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11 November 2017
By email

Dear Ms Reid

Herbert Smith Freehills' Submission - ASIC Consultation Paper 296

We write with some brief observations on the Consultation Paper 296 Funds Management and attached revised regulatory guides.

1 Adequate provision for pricing – RG 134.41

The Corporations Act requires that the constitution of a registered scheme make adequate provision as to the issue price of interests in the scheme.

As you know there has been ongoing legal debate as to ASIC's more prescriptive approach to issue pricing (and ASIC itself has taken a number of different approaches to this issue over time as previous solutions have proved problematic). Currently, ASIC has provided an overlay as to the matters it considers will constitute "adequate provision" and has sought to enshrine these by modifications to the MIS provisions.

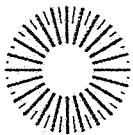
In our submissions on the CCIV draft legislation, we have suggested that anomalies in the MIS pricing regime should not be exported into the CCIV regime, but should be addressed in the law itself. Instead, with the law currently in draft only, ASIC is proposing that the same clarificatory regime which it has adopted for managed investment schemes should also be adopted for the new CCIV laws.

In our view, it would be preferable for this matter to be properly resolved by the legislation itself, so as to clarify the legislative intent. The new law could then operate in accordance with its terms. If necessary, the MIS provisions could be adjusted in the same way.

We accept that there is likely a degree of pragmatism in transporting the current MIS position into the CCIV regime. However, as a policy matter, it does seem somewhat counter-intuitive that ASIC should be proposing clarifications and modifications to a law which has not yet been passed. If the intent of the law is as proposed by ASIC, should this not be handled by submissions on the law itself so that the matter may be considered by the Parliament and the provisions adopted (or not) as the Parliament decides?

We again suggest that the CCIV laws present an opportunity to address a current anomaly in the law.

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2 Section 601GC(2) – RG 134.168

Similarly, there has been considerable competing case law over the meaning of section 601GC(2) of the Corporations Act. In particular, it would seem the Courts have (currently) concluded that almost no change to a constitution is permissible under section 601GC(2), as any such change would necessarily adversely affect members' rights to have the constitution administered in accordance with its current terms. In our view, current case-law appears somewhat at odds with the amendment right given.

The cases have highlighted the anomalies in the provision. Again, in our submissions, we have suggested that the provision be fixed so that the legislative intent can be made clear. If not, the same uncertainties as exist in the current provision will be exported into the new CCIV regime. Rather than to enshrine the current anomalous provision through the guidance note, we would urge ASIC to seek to address the anomaly ahead of the introduction of the law.

Separately, we note the new Guidance Note continues to reference the 360 Capital case. If this provision is to remain, we wonder if this should also reference the later authority in Lewski?

3 Financial Resources test – RG 000.137

RG 000.137 proposes a "waterfall" of financial resource tests. We wonder if paragraph (c) which references assets under management of "greater" than \$500m should read "less" than \$500m (so that the financial resources test is greater where assets under management are lower). Paragraphs (b) and (c) otherwise do not seem to fit well together.

4 Depositary issues

Finally, we strongly urge that paras RG 132.214 to RG 132.219 should be reconsidered. Our comments are as follows:

- One of the most significantly contested areas of the new CCIV regime will be the authority and duties of the depositary in terms of its supervision of the corporate director.
- Para RG 132.210 of the draft RG 132 states that the depositary has a supervisory responsibility to take reasonable care to ensure that the corporate director's activities comply with the Corporations Act, the constitution and any PDS issued by the CCIV, *in relation to:*
 - a) *issuing, redeeming and cancelling shares in the CCIV;*
 - b) *valuing shares in the CCIV;*
 - c) *allocating assets and liabilities to sub-funds of the CCIV;*
 - d) *allocating and distributing in some of the CCIV.*
- The depositary also has a duty to safeguard the assets of the CCIV in addition to its supervisory duties.



- On this basis, we believe the law intends that the depositary's supervisory responsibilities should be limited to compliance in respect of the matters set out in paragraphs (a) to (d) above.
- However in RG 134.214 and following, the duties of the depositary are apparently considerably widened. In particular, the depositary is now to:
 - consider compliance risks relating to the matters for which the depositary has oversight associated with the nature, risk and complexity of the CCIV's investment policy and strategy and with the operations of the corporate director. We are unable to reconcile this paragraph with the requirements of the draft law; and
 - test and verify the procedures that are the responsibility of the corporate director or its delegates. Again, we believe this should be limited to the matters in paras (a) to (d) above.

In our view, the above paragraphs are likely to cause considerable confusion as to the scope of the depositary's duties. It will be difficult to legally advise on the meaning of these requirements when viewed against the draft law.

- The corporate director is then required to allow access to its premises and books and to ensure all instructions related to the "assets *and operations*" [*emphasis added*] of the CCIV are sent to the depositary so it can perform its own verification or reconciliation procedures.

Given that paras RG 132.12 and 132.13 already specify the depositary's obligations to act on instruction in relation to the assets, we assume RG 132.218 is seeking to impose some additional duties? The basis for this is unclear to us.

- Finally, the depositary is required in RG 132.219 to second-guess third party reports and obtain its own evidence on which to base its supervision of the corporate director and outsourced service providers.

This paragraph appears to extend the depositary's supervisory duties further to cover service providers and to look behind audits and third party reports. The basis for this is unclear to us.

In our view, one of the most hotly contested areas of the new CCIV regime will be to define the duties, powers and liabilities of the depositary. Again, if ASIC has views that go beyond the draft law, we believe these are appropriately addressed by submissions on the law itself.

We believe the current draft regulatory guide is likely to cause considerable confusion and legal debate, resulting in a wide variety of possible responses (arising from the mismatch between the apparent legislative intent and ASIC's guidance).

To avoid the issues that arose with the prescribed interest regime (where the line between the duties of trustees and managers was often unclear), we believe the role of the depositary should be strictly defined. This was one of the primary (successful) drivers of the MIS regime.



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We suggest it should be made clear that the depository's role is not one of oversight of all matters in which the corporate director is involved, but only those matters specified in the law. Accordingly, we strongly urge that this part of the regulatory guide be revisited so that the boundaries of responsibility can be clearly defined. We suggest, this will considerably enhance the workability of the new regime.

Thank you in advance for your consideration of our submissions. It does seem to us that the introduction of the new law presents an opportunity to clear up various long-running anomalies (which have added complexity to the legal landscape) and to avoid the creation of new anomalies.

Overall, we believe the guidance provided on the practicalities of the regime is most useful.

Yours sincerely

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