CONSULTATION PAPER 296 - FUND MANAGEMENT

DECEMBER 2017

1. INTRODUCTION

Perpetual Corporate Trust (‘**PCT**’) welcomes the Federal Government’s initiative to establish a regulatory framework for Corporate Collective Investment Vehicles (‘**CCIVs’**). We thank ASIC for the opportunity to respond to Consultation Paper 296 Funds Management (‘**the Paper**’). We also wish to commend ASIC for hosting an industry briefing session as part of the consultation process and encourage ASIC to continue to engage with the industry using similar forums when substantive changes in regulatory guidance are contemplated.

With more than $220 billion in funds under oversight, our response to ASIC’s proposals is provided from the perspective of PCT acting as Responsible Entity, Wholesale Trustee or Custodian for registered and unregistered managed investment schemes. Whilst we acknowledge ASIC’s intention that the updated regulatory guidance is designed to address the pending introduction of legislation enabling CCIVs, we believe it is premature to comment on substantive regulatory guidance in advance of the availability of the final legislative framework. As ASIC may be aware, fund management practitioners have raised a number of issues with the core model encapsulated in the legislative package released by Treasury for consultation in August 2017. We remain hopeful that these issues will be addressed so as to ensure that CCIVs are a commercially viable structuring option for managed investments in Australia.

Our submission specifically addresses ASIC’s draft guidance in respect of:

1. Funds Management: Establishing and registering a fund
2. Funds Management: Compliance and oversight.

We respond only to those questions where we have formulated a view with respect to the proposals outlined in the Paper. Where we do not comment, it should not be assumed that we agree with ASIC’s proposals; rather this implies that we do not have a view, have not formed a consensus view or that the matter is outside of the immediate scope of PCT’s business operations.

Our submission represents the views of PCT only and should not be taken to be indicative or representative of the view of the broader Perpetual Group. Our comments are mainly provided from the perspective of PCT’s role as a provider of Responsible Entity, Wholesale Trustee and Custody Services to investment managers and institutional investors that are not related parties of the broader Perpetual Group.

Our aim in providing this submission is to highlight a number of commercial and operational issues with respect to the proposed guidance that we believe must be addressed in order to ensure that the Australian Funds Management industry remains *both* well-regulated and internationally comparable and competitive. As ASIC would be aware, international competitiveness and enhancing exports of Funds Management products and services underlined the initial key policy rationale for CCIV structures and establishing the Asian Regions Funds Passport. It is imperative that regulatory guidance supports the achievement of these core objectives.

PCT is concerned that the draft regulatory guidance for Funds Management in some cases is overly granular, prescriptive and focused on mitigation of compliance risk. We believe that the proposed approach will result in increased costs of operating investment fund that will not deliver commensurate incremental benefit in terms of improving outcomes for investors. This will ultimately undermine the ability of the domestic industry to offer cost competitive products and services.

PCT notes the substantial body of regulatory work in progress that is aimed at mitigating conduct risk, including the proposed Design and Distribution Powers, ASIC Direction Powers and enhancing penalties for

Financial Services Licensee misconduct. Whilst we can appreciate that ASIC publishes a three year strategic plan, we urge ASIC to consider publishing sector specific roadmaps to assist market participants in understanding the interrelationships and interdependencies between discrete regulatory changes. We also believe that publication of a roadmap will promote a more holistic view regarding the scope and nature of regulatory changes that are being contemplated and enable ASIC to take a sector wide view of the impacts, costs and benefits of proposed regulatory changes, to ensure the regulatory framework is aligned and internally consistent.

Finally, PCT appreciates that the way in which guidance is organised cannot satisfy the needs of all market participants. We urge ASIC to consider publication of guidance both as discrete Regulatory Guides (as is currently the case), but to also make the guidance available in a fully searchable electronic format (or as a Wiki) and to provide online reporting utilities to enable market participants to effectively extract their own view of the relevant regulatory guidance by type of vehicle, license authorisation, fund lifecycle stage or any combination of these and other search parameters.

2. ESTABLISHING AND REGISTERING A FUND

B1 – Registering a Managed Investment Scheme

We welcome ASIC's clarification that a properly appointed alternate directors can sign the director's statement in lieu of a director and assume that ASIC will check whether the alternate director has been validly appointed through searching its own records.

The rationale for a non-standardised set of channels for lodgement of registration documents for a managed investment scheme (hard copy or online) versus a CCIV (online only) is not clear; if hard copy lodgement remains acceptable for a MIS, then this option should also be made available when lodging registration documents for a CCIV.

B2 – Asset Types

Whilst we acknowledge ASIC's desire for more granular information on asset types, PCT does not endorse Proposal B2 as outlined in the Paper. Moreover, we believe that ASIC should be clear in terms of the objectives underlying the collection of the more granular information as the appropriate taxonomy to be applied should be informed by how this information is to be used.

Whilst there is no global standard that can be applied to classify collective investment vehicles by 'type' that has the rigour and wide acceptance of the 'Global Industry Classification Standard[1]' for companies, it is common to consider a number of categories and variables within each category to classify investment funds by type. Common considerations when classifying funds by type are outlined in Exhibit 1 below.

[1] Standard & Poor's: Global Industry Classification Standard (GICS®)

EXHIBIT 1 – CLASSIFYING INVESTMENT FUNDS

Consideration	Description
Asset Class	Referencing the actual assets that the fund invests in. Asset Class has historically been defined with respect to equities, cash and equivalents, fixed interest (or bonds), real estate, infrastructure and commodities. Multi-asset class funds might also be included as a discrete asset class, where the investment strategy does not provide for a dominant exposure to a single asset class
Style	Referencing the investment approach that drives the selection of the underlying investments. Style can be specific to asset class or can be generic across asset classes.
Sector and sub sector	Referencing the actual sector and sub sector (if any) that defines the pool of assets that are within the universe for the fund. Sector represents the first line differentiator for selection of assets and can be geographically based, industry based, market capitalisation based or a combination of these. Sub sector further elaborates as to whether there are any other qualification criteria that are applied when determining the universe of assets that are in scope for achievement of the fund's investment strategy

Whilst we understand that the proposed listing outlined in Table 1 of the Paper is based on a taxonomy in use by Morningstar, the proposed listing extracts the second level classifications into a single pick list, not recognising that there is a first level classification, namely 'Equity Funds', ''Balanced Funds', 'Fixed Income' and 'Other'[2]. In the absence of the first level classification as is normally applied, the single 'pick list' outlined in Table 1 of the Paper includes options that are not mutually exclusive and provides for a mix of asset classes, distribution options, and sector and style parameters.

Recognising that not all investment funds are rated by Morningstar and some are not rated until there is sufficient track record to enable Morningstar to set a rating, detailed guidance from ASIC will be required if the proposed approach is to be operationalised effectively. This guidance will need to prescribe the category to be selected when a fund can be described with reference to more than one of the options that have been articulated, so as to ensure that the classification is consistently applied. Alternatively, ASIC is encouraged to examine the information required by APIR when an application is made for an APIR Code or SPIN Code[3], which (amongst other things) requires 'Currency', Underlying Asset Class', 'Profit Outcome Sought' (growth and/or income) and 'Location of the Asset' to be selected, each based on a discrete set of pre-coded options. It is more likely that investment funds will seek an APIR code from point of inception as opposed to a rating from Morningstar.

It is also not clear how this approach will be applied in the context of a CCIV, where the investment offerings are at the sub-fund level and a single CCIV can conceivably include sub funds that offer access to different investment strategies in terms of asset class, sector and style.

We urge ASIC to consider alternative approaches to collecting the more granular information that is seeking, either through development of a multi-level framework that aligns to the way in which managed investments are more typically classified or through posing an open ended question that requires the prospective RE or Single Corporate Director to articulate the investment strategy and objective for the fund, including identification of key parameters including:

- The underlying asset class
- Sector (and where relevant sub sector) specific details

[2] Morningstar Australasia Pty Ltd, *Morningstar Category™ Definitions*, October 2015
[3] APIR *Registration Guide APIR® Code or SPIN Code*, available at https://www.apir.com.au/docs/2301G.pdf

- Style details, where relevant
- Currency
- Whether or not leverage and derivatives will be used
- The strategic and tactical asset allocation contemplated for the fund
- If known, the *Standard Risk Measure*[4] for the fund.

ASIC should also seek a positive confirmation that the licensee is authorised to operate the fund type proposed.

Whilst we acknowledge ASIC's desire to collect more granular information regarding a scheme's investment strategy, objectives and asset class exposures, we believe that a more nuanced approach is required to ensure that information is collected on a consistent and comparable basis.

B3 – Registering a CCIV and notifying of a sub-fund

Whilst we have no comments at this stage with respect to the process for registering a CCIV, we question whether the notification process for sub-funds created subsequent to the initial registration is appropriate for a wholesale CCIV, where there is currently no equivalent notification process on either establishment of an unregistered managed investment scheme, or creation of a new sub trust or class of units referable to a particular asset for an unregistered attribution managed investment trust.

The draft guidance regarding the notification process for a sub fund implies an 'application and verification' rather than 'notification' process. We question whether this aligns to the intent of the draft legislation. We also note the absence of a committed turnaround time for ASIC to consider and respond to a 'notification of sub fund' and believe that this should be no longer than 5 working days from the date the approved form is lodged on line if the sub fund is of a type that aligns to the type that is already offered through the CCIV, recognising that any verification process should be more straightforward than is required for the initial registration of the CCIV in these instances.

B4 – Registering as an Australian passport fund

There is no timeframe specified for ASIC to respond to an application to register an Australian passport fund. We believe that, to ensure competitive neutrality, the timeframe for responding to an Australian operator that already holds the appropriate AFSL authorisation and is applying to register a passport fund should be aligned to the 21 day timeframe for assessing a notice of intention lodged by a foreign passport fund operator seeking to distribute their product in Australia.

We note that ASIC is seeking to elaborate on the way in which it will apply the various eligibility tests outlined in the Memorandum of Co-operation between participating jurisdictions ('**MoC**'). With respect to certain aspects (including the Assets Under Management Test and the Relevant Qualifications Test), ASIC should already hold documentation that will form 'proofs' regarding whether or not these tests are satisfied, as a result of documents that have already been lodged with the regulator (including, but not necessarily limited to financials statements lodged by each operator with respect to registered managed investment schemes, AFSL audited financial statements and qualification and experience proofs that are required when AFSL holders appoint responsible managers). To the extent that proofs are already held, we believe that ASIC should rely on these and require only supplementary information that is not captured in statutory lodgements.

With respect to the 'relevant qualifications test', ASIC should note that, in diversified financial services firms or firms that operate as part of a Group where a number of subsidiary entities are licensed, there is often no 'Chief Executive Officer' appointed at the subsidiary level. PCT suggests that the 'chief executive officer test' be subsumed into the 'minimum two executive directors' test.

[4] See Financial Services Council and Association of Superannuation Funds of Australia *Standard Risk Measure Guidance for Trustees*.

We also request that ASIC clarify where the existing 'responsible manager' regime fits in terms of demonstrating appropriate qualifications and experience for a domestic passport fund operator.

With respect to the 'financial resources test', it would be useful for ASIC to articulate the additional capital amounts that may be required as against the 'net tangible asset' requirements of licensees that hold an authorisation to operate a registered managed investment scheme.

Whilst we have comments with respect to the proposed 'organisational arrangements test' guidance, these in the main relate to the draft provisions of updated RG 132 and will be articulated in that context.

PCT notes that ASIC has provided guidance with respect to portfolio allocation limits; however, unlike the MoC, there appears to be no distinction between technical breaches arising due to valuation fluctuations occurring after the asset has been acquired (which are outside of the operator's control) as opposed to breaches arising from investment management decisions (effectively, transactional breaches). In practice, a prudent operator will have mechanisms in place to manage technical breaches that include assessments of the costs and benefits of taking action to remediate to determine the course of action that is in the best interests of members.

It should be recognised that enforced sale of assets to address a technical breach may not be in the best interests of members. Aside from cash, the nature of assets held are generally not finely divisible, given securities can only be traded in marketable parcels and/or at parcel sizes that are transaction cost effective. Moreover, there are implications for overall scheme performance and tax consequences that may arise through the forced disposal of assets. At a minimum, we suggest that ASIC differentiates between transactional breaches and technical breaches and provides materiality thresholds and clarifies its expectations as to whether an end of day, end of month or coinciding with fund pricing cycle approach is to be applied when assessing whether a portfolio is outside of allocation limits.

It should also be noted here that the guidance provided with respect to Australian Passport Funds in some cases (for example, portfolio allocation limits) apply not only at the time of registration.PCT questions whether it is more appropriate to create a guidance document specific to Australian Passport Funds, so as to consolidate all relevant guidance with respect to registering and operating an Australian Passport Fund in a single Regulatory Guide.

3. COMPLIANCE AND OVERSIGHT

DI – Compliance Management Systems

PCT is aware that there have been a number of documented high profile instances of poor conduct by AFSL licensees leading to poor compliance outcomes and that investors have experienced financial penalties as a consequence. PCT believes that poor compliance outcomes in these instances arise from organisational cultures that have prioritised operator best interest before member best interests. Simply put, organisational culture drives conduct, which in turn drives compliance outcomes and an increased focus on compliance management systems will not of itself address the root cause, nor prevent additional conduct based failures.

Recognising that compliance risk represents one of the portfolios of risks that must be appropriately managed by the operator of an investment fund, PCT believes that the appropriate reference for guidance regarding compliance management systems should be RG259. Moreover, we believe that ensuring the right risk and compliance management orientation backed with the appropriate systems and resources are assessments that should be undertaken at the time of application for an AFSL or at the time where a new AFSL authorisation is sought.

It is not appropriate or cost effective for market participants to be subject to separate regulatory guidance on risk management systems generally and compliance risk management systems specifically. If ASIC believes that further elaboration is required with respect to compliance risk management, this should be addressed in an update and extension of licensee types subject to RG259 and not through separate guidance.

PCT contends that compliance risk is best managed as part of an integrated risk management system that appropriately contexts and assesses compliance risk amongst all other *material risks* of the AFSL holder. A well governed operator will have a defined risk appetite statement (with a conservative risk appetite with respect to compliance risk) and have implemented an enterprise risk management system that is designed to identify, assess, treat and/or manage risks across the portfolio of potential sources.

We believe the cost of running parallel enterprise risk management and compliance risk management systems will result in additional compliance costs of a minimum of $200,000 per annum per licensee, with potential for this to scale up significantly for large, vertically integrated providers or providers that maintain a diverse portfolio of schemes by investment objectives and strategies.

For a prudent and ethical operator, compliance risk may not represent the most significant risk to be managed, yet an elevated focus on compliance risk management at the expense of what might be more significant risks may result in an overemphasis on managing compliance risks, adding complexity and cost without commensurate benefit. We also question the lack of focus on materiality, which may result in behavioural bias that prioritises compliance risk management at the expense of management of more material risks, so that 'form over substance' compliance with regulatory guidance can be demonstrated.

Where the AFSL holder is inclined to act in accordance with regulatory requirements, a disproportionate emphasis on compliance risk will add cost and complexity without delivering on improvements in market integrity or outcomes for investors.

PCT also contends that an elevated focus on compliance risk is not an effective mitigation against conduct risk. Licensees that are committed to meeting their general conduct obligations under S912(A) of the Act demonstrate the appropriate organisational culture and seek to act in accordance with their conduct obligations at all times. Any inadvertent breach of regulatory requirements is reported to ASIC and actions are undertaken to remedy these. Where commitment to acting in accordance with existing obligations is loose, more detailed elaboration may clarify expectations, but will not of itself drive improvements in desired outcomes.

ASIC would be aware that CAMAC canvassed governance, risk management and compliance for managed investment schemes in some depth in its 2014 Discussion Paper[5], noting amongst other things, the development of international risk management standards for managed funds and that compliance risk is only one of a number of risks a scheme faces. Three options for scheme compliance were canvassed; maintenance of the status quo, introduction of a risk management framework specific to schemes to operate concurrently with the existing compliance regime or subsuming the compliance regime into a broader risk management framework for schemes. Our understanding is that the third option (an integrated risk management framework) aligns to contemporary international practice. In a cost constrained, low return environment, where domestic operators will face competitive pressures from foreign passport funds; it is imperative that Australian issuers are not placed at a comparative cost disadvantage through the implementation of guidance which adds costs that are not aligned to achieving benefits.

[5] Corporations and Markets Advisory Committee *The establishment and operation of managed investment schemes Discussion Paper* March 2014

We believe the draft regulatory guidance relating to Compliance and Oversight should revert to updated and consolidated guidance specific to Compliance Plans

We further question the draft guidance regarding Compliance Management Systems outlined in RG 132:43 through RG 132.73 as this addresses considerations that should inform ASIC's assessment as to whether to accept an application to grant an AFSL or to vary an existing license. We believe this guidance as to minimum expectations at the organisational level should be reflected in updates to ASIC's AFS Licensing Kit Regulatory Guidance (RG 1 though RG 3), with the application to register a specific investment fund focused on provision of proofs that are specific to the fund to be registered.

An applicant should be required to demonstrate the appropriate strategic intent, consideration of operating environment, operating model, controls and review processes at the time that an application to grant an AFSL or add a particular AFSL authorisation. The burden of proof with respect to appropriate organisational orientation and competency (rather than at the scheme level) requirements should be imposed at the time of application for an AFSL or variation of an existing license.

We note that ISO 31000:2009 provides generic guidance on risk management and it is not "intended to promote uniformity of risk management across organizations" The standard also notes that the 'the design and implementation of risk management plans and frameworks will need to take into account the varying needs of a specific organization, its particular objectives, context, structure, operations, processes, functions, projects, products, services, or assets and specific practices employed"[6], PCT questions the level of prescription that has been provided in the draft guidance. PCT believes that reference should be made to in principle compliance with AS/NZ 31000:2009 Risk Management Standard or ISO31000:2009 (recognising that the draft CCIV model provides for foreign operators to provide Depositary services).

If ASIC wish to publish separate guidance on compliance management systems, PCT believes that the guidance should be substantially streamlined, as follows:

i. AFSL holders should be required to satisfy themselves that compliance management systems reflect the requirements of AS ISO 19600:2015, as updated and/or reissued from time to time, customised as required to reflect the nature, scale and complexity of the licensee's operations.
ii. Given copious practitioner and academic guidance as to the inputs and considerations when framing development of strategy, the myriad of methodologies and approaches that can be deployed with respect to same and given that strategic planning processes can of themselves be a source for competitive advantage, inclusion of draft RG132:46 is of questionable merit. If ASIC is interested in understanding where a scheme fits in terms of the operator's broad strategies, then it should require the operator to provide a statement to this effect as part of the application process.
iii. ASIC should clarify whether AFSL Holders who are Financial Services Council Members can rely on compliance with *FSC Standard 23: Principles of Internal Governance and Asset Stewardship* as sufficient in terms of articulation of values, objectives and strategies.
iv. ASIC should clarify whether dual regulated AFSL holders (ASIC and APRA) can rely on compliance with relevant APRA prudential standards with respect to demonstrating the correct strategic intent that underlines ASIC's proposed guidance.
v. ASIC should clarify the extent to which a licensee can rely on Group Level documents with respect to demonstrating compliance with the desired strategic intent, where the licensee operates as part of a broader Group.
vi. The interaction between the listing rules and ASIC's proposed guidance should be clarified for AFSL Holders that are part of listed entities or for investment funds that are to be listed.

[6] ISO31000:2009 *Risk management — Principles and guidelines* Clause 1

vii. We question ASIC's assumption that licensees should have a 'discrete compliance function' as this is 'form over substance' prescription and ignores that there are alternative organisational arrangements including integrated risk and compliance management teams that can be equally effective in achieving desired compliance outcomes. If ASIC wishes to prescribe the appropriate organisational structure that licensees should adopt with respect to compliance management, this should be a licensing requirement that is imposed at time of application .s.

viii. Where an existing licensed operator is seeking to register a new scheme or CCIV or notify of the establishment of a sub fund, ASIC should clarify the extent to which it will leverage documentation that it already holds and consider track record for compliance when it is assessing the application. From an effectiveness and efficiency perspective, the focus at this juncture should be on collection of information relating to the fund to be registered and assessment of differences relative to existing operations.

PCT believes that the requirement that ASIC apply streamlined processes where appropriate is made even more pertinent given the proposed introduction of 'fee for service' levies for certain ASIC services as have been foreshadowed by Treasury[7].

D2 – Compliance Plans

PCT notes the updated draft guide provides for a substantial increase in the scope and granularity of guidance in terms of what constitutes a 'good' compliance plan. We question the merits of the additional elaboration, particularly given that, as noted in the draft guidance, "A compliance plan is one part of an investment fund's operator overall compliance management system" (RG132.73). Moreover, we believe that ASIC should articulate minimum standards and expectations as opposed to detailed elaboration that could be construed as prescription. We also note the unintended consequences of prescriptive guidance, which enforces expectations around the appropriate scope of enquiry to be applied when developing a compliance plan as this may encourage form over substance compliance with guidance and not provide sufficient scope for evolution and adaptation in response to change.

Recognising the diversity of scope, scale and structures adopted by investment fund operators, we believe that guidance with respect to compliance plans is more appropriately provided by way of publication of a 'good practice guide', taking the same approach as has been taken with respect to RG 94.

In our view, to demonstrate good practice, a compliance plan should:

1. Align to and leverage the controls environment of the operator's risk management system
2. Promote multiple lenses to be applied to the same risk, recognising that good compliance is an outcome of an effective risk management system that takes a holistic approach to managing risks. For example, Use of External Service Providers is an outsourcing risk; achieving good compliance in these circumstances emanates from managing outsourcing risk.
3. Consider materiality of compliance risks and focus on those risks that are deemed material to scheme based on the application of a risk assessment methodology.
4. Avoid unnecessary repetition, so where a common control is relied upon to mitigate multiple compliance risks, the control is not repeated at numerous junctions.
5. Provide for plain English elaboration as to the context, controls and testing requirements
6. Focus on the substance rather than form of compliance risk management and associated controls, to avoid the 'tick a box' approach that is anathema to delivery of appropriate regulatory and investor outcomes
7. Able to be dynamically adapted to address changes in the external and internal operating environment.

[7] Treasury, *Introduction of Australian Securities and Investment Commission's Fee for Service under the Industry Funding Model Consultation Paper* November 2017

PCT note the tension between ASIC's expectation that the Compliance Plan be maintained so as it is up to date at all times against the mechanical requirements that require compliance plans on updating to be signed off by all Board Members and lodged with ASIC, and the audit challenges presented where there are changes in Compliance Plans mid-way through the audit year. We request that ASIC provide guidance as to how these conflicting objectives can be simultaneously operationalised in practice.

PCT also notes that implicit assumption in the draft guidance that there is single point responsibility for compliance controls, where in practice, achieving the appropriate compliance outcome may rely upon a network of interactions, some systems driven, others process driven and other people driven; it is the approach and process that delivers the required compliance outcome and there may be more than one point of accountability and dependency. In this context, we believe that 'accountability' should be substituted for 'responsibility' in the detailed guidance.

We commend ASIC for distinguishing between group level and scheme level risks and controls and urge ASIC to extend this concept further through providing investment fund operators with the ability to lodge:

i. A 'Master Compliance Plan' that captures all group level controls that are relevant to an investment fund and as such can be considered to be applicable to all investment funds under its operation and oversight.
ii. Scheme specific Compliance Plan supplements that capture the scheme level controls that are specific to the nature and scope of a specific scheme.

With respect to the risk categories by nature of assets outlined in Table 2, it should be noted that the risks being highlighted here are not in the main compliance risks, but a combination of market, investment and operational risks. This further reinforces PCT's position that risk and compliance management for investment fund operators should be integrated into a single regulatory guide. Moreover, whilst it is helpful to understand ASIC's priority areas of focus, PCT maintains that if ASIC is interested in providing guidance regarding specific risk types, it should adopt a taxonomy that aligns to market practice. For dual regulated licensee or licensees that are members of a Group that includes APRA regulated entities, variations in taxonomies and semantics should not act as a barrier for leveraging the enterprise risk management system.

Additionally, PCT requests that ASIC acknowledge that the risk types that are called out may not be material in certain circumstances and clarify that where the noted risks are not considered material, there is no expectation that investment fund operators will devote resources to managing these risks in preference to those assessed as being more material..

ASIC should take care to ensure that investment fund operators understand material risks and do not prioritise management of non-material risks so as to be seen to comply with regulatory guidance.

D3 – OVERSIGHT

At the outset, PCT notes that the draft guidance provided with respect to 'oversight' conflates 'oversight requirements' with 'structuring for good governance' practices, specifically with respect to RG132:173 through RG132:179.

COMPLIANCE COMMITTEE

For ease of reference and ease of comparability across the discrete oversight bodies (Corporate Director, Responsible Entity and Compliance Committee, where the latter is required), PCT recommends that ASIC removes all content relating to organising for good governance from this regulatory guide and if it deems it is required, incorporate organising for good governance related guidance in a discrete regulatory guide that

addresses the arrangements expected of Responsible Entities, Corporate Directors of CCIVs and Compliance Committees.

ASIC should remove all content relating to organisation of the Compliance Committee that has been captured in this draft regulatory guide and incorporate this into a discrete regulatory guide that addresses ASIC's expectations of the structure and composition required of bodies involved in overseeing investment funds.

With respect to the governance processes outlined at to RG132:173 through RG132:179, it is difficult to comment on these proposals in the absence of context around the equivalent standards ASIC expects of Corporate Directors and Responsible Entities. Nonetheless, we wish to highlight a number of issues with the guidelines as drafted:

i. We question the prescription that tertiary qualifications should be a pre-requisite for engaging members for Compliance Committees, recognising that there are alternative on the job learning pathways that may give rise to adequate skills and experience. We also question the wisdom of prescribing particular degree courses as pre-requisite, recognising again that the skills and experience to fulfil the Compliance Committee oversight functions can be acquired with sufficient work experience.
ii. We question the requirement for 'current work experience' as this implies Compliance Committee members can only be recruited directly from the pool of individuals currently employed in overseeing or managing investment funds. If there is to be a minimum experience requirement, this should be articulated more clearly and should provide for some flexibility so as not to rule those that have been recently, but are not 'currently employed' out of the universe of candidates eligible to be appointed to a Compliance Committee.
iii. We question the absence of guidance to consider whether the Compliance Committee collectively has the depth and breadth of experience required to effectively monitor a registered scheme's compliance with its compliance plan. The guidance that has been provided presumes that each individual must hold the relevant skills in their own right, rather than considering the Compliance Committee's collective mix of relevant and complementary skills.

Any regulatory guidance provided by ASIC with respect to composition of the Compliance Committee (or indeed other governing bodies for investment funds) should be principles based and not prescriptive, recognising that the end objective should be to ensure that the relevant governing body provides the relevant skills, experiences and perspectives based on the collective of individual members.

With respect to the appointment of members, PCT notes that the minimum terms of appointment that have been included in the guidance are deficient in that they do not contemplate a defined length of term and a maximum possible length of all terms. The extent to which oversight is truly independent can be compromised if members are subject to indefinite terms and there is no minimum requirement to consider renewal and succession planning processes.

Guidance regarding the appointment of members to oversight bodies should be mindful to ensure that there are appropriate requirements that prompt the periodic renewal of members and succession planning.

OVERSIGHT OF AUSTRALIAN PASSPORT FUNDS

With respect to oversight of Australian Passport Funds, we request that ASIC clarify its expectations where the external directors (of the responsible entity or Corporate Director of the CCIV) are to act as the 'independent oversight entity'; presumably there is an expectation that there will be a Board Sub Committee comprised only of external directors that will undertake the oversight activities that have been articulated.

PCT requests that ASIC clarifies the requirement that the 'independent implementation review' for an Australian passport fund be in addition to a compliance plan audit for the same. Based on our understanding, there is no requirement in the MoC that would preclude progressing the compliance plan audit and annual implementation review as a single audit engagement. Practically, conducting the compliance plan audit and independent implementation review under a single audit engagement provides for a more efficient and cost effective process. Alternatively, for an Australian passport fund, the independent implementation review could effectively substitute for a compliance plan audit if the scope is specified as inclusive of both ARFP and compliance plan requirements.

Regulatory guidance should clarify that the compliance plan audit and annual implementation review can be progressed as a single, integrated engagement

We also note that the MoC enables the home regulator discretion to exempt a passport fund from this requirement if it is satisfied that it is taking appropriate actions to check compliance during the review period or on an ongoing basis and request that ASIC monitors how this discretion is being used by other passport jurisdictions and considers the circumstances under which it will exercise this discretion for Australian passport funds.

DEPOSITARIES OF CCIVS

Whilst we are grateful that ASIC has confirmed that the depositary can discharge the statutory oversight activities after the fact, we remain concerned regarding the pre-trade verification obligations that are implicit in the requirement for the depositary to verify that the instructions received from the Corporate Director are lawful and in compliance with the constitution.

As we highlighted to Treasury in our submission on the CCIV core model, the only ex ante verification activity that can be feasibly conducted by the depositary overseeing a fund that is subject to intra-day trading of securities is to validate whether the instruction received from the Corporate Director conforms to the format of proper instruction agreed between the Corporate Director and the Depositary. There can be no second guessing at this stage in terms of whether an instruction represents a correct commercial instruction. To impose any higher order pre-trade validation requirement on the depositary is not commercially workable, given the risk that instructions will not be executed in a timely enough manner, exposing the CCIV to commercial loss. For investment funds that rely on algorithmic trading to generate timely orders to market in line with the fund's investment strategy, the depositary cannot feasibly validate these orders in advance of their execution, but can agree the correct format and protocols for transmission of these orders.

ASIC should also be aware that it is the cumulative impact of orders submitted for settlement on the same day that will determine whether an investment fund remains within mandated limits. A pre-trade order by order assessment against mandates for compliance is operationally challenging to implement and may provide little in terms of insights of value.

Any pre-trade validation requirements to be undertaken by the depositary should be restricted to ensuring that there are appropriate systems and processes in place so that only instructions that conform to the agreed form of a proper instruction can be accepted for processing.

PCT believes that the draft guidance with respect to the appropriate operational arrangements between the Corporate Director and its agents and the Depositary outlined in RG132:217 and RG132.219 should be qualified to the extent that the Depositary should only have the right of access and enquiry where the Corporate Director and/or its agent are providing a service that is directly or indirectly material to the scope of the Depositary's statutory oversight function. In other words, the Depositary should not have the right to access or right of onsite visit unless the service provider is involved in processing applications and redemptions, valuations and striking the share price, allocating assets and liabilities and allocating and distributing income.

Whilst guidance has been provided as to the Depositary's right of access and inspection to the records and premises of the Corporate Director and agents appointed by the Corporate Director, we note that there is no reciprocal guidance provided with respect to the Corporate Director's rights of access and inspection to the records and premises of the Depositary and the Depositary's agents.

Guidance should clarify the Depositary does not have rights to access information or conduct onsite visits and inspections where there is no nexus between the role being undertaken by the service provider and the Depositary's statutory obligations.

4. CONCLUSION

Regulatory guidance should strive to strike the correct balance between achievement of regulatory and commercial policy outcomes. We request that ASIC consider the draft regulatory guidance in light of industry feedback to ensure Australia's funds management industry remains well governed, internationally competitive and a driver for economic growth and prosperity, at both the macro (economy wise) and micro (investor) levels.

We expect that the net cost to operators of the draft regulatory guidance on Compliance and Oversight will amount to circa:

- $200,000 per annum at minimum per licensee or group of licensees incurred in running parallel enterprise risk management and compliance management systems.
- Even though we consider our compliance plans already comply with the substance of the regulatory guidance that has been provided, additional direct compliance plan audit costs of circa $3,000 to $5,000 per annum per scheme will be incurred at least in the first instance, recognising the additional scope and granularity of expectations, which, even if not directly addressed will in all likelihood need to be considered by the Compliance Plan auditor and responded to by the operator's employees. Indirect and opportunity costs are not included in the estimates outlined above.

In an increasingly cost constrained, low return environment, ASIC should be mindful to ensure that it does not add unnecessarily to an operator's cost structure, recognising that additional costs will be ultimately borne directly by investors who will experience higher fees and lower net returns. We also urge ASIC to consider the opportunity cost on Australia's economic prosperity if regulatory settings do not support the international competitiveness and further development and growth of the funds management industry.