19 July 2018

The Treasury
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PARKES ACT 2600

By email: CIVreform@treasury.gov.au

Exposure draft legislation on Corporate Collective Investment Vehicles

The Financial Services Council (FSC) welcomes the opportunity to make submissions on the first 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.

The FSC has for some time been supportive of a corporate vehicle for collective investment. Along with the Asia Region Funds Passport (ARFP), this new structure is vital to securing Australia's growth prospects and will deliver on key recommendations of the 2009 Johnson Review, *Australia as a Financial Centre — building on our strengths*.

The implementation of the CCIV becomes particularly important now that the ARFP legislation has passed through Parliament. The focus of the FSC's comments (attached) is on ensuring Australia is competitive in the ARFP.

In particular, we are concerned that if Australia has an uncompetitive CCIV regulatory burden, and does not address important tax issues relating to the ARFP/CCIVs, then managed funds will be established in other ARFP countries instead of Australia, and funds under management will move offshore.

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 Introduction

As we noted in our 2017 submission on the earlier exposure draft (Attached), the FSC strongly supports reforms to introduce a corporate collective investment vehicle (CCIV) and a limited partnership collective investment vehicle. The introduction of these vehicles are important reforms to promote Australia as an exporter of financial services.

In particular, a stated objective of the introduction of the CCIV regime is to provide Australia with a competitive fund structure for the Asia Region Funds Passport (ARFP). In a 2016 Budget announcement, the Government said that the CCIV was being introduced to make it "easier to invest in Australia" and encourage foreign investment, including by helping Australia take advantage of the ARFP. This purpose can only be achieved if CCIVs are flexible, efficient and competitive, as well as in a form familiar to investors in the global market for investment funds.

In addition to encouraging foreign investment into Australia, it is anticipated that the CCIV will better facilitate Australian fund managers managing assets for non-resident investors, as originally proposed by the *Johnson Report.*[1]

In our view, the starting point of design of the regime should be that the CCIV is an investment vehicle. From that base, consideration should be given as to what regulatory protections are needed to equate it with the registered MIS regime (for retail CCIVs), with the adoption of any obligations which arise due to the CCIV being a "company" under Australian laws as a secondary consideration. Regulatory protections and constraints should only be applied to CCIVs to the extent they are compatible with the objective for which the CCIV is introduced, and should not add significant burdens which are disproportionate to any regulatory or investor protection benefit.

Through the lens of these two key concepts – regional competitiveness and appropriate design – this submission seeks to suggest changes to the new material in the exposure draft of the CCIV legislation released on 13 June 2018 (Exposure Draft) that would improve the operation of the CCIV regime, and to re-state the compelling case for changes vital to the success of the regime that were requested in our 2017 submissions which have not been taken up in this Exposure Draft. We also comment on ways in which the Exposure Draft would make a CCIV unworkable in the practical sense.

We are also cognisant of Treasury's approach of using the UCITS standard of regulation as a point of reference. In response, while we acknowledge that reference to European structures has been a useful source for the concept of a corporate director – which provides some alignment with the MIS regime – rigid adherence to EU concepts is inappropriate, because the Australian funds management industry is not primarily competing with European funds; we will be competing with funds established in the Asia region. There is a risk that if Treasury is not more flexible in embracing this key concern and making changes to result in a workable and competitive regime, the CCIV will not be successful in meeting the Government's objectives.

This submission does not seek to replicate or restate the submissions we made in our earlier submission of 25 September 2017 (Attached). Where the provisions in the revised draft legislation have not changed, this submission refers to the discussion of these points in the September 2017 submission.

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[1] Australia Financial Centre Forum, *Australia as a Financial Centre – building on our strengths* November 2009 p63 <http://afcf.treasury.gov.au/content/final_report/downloads/AFCF_Building_on_Our_Strengths_Report.pdf>

We acknowledge and thank Treasury for the changes made to the draft legislation as a result of the previous submissions, including:

- the supervisory task of the depositary changing from a requirement to "ensure" compliance in certain functions, to verification;
- more precision regarding the allocation of assets among sub-funds;
- the ability of the corporate director to redeem shares without necessarily receiving a member request; and
- more appropriate definitions of retail CCIV and wholesale CCIV.

However, substantial concerns remain with provisions that have not been amended, many of which relate to the depositary. These, and our other specific comments, are set out below.

In our view, absent any amendments to the regulatory design of the CCIV, there is a significant risk that many of our members will choose not to use the CCIV. Comments from our members on the current regulatory design are that:

- it is too costly (due to the depositary requirement) to utilise;
- the proposed CCIV does not accord with the stated policy principle of fostering a strong and competitive funds management industry in Australia; and

other jurisdictions (e.g. Hong Kong and Singapore) are offering, or will shortly offer, a superior product. Some FSC members have indicated that not only are the unlikely to utilised the CCIV (or continue to use the MIS regime), they are more likely to utilise other 'superior products' such as the Open-Ended Fund Company (in Hong Kong) or the Singapore Variable Capital Company.

Further, the uncompetitive nature of the CCIV in the ARFP rules may put Australian corporate funds at a competitive disadvantage to corporate funds in other ARFP countries that may be cheaper and more efficient to establish and operate, and offer to final investors in Australia. Strict Australian requirements will not protect consumers if funds are not operating under the Australian regime.

3 Issues relating to the Depositary

3.1 Independence requirements

The FSC notes that the independence requirement set out in proposed s1234D is currently under development, but the Exposure Draft Explanatory Materials sets out the proposed independence requirements. Without any drafting of the provisions, it is difficult to be sure, but it seems one improvement as compared with the 2017 exposure draft is that it should be possible for a separate company in the depositary's group to carry out administrative functions for the CCIV. If this is correct, this essential change is acknowledged as helpful, although it would have been even more in line with industry practice for the depositary entity itself to be able to undertake the administration.

3.1.1 Comparison with global standards

A key aspect that has not improved is the requirement for structural separation via a voting test, so that the corporate director cannot be in the same corporate group as the depositary.

We submit that the structural separation tests for independence of the Depositary from the Corporate Director should be replaced with a functional independence test in line with the IOSCO standard, the UCITS V directive, the approach taken for SICAVs, the requirements of the ARFP and the approach proposed to be taken in Hong Kong (see further comments below). The Australian proposal for the independence test between the CCIV's Corporate Director and Depositary is something of an outlier in international terms. It is noted in the explanatory materials that the structural independence requirements (i.e. the control and voting power tests) are based in part on the requirements in the United Kingdom's OEIC regime that implement the UCITS regime, however, it is submitted that the OEIC structure is not used widely internationally. Further, the structural independence test for the OEIC is set out in a UK guidance note and not in legislation.

The FSC has previously been submitted (see Attachment) and it is submitted again that a structural independence test is too rigid and does not reflect the commercial arrangements currently in existence in the Australian funds management industry and more widely internationally, where independence is instituted by functional independence tests. Functional independence would be a more practical but still robust approach. A functional independence test could include strict physical and electronic separation of reporting lines and systems, and other conflict management processes, and build on the significant work already done by ASIC and industry in recent years under Regulatory Guide 133 to implement minimum standards for asset holders.

Using a functional independence test, fund managers, custodians and fund administrators may be operated by entities within the same corporate group. As noted above, it is our view that the structural independence test will prohibit any such arrangement.

By way of comparison, a functional independence test aligns with the IOSCO standard, the UCITS V directive, the approach taken by SICAVs, the requirements of the ARFP and the approach proposed to be taken in Hong Kong. This is the predominant international position, as summarised below:

- **IOSCO Standards**: The IOSCO standards requires that collective investment scheme assets should be entrusted to a third party custodian that is functionally independent from the responsible entity (IOSCO final report on Standards for the Custody of CIS Assets, 10 November 2015). The standards were endorsed by ASIC in association with the development of ASIC Regulatory Guide 133 (see ASIC Media Release 15-382 ASIC welcomes release of IOSCO custody principles).
- **UCITS V Directive** (Directive 2014/91/EU accessible at http://eur-lex.europa.eu/eli/dir/2014/91oj) requires that the Depositary should (at paragraph 13) "*act honestly, fairly, professionally, independently and in the interest of the UCITS and of the investors in the UCITS*". It also provides that a Depositary should be on an approved list and limited to national central banks, credit institutions, and other legal entities authorised under the law of member states which are subject to prudential supervision and capital adequacy requirements (at paragraph 25). A restriction under the CCIV legislation which limits the extent to which a prudentially supervised organisation can participate in the provision of depositary services would not be consistent with this principle.
- **SICAV (Luxembourg):** The Luxembourg SICAV requirement (implementing UCITS V) (see Memorial Journal Officiel du Grand-Duche de Luxembourg, Recueil de Legislation, A-No.88, 12 May 2016) is for the manager and Depositary to be, in the exercise of their respective functions, acting in a manner which is independent and exclusively in the interest of the investors and in a manner which is honest, loyal and professional.
- **ARFP regime**: The ARFP regime requires separation between functions of the asset holding and investment such that activities that relate to asset holding are being performed by persons who are separate from, and able to act independently from, investment officers. It does not require either Australia or the other participants, against whom Australian fund managers will be competing, to meet independence tests for the Depositary of the kind set out in the explanatory materials (i.e. the voting power test).

- **Hong Kong**: the proposal in the Hong Kong Securities and Future Commission's (SFC) Consultation Paper (June 2017) to establish Open-ended Fund Companies states in paragraph 63 that the custodian has to be a licensed bank in Hong Kong, a trust company which is a subsidiary of such bank, or an overseas banking institution or its subsidiary acceptable to the SFC, and that such custodian meets relevant capital and internal control requirements.
- **UK OEIC**: the stricter model for the UK open-ended investment company (OEIC)] does not go as far as the independence test proposed in the explanatory materials, since the UK legislation refers to the Depositary being independent, and the guidance as to what specific tests may be applied in in a guidance note (FCA Handbook, COLL 6: Operating duties and responsibilities). Further, the UK's OEIC regime does not entrench the independence test in its legislative framework.

We note that Singapore conducted consultation in 2017 on a **Singapore Variable Capital Company** (S-VACC) that included a structural independence test. However, no further details of this consultation are available and it appears the regime has not been finalised – so the final version may not contain the structural test as proposed in 2017.

While we appreciate that there are merits in ensuring regulatory alignment with overseas jurisdictions, we note that Asia is an appropriate region to consider for harmonisation given the Australian financial services market is located in the Asia Pacific region and that Australia's support of the Asia Region Funds Passport is designed to promote Australian funds into an Asian market.

The proposed approach for CCIVs appears to conflict with the policy objective of creating a competitive collective investment vehicle in Australia to attract international investors.

The depositary provides an important benefit in a separate entity holding assets on trust, rather than assets being held directly by the CCIV. It is acknowledged that this provides important investor protections. However, if the depositary requirements depart too much from the existing role of a custodian, which is strongly regulated under ASIC Regulatory Guide 133, the CCIV regime may have little take-up, with the result that in practice few investors will have such protection.

3.1.2 Objectives to mitigate fraud

One purpose of the structural independence test (i.e. the voting power test) appears to be to prevent the circumstances of major fraud such as in the Madoff or Trio Capital scandals. However, the FSC considers the proposed voting test, and the consequent restrictions on integrated service providers would not address a major fraud.

In those scandals, the common theme was a single dishonest person with a network of influence, and doubt as to the existence of assets purported to be owned by the funds. In the Madoff case, it was the auditor's lack of independence which was a key reason why the non-existence of assets was not identified sooner. It is also evident from reports that there was very little or no regulatory supervision of the Madoff organisation, which would not be the case for an Australian financial services licensee, particularly if it is also APRA-regulated (see How Regulators Missed Madoff, Liz Moyer, Forbes 27 January 2009).

3.1.3 Other comments on independence

While the FSC welcomes the proposed approach allowing varied degrees of independence between entities 'performing corporate director functions' and those 'performing depositary functions', and that it appears that 'administrative' activities require a lower degree of independence, we make the following specific observations on the current proposal:

- The categorisations of functions according to ‘tiers’ and ‘groups’ suggested in the Explanatory Materials are complex, and still require structural rather than functional independence. A simpler approach is to have a principles-based legislation, where each of the corporate director and the depository is to take adequate measures to ensure proper management of conflicts through functional independence (and perhaps allow ASIC to provide regulatory guidance once there is experience with the regime).
- Requiring legal (i.e. structural) separation for the relevant independence tests impedes integrated financial institutions from being able to perform depositary, custodial and administrative functions where such services are provided, and can continue to be provided, by divisions or business units within such institutions, with such necessary information and other barriers and conflict management protocols as are required to perform such functions independently. Requiring legal separation may well deter a significant number of quality custody providers which have substantial capital backing, sophisticated IT systems and essential global networks of subcustodians from the market for depositary services. Lack of competition and inefficiency seems likely to add to the cost of the provision of depositary services, undermining the viability of the CCIV regime. However, this is not purely a matter of additional cost to industry or consumers; it goes to the heart of the take-up of the CCIV regime.
- As stated above, the UCITS V model does not require structural independence of depositaries.

The FSC also notes it is apparent that the structural independence test explained in the explanatory materials will prohibit a CCIV, Corporate Director and a Depositary being wholly owned within the same corporate group. However, it is stated at paragraph 4.54 of the explanatory materials: “However, it is possible for the Depositary (or any entity performing Depositary functions) to be in the same corporate group as an entity performing any other Corporate Director functions for the CCIV.” It is not clear how this statement reconciles with the voting power test and it would be helpful if Treasury could explain what it means by this statement at 4.54.

3.2 Replacement of depositary

The proposal that a Depositary, which is mandatory for retail CCIVs, can only be replaced by a meeting of investors might lead to outcomes that are not in investors’ interests. A poorly performing Depositary which fails in their obligations, makes errors, unduly slows down the investment process or raises their fees unjustifiably is unable to be terminated by the Corporate Director under the draft legislation (see section 1235B(5)), unless with a member’s special resolution at a meeting of members. Further, section 1235D states that a new Depositary is chosen only if a meeting of members of the CCIV passes a special resolution choosing the new Depositary.

We do not object to members having a right to requisition a meeting and pass a special resolution to replace the depositary, but submit that this should not be the only mechanism for replacing a Depositary. The Depositary should be appointed by the Corporate Director on behalf of the CCIV under an agreement similar to a custody agreement, and the Corporate Director should be entitled to terminate the Depositary in accordance with that agreement, without having to call a members’ meeting. The agreement could be required to include prescribed terms that are not inconsistent with the Depositary’s statutory duties and role. The terms could be similar to those required under ASIC Regulatory Guide 133, and would cover the information flow between the Corporate Director and the Depositary.

Other options for replacing the depositary are set out in our earlier submission.

If Treasury does not agree that the Corporate Director should have the right to terminate the Depositary in accordance with the contract and select a replacement Depositary, a halfway-house measure would be to include the right of Corporate Director to terminate the Depositary after notifying members of its intention to terminate and appoint a replacement Depositary and if members holding less than 5% of shares object, then the Corporate Director would be entitled to terminate the Depositary and to put in place a replacement.

A similar approach has been utilised by ASIC in a number of instances, in particular in relation to the relief given to a responsible entity under *ASIC Corporations (Attribution Managed Investment Trusts) Instrument 2016/489* to amend a registered scheme's constitution to the extent that it is necessary or incidental to the scheme being able to be operated in a manner permitted by the attribution managed investment trust tax system. ASIC also has used this approach in case-by-case relief where a responsible entity of a registered scheme wishes to retire and have a related body corporate appointed as the replacement responsible entity.

Adapting the model set out under *ASIC Corporations (Attribution Managed Investment Trusts) Instrument 2016/489*, the statutory procedure could be as follows:

- If the corporate director of a CCIV wants to remove the depositary, the corporate director may publish a prominent notice on their website explaining that they intend to remove the depositary and appoint a new depositary. The notice must:
  - comply with the proposed s1235B(7) notice requirements;
  - set out a summary of the reasons for its intention to remove the depositary; and
  - include a statement that the corporate director will remove the depositary and appoint the proposed new depositary in the way it has identified in the notice unless it receives written requests (including by email) to call and hold a meeting from members with at least 5% of the votes that could be cast on a special resolution.
- Members will have at least 7 days from the date the corporate director posts the notice on the website to request a meeting. If no members' meeting is required, the corporate director may remove the depositary and appoint the proposed new depositary without the need for member approval.
  - If the requisite number of members request a members' meeting, the corporate director must call and hold a members' meeting to allow members to consider and vote on a special resolution that the current depositary should be removed and a special resolution choosing a body to be the new depositary.
- For wholesale CCIVs, or where all interests in the CCIV are held by wholesale clients, a corporate director can choose to follow this website notice process described above, or, alternatively, replace the depositary where it has taken reasonable steps to consult with each member before making replacing the depositary. Taking reasonable steps to consult with wholesale clients may include speaking with the members or emailing them and inviting members to seek further information, discuss the proposed replacement or raise any concerns should they wish to do so.
- Where the depositary is replaced using this process, the corporate director must notify ASIC in accordance with proposed s1235(3) before the replacement can take effect.
- The corporate director will also need to give each member a further notice to the effect that the depositary has been replaced the next time they send a communication to all members. The notice need only set the identity of the outgoing depositary and the identity of the new depositary, and the date the change took effect, being the date recorded on the ASIC register under proposed s1235B(1).

The above proposal would require a modification of the proposed s1235B(5), s1235B(7) and s1235D(1)(a).

It is possible that ASIC may adopt the proposed approach above under relief that it may grant, particularly for wholesale CCIVs. The FSC considers that it may be beneficial to incorporate this process in the legislation.

A solution to this problem of entrenchment of the depositary is essential for the CCIV regime to be attractive for both fund promoters and potential providers of depositary services in Australia.

3.3 Depository role and obligations

The FSC welcomes the modification of the wording in proposed s1234L(1) to the effect that the depositary "must take reasonable care to verify" that the activities covered by s1234L(2) are carried out in a manner that complies with the CCIV's constitution and the provisions of the Corporations Act. The FSC would appreciate a very clear statement that the modified wording means that such verification can be carried out after the actions described in proposed s1234L(2) have been undertaken. We refer to our earlier submission of 25 September 2017 (Attached) where we described that the better approach is the one adopted by under the AIFMD and UCITS V regimes of requiring only ex-post controls.

It would be useful to confirm and clarify that the intended supervisory role of the Depository under S1234L is to be limited to a post-transaction verification role.

Additionally, if the intention is that the Depository's supervisory role is limited to post-transaction verification, then the provisions of s1234K are inconsistent with this intention. As drafted, s1234K requires the Depository only to deal with assets of the CCIV on instructions that the Depository reasonably believes are lawful and comply with the CCIV constitution. The Depository is therefore still required to assess the lawfulness of a trade before it is carried out, rather than undertaking post-transaction verification.

It is suggested that to provide further clarification of the Depository's role that s1234K is amended to remove the both words *'that the Depository reasonably believes:'* and paragraphs (a) and (b).

3.3.1 Ability to refuse to act

It is normal practice for a custodian to have the ability to refuse to enter into a dealing with assets if it reasonably considers that the instruction is obviously erroneous, incomplete, unauthorised, uncertain or otherwise does not fit within protocols for orders agreed between them, as well as if it is unlawful or inconsistent with the CCIV constitution.

However, proposed s1234K does not appear to permit the depositary to refuse to act on the instructions of the corporate director or its agents in such circumstances. Providing scope for such a refusal is an important statutory protection for a depositary. A CCIV will not be workable if this provision is retained.

This submission is notwithstanding the point above that we consider that it should not be an obligation of the Depository to have a reasonable belief that a dealing is lawful and in compliance with the CCIV constitution *before* being entitled to act on an instruction.

3.4 Depository and agents

Section 1234H prohibits a Depositary from appointing or engaging an agent to assist in the verification function in section 1234L. This prohibition, however, appears to be impractical, in particular where technology providers may be engaged to assist the Depositary in its functions. For example, outsourcing of IT systems should be allowed, if the Depositary remains ultimately responsible.

3.4.1 Depositary's agents must meet the independence test

Section 1234H requires any agent of the Depositary to meet the independence requirements to be set out in section 1234D. For the reasons set out above, we consider that imposing the voting power test on a Depositary and any sub-custodian is uncompetitive and beyond the functional independence tests used predominantly globally.

Imposing the structural independence test on Depositaries and sub-custodians would prohibit asset managers who become Corporate Directors from appointing an entity with a common parent as a Depositary or a sub-custodian. This means that a number of the major providers of fund custody services (including prudentially regulated deposit-taking institutions) could not act as a Depositary or sub-custodian for the funds operated by the investment division of their organisation.

3.4.2 Strict liability for agents

The draft legislation at section 1234H(3) imposes on the Depositary strict liability for its agents and others engaged to do anything that the Depositary is authorised to do in connection with the CCIV. Custodians generally agree to take care in the selection and supervision of non-affiliated sub-custodians and others who hold fund assets in various jurisdictions, but do not guarantee their solvency, for example. The UCITS V standard, rather than strict liability, should apply. ASIC Regulatory Guide 133 requires a written agreement which includes reasonable liability provisions with all asset holders in the custody chain, and this model would be consistent with international practice.

4 Sub-funds

The FSC considers that the following areas dealing with investments in and of a sub-fund continue to be unnecessary restrictions under the proposed CCIV regime.

4.1 Self-acquisition & inter-funding/cross-funding

It appears the self-acquisition rules in proposed s1246H do not alter the policy position in the earlier draft of the legislation prohibiting a CCIV from acquiring shares that are referable to another sub-fund of the CCIV, except under a court order.

For reasons stated in our earlier submission of 25 September 2017, the FSC considers these rules to be unnecessary and would prevent various forms of inter-funding across sub-funds that are available to managed investment schemes. It was expected that a key benefit of the sub fund feature of a CCIV would be to efficiently create a structure where one fund acquires the investment portfolio, and other funds which including hedging, or are expressed in different currencies, acquire shares in that main fund. This provides much more efficient management and cheaper transaction costs, and would be particularly helpful in a region-wide offer where different currency options are needed.

Any proposal (as discussed in industry working groups and consultative groups) to reform the law after its enactment to permit a cross-ownership of 20% of a sub-fund by another sub-fund of the same CCIV would not achieve the aim of having regulatory parity with managed investment schemes. The facility for interfunding is an important feature and it should be included from the outset, preferably without numerical limits.

4.2 Sub-funds investing in the same asset

Proposed s1233K effectively requires that assets that are not automatically allocated and which are not fungible assets must be converted into money, or two or more fungible assets, before they become assets of a sub-fund according to the proportion determined for the sub-fund. Despite the additional allocation rules under the revised draft legislation, this section effectively continues the requirement under the first draft of the legislation to the effect that the corporate director must not allocate an asset to more than one sub-fund.

For reasons stated in our earlier submission of 25 September 2017, the FSC does not consider this restriction to be needed and the benefits from effectively requiring an interposed entity (such as a trust) are unclear.

4.3 Single assets of a CCIV cannot be an asset of more than one sub-fund

S1233J(1) provides that a single asset of a CCIV cannot be an asset of more than one sub-fund of the CCIV. We question the inclusion of this provision.

Provided that there is a requirement of the Corporate Director to identify and account for each the assets (whole or partial) of a sub-fund with certainty, we submit that an asset could be partially owned by different sub-funds. For example, there could be two sub-funds (with different investors) that enter into a joint venture with respect to an asset, such as where a real estate asset is held as tenants in common. The fact that the interest of one party may need to be realised in case of its insolvency is no different to unrelated companies or unrelated MISs participating in joint venture arrangements.

Further, we note that ‘single asset’ is not defined.

We also query whether this provision means that a single asset could be an asset of more than one sub-fund of separate CCIVs and whether the use of the words ‘the CCIV’ means that this provision only relates to a single CCIV.

4.4 Sub-funds transacting with each other and related party provisions

It is not clear in the draft legislation as to how a sub-fund of a CCIV may transact with another sub-fund of the same CCIV.

The sub-funds will not be separate legal persons, so for them to validly transact with each other, for example to transfer an asset from one to the other they will need statutory validation. We suggest a provision similar in concept to section 24 of the Conveyancing Act NSW, with a restriction that the assurance may only be made if it complies with provisions equivalent to Part 2E of the Corporations Act, adapted for the context of transfers of value between sub-funds which are not legal persons (similarly, trusts are not separate legal persons, but the related party provisions apply to them under Part 5C.7).

4.5 Separate bank accounts for each sub-fund of a wholesale CCIV

Proposed S1233H requires that a separate bank account is required for each sub-fund of a wholesale CCIV. We submit that, for a wholesale CCIV, it should not be a requirement that a separate bank account is required for each sub-fund. This is not currently a requirement for a wholesale MIS.

5 Related Party Provisions

Part 8B.4 makes provision for related party transactions. Currently, under applicable MIS laws, a wholesale MIS is not subject to the related party provisions set out in Part 5C.7 of the Corporations Act.

We question whether it is Treasury's intention to include wholesale CCIVs in Part 8B.4. We submit that the related party provisions in Part 8B.4 should not apply to a wholesale CCIV.

6 Shares

The FSC considers that some rules relating to shares in proposed Part 8B.7 should be clarified or made more flexible. These rules impose significantly more burdensome requirements than those applying to registered schemes.

6.1 Price and timing of redemption of shares

Proposed s1245J states that a redeemable share in a CCIV must be redeemable for a price based on the net asset value, "at the time of the redemption", of the sub-fund to which the share is referable if the sub-fund is liquid. The FSC considers that the requirement that the net asset value "at the time of the redemption" suggests that the valuations of the CCIV's assets must be made at the time of the redemption, which is impracticable and does not reflect that valuations could still be current for the nature of the assets in question or could have been suspended where market conditions (e.g. significant market disruption) require it. We note that ASIC interprets the fairness requirement for withdrawal provisions under s601GA(4) as requiring withdrawal amounts to be "reasonably current" (per RG 134.176) and that notional s601GAF as inserted by ASIC Class Order (CO 13/655) does not specify requirements about the currency of valuations.

The FSC considers that proposed s1245J could be read as allowing redemptions to be based on the net asset value prevailing at the time of the redemption even where the last valuation was some time prior, however, we would prefer that the drafting be clarified.

Section 1232J requires the CCIV constitution to state a specific period within which a redemption must be satisfied. The rules for timing of payment of redemptions from a liquid MIS include appropriate flexibility, by allowing the constitution to specify a time for consideration and processing of redemption requests, plus a time for payment after the redemption takes effect, with both periods able to be extended to deal with unanticipated dysfunction in markets and prices. It is also permissible for the constitution of an MIS to say that the responsible entity has a discretion to redeem on request, but is under no obligation at all to redeem. It is then possible to be guided by what is in members' best interests. A strict obligation for the constitution of a CCIV to specify a time by which shares must be redeemed does not recognise these essential features of an investment fund, and in its practical application is likely to be contrary to the interests of continuing investors, because one person should not be able to exit the fund at an uncertain price or in other circumstances where it would not be fair to continuing investors.

6.2 Distributions

The FSC considers that the test for the payment of dividends in proposed s1245Q, which appears to model the test for companies in s254T, has concepts carried over from the Corporations Law provisions relating to companies and as a result has a significantly higher threshold than the current threshold for managed investment schemes.

A responsible entity or trustee of a managed investment scheme may pay a distribution by simple determination without regard to any distribution-specific statutory requirements. Further, in adopting the test in s254T, residual questions about the application of the long-standing general law principle that dividends may only be paid out of profits remains.

The approach proposed in s1245Q has the CCIV being a corporate structure with company characteristics; instead of this approach, we consider that a CCIV should be a corporate structure with MIS characteristics.

We also note there are no such restrictions upon a retail CCIV in payment of distributions which apply in section 1245Q(2)(c).

In addition, this requirement would appear to apply to both wholesale and retail CCIVs, making the compliance burden unnecessarily high for wholesale CCIVs.

6.3 Capital Distributions

S1245Q and S1246 of the draft legislation impose restrictions on the payment of dividends and reductions of capital, with concepts carried over from the Corporations Law provisions relating to companies.

Section 1246A applies not only compliance with the CCIV constitution and a solvency test (which seem appropriate) but also a fair and reasonable determination and a special resolution of investors before a reduction of capital of the CCIV other than a pure redemption can be made. This is an example of the inappropriate results that can flow from regarding the CCIV as a company with investment features, rather than as an investment vehicle with company features. Responsible entities of managed investment schemes can and do make capital distributions in a range of circumstances, as authorised under the MIS constitution, including as part of normal distributions (along with income), in circumstances where accounts for the financial year have not been drawn up and it is not clear how much of the cash flow of the trust is income and how much is capital, and in a range of transactions including takeovers and reconstructions. So long as a solvency test is met and the corporate director complies with the CCIV constitution, there should be no restrictions on distributions of capital from a CCIV.

If there is to be equivalent functionality with a MIS, capital returns should be allowed if the sub-fund is solvent at the time of the distribution. Capital distributions are necessary for open-ended funds in various contexts, including as part of the periodic distribution of income and capital (as the exact tax character of a payment is often not known until after the end of the financial year), for winding up where the assets are sold in tranches, and for reconstruction including stapling.

6.4 Half-yearly reporting requirements

The requirement to report certain share transactions every 6 months under proposed s1245S also is a new requirement not currently applicable to managed investment schemes.

This requirement would appear to apply to both wholesale and retail CCIVs, making the compliance burden unnecessarily high for wholesale CCIVs.

7 Other issues

We also make high level comments in respect of the draft legislation in respect of the following matters:

CORPORATE DIRECTOR	
1. Corporate Director must be a public company that holds an AFSL authorising it to operate the business and conduct the affairs of the CCIV (section 1231)	See our comments in row 4 relating to the appropriateness of this structure for a Corporate Director for a wholesale CCIV. Further, it is suggested that Treasury should consider including provisions to allow Crown entities to establish CCIVs. The draft legislation requires there to be a Corporate Director of the CCIV that is a public company with an AFSL. Crown entities are, however, unable to obtain AFSLs as they are exempt from complying with the Corporations Act (s5A(4)). The MIT and AMIT rules have included provisions to enable Crown entities to utilise them (e.g. s275-35(2) ITAA 1997), and the same approach should be taken for CCIVs.
2. Corporate Director best interests duty / duty to treat members of different sub-funds fairly (section 1237C)	There is an obligation upon the Corporate Director, and its officers, to treat members of different sub-funds fairly and to act in the best interests of members. This may give rise to problems in the context of transactions between sub-funds within the same CCIV. This duty may place a Corporate Director and its officers in a position of conflict where they would not be able to satisfy their statutory duties to two or more sub-funds at the same time. If these duties are to be retained then it is submitted that safe harbours be provided to allow for the efficient functioning of the sub-fund model. For example, a safe harbour could apply where there are transfers of assets between sub-funds where the transfer is at fair value and is fair and reasonable in the circumstances. A second safe harbour (where a decision in relation to one sub-fund may affect another sub-fund) may be to provide for a Corporate Director (and its officers) to discharge their duties if separate teams (operating behind information barriers) have been established to act for each sub-fund and independent directors act separately for each sub-fund.
SELF-ACQUISITION	
OTHER SPECIFIC PROVISIONS RELATING TO WHOLESALE CCIVS	
3. Retirement and replacement of Corporate Director for a wholesale CCIV (section 1238M)	The draft legislation treats the retirement and replacement of a Corporate Director for a wholesale CCIV in the same way as for a retail CCIV. It is submitted that investors' rights for wholesale CCIVs in respect of the retirement and replacement of a Corporate Director should be subject to the terms of the constitution and/ or be a matter of negotiation between the Corporate Director and investors and not always require a members' vote (as provided for in the draft legislation).

4. Corporate director of a CCIV for a wholesale CCIV (section 1238E)	It is submitted that a Corporate Director of a wholesale CCIV should not necessarily be required to be a public company. Further, it is submitted that a Corporate Director of a wholesale CCIV should have a different authorisation to that required for a Corporate Director of a retail CCIV under the licensing regime. We propose that a separate type of authorisation be provided for to operate a wholesale CCIV and that it should be possible for a licensee authorised to operate CCIVs to appoint an authorised representative to act in that capacity for a wholesale CCIV (as occurs currently under the present rules for wholesale MIS). This would ensure that there are no undue barriers to entry for smaller developing fund managers in setting up a wholesale CCIV compared to a wholesale MIS.
5. No reverse election for a Depositary for a wholesale CCIV (section 1234A)	This section imposes a requirement that if a wholesale CCIV elects to have a Depositary, it is unable to subsequently reverse that decision to not have a Depositary. It is submitted that a wholesale CCIV, after electing to have a Depositary should have the right to then decide subsequently to remove the Depositary and take back the assets and hold them itself with appropriate approval of investors, in a similar way to that for a registered MIS that may deregister and be deregulated if investors agree.
6. Strict liability for agents for a wholesale CCIV (section 1237K (3)(a))	It is submitted that the extent of liability for agents in a wholesale CCIV should be a commercial matter to be agreed between the wholesale investors and the Corporate Director, as it is in the case of wholesale unregistered MIS. The market standard in many circumstances would be that the fund manager is required to take care in the selection and supervision of agents, not to be strictly liable including for an agent’s insolvency.

8 Taxation

We also note the following matters in conjunction with the implementation of this draft legislation:

8.1 Taxation draft legislation for CCIVs

We have previously provided comments in relation to the draft taxation legislation for CCIVs. The proposed CIV framework is clearly not as attractive as any of the foreign competing vehicles or AMITs for the following reasons:

- Australia’s non-resident withholding tax (NRWT) regime is not globally competitive nor consistent with intent to facilitate the export fund management services to Asia. In particular Australia’s NRWT rules are complex with multiple higher rates than those that are applicable to competing vehicles

- The proposed application of the AMIT widely held and closely held tests to foreign investors in CCIVs is of great concern because of both the complexity and uncertainty associated with these rules and the difficulty in satisfying the rules in contexts such as in relation to new funds.
- The introduction of a penalty for attribution ‘unders and overs’ that results from a lack of reasonable care. This is inconsistent with AMIT policy. We submit that it is inappropriate to change the policy as no evidence has been provided that there is substantial issue with ‘unders and overs’ to support this change. We further submit that the penalty should not be introduced.

8.2 State taxation

We note that there are significant stamp duty and other state tax considerations which require the early engagement of state revenue offices. In particular, we expect specific relief may be required for transition of existing unit trusts into CCIVs.