FINANCIAL SERVICES COUNCIL

CCIV Regulatory framework – January 2019 exposure draft

Submission to Treasury

FSC FINANCIAL SERVICES COUNCIL

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1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing almost $3 trillion on behalf of more than 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Introduction

We applaud Treasury and the Government for addressing many of the industry's concerns with the Corporate Collective Investment Vehicle (CCIV) regulatory framework in the draft legislation released in January 2019. The FSC considers this framework provides for a much more appropriate alignment between member protection and commercial feasibility.

This submission covers the regulatory/corporate law issues only, a separate submission deals with the tax issues in the CCIV.

The FSC welcomes many of the changes to the CCIV draft rules as made in the latest draft, including the following:

- Significant improvement of the independence tests between depositary and corporate director.
- Addressing concerns about liability of a depositary for actions of its agents.
- Modification to the requirement on a depositary to verify compliance by the corporate director.
- Removal of concepts of CCIV members being clients of depositary
- Greater certainty for sub-funds relating to various issues including ring fencing, statutory demands and winding up.
- Removal of rules relating to capital reductions, share buy backs and financial assistance which apply to companies but are not appropriate for fund management vehicles.
- Reduced stringency of rules for wholesale CCIVs (although the FSC retains concerns about the regulatory burden on wholesale CCIVs compared to other wholesale vehicles – see Section 7.2 below).

However, some issues remain with the CCIV framework, discussed in more detail in this submission, including:

- the prohibition on listing a CCIV sub-fund on a financial market;
- the inability for a sub-fund of a CCIV to make a cross investment in another sub-fund of the same CCIV;
- the onerous penalty on depositaries for failure to report breaches;
- the inappropriate application of insolvent trading provisions;
- some unnecessary differences remaining between wholesale CCIVs and other wholesale managed funds;
- the inability to amend a CCIV constitution on a sub-fund basis;
- other technical drafting issues with the Bill; and
- features that diminish the international competitiveness of the CCIV regime.

While provisions for transition of existing funds into the CCIV regime have not yet been released, we have included some suggestions relating to this component of the regime.

3. International competitiveness

Australian CCIVs should be competitive with registered managed investment schemes and funds established in other countries in the Asian region.

Harmonisation of the regimes would facilitate adoption of the CCIV and distribution of Australian products throughout Asia.

It is also critical to Australian fund managers to be able to create a domestic vehicle that has the same functionality as foreign products which may be distributed here. This is key to the domestic managers being able to effectively compete with global products that may be available in Australia, particularly under the Asia Region Funds Passport (**Passport**).

The success of the CCIV regime depends on a significant take up by Australian fund managers. This is critical in order to provide a scalable solution for managers which can facilitate the operation of the new funds on a cost effective basis.

With the benefit of seeing details of the Variable Capital Company (**VCC**) proposed in Singapore and the Open-Ended Fund Company (**OEFC**) structure in Hong Kong, the FSC remains concerned that the CCIV structure, whilst prima facie internationally *comparable*, is not internationally *competitive* compared to the VCC, OEFC and other similar structures available for use in other jurisdictions.

Other parts of this submission articulate our concerns in relation to the prohibition on listing, cross investments, and the additional regulatory burden that will apply to wholesale CCIVs relative to unregistered managed investment schemes. This submission also comments on international comparability of the CCIV regime relating to transition of funds and harmonisation of compliance requirements.

The FSC has serious concerns about the tax competitiveness of the CCIV – these issues are dealt with in a separate FSC submission.

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4. Listing and trading on exchanges

Section 1222N of the draft legislation prohibits listing of CCIVs and sub-funds. We maintain that this approach is out of alignment with emerging practices from other jurisdictions and, in practice, will restrict the nature of investment mandates that will be able to be operationalised within a CCIV structure.

4.1. Listing a CCIV with a single sub-fund should be permitted

Investment funds with illiquid assets such as real property and infrastructure are not able to have their securities quoted on the AQUA market due to the absence of regular transparent pricing of the assets,[1] nor are they normally able to offer redemption on request. This means that the only readily available method of exit for investors in such funds at the time of their choosing is trading on a financial market, which could be a barrier to uptake of these funds.

The operators of funds in these significant investment sectors need to use a structure that is adaptable through the life of a fund, from establishment with wholesale seed investors, to retail distribution and ultimately to become market-traded. There does not seem to be any policy reason to exclude these categories of assets from the CCIV regime, indeed the regime for redemptions from a fund with illiquid assets by withdrawal offer specifically contemplates these types of funds.[2]

A high level review of the Corporations Act provisions that may need amendment indicates that the further drafting work to accommodate listing a CCIV that has only one sub-fund is modest.[3] On this assumption, the CCIV itself could be a type of listed company. Aside from amendments to the listing rules of the relevant market, which could be done as a separate exercise, the key changes appear to be:

- amend section 1222N to provide that only a CCIV with a single sub-fund can be, or remain, listed;
- delete sections 1243A to 1243C and provide that the takeover rules, takeovers panel and compulsory acquisition apply to a listed CCIV;
- disapply section 602 to an unlisted CCIV with more than 50 members;
- include a provision, similar to section 604(1)(e), which confers the obligations and powers of the listed entity also on the corporate director; and
- in relation to section 253E, add the ability for the corporate director of a listed CCIV to vote on a resolution to remove them (and the parallel ordinary resolution as per section 601FM for schemes).

Numerous other provisions which refer to listed entities and listing already apply appropriately to a CCIV because the CCIV will be a listed “company” (for example, sections

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[1] A fundamental principle of the AQUA market rules for “exchange traded funds” is that only funds that invest in assets that can be regularly and transparently priced can have their securities quoted on that market. *ASX Rules Framework, AQUA Rules – Products Excluded*, available at https://www.asx.com.au/documents/professionals/asx_aqua_rules_framework.pdf

[2] See section 1231J

[3] Although desirable, we appreciate that listing several sub-funds of a CCIV would be more complex.

793B, 1020B, 1073C). The meeting and PDS provisions are already appropriately applied by the Bill.

We note that the Corporations Act provisions relating to listed entities have recently been amended to accommodate listed Passport funds, so the work done in that regard could be leveraged for this purpose. We appreciate that engagement with ASX and ASIC will also be required, but modifying the express prohibition on listing is an essential first steps on being able to list a CCIV.

We would argue that allowing funds to "list" will be important to the regime's success. Development of the CCIV framework in Australia has occurred in tandem with the development of the OEFC structure in Hong Kong and the VCC in Singapore. In providing a blanket prohibition on listing CCIVs and sub-funds, the CCIV core model is out of alignment with the regulatory frameworks applicable to OEFC and VCCs. The UK open-ended investment company (**OEIC**) on which the CCIV is based is also able to be listed on the London Stock Exchange.

For VCCs, the regulatory framework contemplates a vehicle can be set up as a standalone entity (with a single sub-fund) or an umbrella structure with multiple sub-funds. A VCC can be listed so long as it has only one sub-fund. At a minimum, and for international comparability and regional competitiveness, we believe that the equivalent option should be provided in relation to CCIVs.

Fund operators desire a single platform and single rule set to apply across their portfolio of investment products, to minimise operating costs and operational complexity. Moreover, a fund operator with a diversified portfolio of investment funds may see no incentive to adopt CCIV structures at all if this means that they cannot adopt a CCIV structure for all funds under their oversight.

4.2. Exchange traded funds

FSC member operators of exchange traded funds are currently discussing with the ASX about how the provisions of the draft legislation will operate for exchange traded funds. It is important to confirm that there will be no unintended consequences of the current drafting in s1222N that might be inconsistent with amendment of the AQUA Rules (and other relevant market rules) to allow funds to be traded.

At some point, we will request the involvement of Treasury in these discussions to ensure that the drafting is robust enough to fully facilitate exchange traded funds in a variety of structures. If the draft legislation is to be globally competitive, it will be necessary for flexible approaches to be contemplated such that a single corporate director can efficiently offer a suite of sub-funds with different investment management expertise, currency overlays, and investment strategies.

One issue that has arisen in discussions with ASX is that exchange traded funds quoted on the AQUA market need to be able to trade in their own securities, including on occasions to buy back securities. They may need to undertake what is known as internal market-making, or the "true up" process at the end of a trading day which allows alignment of traded prices

with the underlying net asset value of the fund. This is permissible in the case of interests in managed investment schemes, so long as the units are acquired at the same price that any other person would pay,[4] but section 1231Z currently prevents a CCIV from directly acquiring its own shares. We submit that this provision should be removed from the Bill, for this reason and also for the reasons relating to cross investment set out in section 5 below.

4.3. Redemption rules

Interestingly, the EM contemplates listing of a CCIV in Table 4.1 *Rules for Share Redemptions* (Section 4.30 of the EM), see the highlighted extract below:

1.	Redemptions in a retail CCIV when the sub-fund is liquid.	In addition to the requirements for a wholesale CCIV: • Must be permitted by the CCIV's constitution. • Price must be determined by reference to the net asset value of the sub-fund (for an unlisted CCIV) or the market price just before the redemption (for a listed CCIV).

Although this may be an oversight, if listing is (as we hope) permitted there would need to be clarification in relation to highlighted text.

Redemptions should be paid at net asset value of the sub-fund, irrespective of whether or not a sub-fund is listed or quoted; if the share in the CCIV is listed or quoted, trading occurs on the ***secondary market***; applications and redemptions occur in the ***primary market***. For an open-ended fund, the simultaneous operation of a secondary market for trading shares already issued and primary market to issue and redeem shares provides a mechanism to ensure that shares trade close to net asset value. Moreover, setting a pricing expectation that shares in a listed CCIV can only be redeemed at 'market price' can advantage the redeeming member over all other members if shares are trading at a premium to net asset value and disadvantage the redeeming member over all other members if shares are trading at a discount to net asset value.

The approach in the draft bill can be contrasted to that adopted by the Monetary Authority of Singapore, which provides that VCC redemptions are to be paid at net asset value.[5] The only exception here relates to closed ended funds listed on a securities exchange, where provision is made for the listing rules of the securities exchange to govern issuance, transfer and redemption of interests in the VCC.[6]

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[4] Section 601FG
[5] Republic of Singapore *The Variable Capital Companies Bill* 2018 Clause 19(e)
[6] Ibid Clause 19(f)

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5. Cross investments

Section 1231Z of the revised draft maintains the prohibition on a CCIV directly acquiring its own shares. This means that one sub-fund of a CCIV cannot invest in another sub-fund of the same CCIV. This prohibition defeats one of the otherwise beneficial features of the sub-fund structure, which is to allow groups of investors who want the same investment portfolio but in different currencies, or with a hedging overlay, to be efficiently established within the same structure. Managing pools of assets in this way allows managers to maximise economies of scale. Some FSC members have expressed the view that the omission of cross investment means that the CCIV regime is only suitable for exported funds, not domestic funds.

Omitting this core benefit of a multi-fund structure is out of alignment with the Singapore VCC framework, which imposes no such restriction.[7]

If cross investment is not permitted, to achieve an offering of a single investment strategy in a CCIV to both Australian and offshore investors (who may wish to have their currency risk hedged), it would be necessary to either mange each sub-fund's portfolio separately, which is inefficient, or set up another vehicle outside the CCIV to effectively fulfil the same function – see Sub-fund 1 in Figure 1 below. Operating different currency pools within the same sub-fund does not offer appropriate protection for the unhedged class for liabilities on derivatives in the hedged class. The separation offered by the sub-fund structure is one of the key attractions of the CCIV's multi-fund structure.

[7] See section 31 of the Singapore *Variable Capital Companies Act 2018*, which imposes no restriction on the ability for a sub-fund to acquire by subscription or transfer shares in any other class or classes that are issued in respect of other sub-funds of the VCC.

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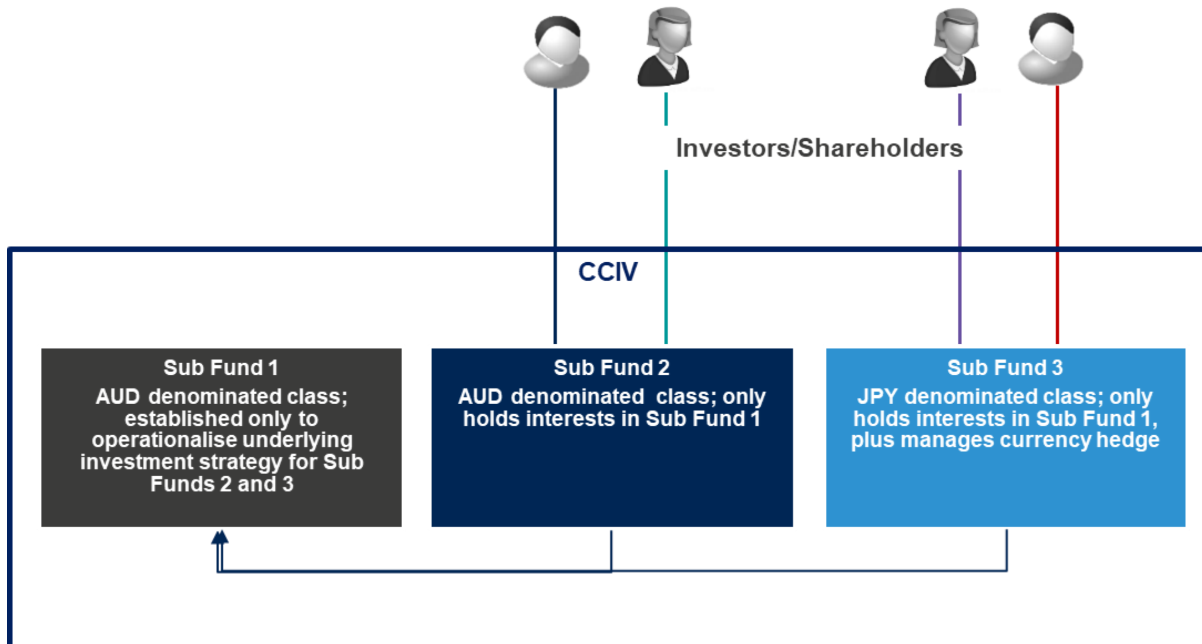
Figure 1 – cross investment example



We submit that there is no policy reason why the prohibition on a CCIV acquiring its own shares should not be lifted so that cross investment is allowed, so long as some technical points are addressed in the legislation, namely:

- **Ability to contract**: At common law a contract where the only parties are the same legal persons may not be able to be enforced. "Capacity" arguments can work in some circumstances (see for example *Re Australand Holdings Ltd* [2005] NSWSC 835 at [20]) but the trust law principles may not translate to this context. The terms of an investment in a sub-fund (the constitution and the offering document/PDS) will need to be as binding on Sub-fund 1 (**S1**) when it invests in Sub-fund 2 (**S2**) as they are binding on all the other investors in S2. This would not be a problem when the applicant for shares in S2 is the depositary, but for a wholesale fund without a depositary this issue will arise. This could be easily addressed by a statement in the legislation that a written agreement signed by the corporate director expressed to be on behalf of each of two or more sub-funds will be as binding as if the sub-funds were separate legal persons.
- **Applications and redemptions**: The legislation will need to contemplate that when assets of S1 are given to S2 as the consideration for an application for shares in S2, they become attributable to S2 and that there is an effective transfer despite the CCIV being the same legal person. The Conveyancing Act (NSW) section 24 assists to validate assurances of property by a person to themselves, but clearly it would be preferable for the point to be resolved at Commonwealth level. The reverse will apply when S1 redeems its shares in S2.
- **Wholesale client test**: Another issue for cross investments in a wholesale CCIV is that the CCIV itself, when it acquires for S1 shares in S2, may not be a wholesale client unless it already has $10 million in assets, and so may put itself in breach of retail fund requirements and PDS laws. In a wholesale trust, the trustee is the entity

that has to qualify as wholesale, and it is often the case because it may hold an AFS licence or control other assets amounting to $10 million. The solution here could be that a CCIV can be regarded as a wholesale client on the basis of its corporate director's AFS licence.

- **Equal treatment**: The corporate director's duty to treat shareholders in the same class in a sub-fund equally may cause an issue where the fees in S2 are waived on an investment by S1. A waiver is desirable to avoid double charging of the ultimate investors. ASIC relief deals with this in the MIS regime (ASIC Instrument 2017/40) but this could be addressed in the legislation.

On some other aspects, we do not think any change is required to permit cross investment:

- **Voting**: Cross investment does not seem to create a problem in this context. Voting in S1 and S2 would be as if they are separate funds, based on the dollar value of shares. Even if S1 owned 50% of the shares in S2 and there was a vote across the whole CCIV, it would still be based on dollar value. Section 253E is applied by section 1229G so that the CCIV and its associates (which seems likely to include the depositary for this purpose) will not be able to vote if any of them have an interest in the resolution other than as a member, so conflicts of interest and duty through cross holdings are managed appropriately and investor protection is retained.
- **Related party**: Where S1 invests in S2, the application and redemption prices for the investment would have to be the same as for all other investors in S2, and would be demonstrably on arm's length terms, with other rights of retail clients under the constitution such as to distributions also being the same because of the equal treatment duty (section 1224D(1)(d)), so there does not seem to be any problem.
- **Tax**: As the draft legislation now provides that the sub-funds are to be treated as separate taxpayers, cross investment should not raise any additional tax issues.

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6. Depositary issues

6.1. Concerns with penalty for breach reporting

Section 1226H imposes a statutory obligation upon a depositary to report material breaches by a CCIV of which it becomes aware, or suspects, to ASIC within 10 business days. This is a civil penalty provision. This statutory provision attracting civil penalty for a breach by a depositary is far more onerous than the current regime applying to custodians acting for a RE of a MIS. The potential maximum civil penalty for a corporation has recently been increased to $525 million, and $1.05 million for an individual involved in the contravention.[8] A penalty of this seriousness is not appropriate for a late report that results from administrative oversight by the depositary, as opposed to a contravention for its own gain or due to its own fraud or negligence. It is also significantly out of step with the treatment of the equivalent obligation on custodians of managed investment schemes (see below).

Further, fear of this serious penalty could result in a depositary reporting 'suspected breaches' pre-emptively, where in fact there has not been an actual breach. It may result in a better compliance process for a depositary to raise the issue of a suspected material breach with the corporate director of the CCIV before being required to report to ASIC.

We recommend that instead of having this strict obligation in section 1226H on a depositary to report a suspected breach to ASIC with a civil penalty for a failure by a depositary to do so, that the similar regime for MIS and custodians as applies under RG 133 an ASIC CO 13/1409 be adopted. This current regime – as provided for in RG 133 and the applicable ASIC CO 13/1409 – requires a RE of a MIS to include provisions to be incorporated into the agreement between a custodian and a RE, where a custodian agrees that it will:

1. report to the RE itself, its board or compliance committee, any material or systematic breaches within a reasonable timeframe of becoming aware; and
2. establish and maintain arrangements to ensure that if it becomes aware or suspects that the RE has failed to meet its own breach reporting obligations under the Corporations Act, the custodian will report this within 10 business days to ASIC.

We appreciate that the depositary is in a slightly different position to a custodian, in that the statute imposes upon it a supervisory role. In this case, the appropriate penalty for failing to report on time would be a fine and a self-reporting requirement under the depositary's AFS licence. The fine could be greater depending on whether the report was one month or three months late, as it is for some other ASIC forms, but should be of an amount that reflects the breach as an administrative failing, not a breach of a fiduciary-like duty, which is normally the basis for civil penalty provisions.[9]

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[8] *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth)*

[9] The fine for a breach of the main licensee reporting requirement under section 912D is only 50 penalty units (or 1 year imprisonment for an offence, which requires proof beyond reasonable doubt of a mental as well as a physical element of the offence, not balance of probabilities as for a civil penalty).

6.2. Services to support the depositary function

There is a concern that section 1226G(3), as drafted, may have unintended consequences. That section requires that "*the depositary may not appoint an agent, or otherwise engage a person, to carry out its functions under subsection (1).*" Subsection(1) refers to the oversight functions of the depositary.

While the position that a depositary should not be permitted to outsource its oversight functions to an **agent** is accepted, we consider that a depositary should be permitted to engage a **service provider** (not acting as an agent) to provide services which it may require in fulfilling the oversight function. The inclusion of the reference to otherwise engaging a person as drafted is too broad and is impractical.

For example, the depositary may wish to engage a business that provides a technology solution to assist in the depositary's oversight functions, where the depositary is still responsible for the oversight functions. Alternatively, a depositary may wish to engage the services of a related group entity in the performance of this oversight function. In this respect, the engagement of outsourced providers – in particular the outsourcing of IT systems or technology solutions or related entities within a group – should be allowed, if the depositary remains responsible.

We do not think such a restriction is intended, and request that the words "or otherwise engage a person" be deleted, which would allow for the appointment of a service provider but not an agent. We accept this deletion may mean a further provision is needed to provide that the Depositary is ultimately liable for the actions of such a service provider who is engaged to assist with the oversight function (similar to that which applies under clause 601FB(2), as amended accordingly).

Also, section 1226F would also need to be amended accordingly.

6.3. Holding on trust by subcustodians

There is also a concern that section 1233ZA is drafted too broadly and should allow for some exceptions. This provision states as follows:

> *A person other than the CCIV who holds money or property of the CCIV is taken to hold the money or property on trust for the CCIV.*

For a MIS, under ASIC Class Orders CO 03/1409 and 13/1410 issued in conjunction with ASIC RG 133, exceptions are made from the requirement for registered MIS assets to be held on trust by custodians where they are held in a jurisdiction that does not recognise trusts, and there are also carve-outs for "special custody assets" in Class Order CO 13/760. We submit that this flexibility will also be needed for CCIVs. This could be achieved by using the ASIC rule making power (see EM at 12.2 to 12.5) to provide for similar exceptions for CCIV assets to be held on trust.

6.4. Omnibus accounts

Subsection 1233ZC(1) provides that: "*A person who holds assets of a sub-fund of a CCIV that have been clearly identified as such in the CCIV's allocation register must hold the*

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assets separately from any other property (including from the assets of any other sub-fund of the CCIV).”

It is noted that this subsection (1) is subject to the CCIV rules.

It is recommended that the CCIV rules include exemptions for omnibus accounts which are regularly reconciled in accordance with the requirements of the Class Orders, which exemptions are needed for the efficient functioning of global custody networks. See further details on this in RG 133.148 to 133.160.

7. Other significant issues

7.1. Insolvent trading

Section 588G of the Corporations Act prohibits directors from incurring debts a company will be unable to pay. The underlying purpose of this section is to protect the interests of creditors dealing with a trading company that is near insolvency, in circumstances where the directors, if they consider that to incur any more debts would leave the company insolvent, may put the company into voluntary administration. A collective investment may be put into a position where it is unable to pay its debts purely because of a fall in market prices, which it outside the control of the director(s). No insolvent trading rules apply to managed investment schemes. Neither a CCIV nor a MIS is "trading" in the same sense as a company which operates an enterprise (in fact the tax rules prevent CCIVs and MISs from 'trading'). A responsible entity company and a corporate director are each enterprises, and the insolvent trading rules apply to them – but should not apply to the investment funds they operate.

The draft EM does not provide a detailed explanation, but it appears from the wording of section 588G that the prohibition on allowing the CCIV to trade while insolvent is imposed on the corporate director. This does not mean, however, that there is no risk of liability to the human directors of the corporate director company. Liability could potentially be extended to them through involvement in a contravention, or "steppingstone liability", as in the *Cassimatis* case, by alleging that the human directors of the CD have not exercised the skill or diligence, or taken all steps that a reasonable person would take to prevent the contravention, under sections 79, 1225(1)(b) and 1225(1)(f) of the Corporations Act.

In the context of an investment fund, where there is a substantial risk of loss resulting from market movements in the portfolio assets as opposed to inappropriate management of an enterprise, and where the funds at risk in a single fund can be more than $1 billion, it is inappropriate for individual directors to have even a slight risk of being personally liable through insolvent trading provisions. If aware of this risk, fund managers may be less likely to choose to establish CCIV structures and will be inclined to remain in the MIS regime. There may be difficulties in finding directors prepared to take this risk, and/or increased insurance costs.

Listed investment companies (LICs) are companies and so their directors are subject to the insolvent trading provisions. However, LICs are closed ended and investors cannot redeem, so they have less concern about cash flow and are better able to manage their liabilities than an open-ended unlisted CCIV would be.[10] This is relevant because the solvency test for the purposes of section 588G is based on a cash flow test, that is, the ability to pay debts when they fall due, rather than excess of liabilities over assets.

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[10] ASIC's Moneysmart website says the following about LICs: "LICs are 'closed-ended' which means they usually don't issue new shares or cancel existing shares as investors join and leave. This allows the manager to focus on selecting investments without having to worry about cash flow. If investors want to exit, they have to sell their shares on the relevant stock exchange, they cannot redeem the investment."

7.2. Wholesale CCIVs compared with other wholesale vehicles

One of the keys to the success of the new corporate collective investment vehicle is that it results in a simplification of processes and operational requirements. It is important that there are not significant and unnecessary disincentives to establish a wholesale corporate collective investment vehicle.

There have been major improvements in the treatment of wholesale CCIVs since the first draft of the legislation in 2017, but there are still some comparative disadvantages which may limit managers' appetite to adopt them, and which could be alleviated.

Private unit trusts are, on the whole, lightly regulated in Australia. Partly for this reason, many wholesale investment vehicles, from widely-held property and infrastructure funds to more closely held consortium vehicles and capital partnerships, are set up as unit trusts and operate as unregistered managed investment schemes.

By contrast, a number of aspects of the proposed CCIV regime relating to wholesale CCIVs place additional burdens on the CCIV and its operator (i.e. its corporate director) when compared with the light touch regime applying to unregistered managed investment schemes. The following rules apply to a wholesale CCIV that do not apply to unregistered MISs:

- Wholesale CCIVs must be registered with ASIC, while this does not apply to unregistered MISs. However, it is recognised that by its very nature, the creation of a wholesale corporate collective investment vehicle will involve it being registered and accordingly its existence will be public, which a wholesale trust is not. This unavoidable difference is accepted, but there are other aspects that could, and should, be changed in relation to wholesale CCIVs.
- The corporate director of a wholesale CCIV must be a public company and must hold an AFSL (while the trustees of unregistered managed investment schemes often require an AFSL, in some structures it is not required).
  - Section 1222(c) could be modified so that the requirement for the corporate director to be a public company applies only if it will operate any retail CCIVs.
  - There could be separate types of AFS licence authorisations granted by ASIC with different conditions (including financial requirements) that apply according to whether the corporate director operates retail CCIVs. Some indication that this is intended in the EM would be helpful.
- The rules of meetings of members of a CCIV (and of any sub-fund) will seemingly apply to wholesale CCIVs. These incorporate Part 2G.4 of the Corporations Act, which applies to registered schemes only. In particular, section 253E restricts the corporate director or any of its associates from voting on a matter in which they have an interest other than as a member. This does not apply to unregistered managed investment schemes.
- Members of a wholesale CCIV have a right to requisition a meeting and remove the corporate director. This is inappropriate in a wholesale context, where it is often quite important in the commercial structure for a trustee to have certainty that it will remain as trustee unless, for example, it breaches its duties.

- If a corporate director of a CCIV retires, the replacement requires a special resolution, whereas a retiring trustee of an unregistered scheme can appoint its own replacement. The rule for a wholesale CCIV could be simply that ASIC must be notified of the change.
- If the above two requirements to hold meetings are removed as requested, and accordingly members do not need information about other members to convene a members' meeting, it should be possible to also modify section 1229D, so that a copy of the register of a wholesale CCIV is not available for public search. A wholesale MIS does not have to reveal its membership, so section 173 should not be applied to wholesale CCIVs.

Paragraph 1.20 of the draft CCIV Explanatory Materials notes the distinction between retail and wholesale CCIVs reflects the fact that sophisticated investors are more equipped than retail investors to negotiate bespoke contractual protection and assess investment risk. We also note that, in the Explanatory Materials accompanying the first exposure draft of the regulatory framework, paragraph 1.18 states that 'regulatory parity is maintained (to the extent possible) between the existing MIS framework and the CCIV framework', which is not necessarily the case in the context of wholesale vehicles for the reasons noted above.

A fund manager, promoter or consortium leader is likely to choose a less heavily regulated vehicle, all else equal, than a more heavily regulated one – there are obvious savings in time, cost and complexity, and less regulation often allows more flexibility to establish a vehicle compatible with the requirements of investors and the relevant transactions.

We appreciate the CCIV has been modelled on vehicles used more commonly as UCITS (retail) funds, and has been designed in conjunction with the Asia Region Funds Passport. As a result, the CCIV regime has been designed primarily with retail investors in mind. Nevertheless, the considerable time and effort which Treasury and industry has spent on designing and consulting on the regime warrants the design of a vehicle which will appeal to as broad a group of fund operators and investors as possible.

The CCIV framework should be intended to be asset-class and investor-class agnostic, so it can be readily adopted by all fund managers and operators; with the Passport framework then governing eligibility characteristics of operators, managers and products in relation to funds that will be distributed under than framework.

Looking forward, the limited partnership collective investment vehicle is likely to be useful to wholesale fund operators, given it is the vehicle of choice internationally for private equity and other alternative asset wholesale funds. It would be worthwhile for all three collective investment vehicles (MIS, CCIV and LPCIV) to be designed in such a way as to create regulatory parity.

7.3. Amendment of constitution

The draft Bill provides that the constitution of a CCIV may only be amended by a resolution passed at a meeting of shareholders in every sub-fund, voting in the aggregate on the proposed amendment, unless the change could have no adverse effect on members. There should be no difficulty in drafting constitution amendments so that they apply only to shares

in the class referable to the particular affected sub-fund, as a similar approach already occurs in the context of meetings of a class of members in a registered MIS.

It is likely that a CCIV constitution would include schedules or rules that apply only to a specific sub-fund. We submit that those sub-fund specific rules should be able to be amended by a special resolution where only shareholders of the particular sub-fund vote on the proposed amendment. This would ensure proper representation of investors and their interest, cost effectiveness and a more timely outcome. Requiring the shareholders of the entire CCIV to vote on a specific schedule will require an unnecessarily difficult process to be applied and hinder implementing changes that may be in the best interest of the cohort of shareholders in an efficient manner. There is also a risk, however small, that members of a particular sub-fund may be adversely affected by strategic voting by members of other unrelated sub-funds.

Similar arrangements could apply to any proposed constitutional amendment relating to more than one sub-fund. Where a proposed change affects the whole CCIV, then the existing requirement should apply.

We note the Singapore VCC rules provide that the directors of the VCC can modify the constitution to introduce a new sub-fund – see Clause 20(2)(a) *The Variable Capital Companies Bill.*

7.4. Conversion of company type

The CCIV draft Bill states the provisions allowing change of company type do not apply to CCIVs (see section 1222P of the draft legislation and the EM at 2.19).

The policy rationale for this broad prohibition is not clear, particularly as this precludes a listed investment company (LIC) becoming a CCIV with sub-funds. FSC members wish to see the transition provisions allow existing investment structures to transition to CCIVs, and recommend that the provisions include the ability to change company types in various situations.

We also note the draft CCIV tax legislation proposes that a CCIV could change its status to an ordinary company in a case where it ceases to meet the criteria to be taxed as a CCIV, but the corporate law provisions do not yet facilitate this.

More generally, the introduction of the CCIV regime provides a significant opportunity to facilitate product simplification and rationalization. The conversion process is important for the ability of managers to simplify their existing structures through the conversion of existing funds into a CCIV. It will have significant benefits to investors through product simplification.

- A product rationalisation scheme for financial services, including managed funds, was advocated by the Financial Services Inquiry in 2014, and the Government accepted this recommendation in 2015 – and no significant progress has been made

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on this issue.[11] A comprehensive rollover regime for CCIVs would help address this issue.

Effective rollover relief requires effective and flexible transitional provisions to allow a unit in an existing managed investment scheme to convert into a CCIV share.

As discussed in section 10 below, the members and assets of a single managed investment scheme (with associated obligations, tax treatment etc.) should be able to transition to become assets and members of a sub-fund of a CCIV. There are significant benefits if the transitional rules were broadly drafted to facilitate fund mergers.

On the same rationale, it would be desirable for investment companies (such as listed investment companies) to change company type and become a CCIV sub-fund. This should be in conjunction with the legislation being changed to accommodate listing. A change of company type, as opposed to a merger, avoids the need for the cost and complexity of members and assets with associated obligations and tax treatment moving from one entity to another.

As long as an entity meets the regulatory and tax requirements of its new status, there seems to be no policy reason why it should not change, assuming there is an appropriate process for disclosure to, and if necessary consent from, members.

The transition arrangements should be included in the Bill and not left to ASIC or for the future.

Further details about the transitional issues are in Section 10 below.

If a restriction on change of company type is to be included, a substance over form test should be applied; the purpose of the company rather than its legal form should dictate whether a change in company type can be accommodated, so as prohibit a trading company as opposed to an investment company from changing type.

7.5. Joint ownership of assets

Under section 1233K, no single item of property is allowed to form part of the assets of 2 or more sub-funds. This effectively means sub-funds are not permitted to jointly own assets.

We have previously made submissions that two or more sub-funds should be entitled to enter into a joint venture, for example, to hold real estate assets as tenants in common.[12] We submit that these points still stand.

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[11] See FSC Pre-Budget submission for 2019–20, available from: https://fsc.org.au/resources/resource-detail/?documentid=324ee583-4341-e911-a96b-000d3ae13a46

[12] Please see the following: https://fsc.org.au/resources/resource-detail/?documentid=ed126410-ac04-e811-812d-480fcff12ac1 and https://fsc.org.au/resources/resource-detail/?documentid=0ff0c487-28af-e811-815d-480fcff12ac1

8. International comparisons

Following on our observations on international competitiveness in Section 3 above, we set out below detail of some concerns that we believe render the CCIV model less internationally comparable and competitive compared to similar fund structures in other jurisdictions.

8.1. Transitional rules

While limited transition rules have been provided in the draft tax laws and are hoped for in the regulatory Bill, we are concerned that the framework will not be sufficient, and consider it important to include in the legislation transitional provisions that enable:

- the effective and efficient transition of existing managed investment schemes into CCIVs,
- a cost effective and timely solution to facilitate restructuring and consolidation of CCIV sub-funds, for example where sufficient scale is not achieved in a product; and
- the resolution of legacy product issues that are inherent in existing trust based investment funds.

This is discussed further in Section 10 below.

In broad terms, the simpler process for transition would be a statutory process providing investor protections rather than a requirement to seek ASIC relief and amendment of the MIS constitution. This is discussed in Section 10.4 below.

8.2. Transfer of funds from offshore

Tied to this is the absence of any suggestion that there will be a framework for transfer of registration of (or ability to redomicile) investment funds that are currently established in offshore jurisdictions to hold (directly or indirectly) interests in Australian assets. Moreover, recognising that the VCC rules do provide for re-domiciliation, we believe there is a requirement to consider the downstream implication for Australian funds that might arise, should, for example a Cayman domiciled entity that is used as a special purpose holding vehicle for Australian investments is re-domiciled in Singapore, particularly given the former arrangement is commonly encountered for wholesale MITs.

If the tax and regulatory settings for the CCIV are set appropriately, then the CCIV could be a selling point for Australia to encourage managed funds to re-domicile from overseas into Australia.

8.3. Requirement for a compliance plan and compliance plan audit

The requirement for a compliance plan and compliance plan audit provides for an assurance architecture that is – as far as we can establish – unique to Australia. Whereas this may have represented best practice when first introduced approximately two decades ago, an emphasis on risk management (with compliance risk management considered in context of all other material risks) represents prevailing global practice in relation to governance, oversight and assurance.

The CAMAC in its 2014 Discussion Paper canvassed the issue of governance, risk management and compliance for managed investment schemes in some depth, noting amongst other things, the development of international risk management standards for managed funds and that compliance risk represents one of a portfolio of risks that require identification, assessment and treatment in connection with operation of a managed investment scheme. Three options for scheme compliance were canvassed; maintenance of the status quo, introduction of a risk management framework specific to schemes to operate concurrently with the existing compliance regime or subsuming the compliance regime into a broader risk management framework for schemes. Our understanding is that the third option (an integrated risk management framework) aligns to contemporary international practice.

Moreover, dual regulated entities or entities that operate in Australia but are part of a global group cannot leverage a consistent framework for governance and oversight of risks, noting Australian requirements for investment funds may not align with APRA's requirements for superannuation funds or the requirements of their home jurisdiction. This results in ongoing operating costs due to the need to maintain parallel risk management and compliance frameworks and policies, procedures and processes to meet the requirements of both.

Though difficult to quantify (as this will depend on nature, scale and complexity of each group), adopting a uniform framework across all investment pools that is informed by APRA and international practice will provide for operational simplification and enduring cost savings to groups that operate across jurisdictions, financial service sectors and/or across licence authorisations.

8.4. Implementation and timing

It is recognised that the suggestions in Sections 8.2 and 8.3 above require consideration at a policy level. If timing of progress of the CCIV legislation into Parliament does not permit full implementation of the concepts to fully internationalise the model at this stage, the principle for funds to re-domicile into Australia, and for compliance processes to be modernised, could be built into the legislation, with the detail to follow in regulations or CCIV rules published by ASIC.

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9. Other technical issues

EM	Section	Issue	Comment
Registration of CCIV			
1.35	1223E	The constitution of a CCIV must be enforceable among its members.	This is not the case for managed investment schemes: section 601GB just requires the constitution to be enforceable as between the responsible entity and members. Section 140 makes an ordinary company constitution binding among members. As a CCIV is more similar in its purpose to a managed investment scheme, where the members are passive investors, why should they have rights against each other? The legislation should be amended so that paragraph (1)(c) of section 140(1) is disapplied for CCIVs.
	1223G(c)	The constitution must state that the CCIV has power to borrow or raise money.	This should be re-expressed to say that if a CCIV is to have the power to borrow, it must be stated in its constitution. That will align the requirement with managed investment schemes, and allow for the existence of funds that specifically wish to prohibit borrowing, for example a fund that is promoted on the basis that it is acceptable under Sharia law.
	1227A	The scope of obligations under a compliance plan is expressed differently to that for a MIS, and there is no apparent reason for this. The CCIV provision refers to measures to be applied in fulfilling its responsibilities in relation to the CCIV to ensure compliance with the Act and constitution.	This compares with the existing MIS requirement to set out measures the responsible entity is to apply in operating the scheme to ensure compliance with the Act and constitution. Unless there is a particular reason for using different language (which should be explained) it is suggested that consistent terminology be used.
1.47		The explanatory memorandum states that the depositary must execute lawful instructions.	This was a provision of the prior draft of the legislation which has, fortunately, been removed. The EM should be amended to align with the new draft.

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EM	Section	Issue	Comment
2.29	1222	The requirements for registration as a CCIV include that it “is” a company limited by shares	The CCIV will not be a company until it is registered. This should be changed to “will be” or “is proposed to be”.
Corporate governance – including depositary			
3.86	1223H(2)(a)	The constitution must specify a period within which a redemption must be satisfied while the fund is liquid.	We appreciate that the reason for this change could be that the period for redemptions is the point of reference for determining whether a fund is “liquid”. However, it should be drafted to allow for circumstances where the intended timing for redemptions simply cannot be met. This occurred during the financial crisis of 2007/8 when quite suddenly it became impossible to calculate a fair price for the assets of fund and accordingly a fair redemption price could not be calculated. This provision should change “must” to “will normally” or an equivalent expression, to allow for unanticipated circumstances such as a market freeze. Under the MIS law, ASIC has discretion to allow constitutions to include such qualifications on the redemption period, but the CCIV law as drafted would prevent that common sense outcome.
3.339	1228E(2)	Related parties of a CCIV are stated to include a person engaged by the corporate director.	This would mean that any third party service provider engaged by the corporate director, such as an independent third party fund manager they engage to manage the assets of a sub-fund, is a related party. This does not make intuitive or practical sense.
Financial services regulation			
9.27	1244N	The PDS regime applies to an offer of securities in a CCIV	There is no mention in the EM of the changes to permit or require a CCIV that is the equivalent of a “simple MIS” to be offered in the 8 page shorter PDS format. We suggest that the substantive disclosure requirements for an investment fund should be the same irrespective of whether it is structured as a CCIV sub-fund or MIS.

EM	Section	Issue	Comment
9.27	1244N	The express application of the PDS regime under this section suggests that without this provision, the shares in a CCIV sub-fund are considered to be securities for which the disclosure would otherwise be regulated under Chapter 6D. However this is not clearly stated and it would be helpful to put the point beyond doubt in the EM, if that is Treasury's view.	A share in a company is, in concept, an interest (issued by the company) in the capital of the company[13]. An interest in a managed investment scheme is an interest (issued by a company, the RE) in a pool of assets held by the RE for the investors. It is arguable that each sub-fund is a pool of assets held for the investors, and that the interest issued is not in the overarching capital of the company but in that pool. Unless a share in a CCIV falls squarely into the exemption in the definition of managed investment scheme for an interest in a body corporate, it will be an interest in a MIS as well as a share, and a provision expressly disapplying the MIS regime would be needed. Clarification of this point, at least in the EM, would be helpful.

[13] Section 761A defines a security to include a share IN a body, including a body corporate (not a share issued by a body corporate).

10. Attachment – transitional issues

We submit that it is important to facilitate transition of existing investment funds into a CCIV structure. The tax issues relating to transition are addressed in a separate submission.

Transition could be achieved by a process akin to a traditional trust scheme (see Section 10.2), or purely by legislation (see Section 10.4).

10.1. Considerations in facilitating transition

The following issues should be considered in developing transitional rules:

- **Investor protection and efficiency:** It is important that there be an appropriate balance to protect the interests of unitholders in a managed investment scheme (**MIS**) which it is proposed to transition to a CCIV, whilst facilitating the conversion without undue process and associated costs. The proposals below take into account those factors.
- **"Exchange" of securities:** A typical transition will involve an investor foregoing a unit in a MIS and receiving a share referable to a sub-fund of a new or existing CCIV. A legal mechanism to simultaneously transfer, redeem or cancel all of the units, and at the same moment issue the shares, without the individual consent of each investor is needed. The different mechanics for this are set out below.
- **Vesting of property:** The assets and liabilities of the MIS must be vested in the CCIV or its depositary, in respect of the correct sub-fund, at the same moment as the shares are issued. Section 601FS of the Corporations Act, and 1224ZA and 1226Y of the CCIV Bill, set the precedent for this process. Because statutory "novation" provisions of this nature vest the assets of the fund in the CCIV or its depositary without the need for any form of transfer, tax liabilities for investors such as capital gains tax and stamp duty should not be triggered. However, confirmation from appropriate revenue authorities will be needed.
- **Contracts and other documents to which the responsible entity or trustee is party for the MIS:** If contracts have been entered into for the MIS, they will remain binding on the responsible entity or trustee unless a change of party is individually agreed to by each counterparty, or legislation provides for novation so that the CCIV becomes a party in place of the responsible entity or trustee, with the correct sub-fund nominated. The mechanism under section 601FT of the Corporations Act, and 1224ZB and 1226Z of the CCIV Bill, sets the precedent for this process.
- **Fiduciary and statutory duties:** In implementing a trust scheme, the responsible entity of a registered scheme must be comfortable that the decision to propose the trust scheme is in the best interests of members and consistent with its duties, and a trustee has similar fiduciary duties. A statutory "blessing" of the transition would avoid the need for a court hearing to seek judicial advice, or the expense of other legal advice on the point, which would be the same or similar question for each fund; that is, a comparison of rights and obligations of investors under the CCIV regime as opposed to the MIS regime.
- **Becoming a member of a company:** Section 231 of the Corporations Act requires that a person agree to become a member of a company, and 100% of members must

agree unless their agreement is deemed by statute or under a trust scheme process, where the trustee or responsible entity is empowered to agree on their behalf. Again, this is best achieved by statute.

- **Wholesale managed investment schemes:** If a wholesale investment trust wishes to transition to become a CCIV, ASIC has no power to assist it with relief because it only has powers in relation to registered schemes. The trustee would need to obtain the consent of 100% of investors, or at least hold a meeting to pass a special resolution, and agreement of all contractual counterparties to achieve transition. Legislation could remedy this gap, and transition could be on the same conditions as for retail clients and so not require more than a little additional legislative drafting.

10.2. Process for conversion – trust scheme and legislative amendments

The conversion of one or more MISs into sub-funds of a CCIV by the trust scheme[14] method would require amendment of the terms of the constitution of each MIS. The amendments would, amongst other things, empower the responsible entity or trustee of the MIS to act as attorney of each member in a transaction which is effectively an exchange of units in the MIS for shares referable to a sub-fund of the CCIV. The exchange of units for shares would be put into effect by transfer of all units to the CCIV in exchange for issue of the same number of shares to each investor, as if the MIS and CCIV were undertaking a trust scheme merger. In a trust scheme, responsible entity or trustee would typically approach the Court for judicial advice to confirm that it is acting in accordance with its duties, but a statutory provision confirming that such a change would be taken to be in the best interests of members would alleviate that concern (see 10.1(e) above).

Under the law as it stands, particularly following the recent High Court decision in *ASIC v Lewski*[15], it is clear that for registered managed investment schemes a members' meeting would be required to pass a special resolution to make the amendments to a MIS constitution needed for transition by trust scheme. As the amendments would be materially similar for every MIS that sought to transition and would be for the same purpose, a members' meeting for every MIS involved would be a waste of fund assets. We propose that an appropriate level of investor protection would be afforded in the case of transition without necessarily holding a members' meeting if ASIC relief from the meeting requirement was granted on conditions that mirror the existing relief for AMITs in *ASIC Corporations (Attribution Managed Investment Trusts) Instrument 2016/489*. The transition provisions could reflect wording in that instrument, in so far as it allows amendments to the constitution that are necessary or incidental for the process to convert to the CCIV regime.

The query has been raised as to whether the threshold for the proportion of units that would allow members to requisition a meeting, which is 5% in Instrument 2016/489, should be different as between funds that permit redemptions on request as opposed to illiquid funds that can only allow redemption by withdrawal offer. We submit that the threshold should be the same in all cases. Investors subscribe based on the terms of the investment, including

[14] "Scheme" in this context refers to a process analogous to a scheme of arrangement. It is not a reference to a managed investment scheme.
[15] [2018] HCA 63

the conditions for withdrawal. The change of structure would not affect the performance of their investment or whether they can withdraw, only the type of security and the legislative framework. If the tax legislation is amended to address our remaining concerns (to be noted in our separate submission) there should also be no disadvantages to the transition from that perspective.

As well as a method of exchanging a unit for a share, statutory provisions would also be needed, to vest the assets of the former MIS in the CCIV or its depositary, and provide that contracts and other documents have effect as if the CCIV (for the relevant sub-fund) had originally been a party to them from the moment the shares are issued (see 10.1(d) and (d) above). Legislation is needed for this step because it is not desirable that fund property be the subject of individual transfers, as stamp duty may be incurred, which would be unnecessarily disadvantageous to investors.

The responsible entity or trustee could enter a customary merger implementation agreement with the CCIV, but this may not be necessary if the transition provisions are adequate.

Immediately following the transition, the CCIV or its depositary would hold all the units in the MIS, but as the trust would no longer have any property, it would cease to be a trust in equity and, if it is registered as a managed investment scheme, the former responsible entity could proceed to deregister it.

10.3. Constitutional amendments similar to the AMIT ASIC relief instrument

If ASIC relief for constitution amendment to facilitate transition is granted on similar terms to *ASIC Corporations (Attribution Managed Investment Trusts) Instrument 2016/489*, responsible entities proposing to rely on the relief would need to provide notice to MIS members of the proposed amendments, and will be relieved of the requirement to hold a members' meeting provided that they do not receive a request for a meeting by a specified percentage of members.

Broadly, the conditions are:

1) Responsible entities need to post a statement on their website explaining that:
   a) the Trustee intends to:
      i) amend the constitution, the reasons for this and the effect of the amendments.
      ii) undertake a statutory merger in accordance with the constitution and the enabling provision to be included in the Bill, the reasons for this and the effect of the conversion.
2) The statement will also need to explain that members can make a request within seven days that a meeting be called and give an email address for members to make this request.
3) If five per cent or more of the total number of members request a meeting within seven days of the statement being posted on the website, a members' meeting will be required to approve the amendments and the statutory merger.
4) If no members' meeting is required after seven days since the statement was posted on the website, responsible entities can:
   a) make the amendments without the need for member approval;

b) resolve to undertake the statutory merger.

A simple notification process applies under the relief where all members of the scheme are wholesale clients.

10.4. Process for conversion – statutory process only

The process could be further simplified if the CCIV Bill provided that, following satisfactory completion of a process of notifying members and allowing for a meeting on request, the former responsible entity or trustee could give notice of the proposed transition to ASIC and apply for registration of a CCIV (or a sub-fund of an existing CCIV) specifying that the members on establishment would be all the members of the transitioning MIS. The provisions could state that upon issue of the shares each corresponding unit is cancelled.

This would provide the same investor-protection steps, but avoid the need for ASIC relief and amendment of the MIS constitution which would, in any case, become a redundant document after transition. We are conscious that this proposal is slightly different to that raised in earlier consultations, but as statutory provisions of the kind described in paragraphs 10.1 (c) to (f) above are needed in any case, it may be preferable to streamline the transition process by setting it all out in the Bill.

There is some historical precedent for this in the legislative provisions that facilitated transition of prescribed interests to managed investment schemes under the *Managed Investments Act 1998.*

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11. Transition from listed investment companies into a CCIV

A listed investment company is already in a corporate form and has a specific tax regime which applies to it.

The approach taken to the vehicle to be rolled into the CCIV may be simplified as it is unlikely that the listed investment company would have different classes.

The suggested approach is that the existing corporation be converted into a CCIV. That is, the existing corporation has its status under the terms of the corporations law altered.

11.1. Amendment of constitutions

The conversion is likely to require an alteration to the terms of the constitution for the listed investment company so as to ensure its compliance with the requirements for the new CCIV regime.

As listed investment companies hold a general meeting each year, it may be possible to amend the terms of the relevant constitution at a general meeting.

11.2. Form of statutory merger for a LIC

A change of company type from LIC to a single sub-fund CCIV would involve an election by the LIC to undertake a statutory conversion in the manner prescribed by transitional rules. The rules could provide for notification and opportunity for a members' meeting, similar to the suggestion for MISs above, and either transfer of the LIC shares to the CCIV, which would then wind up the LIC, or statutory cancellation of the LIC shares upon issue of the CCIV shares.

11.3. Form of statutory relief for a LIC

If the transitional legislation does not authorise the amendments to the constitution for the original vehicle, this is less problematic than for managed investment schemes, as LICs already hold annual general meetings to which the resolution could be put. For consistency, it would be preferable if the regime did facilitate these changes without a shareholder meeting.

The transitional legislation would not need to provide for the statutory vesting of property and rights, as in the case of a MIS.