Allens › ‹ Linklaters

Corporate Collective Investment Vehicle

SUBMISSION TO TREASURY

Allens, July 2018

Allens welcomes the opportunity to provide comments on the exposure draft of the Treasury Law Amendment (*Corporate Collective Investment Vehicle*) Bill 2018, and the accompanying draft explanatory memorandum (together, the ***Exposure Draft***). We recognise that the Exposure Draft is a significant step towards the implementation of the Corporate Collective Investment Vehicle (***CCIV***) regime, and once fully developed, will be of benefit to Australia's fund management industry and investors (both local and overseas).

Set out below are our comments and recommendations on the proposed Exposure Draft which, in our view, will assist in the CCIV being an attractive investment vehicle option for fund managers, and ensure that the regime will operate more efficiently once implemented while preserving appropriate protections for investors.

1. REGISTRATION AND BASIC FEATURES OF A CCIV

	Section of Act	Issue	Allens Comment
1.1	1232B	Constitution of a CCIV	We note that any CCIV (whether wholesale or retail) must lodge a copy of its constitution (and any modifications thereto) with ASIC. There is no requirement to lodge with ASIC the trust deed or other constituent document of an unregistered managed investment scheme. Wholesale fund constituent documents typically contain a plethora of proprietary information which our clients go to great lengths to ensure does not become publicly available (and, in particular, does not become available to competitors). On that basis, a requirement to lodge the constitution of a wholesale CCIV with ASIC (and for that document to be publicly available) would in our view serve as a significant disincentive to managers considering establishing a wholesale CCIV. In the same way that the requirement to lodge a constitution and any amendments to a company constitution under s 136(5) does not apply to proprietary companies, we submit that the requirement should apply only to retail CCIVs and not to wholesale CCIVs.
1.2	1232F	Meaning of a retail CCIV	We previously submitted that defining a retail CCIV only by reference to its promoter or an associate of its promoter – being in the business of promoting CCIVs to persons who are, or would be, retail clients – was misconceived and had suggested the inclusion of an equivalent exception to that contained in s 601ED(2). In summary, a CCIV will be a retail CCIV and subject to additional regulatory requirements if the issuing of a security would give rise to the need to give a Product Disclosure Statement. We note that this definition tracks the exception to the need to register a managed investment scheme under s 601ED(2) but that the tests in s 601ED(1) do not seem to apply to CCIVs (ie, unlike an MIS, even if a CCIV has 20 members or less and is not promoted by a person or an associate of a person who is in the business of promoting CCIVs, it will still be a retail CCIV and subject to additional regulatory requirements). We propose that the test for whether a CCIV is as retail CCIV and therefore subject to the increased regulatory requirements should track the test for registration of an MIS (ie, a CCIV will be a retail CCIV if one of the tests in s 601ED(1) applies, unless the new s 1232F applies).

2 SUB-FUNDS

	Section of Act	Issue	Allens Comment
2.1	1233J(1)	Single asset of a CCIV cannot be an asset of more than one sub-fund of the CCIV	It is important that a sub-fund's assets be identified or identifiable. However, the drafting needs to be flexible enough to recognise the various ways in which property may be owned, which may make it difficult to say that two or more sub-funds do not have an interest in the same underlying asset. This will particularly be the case for real estate and infrastructure investments. For example: • **Tenancy in common:** a type of co-ownership where the tenants in common hold undivided shares, possessing the property in common and without exclusive possession of any part of it. • **Partnership:** a partner has a beneficial interest in the partnership assets, indeed in each and every asset of the partnership. If the assets of two or more sub-funds are held in partnership (ie, the CCIV is a partner of a partnership in relation to two or more sub-funds, with third parties) the sub-funds have an interest in each and every asset of the partnership. While it may be argued that the partnership interest itself is a separate asset that may be held separately by a sub-fund, it has also been held that a 'share [in a partnership] is not a thing separate from the share of another partner. It is a fractional interest in a surplus of assets over liabilities on a winding-up and a fractional interest in the future profits of the partnership business.' This could create uncertainty about compliance with this requirement. • **Contract:** if the CCIV enters into a contract for the benefit of more than one sub-fund, rights under the contract, which are assets, will be assets of more than one sub-fund, creating uncertainty about compliance with this requirement. If s 1233J(4) is intended to provide this flexibility, then this should be more explicit. Consequently, the operation of s 1233K(7) would need to be clarified (see item 2.2) and the operation of s 1233L(3) would need to be changed to allow a sub-fund to deal with an asset that is owned as described above. We submit that greater flexibility should be provided for the corporate director to allocate assets on a fair and reasonable basis in circumstances where the nature of the investments made by the relevant sub-funds is such that they acquire interests in common as tenants in common, in partnership etc.
2.2	1233K(7)	Corporate director must convert asset	A corporate director is required to convert an asset that is not automatically allocated to a sub-fund into two or more fungible assets that could be allocated. This obligation should be clarified, as it may be seen to create an obligation to convert an asset in circumstances where its conversion is not anticipated or required as a commercial matter (eg, where two sub-funds have been invested in a building as a tenant in common).

3 OFFICERS AND EMPLOYEES

	Section of Act	Issue	Allens Comment
3.1	1237B	General duties	Thank you for clarifying that Subdivision B (ie, the duties owed by officers of a CCIV, officers of a corporate director and employees of a corporate director) does not apply in relation to a corporate director or other officer of a wholesale CCIV, or officer or employee of a corporate director of a wholesale CCIV.
3.2	1237C(1)(c) and 1237D(1)(c)	Duties owed by corporate director and officers of corporate director	We note that it is still proposed that the corporate director owes, among other things, a statutory duty to each member of the CCIV to act in the best interests of the members. The same statutory duty is imposed on the officers of the corporate director (s 1237D(1)(c)). As previously submitted, this would give rise to difficulties in the context of transactions between sub-funds (eg, where sub-fund A wishes to acquire the interests in sub-fund B), or in the context of the transactions of one sub-fund which could affect another sub-fund. In such circumstances, these duties could place the 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 the best interests duty is retained, in our view, safe harbours should be provided to allow the efficient functioning of the sub-fund model. As previously submitted, one such safe harbour may permit transfers between sub-funds where the transfer is at fair value and is fair and reasonable in all of the circumstances. Where a decision is made in relation to sub-fund A which may affect sub-fund B, a second safe harbour may be to permit the corporate director (and its officers) to discharge their duties in separate teams (operating behind information barriers), so that the decision by sub-fund A is made without regard to the interests of sub-fund B, and sub-fund B has its own team to look after its interests.

4 CORPORATE DIRECTOR

	Section of Act	Issue	Allens Comment
4.1	1238H	Requirement for external directors of corporate director	Thank you for clarifying that the requirement for at least half of the directors of the corporate director to be external directors only applies to retail CCIVs.
4.2	1238M, 1238N	Retirement of corporate director and removal of corporate director by members	We note that if a corporate director wishes to retire, it must call a members' meeting to enable the members to vote on a resolution to choose a company to be the new corporate director. This resolution must be a special resolution, when previously it was an extraordinary resolution. Similarly, the resolutions to remove the existing corporate director and appoint a new corporate director have been amended to require special resolutions. It is unclear to us why the amendment has been made from extraordinary resolution to special resolution. We would be grateful if the rationale can be provided in the Explanatory Memorandum. Given that the registered managed investment scheme regime requires an extraordinary resolution for the appointment of the replacement responsible entity when a responsible entity retires, in our view, this does not maintain the regulatory parity between the existing MIS framework and the CCIV framework as intended (see paragraph 1.18 of the EM).

5 RELATED PARTY TRANSACTIONS

	Section of Act	Issue	Allens Comment
5.1	1242	Related party transactions	We note the restrictions in relation to related party transactions (which apply to bodies corporate and, in a modified way, responsible entities of registered managed investment schemes but which do not apply to operators of unregistered managed investment schemes) will apply to CCIVs. As with a number of the proposed features of the CCIV, we assume it is understood that this will make the CCIV less attractive to operators of wholesale funds.

6 SHARES

	Section of Act	Issue	Allens Comment
6.1	1245A(4)	Definition of redeemable shares	Thank you for clarifying that a redeemable share as defined cannot be a preference share (and that the right to redeem will not itself be a preference - s 254A(5)) and that a CCIV can issue a preference share (s 1245C). Under s 254A(2), however, the terms of a preference share must be set out in the constitution or be approved by a special resolution of the company. We therefore suggest an additional provision to clarify that for CCIVs, the special resolution is for the relevant sub-fund.
6.2	1245A(4)	Definition of redeemable share	Thank you for clarifying that a redeemable share may be redeemed at the option of the CCIV, or the member (or both).
6.3	1245C	Conversion of shares – preference shares	A CCIV share can only be referable to one sub-fund (s 1245). Section 1245C, however, provides that a resolution is required 'for each sub-fund of the CCIV to which the shares are referable'. This is presumably a drafting point.
6.4	1245E	Redemption of redeemable shares	We take it that it would not be possible to redeem redeemable shares by way of capital reduction under the modified s 256B? (We note, however, that the shares could be bought back.)
6.5	1245J	Redemption of preference shares – retail liquid sub-funds	This section requires that the redemption price be 'based on the net asset value' of the sub-fund. This indirectly imposes a redemption price for retail liquid funds where such a requirement is not imposed directly. Furthermore, this requirement is not imposed for redemption of illiquid funds. Yet there is no certainty as to whether or when a sub-fund will be liquid or illiquid.
6.6	1245K	When a sub-fund is liquid	This section replicates the test for a liquid registered scheme. As noted in s 7.2 of our first submission, for retail CCIVs, the draft legislation uses the liquid/non-liquid distinction as developed under Chapter 5C. In our view, this is problematic for a range of reasons. In the context of Chapter 5C, that distinction has been notoriously difficult to apply and open to manipulation (see, for example, the discussion in Australian Managed Investment Law & Practice at [69-300]). Given that there will be a solvency threshold for redemptions, we submit that a liquidity test is less necessary and is best avoided.

7 TRANSACTIONS AFFECTING SHARE CAPITAL AND DEBENTURES

	Section of Act	Issue	Allens Comment
7.1	1246A(2)	Reduction of capital – constitution requirement	The section effectively deems s 256B(1) to be complied with if specified criteria are met. These are modified versions of the s 256B(1) requirements. An additional requirement is that the CCIV constitution permits the reduction. We submit that this is an unnecessary and unhelpful requirement. It is unnecessary because investor approval is required as well. It is unhelpful because it can produce arbitrary results: it will depend on whether whoever prepared the constitution remembered to provide for capital reductions. Also, when will the reduction be 'provided for'? Would a very general permission be sufficient? If so, how does the requirement protect investors? It is also not consistent with generally only requiring that matters be dealt with in the constitution in the case of retail CCIVs.
7.2	1246B(2)	Reduction of capital – shareholder approval	This section provides that if the reduction of capital would affect two or more sub-funds, then the approval of each affected sub-fund must be obtained. This and the phrasing of s 246A(2) suggests that a capital reduction of more than one sub-fund can be conducted at the same time. Is this intended? Given the structure of sub-funds, it seems unlikely that a reduction of share capital referable to one sub-fund would affect another sub-fund.
7.3	1246H	Self-acquisition of shares	We repeat the suggestions made in our earlier submission at 7.3, set out below: In the general company context, exemptions from Corporations Act requirements are required in some cases (eg, where there are cross investments between investment vehicles managed by members of a corporate group). These situations could also be problematic for CCIVs where, for example, the CCIV acquires units in a trust and that trust holds shares in the CCIV. It would be helpful, especially in the CCIV context, if it could be made clear that a beneficial interest in a trust did not constitute a 'unit' in a share (at least where the trustee of the trust is not a related body corporate of the corporate director). We accept that this may be an issue that can be left for ASIC to consider in the context of its powers in proposed [now] s 1269B. Furthermore, it seems that s 259C would operate to prevent the CCIV from acquiring shares in the corporate director (and possibly parent companies of the corporate director). This could easily lead to acquisitions by the CCIV being void, especially where the corporate director or its parent is a listed entity and the sub-fund invests in listed securities. Also, we note the observation in the Explanatory Materials that the rule will prevent one sub-fund investing in another and that this is intentional to avoid 'contagion between the sub-funds' (at 8.74). It is not clear to us what the risk is here beyond any other investment.
7.4	1246J	Taking security over own shares	We repeat the points made in our earlier submission at 7.4, set out below: (a) The issue regarding 'units' of shares also arises here. (b) The prohibition extends to an entity that controls the CCIV (based on the s 50AA test). Given proposed [now] s 1237J(1), should this not always be the corporate director? Having a general control test makes the scope of the prohibition uncertain and unclear.

8 FINANCIAL REPORTS AND AUDIT

	Section of Act	Issue	Allens Comment
8.1	Part 8B.10	Preparation of financial report for CCIV as a whole	It is proposed that the general obligation to keep financial records will apply to a CCIV and each sub-fund of the CCIV. The stated intention is that 'Part 8B.10 modifies the application of Chapter 2M so that the reporting requirements in Chapter 2M apply to CCIVs in the same way as they apply to registered schemes'. We agree that the RE of a registered scheme must prepare financial reports both in relation to its own activities (because it is a public company) and in relation to the activities of the registered scheme of which it is the RE. But it is not clear that the financial reports a CCIV prepares in relation to its own activities are separate from those of its sub-funds. We submit that this should be made clear to avoid a CCIV having to prepare a financial report which aggregates the financial performance of all of its sub-funds.

9 OTHER

	Section of Act	Issue	Allens Comment
9.1	1241B	Contents of a compliance plan	We note that unlike s 601HA, s 1241B does not set out minimum requirements for the compliance plan of a CCIV. While we appreciate that ASIC will provide some guidance as to the contents of a compliance plan in its regulatory guide, in our view, statutory requirements should be included to address matters that are of particular importance to a retail CCIV.
9.2		Meetings and wholesale CCIVs	Again, it seems that the Meeting provisions will apply to wholesale CCIVs. These incorporate Part 2G.4, which applies to registered schemes only. The registered scheme meeting rules are complex and unclear (eg, the voting requirements). We submit that they should only apply to retail CCIVs.