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The Treasury
Langton Crescent
PARKES ACT 2600

By email: CIVreform@treasury.gov.au

Exposure draft legislation on Corporate Collective Investment Vehicles – 2nd tranche

The Financial Services Council (FSC) welcomes the opportunity to make submissions on the second tranche of the *Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2018* and explanatory materials.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 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.

As indicated in the FSC's submission on the first tranche of the Corporate Collective Investment Vehicle (CCIV) legislation, the FSC has for some time been supportive of a corporate vehicle for collective investment. We consider the CCIV is vital to securing Australia's growth prospects and potential for financial services exports.

The FSC's comments (attached) are focussed on ensuring the CCIV regime works as intended.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

[signed]

Michael Potter
Senior Policy Manager

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2 Comments on Part 8B.12- External administration

2.1 Statutory demand not required to identify a sub-fund

Proposed section 1249G(2) states that a statutory demand served on a CCIV need not identify a sub-fund of the CCIV.

We note that the explanatory memorandum at paragraph 2.28 states "*bespoke rules are used to compel the CCIV, rather than the creditor, to identify the relevant sub-fund. This ensures that creditors who may be unable to identify the relevant sub-fund are not disadvantaged and recognises that the CCIV is best placed to identify the sub-fund to which a liability has been allocated*."

We submit that the above explanation for not requiring a creditor serving a statutory demand to identify the relevant sub-fund in respect of which the statutory demand relates is excessively weighted to the benefit of creditors and against the interest of investors in other sub funds of the CCCIV.

We understand that this provision is seeking to protect small creditors (eg the cleaner or stationery provider) or broader claims (eg an environmental claim) but we consider these situations will be the exception rather than the rule. We consider that it should be the responsibility (and should be the subject of standard commercial arrangements) for a creditor to have identified in their contractual arrangements with a CCIV the relevant sub-fund they have contracted in relation to (noting, however, this does not apply to claimants who have claims which are not contractual claims). This accords with the legislative principle of ring-fencing the liabilities of a sub-fund and legislative intent to ensure that members of a sub-fund are not affected by the liabilities of another sub-fund.

On this issue, we consider that the legislation should be primarily directed at standard commercial arrangements and, if considered necessary, include some protections for more unusual circumstances.

Accordingly, we submit that there should be a requirement to nominate the relevant sub-fund in any statutory demand but there could be some provisions that provide a mechanism for creditors to obtain information from the CCIV confirming the correct sub-fund.

The statement by the creditor in the statutory demand as to the identity of the sub-fund would be presumed to be correct, providing a level of protection to creditors, but that presumption would be rebuttable by evidence provided by the Corporate Director or any other interested person – noting that the Corporate Director is required to act in the best interests of CCIV members, and so should take steps to correct any incorrect notices.

The provision, as currently drafted, could strongly disadvantage the CCIV and the Corporate Director. This is because the CCIV may have multiple sub-funds and the creditor serving the statutory demand may have a liability with respect to one or a few sub-funds. If a statutory demand is issued to the CCIV as a whole, if publicly announced, this will have a detrimental reputational and commercial impact on the CCIV and the Corporate Director, in particular where members (and the general public) do not have an understanding of the external administration rules and procedures relating to CCIVs. In the statutory demand process for companies (under the Corporations Act 2001 (Cth) (**Corporations Act**)), it is a requirement that the relevant party issuing the statutory demand properly identify the company to whom the statutory demand is to be addressed and served. We see no difference here. A relevant creditor should know which sub-fund they have contracted in

relation to with the CCIV in respect of the relevant liability and should therefore, in the statutory demand, identify the correct sub-fund.

We also submit that the following wording should be removed from page 9 of the Explanatory Memorandum (and any associated sections of the draft legislation) based on the same reasons set out above: *"If the CCIV fails to comply with the statutory demand and it has multiple sub funds, the CCIV is taken to have failed to comply with the statutory demand in respect of each and every sub fund unless it identifies the relevant sub fund or sub funds in a written notice."*

2.2 Application for a winding up order need not identify a sub-fund

Proposed section 1249L(2) and 1249L(3) state that applications for a winding up order (under sections 234, 459P, 462 or 464 of the Corporations Act) and applications for leave to make a winding up order (under section 459P of the Corporations Act) do not need to specify the sub-fund.

For similar reasons stated above, we submit that the relevant member, creditor or regulator making any such application (whether under any of sections 234, 459P, 462 or 464 of the Corporations Act) should be required to identify the sub-fund. An application for a winding up order is a public court document and if the application only states the CCIV as the respondent (and the application is not required to specify the sub-fund) this could result in adverse reputational and commercial impact to the CCIV and the Corporate Director. There will be a time lag between when such application is made (and publicly announced) and when the CCIV is able to respond identifying the name of the relevant sub-fund in its response (by way of public announcement). Accordingly, in this time period there could practically be reputational and commercial damage to the CCIV and Corporate Director, in particular where members do not understand the external administration rules and processes applicable to CCIVs. Further, we consider that it is not appropriate from a policy perspective that an applicant be permitted to make an application without having the relevant information as to which sub-fund the application relates. This could lead to mischief in the manner in which the application is used to put pressure on, and gain leverage, against the CCIV and the Corporate Director for ulterior purposes.

For these reasons, we submit that the relevant applicant should be required to specifically state the name of the sub-fund of the CCIV in respect of which an order for winding up is made.

2.3 Sub-fund winding up – appointment of liquidator

In the draft provisions relating to winding up, whether a voluntary winding-up, creditor winding-up, member winding-up or regulator winding-up (including under any of sections 234, 459P, 462 or 464 of the Corporations Act as set out in section 1249L), in each case the provisions do not state who appoints the liquidator, how the liquidator is appointed and when the liquidator is appointed.

We request that Treasury inform stakeholders as to whether there will be additional provisions which provide the required detail in respect of these arrangements for the appointment of a liquidator.

2.4 Sub-fund name and ARFN to be used on written documents

Proposed section 1249N states, in general terms, that in the winding up of a CCIV the name and ARFN of the relevant sub-fund being wound up must be set out in the relevant document.

It is not clear how to reconcile this requirement with the option (in proposed subsection 1249L(2)) that applications for leave to make a winding up order and applications for a winding up order need not specify the sub-fund.

2.5 Ipso facto clauses

We note that the insolvency provisions in respect of CCIVs and CCIV sub-funds have not yet been released however we make the following observations:

- In September 2017 the Parliament passed the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act 2017 (Cth)* (**Act**) which introduced significant reforms to Australia's insolvency regime, including the imposition of a stay on the enforcement of certain contractual rights when a contractual counterparty suffers certain types of insolvency events, namely voluntary administration, receivership or scheme of arrangement. The new regime, known as the ipso facto regime, came into effect on 1 July 2018.
- We believe that the ipso facto regime should apply to CCIVs and CCIV sub-funds as these bodies should benefit from the protection afforded under the new regime. The explanatory memorandum in respect of the Act provides that the purpose of the new regime is to "promote the preservation of enterprise value for companies, their employees and creditors, reduce the stigma of failure associated with insolvency and encourage a culture of entrepreneurship and innovation."

2.6 Voluntary administration and ASIC-initiated wind up procedures

We request Treasury provide further information about why the voluntary administration and ASIC-initiated winding up procedures will not apply to CCIVs.

3 Comments on Part 8B.17- Financial Services and Markets

3.1 General comment about drafting

We note that the current drafting seeks to insert amendments into the Corporations Act by inserting deeming provisions in the proposed Chapter 8B. Terminology such as 'treat' and 'as if' are used as devices to give effect to these deeming provisions.

We consider that there will be ambiguity and complexity arising as a result of this method of statutory drafting. An example of the confusion caused by these linguistic devices is set out below in our commentary regarding proposed section 1250C (see section 3.2 of this submission).

Further, we do consider that any merit associated with including all CCIV provisions in proposed Chapter 8B in that chapter is outweighed by the ambiguity and complexity caused by this approach. Regulated persons and their advisers will be required to read settled provisions in other Chapters of the Corporations Act subject to these deeming provisions, which adds to complexity.

Therefore, the FSC considers it would aid the implementation and understanding of these machinery provisions in tranche 2 of the exposure draft legislation if the amendments were made to relevant provisions of the Corporations Act so that the provisions relating to CCIVs could be viewed in context.

3.2 Extra kinds of financial services described in proposed subsection 1250C(1)

We consider that the drafting in proposed subsection 1250C(1) is unclear. It appears that the intention of the section is to state that:

a) operating the business and conducting the affairs of a CCIV is a financial service for the purposes of section 766A; and
b) acting as a depositary of a CCIV is a financial service for the purposes of section 766A.

If the above understanding is correct, we consider that section 766A should be modified to include the above types of financial services in the list of financial services in that section, similarly to the way that providing a crowd-funding service was added as paragraph 766A(1)(ea).

Further, we consider that is unnecessary to refer to '*operates the business and conducts the affairs of*' a CCIV in the description of the financial service provided by the corporate director. Borrowing from paragraph 766A(1)(d) relating to operating registered schemes, we consider that it would be sufficient and simpler to use similar terminology such as '*operate a CCIV*'. Further, the concept of 'operating a business' may cause unintended consequences from a taxation point of view because a CCIV is intended to be a passive flow-through tax vehicle that does not actively engage in a trading business – while 'operating a business' could imply some elements of trading. The expression "carry on business" has a particular meaning under Australian law, for example in the context of whether a financial services licence is required, and to use it in the context of operation of a CCIV would be confusing. Similar changes would also be required elsewhere for consistency such as section 1250L.

We also submit that the similar wording in proposed paragraph 1237J(1)(a) also be reviewed for these reasons.

3.3 Clients of a depository's financial service

Proposed subsection 1250C(2) states that each of the members of a CCIV is a client for the purpose of the financial service of acting as a depositary of a CCIV. This provision suggests that a depositary would be providing a financial service to shareholders in the CCIV, suggesting a direct legal relationship between a depositary and CCIV members.

We consider this provision to be inconsistent with the principles established in the first tranche of the CCIV legislation released in June 2018. The effect of proposed Subdivision B of Division 4 of Part 8B.2 is that depositary holds the assets of a CCIV on trust for the CCIV and not on trust for the CCIV members. Proposed section 1234N states that in exercising its powers and carrying out its duties, the depositary must act in the best interests of the CCIV (not the CCIV members), and this section in the revised tranche one of the draft legislation was modified from the former proposed section 1164D (under the first draft of the CCIV issued in August 2017) to delete specifically the obligation of a depositary to apply an equal treatment rule in respect of CCIV members.

Further:

- if a depositary is providing a financial service to a retail client then it will need to give that client a Financial Services Guide under section 941A of the Corporations Act; and
- a number of the larger custodians who operate in the Australian market and may otherwise be inclined to provide depositary services for CCIVs are not licensed to provide financial services to retail clients and are not required under current arrangements to have that authorisation. This is because they provide services to the responsible entities of registered schemes and the trustees of regulated superannuation funds, which are always wholesale clients. Requiring a different model so that these providers are excluded from the market for depositary services could limit competition.

We request that the reference to paragraph (1)(b) in subsection 1250C(2) be removed.

3.4 Listing of sub funds and takeover laws

The Explanatory Memoranda for tranches 1 and 2 of the Exposure Draft have indicated that listing of a CCIV will be prohibited, and the takeover laws will not apply to CCIVs, with the understanding this issue will be reconsidered later. We do not think that this important aspect of fund structuring

should be left for later consideration. Fund managers are increasingly looking to financial markets to provide liquidity and convenient dealing for investors in managed fund products, as evidenced in the growth of ETFs and managed fund products quoted on ASX's AQUA market, and ASX's fund settlement platform, mFund. However, AQUA only accommodates certain types of funds, generally those with assets that are transparently and frequently priced, and so does not include funds that invest in property, infrastructure or private equity, for example. To provide liquidity for investors, these types of funds seek listing on an exchange. It would seem to diminish the utility of the CCIV regime if listed funds cannot be accommodated. Further, there seems to be no policy reason why a listed sub fund of a CCIV should not be subject to the same takeover laws as apply to listed managed investment schemes. Such laws provide protection for minority investors, and ensure they are entitled to share in any control premium paid on an acquisition.

More significantly, while the use by CCIV sub funds of the trading and settlement facilities offered by AQUA and mFund would seem to require only changes to ASX's rules governing those platforms, the Exposure Draft does not currently facilitate listing of a CCIV sub fund on a financial market. This is because, when a sufficient number of shares are acquired on market for a bidder to requisition a meeting to vote on a change of corporate director, the special resolution, if it is passed, would change the corporate director for all sub funds in the CCIV at the same time, not just the one in which the bidder has acquired the shares (section 1238N). The ability to change corporate director of one sub fund only could be achieved by a provision that requires the requisitioning shareholders to propose an alternative CCIV and corporate director to which the assets and obligations of the sub fund would pass by "statutory novation", which proposal is sanctioned by a special resolution of members of that sub fund only.

A sub fund could effectively be taken over by acquisition on market of units, whether the takeover provisions apply or not. If the ability to allow separation of the sub fund from its existing CCIV/corporate director structure is not contemplated in the legislation, it may not be possible to allow listing without returning to the Parliament with a bill to amend the Corporations Act, because the issue goes to the basic structure of a CCIV. This may make the CCIV regime unattractive to fund managers and promoters.

3.5 Definition of managed investment scheme

Each sub fund of a CCIV will have the characteristics of a managed investment scheme – people contributing money to a pooled fund which is not controlled by them, and a separate plan of action (investment mandate) that applies to the sub fund. This means that, notwithstanding the reference in section 9 to a body corporate being carved out of the definition of managed investment scheme, the shares in a CCIV which are referable to a sub fund could be interests in that sub fund which could be categorised as interests in a managed investment scheme. We suggest modification of the definition in section 9 to manage this risk by providing that a CCIV sub fund is not a managed investment scheme. Otherwise, a disappointed investor may be able to claim that a sub fund is a scheme which should have been registered, encouraging remedies for the "scheme" to be wound up and for investors to make civil claims.

One consequence of this analysis is that Treasury may need to consider whether a CCIV share which is referable to a sub fund is automatically covered by the definition of "security" in the Corporations Act, or if it should be added to the list of specific things that are financial products in section 764A.

3.6 Product Disclosure Statements

This provision states that section 1012E applies to financial products that are securities in a CCIV. For this exception to function on a comparable basis to managed investment schemes, the ceilings of 20

investors and $2 million in 12 months should be applied to each sub fund, not to the CCIV as a whole.

This is one of a number of cases where the Exposure Draft does not appropriately contemplate that the investment offering is the sub fund, and not the CCIV. Further examples are:

- the continuous disclosure provisions, which are stated under the Explanatory Memorandum for Tranche 2 to apply to a CCIV as the disclosing entity (although there is some doubt that the drafting currently has this effect) – in practice, the sub fund should be the disclosing entity, because it will have a separate group of investors in a separate pool of assets;
- the provisions referred to in 3.6.1 and 3.6.2 below;
- the issues pointed out at 3.4 above regarding listing and takeovers;
- the definition of managed investment scheme (see 3.5).

3.6.1 Product Disclosure Statements (s1250S)

We recommend clarifying that certain provisions in relation to Product Disclosure Statements (PDS) should apply on a per sub-fund basis.

In particular, we note it is not immediately apparent how the main content requirements under s1013D of the Corporations Act should apply and we suggest that the legislation should identify that the content requirements apply on a per sub-fund basis. We also submit the proposal under s1250S(1) of the Exposure Draft requires further refinement to apply on a per sub-fund basis.

Section 1250S(1) of the Exposure Draft proposes to treat s1013D(2A) as "also including securities in a CCIV". Section 1013D(2A) of the Corporations Act specifically triggers the requirement to disclose the extent to which labour standards or environmental, social or ethical considerations are taken into account. These particular standards and considerations are likely to differ between sub-funds. For example, a real estate securities fund and a global securities fund will typically have a different investment strategy and different investment parameters. Accordingly, we submit it would be more appropriate to treat s1013D(2A) as including securities in a CCIV referable to a sub-fund.

In addition, we suggest the legislation consider introducing further clarifications such that the content requirements apply on a per sub-fund basis. From a practical perspective, the Corporate Director should have the flexibility to issue either:

a) one PDS that includes information on each of the sub-funds; or
b) one PDS per sub-fund.

We expect that a number of CCIVs are likely to require this flexibility particular as this flexibility exists under the existing PDS regime for managed investment schemes.

3.6.2 Product Disclosure Statements (s1250X)

We recommend clarifying that the cooling off period in relation to a PDS should apply on a per sub-fund basis.

Section 1250X proposes to treat Division 5 of Part 7.9 of the Corporations Act "as if securities in a CCIV were another class of financial product covered by paragraph 1019A(1)(a)". Section 1019A(1)(a) lists the financial products that the division applies to before specifying the process in which a cooling-off period applies. Specifically s1019B(3) specifies a 14 day time period for exercising the right to return the "product". We submit that there is the potential for ambiguity in relation to this time period if this section broadly applies to securities in a CCIV and does not apply on a per sub-

fund basis. For example, an investor may acquire an interest in an Australian securities fund and an interest in a global securities fund at different times and it is unclear from the proposed drafting when the time period for exercising the cooling off period ceases to apply as the between the sub-funds.