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Investment Funds

Australia
Law & Practice
and
Trends & Developments

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AUSTRALIA

Law and Practice

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1. Investment Funds Market Overview

1.1 State of the Investment Funds Market

The Australian investment funds market is highly developed, both from a regulatory and commercial perspective. Australia is a jurisdiction that is welcoming to retail and alternative fund strategies and managers.

The COVID-19 pandemic has coincided with more restrained activity in the Australian funds market. There has still been a significant flow of transactional and regulatory matters, and this is anticipated to grow in the year ahead.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

The most commonly used structure is a unit trust, due to its flexibility.

For private equity and venture capital funds, a unit trust or a limited partnership, usually in the form of a venture capital limited partnership or early stage venture capital limited partnership (in certain circumstances), can be used.

A unit trust is simpler to establish and offers greater flexibility with respect to the asset classes in which it can invest; however, certain limited partnerships can attract tax benefits for investors and fund managers where requirements are met.

For hedge and credit strategies, a unit trust is the only suitable local structure.

2.1.2 Common Process for Setting up Investment Funds

A regulated Australian unit trust will require registration with the Australian Securities & Investments Commission (ASIC). Such unit trusts are known as registered managed investment schemes. Once an application for registration is received by ASIC, a decision on registration must be made by ASIC within 14 days. Key approval requirements are:

- the trustee of the fund holds an Australian financial services licence (AFSL) authorising it to be a "responsible entity" of a registered managed investment scheme;
- the responsible entity is an Australian public company; and
- the constitution of the fund meets the requirements of the Corporations Act 2001 (Cth) (Corporations Act).

The key required documentation is a constitution/trust deed. In addition, an investment management agreement is typically required, by which the trustee outsources investment management to a manager entity.

The setting-up process is not lengthy and costs are reasonable. Establishment, and registration with ASIC, of a registered managed investment scheme can take place within three to four weeks.

An unregistered unit trust can be established within one to two weeks.

The above timings assume a simple structure and that relevant licensing arrangements are previously in place.

Venture capital limited partnerships and early stage venture capital limited partnerships are incorporated limited partnerships established under State-based legislation. They are bodies corporate and need to be registered with relevant State regulatory bodies. In addition, these entities require registration with Innovation Australia. Due to legislative requirements, the general partner of the venture capital limited partnerships and early stage venture capital limited partnerships must also be an incorporated limited partnership (VCMP). The general partner of that VCMP is generally a company.

The benefit of registering venture capital limited partnerships and early stage venture capital limited partnerships is primarily the manner in which investment proceeds are taxed for both the manager and the investor. Managers of each of these vehicles are required to hold an Australian Financial Services Licence, or be an authorised representative of an Australian Financial Services Licence holder, or have the benefit of a relevant exemption. Key documents for partnership are a partnership agreement, a subscription agreement and a management agreement, and a CAR Agreement and any side letters. A partnership agreement for the VCMP is also required.

Incorporation of a limited partnership can occur in approximately two business days. Registration of a venture capital limited partnership and early stage venture capital limited partnership can take as little as one month, assuming all required documents have previously been prepared. Registration fees are modest.

A significant work stream to be undertaken on fund inception is the relevant "carry" vehicles and rules applicable for the carry participants.

2.1.3 Limited Liability of Investors

The trust deed for most unit trusts includes what is, in effect, a contractual limitation of liability of investors. The effectiveness of such limitations has broad commercial acceptance.

Despite such acceptance, the question of the legal effectiveness of such limitations has been the subject of New South Wales Law Reform Commission Report 144 (issued in May 2018), which outlines reasons for amendments to legislation to give statutory effect to such limitations. It remains to be seen whether such amendments will be made.

In relation to limited partnership structures, as a general rule, an investor's liability is limited to their capital committed to the investment vehicle. Typically, if there is a tax impost relating to an investor's commitment, the investor must fund that impost.

2.1.4 Disclosure Requirements

A fundamental disclosure requirement is that communications to investors cannot be misleading or deceptive, including by omission.

Where retail investors are being issued with interests in a fund, the product disclosure statement must comply with statutory disclosure rules, including detailed costs' disclosure. The issuer of the product has continuous disclosure obligations.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Alternative funds are frequently invested by institutional investors from both Australia and offshore. Most major Australian institutional investors have an allocation for private equity funds.

2.2.2 Legal Structures Used by Fund Managers

Unit Trusts

In Australia, unit trusts can be structured as open- or closed-end vehicles, where performance fees can take the form of a traditional performance fee on net asset value increase or a private equity-style "carry waterfall".

There are very few legal requirements that apply to Australian unit trusts, which are simple to establish and, provided they are only offered to wholesale investors, often have no regulatory or other registration or approval requirements (note that there would typically be regulatory requirements for the manager or trustee; see **2.3 Regulatory Environment**).

A unit trust is managed by its trustee, who may, in practice, appoint an investment manager to provide investment management services in respect of the trust. The use of corporate trustees is common by fund managers who either do not desire to manage the day-to-day administration of their own trust, or who may lack the necessary regulatory licence to act as a trustee.

Partnerships

In Australia the only form of corporate investment vehicle is an incorporated limited partnership.

The common partnership structures used by a private equity or venture capital fund to invest primarily in Australian businesses are known as venture capital limited partnerships (VCLPs) for private equity and venture capital funds or early stage venture capital limited partnerships (ESVCLPs) for early stage venture capital funds.

Overview of VCLPs and ESVCLPs

An incorporated limited partnership must meet specific requirements before it can be registered as a VCLP or an ESVCLP with Innovation and Science Australia, an Australian government department. There are specific requirements for a VCLP and an ESVCLP set out in the Venture Capital Act 2002 (Cth) (VC Act), with many consistencies between the two, including:

- the term of the partnership must be more than five years and less than 15 years;
- the minimum committed capital is at least AUD10 million; and
- the partnership must only carry on activities that are related to making eligible venture capital investments, as defined by relevant Australian tax legislation.

An EVCI is an equity investment in an unlisted company or unlisted trust that is located in Australia, does not exceed more than 30% of the partnership's committed capital and that has a predominant activity that is not an ineligible activity. An ineligible activity includes property development or land ownership, banking, providing capital to others, leasing, factoring, securitisation, insurance, construction or acquisition of infrastructure facilities and/or related facilities, and making investments that are directed at deriving income in the nature of interest, rent, dividends, royalties or lease payments. In order for an investment to qualify as an EVCI, the investment must not exceed the value restriction imposed at the time of the investment (ie, AUD50 million for an investment by ESVCLP and AUD250 million for an investment by VCLP).

In addition to the requirements for registration, the VC Act applies various restrictions to these structures:

- no single investor in an ESVCLP, other than in certain defined circumstances, can contribute more than 30% of the total committed capital;
- the maximum committed capital for an ESVCLP is AUD200 million;

- VCLPs and ESVCLPs cannot invest in a single investment whose total assets exceed AUD200 million at the time of investment; and
- in general, they cannot make debt investments other than permitted loans as defined in the VC Act.

Given the strict requirements and restrictions imposed on VCLPs and ESVCLPs, many fund managers establish these vehicles together with parallel funds (usually soft stapled-unit trusts). This structure allows fund managers to obtain the tax benefits afforded to VCLPs and ESVCLPs in respect of investments that are EVCIs, whilst providing the fund manager the flexibility to invest in non-EVCIs via the parallel funds. This has been a common strategy for leading Australian private equity and venture capital funds.

2.2.3 Restrictions on Investors

Australia has a highly developed and continually evolving regulatory regime in relation to investments from offshore into Australia.

In summary, the Treasurer of Australia, acting through the Foreign Investments Review Board (FIRB), can block foreign direct investment that is "contrary to Australia's national interest" if clearance is required:

- "foreign persons" involved in applicable transactions are required to notify FIRB;
- "foreign persons" essentially means individuals, companies offshore, or onshore in which offshore foreigners hold a substantial interest; and
- "foreign persons" includes private foreign investors and foreign government investors.

Changes to the rules applied by FIRB effective as at 1 January 2021 give the Treasurer "call-in powers" and "last resort powers", by which the Treasurer may prohibit a relevant investment. In addition, a new set of rules applies for screening national security businesses (broadly, covering critical infrastructure such as ports, electricity networks, gas pipelines and water networks).

2.3 Regulatory Environment

2.3.1 Regulatory Regime for Alternative Funds

Entities managing alternative funds should hold an AFSL with appropriate authorisations, be appointed as the authorised representative of the holder of an AFSL or otherwise fall within a relevant licensing exemption under the Corporations Act. Where the fund is a unit trust, both the trustee and the manager should have the appropriate authorisations in respect of managing, and issuing, interests in a managed investment scheme. Where a foreign manager wishes to offer an Australian fund, it is common to appoint a corporate trustee as the trustee of the fund, who would appoint the manager as the investment manager of the fund (see **2.3.3 Local Regulatory Requirements for Non-local Managers** regarding regulation of the manager).

From a regulatory perspective, alternative funds open to wholesale clients only operate with relative freedom.

There are very few limitations applying to alternative funds. Significantly for private equity funds, there are adverse tax implications if a trust were to control a business such that it would be designated a "trading trust". In such a case, the trust would potentially not be eligible to qualify as a managed investment trust and potentially could be like a company (where the trust is widely held). The concept of "control" is widely interpreted for Australian income tax purposes.

In certain circumstances, including where 20% of the interests in an Australian fund are held by a foreign entity or 40% of the interests in aggregate in an Australian fund are held by foreign entities and their associates, approval may be required by FIRB in respect of the investments of such fund.

2.3.2 Requirements for Non-local Service Providers

Please see **2.3.3 Local Regulatory Requirements for Non-local Managers**.

2.3.3 Local Regulatory Requirements for Non-local Managers

Non-local providers of financial services, including investment managers, have two main options to provide financial services to Australian wholesale clients, in addition to the option of holding a full AFS licence:

- to apply for a foreign AFS licence, which is a more limited kind of AFS licence; or
- to rely on the Funds Management Relief.

Foreign AFS Licence

The new FFSP framework allows FFSPs that are from jurisdictions that are regulated in a "sufficiently equivalent jurisdiction to Australia" to apply for a foreign AFS licence so they can provide a range of financial services to Australian wholesale clients, whether from inside or outside Australia.

In that way, it is similar to the former Passport Relief that was previously available to FFSPs regulated by the FCA (UK), SEC (US) (and certain other US regulators), MAS (Singapore), SFC (Hong Kong), BaFin (Germany) and CSSF (Luxembourg).

To be eligible to apply for a foreign AFS licence, FFSPs must satisfy a number of conditions. Most importantly, they must be regulated under an overseas regulatory regime that has been assessed by ASIC as "sufficiently equivalent" to Australia's regime. This includes not only those listed above but also those regulated by the Danish FSA, the Swedish FI, the French AMF or ARPR, or the Ontario Securities Commission (subject to holding relevant authorisations).

Foreign AFS licensees do not need to comply with all the obligations of normal AFS licensees but they do have a broader range of obligations than FFSPs relying on the Funds Management Relief.

Funds Management Relief

The Funds Management Relief exempts FFSPs from having to hold an AFS licence if they provide, from offshore, "funds management financial services" to "eligible Australian users" and do not otherwise carry on a business in Australia.

There are three kinds of funds management financial services covered by the relief:

- dealing in, advising on, making a market in (as issuer) or providing a custodial and depository service in relation to an offshore fund;
- dealing in, providing advice on or making a market in any kind of financial product under a portfolio management services agreement; and
- providing a custodial or depository service under, or in relation to, a portfolio management services agreement.

"Eligible Australian users" includes responsible entities of registered schemes, superannuation trustees if the fund has at least AUD10 million net assets, licensed trustees of wholesale trusts, banks and insurance companies regulated by the Australian Prudential Regulation Authority and government authorities.

2.3.4 Regulatory Approval Process

A regulated fund (typically, an Australian unit trust) is known as a registered managed investment scheme, meaning that it is registered with ASIC. The registration process is relatively straightforward and only requires that:

- the trustee of the fund holds an AFSL authorising it to be a "responsible entity" of a registered managed investment scheme;
- the responsible entity is an Australian public company; and
- the constitution of the fund meets the requirements of the Corporations Act.

Once an application for registration is received by ASIC, a decision on registration must be made within 14 days.

As noted above, incorporation of a limited partnership can occur in approximately two business days. Registration of VCLPs and ESVCLPs can take as little as one month, assuming all required documents have been prepared. Registration fees are modest.

2.3.5 Rules Concerning Marketing of Alternative Funds

Marketing an alternative fund may involve the provision of financial services in Australia, for which an Australian financial services licence will be required, subject to applicable exemptions.

Non-local providers of financial services should refer to **2.3.3 Local Regulatory Requirements for Non-local Managers**.

2.3.6 Marketing of Alternative Funds

Alternative funds can be marketed to any client in Australia, as long as the person marketing the fund is authorised under an AFSL (or an exemption – see **2.3.3 Local Regulatory Requirements for Non-local Managers**) to provide financial product advice, or deal in the relevant fund interests to the relevant client group. Typically, these funds would be marketed to wholesale clients only.

If the person is not authorised to provide these services to retail clients, then marketing activities must be limited to wholesale clients. In addition, where the fund is distributed to retail clients, it would usually need to be registered with ASIC as a "registered managed investment scheme" (see **2.3.4 Regulatory Approval Process**) and comply with regulated disclosure requirements (see **3.3.1 Retail Funds Regulatory Regime**) and associated rules applying to regulated products.

2.3.7 Investor Protection Rules

Investor protection rules in relation to financial services provided to wholesale clients are primarily focused upon compliance with the conditions applicable in relation to the AFSL under which the relevant financial service is being provided. This includes compliance with relevant provisions of the Corporations Act, including restrictions on misleading and deceptive conduct.

Investor protection rules in relation to financial services provided to retail clients include compliance with the matters noted immediately above, and additional rules designed to protect retail clients, including membership of an alternative dispute resolution system, and more detailed and prescriptive product disclosure rules.

From October 2021, persons issuing and distributing financial products to retail clients will be subject to provisions of the Corporations Act known as the financial product "Design and

Distribution Obligations" (DDO). This has been a significant focus of the industry in recent times.

Under the new obligations, to ensure that their products are designed and distributed appropriately, issuers are required to make a target market determination (TMD) for each product that identifies, amongst other things, the intended class of consumers. They are then required to take "reasonable steps" that will (or are reasonably likely to) result in the financial product being distributed in a manner that is consistent with the TMD. Issuers are obliged to conduct reviews of the TMD periodically and keep certain records, and where there are significant dealings in the financial product that are inconsistent with the TMD, issuers are required to notify ASIC.

Distributors are also subject to certain obligations in the DDO, specifically, not to engage in retail product distribution unless they reasonably believe a TMD has been made or is not required, to take "reasonable steps" that will (or are reasonably likely to) result in distribution being consistent with the TMD, to notify the issuer of significant dealings that are inconsistent with the TMD and to keep certain records.

2.3.8 Approach of the Regulator

ASIC, as the non-prudential regulator of the Australian financial services industry, plays an active role. It conducts surveillance and enforcement of the industry and facilitates regulatory development and implementation.

ASIC's position on a range of regulatory matters is publicised via the ASIC website and through other communication channels. Documents issued by ASIC include regulatory guides, information sheets and media releases.

Face-to-face meetings between industry participants and ASIC take place from time to time, in a variety of contexts.

2.4 Operational Requirements for Alternative Investment Funds

The key restriction applicable in relation to the operation of an alternative investment fund is licensing. Each entity involved in the operation of the fund must hold, or be authorised under a relevant AFSL, or be subject to, an applicable exemption.

As noted above, there are very few limitations applying to alternative funds. Significantly for private equity funds, there are adverse tax implications if a trust were to control a business such that it would be designated a "trading trust". In such a case, the trust would potentially not be eligible to qualify as a managed investment trust and potentially could be like a company (where the trust is widely held). The concept of "control" is currently widely interpreted for Australian income tax purposes.

Provided the trustee of the fund is appropriately authorised under its AFSL, it is not a legal requirement for a depository or a custodian to be appointed to hold fund assets.

Specific operational requirements for AFSL holders include:

- providing financial services efficiently, honestly and fairly;
- having in place adequate arrangements for the management of conflicts of interest;
- complying with the conditions on the entity's AFSL;
- complying with the financial services laws of Australia;
- taking reasonable steps to ensure that its representatives comply with the financial services laws of Australia;
- having available adequate resources (including financial, technological and human resources) to provide the financial services covered by the entity's AFSL;
- maintaining competence to provide the financial services; and
- ensuring that its representatives are adequately trained.

ASIC has issued guidance in relation to compliance with the above obligations and there are various practical ways in which AFSL holders satisfy the obligations.

2.5 Alternative Investment Funds: Fund Finance Market

The fund finance market in Australia is highly developed.

Restrictions on borrowings may arise due to the agreements that the fund equity holders have in place between themselves, or as a function of the constituent documents of the fund. In addition, financier-imposed borrowing restrictions and covenants will be relevant.

It is common for financiers to take security for finance provided, including mortgages, in relation to property and infrastructure funds.

In relation to limited partnership structures, private equity managers often utilise capital call facilities, which are secured by the unpaid capital commitments of the investors to the investment vehicle, rather than the assets of the vehicle.

Certain large, institutional-grade investors do not support the use of capital call facilities.

There are limited examples of funds raising debt via bond markets, which typically takes place offshore.

2.6 Alternative Funds Tax Regime

Taxation of a Trust

Typically, the income and gains of a trust are subject to flow-through tax treatment (ie, taxable income of a trust is taxed at the hands of the investors) and, therefore, investors are taxed directly on their pro rata share of the income of the trust and gains arising from the disposal of any investment of the trust.

Where the trust qualifies and elects to be a "managed investment trust" (broadly, the trust needs to be (i) managed by an AFSL holder, (ii) widely held, (iii) not closely held and (iv) cannot control a trading business in order for the trust to qualify as a "managed investment trust"):

- fund payment distributions made by the managed investment trust to foreign investors may be subject to the concessional managed investment withholding tax of 15%; and
- investors' share of the gains arising from disposals of investments by the funds should be taxed under the capital gains tax provisions (where certain election has been made by the trust). As a result, a capital gains tax (CGT) discount may be available for eligible Australian resident investors.

Further detail is provided in **3.6 Retail Fund Tax Regime**.

Taxation of a VCLP or ESVCLP

A VCLP or ESVCLP provides fund managers and investors with support to help stimulate venture capital investments by way of tax benefits.

For a VCLP, the key Australian tax implications include:

- "flow-through" treatment – taxable income derived by the VCLP "flows through" the partnership to the investors and will be taxed in the hands of the investors; and
- CGT exemption – a full CGT exemption is available for eligible venture capital partners (ie, tax-exempt foreign residents or foreign venture capital funds) on gains derived from disposal of EVCIs made by the VCLP (subject to satisfying certain requirements).

For an ESVCLP, the key Australian tax implications include:

- "flow-through" treatment – taxable income derived by the VCLP "flows through" the partnership to the investors and will be taxed in the hands of the investors;
- tax offset – a non-refundable carried-forward tax offset is available to investors for the lesser of either 10% of their eligible contributions or share of investments in the ESVCLP (subject to satisfying certain requirements);
- revenue gain or profit exemption – any revenue gain or profit arising from the disposal of an EVCI by an ESVCLP will be excluded from the taxable income of an investor of the ESVCLP, which applies only if the revenue gain that arises would have been subject to the CGT exemption if the asset disposed of was a CGT asset (note that the exemption is capped where the relevant investment exceeds AUD250 million); and
- income exemption – an investor's share of income (eg, dividend) derived from EVCIs made by an ESVCLP will be excluded from the partner's taxable income calculation if the partner is a limited partner of an Australian-resident general partner.

Generally, a resident trust should be able to qualify for the benefits of a double tax treaty between Australia and a foreign jurisdiction. However, this should be considered on a jurisdiction-by-jurisdiction basis.

3. Retail Funds

3.1 Retail Fund Formation

3.1.1 Retail Fund Structures

Legal Vehicle and Nature of Interests Held by Investors

The most commonly used structure for retail funds in Australia is a unit trust. A unit trust is a type of trust that divides the trust property, which is held by the trustee on trust for the unit holders (ie, the investors), into units that are subscribed for and held by unit holders. Each unit entitles the unit holder to a beneficial interest in the trust property as whole, but not in any particular asset comprising the trust property.

The trustee (which in the context of retail funds is referred to as a responsible entity) is responsible for the operation and management of the unit trust. As retail funds are regulated in Australia, the Corporations Act requires that the responsible entity be an Australian public company that holds an AFSL. For this reason, offshore managers looking to establish an Australian retail fund will often use the services of a local responsible entity for hire to act as responsible entity of the fund, as opposed to establishing their own responsible entity in Australia.

The responsible entity may then appoint an investment manager to manage the assets of the fund. The investment manager can be an offshore entity or could be a locally established (usually an Australia propriety company limited by shares) subsidiary of an offshore manager. The investment manager, regardless of whether it is locally established or offshore, would generally need to obtain an AFSL, a foreign AFSL or be able to rely on a relevant exemption. Please see **3.3.3 Local Regulatory Requirements for Non-local Managers** for further discussion regarding the local regulatory requirements for offshore managers.

Key Advantages and Disadvantages of Unit Trusts

The key advantages of unit trusts include the following:

- tax "flow through" – unit trusts that have passive investments (and do not have active businesses) are typically managed as a flow-through vehicle for tax purposes, which means that, unlike a company, a unit trust does not itself pay tax; rather, the unit holders of the unit trust will pay tax on their proportional share of the distributions to them;
- asset protection – unit trusts offer additional asset protection from internal and external parties as the assets of the unit trust are held by the trustee on trust for the unit holders. The trustee is also subject to fiduciary and (as responsible entity) statutory duties, including to act in the best interests of unit holders.

The perceived disadvantages of unit trusts include the following:

- unit trusts not common offshore – unit trusts tend to be creatures of common law jurisdictions and hence they are often used or well understood in some offshore jurisdictions; and
- no separate legal identity – unlike a company, a unit trust is not itself a separate legal entity and therefore any contracts relating to the fund will be entered into by the responsible entity. This can give rise to some additional complexities when applying the insolvency rules.

3.1.2 Common Process for Setting up Investment Funds

Registration Requirement

A retail fund in Australia will generally be required to be registered with ASIC as a managed investment scheme in accordance with Chapter 5C of the Corporations Act, unless all investors are wholesale clients. Wholesale clients include:

- professional investors (for example, AFSL holders, trustees of superannuation funds with net assets of at least AUD10 million, entities regulated by the Australian Prudential Regulation Authority);
- sophisticated investors (ie, persons regarded as having sufficient experience to assess the relevant investment);
- investors investing at least AUD500,000; and
- investors meeting the requisite wealth test of net assets of AUD2.5 million or gross income of AUD250,000 in each of the previous two years.

Investors that do not satisfy one of the wholesale client tests are considered retail clients.

Process and Documentation Required

To register a fund with ASIC, the responsible entity must lodge the following documentation with ASIC:

- a prescribed form including details of the responsible entity, fund and the auditor and compliance plan auditor;
- the constitution (ie, the trust deed) for the fund, which complies with the prescribed requirements in the Corporations Act and relevant ASIC guidance; and
- the compliance plan for the fund, which complies with the prescribed requirements in the Corporations Act and relevant ASIC guidance.

Once an application for registration has been lodged with ASIC, ASIC has a statutory 14-day period to consider the application and register the fund or reject the application. During the 14-day registration period, ASIC will generally respond with queries and comments in relation to the constitution and compliance plan.

Despite the prescribed requirements for constitutions and compliance plans, the cost of preparing and lodging these documents with ASIC for registration is reasonable.

3.1.3 Limited Liability of Retail Fund Investors

The trust deed for most unit trusts includes what is, in effect, a contractual limitation of liability of investors. The effectiveness of such limitations has broad commercial acceptance. Despite such acceptance, the question of the legal effectiveness of such limitations has been the subject of New South Wales Law Reform Commission Report 144 (issued in May 2018), which outlines reasons for amendments to legislation to give statutory effect to such limitations. It remains to be seen whether such amendments will be made.

3.1.4 Disclosure Requirements

Product Disclosure Statement

The offer of units in an Australian retail fund to retail investors will generally require a product disclosure statement (ie, a regulated offer document), except in certain limited circumstances. The product disclosure statement will need to comply with the prescribed content requirements in the Corporations Act and relevant ASIC guidance and include disclosure regarding the benefits, risks and fees associated with the fund.

Confirmations

As the issuer of the Australian retail fund, the responsible entity will have an obligation to provide retail clients with certain confirmation statements. Broadly, these are provided in relation to transactions where a retail client acquires units in the fund or redeems some or all of their units in the fund.

Ongoing and Continuous Disclosure Requirements

The responsible entity of an Australian retail fund will also have continuous disclosure requirements with which they must comply under the Corporations Act. Broadly, these obligations require the responsible entity to disclose material changes, significant events and information that is not generally available and that a reasonable person would expect to have a material effect on the price or value of the units in the fund (that is, influence persons who commonly invest in units in deciding whether to acquire or dispose of the units).

Periodic Reporting

The responsible entity will have certain periodic disclosure requirements where the Australian retail fund is issued to retail clients. This generally involves providing retail clients with an annual periodic report detailing certain matters concerning their investment. For example, opening and closing balances, details of transactions during the reporting period and the return on investment.

Breach Reporting

In addition to the above disclosure and reporting requirements, the responsible entity as the holder of an AFSL will also have an obligation to notify ASIC of certain significant breaches of its obligations under the Corporations Act and relevant financial services laws.

Certain changes to the breach reporting requirements are due to commence in October 2021. Please see **4.1 Recent Developments and Proposals for Reform** for further discussion in relation to this.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Investor demand in the Australian retail funds market continues to grow, with approximately AUD416 billion total funds under management as at the end of September 2020 (Australian Bureau of Statistics, Managed Funds, Australian, September 2020). The size and steady growth of the market is largely underpinned by the compulsory superannuation contribution system in Australia that was introduced in the early 1990s.

3.2.2 Legal Structures Used by Fund Managers

Retail fund managers established in Australia are themselves typically structured as Australian proprietary companies limited by shares. However, fund managers' internal structures often provide that the Australian management entity may contract with other internal entities for the provision of investment management service to mitigate any tax and legal exposure.

3.2.3 Restrictions on Investors

There are no restrictions on the types of investors that may, or are eligible to, invest in an Australian retail fund that is a registered managed investment scheme. Therefore, both retail clients and wholesale clients could invest in an Australian retail fund. Please see **3.1.2 Common Process for Setting up Investment Funds** for further discussion on the definitions of "retail client" and "wholesale client".

3.3 Retail Funds Regulatory Environment

3.3.1 Retail Funds Regulatory Regime

The regulatory regime governing Australian retail funds includes three key areas, namely, registration, disclosure and licensing requirements.

Registration

A retail fund in Australia will generally be required to be registered with ASIC as a managed investment scheme in accordance with Chapter 5C of the Corporations Act, unless all investors are wholesale clients. Please see **3.1.2 Common Process for Setting up Investment Funds** for further discussion regarding the process and documentation involved in applying for registration with ASIC.

As a registered managed investment scheme, the fund will be governed by the provisions in Chapter 5C of the Corporations Act together with the fund constitution. Under Chapter 5C of the Corporations Act, the responsible entity and its officers will have certain statutory duties, including duties to act honestly, exercise care and diligence, and act in the best interests of members. Chapter 5C of the Corporations Act also governs the process by which a responsible entity may retire and be appointed as responsible entity of the fund.

Notably, an Australian retail fund is not subject to any investment limitations or restrictions under the Corporations Act (although the introduction of the DDO in October 2021 may mean that some Australian retail funds will need to restrict their scope of investments – please see **4.1 Recent Developments and Proposals for Reform**). Rather, the scope of investments and permitted assets is governed by, and documented in, the constitution.

Disclosure

The offer of units in an Australian retail fund to retail investors will generally require a product disclosure statement (ie, a regulated offer document), except in certain limited circumstances. The product disclosure statement will need to comply with the prescribed content requirements in the Corporations Act and relevant ASIC guidance, and include disclosure regarding the benefits, risks and fees associated with the fund. Please see **3.1.4 Disclosure Requirements** for further discussion regarding product disclosure statements.

Licensing

The Corporations Act requires a person, regardless of whether they are local or from offshore, who "carries on a financial services business in Australia" to hold an AFSL covering the provision of such services, unless an exemption applies. A person provides a financial service if, among other things, the person provides financial product advice, deals in a financial product or operates a registered managed investment scheme. For these purposes, a unit in an Australian retail fund that is a registered managed investment scheme will be a financial product.

The responsible entity and investment manager would generally hold an AFSL or rely on an available exemption in order to provide these financial services.

3.3.2 Requirements for Non-local Service Providers

As discussed in **3.3.1 Retail Funds Regulatory Regime**, the Corporations Act requires a person, regardless of whether they are local or from offshore, who "carries on a financial services business in Australia" to hold an AFSL covering the provision of such services, unless an exemption applies. Depending on the scope and structure of the provision of the relevant services, a non-local service provider may require an AFSL or be able to rely on an exemption in order to provide their services to an Australian retail fund.

Australian Licensing Options

If a non-local service provider is deemed to be carrying on a financial services business in Australia, it will either need to obtain an AFSL, apply for a foreign AFSL or consider if there are any available exemptions.

Funds Management Relief

The Funds Management Relief forms part of the new regime for foreign financial service providers (together with the new foreign AFSL) in Australia and will be available from 1 April 2022.

The Funds Management Relief allows foreign financial service providers to provide the following "funds management financial services" to "eligible Australian users":

- dealing in, advising on, making a market in (as issuer) or providing custodial and depository services in relation to an offshore fund;
- dealing in, providing financial product advice or making a market in any kind of financial products under a portfolio management services agreement; and
- providing a custodial or depository service under, or in relation to, a portfolio management services agreement.

The definition of "eligible Australian users" is relatively narrow and includes responsible entities of registered schemes, superannuation trustees if the fund has at least AUD10 million net assets, licensed trustees of wholesale trusts, banks and insurance companies, companies regulated by the Australian Prudential Regulation Authority and government authorities.

Authorised Representative Exemption

An alternative exemption would be for a person to be appointed as an authorised representative of a holder of an AFSL. This effectively enables the non-local service provider to provide the same financial services as the AFSL holder and the AFSL holder will be responsible for the provision of the relevant financial services by the non-local service provider.

Foreign AFSL

The foreign AFSL allows foreign financial service providers that are from jurisdictions that are regulated in a "sufficiently equivalent jurisdiction to Australia" to apply for a foreign AFSL so they can provide a range of financial services to Australian wholesale clients, whether from inside or outside Australia. It is important to note that the foreign AFSL limits the provision of financial services to wholesale clients only.

Regulatory regimes that have been deemed to be "sufficiently equivalent" are the FCA (UK), SEC (US) (and certain other US regulators), MAS (Singapore), SFC (Hong Kong), BaFin (Germany), CSSF (Luxembourg), FSA (Denmark), FI (Sweden), AMF or ARPR (France) and the Ontario Securities Commission (Canada), subject to holding the relevant authorisations.

AFSL

If a non-local service provider is not able to rely upon a suitable exemption or does not qualify for the foreign AFSL regime, then the non-local service provider will likely need to apply for an AFSL.

Registration as a Foreign Company

Additionally, to the extent that a foreign company, either itself or through its agents, is carrying on a business in Australia, Australian law will require that company to be registered with ASIC as a foreign company in Australia.

3.3.3 Local Regulatory Requirements for Non-local Managers

Similar to **3.3.2 Requirements for Non-local Service Providers**, any non-local manager that provides financial services in Australia will be bound by Australian financial services laws and would either need to hold an AFSL, a foreign AFSL or seek to rely on an alternative exemption, depending on the scope of the services and the category of clients to whom those services are provided.

Where a non-local manager manages an Australian retail fund, particular consideration will need to be given as to whom the services are provided to. For example, if the non-local manager provides services directly and solely to the responsible entity of the fund and/or to wholesale clients, it could seek to rely on the Funds Management Relief or obtain a foreign AFSL.

Alternatively, if the non-local manager provides financial services directly to retail clients in Australia, it would likely be required to obtain an AFSL or be appointed as an authorised representative to cover the provisions of these services to retail clients.

For more information on the key licensing options/exemptions that may be available, please see **3.3.2 Requirements for Non-local Service Providers**.

3.3.4 Regulatory Approval Process

Applying for Registration

As discussed in **3.3.1 Retail Funds Regulatory Regime**, the regulatory approval process for an Australian retail fund is relatively straightforward. Once the requisite documentation has been prepared (that is, the fund constitution and compliance plan), these are lodged with ASIC for their consideration. Under the Corporations Act, ASIC then has a statutory 14-day period to consider the application and register the fund or reject the application. During the 14-day registration period, ASIC will generally respond with queries and comments in relation to the constitution and compliance plan.

Applying for an AFSL or Foreign AFSL

As discussed in **3.3.2 Requirements for Non-local Service Providers**, separate to registering the fund with ASIC, depending on the structure and scope of services to be provided in relation to the fund, an AFSL or foreign AFSL may be required for the investment manager and/or responsible entity. The process of applying for an AFSL or foreign AFSL can be relatively lengthy and involves preparing a number of documents to be submitted to ASIC. The time to prepare an application, lodge it with ASIC and obtain the AFSL or foreign AFSL can take six to eight months or more.

3.3.5 Rules Concerning Marketing of Retail Funds

Similar to the discussion in **3.3.2 Requirements for Non-local Service Providers** and **3.3.3 Local Regulatory Requirements for Non-local Managers** in relation to non-local service providers and non-local managers, an entity, whether local or offshore, that is involved in, or engages in, the marketing of an Australian retail fund to Australian clients (whether retail clients or wholesale clients) will need to consider its Australian licensing options. This is because the activity of marketing the fund will likely involve the provision of financial product advice and also potentially dealing or arranging for a dealing in financial products.

3.3.6 Marketing of Retail Funds

The Corporations Act does not impose any restrictions on the types of investors that an Australian retail fund may be marketed to. Therefore, an Australian retail fund that is registered as a managed investment scheme may be marketed to any person in Australia, provided the entity marketing the fund holds an appropriate AFSL, a foreign AFSL or is able to rely on an available exemption that authorises it to provide the relevant financial services in relation to both retail clients and wholesale clients.

The introduction of the DDO in October 2021 may, however, mean that some Australian retail funds will need to restrict their marketing activities to particular types of investors to comply with the new obligations. Please see **4.1 Recent Developments and Proposals for Reform** for further discussion.

3.3.7 Investor Protection Rules

Investor protection rules in relation to financial services provided to a retail client in an Australian retail fund are primarily focused upon compliance with the conditions applicable to the AFSL under which the relevant financial service is being provided. This includes compliance with the Corporations Act, which includes prohibitions on unconscionable conduct and engaging in misleading, deceptive or dishonest conduct.

The investor protection rules also include provisions designed to protect retail clients. In addition to the prescribed product disclosure requirements discussed in **3.1.4 Disclosure Requirements**, these include obligations regarding dispute resolution systems, compensation and breaches of product disclosure statement obligations.

In addition to the above, the new DDO will apply to product issuers and distributors from October 2021. Please see **4.1 Recent Developments and Proposals for Reform** for further discussion.

3.3.8 Approach of the Regulator

The provision of financial services in Australia is regulated and licensed by ASIC, which is an independent Australian government body that is established and administered under the Australian Securities and Investments Commissions Act 2001.

ASIC's relationship with entities that are licensed or providing financial services in Australia is generally one of an ad hoc nature, as opposed to an ongoing one, and usually arises in the context of specific circumstances or matters (for example, in response to lodgment of a breach report). While entities will generally not be assigned a designated officer for their relationship with the regulator, depending on the circumstances, it is often possible to reach out to ASIC to discuss or obtain feedback on certain matters.

3.4 Operational Requirements for Retail Funds

There are a number of operational requirements that should be considered in the context of an Australian retail fund.

Obligations as a Responsible Entity of an Australian Retail Fund

An Australian retail fund must be operated by its responsible entity in accordance with its constitution, compliance plan and the provisions of the Corporations Act. While the Corporations Act does not prescribe the types of assets that may be held by, or the types of investors that may invest in, an Australian retail fund, as discussed in **3.1.2 Common Process for Setting up Investment Funds**, the Corporations Act does prescribe certain matters to be addressed in the content of the constitution and compliance plan. ASIC then provides additional guidance in relation to these matters.

From an operational perspective, some of the key considerations will include:

- the issue and redemption pricing for units in the fund;
- the valuation of fund assets; and
- the holding of fund assets by the responsible entity itself or by a custodian.

Obligations as an AFSL Holder

As an AFSL holder, the responsible entity of the Australian retail fund will be required to comply with obligations regarding management of conflicts, availability of adequate resources, training of representatives, risk management and dispute resolution.

ASIC provides guidance in relation to compliance with each of these requirements that should be considered when developing the relevant policies and procedures to address these matters.

Other Operational Considerations

Other obligations and requirements that will need to be considered from an operational perspective include anti-money laundering, insider dealing and market abuse, short selling and derivatives transaction reporting.

3.5 Retail Fund Finance

There continues to be strong growth and competition in the Australian fund financing market, providing great accessibility to retail funds looking to borrow or leverage their portfolio. The Australian domestic banks tend to be the key players; however, offshore commercial banks and investment banks are becoming increasingly active in the fund financing market.

The facilities are usually provided on a bilateral basis, as opposed to a syndicated basis, and the lender will take some form of security; for example, over the assets of the fund or in the form of a guarantee. The fund financing documentation will also often impose certain limitations and restrictions in terms of the use of the borrowings.

In terms of the retail fund itself, a key consideration will be to ensure that the constitution of the fund permits the responsible entity to borrow and grant security over the assets of the fund.

3.6 Retail Fund Tax Regime

Overview of Tax Regime

The tax regime applying to Australian retail funds (ie, to trusts) is comprehensive and complex, and should be carefully considered when establishing a fund in Australia. The Australian Taxation Office (ATO) is responsible for administering the federal tax laws in Australia.

Typically, the income and gains of a trust are subject to flow-through tax treatment, which means that the taxable income of a trust is taxed in the hands of the investors, and not the trust itself. Therefore, investors are taxed directly on their pro rata share of the income of the trust, gains arising from the disposal of any investment of the trust and any disposal of their interests in the trust.

For Australian income tax purposes, different kinds of investors are subject to different taxation principles and taxation rates (eg, corporates are taxed at the corporate tax rate (generally 30% unless a complying small business), individuals are taxed at the relevant marginal tax rate (the highest being 45%) and complying superannuation funds are taxed at a rate of 15%). It should be noted that tax concessions may be available for foreign pension funds and sovereign wealth funds.

Where such a capital gain has been derived by an Australian resident investor from its investment in a trust (ie, as a result of a disposal of a capital asset by the trust or a disposal of an interest in the trust), the capital gain could be subject to a discount where the relevant asset has been held for at least 12 months and the investor is a qualifying taxpayer (ie, not a company).

Where a capital gain has been derived by a non-resident investor from its investment in a trust (ie, as a result of a disposal of a capital asset by the trust or a disposal of an interest in the trust), the capital gain could be exempt if the relevant asset is not taxable Australian property (TAP). TAP is generally limited to interests in land and certain interests in land-rich entities. No capital gains discount is available for non-resident taxpayers.

Where a non-resident investor disposes of an asset that qualifies as TAP (eg, interest in a land-rich Australian fund), the purchaser will be required to withhold 12.5% of the purchase price and remit this amount to the ATO. The non-resident investor should be able to claim a tax credit for the amount withheld (which could be refundable if the tax liability of the non-resident investor is lower than the withheld amount).

Managed Investment Trust

Where the trust qualifies and elects to be a "managed investment trust" (MIT), certain MIT tax concessions are available. These include:

- reduced withholding tax for foreign investors – fund payments (ie, distributions) made by an MIT to foreign investors (ie, non-resident investors) may be subject to the concessional managed investment withholding tax of 15% where they are resident in exchange of information jurisdictions; and
- capital gains tax treatment – investors' share of the gains arising from disposals of investments by an MIT should be taxed under the CGT provisions (where a certain election has been made by the MIT). As a result, a potential CGT discount may be available for eligible Australian resident investors.

Broadly, to qualify as a MIT, the trust must satisfy the following requirements:

- it must be managed by an AFSL holder;
- it must be widely held;
- it must not be closely held; and
- it cannot control a trading business.

AMIT

The attribution management investment trust (AMIT) regime provides for taxation on an attribution basis as opposed to distributing funds on a distribution basis and is designed to provide greater flexibility for trusts and fairness for their investors. Under the AMIT regime, investors are taxed on income that is attributed to them on a "fair and reasonable basis" for each financial year and the trust would not be liable to tax, provided all its taxable income is attributed to investors.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

There have been a number of recent legal and regulatory developments and proposals for reform in the financial services industry in Australia, particularly in light of the recommendations that came out of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Some of the key areas of development and proposals for reform that will impact on the Australian retail funds market are as follows.

The New Design and Distribution Obligations Regime

The introduction of the new DDO regime is set to commence on 5 October 2021, under which, issuers and distributors will have increased responsibility to design and distribute products that are fit for their purpose and consistent with the likely objectives, financial situation and needs of the consumers they are intended for. Under the new regime, issuers are required to make a TMD for their products that, amongst other things, identifies who the intended consumer is. Issuers and distributors are then required to take reasonable steps to ensure that the product is distributed in a manner that is consistent with the TMD. This new regime applies broadly to the distribution of retail products and will not be applicable to wholesale products, such as alternative investment funds.

The Updated Fees and Costs Disclosure Regime

Following an extensive review and consultation process of the existing RG 97 regime, ASIC released a new ASIC Regulatory Guide 97 (released November 2019 and reissued 2020) (New RG 97) and ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070 (Instrument) that is set to apply to product disclosure statements (PDSs) issued on or after 30 September 2022 and periodic statements for reporting periods that commence on or after 1 July 2021 (noting, however, that issuers can choose to opt in early). The key changes that have come out of the New RG 97 and Instrument include:

- an updated fees and costs table that now includes transaction costs and buy/sell spread, and discloses performance fees separately from the management costs figure;
- an updated example of fees and costs that includes transaction costs and performance fees as separate line items; and
- the introduction of a single "cost of product" figure where there are multiple products offered under the one PDS.

The New RG 97 and Instrument apply to products issued pursuant to a PDS and is not applicable to wholesale products.

"True to Label"

ASIC recently undertook a targeted surveillance of 37 managed funds operated by 20 responsible entities in which is examined the appropriateness of the product labels and assessed whether the funds were described and promoted in a manner that reflects the underlying assets in terms of risk and liquidity. ASIC made two key determinations: that a number of products had "confusing" and "inappropriate" product labels (ie, funds labelled as "cash" but that were, in ASIC's opinion, fixed-income funds) and that the redemption features of a number of funds did not match the liquidity of the underlying assets. ASIC outlined its key expectations: that responsible entities must ensure that their products are "true to label" and that the product name aligns with the underlying assets and the liquidity characteristics of the underlying assets.

The New Breach Reporting Rules

The new breach reporting rules were introduced to the House of Representatives on 12 November 2020 as part of the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020. The new breach reporting regime focuses on clarifying and strengthening breach reporting, replacing the current reporting obligations for Australian Financial Services Licensees and Australian Credit Licensees. In particular, the new regime seeks to extend the kinds of situations that need to be reported to ASIC, including investigations into whether a significant breach has occurred or will occur, conduct that constitutes gross negligence or serious fraud, conduct that amounts to misleading or deceptive conduct and serious compliance concerns about individual financial advisers operating under another licence.

Under the new regime, licensees will be required to lodge breach reports with ASIC within 30 days upon first knowing, or becoming reckless with respect to whether there are reasonable grounds to believe that a reportable situation has arisen. The new breach reporting rules would come into effect on 1 October 2021.

The New Complaints Handling Regime

In July 2020, after extensive consultation with the industry, ASIC released a new RG 271 clarifying new enforceable standards and requirements for internal dispute resolution (IDR) procedures of financial firms. The key changes coming out of the new RG 271 include:

- the adoption of a new, broader definition of complaints and the amendment of the definition of small business;
- the introduction of reduced timeframes for responding to complaints;
- outlining of the type of information that firms must include in their complaint responses to consumers;
- the introduction of new timeframe requirements for customer advocate reviews of appeals against IDR decisions; and
- further guidance on how firms can deal with representatives who are not acting in consumers' best interests.

The new RG 271 will apply to complaints received by financial firms on or after 5 October 2021. Until that date, RG 165 (Licensing: Internal and external dispute resolution) continues to apply.

The New Foreign Financial Service Providers Regime

Please refer to **3.3.2 Requirements for Non-local Service Providers** for further information.

MinterEllison operates in every capital city in mainland Australia, as well as New Zealand, Hong Kong, China, Mongolia and the UK, through a network of integrated and affiliated offices. The firm is recognised as having one of the most specialised and largest financial services practices in Australia. With over 40 qualified practitioners and a dedicated alternative funds group, the funds team has a deep understanding of the financial services regulatory environment and is an active participant in industry working groups. The team's expertise includes advising on fund (including retail) formation, fundraising, distribution and investor disclosure; addressing regulatory requirements and liaising with regulators; third-party/service-provider engagement; advising on investments; participating in investor negotiations; and project management. The team has been instrumental in advising on leading alternative methods of raising funds in the industry, with clients including Next Capital, Quadrant Private Equity, Carthona Capital, Metrics Credit Partners and Tanarra Credit Partners. The team also works with BlackRock, Vanguard, BetaShares, Challenger and Qualitas in relation to their investment management businesses, including extensive work in exchange-traded funds and A-REITs. MinterEllison has the unique multidisciplinary expertise required to help companies design and deliver BEAR and FAR implementation, including corporate governance, regulatory, employment law and risk management expertise.

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Trends and Developments

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1 The Australian Investment Funds Regulatory Context

The Australian regulatory context in 2021 is expected to be influenced by two key events. Firstly, the regulatory response to the findings of the 2018 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), and ongoing regulatory adjustments having regard to the COVID-19 pandemic.

The Australian Securities and Investments Commission's (ASIC's) Interim Corporate Plan for 2020–21 addresses both of the above events. In it, ASIC identifies five strategic priorities:

- protecting consumers from harm at a time of heightened vulnerability;
- maintaining financial system resilience and stability;
- supporting Australian businesses to respond to the effects of the COVID-19 pandemic;
- continuing to identify, disrupt and take enforcement action against the most harmful conduct; and
- continuing to build ASIC's organisational capacity in challenging times.

In light of COVID-19, ASIC has deferred a number of its regulatory activities it considers less time critical than others that have arisen due to the pandemic. ASIC has also provided limited regulatory relief in a number of areas, such as capital raisings, member meetings, financial advice and the lodgement of financial reports.

ASIC's Interim Corporate Plan also reminds industry participants that ASIC has not lost sight of the many regulatory priorities to which ASIC had previously committed. In particular, ASIC's Interim Corporate Plan details ASIC's continued work on enforcement matters arising from the Royal Commission, and on other high deterrence matters.

Set out in sections 1.1 to 1.4 below is a brief update on regulatory developments affecting Australia's fund managers in the above context.

In sections 2 to 5 below, more detailed analysis is provided in relation to further regulatory matters relating to the Australian investment funds industry in 2021.

1.1 New breach reporting rules for Australian financial service licensees and Australian credit licensees

The Financial Sector Reform (Hayne Royal Commission Response) Bill 2020, introduced to Parliament in November 2020, proposes to legislate the government's response to 20 recommendations in the Royal Commission Final Report, together with one additional commitment. Amongst the key reforms in the Bill is a new breach reporting regime to clarify and strengthen breach reporting, and to replace the current reporting obligations for Australian financial services licensees and Australian credit licensees.

Currently, licensees are required to report breaches and likely breaches that are significant but are not required to report investigations. Under the proposed regime, the kinds of situations that will need to be reported to ASIC will be expanded to include:

- investigations into whether a significant breach has occurred or will occur if the investigation continues for more than 30 days and the outcomes of those investigations;
- conduct that constitutes gross negligence or serious fraud;
- conduct that amounts to misleading or deceptive conduct under the financial services law; and
- serious compliance concerns about individual financial advisers operating under another licence.

Licensees will be required to lodge breach reports with ASIC in the prescribed form, within 30 calendar days after the licensee first knows that, or is reckless with respect to whether there are reasonable grounds to believe a reportable situation has arisen. If passed, the changes are expected to come into effect on 1 October 2021.

1.2 New complaints handling regime

Following consultation, ASIC has released updated internal dispute resolution (IDR) guidance for financial firms (Regulatory Guide 271 Internal Dispute Resolution (RG 271) and registered a legislative instrument (ASIC Corporations, Credit and Superannuation (Internal Dispute Resolution) Instrument 2020/98) clarifying new enforceable standards and requirements for IDR procedures.

ASIC is responsible for overseeing the operation of Australia's financial services dispute resolution framework, which comprises the IDR systems of financial firms and the external dispute resolution system, the Australian Financial Complaints Authority (AFCA).

The revised guidance and accompanying legislative instrument are intended to "drive fair and timely complaint outcomes for consumers and sharpen industry's focus on systemic issues". The new changes provide an opportunity for firms to restore consumer trust and remain connected with their customers' experience, according to ASIC's Deputy Chair, Karen Chester. Among other things, the guidance:

- adopts a new, broader definition of complaints and amends the definition of small business;
- stipulates shorter maximum timeframes for responding to IDR complaints;
- outlines requirements for the content of the complaint responses; and
- provides guidance on the identification and management of systemic issues (including the role of boards and "frontline" staff in this process).

Certain standards and requirements in the guidance are enforceable through obligations under s912A of the Corporations Act 2001 (Cth) and s47 of the National Consumer Credit Protection Act 2009 (Cth). RG 271 will apply to complaints received by financial firms on or after 5 October 2021. Until that date, ASIC Regulatory Guide 165 (Licensing: Internal and external dispute resolution) continues to apply.

1.3 True to label advertising

Ensuring that fund managers do more to ensure their products are "true to label" has been a recent focus of ASIC. In September 2020 ASIC reported that it had undertaken a targeted surveillance of 37 managed funds operated by 20 responsible entities that collectively hold approximately AUD21 billion in assets, following concerns identified by ASIC in May 2020 with product labelling practices. The surveillance found that fund managers must do more to ensure their products are "true to label" – that the product name aligns with the underlying assets.

In May 2020 ASIC cautioned that the marketing of investment products should be "true to label", meaning that products should not be marketed as having certain features unless the product issuer has reasonable grounds to believe this is true and will remain so through economic cycles. In June 2020 ASIC warned responsible entities of managed investment schemes that their advertising must provide information that is clear, balanced and accurate. In particular, ASIC was concerned to find that some managed funds were providing inadequate information, or failing to clearly and accurately present key features of their investment products.

Following the review, ASIC sought corrective action from 13 responsible entities where significant concerns were identified.

1.4 Application of the New RG 97 and Instrument

Following a review and consultation process by ASIC of the existing ASIC Regulatory Guide 97 (RG 97) fees and costs disclosure regime, ASIC released in November 2019 (and subsequently reissued in September 2020) a new RG 97 (New RG 97) and ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070 (Instrument), which will replace the transitional RG 97 ASIC released in March 2017 and CO 14/1252.

The New RG 97 applies to an issuer of a superannuation product or managed investment product and requires issuers to disclose fees and costs for that product to new investors by way of a product disclosure statement (PDS) and to existing investors by way of periodic statements. The issuer is also required to notify existing investors of material changes and significant events impacting their holdings, including changes to fees and costs. The fees and costs incurred by an interposed vehicle may also need to be included as part of the fees and costs for a superannuation product or managed investment product.

The New RG 97 permits issuers to elect to apply the new requirements to a PDS dated from 30 September 2020. PDSs given on or after 30 September 2022 must comply with the new requirements. The new requirements apply to periodic statements for reporting periods that commence on or after 1 July 2021. Issuers may choose to opt in early to the new requirements for periodic statements that commence on or after 1 July 2020 or for an exit statement where the reporting period ends on or after 1 July 2020.

2 The New Design and Distribution Obligations Regime

In light of the current COVID environment, the commencement of the new design and distribution obligations (DDO) has been pushed back from 5 April 2021 to 5 October 2021.

The implementation of DDO has been a key area of focus for the financial services industry in 2020 and with the much-anticipated release of the final ASIC DDO regulatory guide in December 2020, the authors anticipate that DDO and its implementation will continue to be a central area of focus during 2021.

2.1 What is DDO?

DDO is focused on ensuring that issuers and distributors provide a more consumer-centric approach to the design, marketing and distribution of financial products to retail clients.

DDO applies broadly to financial products that require a product disclosure statement, securities that require a prospectus, financial products under the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act) (such as credit contracts and consumer leases) and credit facilities under the ASIC Act.

Under the new obligations, to ensure that their products are designed and distributed appropriately, issuers are required to make a target market determination (TMD) for each product that identifies, amongst other things, the intended class of consumers. They are then required to take "reasonable steps" that will (or are reasonably likely to) result in the financial product being distributed in a manner that is consistent with the TMD. Issuers are obliged to conduct reviews of the TMD periodically and keep certain records and where there are significant dealings in the financial product that are inconsistent with the TMD, issuers are required to notify ASIC.

Distributors are also subject to certain obligations in DDO; specifically, not to engage in retail product distribution unless they reasonably believe a TMD has been made or is not required, to take "reasonable steps" that will (or are reasonably likely to) result in distribution being consistent with the TMD, to notify the issuer of significant dealings that are inconsistent with the TMD and to keep certain records.

2.2 Key areas of focus for industry

As issuers and distributors have begun to consider and implement their new DDO framework, there have been a number of key issues identified that industry has been, and will continue, working through. Some of the key areas on which industry has sought additional guidance and clarification from ASIC are as follows.

- Target market determination – as issuers begin to develop their TMDs, key areas of discussion have been around balancing the level of detail in the TMD with the operational and practical considerations (ie, how this will be implemented in practice and how detailed does the TMD need to be) and the development of standardised definitions across industry to support common understanding and approach.
- "Reasonable steps" – issuers and distributors each have obligations to take "reasonable steps" that will (or are reasonably likely to) result in the financial product being distributed in a manner that is consistent with the TMD. What is considered "reasonable steps", however, is one area that industry is working through to better understand what is required and what the expectations on issuers and distributors are to meet this obligation. In particular, the distribution of products through platforms will potentially present some challenges in this regard.
- Exchange-traded products – as the DDO regulations made clear that issuers of exchange-traded products are required to make a TMD, industry has sought clarification on who is identified as a distributor of the product (ie, the exchanges, market makers, the issuer and/or executing brokers), how the distribution obligations apply to exchange-traded products and how to apply "reasonable steps" in the context of products that are freely traded by retail investors on a secondary market.
- Product governance framework – issuers have also been considering what the new product governance framework looks like and what ASIC's expectations will be in relation to "monitoring" and "supervising" distributors under this framework.

2.3 What's next?

In December 2020, ASIC issued Regulatory Guide 270 on DDO, which sets out:

- the financial products to which the design and distribution obligations apply;
- ASIC's interpretation of the obligations; and
- ASIC's administration of the obligations.

It is anticipated that the early part of 2021 will be spent by industry implementing DDO, including making TMDs for all relevant existing products, reviewing and updating existing compliance and product governance frameworks to incorporate DDO and navigating any additional issues that are not addressed by the final ASIC guidance.

3 Foreign Financial Service Provider Regime

ASIC released the much-anticipated new regulatory framework for foreign financial service providers (FFSPs) that provide financial services to Australian wholesale clients in March 2020.

The new FFSP framework replaces:

- the existing sufficient equivalence class orders and bespoke sufficient equivalence instruments (Passport Relief) granted by ASIC that exempted certain FFSPs from the need to hold an Australian Financial Services (AFS) licence under Section 911A of the Corporations Act 2001; and
- the limited connection relief contained in ASIC Corporations (Foreign Financial Services Providers—Limited Connection) Instrument 2017/182 (formerly Class Order 03/824) (Limited Connection Relief).

3.1 What is the new FFSP framework?

The new FFSP framework provides FFSPs with two main options to provide financial services to Australian wholesale clients in addition to the option of holding a full AFS licence:

- to apply for a foreign AFS licence, which is a more limited kind of AFS licence; or

- rely on the funds management relief.

Foreign AFS licence
The new FFSP framework allows FFSPs that are from jurisdictions that are regulated in a "sufficiently equivalent jurisdiction to Australia" to apply for a foreign AFS licence so they can provide a range of financial services to Australian wholesale clients, whether from inside or outside Australia.

In that way, it is similar to the former Passport Relief that was previously available to FFSPs regulated by the FCA (UK), SEC (US) (and certain other US regulators), MAS (Singapore), SFC (HK), BaFin (Germany) and CSSF (Luxembourg).

To be eligible to apply for a foreign AFS licence, FFSPs must satisfy a number of conditions. Most importantly, they must be regulated under an overseas regulatory regime that has been assessed by ASIC as "sufficiently equivalent" to Australia's regime. This includes not only those listed above but also those regulated by the Danish FSA, the Swedish FI, the French AMF or ARPR, or the Ontario OSC (subject to holding relevant authorisations).

Foreign AFS licensees do not need to comply with all the obligations of normal AFS licensees but they do have a broader range of obligations than FFSPs relying on the funds management relief. These include:

- ensuring that financial services are provided efficiently, honestly and fairly;
- having adequate arrangements for the management of conflicts of interest and adequate risk management systems;
- complying (and taking reasonable steps to ensure its representatives comply) with Australian financial services laws and the conditions of its foreign AFS licence;
- reporting a "significant breach" (or likely significant breach) to ASIC within the specified timeframe; and
- notifying ASIC of various matters, such as changes to the licensee's authorisations in the relevant home jurisdiction and any significant investigation, enforcement or disciplinary action undertaken by the relevant overseas regulatory authority against the licensee.

Funds management relief
The funds management relief exempts FFSPs from having to hold an AFS licence if they provide, from offshore, "funds management financial services" to "eligible Australian users" and do not otherwise carry on a business in Australia.

There are three kinds of funds management financial services covered by the relief:

- dealing in, advising on, making a market in (as issuer) or providing a custodial and depository service in relation to an offshore fund;
- dealing in, providing advice on, making a market in any kind of financial products under a portfolio management services agreement; and
- providing a custodial or depository service under, or in relation to, a portfolio management services agreement.

"Eligible Australian users" include responsible entities of registered schemes, superannuation trustees if the fund has at least AUD10 million net assets, licensed trustees of wholesale trusts, banks and insurance companies regulated by the Australian Prudential Regulation Authority, and government authorities.

The funds management relief is intended to be available to FFSPs that previously have relied on the Limited Connection Relief (although FFSPs that previously relied on the Passport Relief may also decide to rely on this relief). More specifically, it is targeted towards offshore fund managers who offer interests in their funds to institutional investors in Australia.

3.2 When does the new FFSP framework take effect?
On 1 April 2020, the Passport Relief expired and the new foreign AFS licence regime came into effect. There is, however, a transition period for FFSPs that were relying on the Passport Relief as at 31 March 2020 to continue to rely on it until 31 March 2022. The transition period is designed to give FFSPs time to consider their Australian licensing options and, if necessary, apply for a foreign AFSL or rely on another exemption.

The new Funds Management Relief will be available on and from 1 April 2022. Until then, FFSPs can continue to provide financial services from offshore to wholesale clients in reliance on the Limited Connection Relief or the Passport Relief.

From 1 April 2022, FFSPs relying on the Passport Relief, as well as those relying on the Limited Connection Relief, will need to comply with the new FFSP framework.

4 Asia Region Funds Passport
4.1 Background to the Asia Region Funds Passport
The Asia Region Funds Passport (ARFP) is a multilateral framework designed to facilitate the marketing of passport funds in participating economies to retail investors located in other participating economies. The arrangement supports the development of an Asia-wide funds management industry through expanded market access and regulatory harmonisation by allowing fund managers to distribute their fund products in participating economies, where it would otherwise be more difficult to do so.

As at January 2021, the participating economies are Australia, New Zealand, Japan, South Korea and Thailand.

The ARFP arrangements were launched on 1 February 2019. From that date, Japan, Thailand and Australia were ready to receive registration applications from local prospective passport funds and entry applications from foreign passport funds. New Zealand became ready to do so on 26 July 2019. South Korea has completed the revision of the Financial Investment Services and Capital Markets Act and other relevant rules required for the implementation of the Passport and was expecting to be operationally ready to receive registration applications under the ARFP by the end of 2020.

The eighth ARFP joint committee meeting was held virtually in May 2020. In this meeting it was announced that the Financial Markets Authority of New Zealand was working with the Passport's first applicant for registration as a passport fund. The ninth meeting was planned for October 2020 but was not held and no replacement meeting has been announced.

4.2 Practical requirements

In order to take advantage of the ARFP arrangements, the prospective passport fund must, in summary:

- be structured so as to be eligible for registration as a passport fund;
- apply for and obtain registration from the home economy regulator as a passport fund;
- notify the host economy regulator; and
- comply with (i) the regulations of the home economy in which the fund is registered as a passport fund, (ii) the regulations applicable in relation to the offer of the passport fund in the host economy and (iii) the Passport Rules.

The Passport Rules are set out in the Memorandum of Cooperation on the Establishment and Implementation of the Asia Region Funds Passport (Annex 3) and apply in any economy in which they become enforceable. The Passport Rules include rules about permitted investments, portfolio restrictions and limits, breach reporting, notifying the home and host regulators of certain changes, custody, financial reporting, annual reviews of compliance with the Passport Rules, redemption and valuation, and deregistration.

4.3 Specific requirements for a foreign passport fund to be distributed in Australia

For a foreign passport fund to be eligible for distribution in Australia, the operator of the foreign passport fund must:

- be a registered foreign company;
- meet the ongoing offer of interests in the fund's home economy requirement in one of the available ways (see Section 17 of the Australia Passport Rules);
- check if the name of the foreign passport fund is available for use;
- complete and submit a notice of intention to offer interests in Australia;
- pay the relevant fee, which is set out in the notice of intention; and
- comply with certain ongoing requirements under Australian law. The most important of these include the requirements to (i) hold an Australian financial services licence or relevant exemption and (ii) ensure the passport fund has an offering document that meets Australian product disclosure statement requirements.

ASIC Regulatory Guide 138 provides further information regarding the Australian Passport Rules, applicable Australian legislation, regulations and registration procedures.

5 The Proposed New Financial Accountability Regime (FAR) and the Existing Banking Executive Accountability Regime (BEAR)

In early 2020, the Australian government released a proposal paper seeking feedback on plans to extend the existing Banking Executive Accountability Regime (BEAR) to all Australian Prudential Regulation Authority (APRA) regulated entities, under a new regime to be known as the Financial Accountability Regime (FAR).

5.1 What is BEAR?

The existing BEAR, operational since mid-2018, requires certain institutions, and individual directors and senior employees, to take steps to conduct business in accordance with certain accountability obligations. A "map" of accountability for every aspect of the business must be created and each accountable individual is required to have a clear statement of accountabilities, with remuneration deferral and claw-back requirements for accountable individuals.

5.2 Why is BEAR being expanded?

The FAR will extend the BEAR-like strengthened responsibility and accountability framework that currently applies to directors and the most senior executives of ADIs across all APRA-regulated industries. The purpose of the FAR, according to the paper, is to "increase the transparency and accountability of financial entities in these industries and improve risk culture and governance for both prudential and conduct purposes". Announcing the consultation, Australia's Treasurer, the Hon Josh Frydenberg MP, said that the proposed changes "will ensure that senior executives of these financial entities will be more accountable for the activities of the organisation for which they are responsible and, consistent with the BEAR, impose strict consequences for those who fail to perform their roles with competence, honesty or integrity".

5.3 Who will the FAR apply to?

In addition to all ADIs already subject to the existing BEAR, the new FAR will cover general and life insurers, private health insurers, superannuation entities and licensed non-operating holding companies.

Following the implementation of the FAR to prudentially regulated entities, the government has indicated it will consult on extending the FAR to solely ASIC-regulated entities.

Though the structure of the proposed FAR is broadly similar to that of the BEAR, it differs in a number of material respects, including that:

- it will be jointly administered by APRA and ASIC;
- civil penalties for breach of FAR obligations will be larger (and will apply to both entities and individuals);
- it will incorporate end-to-end executive product responsibility requirements;
- APRA will have a (reserve) power to veto the appointment of accountable persons where they are considered not to be suitable/ceased to be suitable;
- all FAR entities (regardless of their size) will be subject to the same deferred remuneration obligations; and
- smaller entities will be exempt from requirements to provide accountability statements/maps.

The Australian government's initial intention was to introduce a bill to Australia's Parliament by the end of 2020; however, the COVID-19 pandemic has led to delays and a replacement timeframe has not yet been provided.

MinterEllison operates in every capital city in mainland Australia, as well as New Zealand, Hong Kong, China, Mongolia and the UK, through a network of integrated and affiliated offices. The firm is recognised as having one of the most specialised and largest financial services practices in Australia. With over 40 qualified practitioners and a dedicated alternative funds group, the funds team has a deep understanding of the financial services regulatory environment and is an active participant in industry working groups. The team's expertise includes advising on fund (including retail) formation, fundraising, distribution and investor disclosure; addressing regulatory requirements and liaising with regulators; third-party/service-provider engagement; advising on investments; participating in investor negotiations; and project management. The team has been instrumental in advising on leading alternative methods of raising funds in the industry, with clients including Next Capital, Quadrant Private Equity, Carthona Capital, Metrics Credit Partners and Tanarra Credit Partners. The team also works with BlackRock, Vanguard, BetaShares, Challenger and Qualitas in relation to their investment management businesses, including extensive work in exchange-traded funds and A-REITs. MinterEllison has the unique multidisciplinary expertise required to help companies design and deliver BEAR and FAR implementation, including corporate governance, regulatory, employment law and risk management expertise.

Authors

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