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* Associated Firm

** In cooperation with
Trench, Rossi e Watanabe
Advogados

3 March 2022

██████████
Senior Analyst
Market Infrastructure
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001

Dear ██████████

CP 356 Submission - Baker McKenzie & Perennial Investment Management Limited

Baker McKenzie appreciates the opportunity to comment on the proposals of the Australian Securities and Investments Commission (ASIC) in Consultation Paper 356 on ETP naming conventions: Updates to INFO 230 (the **Consultation Paper**). We are providing this submission together with our client Perennial Investment Management Limited.

We regularly advise issuers of ETFs, Managed Funds, and Structured Products, including in relation to the naming of such products.

Perennial Investment Management Limited is the responsible entity of a number of quoted and unquoted managed investment schemes

We are also instructed that Gold Corporation, another client of Baker McKenzie (and the issuer of the PMGOLD Structured Product) shares our views regarding the naming of Structured Products as set out in this submission. Otherwise, the views expressed in this submission are ours alone, and do not necessarily reflect the views of our clients.

1. Summary

We are generally supportive of the proposed changes to ETP naming conventions. Our primary concerns are that the universe of ETPs which would be required to use the Complex label is too broad for the label to provide a meaningful comparison between ETPs and the relative risks, and sufficient guidance on permitted derivative use has not been provided.

Additionally, we do not think the "Structured Product" label is suitable for the existing structured products quoted on ASX, as, in our opinion, the label "Structured Product" implies a high level of complexity and risk which we do not believe is applicable to those existing products, which all provide a simple long only unleveraged exposure to commodities – we believe a more suitable label would be "Exchange Traded Commodity".

By email
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2. Consultation Questions

B1Q1

What have your experiences been with ETP naming conventions to date?

We act for a number of issuers of ETF, Managed Funds, and Structured Products and generally we consider ETP naming conventions to be an important feature to assist investors in distinguishing between passive and active strategies and associated risks. However, results to date have been controversial as many names lack clarity and can be confusing or misleading. For example, as the hedge fund label is required when only two out of five categories are satisfied, there is a broad spectrum of possible ETP strategies which can all be grouped under the hedge fund label. Most people have little idea as to what is meant by "hedge fund" and the range of products grouped under that title could have widely different attributes (including not even overlapping attributes) and risk profiles.

If the goal of changing the naming conventions associated with ETPs is a way to deal with the fact that investors may not read the product disclosure statements for their ETP investments, we do not believe this update to the naming conventions is the best or an appropriate way to manage this factor.

B1Q2

Do you agree that naming conventions for ETPs are useful in alerting investors to important features and risks of ETPs? If not, why not? Please provide any evidence or research to support your views.

ETP naming conventions are useful to assist investors in distinguishing between passive and active strategies, however we consider that labels relating to sub-categories of Managed Funds to date have been less useful. For example, issuers may structure ETPs to avoid the hedge fund label while using strategies which are materially more risky than other Managed Fund products. In addition, given that the hedge fund label is required when only two out of five categories are satisfied, there is a broad spectrum of possible ETP strategies which can all be grouped under the hedge fund label. For this reason we do not consider that labels relating to sub-categories of Managed Funds (like the hedge fund label) have been particularly useful to assist investors in distinguishing between products.

B1Q3

Do you agree that ASIC should continue to outline ETP naming conventions for licensed exchanges and product issuers? If not, why not?

Yes, provided it is done in a manner which is consistent, understandable and helpful.

B1Q4

Do you agree with ASIC's assessment that the current naming conventions require updating? Please provide examples and assessment to support your response.

Yes. For example:

- (a) "Managed Fund" is not a clear label given most ETPs, including ETFs and Managed Funds, are legally considered to be a "managed investment scheme" under the Corporations Act, which is a similar term to "Managed Fund";
- (b) the wide definition of hedge fund arguably ends up being confusing and misleading in many cases; and
- (c) it's not clear whether retail investors would understand what is meant by the term "synthetic". In our experience, for this reason issuers of ETPs actively avoid structuring products in a way which would trigger the "synthetic" label.

B1Q5

Do you agree with the proposed two-level naming convention approach? If not, why not?

Yes.

B1Q6

Are there any gaps or areas of inconsistency between ASIC's guidance on ETP naming conventions and the application of design and distribution obligations to ETPs that would benefit from additional clarification?

ASIC may wish to clarify that an ETP being required to use a particular label does not necessarily mean that the ETP is only suitable for a particular class of retail investor.

Given the design and distribution obligations regime has only recently been implemented, it is difficult to determine with certainty whether there is any gaps or areas of inconsistency between ASIC's guidance on ETP naming conventions and the application of design and distribution obligations to ETPs. We would highly recommend that ASIC seek additional industry feedback in the future in order to understanding the full implications of the naming conventions and whether there is any related DDO issues.

B1Q7

Do you foresee any difficulties or unintended consequences resulting from the introduction of the design and distribution obligations and ASIC revising its guidance on ETP naming conventions?

Given the increase in the number of ETPs which now offer off-market applications and redemptions, ETP labels may cause confusion in off-market distribution channels. ASIC may wish to consider engaging with industry participants in the unlisted product space to determine whether they expect there to be any difficulties or unintended consequences. ASIC may wish to consider engaging in consultation with the unlisted funds industry with respect to implementing fund labels across all of the unlisted and listed space, to provide consistency across the wider industry.

B1Q8

Do you have any other feedback or comments for ASIC to consider on how to support or encourage investor education on different ETP product features?

Account opening documents between brokers and clients could be mandated to include a standardised information section which describes the relevant features of ETPs and the naming conventions, including an explanation of features which can cause an ETP to be labelled as Complex. This information could also be required to be prominently displayed on the websites of exchanges and brokers.

Given this day and age and the myriad methods that investors receive education on funds, investment markets, Issuers etc., we believe that ASIC should take a digital first approach to support investor education. We believe ASIC should take a proactive approach and engage with investors where they seek this information to support their investing behaviour e.g. podcasts, Reddit, Tiktok, webinars etc. Whilst we appreciate that ASIC does recommend a whole of industry approach to support investor education (of which most issuers do support these efforts), there is always more that can be done.

ASIC may wish to consider whether to implement sharing of investor contact information between brokers and issuers of ETPs, which would facilitate direct communication between investors and issuers of the ETPs acquired by those investors. This would allow issuer of ETPs to offer product education directly to holders of their products. However we appreciate privacy legislation may not permit such an approach.

PDSs of "Complex" products could be required to include prominent disclosure regarding which features of the ETP cause it to be Complex, similar to the RG 240 hedge fund disclosure principles or RG 46 unlisted property fund disclosure principles.

B2Q1

Do you agree with the proposed distinction between these product types? If not, why not?

Yes, other than we do not agree with the name of the "Structured Product" label. In our experience, the term Structured Product typically implies a complex and risky product and often comes with negative connotations in the minds of investors (for example, the GFC is often blamed on structured products such as collateralised debt obligations (CDOs) and similar products).

By way of background, we acted on the establishment of the six Structured Products currently quoted on ASX. Historically, the primary reason these products use their current structures is because the rules of ASX at the time the products were established would not have permitted the products to operate under (what is now) the normal trust structure used for ETPs. Each of these six existing products provide a simple unleveraged long exposure to a commodity. Given the evolution of rules for ETPs in the time since these products were first established and the wide variety of assets now permitted to be held by ETFs and Managed Funds, we consider it unlikely that further types of Structured Products will be quoted on ASX or Cboe, as the market preference is to use trust structures where possible.

We suggest an alternate label for the existing Structured Products, for example, "Exchange Traded Commodity" (ETC).

B2Q2

Do you agree that issuers of listed investment products (LICs and LITs) should be unable to use the term 'Exchange Traded Fund' or 'ETF'? If not, why not?

Yes.

B2Q3

Should the updated guidance include a standard abbreviation for Structured Products (similar to 'ETF' for Exchange Traded Funds)? If yes, please indicate your preferred abbreviation for Structured Products and provide reasons for your response.

No.

B2Q4

Do you agree with the position that sub-funds of CCIVs, should be considered within the same conventions as managed investment schemes, subject to any explicit requirements in the final law passed in relation to the Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021? If not, why not?

Yes.

B2Q5

Do you have any further suggestions to increase clarity between product types, particularly when comparing quoted managed investment schemes and quoted CCIVs to LICs, LITs and other listed investment products (including listed CCIVs)? Please provide reasons and any available evidence to support your answer.

Yes – given that LICs and LITs in particular are subject to different rules and operating practices relative to ETFs and Managed Funds, we believe LICs and LITs should be differentiated in similar ways to ETFs and Managed Funds (importantly for example, LICs and LITs are closed-ended vehicles and are not subject to market making requirements, which typically results in interests in these vehicles trading at a discount to NAV).

PDSs for ETFs and Managed Funds are currently required to set out the differences between the ASX Listing Rules and the relevant rules for the quotation of the ETF or Managed Fund, however, we query whether this is sufficient, as in practice we assume that many retail investors are unlikely to read the PDS or if they do read the PDS then they are unlikely to truly appreciate the differences between the relevant rules for listing and quotation – further, we consider it likely that many retail investors do not appreciate there is any difference at all between a LIT and an ETF or Managed Fund.

ASIC may wish to consider applying labels to LICs and LITs to help address this potential knowledge gap, for example, LICs and LITs could be labelled as "Closed-

Ended" or similar. This is likely to be more applicable to LITs as it should already be clear that a LIC is a company and not a fund.

B3Q1

Do you agree with ASIC continuing to provide good practice guidance on specific risk-based or strategy-based labels for ETPs to alert investors to the presence of additional risks where this is appropriate? If not, why not?

Yes.

B3Q2

Do you support the two secondary labels that we have proposed for ETPs? Please provide reasons for your response.

Generally yes, but subject to further comments as follows.

Further guidance should be provided with respect to derivatives used by ETPs, in particular further guidance regarding what does and does not constitute using derivatives "to gain material economic exposure to affect the underlying investment strategy". For example, we consider that ASIC should provide confirmation on whether this includes the same carve outs which currently apply to the use of derivatives as described in RG 240, and whether a deferred purchase agreement will be considered to be a derivative (as is the case in RG 240).

RG 240 currently permits unrestricted derivative use in respect of interest rate and exchange rate hedging. Given the recent increase in quoted fixed income funds, we suggest that ASIC also consider excluding the use of credit risk derivatives from the Complex label (including OTC credit derivatives). We understand such credit risk derivatives are commonly used by fixed interest funds to manage credit risk in the same way that equities funds use derivatives to manage exchange rate risk, and without such an exclusion this may create an unintuitive outcome where virtually all fixed income ETPs are labelled "Complex" whereas equities funds, which are normally regarded as higher risk, are not. A 'net exposure' threshold may possibly be more relevant here as an alternative. Further consultation may be required.

ASIC should further consider whether it would be appropriate to include thresholds for short selling and leverage or inverse exposures (for example, allow ETPs with no more than 30% (purely as an example threshold) short/leveraged/inverse exposures to avoid the "complex" label), otherwise, we believe there is a risk the "complex" label becomes too broad and fails to provide meaningful information to investors. For example, an ETP which has an ability to enter into limited short positions for hedging purposes will generally be materially less risky than a similar fund which has the ability to enter into unrestricted short positions and other inverse or leveraged positions (and if managed skilfully, such an ETP may even be less risky than a 'plain vanilla' long only managed fund).

ASIC should consider how the increasing use of custom indices interacts with the proposed "Active" label. Where an ETF tracks an index which has been designed by the issuer of the ETF and published by a third party index provider for the purposes of the

ETF investing in a particular sector while still calling itself an ETF, this seems more akin to an actively managed or rules based ETP, relative to an ETF which tracks a widely regarded index such as the ASX 200.

B3Q3

Do you support the updated definition for the 'Active' label? If not, why not, and what alternative definition would you suggest?

Yes. However, if there is any intention to expand fund labelling to the unlisted space then it is recommended that further consultation with issuers from the unlisted segment of the market should be conducted prior to implementation of any changes.

B3Q4

In relation to the proposed 'Complex' label:

(a) do you agree that a single label can effectively alert investors to the presence of a range of important risks? If not, why not?

Yes it may alert investors to the presence of a range risk however it may not be sufficient to alert investors to the materiality or likely or approximate materiality of the risks. Care needs to be taken in defining the risks and thresholds which trigger the label, to avoid capturing too broad a range of risk profiles. If the label captures too broad a range of risk profiles, then it does not meaningfully inform investors as to the risks involved in a particular product. For example, if there are two ETPs which allow leverage and are therefore labelled as "Complex", but one is limited to gross exposures capped at 110% of NAV and the other at 200%, the "Complex" label is not going to meaningfully describe the risks present in these two ETPs.

(b) if the 'Complex' label is adopted, do you agree that only derivatives used for exchange rate hedging purposes are able to be excluded? If not, do you have any suggestions for how to revise the consideration of derivatives in the 'Complex' label?

No. The same exclusions as those which currently apply to derivative use under RG 240 should also be implemented (for example, interest rate hedging, short term derivative use, and exchange traded derivatives up to 10% of NAV). Additionally, we also suggest excluding derivatives used for managing credit risk – please also refer to our response to B3Q2 for more detail on this point.

(c) do you have any suggested amendments to the proposed definition, or examples of specific product strategies or risks that should be captured by the 'Complex' label but are not currently included in the definition?

We suggest that ASIC further engage with industry to determine appropriate thresholds and features which will trigger the Complex label as currently it appears to be overly broad. Please also refer to our response to B3Q2.

(d) we are open to alternatives to the word 'Complex' to describe this category of ETPs. Please let us know if you have any one-word or two-word suggestions.

We don't have any particular suggestions for an alternative word however ASIC should carefully consider whether additional labels are required or a refining of the Complex definition is required.

B3Q5

As an alternative to the 'Complex' label, would you prefer that the current distinction between 'Synthetic' funds, 'Hedge funds' and other 'higher risk' ETFs be preserved but updated to address overlap and confusion? If so, do you have any suggestions for how those definitions could be revised?

No.

B3Q6

Are there any other risk-based or strategy-based naming conventions that you think should be included in ASIC's guidance on ETP naming conventions? If yes, please outline why, including why other forms of disclosure (e.g. PDSs) or consideration (e.g. within being true to label) are not sufficient for the risk or strategy.

No.

B3Q7

Do you agree that for products that apply the Structured Product label there is no need to outline secondary labels? If not, why not?

No. There is potentially a wide variety of types of Structured Products (however only long unleveraged commodity products are currently quoted on ASX). For example, a Structured Product may be economically equivalent to a vanilla long only equity managed fund or it may be economically equivalent to an option or other type of derivative product, including the ability to provide inverse or leveraged exposures. Labelling a product as only a "Structured Product" is not sufficient to communicate the likely degree of risk to an investor or to provide any meaningful information to an investor except that the product is not a managed investment scheme.

Further, as per our response to B2Q1, we do not agree that "Structured Product" is a suitable label for the kinds of structured products currently quoted on ASX.

B3Q8

Are there likely to be any unforeseen consequences related to ASIC's proposed updates to the INFO 230 naming conventions? If yes, please elaborate.

Given the new development of ETPs offering off-market access, ASIC should consider how naming conventions will impact the distribution of funds in the unlisted market. Funds which are unquoted may be unfairly advantaged if they are not required to use the same labels as quoted funds which offer off market access, depending on the perception of the naming conventions in the unlisted space.

B3Q9

Do you have any other ideas for future development or improvement of ETP naming conventions to promote confident and informed investment in Australian ETPs?

No.

C1Q1

Do you agree with our proposed conventions concerning the appearance of any naming convention labels applied? If not, please provide reasons.

Yes.

C1Q2

Are there alternative conventions for the display or appearance of labels that you would recommend in addition to or as an alternative to this proposal? If yes, please explain what and why.

No.

C2Q1

Do you agree with our proposal for licensed exchanges to implement consistent rules concerning ETP naming at the time of admission? If not, why not?

Yes.

C3Q1

Do you agree that ETP name changes at any time after admission should also require the approval of the licensed exchange? If not, why not?

Yes, provided the approval of the new name must be granted unless in the reasonable opinion of the exchange the name would be inconsistent with the rules of the exchange or any ASIC guidance.

C3Q2

Do you agree with licensed exchanges having an explicit power to require product issuers to change the name of a product? If not, why not?

Yes, provided the power is only exercised reasonably and for the purposes of ensuring the name is consistent with the rules of the exchange and any ASIC guidance. Generally it should be expected that such power would only need to be exercised if an ETP changed its investment strategy to an extent sufficient to require a new label or name, or if ASIC changed its naming requirements. It should be the responsibility of the exchange to ensure that when an ETP is first quoted it is using the appropriate name.

C3Q3

Are there any other rules or initiatives of licensed exchanges that would help to give effect to the aim or purpose of ASIC's guidance on ETP naming conventions?

ASIC should ensure rules regarding names of ETPs are consistent across all relevant exchanges.

C4Q1

Do you support a transition to updated primary labels being made mandatory (for all ETPs or classes or subsets of ETPs) to promote consistency across the industry and reduce investor confusion? Please provide reasons for your response.

Yes. We consider it likely that if existing ETPs do not adopt any new naming conventions then investors will be confused. For example, investors may be under the impression that the new naming conventions are separate labels in addition to the current labels, rather than replacing the existing labels. However a reasonable compliance timeframe should be allowed for existing ETPs.

C4Q2

Please outline your understanding of what would be required from you to implement the new naming conventions, including:

(a) an estimate of costs;

(b) what you would consider a reasonable timeframe if adoption was to be mandated for all or any class of products; and

(c) any relief or other assistance from ASIC that you consider may be needed to facilitate a transition for existing products.

Response not provided.

C4Q3

For product issuers, it would greatly assist our consideration of these issues if you were able to provide a preliminary indication of your appetite to adopt updated naming conventions of the type described at proposals B2 and B3 for any or all of your existing ETPs.

Response not provided.

C4Q4

Are there any other matters related to transition that ASIC should consider in connection with making revisions to INFO 230 guidance on ETP naming conventions?

No.

We would welcome any request to discuss our submission in greater detail.

Yours sincerely

[REDACTED]

[REDACTED]

Partner

[REDACTED]

[REDACTED]