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Investment Funds 2022

Australia: Law & Practice
and
Australia: Trends & Developments

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Law and Practice

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1. MARKET OVERVIEW

1.1 State of the 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.

There has still been a significant flow of transactional and regulatory matters following initially restrained activity during the COVID-19 pandemic, 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 (VCLP) or early stage venture capital limited partnership (ESVCLP) (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, when certain 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 ASIC receives an application, it must make a decision on registration within 14 days. Key approval criteria 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) (the “Corporations Act”) and relevant ASIC guidance.

The key required documentation is a constitution/trust deed. An investment management agreement is also 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 of a registered managed investment scheme and registration with ASIC 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.

VCLPs and ESVCLPs are incorporated limited partnerships established under state-based legislation. They are bodies corporate and need to be registered with relevant state regulatory bod-

ies. In addition, these entities require registration with Innovation Australia. Due to legislative requirements, the general partner of the VCLPs and ESVCLPs must also be an incorporated limited partnership (VCMP). The general partner of that VCMP is generally a company.

The benefit of registering VCLPs and ESVCLPs 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 either hold an AFSL, be an authorised representative of an AFSL holder, or have the benefit of a relevant exemption. Key documents for partnerships are a partnership agreement, subscription agreement, management agreement and corporate authorised representative (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 VCLP and ESVCLP 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

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 not been settled across Australia's states and territories.

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 (PDS) 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

Institutional investors from Australia and offshore frequently invest in alternative funds. 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 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, currently the only form of corporate investment vehicle is an incorporated limited partnership; however, draft legislation has been introduced for a new corporate collective investment vehicle (CCIV) (see **4.1 Recent Developments and Proposals for Reform**).

The common partnership structures used by a private equity or venture capital fund to invest primarily in Australian businesses are known as VCLPs for private equity and venture capital funds or 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 Industry 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) (the "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 (EVCIs), 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 an ESVCLP and AUD250 million for an investment by a 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 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 companies onshore in which offshore foreigners hold a substantial interest. It includes private foreign investors and foreign government investors.

Changes to the rules applied by FIRB from 1 January 2021 also give the Treasurer "call-in powers" and "last resort powers", by which the Treasurer may "call in" investments not notified to FIRB for review and in exceptional circumstances may exercise "last resort powers" to impose conditions, vary existing conditions or require divestment of approved investments where national security risks emerge. In addition, a new set of rules applies for screening national security businesses, which include:

- communications (including telecommunications, broadcasting and domain name systems);
- higher education and research;
- data storage and processing;
- the defence industry;
- energy (including electricity, gas, energy market operator and liquid fuels);
- food and grocery;
- financial services and markets (including banking, superannuation, insurance and financial market infrastructure);
- healthcare and medical (including hospitals);
- space technology;
- transport (including ports, freight infrastructure, freight services, public transport and aviation); and
- water and sewerage.

The critical infrastructure rules and FIRB's guidance also outline some specific entities (eg, Australia's big supermarkets, banks, insurers and superannuation funds) as critical infrastructure assets.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Entities managing alternative funds should hold an AFSL with appropriate authorisations, be appointed as the authorised representative of the holder of an AFSL or fall within a relevant licensing exemption under the Corporations Act. Where the fund is a unit trust, 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 interests in 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 only wholesale clients 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 could potentially be treated 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 AFSL:

- to apply for a foreign AFSL, which is a more limited type of AFSL; or
- to rely on some form of transitional relief.

Foreign AFSL

The foreign financial services providers (FFSPs) framework is under review. A new regime was initially proposed to take full effect in March 2022, but has been delayed until 1 April 2023. The Australian federal government (the "Federal Government") announced consultation on a new direction for the regime in April 2021 and introduced draft legislation on 20 December 2021. In the meantime, the current licensing arrangements for FFSPs remain in a transitional period. See "The New Foreign Financial Service Providers Regime" in **4.1 Recent Developments and Proposals for Reform** for further information.

ASIC has announced it will pause assessment of "foreign AFS licence" applications already lodged by FFSPs, unless specifically requested to proceed by the applicant. FFSPs that have been or are granted a foreign AFS licence will be able to continue to operate under the licence issued by ASIC, noting the Federal Government's consultation is ongoing at the time of writing.

A foreign AFS licence 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 other forms of relief.

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 within 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 AFSL 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 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 marketed 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.

Since October 2021, persons issuing and distributing financial products to retail clients have been 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 rea-

sonably 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 under the DDO; specifically, not to engage in retail product distribution unless they reasonably believe a TMD has been made or is not required to be made, 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 (AFS) 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.

Meetings between industry participants and ASIC take place from time to time, in a variety of contexts.

2.4 Operational Requirements

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, or validly rely on, 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 treated 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, there is no legal requirement for a depository or a custodian to be appointed to hold its 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 Fund Finance

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 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 Tax Regime**.

Taxation of a VCLP or an ESVCLP

A VCLP or an 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 the 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 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 Fund Formation

3.1.1 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. Each unit entitles the unit holder (ie, the investor) 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 Australian proprietary 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 (if available) 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; and
- 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 a 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 are not common offshore – unit trusts tend to be creatures of common law jurisdictions and hence they are often only 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, or 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, 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

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 not been settled across Australia's states and territories.

3.1.4 Disclosure Requirements

Product Disclosure Statement

The offer of units in an Australian retail fund to retail investors will generally require a PDS (ie, a regulated offer document), except in certain lim-

ited circumstances. The PDS 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 breaches or likely breaches of its obligations under the Corporations Act and relevant financial services laws.

Certain changes to the breach reporting requirements commenced 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 AUD476 billion total funds under management as at the end of September 2021 (Australian Bureau of Statistics, Managed Funds, Australian, September 2021). 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 services to mitigate 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, 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 Regulatory Environment

3.3.1 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. 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 means that some Australian retail funds will need to restrict the scope of their 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 and associated disclosure documentation.

Disclosure

The offer of units in an Australian retail fund to retail investors will generally require a PDS (ie, a regulated offer document), except in certain limited circumstances. The PDS 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 PDSs.

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 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 need 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 (if available) or consider if there are any available exemptions. Please see **2.3.3 Local Regulatory Requirements for Non-local Managers** and **4.1 Recent Developments and Proposals for Reform** for further discussion.

Authorised Representative Exemption

An alternative exemption available is 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.

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, itself or through its agents, is carrying on 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 AFS laws and would either need to hold an AFSL, a foreign AFSL (if available) 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.

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 Regulatory Regime**, the regulatory approval process for an Australian retail fund is relatively straightforward. Once the requisite documentation has been prepared (ie, the fund constitution and compliance plan), these are lodged with ASIC for its 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 (if available) 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**, 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 (if available) or is able to rely on an available exemption that authorises it to provide the relevant financial services in relation to retail clients and wholesale clients.

The recent introduction of the DDO in October 2021 means that some Australian retail funds must ensure their marketing activities 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 PDS obligations.

In addition to the above, the new DDO regime applies to product issuers and distributors. 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 (Cth) (the “ASIC Act”).

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 lodgement 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

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 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 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 and counter-terrorism financing, insider dealing and market abuse, short selling and derivatives transaction reporting.

3.5 Fund Finance

There continues to be strong growth and competition in the Australian fund financing market, providing greater 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 on the use of the borrowings.

In terms of the fund documentation 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 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; for example, 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%. 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 an 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 (the "Royal Commission").

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

The Design and Distribution Obligations Regime

The DDO regime commenced on 5 October 2021. This new regime applies broadly to the distribution of retail products and is not applicable to non-retail client products, such as wholesale investment funds. Please see **2.3.7 Investor Protection Rules** and **3.3.7 Investor Protection Rules** for further information.

The Updated Fees and Costs Disclosure Regime

Following an extensive review and consultation process of the existing ASIC Regulatory Guide 97 regime, ASIC released a new ASIC Regulatory Guide 97 (released November 2019, which has since been reissued) (the "New RG 97") and ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070 as amended (the "Instrument") that is set to apply to all PDSs issued on or after 30 September 2022 and periodic statements for reporting periods that commenced 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 spreads, 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 are 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 it 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 profile 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 for AFS licensees (and Australian Credit Licensees) came into effect on 1 October 2021, arising from amend-

ments to the Corporations Act, as inserted by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth). These reforms seek to address recommendations made by the Royal Commission that called for the strengthening and clarification of the breach reporting regime for financial services licensees. The strengthened reporting requirements seek to ensure that more misconduct is reported, reports are provided in a timely manner, and ASIC's ability to take any necessary enforcement action is strengthened.

In particular, the new regime requires AFS licensees to report four types of "reportable situations" to ASIC, including:

- significant breaches or likely significant breaches of "core obligations" listed under Section 912D(3) of the Corporations Act;
- investigations into whether a significant breach of these "core obligations" has occurred or will occur;
- conduct that constitutes gross negligence or serious fraud, or other circumstances prescribed by the regulations, such as misleading or deceptive conduct; and
- reportable situations about other licensees, including situations relating to conduct in certain prescribed circumstances of financial advisers operating under another licence.

A breach or likely breach of a "core obligation" under Section 912D(3) of the Corporations Act is only required to be reported if the breach is significant. Under Section 912D(4) of the Corporations Act, certain breaches are deemed as significant. Deemed significant breaches include:

- offences under the Corporations Act that are punishable by imprisonment of three months or more if the offence involved dishonesty, or imprisonment of 12 months or more in respect of any other offence;
- breaches of a civil penalty provision of the Corporations Act;
- breaches of Section 1041H(1) of the Corporations Act or Section 12DA(1) of the ASIC Act, relating to misleading and deceptive conduct; and
- breaches that result, or are likely to result, in material loss or damage to persons to whom the AFS licensee provides financial products or a financial service as a wholesale or retail client or otherwise members of the managed investment scheme.

Under the new regime, licensees are 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.

ASIC has provided guidance on the new breach reporting obligations in RG 78: Breach Reporting by AFS licensees and credit licensees (updated 7 September 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. These standards came into effect on 5 October 2021 and apply to complaints received by financial firms, including AFS licensees. Some 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;
- an outline 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.

Corporate Collective Investment Vehicles (CCIVs)

Draft legislation has been introduced to establish a corporate collective investment vehicle (CCIV) as a new type of a company limited by shares that is used for funds management. The draft legislation was introduced to Parliament on 25 November 2021 through the Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021, which, if passed by Parliament, would amend the corporate and financial services law to establish CCIVs and amend the taxation law to specify the tax treatment for the newly established vehicle.

As a company, a CCIV will generally be subject to the ordinary company rules under the Corporations Act unless otherwise specified in the proposed legislation. Features of the managed investment scheme regime have also been incorporated into the design of CCIVs, with a view to achieve regulatory parity between the two structures to the extent possible.

A CCIV will be comprised of one or more sub-funds, which will need to be registered with ASIC and operated by a single corporate director that is a public company that holds an AFSL authorising it to operate the business and conduct the affairs of a CCIV. Significantly, the legislation provides that, subject to particular exceptions, the assets and liabilities of a sub-fund are ring-fenced, such that generally the assets of a sub-fund cannot be used other than in connection with that sub-fund. CCIVs may issue shares and debentures to investors, provided that each security issued by the CCIV is referable to a particular sub-fund of the CCIV.

The proposed regime would allow for a CCIV to be a retail or wholesale CCIV. Retail CCIVs would be subject to additional regulatory requirements compared to wholesale CCIVs, aimed at protecting the interests of retail investors who may not have the knowledge, resources or expertise to protect their own interests. The requirements have been designed to be broadly similar to registered managed investment schemes.

The CCIV regime is broadly based on the UK open-end investment company regime. The key policy objective of the CCIV regime is to enhance the international competitiveness of the Australian funds management market by enabling fund managers to offer investment products to overseas markets using familiar concepts to overseas investors and is designed to provide an internally competitive and recognised funds management vehicle.

The New Foreign Financial Service Providers Regime

In the 2021–22 Federal Budget, the federal government announced that it would "consult on options to restore previously well-established regulatory relief" from holding an AFSL for FFSPs that are licensed and regulated in jurisdictions with comparable financial services rules and obligations to, or have limited connection with, Australia. In addition, the federal government indicated it would consult on options to create a "fast track" licensing process for FFSPs that wish to establish more permanent operations in Australia.

This announcement has created uncertainty for the new FFSP regulatory framework introduced by ASIC on 1 April 2020, which is set to commence on 1 April 2022. This new regulatory framework repeals "sufficient equivalence

relief" and "limited connection relief" for FFSPs, introducing a new "funds management relief" in their place. In light of the federal government's announcement regarding relief for FFSPs, complete implementation of the new regulatory framework has been delayed until 1 April 2023 under ASIC Corporations (Amendment) Instrument 2021/510.

As a result of this delay, ASIC's transitional relief for FFSPs from the requirement to hold an AFSL will remain in place until 31 March 2023, pending the outcome of the federal government's consultation. During this period, ASIC will consider new temporary licensing relief applications, or foreign AFSL applications for entities that cannot rely on the transitional relief.

FFSPs that have been granted a foreign AFSL or are granted one during this period are able to continue operating their financial services in Australia.

FFSPs currently already validly relying on sufficient equivalence relief (relief for FFSPs that are already covered by regulations sufficiently equivalent to those in Australia) can continue to do so until 31 March 2023, but new applications for this relief cannot be made.

FFSPs may still apply for limited connection relief to allow them to provide financial services to wholesale clients in Australia, until 31 March 2023. This type of relief allows FFSPs operating outside Australia to provide financial services to wholesale clients in Australia.

On 20 December 2021, the federal government released draft legislation seeking a short period of industry consultation on the introduction of revised regulatory relief for FFSPs. This new legislation aims to restore elements of previously well-established regulatory relief and provide fast-tracked applications for FFSPs that meet certain criteria. At the date of writing, it remains to be seen what the outcome of this consultation will be, and whether the federal government will effect further changes throughout 2022.

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.

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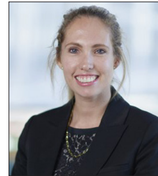

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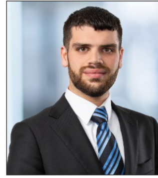

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Trends and Developments

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The Australian Investment Funds Regulatory Context

The Australian regulatory context in 2022 is expected to be influenced by two key events: (i) the continued regulatory response to the findings of the 2018 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the "Royal Commission"); and (ii) ongoing regulatory adjustments having regard to the COVID-19 pandemic.

The Australian Securities & Investments Commission's (ASIC's) Corporate Plan for 2021–25 addresses both the above events. In it, ASIC identifies four internal strategic priorities and four external strategic priorities. The stated external strategic priorities of ASIC are:

- promoting economic recovery – including through better and more efficient regulation, facilitating innovation, and targeting regulatory and enforcement action to areas of greatest harm;
- reducing risk of harm to consumers exposed to poor product governance and design, and increased investment scam activity in a low-yield environment;
- supporting enhanced cyber resilience and cybersecurity among ASIC's regulated population; and
- driving industry readiness and compliance with standards set by law reform initiatives, some of which are described below.

Set out below is a brief update on certain regulatory developments affecting Australia's fund managers.

1. New breach reporting rules for Australian financial service licensees and Australian credit licensees

The new breach reporting rules for Australian financial services (AFS) licensees (and Australian credit licensees) came into effect on 1 October 2021, arising from amendments to the Corporations Act 2001 (Cth) (the "Corporations Act"), as inserted by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth). These reforms seek to address recommendations made by the Royal Commission, which called for the strengthening and clarification of the breach reporting regime for financial services licensees. The strengthened reporting requirements seek to ensure that more misconduct is reported, reports are provided in a timely manner, and ASIC's ability to take any necessary enforcement action is strengthened.

In particular, the new regime requires AFS licensees to report four types of "reportable situations" to ASIC:

- significant breaches or likely significant breaches of "core obligations" listed under Section 912D(3) of the Corporations Act;
- investigations into whether a significant breach of these "core obligations" has occurred or will occur;
- conduct that constitutes gross negligence or serious fraud, or other circumstances prescribed by the regulations, such as misleading or deceptive conduct; and
- reportable situations about other licensees, including situations relating to conduct in certain prescribed circumstances of financial advisers operating under another licence.

A breach or likely breach of a core obligation under Section 912D(3) of the Corporations Act is only required to be reported if the breach is significant. Under Section 912D(4) of the Corporations Act, certain breaches are deemed as significant. Under the new regime, licensees are 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.

ASIC has provided guidance on the new breach reporting obligations in Regulatory Guide 78: Breach Reporting by AFS licensees and credit licensees (updated 7 September 2021).

2. New complaints handling regime

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

Following extensive consultation, ASIC released updated IDR guidance for financial firms (Regulatory Guide 271 Internal Dispute Resolution, or "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. These standards came into effect on 5 October 2021 and apply to complaints received by financial firms, including AFS licensees.

The revised guidance and accompanying legislative instrument seek to "drive fair and timely complaint outcomes for consumers and sharpen industry's focus on systemic issues". 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 Section 912A of the Corporations Act and Section 47 of the National Consumer Credit Protection Act 2009 (Cth).

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 earlier that year 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.

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 (which has since been reissued) a new RG 97 (the "New RG 97") and ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070 as amended (the "Instrument"), which will replace the transitional RG 97 ASIC released in March 2017 and Class Order 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.

Issuers may 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. The key changes that have come out of the New RG 97 and the Instrument include:

- an updated fees and costs table that now includes transaction costs and buy/sell spreads, 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 are not applicable to wholesale products.

5. Corporate collective investment vehicles (CCIVs)

On 25 November 2021, draft legislation was introduced to Australia's Parliament to establish a CCIV as a new type of company limited by shares that is used for funds management. If passed by the Australian Parliament, the draft bill would amend the corporate and financial services law to establish CCIVs and amend the taxation law to specify the tax treatment for the newly established vehicle.

As a company, a CCIV will generally be subject to the ordinary company rules under the Corporations Act unless otherwise specified in the proposed legislation. Features of the managed investment scheme regime have also been incorporated into the design of CCIVs, with a view to achieve regulatory parity between the two structures to the extent possible.

A CCIV will be comprised of one or more sub-funds, which will need to be registered with ASIC and operated by a single corporate director that is a public company that holds an Australian

Financial Services Licence (AFSL) authorising it to operate the business and conduct the affairs of a CCIV. Significantly, the legislation provides that, subject to particular exceptions, the assets and liabilities of a sub-fund are ring-fenced, such that generally the assets of a sub-fund cannot be used other than in connection with that sub-fund.

The CCIV regime is broadly based on the UK open-end investment company regime. The key policy objective of the CCIV regime is to enhance the international competitiveness of the Australian funds management market by enabling fund managers to offer investment products to overseas markets using concepts familiar to overseas investors and the vehicle has been designed to provide an internally competitive and recognised funds management vehicle.

6. The new design and distribution obligations regime

The implementation of the new design and distribution obligations (DDO) was a key area of focus for the financial services industry in 2021 and the authors anticipate that DDO and its implementation will continue to be a central area of focus during 2022.

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 PDS, securities that require a prospectus, financial products under the Australian Securities and Investments Commission Act 2001 (Cth) (the “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 under the DDO; specifically, not to engage in retail product distribution unless they reasonably believe a TMD has been made or is not required to be made, 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.

7. Foreign financial service provider regime

In the 2021–22 Federal Budget, the federal government announced that it would “consult on options to restore previously well-established regulatory relief” from holding an AFSL for foreign financial service providers (FFSPs) that are licensed and regulated in jurisdictions with comparable financial services rules and obligations to, or have a limited connection with, Australia. In addition, the federal government indicated it would consult on options to create a “fast track” licensing process for FFSPs that wish to establish more permanent operations in Australia.

This announcement created uncertainty for the new FFSP regulatory framework introduced by ASIC on 1 April 2020, which is set to commence on 1 April 2022. This new regulatory framework repeals “sufficient equivalence relief” and “limited connection relief” for FFSPs, introducing a

new "funds management relief" in their place. In light of the federal government's announcement regarding relief for FFSPs, complete implementation of the new regulatory framework has been delayed until 1 April 2023.

As a result of this delay, ASIC's transitional relief for FFSPs from the requirement to hold an AFS licence is set to remain in place until 31 March 2023, pending the outcome of the federal government's consultation. During this period, ASIC will consider new temporary licensing relief applications, or foreign AFSL applications for entities that cannot rely on the transitional relief.

FFSPs that have been granted a foreign AFSL or are granted one during this period are able to continue operating under this licence in Australia.

FFSPs currently already validly relying on sufficient equivalence relief (relief for FFSPs that are already covered by regulations sufficiently equivalent to those in Australia) can continue to do so until 31 March 2023, but new applications for this relief cannot be made.

FFSPs may still apply for limited connection relief to allow them to provide financial services to wholesale clients in Australia, until 31 March 2023. This type of relief allows FFSPs operating outside Australia to provide financial services to wholesale clients in Australia.

On 20 December 2021, the federal government released draft legislation seeking a short period of industry consultation on the introduction of revised regulatory relief for FFSPs. This new legislation aims to restore elements of previously well-established regulatory relief and provide fast-tracked applications for FFSPs that meet certain criteria. As at the date of writing, it remains to be seen what the outcome of this consultation process will be, and whether the federal government will effect further changes throughout 2022.

8. Asia Region Funds Passport

The Asia Region Funds Passport (the "Passport", or 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 2022, the following economies have signed the Memorandum of Cooperation: Australia, New Zealand, Japan, the Republic of Korea and Thailand.

The Asia Region Funds Passport Joint Committee held its ninth meeting in a virtual format on 22 April 2021. Following a successful implementation of the Passport by the Republic of Korea at the end of 2020, the Joint Committee members are all now ready to receive registration applications from local prospective passport funds and entry applications from foreign passport funds.

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 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.

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;
- 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 AFSL or relevant exemption and (ii) ensure the passport fund has an offering document that meets Australian PDS requirements.

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

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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.

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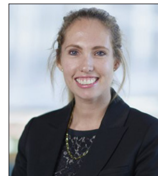

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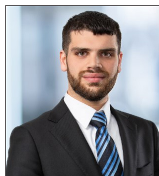

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