFs and other state owned entities such as pension funds and state owned university investment funds which invest in private equity funds. In the United States of America (**US**) in particular, the level of ownership of these investors is often greater than 15% in any one fund (or more than 40% in aggregate by these types of investors).

Importantly, however, such investments are usually passive and none of the relevant government entities have any influence or control over the investment or operational decisions of the private equity fund. In the experience of BLS members the most common investment form is a limited liability partnership where the SWF investor holds passive limited partnership interests. It is the general partner of such an entity that exclusively makes investment decisions.

The BLS is concerned that the current regulation of foreign government investors is not targeted to address government policy concerns that there is a risk that such investments might not be commercial in nature or could be undertaken in pursuit of political or strategic objectives that may be contrary to Australia's national interest.

BLS Recommendations:

- exempt non-controlling investment by "commercial" funds such as private equity funds so that the thresholds are consistent with the general review thresholds.

2. *Clarify requirements for SOE acquisitions of interests in land*

The Policy states that "Foreign government investors must notify the Government and get prior approval to...acquire an interest in land."

The BLS understands that the Foreign Investment Review Board (**FIRB**) interprets "interest in land" with reference to the FATA s12A definition of "interest in Australian urban land" as though all references to "Australian urban land" in FATA s12A are taken also to refer to "Australian rural land". This should be clarified in the Policy.

The BLS also understands that FIRB takes the view that none of the exemptions for Australian urban land interest acquisitions in regulation 3 of the FATR apply to the Policy. This should be clarified in the Policy.

The BLS also understands that the acquisition by a foreign government investor of securities in an Australian urban land corporation or Australian urban land trust estate constitutes an acquisition of an "interest in land" for which prior approval is required under the Policy. It is unclear whether this means the acquisition of any securities or only the acquisition of securities which would constitute a "direct investment" (e.g. more than 10%). The BLS submits it should be the latter. The position should be clarified in the Policy.

BLS Recommendations:

- clarify the Policy that “interest in land” is defined with reference to the FATA s12A definition of “interest in Australian urban land” as though all references to “Australian urban land” in FATA s12A are taken also to refer to “Australian rural land”;
- clarify the Policy that the FATR 3 exemptions for acquisitions of interests in Australian urban land do not apply to the Policy; and
- clarify the Policy so that only acquisitions of security interests over shares in an Australian urban land corporation or units in an Australian urban land trust estate which constitute a direct investment (10% or more) is subject to approval under the Policy.

3. Provide more guidance as to what loans fall within SOE direct investment

There is widespread confusion as to whether and to what extent a loan by a foreign government investor constitutes a “direct investment” requiring prior approval under the Policy. Further guidance on this issue is essential.

What the current Policy states in relation to loans is that:

- foreign government investors regulated by Australian Prudential Regulation Authority (**APRA**) do not need to obtain prior approval to obtain security as part of a lending agreement or to subsequently enforce the security and sell the assets (see footnote 2);
- however, APRA-regulated foreign government investors must obtain prior approval to gain control over a previously secured asset and to retain it for more than 12 months (see footnote 2);
- a foreign government investor must obtain prior approval to obtain an interest in an entity of less than 10% if that investor also extends a loan to the entity (see definition of “direct investment”); and
- a foreign government investor must obtain prior approval to retain an interest in an entity of 10% or more following enforcement of a security interest (see definition of “direct investment”).

Given the Policy's focus on secured loans, the BLS assumes that approval is not required for unsecured loans. However, the Policy should confirm if this is the case, given that it is common for even unsecured loans to contain undertakings and covenants in favour of the lender which could be construed as providing the lender with “potential influence or control over the target” (see Policy's definition of “direct investment”).

In terms of secured loans, the Policy should explain how, as a practical matter, FIRB applies the “direct investment” test. As a threshold matter a secured loan should only constitute a “direct investment” where security is being granted over 10% or more of the borrower's assets by book value.

There should also be clarification of how the 10% threshold applies in the case of a syndicated secured loan. The BLS understands it is with reference to a financier's participating interest in the loan. Consistent with the previous paragraph, a foreign government investor's participation in a secured syndicated loan should only constitute a “direct investment” where the participating interest is 10% or more and where security is being granted over 10% or more of the borrower's assets by book value.

BLS Recommendations:

- clarify the Policy that unsecured loans are not direct investments requiring prior approval;
- limit the definition of direct investment in the Policy to secured loans where security is being granted over 10% or more of the borrower's assets by book value;
- clarify the Policy that a foreign government investor's participation in a syndicated secured loan should only constitute a "direct investment" where the participating interest is 10% or more and where security is being granted over 10% or more of the borrower's assets by book value; and
- include a specific exemption for banks acting as security trustees.

4. Provide more guidance as to what equity investments fall within SOE direct investment

It would be helpful if the Policy could provide more guidance on what types of equity investments constitute "direct investments" requiring prior approval under the Policy.

In particular it is unclear as to how the following sentence is to be applied in situations other than those involving only acquisitions of issued shares or units in a single class: "Any investment of an *interest* of 10 per cent or more is considered to be a direct investment."

It would be preferable if the concept of "interest" is defined with reference to the definition of "substantial interest" at FATA s9. That is to say, a person is taken to have an "interest" of 10% or more in an entity if the person:

- has voting power of at least 10%;
- has potential voting power of at least 10%;
- holds interests in at least 10% of the entity's issued shares or units; or
- would hold interests in at least 10% of the entity's issued shares or units if shares or units were issued as a result of the exercise of convertible securities.

BLS Recommendations:

- define "interest" in the definition of "direct investment" and generally in the revised Policy with reference to the definition of "substantial interest" at FATA s9 (see above).

SCHEDULE 3

MODIFIED DEFINITION OF "ASSOCIATE" FROM BROADCASTING SERVICES ACT

For the purposes of this Act, "associate" means:

- (a) the person's spouse or a parent, child, brother or sister of the person; or*
- (b) a partner of the person or, if a partner of the person is a natural person, a spouse or a child of a partner of the person; or*
- (c) if the person or another person who is an associate of the person under another paragraph receives benefits or is capable of benefiting under a trust--the trustee of the trust; or*
- (d) a person (whether a company or not) who:*
 - (i) acts, or is accustomed to act; or*
 - (ii) under a contract or an arrangement or understanding (whether formal or informal) is intended or expected to act;**in accordance with the directions, instructions or wishes of, or in concert with, the first-mentioned person or of the first-mentioned person and another person who is an associate of the first-mentioned person under another paragraph; or*
- (e) if the person is a company--another company if:*
 - (i) the other company is a related body corporate of the person for the purposes of the Corporations Act; or*
 - (ii) the person, or the person and another person who is an associate of the person under another paragraph, are in a position to exercise control of the other company.*