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# Proposed Australian Corporate Collective Investment Vehicle

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Authors: Natalie Kurdian, Lynda Reid and Jane Ann Gray

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## ***In brief***

In its 2016-17 Budget, the Federal Government committed to developing a regulatory framework for a corporate collective investment vehicle (**CCIV**) followed by a regulatory framework for a limited partnership collective investment vehicle. The exposure draft of the CCIV legislation was released by Treasury on 25 August 2017, in the form of a new Chapter 7A of the [\*Corporations Act 2001 \(Cth\)\*](#) (**Exposure Draft**).

The Exposure Draft structures the CCIV as a body corporate, which houses one or more sub-funds for collective passive investment purposes. While the tax detail is yet to be released, CCIVs are to provide tax neutrality for investors, as well as features familiar to both the domestic and offshore funds markets, in order to resolve perceived regional unpopularity of Australian unit trusts as commercial investment vehicles.

The CCIV is a hybrid: a body corporate operated as a trust, more particularly a managed investment scheme (**MIS**). Key elements of the proposed regime remain to be drafted, but Treasury's 'core framework' imports the language and mechanisms of a trust, presumably with trust law overlay, to a body corporate.

The UK applies the corporate form in its well-tested, open-ended investment company (**OEIC**). However, the UK regulatory framework operates as a standalone set of regulations, borrowing only select concepts from other sources such as the *Companies Act 2006*, *Insolvency Act 1986*, and the FCA Handbook. The Australian CCIV regime sits in the Corporations Act and the Exposure Draft has created some anomalies between the traditional character of a corporate and a trust.

In particular, further consideration must be given to additional legislation to provide:

- a) certainty of governance and authority;
- b) clarity of responsibility and accountability for persons and entities within the structure;
- c) effective operational flexibility.

The detail for the regime's operations will follow the initial consultation process. Given the work yet to be done, an effective date of 1 July 2018 appears ambitious, unless the regime is to be overly dependent on Australian Securities and Investments Commission's (ASIC) proposed rulemaking powers to supplement the legislation.

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This first LegalTalk Alert considers some initial issues stemming from the hybrid between corporate entity and MIS; and the governance and authority challenges inherent to the ‘trust in a corporate box’ approach and key features of the proposed form of CCIV. In a LegalTalk Alert to follow, we will provide more detailed commentary on responsibility and accountability issues for the CCIV in the context of the duties of its corporate director, as well as key matters for consideration under the regime to be released for insolvency.

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## ***In detail***

### ***Historical challenges with trust structures***

Historical concerns<sup>1</sup> in relation to the commercial adequacy of the trust and MIS structure, when compared to the global managed funds landscape, include that:

- a) such vehicles are not separate legal entities:
  - i) they cannot exist in perpetuity;
  - ii) they have no capital base; and
  - iii) their members do not have the benefit of general law or statutory limited liability.
- b) there is no coherent insolvency regime. In particular, access to trust assets is not necessarily guaranteed in insolvency where the rights of unsecured creditors to access the assets of the trust depend on the trustee’s right of indemnity being unimpaired; and
- c) there is disharmony of regulation; any gaps under the Corporations Act require reference to state based trustee acts.

### ***Objectives of new legislation***

In its consultation, Treasury identified some key objectives:

- a) CCIVs are to reflect best practice for export, including by providing an insolvency regime;
- b) a policy directed towards:
  - i) aligning CCIVs with the MIS regime, so both provide tax neutrality for investors (i.e. CCIVs are limited to passive investment);
  - ii) avoiding leaving the MIS at a domestic competitive disadvantage to CCIVs;
  - iii) facilitating migration from MIS to CCIV (where it makes sense to do so); and
  - iv) regulatory and compliance simplification.

Have the policy objectives been met? Assessment at this stage would be premature, for the reasons below:

- **Tax:** the relevant legislation has not yet been released, although it is presumed to follow a similar conceptual basis to that already in place for managed investment trusts.
- **Competitive domestic (dis)advantage:** is difficult to gauge. The Australian domestic market is comfortable with MIS structures; a new structure with a new regulatory framework may not have immediate appeal for established funds managers relying primarily on Australian sourced investment, although there is likely to be interest from Europe and Asia.
- **Facilitation of migration to CCIVs:** Application of MIS concepts to the CCIV structure does suggest that a responsible entity (**RE**) could adapt its existing business model to include an additional Australian Financial Services Licence (**AFSL**) authorisation to operate CCIVs in a similar fashion to that which it employs for existing MIS. Migration facilitation will also rely on appropriate tax rollover relief.
- **Insolvency:** Treasury will provide the insolvency regime in the next release of legislation.

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<sup>1</sup> [Johnson Committee Report on Australia as a Financial Centre]

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## ***Key objective: regulatory and compliance simplification***

This last objective is arguably the most important. Treasury's commentary in the Explanatory Memorandum to the Exposure Draft suggests that CCIVs will rely heavily upon ASIC to make CCIV rules under legislative instruments, specific exemption and modification orders. A regulation making power is also included for the new regime.

ASIC's Consultation Paper 296 sets out that it proposes to 'provide guidance about key aspects of the CCIV and Asia Region Funds Passport regimes in a suite of substantive regulatory guides'. ASIC has also taken this opportunity to reorganise its existing guidance to include requirements for CCIVs. The proposed regulatory guidance covers establishing and registering funds, constitution requirements, compliance and oversight, holding assets, and proposed guidance for passport funds under the new regime for that model.

The Australian financial services industry has struggled increasingly under the difficulties posed by pivotal regulatory requirements being spread among the Corporations Regulations, numerous regulatory guides, legislative instruments and other documents, making regulatory compliance a complex, expensive and labour intensive process. This paper respectfully submits that the CCIV regime would benefit greatly from more detail and clarity in the primary legislation in lieu of a similar series of fixes after the fact.

### ***CCIV structural solution: a trust/ company hybrid***

The CCIV, being a body corporate, has its own legal identity, so that it can:

- exist in perpetuity;
- provide a 'corporate veil' for members;
- own and deal with its own assets; and
- transact and be solvent or insolvent in its own right.

However, the CCIV is an unusual body corporate. It is a 'company' limited by shares, with a sole corporate 'director' (**Corporate Director**) to function in accordance with trust based principles. The Corporate Director is required to act on behalf of the CCIV in a fashion similar to that of the RE, as trustee of an MIS.

Accordingly, more detail will be required to complete the CCIV framework, in particular, to identify and neutralise those trust and company law principles that are inconsistent with a well understood corporate funds management model meeting international and domestic expectations.

### ***CCIV features***

#### *Constitution*

The CCIV is a special Australian company limited by shares, identified by the letters 'CCIV' at the end of its name, and able to be incorporated as 'wholesale' or 'retail'. Its constitution, which must be lodged with ASIC, will act as the statutory contract between the CCIV, its members and the Corporate Director. The replaceable rules in the Corporations Act (containing basic structural and procedural features of a company) cannot apply to a CCIV.

Both the retail and wholesale CCIVs are to be registered with ASIC. Similar to registered MIS, there will be statutory requirements for the constitution of a retail CCIV (but not for the wholesale CCIV). Unlike wholesale unregistered MIS, the requirement for registration of the wholesale CCIV and lodgement of its constitution may mean wholesale CCIVs will not be popular with those sophisticated investors who prefer to keep their negotiated commercial arrangements (usually embodied in the constitution) out of the public domain.

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### *Corporate Director*

The CCIV will have a sole Corporate Director and no other employee or officer. The Corporate Director must be an Australian public company holding an appropriate AFSL akin to an RE.

The Corporate Director may appoint an agent, or otherwise engage a person to do anything the Corporate Director is authorised to do in connection with the CCIV. The Corporate Director is liable for those agents, even if they act fraudulently or outside authority. Again, importing statutory concepts from the Corporations Act which apply to an RE.

As with an RE, the Corporate Director can retire or be removed by members, but must be replaced (including by a temporary Corporate Director undertaking the process to replace itself) or the CCIV must be wound up. If the Corporate Director changes, provisions in the legislation which mirror the statutory novation provisions applying on the change of an RE will also apply.

### *Depository – retail CCIV requirement to supervise Corporate Director functions*

The retail CCIV regime has imported the European Undertakings for Collective Investment in Transferable Securities (**UCITS**) requirement for a depository entity (**Depository**) that is independent from the Corporate Director. The Depository is to hold (on trust) the assets for a retail CCIV, execute the directions of the Corporate Director in relation to those assets, and supervise various functions undertaken by the Corporate Director (including issuing, redeeming, cancelling and valuing shares in the CCIV). The Corporate Director can also appoint a custodian to hold CCIV assets.

Wholesale CCIVs do not require a Depository, however they can make an irrevocable election into the Depository regime. Necessity for a Depository in the Australian context (other than to follow UCITS norms) is not immediately clear. The requirement is not a feature of the MIS regime, and will add a layer of investor costs with questionable regulatory gain.

### *Transactions affecting share capital*

The current Australian statutory regime applicable to transactions affecting share capital, such as reductions of capital, buy backs, self-acquisition and financial assistance, will not apply to CCIVs, which will have their own regime. A CCIV can undertake reductions of capital, based generally on principles of fairness as between members of affected sub-funds, and solvency of the sub-fund immediately before and after the reduction. Self-acquisition of CCIV shares and financial assistance to acquire shares are prohibited (without exception).

In addition, while not entirely clear from the Exposure Draft, payment of dividends to CCIV members will be subject to new requirements particular to this kind of entity (potentially in addition to, or in replacement of, the net assets test).

The CCIV will permit a single corporate entity to offer investors a number of different investment portfolios through its sub-funds. A sub-fund may constitute a single profile portfolio or offer variations to the portfolio within the sub-fund through different classes of shares issued referable to the sub-fund (for example capital and income alternatives).

### ***Issues of certainty of governance and authority***

#### *Corporate theory*

Traditional corporate theory provides for a company to act through its two organs: the board of directors and the members in general meeting. The board of directors is not an agent of the company, it is the company; its governing mind. The Exposure Draft provides however, that the Corporate Director of a

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CCIV is to 'operate the CCIV' and to 'perform the functions conferred' on the Corporate Director by the CCIV's constitution and the Corporations Act, as an RE/trustee of an MIS/trust manages the property it holds on trust.

The Exposure Draft also distinguishes some functions of the CCIV from those of the Corporate Director. For example, the redemption of shares and allocation of assets and liabilities to sub-funds is done by the Corporate Director on behalf of the CCIV, rather than by the CCIV itself. The Corporate Director is in this way more akin to an agent of the CCIV with some rights and obligations in relation to its function being personal. This raises the question as to who constitutes the CCIV, in particular for the purposes of identifying the principal in dealings of the Corporate Director with third parties.

#### *Uncertainty as to capacity of contracting party*

The legislation proposed is unclear on how a CCIV executes documents. On the basis of the proposed provisions, it appears that the Corporate Director will execute contracts as 'Corporate Director', rather than the CCIV entering contracts in its own capacity (unlike a conventional Australian body corporate). Detail as to statutory assumptions or safe harbour rules is yet to be provided, including how third parties might be entitled to assume certainty of capacity.

Unless statutory certainty is provided, the basis for determining which are personal rights and obligations of the Corporate Director and which are rights and obligations of the CCIV need to be determined under the general law. To date, the Court has determined that the capacity in which an RE purports to contract is not determinative. The extension of these challenging concepts to a Corporate Director, which does not hold assets on trust, has the potential to create significant complexity in the event of a dispute.

Commercial acceptance of the CCIV requires that third parties be able to engage with the Corporate Director with a clear understanding of the capacity in which the Corporate Director contracts; this area is one that will benefit from greater clarity in the next draft of the legislation.

#### ***The takeaway***

It is encouraging to see greater consideration of alternative investment structures being considered for adoption in Australia. Such investment vehicles, structured properly, should lead to improved investor perception as Australia as a hub for financial investment, particularly inbound foreign financial investment. However, in its current form, the CCIV is a hybrid: a body corporate operated as a trust; some of its proposed features have created some anomalies between the traditional character of a body corporate on the one hand, and a trust on the other; and the tax detail is yet to be released.

Further consideration must be given to additional legislation to provide CCIVs with:

- a) certainty of governance and authority;
- b) clarity of responsibility and accountability for persons and entities within the structure;
- c) effective operational flexibility.

What is clear from the above, is that there is certainly more water under the bridge to go before CCIVs become an accepted alternative to the traditional MIS/trust vehicle that is commonly used in Australia.

#### ***Let's talk***

For a deeper discussion of how these issues might affect your business, please contact:

Natalie Kurdian, Sydney  
+61 (2) 8266 2763  
[natalie.kurdian@pwc.com](mailto:natalie.kurdian@pwc.com)

Andrew Wheeler, Sydney  
+61 (2) 8266 6401  
[andrew.wheeler@pwc.com](mailto:andrew.wheeler@pwc.com)

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