

Foreign Acquisitions and Takeovers Amendment Regulations 2004 (No. 1) 2004 No. 49

EXPLANATORY STATEMENT

Statutory Rules 2004 No. 49

Foreign Acquisitions and Takeovers Act 1975

Foreign Acquisitions and Takeovers Amendment Regulations 2004 (No. 1)

Section 39 of the *Foreign Acquisitions and Takeovers Act 1975* (the Act) provides that the Governor-General may make regulations, not inconsistent with the Act, prescribing all matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed, for carrying out or giving effect to the Act.

The purpose of the Regulations is to amend the *Foreign Acquisitions and Takeovers Regulations 1989* (the Principal Regulations) to exempt, from the operation of the Act, a foreign custodian company's holding of a legal interest in a share of an Australian corporation held on behalf of an Australian investor.

Further details of the legislative framework are at [Attachment A](#).

Foreign custodian companies are foreign persons under the Act and are required to notify the Treasurer of proposed acquisitions of substantial shareholdings in Australian corporations. This investment has subsequent or 'second round' effects on Australian corporations. If the foreign custodian company acquires a substantial interest (ie, greater than 15 per cent) in an Australian corporation, that Australian corporation is also caught by the notification provisions of the Act (sections 25, 26 and 26A). By virtue of the foreign substantial interest the Australian corporation must notify the Treasurer of proposed acquisitions of business assets, shares and real estate, even if the substantial interest is not a controlling interest and the Australian corporation is not a foreign person.

The number and magnitude of foreign custodian companies holding significant stakes in Australian corporations is increasing and, as a result, more and more Australian corporations are likely to be caught by the notification provisions of the Act and/or deemed a foreign person. The diverse nature of Australian businesses and the wide scope of the Act have resulted in significant compliance issues for Australian corporations that are caught as well as the foreign custodian companies.

Foreign custodian companies usually acquire and hold the legal interest in shares on behalf of investors but, by arrangement, exercise the voting right attached to the shares under instruction from their clients and do not exercise independent control. In the case of foreign custodian companies investing in Australian corporations, a significant proportion of the shares may be held on behalf of Australian investors who hold the beneficial or equitable interest in the share and control the voting rights.

The underlying rationale of the Act is to screen investment proposals by foreign persons and not to capture investments by Australians in Australian corporations. When the Act was first drafted, the significant growth in the demand for custody services by Australian investors was unforeseen and the current situation unintended. Consequently there is a case for exempting, under certain circumstances, the activities of foreign custodian companies acting on behalf of Australian investors from the scope of the Act.

Previously, no exemption was afforded to foreign custodian companies holding the legal interest in a share on behalf of Australian investors or to Australian corporations caught by the operation of the Act by virtue of a substantial interest held by a foreign custodian company.

The Regulations exempt, from the operation of the Act, a shareholding in an Australian corporation held by a foreign custodian company on behalf of Australian investors:

- (i) who hold the beneficial or equitable interest and control the voting rights attached to the share; or
- (ii) where foreign based charitable institutions, trusts, life insurance or insurance companies, corporations that operate a superannuation fund or a managed investment scheme hold the beneficial or equitable interest (not being a substantial shareholding) and control the voting rights attached to the share primarily for the benefit of persons ordinarily resident in Australia.

The Regulations, representing a specific and narrow liberalisation of policy, eliminate the unintended 'second round' effect of Australian corporations being caught by the operation of the Act.

The Regulations also make minor technical amendments to update references to legislation and ensure consistency of style.

Details of the Regulations are set out in [Attachment B](#).

The Regulations commenced on gazettal.

ATTACHMENT A

Further details of the legislative framework

Section 5 of the Act defines a 'foreign person' as including:

- a corporation in which a natural person not ordinarily resident in Australia or a foreign corporation holds a controlling interest; and
- a corporation in which 2 or more persons, each of whom is either a natural person not ordinarily resident in Australia, or a foreign corporation, hold an aggregate controlling interest.

Section 26 of the Act requires specified persons to notify the Treasurer of agreements to acquire a substantial shareholding in an Australian corporation. An Australian corporation includes a trading corporation, a financial corporation and a corporation incorporated in a Territory under the law in force in that Territory relating to companies. It does not include a corporation, the value of whose total assets does not exceed \$50 million.

Persons to whom section 26 applies include:

- a corporation in which a natural person not ordinarily resident in Australia or a foreign corporation holds a substantial interest; and
- a corporation in which 2 or more persons, each of whom is either a natural person not ordinarily resident in Australia or a foreign corporation, hold an aggregate substantial interest.

Sub-section 26(6) of the Act provides that an agreement to acquire a substantial shareholding is a reference to an agreement to acquire any interests in any shares in a corporation where that person already holds a substantial interest in the corporation or would thereby acquire a substantial interest.

Sub-section 11(1) of the Act provides that a person holds an interest in a share if the person has any legal or equitable interest in the share.

Paragraph 9(1)(a) of the Act provides that a person is taken to hold a substantial interest if, together with any associates, they are in a position to control not less than 15 per cent of the voting power in the corporation or hold interests in not less than 15 per cent of the issued shares in the corporation. Subsection 9(2) of the Act provides that a substantial interest is taken to be a controlling interest in a corporation, unless the Treasurer is satisfied that the person is not in a position to determine the policy of a corporation.

Section 18 of the Act provides the Treasurer with the power to prohibit or unwind the acquisition of shares, when satisfied that a change in control (as stipulated) would be contrary to the national interest. Alternatively, by virtue of section 25 of the Act, the Treasurer may raise no objections to, and/or impose conditions on, proposals to ensure they would not be contrary to the national interest.

ATTACHMENT B

Details of the *Foreign Acquisitions and Takeovers Amendments Regulations 2004 (No. 1)*

Regulation 1 describes how the regulations are to be cited.

Regulation 2 provides that the regulations commence on gazettal.

Regulation 3 provides that the *Foreign Acquisitions and Takeovers Regulations 1989* (the Principal Regulations) will be amended in accordance with Schedule 1 of the regulations.

The Regulations would exempt, from the operation of the Act, a shareholding in an Australian corporation held by a foreign custodian company on behalf of Australian

investors, provided the Treasurer certifies that the shareholding held by the foreign custodian company is exempt from the operation of the Act.

Schedule 1, Item 1 inserts new regulations '2A Prescribed interests in shares', '2B Kind of interest' and '2C Certificate of exemption in respect of an interest' which prescribe, under paragraph 11(5)(c) of the Act, the kind of share and the class of persons holding that interest.

More specifically:

- '2A Prescribed interests in shares' prescribes an interest in a share as an interest of the kind described in regulation 2B and held by a foreign custodian company (that being a foreign person, in the business of providing custodian services, holding a financial services licence and a certificate mentioned in regulation 2C).
- '2B Kind of interest' prescribes the interest as an interest in a share of an Australian corporation where the holder of the legal interest in the share exercises voting rights only at the direction of the holder of the equitable interest in the share. The holder of the equitable interest must not be the holder of the legal interest and must be a person who is not a foreign person or must be a foreign person referred to in paragraph (2B)(3).
- '2C Certificate of exemption in respect of an interest' prescribes that a foreign custodian company may apply in writing to the Treasurer for a certificate that certifies that the foreign custodian is exempt from the operation of the Act with respect to an interest in a share described in regulation 2B. The Treasurer must be satisfied that the certification is not contrary to the national interest and may impose conditions necessary for the national interest or revoke the certificate if the revocation is in the national interest.

Schedule 1, Item 2 omits the words 'The Act does not apply' under regulation 3 and inserts the words 'For subsection 12A(8) of the Act, the Act does not apply. This is a technical amendment to include a reference to the subsection in the Act to which the regulation refers.

Schedule 1, Item 3 omits the words 'within the meaning of the *Life Insurance Act 1945*' under paragraph 3(b) and inserts the words '(within the meaning of the *Life Insurance Act 1995*)'. This is a technical amendment to update the reference from repealed to current legislation.

Schedule 1, Item 4 omits the words 'within the meaning of the *Occupational Superannuation Standards Act 1987* under paragraph 3(d) and inserts the words '(within the meaning of the *Superannuation Industry (Supervision) Act 1993*)'. This is a technical amendment to update the reference from repealed to current legislation.

Schedule 1, Item 5 omits the words 'within the meaning of the *Migration Act 1958*' under paragraph 3(q)(i) and inserts the words '(within the meaning of the *Migration Act 1958*)'. This is a technical amendment to give greater consistency to the style of writing used in the regulation.

Schedule 1, Item 6 omits the words 'within the meaning of that Act' under paragraph 3(q)(ii) and (iii) and inserts the words '(within the meaning of that Act)'. This is a technical amendment to give greater consistency to the style of writing used in the regulation.

Schedule 1, Item 7 omits the words 'the Corporations Law' under paragraph 3(u) and inserts the words 'the *Corporations Act 2001*'. This is a technical amendment to refer to the particular legislation.

REGULATION IMPACT STATEMENT

Background

The Government's approach to foreign investment policy is to encourage foreign investment consistent with community interests. In recognition of the contribution that foreign investment has made and continues to make to the development of Australia, the general stance of policy is to welcome foreign investment. Foreign investment provides scope for higher rates of economic activity and employment than could be achieved from domestic levels of savings. Foreign direct investment also provides access to new technology, management skills and overseas markets.

2. The Government recognises community concerns about foreign ownership of Australian assets. One of the objectives of the Government's foreign investment policy is to balance these concerns against the economic benefits to Australia that arise from foreign investment.
3. The foreign investment policy provides for Government scrutiny of many proposals by foreign persons to acquire interests in Australian businesses and properties. The Government has the power under the *Foreign Acquisitions and Takeovers Act 1975* (the Act) to block proposals that are determined to be contrary to the national interest.
4. Section 26 of the Act applies to a corporation in which a natural person not ordinarily resident in Australia or a foreign corporation holds a substantial interest. This section requires any person to whom the section applies to notify the Treasurer in advance of any acquisition of shares, by virtue of which that person will acquire or increase a 'substantial shareholding' in an Australian corporation valued at \$50 million or more.
5. Subsection 26(6) makes it clear that a person acquires a 'substantial shareholding' for the purposes of section 26 when that person holds a 'substantial interest' in a corporation. Section 9(1) provides that a person is taken to hold a 'substantial interest' in a corporation if the person, together with associates, is in a position to control at least 15 per cent of the voting power of the corporation, or holds interests in at least 15 per cent of the issued shares in the corporation.
6. Subsection 11(1) provides that a person holds an interest in a share if the person has any legal or equitable interest in that share.
7. In summary, foreign persons, which fall within the class of persons defined in section 26, are required to notify the Treasurer in advance for any proposal to acquire shares in an

Australian company valued at more than \$50 million by virtue of which they would hold a legal or equitable interest in at least 15 per cent of the issued shares of that corporation.

8. Generally, foreign owned custodians are included within the class of persons subject to section 26, as a foreign custodian is usually either: a corporation in which a natural person not ordinarily resident in Australia or a foreign corporation holds a substantial interest; or a corporation in which 2 or more persons, each of whom is either a natural person not ordinarily resident in Australia or a foreign corporation, hold an aggregate substantial interest. The majority of custodians operating in the global custody industry fall into this particular class of person.

9. Custodians provide a range of services for their clients, which are generally institutional investors, money managers and broker/dealers. These services include: settlement of trade and safekeeping of financial assets on behalf of the client; collection of income arising from portfolios; application of entitlements to reduce rates of withholding tax at source and reclaiming tax withheld; and notification and dealing with corporate action. Generally, custodians only exercise voting rights attached to their holdings under direct instruction from their client and do not normally exercise influence independent of their client.

10. The global custody industry is a major growth area within the financial services industry, with a significant increase in the value of assets under custody over recent years. This growth is expected to continue and can be attributed to a number of factors, including: an increased demand by investors for cross border assets in emerging markets and access to a wider range of financial instruments; an increasing trend for investment managers and banks to use global custodians to replace their own networks of local custodians; and an increasing demand for superannuation and pension types of investment with custody banks. Foreign owned nominee holdings, which encompass custody arrangements, are now relatively common on the share registers of Australian companies (though they usually hold less than 15 per cent).

11. Both the global custody market and the Australian custody market are dominated by a number of key players, comprising major banks and specialist providers. Foreign owned custodians have around 50 per cent of the domestic custody market.

Problem

12. The underlying rationale of the Act is to screen investment proposals by foreign persons. The Act was not intended to capture investments by Australians in Australian corporations. However, the significant growth in the demand for custody services by Australian investors was unforeseen when the Act was drafted and it is now the case that shares of many Australian corporations are held by Australian investors through foreign custodians.

13. In early 2002, the Government became aware of the increased activity of foreign custodians in the Australian financial markets and the need for these custodians to seek Government approval for investments in Australian companies on behalf of Australian investors.

14. Under the Act, these foreign custodians are required to notify the Treasurer in advance of any acquisition of shares in an Australian company valued at more than \$50 million by virtue of which they would acquire or increase a substantial interest in the issued shares of the corporation. This applies regardless of whether or not the foreign custodian's interest in the shares is to be held for the benefit of Australian or foreign investors.

15. Given the nature of custodian operations, the increase in operations of foreign custodians in Australia and the increase in demand from Australian investors to utilise the services of global custodians, it is likely that more foreign custodians will be required to seek approval for acquisitions of interests in Australian businesses despite the beneficial interest of the shares held by Australian investors. It seems contrary to the underlying rational of the Act to screen the operations of foreign custodians operating in Australian when they act on behalf of Australian investors.

16. Furthermore, the second round effect of a foreign custodian holding a substantial interest in an Australian company is that the Australian company then becomes a person to whom section 26 of the Act applies. As a potential and unintended consequence, major Australian companies could become 'foreign' under the Act and subsequently be required to seek advance approval for all transactions that fall within the scope of the Act or the wider foreign investment policy. This is particularly significant when considering custodian investment in major Australian financial institutions. Given the diverse nature of these Australian businesses, which could encompass funds management, trustee, executor of estates, corporate lending and the holding of assets other than by way of security, custodian and nominee operations and the wide scope of the Act in relation to investments in real estate and share and business acquisitions, some of these institutions are concerned that the consequential notification requirements will impact on their ability to conduct business efficiently and competitively. Consequently, this will effect the manner in which these Australian companies conduct business and ultimately effect those Australian investors holding shares in these companies and Australian consumers utilising their services.

17. To summarise:

(a) The operations of foreign custodians acting on behalf of Australian investors are unnecessarily restricted by the *Foreign Acquisitions and Takeovers Act 1975* and hence foreign custodians operating in Australia on behalf of Australians are exposed to an administrative burden in ensuring compliance with the Act.

(b) The competitiveness of foreign custodians operating in Australia on behalf of Australians is reduced due to the restrictiveness of, and administrative burden of compliance with, the Act.

(c) Australian investors utilising the services of foreign custodians are disadvantaged by the restrictiveness of, and the administrative burden of compliance with, the Government's foreign investment policy.

(d) As a second round effect, Australian companies, in which a foreign custodian acting on behalf of Australian citizens holds a substantial interest, are exposed to the

restrictiveness of, and the administrative burden of compliance with, the Government's foreign investment policy.

18. The risk of these problems increasing is compounded by the growth of foreign custodians in the Australian financial markets. While these problems arise only in the specific situation of foreign custodians acquiring shares over a specific level in major Australian companies, if no action is taken, the likely consequence is negative. Two of the areas most likely to experience the greatest increase in costs as a result of no action are:

(a) Operations costs for foreign custodians operating in Australia on behalf of Australian investors will continue to increase and the restrictiveness and administrative burden of complying with the Government's foreign investment policy is likely to cause foreign custodians to be at a competitive disadvantage in the Australian market.

(b) Australian companies, in which Australian investors hold shares through a foreign custodian, will be subject to section 26 of the Act and exposed to a costly administrative burden of complying with the Government's foreign investment policy.

19. These costs are not quantified as the nature of the detriment is such as to make estimates unreliable. However, it is apparent that:

(a) problems exist in the current restrictions concerning holdings in Australian companies by foreign owned custodians on behalf of Australians;

(b) these problems are not insignificant for the Australian investment and business community;

(c) the market cannot remedy them; and

(d) without action from the Government they are likely to compound.

Objectives

20. The Government's primary objective in addressing the problem is to ensure the efficiency and competitiveness of the Australian custodian market is maintained while balancing community concerns about foreign investment and the existing framework of the Act and the wider foreign investment policy. More specifically, the proposal aims:

(a) to reduce problems and costs arising for foreign custodians operating in Australia on behalf of Australian investors while still ensuring compliance with the Act and the existing foreign investment policy; and

(b) to avoid Australian companies being considered 'foreign' for the purposes of the Act by virtue of a foreign custodian, operating in Australia on behalf of Australian investors, holding 15 per cent or more in those companies' issued share capital.

21. A secondary objective for the Government is to ensure that, in the pursuit of a solution for the above primary objectives, an exemption is not extended to any other entity other than foreign custodians operating in Australia for the benefit of Australian investors.

That is, the Government's foreign investment policy must continue to extend to other entities currently considered to be within the specific class of person under section 26, other than those specific foreign custodians operating in Australia for the benefit of Australian investors. The Government does not intend to widen the scope of its existing foreign investment policy.

Identification of Options

Option One

22. Draft a regulation under the Act to permit the Treasurer to exempt from the scope of the Act interests in shares in Australian companies held by foreign custodians operating in Australia on behalf of Australian investors.

23. The proposed regulation would prescribe that a legal interest in a share in an Australian corporation held by a foreign custodian company on behalf of an Australian investor who holds the equitable interest and exercises the voting rights, would be disregarded under the Act. The Treasurer would have to be satisfied that the interest in the share is of a kind specified in the regulation and the person is a foreign custodian company as prescribed, and would have to certify that the foreign custodian company is exempt from the operation of the Act with respect to that legal interest in the share. The foreign custodian would only be certified where it met certain qualifications specified in the regulation, which would remove any possibility of it independently exercising influence over the Australian businesses in which it had an interest.

Option Two

24. Reject proposals by foreign custodians to acquire a substantial interest in Australian corporations and take action against any foreign custodian that acquired a substantial interest in an Australian corporation without prior foreign investment approval. Under subsection 18(2) of the Act, the Treasurer may make an order prohibiting a proposed acquisition. Furthermore, under subsection 18(4) of the Act, where a foreign person has acquired shares in a corporation the Treasurer has the power to make an order directing that person to dispose of those shares within a specified time to any person or persons approved in writing by the Treasurer.

25. The two options listed above represent the most feasible from a very limited range of possible regulatory and non-regulatory measures. Only the first is subject to a detailed analysis in the following section, as the second option would not achieve the objectives stated above and thus is not considered further.

Impact Analysis

26. The Government has assessed from a public interest perspective whether the costs associated with Option 1 exceed the benefits to be derived from its adoption. A qualitative assessment of the expected effects of the proposed option is the most feasible assessment possible as the costs and benefits derived from any Government action will depend greatly

on the future actions of third parties, namely foreign custodians and will flow in various direct and indirect ways to many other parties in the community.

27. The analysis lists first the parties likely to be affected by the proposed option, second, likely interaction with existing regulations and third, costs and benefits attached Option 1.

Affected Parties

28. Parties likely to be most directly affected by the proposed option are:

- (a) foreign custodians operating in Australia for the benefit of Australian investors; and
- (b) Australian companies valued at more than \$50 million in which foreign custodians, operating in Australia for the benefit of Australian investors, hold 15 per cent or more of their issued share capital.

29. Parties likely to be indirectly or less directly affected by the proposed option are:

- (a) the Government, notably the Department of the Treasury and the Foreign Investment Review Board;
- (b) Australian investors utilising the services of foreign custodians operating in Australia for the benefit of Australian investors; and
- (c) other participants in the Australian custody market.

Effect of Existing Regulations

30. It is intended that the proposed amendment allow only a specific and narrow liberalisation of policy and should not effect the operation of the Act or the Government's foreign investment policy except in the narrow and specific situation of a foreign custodian which operates in Australia on behalf of Australian investors.

31. Section 39 of the Act provides that the Governor-General may make regulations, not inconsistent with the Act, prescribing all matters required or permitted by the Act to be prescribed or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

32. Paragraph 11(5)(c) of the Act provides that an interest of a prescribed kind in a share maybe disregarded, being an interest of such person, or of the persons included in such class of persons, as prescribed.

Option Analysis

33. The regulation would prescribe that a legal interest in a share in an Australian corporation held by a foreign custodian company on behalf of an Australian investor would be exempt from the Act. For the exemption to be effective, the Treasurer would certify that the foreign custodian company is exempt from the operation of the Act with respect to a particular type of shareholding in an Australian corporation.

34. The regulation would prescribe: (a) a kind of interest in a share; and (b) a person or class of persons who has the interest.

35. The interest in the share is a legal interest. Custodian companies are generally trustees and hold the legal interest in the shares and are named on the share register as the owners of those shares. The beneficial or equitable interest is normally held by someone other than the person who holds the legal interest. The beneficial interest in the shares must be owned by an Australian investor who is not a foreign person under the Act.

36. The exemption would also apply to the following foreign entities who, through foreign custodians, hold less than a substantial shareholding in an Australian corporation.

(a) Charitable institutions operating in Australia primarily for the benefit of persons ordinarily resident in Australia and trustees of foreign-controlled trusts established for charitable or benevolent purposes where the beneficiaries of the trust are persons ordinarily resident in Australia.

(b) Life insurance companies operating in Australia where they invest their statutory funds primarily for the benefit of policy holders ordinarily resident in Australia.

(c) Insurance companies (other than life insurance companies) operating in Australia where investments are made from the reserves of the company and their investments are consistent with their obligations under insurance legislation.

(d) Corporations operating in Australia that maintain a superannuation fund for employees and dependants who are persons ordinarily resident in Australia and the investment is for the benefit of those members.

(e) Responsible entities of managed investment schemes registered under section 601EB of the Corporations Act 2001 investing primarily on behalf of persons ordinarily resident in Australia.

37. The holder of the legal interest in the share, or any of its associates, may not exercise voting rights associated with the interest except at the express direction of the person who owns the beneficial or equitable interest.

38. Corporation law does not restrict the ability of custodian shareholders to exercise their rights as shareholders of a company. However, by arrangement or agreement the custodian companies generally agree to exercise the voting rights attached to their shareholding under instruction from the clients. These arrangements can vary and how they exercise those rights is entirely a matter between themselves and their principals.

39. Given the number of custodian companies and the range of instructions, it is necessary to avoid ambiguity in interpreting the scope of the exemption. To mitigate against ambiguity, the regulation would provide that shareholdings of custodian companies are only exempt where: -

(a) the Treasurer is satisfied that:

- (i) the interest in shares is of the kind specified in the regulation;
 - (ii) the foreign custodian company meets the criteria; and
 - (iii) the certification for the exemption of the custodian company is not contrary to the national interest; and
- (b) the Treasurer certifies that the foreign custodian company is exempt from the operation of the Act with respect to the shareholding.

40. The certificate may be issued subject to certain conditions imposed by the Treasurer (time limitations, annual report requirements and no exercise of voting rights without express direction from the Australian investor). Upon expiry of a certificate, the foreign custodian would be required to seek a renewal for the exemption to continue.

41. Should the Treasurer decide that the continued certification of a custodian was contrary to the national interest, the Treasurer would be able to revoke the certificate in writing at any time. A certified foreign custodian company would be exempt from the operation of the Act with respect to any interest in a share which was held for the benefit of Australian investors.

42. The process of certification differs from the process of foreign investment approval in a number of aspects:

- (i) Certification would exempt the applicant in all applicable transactions rather than a specific transaction;
- (ii) Once certified, a foreign custodian would be exempt for a specific time period, usually 12 months, and renewal would only be required after the expiry of the certificate. Under the present legislation, foreign investment approval is required prior to the execution of each specific transaction.
- (iii) Certification only requires the satisfaction of the criterion outlined in paragraph 41, rather than a transaction specific statutory notice and full details of each transaction (ie contracts and identification of parties) as required under the Act.

Costs

43. A foreign custodian would be required to identify the nationality of each of its investors and ensure that it was able to differentiate between those shares held for the benefit of Australian investors and those held for the benefit of foreign investors. However, these costs would be minimal as foreign custodians are required to identify the nationality of clients for tax purposes.

44. An administrative cost would be incurred by foreign custodians for an annual application to the Treasury for renewal of the certificate. These costs relate only to the preparation of the annual application. No fee is to be charged for the issue of the certificate. These administrative costs are minimal compared with those costs associated with foreign custodians seeking foreign investment approval for every transaction in which they would

acquire, or increase, a substantial shareholding in an Australian corporation as a result of a decision by an Australian investor.

Benefits

45. Efficiency gains are achieved by issuing such a certificate as it alleviates the need for foreign custodians to seek prior foreign investment approval for each proposed acquisition of shares in Australian corporations on behalf of Australian investors. While foreign custodians would still be required to seek foreign investment approval for proposals to acquire a substantial interest in an Australian corporation where that interest is to be held on behalf of foreign custodians, certified foreign custodians would not be required to seek separate foreign investment approval for every transaction involving Australian investors investing in Australian corporations. As the certificate would exempt the custodian, rather than the transaction, Government scrutiny would only be required during the issue and renewal of certificates, usually on an annual basis. Furthermore, as the certificate would be issued in advance, it would remove the requirement for foreign custodians to negotiate transactions on condition of foreign investment approval. The proposed regulation would ensure that foreign custodians were not at a competitive disadvantage when acting for Australian investors in the Australian custody market. The effect of the proposed regulation would be to remove the detriment to Australian investors who choose to utilise the services of a foreign custodian.

46. The second round effect of the proposed regulation is that those Australian corporations, in which foreign custodians hold interests on behalf of Australian investors, would not be required to consider those interests in determining their level of foreign ownership. This would ensure that Australian corporations could reflect more accurately the true level of foreign ownership in determining whether they are subject to the Act. This effect would fit better with the underlying purpose of the Act and avoid the situation where Australian corporations in which Australian investors through foreign custodians hold a substantial interest are subject to the administrative requirements of the Act.

Consultation

47. Consultation was a key part of the process undertaken by the Government in identifying the problem and subsequently drafting an effective solution to the problem. Consultation was undertaken with a range of stakeholders including: a number of major Australian financial institutions; a number of major Australian and foreign custodians operating in Australia; a number of firms which provide Australian and foreign custodians with legal services; and the Australian Custodial Services Association. Submissions were sought from these stakeholders in writing and meetings between concerned stakeholders and senior staff of the Commonwealth Treasury were undertaken to seek further comment on the proposed regulation.

48. Those parties consulted generally reacted well to the proposal. Representatives of custodians were of the opinion that the regulation "would ameliorate many of the existing regulatory and economic inefficiencies caused by the [Act]". Those Australian companies in which foreign custodians held a substantial interest were pleased that this regulation would ensure a correct level of foreign ownership was reflected, thereby removing the need for

foreign investment approval and reduce the obligation to negotiate transactions on a conditional basis.

49. Some concern was raised that custodians would be required to identify the nationality of the underlying beneficial ownership of the shares for which the custodial services are provided. However, the point was made that custodians are already required to identify the nationality of investors for tax purposes and the general view was that the reporting requirements would be considerably less onerous than the requirement to seek foreign investment approval for transactions that as a result of Australian investment breach the Act. Other custodians consulted proposed to "address this compliance issue by seeking confirmation from each client as to whether they are or are not foreign persons". Furthermore, these custodians were prepared to seek annual certification and, if required, report annually on their activities.

Conclusion and Recommended Option

50. The Government considers that, on balance from a public interest perspective, the benefits of Option 1, a regulation exempting certain foreign custodian holdings in Australian companies, exceed the expected costs of its implementation. The manner in which Option 1 satisfies the objectives stated above can be briefly summarised as follows:

Objective: to reduce problems and costs arising for foreign custodians operating in Australia on behalf of Australian investors.

Achieved by: foreign custodians operating on behalf of Australian investors, once certified, would no longer be considered to be a person to whom the Act applies and thus would not be required to seek prior approval for acquisitions on behalf of Australian investors.

Objective: to avoid Australian companies from being considered 'foreign' for the purposes of the Act, by virtue of a foreign custodian, operating in Australia on behalf of Australian investors, holding 15 per cent or more in those companies' issued share capital.

Achieved by: the holdings in Australian companies by certified custodians on behalf of Australians would no longer be considered in the calculation of a substantial interest, thus avoiding this situation.

Objective: to ensure the exemption is not extended to any other entity other than foreign custodians operating in Australia on behalf of Australian investors.

Achieved by: ensuring the exemption of foreign custodians is only permissible by certification by the Treasurer. Accordingly, control of the exemption remains with the Government.

51. The conclusion to adopt Option 1 is based on the view that all objectives will be achieved by the mechanisms of the proposed regulation.

Implementation and Review

52. For initial certification, foreign custodians would be required to meet the criteria outlined in the regulation. This would involve the identification of the nationality of those investors for the benefit of whom that custodian holds an interest in an Australian corporation. Furthermore, those foreign custodians would be required to ensure that the voting rights associated with the interest could only be exercised at the direction of those Australian investors. Once a certificate is issued an internal registrar of certificates will be established within the Commonwealth Treasury to aid with compliance, monitoring and review of the process.

53. Certificates will only be issued for a certain time period, usually 12 months, and those foreign custodians wishing to renew their certificate will need to apply. The renewal process will be relatively straightforward and require confirmation that the foreign custodian continues to meet the criteria. The requirement for annual renewal of certificates ensures that the Government can monitor and review the activities of those certified custodians and effectiveness of the proposed regulation.