Law Council OF AUSTRALIA

Business Law Section

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By email: CIVreform@treasury.gov.au

Dear Mr Bell

Submission on Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2018

The Corporations Committee (**CC**) and Financial Services Committee (**FSC**) of the Business Law Division of the Law Council welcomes the opportunity to provide a submission in relation to the second Exposure Draft of the Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2018 (**Exposure Draft**) and the accompanying Explanatory Materials (**Draft EM**).

We note that a key purpose of the Corporate Collective Investment Vehicle (**CCIV**) regime is to facilitate international competitiveness. Paragraph 1.10 of the Draft EM states that "*a key policy objective has been to increase the competitiveness of Australia's managed fund industry through the introduction of internationally recognisable investment products"*. We support this objective.

However, as the "*introduction of the CCIV is also intended to support the establishment of the Passport [regime]"* (paragraph 1.13 of the Draft EM), it is essential that the Australian funds management be able to compete in Asia, just as the Passport regime will allow Asian funds managers to compete in Australia.

To that end, three key concepts need to be engaged, and our primary submissions are directed towards these:

1. The regime needs to be sufficiently **familiar** to Asian investors, and able to compete against other Asian jurisdictions on price and functionality. Thus, it should look similar to an international standard such as Undertakings for Collective Investment in Transferable Securities (**UCITS**), but need not be identical to the UK open-ended company regime on which it is apparently modelled;

2. It must be **workable**. Australian entities that are already operating managed funds must be readily able to employ it. This means certain existing ways of operating need to be allowable; and

3. There should be **no roadblocks** to its adoption by Australian fund managers, otherwise new managed funds in Australia will continue to be structured as trusts, existing managed investment schemes will not transition to the CCIV regime, Australia will be at a competitive disadvantage in the Asian region, and the Government's initiative will unfortunately be seen to fail.

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We acknowledge the progress that Treasury has made since the first exposure draft released in August 2017, by addressing the allocation of assets among sub funds, the timing of supervision by the depositary, and the retail/wholesale definition, and by proposing that the administration and asset-holding services can be provided by the same group. However, the Exposure Draft is still in a form that has not addressed key elements of many well-reasoned submissions from industry participants and the legal profession that were provided on the 2017 draft. If passed in its current form, the legislation could place the Australian funds management industry at a competitive disadvantage in our region. We suggest that it is more important than immediate progress through the Parliament to take the time to settle a draft of the new laws that will meet the legitimate needs of Australian businesses while maintaining an appropriate level of investor protection, at least on the key issues in Part 1 below.

In Treasury's own words, the objects of the new Chapter 8A are:

> "(a) *to provide a regulatory framework for corporate collective investment vehicles that is fair, efficient and competitive; and*
>
> *(b) together with Chapter 7, to promote confident and informed decision making by consumers of financial products and services related to shares in corporate collective investment vehicles."*

This is a positive aspiration for the framework, and the drafting of the legislation should support the objectives of being efficient and competitive, as well as protecting consumers.

In this context, we would encourage Treasury to commit to industry consultation and review of the functioning of the new regime, including its uptake and international competitiveness, within a period of 2 years following its introduction.

This submission is divided into two parts:

Part 1 contains our primary submissions, which, if not dealt with, in our opinion potentially reduce or even destroy the utility of the regime internationally.

Part 2 sets out our detailed submissions, which we think would improve the operation of the regime.

We would be happy to meet to discuss any of these points and to assist in helping to develop solutions to any problems. If you wish to discuss or have any questions or comments on this submission, please do not hesitate to contact CC members David Eliakim (david.eliakim@au.kwm.com or 02 9296 2061) or Alan Shaw (alanjshaw@outlook.com or 0419 300 611)

Yours sincerely

Rebecca Maslen-Stannage
Chair, Business Law Section

1. Part 1 – Primary Submissions

These are matters which, if not dealt with, in our opinion potentially reduce or even destroy the utility of the regime internationally.

1.1 Depository independence

(a) The depositary is "*a new concept in Australian funds management with a broader range of functions than custodians under the MIS regime*" (paragraph 4.2 of the Draft EM) and must meet independence requirements that, according to the Draft EM, have no equivalent in the current law, and for which the drafting is "*under development*" (note to section 1234D). Accordingly, we make this submission based on general policy considerations.

(b) Accepting that the depositary is a key consumer protection, we submit that there is no loss of protection, but significant business utility, in allowing the independence test for the depositary to be based on a functional not a structural test, as proposed by a clear majority of submissions in 2017[1]. This change would also be in the interests of efficiency and competition, and therefore be consistent with the objects of the Chapter. Moreover, allowing functional separation would facilitate managed investment scheme (**MIS**) transition. On the other hand, not allowing functional separation risks:

- Inconsistency with the international standard, adopted by UCITS/Société d'investissement à capital variable (**SICAV**s), International Organization of Securities Commissions (**IOSCO**), the Asia Region Funds Passport (**ARFP**) rules and Hong Kong; and
- shutting out current big players who also operate funds management arms, with potential negative consequences for competition, choice, price and efficiency in depositary services in the Australian market, noting that not all providers have the sophisticated IT systems or subcustodian networks required by certain managed funds.

(c) Consumer protection might be adequately catered for by several measures, for example:

- providing for a category of "approved depositary" by setting standards and/or application to Australian Securities and Investments Commission (**ASIC**);
- requiring the depositary to be a separate legal entity with no common directors, which has strong conflict protocols including separate staff and reporting lines; and
- imposing the same requirements as have applied to all responsible entities and licensed custody providers since November 2015, as set out in ASIC Regulatory Guide 133, which align with paragraph 24 and other key requirements of the UCITS V Directive[2].

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[1] Written submissions from 10 organisations expressly proposed a functional independence test in place of the proposed structural test: Financial Services Council, Property Council of Australia, Perpetual Corporate Trust, TMF Corporate Services, King & Wood Mallesons, Herbert Smith Freehills, K&L Gates, KPMG, Henry Davis York and McMahon Clarke. Only one submission supported the structural test. The remaining 7 did not comment on the issue.

[2] See the UCITS V Directive (Official Journal of the European Union, L 257/187) paragraph 24 which provides that rules should ensure "a clear separation of tasks and functions between the depositary, the UCITs and the

(d) In the recent Treasury roundtable, participants were invited to point out differences between the UCITS Directive and the Exposure Draft. Accordingly, we note the following:

- The Directive does not prevent the depositary from being in the same group as the investment manager of a fund. It provides in paragraph 13 "*In performing its tasks, a depositary should act honestly, fairly, professionally, independently and in the interests of the UCITS and of the investors of the UCTS*". We support the principle of the depositary acting independently, but this can be achieved through conflict management measures such as those noted above; and
- While the Exposure Draft proposes structural separation of the depositary as a method of investor protection, the Directive recognises the need for high quality depositary services. In paragraph 25, it states "*In order to ensure a high level of investor protection and to guarantee an appropriate level of prudential regulation and ongoing control, it is necessary to establish an exhaustive list of entities that are eligible to act as depositaries. Those entities should be limited to national central banks, credit institutions, and other legal entities authorised under the law of Member States to carry out depositary activities … which are subject to prudential supervision and capital adequacy requirements …"* (emphasis added). The Hong Kong Securities and Futures Commission (**SFE**) has proposed that its corporate collective investment regime for the Open-ended Fund Company, which is due to come into effect on 18 July 2018, would require a custodian which is a licensed bank in Hong Kong, a trust company which is a subsidiary of such a bank, or an overseas banking institution or its subsidiary acceptable to the SFE, and that such custodian meets relevant capital and internal control requirements[3]. A comparable requirement in the Australian market could refer to entities supervised by Australian Prudential Regulation Authority (**APRA**) and their related companies. There is a good argument that a requirement for a depositary to be part of a prudentially supervised organisation is a superior investor protection measure to the voting test proposed in the Exposure Draft.

(e) Also, practical problems would be alleviated by amending section 1234H so that the depositary is not prohibited from delegating back to a company in the corporate director group to hold the assets. If, for example, an international bank is the only reputable provider of custody and clearing services in a particular jurisdiction, should managed funds operated by another division of the bank be prevented from dealing in that jurisdiction because the proposed asset-holder is in its corporate group?

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management company or the investment company". See also paragraphs 17 (holding assets separately), 20 (appropriate responsibility for subcustodians), 22 (use of omnibus accounts).

[3] SFC Consultation Paper, June 2017, paragraph 63. The requirements for custodians in the SFC *Consultation Paper on Proposed Amendments to the Code on Units Trusts and Mutual Funds* December 2017 also include at paragraph 25: "Although the trustee or custodian and the management company must be persons who are independent of each other, they are permitted to be subsidiaries of the same holding company if specified conditions are met to ensure **functional independence** to address the potential conflicts of interest issues which may arise." (emphasis added)

We recommend facilitating efficiency and competition in the market for depositary services by better aligning the depositary independence requirement with international norms.

1.2 Agents of the depository

Section 1234H(1) (Appointing an agent or engaging a person) states:

> *(1) The depositary has power to appoint an agent, or otherwise engage a person, to do anything that it is authorised to do in connection with the CCIV (other than its functions under subsection 1234L(1)). The agent or person:*
>
> *(a) must not be the corporate director of the CCIV; and*
>
> *(b) must meet the independence requirement set out in section 1234D.*

As the wording of 1234D is not yet available, it is not clear if this section prohibits the depositary from using one of its group companies to carry out the verification process in its supervisory role, but this should be permissible. This is in addition to the reason for amending section 1234H as noted at 1.1(e) above.

We recommend ensuring that section 1234D is drafted to accommodate these concerns.

1.3 Changing the depository

(a) Section 1235B (Initiating retirement or removal of depositary) sets out a regime for changing the depositary, either if the depositary wants to retire or the corporate director of the CCIV wants to remove them, that always requires a vote at a meeting of members of the CCIV.

The requirement for meetings is a major departure from existing arrangements for appointment of custodians by managed investment schemes, where an agreement which complies with the Class Order under ASIC Regulatory Guide 133 is required, but the responsible entity can generally terminate the custody agreement “for cause” if the services are below agreed standards, and fees and charges are periodically renegotiated to competitive levels. Both of these pressures on custodian performance are in the interests of fund members, and they would not exist if the asset holder (depositary) could only be changed by special resolution of members.

In terms of the marketability of the CCIV regime, we do not perceive that it would be a significant selling point to foreign investors that the depositary would have, in addition to independence, an entrenched statutory role. Indeed, it may be a negative if the structure could result in depositary services that are inefficient or uncompetitive. To use terminology from the managed investment scheme regime, the role of the depositary as designed in the Exposure Draft means it resembles a “*second responsible entity*”.

(b) There is no problem in giving investors rights to vote to have the depositary removed, or for ASIC to intervene, but for the corporate director to be unable to have the depositary removed for underperformance or overcharging except by a 75% vote of all the members in all the sub funds together effectively entrenches the depositary and creates an inefficient and anti-competitive arrangement, contrary to the objects of the Chapter. In practice, changing asset-holder is a complex and time-consuming transition not lightly undertaken, but if the custodian/depositary is under performing or over charging, it should be an option for the fund operator.

The corporate director should be required to appoint the depositary by contract, which would include at the very least a right for the corporate director to terminate the depositary "for cause", such as failing to deliver services to a reasonable standard[4]. Other governance rights could be given to members and ASIC in addition to that, to ensure that a corporate director does not dismiss the depositary merely because the depositary is properly performing its supervisory role and asking uncomfortable questions of the corporate director.

Two very positive ideas for additional alternative methods of changing depositary were discussed at the Treasury roundtable meeting on 28 June 2018:

- *Suggested by ASIC*: investors would be given a postal notice of the proposed change of depositary, and meeting must be convened to vote on the change if more than 5% or 100 investors respond to request this, as for a change of responsible entity to a related party; and
- *Suggested by Treasury law design*: the corporate director and depositary could mutually agree to a change. Presumably investors should be given notice of this as well, with enough time that they could requisition a meeting under the equivalent of Part 2G.4 if they wish.

Another protective measure could be to afford a depositary or former depositary qualified privilege (similar to section 1235N) to raise issues if there was any suggestion that the corporate director was proposing to replace the depositary for improper reasons, and to pass appropriate information to a replacement depositary.

We recommend that these alternatives to changing the depositary by special resolution be adopted

1.4 Obligations and liabilities of the depositary

(a) **Liability of the depositary for its agents**: The extent of liability of the depositary for its agents in section 1234H(3), "*even if the person or agent was acting fraudulently or outside the scope of the authority or engagement*", seems to go too far. This standard, applicable to the responsible entity of a registered scheme, makes sense for the corresponding role of the corporate director in respect of the CCIV, but is problematic for a custodian/depositary, which cannot take responsibility for the insolvency of unaffiliated subcustodians in international markets. The result of such a requirement, which is contrary to international norms, would be that depositaries/custodians will not offer trading

[4] Section 601FCAB(2)(j) inserted in the Corporations Act by ASIC Class Order [CO 13/1409] requires a responsible entity to include in its agreement with a custodian a provision to the effect that the responsible entity may terminate the agreement without penalty if there are reasonable ground to believe that the custodian has breached the agreement or certain non-compliance with requirement of the Class Order.

in certain jurisdictions. The legislation should allow for this normal practice of carving out that liability.

The appropriate standard would be that under UCITS V, which requires an objective reason for delegation, care in selection, supervision, audit and taking all necessary steps to ensure that assets of the UCITS are not available on insolvency. This is similar to the requirements for appointment of subcustodians under ASIC RG 133.

Also, under section 1234L, the depositary may not engage a person to carry out its functions under subsection (1), which include reasonable steps to verify what is being done in subs (2). It may be a drafting matter, but this could well stop a corporate director employing lawyers/accountants to advise. One way to fix this, for example, may be for this provision to state "*While reasonable care might include the depositary engaging a person to carry out its functions under subsection (1), it remains liable notwithstanding*."

We recommend that the UCITS V standard of liability for agents and delegates of the depositary be adopted.

(b) **Trading instructions to the depositary.** Section 1234K provides that:

"The depositary of a CCIV may deal with assets the depositary holds only on instructions given by, or on behalf of, the corporate director or the CCIV, that the depositary reasonably believes:

(a) are lawful; and

(b) comply with the CCIV's constitution."

This provision is identical to section 1164A in the 2017 exposure draft and has not been amended to align with the change to section 1164B (now 1234L), which refers to the depositary taking "*reasonable care to verify*" compliance of certain activities *after* they have occurred.

Section 1234K is unworkable – the depositary cannot check that each transaction is "lawful" and complies with the constitution before implementing settlement. Moreover, a custodian/depositary needs to operate on the basis that it complies with proper instructions but is able to decline them if they are not clear or complete, or if it believes they are in contravention of some requirement. This is an operational matter that should be governed by the contract between the depositary and the CCIV, not in legislation.

We recommend that if section 1234K is retained, it should state that the depositary may only refuse to deal with assets on instructions from the corporate director if the depositary reasonably considers that the instructions are not lawful or do not comply with the CCIV's constitution, or as otherwise provided in the agreement under which the depositary is appointed.

1.5 Ease of payments of income and capital

Submissions in 2017 noted that the rules relating to preservation of capital and dividends applicable to trading companies were inappropriate for a CCIV, which functions as an open-ended investment structure and will never be a trading entity (it would be denied flow-through tax treatment if it were to engage in trading). Unfortunately, rather than being eliminated as requested, the extent of provisions reflecting laws appropriate for trading companies has increased in the current Exposure Draft. While we recognise the importance of an assessment of solvency of the CCIV before the corporate director can borrow or assume other obligations to third parties, placing other additional steps and restrictions on return of capital and payment of distributions of income from a CCIV will make it less attractive for fund operators than a managed investment scheme structure. There are two significant reasons why managed funds in Australia are structured as managed investment schemes in the form of trusts – flow through tax treatment, and ease and simplicity of return of capital and payment of income. While the first may be solved by the application of a tax regime to CCIVs which is similar to that for trusts, if the second is not properly designed the take-up of the CCIV regime may be poor.

(a) **Return of capital.** The provisions should start from the premise that any share may be redeemed in the same circumstances as for a unit in a registered scheme, if the CCIV's constitution permits, and any amount of capital paid as a distribution, and overlay that principle with appropriate consumer protection restrictions – not start with the proposition that all capital returns are prohibited unless permitted. For example, section 1246A(2) states that:

"A reduction of share capital by a CCIV is taken to comply with subsection 256B(1) if:

(a) The reduction is permitted by the CCIV's constitution; ***and***

(b) The reduction is fair and reasonable to the members of each affected sub-funds; ***and***

(c) each sub-fund that the reduction affects:
(i) is solvent immediately before the reduction; and
(ii) will not be insolvent immediately after the reduction; ***and***

(d) the reduction is approved by shareholders under section 256C (but see section 1246B)." [emphasis added].

A return of capital, either by redemption of shares or declaration of a distribution, should only require satisfaction of conditions (a) and (c) above and be subject to the general duty to act in members' best interests. To also require a vote of investors and an assessment by the corporate director that the payment is fair and reasonable are inconsistent with the way investment funds work. It is extremely common for a registered scheme to pay a distribution of capital along with annual distributions of income. There is nothing adverse for investors about this practice so long as the potential tax effect – of reducing the investor's cost base – is properly disclosed. Also, a capital distribution is often a key step in stapling, capital reallocation or other restructuring transactions. The inability to carry out these normal practices would make the use of CCIVs unattractive relative to managed investment schemes. Further, although redemption of shares is dealt with in other provisions (see 1232J – Redemption of redeemable shares to be provided for in constitution), it should be made clear that this set of requirements in section 1246A (reduced as per our submission) does not in any way restrict redemptions.

(a) **Distribution of income.** Again, in our view these provisions proceed from the wrong premise. A distribution of income, albeit referred to as a dividend in the context of a corporate-form managed fund, should always be able to be paid except if the sub-fund is "insolvent" as defined. The standard practice for managed investment schemes is to pay all, or nearly all, of the income to investors at regular intervals, which may be annual, quarterly or monthly. The distribution may include a capital component (see (a) above).

Currently, section 1245Q(2)(c) states that: "*A CCIV must not pay a dividend unless …*

(c) the payment of the dividend is fair and reasonable to the members of the sub-fund as a whole …"

What is the rationale in the context of an open-ended managed fund, which is not a trading company, to impose this extra requirement? As investors will expect managed funds to just pay all or nearly all of the fund's income, unless a reinvestment plan is offered, the corporate director should be able to do that without further restriction, so long as the CCIV is solvent.

We recommend that other than a solvency requirement, it should be no more difficult to return capital and make distributions of income from a CCIV than it is from a managed investment scheme. To retain the existing provisions in the Exposure Draft creates a structure for the CCIV which is not readily workable. For similar reasons, the self-acquisition rules applicable to trading companies are also not relevant and should be removed to the extent possible, primarily because they prevent the common and useful practice of one fund investing in another, for example because one is a hedged or wholesale version with the same investment mandate[5].

1.6 Consumer protection – general observations

We understand the need for a strong focus on protection of Australian consumers in designing this new regime and agree that is an important and worthy objective. However, the aspiration to add another layer of consumer protection by requiring a depositary for retail funds will have no consumer protection benefit at all if the regime is so unattractive to fund managers and promoters that it is not utilised. A balance is required, and investor protection measures will achieve this if they are generally equivalent to those afforded to investors in registered managed investment schemes but aligned a little more to the UCITS V standard without unnecessarily inhibiting functionality, imposing excessive cost or reducing competition.

[5] See our comments on section s 1246H/1246J below.

2. Part 2 – Detailed submissions

These are the changes we request to improve the operation of the regime.

Section	Heading	Text from the Exposure Draft	Comments
These issues with the operation of the regime are in addition to those noted in Part 1. The more important points are marked red and other significant points orange. Some drafting and other points are marked yellow.			
1232J	**Redemption of redeemable shares to be provided for in constitution**	*(2) The constitution of the CCIV <u>must</u> make provision for redeemable shares in the CCIV to be redeemed. The provision must:* *(a) specify a period within which a redemption <u>must be satisfied</u> while a sub-fund is liquid;* (emphasis added)	It is not workable for the constitution to state a period within which a redemption MUST be satisfied. For an MIS, the responsible entity can indicate a timeframe for redemptions, or say that redemptions are at its discretion. If a timeframe is set, it is critical that there be a discretion to extend the period, so asset sales are not forced should there be a suspension in trading in the assets or inability to fairly price the assets. It is contrary to the interests of continuing investors to force the fund to pay redemptions and force a fire sale of assets or set an unfair or uncertain redemption price. “Must” in subsection (a) should be changed to “may’.
1233J	**What are the assets of a sub-fund**	*(2) The **assets** of a sub-fund of a CCIV at a particular time are the following:* *(b) money deposited with or lent to the CCIV under debentures that are referable to the sub-fund;*	This is expressed as an exhaustive definition of sub-fund assets, but excludes, for example, money received by a loan to the CCIV in respect of the sub-fund, and rights such as rights under a contract or judgement. The customary way to describe the assets of a fund is to refer to all the property, rights and income of the fund – in this case you would add “referable to the sub-fund”.

	Section	Heading	Text from the Exposure Draft	Comments
		Duties owed by officers of corporate director	*1) An officer of the corporate director of a CCIV must:* *(a) act honestly; and* *(b) exercise the degree of care and diligence that a reasonable person would exercise in the officer's position* *(c) act in the best interests of the members and, if there is a conflict between the members' interests and the interests of the corporate director, give priority to the members' interests …*	We appreciate that this wording reflects the duties of officers of a responsible entity in section 601FD, but a direct copy of that language is not appropriate in the situation of directors of a company which in turn acts as director of a company, as opposed to directors of a company acting as trustee of a trust. The section does not make it clear that the reference to "members" in paragraph (c) is a reference to members of the CCIV, as opposed to members of the corporate director company. Further, the obligations of the directors of the corporate director to that company are duplicated and conflicting. Under section 180(1) there is an obligation of care and diligence, which is subject to a business judgement qualification which imports a concept of good faith. The duties under section 1237D(a) and (b) are differently expressed and do not include the qualification. Directors should not be subject to two sets of differently worded obligations in relation to their duties to the corporate director company. The issue can perhaps be resolved by narrowing paragraphs (a) and (b) to relate only to actions of the directors that directly affect members of the CCIV, as opposed to affecting the corporate director company itself.

	Section	Heading	Text from the Exposure Draft	Comments
				It is also unclear whether directors retain the benefit of the reliance and delegation provisions in sections 189 and 190.
	1245J	**Liquid sub-fund – consideration must be based on net asset value**	A redeemable share in a CCIV must be redeemable for a price based on the net asset value, <u>at the time of the redemption</u>, of the sub-fund to which the share is referable if the sub-fund is liquid.	The price for redemption of a share should be set in the constitution, the way it is for managed investment schemes. It is not even possible for the net asset value to be precisely calculated *at the time of redemption* in all cases. Some assets are more difficult to value, and there are always time lags.
	1231	**Types of companies—basic requirements for registration as a CCIV**	*A company may be registered as a corporate collective investment vehicle only if:* *(a) the company is a company limited by shares; and* *(b) the company has a constitution; and* *(c) the proposed director of the company is a public company that holds an Australian financial services licence authorising it to operate the business and conduct the affairs of the CCIV.*	In saying that "a company may be registered" as a CCIV, this drafting seems to require that there be an ordinary company registered first, with natural person directors, which then applies to become a CCIV and replaces those persons with a corporate director? It could be expressed as – *the proposed corporate director may apply to register a CCIV if it will be …*
	1232H	**Changing the constitution**	*The constitution of a retail CCIV may be modified, or repealed and replaced with a new constitution:* *(a) by special resolution of the members of the CCIV; or* *(b) by the corporate director if the corporate director reasonably considers the*	Under this provision, amending the constitution of the CCIV will require a 75% vote across all sub-funds, even if the change only affects one sub-fund. There should be the ability to amend provisions which relate to one class of shares (referable to a sub-fund) only by resolution of

Section	Heading	Text from the Exposure Draft	Comments
		change will not adversely affect members' rights.	a class meeting of the members of that sub-fund.
1232K	**Part 2B.7 does not apply to a CCIV**	Part 2B.7 (about changing company type) does not apply to a CCIV.	It would be useful and sensible to have the ability to change company type from a CCIV to an ordinary proprietary or public company, for example if the CCIV has no retail client investors, all investors consent and the proposed future activities will include activities incompatible with flow-through tax status. The CCIV should not be forced to wind up and cause investors a tax event in this situation.
1233L(2)	**Segregated application of asset of sub-funds**	*(2) The assets of a sub-fund must not be applied:* *(a) for any purpose other than:* *(vii) making any other distribution to members of the sub-fund that the CCIV is <u>permitted by this Act</u> and its constitution to make;*	This should say *not prohibited* rather than *permitted*. The Act does not expressly "permit" all legitimate payments from a fund.
1233L(4)	**No joint investments**	*(4) The assets of 2 or more sub-funds of a CCIV must not be applied jointly to acquire a single asset of the CCIV*	The draft EM at paragraph 3.68 states "The assets of different sub-funds must not be applied jointly to acquire a single asset". It would be useful to clarify that two sub-funds could each have separate holdings in a company or unit trust that held an asset (for example, a large real property asset like a shopping centre) without breaching this provision. We note that registered schemes are not prohibited from investing jointly with other registered schemes that

Section	Heading	Text from the Exposure Draft	Comments
			have the same responsible entity. It would also be useful to clarify that an allocation of an asset between multiple sub-funds under section 1233K is not a breach of section 1233L.
1233V	**Sub-fund changing its name**	*(1) If the members of a sub-fund of a CCIV want to change the name of the sub-fund:* *(a) the members must pass a special resolution adopting a new name;*	The name of a managed investment scheme can be changed under its constitution and by just selecting a unique name and notifying ASIC. What policy purpose is addressed by imposing this special resolution requirement? Is it intended to stop the common practice of "white labelling" funds?
1234Q	**Dealing with conflicting duties**	*An obligation placed on the depositary of a CCIV by this Subdivision overrides any conflicting duty an officer or employee of the depositary has under Part 2D.1.*	This provision seeks to compare the duties of natural persons with duties of a company. As they are not comparable, this section should be deleted.
1235J	**Application to Court for winding up if permanent depositary not appointed**	*(1) This section applies if:* *(a) a temporary depositary is appointed by the Court under section 1235G; and* *(b) either:* *(i) the corporate director fails to call a meeting within the period required by section 1235H; or* *(ii) the corporate director calls a meeting within the period required by section 1235H, but a new depositary is not chosen.* *(2) An application to the Court for a winding up of the CCIV*	This should state that an application <u>may</u> be made if it is in members' best interests to do so, not that it must be made. 3 months is not long to appoint a permanent depositary, and it is a "nuclear option" from an investor's perspective to terminate their investment and cause a capital gains tax event for them.

	Section	Heading	Text from the Exposure Draft	Comments
			<u>must</u> be made by the corporate director of the CCIV. (emphasis added)	
	1238A	**Extended operation of section 199B (about insurance premiums for certain liabilities)**	*(2) If the CCIV is a retail CCIV, for the purposes of subsection (1), paragraph 199B(1)(b) is taken to include a reference to contraventions of the following provisions (which are about duties owed to members of a CCIV):* *(c) section 1237E.*	Section 1237E deals with liability of employees, not officers. Section 199B(1) currently only deals with the position of officers. There should not be a prohibition on insurance covering liability of employees, as this sits outside the normal relationship between the Corporations Act provisions and directors' and officers' insurance, which does not cover employees.
	1238H	**Additional protection for retail clients—requirement for external directors of corporate director**	*(2) A director of the corporate director is an external director if the director:* *(e) does not have a material interest in the corporate director or a related body corporate;*	While this seems OK on its face it does not work the same as for responsible entities of registered schemes. The CCIV is a related body corporate of the corporate director, so every CCIV operated by the group is off-limits for substantial investment by any external director. Is that consistent with policy? It is usually considered that directors investing in funds is a sign of confidence in management and alignment of interests.
	1242B(3)	**Exception for remuneration does not apply to CCIV**	*Member approval is not needed to give a financial benefit if:* *(a) the benefit is fees paid, or to be paid, by the CCIV to the corporate director of a wholesale CCIV for the performance of duties as an officer of the CCIV; and* *(b) to give the benefit would be reasonable in the*	The reference in paragraph (b) to benefits being "*reasonable in the circumstances*" is akin to imposing an arm's length test. Why should this be imposed where the CCIV is wholesale? CCIVs.

Section	Heading	Text from the Exposure Draft	Comments
		circumstances of the CCIV giving the benefit.	
1245(2)	**Half-yearly report to ASIC about shares in a CCIV**	*Within 28 days after the end of each reporting period, a CCIV must lodge with ASIC a notice in the prescribed form that sets out the following:* [a list of details about the shares in each sub fund, including redemptions]	A managed investment scheme is not required to report this information. Why should a CCIV?
1245(3)	**"**	*If any shares referred to in paragraph (2)(b) were issued during the reporting period for a non-cash consideration under a contract, the CCIV must … prepare a certificate stating that all stamp duty payable on the contract under any applicable law relating to stamp duty has been paid …*	Again, this is totally foreign to a managed investment scheme. It seems to be based on section 254X of the *Corporations Act 2001* (Cth) but it is not relevant for a non-trading body such as a CCIV.
1245D	**Resolution to convert shares in to larger or small number**	*Subsection 254H(1) applies in relation to a CCIV as if a reference to a general meeting were instead a reference to a meeting of the members of each sub-fund of the CCIV to which the shares are referable.*	In a managed investment scheme, the constitution typically allows the responsible entity just to decide to consolidate or divide the units. As there is no effect on the value for investors, other than rounding of one share, it should not require a vote.
1245E(2)	**General requirements for redemption of redeemable shares**	*A CCIV may only redeem redeemable shares if:* *(a) the shares are fully paid-up; and* *(b) each sub-fund to which the shares are referable:* *(i) is solvent immediately before the redemption; and*	The requirement for solvency is sensible, but why should shares be required to be fully paid before redemption? In the context of a managed investment scheme, a formula is applied that takes account of the amount outstanding in calculating the redemption price, and the unit is redeemed for that lower value. There is no reason

Section	Heading	Text from the Exposure Draft	Comments
		(ii) will not be insolvent immediately after the redemption.	why a CCIV should not be the same.
1246C	**The CCIV's power to buy back its own shares**	*A CCIV may buy back its own shares. However, if the buy-back involves a reduction of share capital, the reduction must be authorised by law.*	It should be made clear that this does not prevent, for example, the corporate director buying shares to provide an internal market making facility for AQUA quoted managed funds. As noted in our primary submissions, it would be preferable for restrictions on self-acquisition not to apply at all.
1246H/1246J	**Directly acquiring own shares**		These provisions prevent cross investment between sub funds. Prior submissions emphasised the importance of this feature for CCIVs, especially for hedged and unhedged sub funds – otherwise what efficiency does the protected cell structure deliver, particularly as each cell now has to register separately? When asked about this at the roundtable, Treasury said they are considering introducing cross investment later, as done in the UK, where it can be done for up to 20%. The question remains, if it can be done, why not from the start?
EM 1.21	**Listed funds**	The CCIV regulatory framework has been developed on the basis that CCIVs will be prohibited from being listed on a prescribed financial market, but securities in a CCIV could be quoted on financial markets or settled using financial market	This is unsatisfactory for two reasons: - industry should know from the outset whether it will be able to list a fund or quote securities, and what the conditions will be –

	Section	Heading	Text from the Exposure Draft	Comments
			infrastructure (subject to the rules of the relevant market). Listing of CCIVs will be considered further once the CCIV regime is operating.	some funds start as unlisted and transition to listed or quoted status once a track record or fund size is achieved, so it is necessary to know at the start if listing/quotation will be possible - this suggests that shares in a sub fund might be able to be quoted on AQUA, which would be helpful, but there is still a reference to "listing" of CCIVs. It would never be the CCIV listed, only a sub fund, and this requires consideration by Australian Securities Exchange (**ASX**) including modifications to the Listing Rules, along the same lines that a trust is the listed entity but the body responsible for compliance is the responsible entity.
	Less significant issues with the operation of the regime – drafting and other points			
	1231A	**Minimum of 1 sub-fund**	*(2) Section 114 is taken to also require each sub-fund of a CCIV to have at least 1 member.*	It is possible to register a managed investment scheme without any unitholders, and this is helpful in some restructuring, where for example the number of securities in one entity need to match another. While this rule is similar to an ordinary company, is it necessary?

	Section	Heading	Text from the Exposure Draft	Comments
	1233	**Meaning of *sub-fund***	*(1) A **sub-fund** of a CCIV is all or part of the business of the CCIV that is registered as a sub-fund under section 1233D.*	"Operation" or "activities" would be preferable to "business" in the various places this is used in the exposure draft. The CCIV is a flow-through vehicle for tax, and so is not conducting a business.
			(viii) a purpose specified in the CCIV rules for the purposes of this subparagraph; or *(b) for a purpose specified in the CCIV rules made for the purposes of this paragraph.*	These two paragraphs in the section repeat. Should one refer to what is prohibited, and the other permitted?
	1238M(4)	**Retirement of corporate director**	*If the members do not choose a company to be the new corporate director, or the company they choose does not consent to becoming the CCIV's corporate director, an application to the Court for appointment of a temporary corporate director under section 1238Q may be made by any of the following:* *(a) the current corporate director of the CCIV;* *(b) if the CCIV has a depositary—the depositary of the CCIV.*	This provision gives the current corporate director and the depositary a right to apply to the court to appoint a temporary corporate director, but not to members. If a meeting fails to choose, a member should have this right, as they do under section 1238P. There should be consistency in the various circumstances as to who can apply to the Court.
	1241B	**Contents of the compliance plan**	The compliance plan of a CCIV must set out adequate measures that the corporate director is to apply in fulfilling its responsibilities in relation to the CCIV to ensure compliance with this Act and the CCIV's constitution.	The requirement refers to setting out measures that the CD "is to apply in fulfilling its responsibilities in relation to the CCIV" whereas for a MIS it is the measures the RE must take in operating the scheme – to ensure compliance. Is this intended to mean something different than if it had said "operating

	Section	Heading	Text from the Exposure Draft	Comments
				the CCIV"? 5.107 of the EM refers to "operating" so this may be an oversight.
	1241D	**Directors must sign lodged copy of compliance plan**	The copy of a CCIV's compliance plan that is lodged with ASIC must be signed by all the directors of the corporate director.	In the MIS context, the equivalent provision causes practical problems unless the directors have each personally appointed an agent to sign on their behalf. As this requirement is an inconvenience with no apparent regulatory benefit, can it be changed to the same level of signing as section 127 of the Corporations Act? If this change is not made, at least there should be a regulation that mirrors *Corporations Act 2001* (Cth) Regulation 5C.4.01.
	1242	**Application of Chapter 2E to CCIVs**	Subject to this Part, Chapter 2E applies (a) to a CCIV in the same way as it applies to a public company …	As a policy matter, should the related party rules ever apply to wholesale CCIV's? Should this section just refer to application to <u>retail</u> CCIVs?
	1244E	**Members' resolutions**	Subsection 252L(1B) applies in relation to a CCIV as if: (a) the requirement in paragraph 252L(1B)(c) that the registered scheme be listed did not apply; and (b) the resolution is subject to a further requirement that it must not treat members of any sub-fund of the CCIV differently from members of any other sub-fund of the CCIV.	It is not clear why the rules should be different to the MIS arrangements, in the removal of the difference for listed trusts, and the inclusion of a new requirement to treat sub-funds equally. Members should be able to requisition a class meeting.

Section	Heading	Text from the Exposure Draft	Comments
1248A	**Obligations to keep financial records for sub-funds**	Under (1)(b) there is a reference to keeping financial records of transactions relating to the sub-fund extending "to transactions undertaken as trustee"	That appears to have no relevance and be a drafting error.
1248F and 1248G	**Half-year directors' reports for CCIVs**		Only disclosing entities should be required to file half yearly reports, consistent with other laws. These sections should be qualified accordingly.
1248K	**Reporting to ASIC**	Paragraph (b) refers to the "overall financial position of either the CCIV or the sub-fund".	The CCIV won't have an overall financial position – all assets and liabilities are allocated to sub funds. When asked about this, Treasury said the intention would be for the CCIV to prepare consolidated accounts of all the sub funds. However, this would not be meaningful information for investors, and we query its necessity
1269B	**ASIC's power to make exemption and modification orders**		As per earlier submissions, ASIC's power to modify and vary the Chapter should be by reference to the objects of the chapter, as it is for making CCIV rules. As we have seen from Class Orders 13/760 and 13/1409, ASIC has adopted a practice of using Class Orders to insert active obligations into the Corporations Act through its licensing power, and as a matter of consistent policy these require the same constraints as rule-making.

Clarification sought – small scale offerings in the context of CCIVs and responsible entities of multiple registered schemes

We also note the definition of "*retail CCIV*" is based upon whether or not a Product Disclosure Statement (**PDS**) was required to be given for the issue of a security.

While we agree that is an appropriate test, it would be useful to have clarity on the availability and application of the PDS exemption in section 1012E to CCIVs.

Section 1012E of the *Corporations Act 2001* Cth) provides an exemption from the requirement to give a PDS for "*personal offers*" (as defined in subsection 1012E(5)) where, in a 12 month period, the "*20 purchasers ceiling*" and the "$*2 million ceiling*" are not exceeded. Issues that are covered by other PDS exemptions do not count towards the ceiling (subsection 1012E(8)).

Firstly, under subsection 1020E(1) the exemption applies to managed investment products and other financial products prescribed by regulations (and regulation 7.9.16A of the *Corporations Regulations 2001* (Cth) prescribes interests in unregistered managed investment schemes). Is it the intention that CCIVs will be so prescribed? We have assumed so for the purposes of our comments below.

Section 1012E was modelled on subsection 708(1) in Chapter 6D, which allows shares to be issued without a prospectus for personal offers that do not breach the above-mentioned ceilings. Under subsection 708(3) the "*20 investors ceiling*" is breached if "*securities of the body*" have been issued to more than 20 people and the "$2 million ceiling" is breached if "the amount raised by the body by issuing securities" exceeds $2 million, in each case in any 12 month period.

Subsection 1012E(6) refers to the 20 purchasers ceiling by reference to "*the number of people to whom the issuer has issued financial products*" and to the $2 million ceiling by reference to "*the amount raised by the issuer from issuing financial products*".

In a Chapter 6D company scenario, the issuer will be the company, which has a single Australian Company Number (**ACN)** and will only be issuing shares in itself – a single financial product. A CCIV can issue shares in multiple sub-funds, with separate Australian Retail Financial Networks (**ARFN**s), and the shares in each sub-fund are a distinct financial product.

As drafted, it appears that the 20 purchasers ceiling and the $2 million ceiling in section 1012E could apply cumulatively to all financial products issued by an issuer, so that in the CCIV context, for the section 1012E exemption to be available:

(a) the CCIV could only make 20 personal offers across all sub-funds in a 12 month period, rather than 20 personal offers of each sub-fund product; and

(b) the CCIV could only raise $2 million across all sub-funds, rather than $2 million from each sub-fund.

It is not clear to us whether or not the drafters of section 1012E contemplated that there could be more than one financial product issued by the same product issuer. Paragraph 14.52 of the Revised Explanatory Memorandum to the *Financial Services Reform Bill 2001* (Cth) simply says:

> "*The exemption from the requirement to give a disclosure document in relation to small scale offerings of managed investment products in current section 708 of the Corporations Act is preserved by proposed section 1012E*."

We submit that each sub-fund is a separate and distinct investment and a separate financial product, and that therefore the ceiling limits in section 1012E ought to apply separately on a sub-fund by sub-fund basis rather than cumulatively on a whole of CCIV basis. If this statement reflects the intended outcome, then we would encourage amendments to section 1012E to clarify that the ceilings apply separately to each financial product issued by the issuer, rather than cumulatively across all financial products issued by the issuer.