Corporate collective investment vehicles: Preparing for the commencement of the new regime

Response to ASIC consultation paper 360

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1. Introduction

Challenger operates three core businesses dedicated to providing our customers with financial security for a better retirement. We are the country's leading and most recognised provider of retirement income to Australian retirees. Challenger's leading market position comes from our guaranteed income products (annuities), our retirement focused retail bank, and our funds management business, which is a leader in actively managed income and growth strategies.

2. Principal points

The Corporate Collective Investment Vehicle (CCIV) regime creates an alternate collective investment vehicle to the Managed Investment Scheme (MIS). The CCIV facilitates efficient tax flow though for investors and maintains similar consumer protections to the MIS framework, via a corporate, rather than a trust structure. The corporate structure is well understood and preferred by international investors. Over time, the intention is that the CCIV framework will become the dominant governing framework for collective investment in Australia.

While this is the overarching objective of the CCIV regime, the transition to the new regime will take time. First, the Parliament is yet to legislate transitional arrangements to allow MISs to be converted into CCIV sub funds. Secondly, there is an industry-wide issue with legacy MISs, which are closed to new members but cannot, due to legislative constraints, be wound up or converted into a modern structure. In the 2021/2022 Budget, the Government announced measures to seek to deal with legacy life insurance and MIS products, and that process is ongoing.

Until the legacy product issue is resolved and a transitional regime from MIS to CCIV is legislated, we expect both types of vehicles to be offered broadly to Australian and international investors. The full expected transition away from MISs as a form of collective investment will most likely take many years to be achieved, and we expect many Australian fund managers to offer both types of vehicles throughout that time.

While there are some minor differences between the two collective investment vehicle regimes, they are substantially the same in operation and effect. Launching and managing a MIS and a CCIV will be virtually identical business for the relevant licensee – the disclosure required, the duties owed to investors, much of the governance that sits around the collective vehicle, the asset classes invested in, etc, will be the same regardless of which type of vehicle is used.

Given the activities involved in operating both vehicles are the same, and that the CCIV regime will eventually overtake the MIS regime, we submit that separate and duplicative regulatory requirements for insurance and other financial requirements is not warranted. Imposition of these duplicative requirements will add substantial additional costs to the new regime which in turn is likely to make the CCIV less appealing in the market, negatively impacting on competition, and frustrating the underlying policy intent of the CCIV framework; that is, to facilitate a new collective investment regime that represents global best practice.

We have explained in more detail below how two aspects of ASIC's proposals in draft CP360 will likely result in this significant additional cost to fund managers who would like to operate a CCIV after the new regime takes effect.

3. E: Compensation and Insurance Arrangements

E1Q1 Do you agree with our proposal? If not, why not?

E1Q2 Are there any practical problems associated with our proposal? Please give details (including details of any issues that you consider will arise in relation to acquiring PI insurance, based on relevant experience and engagement with insurers).

E1Q3 Are there any additional costs associated with the implementation of our proposal? Please give details and, if possible, quantify these costs.

Challenger broadly agrees that licensees who operate a form of collective investment vehicle should be required to maintain professional indemnity insurance. We also agree that cover should be adequate, considering the nature of the activities that will be carried out under the licence, and should cover claims amounting in aggregate to the lesser of $5m or the sum of total assets under management (AUM) of the licensee.

The activities carried out by a Responsible Entity (RE) of a MIS, and those undertaken by a Corporate Director (CD) of a CCIV, are virtually identical. Given this, there does not appear to be any reason why indemnity cover should be a separate requirement for these two types of licensees when they exist within the one corporate group.

Separating the indemnity cover requirements may lead to additional cost and cost anomalies/regulatory arbitrage across the industry. This will be dependent on how corporate groups structure their business for commercial purposes and how quickly each moves to transition existing MIS business into the new CCIV regime, once an appropriate transitional regime exists.

For example, Fund Manager A has an RE business with $5.2m in AUM in one or more MISs, and a CD business with $5.2m in AUM in one or more CCIV sub funds. Under ASIC's proposal in draft CP360, Fund Manager A would need a total of $10m in indemnity cover.

Fund Manager B on the other hand has an RE business with $7m in AUM in one or more MISs, and a CD business with $3.4m in AUM in one or more CCIV sub funds. Under ASIC's proposal in draft CP360, Fund Manager B would only need a total of $8.4m in indemnity cover.

Both fund managers would be undertaking essentially identical activities to operate their respective MISs and CCIVs, and both hold total AUM of $10.4m on behalf of investors. Despite this, under the proposed requirements, Fund Manager B would require less cover, at a lower cost, than Fund Manager A.

Additional cost and inconvenience, and the opportunity for regulatory arbitrage across different structures and the industry, should be avoided. It is not warranted given the similarity in the role and function of REs and CDs and may undermine the policy intent of the new regime. The intent of the new regime is to provide an alternate collective investment vehicle that is more appealing to international investors, and which will boost Australia's competitive standing internationally, and in particular the Asia region.

In addition, many fund managers will already be subject to additional insurance costs resulting from the maintenance of multiple RE licenses within the one corporate group. This is because consolidation of MIS business can be hampered by various issues, including cost issues, associated with legacy MIS products.

Further, the new regime includes some different governance requirements for CDs than those that currently apply to a REs. Notably the requirement to have at least 50% independent directors on the Board of the CD, with no alternate compliance committee option, will necessitate the separation of RE and CD entities within some corporate groups. This issue when combined with the legacy product issue may mean that consolidation to reduce costs will not be possible for some fund managers. Where this is the case, the requirement for independent directors at the CD Board level will present additional costs to fund managers wishing to offer a CCIV to investors. This additional cost in and of itself will likely be a disincentive to take up of the new structure, negatively impacting on competition, and further costs associated with the licensing framework will only exacerbate this issue.

We recommend ASIC consider allowing a fund manager to satisfy the insurance requirements in aggregate across all MIS and CCIV business within the one corporate group.

4. F: Financial Arrangements

F1Q1 Do you agree with our proposals? If not, why not?

F1Q2 Are there any practical problems associated with our proposals, or is any additional guidance required? Please give details, including details of whether any additional changes are required to the categories of 'Tier 500,000 class assets' (see RG 166.189 of draft updated RG 166) and 'special custody assets' (see RG 166.188 of draft updated RG 166) to reflect the CCIV assets of a retail CCIV.

F1Q3 Do you agree with our proposal (see Table 2) to use the assets of all sub-funds in the retail CCIVs operated by a corporate director in calculating a corporate director's NTA requirement? If not, why not?

F1Q4 Do you agree with our proposal (see Table 2) to exclude the value of cross-invested shares for the purposes of calculating a corporate director's NTA requirement? Please give reasons for your response.

F1Q5 Are there any additional costs associated with the implementation of our proposals? Please give details and, if possible, quantify these costs.

Challenger broadly agrees that a CD should have sufficient resources to meet anticipated cash flow expenses, audit requirements, and financial (NTA) requirements that reflect the financial products and services offered. Given the different governance requirements on CDs under the new regime, and the likelihood that this will result in separate RE and CD entities within many corporate groups, tailored cash needs and audit reporting for CDs is appropriate.

We also agree that the total assets of all sub funds, excluding the value of cross-invested shares, in retail CCIVs operated by a CD should count towards the NTA requirement. However, in line with our similar comments on the proposed insurance requirements for CDs, we do not agree that the NTA requirements should be standalone for CDs and REs within the same corporate group. This will result in a duplication of capital requirements across businesses within the same group that are performing essentially identical functions.

The purpose of NTA requirements is to ensure that an entity has the financial resources to properly conduct its business and to provide a buffer to mitigate some of the risk to investors of business failure. The risk to investors in a CCIV is broadly commensurate to their investment amount, and this is the same for retail investors in a MIS. The NTA requirement should be based on the total risk exposure for retail investors with respect to a particular fund manager, regardless of what type of vehicle they are invested in. This is because there is no different level of risk that attaches to each vehicle.

Separate minimum NTA requirements for both REs and CDs within the same corporate group will impose a substantial additional layer of cost without any corresponding consumer protection benefit. In circumstances where a fund manager seeks to offer a single CCIV for the first time or transition a single MIS into the new CCIV structure, this duplicative capital requirement is likely to present a major barrier. For some managers the cost will be prohibitive, and this will have a negative impact on take up of the new regime across the industry.

In line with the section on insurance above, many fund managers will be facing into cost pressures associated with legacy products hampering the consolidation of RE business within the group, as well as the costs associated with the governance requirements under the new CCIV regime. Duplicate NTA requirements within a single corporate group will exacerbate these existing cost pressures, which may seriously impede the success of the new CCIV framework.

We recommend ASIC consider allowing a fund manager to satisfy the NTA requirements in aggregate across all MIS and CCIV business within the one corporate group.