FSC

FINANCIAL SERVICES COUNCIL

Corporate Collective Investment Vehicle Draft regulations

FSC Submission to Treasury

21 January 2022

1. About the Financial Services Council

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

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. 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 $3 trillion on behalf of more than 15.6 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. General Comments

The FSC welcomes the opportunity to provide a submission on the Draft Regulations for the Corporate Collective Investment Vehicle (**CCIV**).

The FSC's members support the Draft Regulations, and welcome the changes made from previous iterations of the CCIV policy proposals following discussions with FSC members. In particular, we welcome the approach taken in the Draft Regulations relating to cross investment.

3. Holding of assets (Part 8B.5)

The FSC makes the following comments on Part 8B.5 of the Draft Regulations.

This part of the Draft Regulations applies – in condensed form – the same sort of rules for holding of assets of a CCIV as apply to registered schemes and custodians under ASIC Class Orders [CO 13/1409] and [CO 13/1410].

The FSC welcomes the reduction in prescriptive detail in the Draft Regulations, as compared to the Class Orders. However, in some cases the use of different language has resulted in the following issues:

- Foreign bank accounts: A significant reason why operators of equity funds use custodians is because global custodians have the relationships in various countries around the world to allow trading on markets in those jurisdictions. Trading in a foreign jurisdiction will typically require some of the Australian fund's cash to be held in that country for settlement of trades. There will need to be a commingled bank account held by the global custodian in that country for settlements for its clients. In the Draft Regulations, the rules for omnibus cash accounts in 8B.5.60(1)(b) refer to a deposit-taking facility made available by an Authorised Deposit-taking Institution

(**ADI**). The FSC submits this should be broadened to include accounts with foreign banks, many of which will not be ADIs.

- Securities: This word has two meanings in the Corporations Act, in sections 9 and 92 respectively. The FSC submits it should be clear that interests in managed investment schemes can be held in omnibus accounts along with CCIV shares, so it would be preferable to make it clear that the section 92 definition applies, as it is broader. See 8B.5.60(1)(c) of the Draft Regulations and the reference to section 92 in the Class Orders.

- Adequate safeguards: The FSC considers the new concept in the Draft Regulations in 8B.5.60(2)(b) is appropriate, but the FSC submits it should be clear that simply having the assets held on trust (which is mandatory for assets in Australia and implemented as far as practicable in other jurisdictions) meets the requirement to put in place an "adequate safeguard". The FSC submits this would be best addressed by amending the provision to say "a requirement that assets be held on trust or that there are other adequate safeguards in place for the protection of the prescribed assets".

- Topping up omnibus accounts: The FSC submits that 8B.5.60(2)(e) of the Draft Regulations be amended to refer to "ensure that the discrepancy is rectified" rather than "rectify the discrepancy" so that the deficiency in the account can be topped up by someone other than the custodian, for example where the deficiency is caused by one of the custodian's other clients. This is consistent with the MIS Class Orders.

The FSC proposes the changes above in order to bring the rules more closely into line with the same rules for responsible entities and custodians, so the FSC submits these changes should be uncontroversial. They are, however, important for consistency with the requirements in the Class Orders, as custodians are likely to have to comply with both.

4. Distributions

The FSC recommends that a regulation be made, under section 1231A, to state that a distribution made by a CCIV sub-fund may be sourced from profits or share capital and that there is no need in making the distribution to delineate the extent to which the distribution represents either profits or share capital.

The argument for this change is below.

4.1. Solvency distribution requirements

The basis for a distribution by a CCIV sub-fund should not depend on whether, and to the extent that, the relevant amount is sourced from profits or share capital.

As a variable capital company, it should not be necessary for a CCIV to have differential treatment for the purposes of the corporations law of a particular form of distribution. This is,

in part, because the CCIV regime has been designed to align with the attribution managed investment trust (**AMIT**) regime, and the law does not recognise any distinction between different sources of AMIT distributions, rather it focuses on the attribution of the relevant taxable income.

Although the Explanatory Memorandum to the CCIV Bill recognises that there is no explicit requirement for sub-fund dividends to be paid from profits, there is a concern that the CCIV provisions which require an amount to be treated as a dividend impose an implicit requirement that those dividends must be sourced from profits. This is at odds with the essential element of a variable capital company.

A similar issue arose in the consideration of the provisions dealing with dividends for a conventional company under Section 254T of the Corporations Law.

The ability for a sub-fund to make distributions should not depend upon having to decide whether, and to the extent that, the relevant amount is sourced from accounting profits or share capital. The existing provisions arguably appear to require this decision to be made.

4.2. Primary tax treatment

The tax treatment of CCIV sub-funds is dependent upon the appropriate attribution of the taxable income to members of a relevant sub-fund.

4.3. Default tax treatment

FSC members have expressed concerns about the operation of the default tax treatment of a CCIV sub-fund.

One concern is the CCIV sub-fund reliance on the concept of a dividend for tax purposes. This results in the specific provisions within the tax definition of a dividend being required to be considered when sub-fund distributions are being made. This is because of the specific inclusions and exclusions which are based on share capital accounts for tax purposes. The reliance for tax purposes on these concepts can result in inappropriate outcomes for sub-fund members.

Moreover, it creates an inappropriate administrative burden to maintain records for the purposes of the tax rules about what constitutes a sub-fund's share capital in circumstances where the sourcing of the relevant amount is not relevant or appropriate to be taken into account.

4.4. Combined impact of corporate and tax rules

The combined impact of the corporate and tax rules for CCIVs is to create an artificial need for a sub-fund to maintain distinctions between profits and share capital and to differentiate when making distributions about the extent to which the relevant distribution is from profit or alternatively from share capital.

However, the FSC submits there should be no difference, for corporations law purposes, when a sub-fund distribution is made to determine whether that distribution is to be made to members from accounting profits or share capital.

The FSC also submits that incorporation, even indirectly, of the application of the accounting standards as a means for determining when and how distributions can be made by a CCIV is not appropriate.

Therefore, the FSC recommends that the use of the regulation making power relating to capital distributions should be used to reduce this unnecessary complexity.

4.5. FSC Proposal: Use of specific regulation to remove the distinction between profits and share capital

There is a regulation making power in section 1231A which enables distributions to be made from share capital in specific circumstances prescribed in those regulations.

The FSC submits this regulation making power should be used to ensure that there is no need, for corporations law purposes, to distinguish the source of a distribution as being from either profits or share capital. The FSC recommends the regulation should make it clear that a distribution made under the power may be sourced from profits or share capital and that there is no need in making the distribution to delineate the extent to which the distribution represents either profits or share capital.

This proposal would remove the need for an artificial distinction about the making distributions from a sub-fund of a CCIV for Corporations Law purposes. It would also provide an important basis for removing the significance for Corporations Law purposes of the source of the distribution.

The FSC submits that this flexible approach could accommodate an outcome where the existing tax rules proposed for the CCIV regime are able to be administered by the ATO in a manner which does not require inappropriate record keeping and unnecessary sourcing of distributions to members of the sub-fund.

This approach should facilitate a sensible administration of the default tax rules dealing with sub-funds and remove unnecessary complexity and cost. It should leave the tax attribution provisions as the relevant code to attribute the taxable income of the CCIV to the members.