

## AFS licence requirements for operators of unregistered funds

The Australian financial services (AFS) licence requirements for operators of unregistered funds (also known as “excluded offers”) differ to those of responsible entities of registered or listed funds.

This fact sheet provides an outline of the AFS licence requirements for operators of unregistered funds.

The actual AFS licence authorisations an entity requires will always depend on the nature of the financial services business to be operated and the kinds of assets under management.

### Need for an AFS licence

Some operators of unregistered funds will avoid the need to hold an AFS licence on the basis they are not “in the business” of providing a financial service, e.g., if it is their first offer or the operator has appointed an appropriately authorised licensee to undertake certain functions, such as arrange the issue of interests in the fund.

It is advisable to obtain legal advice about the need to hold an AFS licence prior to establishing a fund or financial services business.

### Financial product advice

Product issuers are exempt from the requirement to hold an AFS licence to provide general financial product advice on their own products. However, product issuers who rely on this exemption are required to provide a warning to recipients about the nature of the advice provided and that they do not hold an AFS licence.

The inclusion of this warning can impact on the effectiveness of marketing activities.

Despite this exemption, it is common for operators of unregistered funds to hold an AFS licence authorising the provision of advice. The AFS licence can be restricted so that the licensee is only authorised to provide advice on interests in their own funds, which can simplify the AFS licence application process for the applicant.

### Dealing in a financial product

Operators of unregistered funds generally perform a range of dealing functions as part of the establishment and ongoing operation of their funds. The term “dealing” includes the issue of interests, such as units, in the fund as well as the acquisition or disposal of financial products in connection with the operation of the fund.

The dealing activities required for an AFS licence are restricted to “financial products” (which is defined in the *Corporations Act 2001*) and includes interests in managed funds, securities (such as shares and debentures), general insurance products, derivatives and foreign exchange contracts.

Accordingly, operators of unregistered funds are not required to hold an AFS licence to deal in assets which are not “financial products”, such as real property.

The dealing authorisations for an operator of an unregistered fund will therefore be dependent upon the underlying assets of the fund, as follows:

- **Direct real property funds**—these types of funds acquire real property, such as land and buildings. However, these funds will also hold financial products, namely general insurance products and bank accounts.
- **Property development funds**—these types of funds acquire development rights, e.g., the right to proceeds from the sale of a completed development. Property development funds which own the underlying land will be considered direct real property funds.
- **Financial asset funds**—these types of funds acquire interests in various financial assets, such as managed funds, shares, debentures, term deposits and derivatives. The dealing authorisations will need to include these financial products (as required).
- **Hedge funds**—these types of funds not only buy financial assets (such as managed funds, shares, bonds, currencies and derivatives) but also sells them short. The dealing authorisations will need to include these financial products (as required).

It is important to note that other dealing authorisations may be required for an operator of an unregistered fund. For example, if the fund will be hedging against interest rate fluctuations, then it will be required to be authorised to deal in derivatives. Similarly, if a fund holds foreign assets or receives foreign sourced income, then it will generally be required to be authorised to

deal in foreign exchange contracts to hedge against foreign currency fluctuations.

### **Custodial service**

A custodial service is essentially the holding of a financial product on behalf of another person.

There are a number of exemptions under the *Corporations Act 2001* which avoid the need to hold an AFS licence authorising the provision of a custodial service, e.g., where the service is provided to less than 20 persons in total.

For example, real property is not a financial product and therefore can be held without the requirement to hold an AFS licence. However, other assets such as securities, derivatives and general insurance are financial products and holding such assets (even in an incidental manner) will require the operator to hold an AFS licence authorising the provision of a custodial service.

If an external custodian is appointed to hold the assets of a fund on behalf of the operator, then the operator will still be required hold an AFS licence authorising the provision of a custodial service. This is because the operator is deemed to hold a beneficial interest in the financial products for the members of the fund.

### **AFS licence application process**

McMahon Clarke Legal is very experienced in obtaining AFS licences for its clients. Please contact us to provide you with a detailed proposal which outlines the steps, costs and timing in obtaining an AFS licence.

For more information, contact—

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