27 January 2023

The Treasury
Langton Crescent
Parkes ACT 2600

Submitted via email to: prebudgetsubmissions@treasury.gov.au

RE: Pre-Budget Submission

To the Treasury

BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, Australian Financial Services Licence No. 230523 (BlackRock) appreciates the opportunity to make this pre-Budget submission for the 2023/2024 Federal Budget.

BlackRock provides investment solutions to institutional and wealth clients worldwide, across equity, fixed income, liquidity, alternatives, and multi-asset strategies. Our clients include superannuation funds, banks, insurance companies and corporations, and through those clients, millions of individuals who are largely saving for long-term goals, such as retirement. BlackRock’s purpose is to help more and more individuals experience financial well-being. Because our clients have diverse financial objectives, we consider a variety of investment factors, risks, and opportunities, and take a long-term perspective.

BlackRock acknowledges the Government’s commitment and actions toward unlocking investment opportunities in national priority areas. We are pleased to be able to make a direct contribution to the Investor Roundtable discussions, to be one of the entities that have endorsed the National Housing Accord, and we support the plan to develop a sustainable finance strategy for Australia.

In this context, we make the following two suggestions for inclusion in the 2023/2024 Federal Budget:

(i) consult on amendments to the foreign investment laws to ensure that foreign-owned asset managers who are facilitating the passive flow of capital in the Australian economy are not unfairly penalised under the regime; and

(ii) create an unlisted investment vehicle to pool institutional investment, create liquidity, and reduce risk, for investment into the Government’s priority areas.

These two initiatives, particularly if implemented together, would make investment into priority areas more attractive for both international and domestic investors. Amendment of the foreign investment regime would reduce cost for investors in index, exchange traded funds, making this form of investment more appealing to cost-sensitive investors. Costs would also be reduced for domestic institutional, and ultimately end-retail investors, in active strategies who benefit from exposure to certain asset classes or strategies through inter-funding.
A pooled investment vehicle that is managed or supported by the Federal Government could spur investment in areas that have not traditionally presented an adequate risk/return profile for local institutional investors, by allowing incentives to be applied at the fund level and mitigating liquidity, regulatory and other risks. It would also present efficiencies by removing the need for separate negotiations and agreements with individual investors and would provide a source of fee revenue for the manager.

We provide more detail on these proposals below and would welcome a further discussion on them. Any questions in relation to this submission should be directed to Eve Brown at the contact details below.

Yours faithfully,

Andrew Yik  
Director | Legal, General Counsel  
Australia | BlackRock

Eve Brown  
Director | Public Policy  
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Consult on amendments to the FIRB regime

Since coming to office in May 2022, the Government has taken several steps to facilitate investment in national priority areas, and particularly the energy transition. The next Investor Roundtable will seek to identify the barriers to investment in renewable energy projects and the Government has committed to sweeping reforms to ensure Australia can grasp the opportunities from more investment in the transition.

The foreign investment framework (FATA) administered by the Foreign Investment Review Board (FIRB) presents a significant cost and administrative barrier to investment. This is across all economic sectors, including energy-related projects essential to Australia’s transition. These barriers will only increase as more wealth is generated by Australians and greater investment is needed to fund the transition. Given exactly the same activities are conducted by both Australian and foreign-owned asset managers, the application of the FATA to foreign-owned asset managers only creates an unlevel playing field that favours domestic managers and is a disincentive to investment by international asset managers. Passive investment should be excluded from the operation of FATA.

As the foreign-owned segment of the industry continues to grow, the FATA regime’s scope of application will correspondingly widen, prompting more significant change in investment behaviour. Prior to the recent imposition of significant application fees and penalties, the asset management industry had not generated material revenue under FATA. In our view, the tax revenue foregone from growing wealth and curtailing and/or redirecting offshore investment is likely to significantly outweigh any increased fee and penalty revenue under the regime.

The Australian entity of a foreign owned manager is usually licensed by ASIC and operates a local office staffed with Australian resident employees. Besides offering products to Australian resident investors, foreign owned asset managers have connections with their large global client base which can be leveraged to attract foreign capital flows into Australia.

The FATA impacts on passive investment, which is a legitimate and routine funds management activity. If an asset held by a foreign owned fund manager triggers a FATA threshold, FIRB exemptions and ongoing, bespoke and voluminous reporting, is required. The combination of FIRB exemption fees and ongoing compliance costs are significant. Cost is a particularly important factor for investors in exchange traded funds (ETFs), a common investment vehicle operated by both Australian and foreign owned funds managers.

Costs associated with the FATA regime could prompt fund managers to stop offering strategies that invest in asset classes covered by the FATA, diverting investment away from certain critical sectors, and in turn depriving investors of choice and access to specific exposure vehicles. The fees are material and have
recently doubled. Ultimately, these costs are borne by the institutional and end-retail investors, the substantial majority of whom are Australian residents.

In addition, it is commonplace for asset managers who operate more than one active strategy fund to invest some of the investors’ assets in one fund into another fund. This inter-funding activity allows investors in the first fund to get exposure to the assets and strategy of the second fund. Where the asset manager of both funds is foreign-owned, inter-funding will trigger the FATA regime, and with it the requirement to seek exemptions and produce ongoing reports, as previously explained.

This regulation of the investments of foreign owned asset managers might be justified where there is control or influence exercised in relation to an investee entity or where the investment presents a threat to Australia’s sovereignty or national security, both of which are worthwhile objectives of the FATA regime. However, passive investment management does not involve the exercise of control or influence, and it does not, and could not feasibly, present a threat to national security. Asset managers, regardless of their ownership, act as fiduciaries and invest on behalf of predominantly Australian resident retail investors or superannuation members. They are not investing on their own account nor seeking to control any aspect of the Australian economy. Australia imposes a robust takeover regime to which foreign owned fund managers are already subject.

It is also clear from the complete omission of the funds management industry in the regulatory impact statement that accompanied the FATA draft law that the industry was not intended to be caught under the regime. Further, a letter dated 18 May 2004 from the then Australian Minister for Trade to the then United States Trade Representative, explicitly notes that portfolio investment, such as index investment, is currently inadvertently captured by the operation of the FATA. This letter was sent in the context of Australia having entered into the AUS-US Free Trade Agreement (FTA). In the spirit of that agreement the Minister for Trade committed to a review (within 18 months) of the treatment of portfolio investment under the FATA. To the best of our knowledge this review never occurred, but the matter was not urgent then as there were no fees or penalties under the law.

For the extensive reasons set out above, a review of the FATA regime’s application to the funds management industry is not only overdue but is essential to ensure that the Government delivers on its broader economic agenda and its plan to boost investment in national priority areas. A Treasury-led review of the regime could build on the previous Government’s March 2022 consultation on Enhancing Australia’s Foreign Investment Framework, allowing it to be concluded at less cost. Reform of the FATA regime for passive investment by the funds management industry is particularly important as Australia emerges from the pandemic and seeks increased capital inflows to deal with high inflation, slow wages growth and depressed global markets.
Pooled (unlisted) Investment Vehicle

The Government’s inaugural Investor Roundtable focused on the nation’s housing needs for essential workers and other demographic groups. Consideration was given to how capital flows towards these initiatives could be encouraged by removing the barriers to residential housing investment that present for both local and international investors. In summary, those barriers include:

- administrative costs associated with the foreign investment framework;
- non-resident withholding and other taxes;
- the performance test in the superannuation law;
- liquidity risk;
- inefficiencies in the planning and development process; and
- inadequate return profile from difficulties in delivering these projects at scale.

A pooled investment fund that invests into designated housing projects could address many of these barriers, particularly if managed by a Federal Government entity, but also to a significant extent if managed by a private manager with the support of Government.

Pooling the investments of multiple institutional investors would create scale quickly, giving the fund an improved return profile from the outset. Smoother returns over the period of investment would also make it comparable to other more developed markets which would help institutional investors assess the option in the context of their fiduciary duty to end-retail investors.

A variety of risks could also be reduced for investors by the Government assuming certain risks and the spreading of risk across multiple investors. The manager of the fund would assume the usual legal risks that arise from the offer of units in a fund, such as disclosure and other compliance risks. Operational risks associated with for example state/territory planning and development laws and valuation risk could be somewhat mitigated where the fund is managed by the Government and intergovernmental agreements, such as the National Housing Accord, are in place.

The manager of the fund could also address the liquidity risk of direct investment in infrastructure assets. On a bi-annual basis a secondary market could be created, where units in the fund are made available for sale and purchase by private placement. This would give existing investors the ability to withdraw some or all of their investment, as required, and give new investors periodic opportunity to join the fund.

The fund could be arranged into classes of investors, allowing different incentives to be applied at the fund level which would then benefit the investors in each class. For example, the application of the performance test could be modified for the fund and tax incentives could be applied to the fund to make investment in it cheaper and more appealing to investors. The tax on earnings could be reduced to align with investments in commercial property, and non-resident withholding rates could also be adjusted for international investors in the fund. Similarly,
where managed by a government entity, an investment in the fund would not trigger the application of the foreign investment laws where international investors buy into the fund, removing this cost barrier for those investors.

Applying incentives at the fund level would be more efficient as it would eliminate the need for individual negotiations on separate transactions and would ensure that any incentives are consistently applied to all participants and across all projects. In addition, the Government could set the terms of the investment for each asset class, deciding for example the number of dwellings within a build-to-rent development that will be reserved for essential workers, how essential workers will be defined, and what discount rate of rent will be applied to them.

We also envisage that the manager of the fund would collect an investment management fee that could be applied towards the engagement of legal, compliance and investment experts. The fee could also be adjusted in response to the returns generated by the fund.