ThomsonsLawyers

Funds Management & Financial Services: Quarterly Review

April 2013

Editorial

Welcome to the April 2013 edition of Thomsons' quarterly snapshot of legal developments in the funds management and financial services sector.

As the countdown to the Future of Financial Advice (FOFA) commencement date of 1 July draws closer, all but the four brave souls who have registered for the reforms to apply early will be working towards complying with the new regime. Likewise, the regulator has been steadily issuing guidance on how it will enforce the regime. Of prime importance has been the release of ASIC's policy on how it will deal with the ban on conflicted remuneration in Regulatory Guide 246: *Conflicted remuneration*. I take a look at the new policy inside this edition.

Whilst the FOFA reforms recommended by the Ripoll Inquiry have all but been implemented (the wholesale/retail client distinction aside), the reforms arising from the collapse of Trio Capital are still in their infancy. ASIC has released two consultation papers dealing with recommendations from Trio, seeking to address what ASIC referred to as 'gatekeeper failure'. In consultation paper 197 (**CP 197**) *Holding scheme property and other assets* and consultation paper 204 *Risk management systems of responsible entities*, ASIC is looking to shore up what it sees as systemic fallibilities by imposing further obligations on custodians and responsible entities.

ASIC also released its proposed policy on the new financial requirements for managed discretionary account (**MDA**) operators. ASIC is seeking to impose responsible entity-like net tangible asset requirements on these businesses.

In addition to covering all of these issues, this edition looks at a recent case involving unitholder disharmony and how the responsible entity dealt with it, as well as a decision about when ASIC will refuse to consent to the appointment of a replacement compliance plan auditor. Sonya Parsons has the details.

George Hodson looks at changes to our tax laws proposed to stimulate foreign and domestic investment in venture capital and private equity funds, and potential opportunities for wealth managers in that sector.

I hope you find this edition informative and thought-provoking.

Kind regards,

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Articles

Sector developments

Important dates

19 April 2013: Submissions close on Consultation Paper 200 *Managed discretionary accounts: Updates to RG 179*

26 April 2013: Submissions close on the draft legislation to implement Element 3 of the Investment Manager Regime

1 May 2013: Submissions close on Consultation Paper 205 *Derivative transaction reporting*

3 May 2013: Submissions close on Consultation Paper 204 *Risk management systems of responsible entities*

1 July 2013: FOFA reforms commence

ASIC to start accepting applications for the limited AFS licence for accountants.

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Judicial advice: dealing with competing unitholder interests

The recent Supreme Court of New South Wales case of *Re Real Estate Capital Partners Managed Investments Limited as Responsible Entity of the Real Estate Capital Partners USA Property Trust [2013] NSWSC 190* highlights the potential benefits of a responsible entity (**RE**) obtaining judicial advice where it finds itself in the midst of competing interests of unitholders.

Facts

Real Estate Capital Partners Managed Investments Limited (**ReCap**) was likely to be replaced as the RE of the Real Estate Capital Partners USA Property Trust (**Trust**). The unitholders had resolved to sell the majority of the Trust assets to another entity, but had voted against the distribution of the Trust's net assets after the sale. Before the meeting to decide ReCap's replacement as RE, unitholders representing approximately 20% of the units in the Trust requested that their units be redeemed.

ReCap wrote to unitholders noting that it was, in the best interests of all unitholders, going to accept the redemption requests and also to offer all of the Trust's unitholders the opportunity to submit redemption requests.

Unitholders holding approximately 45% of the units opposed the relief sought by ReCap, namely that the Court determine that ReCap had the power under the Constitution of the Trust to redeem units the subject of discretionary redemption requests.

Why would ReCap seek the Court's advice?

ReCap was able to seek the Court's advice under s 63 of the *Trustee Act 1925* (NSW). Once such advice is obtained, if the RE acts in accordance with the advice, the RE shall be deemed to have discharged its duty and its actions cannot be claimed to be beyond its powers by disaffected unitholders.

In circumstances where ReCap obviously found itself caught between competing sets of unitholders – those who wanted to redeem their units (**redemption unitholders**) and those who wanted all the Trust's assets to be reinvested, effectively opposing the redemptions and seeking to replace the RE (**opposing unitholders**) – ReCap was wise to seek the Court's direction as to the exercise of its powers under the Constitution.

If ReCap had proceeded with the redemption requests without such direction from the Court, it could have opened itself up to potential challenge by the opposing unitholders and to a claim for damages (not to mention the cost and time of the potential litigation) by the opposing unitholders and any other affected unitholders.

What did the Court consider?

The Court looked closely at the Constitution of the Trust, as well as the provisions of the *Corporations Act 2001* (**Corporations Act**) in relation to the proposed exercise of ReCap's powers.

The Court also considered the main submissions of counsel for the opposing unitholders. The most interesting of these is the argument that the redemptions could not proceed because giving effect to the redemption requests would contravene the takeover laws in the Corporations Act. The takeover laws are intended to apply to listed schemes as if they were companies.

Under these takeover provisions, an entity is prohibited from acquiring a 'relevant interest' in units in a listed scheme if the voting power of a person in the entity will increase to 20% or more, or from a starting point of between 20% and 90% as a result of that acquisition. The opposing unitholders alleged that by accepting redemption requests from 20% or more of the unitholders, and the subsequent reduction of units on issue, consequentially the voting power of one unitholder and its associate (both opposing unitholders) would increase above the permitted threshold.

The decision

The Court found that giving effect to a redemption request will not be a breach of the takeover provisions of the Corporations Act by an RE because in any scheme with withdrawal provisions, the RE has a 'relevant interest' in those units from the point of their issue (although this may depend on the drafting of the withdrawal provisions). There is, in effect, no acquisition of a relevant interest when a redemption request is made or satisfied. Despite the increase in voting power by the relevant unitholder and its associate due to the redemptions, if there was no acquisition of a 'relevant interest', there was no breach of the takeover provisions.

The Court also found that the takeover provisions could not be seamlessly applied to a listed scheme as if it were a company because of the different constituent rights of each legal structure, particularly in the case of redemptions. A company is only entitled to redeem its shares under the buy-back provisions of the Corporations Act whereas a scheme can determine its own capital reduction procedures when it is liquid.

The Court also held that ReCap was not bound by the previous resolution of the Trust unitholders not to distribute its net assets. It said that a trustee is not required (again, depending on the terms of the Constitution) to act in

accordance with the views of the majority of beneficiaries, or even the views of all the beneficiaries, except where the beneficiaries are entitled to call for a transfer of the trust property to terminate the trust.

The outcome

The meeting to replace ReCap as RE of the Trust never took place as claims about misleading and deceptive conduct by ReCap made by the opposing unitholders agitating for ReCap's removal were settled. Using the permission granted to it by the Court, approximately 90% of unitholders redeemed their units in the Trust.

Important points for REs from the decision:

- It may be appropriate and beneficial at certain times for REs to seek judicial advice before proceeding on a course of conduct, particularly where there appear to be conflicting interests of unitholders.
- The takeover provisions of the Corporations Act are unlikely to be activated by the redemption of units in listed managed investment schemes in most cases.
- REs are not bound to act in accordance with the views of the majority of beneficiaries, except in limited circumstances. They must always act in the best interests of unitholders as a whole.

If you would like any further information about the case or you would like to discuss when to consider seeking judicial advice, then please contact Sonya Parsons.

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Fund managers and the ban on commissions

ASIC releases guidance on conflicted remuneration

As part of its roll out of policy on the Future of Financial Advice (**FOFA**) reforms, the Australian Securities and Investments Commission (**ASIC**) has recently released its guidance on how it will regulate the ban on conflicted remuneration in Regulatory Guide 246: *Conflicted remuneration.*

The policy contains important guidance about the circumstances in which ASIC considers a fee will be conflicted remuneration. In particular, it addresses common fee structures between fund managers, dealer groups and platforms. Set out below are some examples of common fee structures and how ASIC is going to apply the ban on the payment of conflicted remuneration.

Commissions paid through application forms with consent (not banned)

One of the key FOFA reforms was to ban commissions paid by fund managers to financial advisers for the distribution of the fund manager's products. However, ASIC considers that where a commission has been authorised by the client, then such a payment will be excluded from the ban.

Therefore, with the following adjustments, the practice of fund managers collecting commission payments from investors and paying those to financial advisers can continue:

- The fund manager and the financial adviser should formally agree that any fee the client agrees to pay the adviser for advice is collected by the fund manager as the adviser's agent. An agency agreement would be an appropriate legal mechanism to enshrine this arrangement.
- Before the investor signs the application form, the adviser must make it clear to the investor that the investor is authorising the adviser to receive the fees set out in the application form. It should also disclose to the investor that it has a formal arrangement with the fund manager to collect the payment and to pay it to the adviser.
- The application form should be amended to include the following:
  - provision for the investor, or the adviser on behalf of the investor and with its specific authority, to nominate the fee to be paid to the adviser from the investment money;
  - a statement that the fee paid by the investor will be collected by the fund manager as agent for the adviser and paid to the adviser; and
  - a section for the adviser to consent to the arrangement.

Volume-based fees paid under white label arrangements (banned)

ASIC considers that fees accessed by a dealer group in the following circumstances would contravene the ban on conflicted remuneration (unless the fund manager can prove to the contrary):

- The fund manager provides a white label managed investment scheme to a dealer group to brand as its own.
- Investors in the white label fund pay the fund manager a bundled fee (management fee) for administration services provide by the fund manager and promotion and distribution services provided by the dealer group.
- The management fee is collected by the fund manager but a portion of it is paid to the dealer group depending on the proportion of funds under management sourced by the dealer group.

Preferred marketing payments to platform operators or dealer groups (banned)

Where a funds manager makes a payment (either volume-based or a flat fee) to a licensed dealer group that is also a platform operator to get preferred marketing access to the licensed dealer group's adviser, then ASIC considers the payment will be conflicted remuneration and subject to the ban. This is the case because ASIC believes the dealer group's advisers are more likely to recommend that a retail client acquire the funds manager's products through the platform.

Volume bonuses paid to dealer groups (banned)

Where a funds manager makes a payment to a licensed dealer group that is also a platform operator and the payment is based on the volume of the fund manager's products acquired by clients of the dealer group's advisers, then ASIC considers the payment will be conflicted remuneration and subject to the ban. This is the case because ASIC believes that such a payment is likely to influence the dealer group's advisers to recommend the funds manager's products to retail clients.

Management fees (banned, but no action position issued)

ASIC considers that the ban on conflicted remuneration may prevent fund managers from giving advice to their clients to increase or maintain their investment in the fund managers' products. However, ASIC states that it will not take any action against a fund manager for accepting management fees provided it does not provide *personal* financial product advice about its products.

Commissions rebated to clients (not banned)

In the circumstances where a volume-based benefit paid by a fund manager to an adviser is passed on in whole to the adviser's clients, then it is unlikely that ASIC will consider the benefit to be conflicted. The conditions the fund manager must satisfy in order to satisfy itself that it will not be giving conflicted remuneration if it makes such payments are that:

- the benefit is given on the condition it is passed on in its entirety to the client; and
- the fund manager reasonably believes the benefit will be passed on.

Volume-based shelf-space fees rebated to clients (not banned)

ASIC states that it will not take action against a platform operator that accepts a volume-based shelf space fee if that fee is passed on to its clients as soon as reasonably practicable (and not later than three months) after it is received. This is the case because ASIC considers such a fee is unlikely to influence how platform operators select which products are available on the platform or the prominence they are given.

Principles-based policy

ASIC's approach to the ban on conflicted remuneration is principles-based: if a benefit is likely to influence the advice given then it will fall within the ban. This policy means that in certain circumstances, volume-based remuneration may be acceptable where it does not influence advice.

If you need assistance determining whether your remuneration structures are likely to fall within the ban, then please contact Chris Mee.

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Tax reforms to boost investment in venture capital vehicles

Recent announcements

The Federal Government has announced that it will support all the proposals made by the Board of Taxation (**Board**) in its recent review of the Venture Capital Limited Partnership (**VCLP**) and Early Stage Venture Capital Limited Partnership (**ESVCLP**) regimes (together the '**VC Regimes**'). It is hoped that the changes to be implemented will provide a significant boost to these relatively under-used investment vehicles.

What are the VC Regimes?

The VCLP and ESVCLP regimes were established in 2002 and 2007 respectively. The policy objectives of the VC Regimes were two-fold:

- to increase domestic and off-shore investment in entities seeking to commercialise innovative Australian research; and
- to provide an internationally-accepted investment vehicle for venture capital, leading to the development of skills and experience for Australian venture capital managers.

The VC Regimes provide special tax treatments for those who invest through them. They receive the benefit of flow-through taxation and eligible foreign investors are exempt from income tax on profits or gains derived from the sale of eligible investments by them.

According to the submissions made to the Board, the levels of investment in VCLPs, and particularly ESVCLPs, are very low. The Board estimates approximately $1.6 billion has been invested by VCLPs since they were introduced in 2002 and a paltry $5.5 million by ESVCLPs. It seems the ESVCLP regime has been particularly beset by problems since it was introduced in 2007. Firstly, the GFC hit shortly after its introduction, but in addition, the regime required the states and territories to each pass amendments to their partnership legislation to allow ESVCLPS to be established and this was not achieved until 2009.

What were the Board's recommendations?

To increase investment in the VCLP Regime, the Board made the following recommendations to improve the operation of each regime:

- For VCLPs:
  - Any gains or losses made by a VCLP on the disposal of an eligible venture capital investment held for 12 months which flow through to partners should be deemed to be on capital account for eligible domestic partners.
  - Eligible domestic investors should be defined consistently with eligible foreign partners.
  - An Australian managed investment trust (**MIT**) should be able to invest as a limited partner in a VCLP and retain its MIT status and tax concessions.
  - The restriction for foreign venture capital 'fund of funds' should be removed provided the fund is widely held.
- For ESVCLPs:
  - An investee entity should have greater flexibility to invest in other complementary ventures, provided the investee entity acquires a controlling stake in the other entity and the other entity is otherwise an eligible investment.
  - The holding company exception should be modified to allow an ESVCLP to invest in a holding company which has existing interests in multiple subsidiaries, as long as those subsidiaries satisfy the eligible venture capital investment requirements.
  - Innovation Australia should have discretion to allow ESVCLPs to exceed the 20 per cent foreign investment cap provided the investment has a material national benefit (as associated with the commercialisation of Australian research and development).
  - An Australian MIT should be able to invest as a limited partner in an ESVCLP and retain its MIT status and tax concessions.
  - Where a limited partner in an ESVCLP is a trust (that is not taxed as a corporate), the investors in that trust should not be prevented from accessing the special tax treatment accorded under the ESVCLP regime.

Other important announcements

At the time the Federal Government announced it was supporting the Board's proposals about the changes to the operation of the VC Regimes, it also announced the other significant reforms to the regulation of the venture capital industry as follows:

- Lowering the minimum investment capital required for entry into the ESVCLP program from $10 million to $5 million to facilitate increased funding from 'angel' investors.
- Administering the VCLP and ESVCLP programs as a single regime to provide clearer entry for investors and managers wishing to use these investment vehicles.
- Phasing out the Pooled Development Fund program over a number of years.

Impact of the proposed changes

The adoption of the above proposed changes by the Government to the taxation of VCLPs may lead to an increase in investments through VCLPs in Australian private equity fund structures. The proposed changes are intended (amongst other things) to partially equalise the taxation benefits currently provided to MITs so that there

may ultimately be no taxation difference for most investors electing to invest in either a MIT or a VCLP.

Some of the other proposed changes, such as permitting a MIT to invest as a limited partner in a VCLP and retain its MIT status and tax treatment (which was previously denied by the Commissioner), should also increase VCLP investment and may open a significant source of capital for VCLPs given the rise of investment in MITs since 2010.

Fund managers will continue to prefer to include VCLPs in fund structures as the general partner of a VCLP is entitled to claim its carried interest in the fund on capital rather than revenue account. This is contrary to MITs, where the manager's carried interest is taxed on revenue account. Many non-resident investors will also continue to prefer investing in VCLPs rather than MITs as unitised trust structures are not commonly used in other jurisdictions and contain concepts foreign to many offshore investors.

It is therefore likely that most venture capital and private equity fund structures will continue to comprise, or at least initially offer participation in, a VCLP and a MIT. However, there may no longer be a need to quarantine specific investors in specific vehicles or separate investors into different investment 'streams' as a result of the proposed changes.

However, with increasing pressure on fund managers to decrease fund costs and increase fund administration efficiency, managers may elect to proceed with a VCLP as the only initial investment vehicle and, where necessary, staple a MIT to the structure where the fund intends to make investments which are ineligible for a VCLP. Other fund managers, particularly those offering interests solely to resident investors, may prefer to continue with a MIT as the sole investment vehicle of the fund given the more significant investment restrictions placed on VCLPs, which are set to continue.

If you would like any further information about the proposed changes or you would like to discuss the taxation benefits of investing through the VC Regimes, then please contact George Hodson.

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Replacing a compliance plan auditor

Sophisticated businesses are used to changing their professional service providers if there is any issue with the cost of that service, or the services themselves. So what happens if a responsible entity (**RE**) wants to remove the auditor of its compliance plan, but ASIC (whose consent to the removal is required under *Corporations Act 2001* (Cth)) will not agree to that removal?

That is the situation that Benchmark Capital Limited (**Benchmark**) found itself in (see *Whitchurch and Australian Securities and Investments Commission* [2012] AATA 784). Benchmark applied to ASIC for the removal of its auditor, and that application was refused. Benchmark subsequently applied to the Administrative Appeals Tribunal (**AAT**) for a review of that decision.

The AAT found that clear auditor independence is of great importance in regulating corporate entities. Accordingly, the AAT agreed with ASIC's concerns that Benchmark may have been 'opinion shopping' and seeking to replace the auditor with one that agreed with proposed accounting treatments of various kinds. The failure of Benchmark to lodge various audit reports and to maintain certain documents also did not count in its favour and served to cast doubt on its motives in seeking the auditor's removal.

So however much you might not like your auditor's reports, if you want to remove your auditor, you will be well advised to ensure that you have 'clean hands' and clear and appropriate motives for seeking that removal.

If you would like any further information about how to remove your compliance plan auditor, then please contact Sonya Parsons.

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Sector developments[1]

FOFA

ASIC key FOFA guidance released—conflicted remuneration

ASIC has finalised guidance to help industry understand the practical operation of the ban on conflicted remuneration and how ASIC will administer it.

Please see the article by Chris Mee above for further details.

Fee disclosure statements

ASIC has released guidance for Australian financial services (**AFS**) licensees and their representatives on how

[1] The material in this section contains edited excerpts from Government and ASIC media releases.

to comply with the fee disclosure statement (**FDS**) requirements under the Future of Financial Advice (**FOFA**) reforms.

Regulatory Guide 245 *Fee disclosure statements* (**RG 245**) outlines the requirements that will apply to AFS licensees and their representatives who receive ongoing fees from retail clients to whom they have given personal advice.

Under the FOFA reforms, advice providers receiving fees for giving personal advice under an ongoing arrangement with a retail client must provide the client with an annual FDS setting out information about:

- the fees paid by the client;
- the services provided to the client; and
- the services that the client was entitled to receive.

This obligation is designed to help clients determine whether the ongoing fees they are paying are proportionate to the services they have received, or they were entitled to receive.

RG 245 explains:

- the FDS obligations and when they apply;
- who must give an FDS;
- the circumstances giving rise to the obligation to give an FDS; and
- the information that must be disclosed in the FDS.

RG 245 also sets out three limited no-action positions ASIC is taking to assist industry make a smooth transition to meeting the FDS obligations within the FOFA regime.

Codes of conduct

ASIC has released an update to Regulatory Guide 183 *Approval of financial services sector codes of conduct* (**RG 183**) which details how ASIC will approve codes and use its relief powers.

Under the *Corporations Act 2001* (Cth), a financial adviser who enters into an ongoing fee arrangement with a retail client after 1 July 2013 must give that client a renewal notice every two years. If the client does not agree to continue the fee arrangement, or does not respond to the renewal notice, then the arrangement terminates. This is known as the 'opt-in requirement'.

As an alternative, ASIC may grant relief from compliance with the opt-in requirement if it is satisfied the adviser is bound by an approved code which 'obviates the need' for opt-in. The adviser has at least until 1 July 2015 to either comply with the opt-in requirement or have joined an ASIC-approved code.

The guidance:

- confirms ASIC will, for the purposes of FOFA codes only, accept an application for approval of a code with limited content;
- confirms ASIC will not accept an application for approval of a single entity FOFA code;
- includes a checklist of code content that 'obviates the need' for complying with the opt-in requirement; and
- introduces a requirement that an administrator of a FOFA code must maintain a public register of members.

ASIC's code content checklist requires a FOFA code applicant to address the scope and renewal of ongoing fee arrangements, what ongoing services are to be delivered to clients and appropriate record keeping.

Managed investment schemes

ASIC has issued two consultation papers in the last few months which both address issues arising from the recommendations of the Parliamentary Joint Committee, Corporations and Financial Services Inquiry into the collapse of Trio Capital.

New requirements for custodians and responsible entities holding scheme property

ASIC's Consultation Paper 197 (**CP 197**) *Holding scheme property and other assets* has proposed changes to Regulatory Guide 133 *Managed investments: Scheme property arrangements*.

The main proposals in CP 197 are as follows:

- ASIC wants to modify the *Corporations Act 2001* (Cth) by class order so that from 1 July 2014, asset holders must meet minimum standards for organisational structure, staff capabilities, capacity and resources and checks on clients.
- ASIC would expect and require that responsible entities have a documented process for selecting a custodian and that they should consider what ongoing checks will need to be made of the asset holders activities to ensure they are not facilitating unlawful activities.
- The agreement between a responsible entity and a custodian must include the following terms:
  - Under the terms of the client agreement, the asset holder and any master custodian (as applicable) must indemnify the client against any loss or damage that arise from a failure to comply with the client agreement or to meet prevailing standards of good practice for holding assets in the places in which the assets are held.

- If it is not possible for the responsible entity to obtain an indemnity on reasonable commercial terms for assets located outside Australia, then it must take all reasonable steps and negotiate the most favourable liability provisions and consider what additional protections it should reasonably have in place to manage the associated risks.
- The custodian agreement must oblige the custodian to have adequate arrangements to ensure that it will report to ASIC within 10 business days if it suspects the client may be in breach of its obligations to report significant breaches to ASIC.

- Also under consideration is a proposal that responsible entities should clearly describe the role of an asset holder in any PDS, FSG or other material available to retail clients to ensure that the clients are unlikely to be misled about the asset holder's role and minimise the possibility of giving retail clients unwarranted reassurance because of the custodian's appointment.
- There are also some proposals to extend the list of what is a 'special custody asset'. 'Special custody assets' are assets which a responsible entity may hold without meeting the relevant net tangible asset requirements.

The proposals, if adopted, are clearly going to add to custodial cost. The proposals seek to apply higher standards to custodians to perform a broader role and take a greater interest in the activities of the responsible entity or other entity for whom they are providing a custodial service.

Risk management systems of responsible entities

In further response to the collapse of Trio Capital, ASIC has recently issued Consultation Paper 204 *Risk management systems of responsible entities* (**CP 204**). This consultation paper follows ASIC's report on the adequacy of risk management systems of responsible entities in September 2012.

The consultation paper notes that ASIC seeks to standardise risk management systems, as its report found that APRA-regulated responsible entities (**REs**) in general have better risk management systems than non-APRA regulated bodies. ASIC also appears concerned that following the GFC, little has changed in terms of risk management systems for REs and it seeks, in line with international trends, to increase the obligations on REs to foster strong risk management procedures.

ASIC does seem to understand that a 'one size fits all' approach is not appropriate and what is necessary for a risk management system for a large RE will not be suitable for a smaller RE.

Some of the main requirements that are now proposed are:

- For REs to ensure that they still retain oversight of risk management when they delegate their risk management systems to either a single employee or an external service provider. Reading between the lines, ASIC will not excuse any breaches by an RE on the basis of this type of delegation.
- The slightly nebulous requirement for REs to 'foster a risk management culture'. This will mean that the risk management culture needs to be endorsed by management, and that unchecked risky behaviour should not be ignored. It might also mean splitting the roles of assessing risk and monitoring risk to avoid conflicts that may arise. REs need to keep staff informed of the RE's risk management systems and may need to have their staff undergo training on the systems as appropriate. The RE should also set out its risk appetite in writing and review this annually, as well as reviewing the risk management system generally in the same timeframe. If the RE is involved in perceived 'riskier' schemes such as unlisted property, mortgages, agribusiness or hedge funds, the RE should review their risk management system at least quarterly.
- Increased emphasis on monitoring compliance with risk management systems including having clear policies in place and amending those policies where the business of the RE changes.
- REs should also conduct stress testing for investment risk and liquidity risk and if the RE does not do so, it must document why it does not conduct such testing.

The changes will not apply to those REs that are already regulated by APRA. However the Consultation Paper notes that if the *Superannuation Legislation Amendment (Service Providers and other Governance Measures) Bill 2012* is passed, the changes will apply to APRA-regulated registrable superannuation entity licensees that manage non-superannuation registered managed investment schemes (dual-regulated entities).

Comments on the Consultation Paper will be received by ASIC up until 3 May 2013.

Once the changes are implemented by ASIC, we will have to wait and see whether tighter regulations on asset holders and REs will stop another Astarra/Trio-style fraud.

Financial advice

Legislative amendments relating to the use of the expressions 'financial planner' and 'financial adviser'

The Federal Government has introduced legislation into Parliament to define the terms 'financial adviser' and 'financial planner'.

Under the proposed laws, anyone who is not licensed to provide personal financial product advice on a broad range of financial products is not able to use the term 'financial planner' or 'financial adviser'. The use of those terms is now restricted in the same way the use of the term 'stockbroker' is restricted.

Replacement of the accountant's exemption

The Federal Government has announced that it will finalise the regulations to replace the accountants' licensing exemption with a limited Australian financial services (**AFS**) licence in April 2013, following industry feedback on draft regulations published in late 2012.

The limited AFS licence will enable holders to provide strategic advice to their clients. Licence holders will be able to provide advice on self-managed superannuation funds as the accountants' exemption currently provides for, plus licensees will be licensed to provide advice on "class of product advice" on basic deposit products, general and life insurance, securities and simple managed investment schemes. The new licence will be open to accountants and other financial practitioners.

The new regime will require licensees to provide advice in accordance with the consumer protection provisions of the *Corporations Act 2001* (Cth) including the best interests duty obligation enacted through the FOFA reforms.

A streamlined application process will apply from 1 July 2013 to 1 July 2016 to allow accountants to transition into the AFSL regime in recognition of their existing professional qualifications. Consideration will also be given to other professional organisations accessing the streamlined process.

Derivatives and CFD providers

ASIC has proposed draft rules addressing the mandatory trade reporting obligations for over-the-counter (**OTC**) derivatives such as interest rate swaps.

Consultation Paper 205 *Derivative transaction reporting* (**CP 205**) proposes rules governing the reporting of OTC derivative transactions to derivative trade repositories. CP 205 covers issues such as which institutions will need to report to trade repositories, what information will need to be reported, and when the reporting obligation will start for different classes of reporting entities.

The rules aim to comply with internationally-agreed standards on transaction reporting developed by the International Organization of Securities Commissions and the Committee on Payment and Settlement Systems.

ASIC has also considered the transaction reporting regimes being implemented in other parts of the world including the EU, US, Singapore, Hong Kong and Canada, aiming to ensure consistency by identifying and trying to mitigate any conflicting or overlapping rules across jurisdictions.

Under ASIC's proposals:

- major financial institutions (being those with at least $50 billion of notional outstanding positions in OTC derivatives on 30 September 2013) would be subject to a reporting obligation in some asset classes from 31 December 2013; and
- other smaller financial institutions would be subject to a reporting obligation in some asset classes from 30 June 2014.

CP 205 also proposes a reporting obligation on entities that do not hold an Australian financial services (AFS) licence using OTC derivatives from the end of 2014, but further public consultation and an ASIC rule change will be needed before this obligation could take effect, as set out in the draft rules which accompany CP 205.

Submissions to CP 205 are due by 1 May 2013.

MDA operators to meet new financial requirements

ASIC has issued Consultation Paper 200 *Managed discretionary accounts: Updates to RG 179* (**CP 200**) outlining proposed changes to the guidance and relief for managed discretionary accounts (**MDA**). No changes have been made to this guidance since 2004 and since then, ASIC considers that the sector has changed significantly. ASIC consulted with overseas regulatory bodies in the United States, the UK and Canada to ascertain whether ASIC's approach was in accordance with those foreign jurisdictions.

An MDA is likely to have the following features:

- The client gives the MDA operator the authority to make investment decisions on their behalf.
- The MDA is or should be personalised for the client.
- The client holds a direct or beneficial interest in the underlying assets of the MDA.

Given changes in the sector and the increase in popularity of MDAs (particularly in the SMSF sector), ASIC has proposed the following amendments:

- To revoke outstanding 'no action' letters under which ASIC would not take action where such action would be a breach but for the fact that the MDA was only operated for family members. However, an MDA can still be operated only for family members and is not subject to the same regulation.
- To increase requirements on MDA operators and custodial services, akin to requirements for responsible entities of managed investment schemes in relation to solvency, cash flow requirements and auditing. It is proposed that MDA operators would have to hold the greater of either $150,000 in net tangible assets (**NTA**), 0.5% of the average value of all of the portfolio assets of the MDAs operated up to $5 million NTA; or 10% of average operator revenue. Custodian services would need to hold $10m of NTA or 10% of average revenue.
- In relation to leveraged investments where losses may exceed the client's contribution such as contracts for difference, ASIC has proposed three possible alternatives: that the MDA operator either be required to issue risk warnings, to obtain the express consent of the client to enter into such transactions, or that there be a prohibition on MDA operators entering into such transactions for retail clients.
- Greater disclosure by MDA operators in relation to the type of investment strategy which must be updated annually, fees, outsourcing (if applicable) and the termination process for the MDA including how to terminate and how long that process will take.
- ASIC also proposes to provide additional guidance in relation to both conflicts of interest and the FOFA reforms as they pertain to MDA operators regarding the best interests duty, fee disclosure statements and the opt-in requirement (to give a client a written renewal notice every two years which requires the client to 'opt in' to renew that fee arrangement).

ASIC has indicated that the proposed changes (by way of class order) will commence at the end of 2013.

The proposed changes will not apply to wholesale clients. Submissions on CP 200 close on 19 April 2013.

Debenture issuers

ASIC has released Consultation Paper 199 *Debentures: Reform to strengthen regulation* (**CP 199**) which seeks to introduce minimum capital and liquidity requirements for retail debenture issuers.

The release of this consultation paper follows a number of high-profile collapses in the sector, including Banksia Securities Ltd (**Banksia**), the subsequent ASIC debenture taskforce and the Federal Government's December 2012 announcement about law reform for this sector.

After the collapse of Banksia, there was an admission by ASIC that they had reached the limits of their disclosure-led policy and that a new approach would be required. CP 199 contains the following proposed changes to the regulation of the retail debenture industry:

- Retail debenture issuers should meet mandatory capital and liquidity requirements where the money they borrow is used to:
  - provide finance; or
  - fund property lending, development and investments and these funds in aggregate are more than 10% of the issuer's total assets.
- Retail debenture issuers should be required to have a minimum capital ratio of 8% of their total risk weighted assets and that there should be a discretionary power for ASIC to raise or lower the 8% minimum capital threshold on a case-by-case basis. ASIC also proposes to include a risk rating to various assets that might appear on the balance sheet of a debenture issuer including that claims for the purpose of, or secured by, construction or property development would have a risk rating of 150%.
- ASIC proposes that retail debenture issuers should maintain 9% of liabilities in liquid assets.
- Significantly, ASIC are again turning to the trustees to provide greater levels of supervision over the debenture issuers by ensuring they comply with their capital and liquidity requirements, that they regularly assess the issuer's financial position, performance and viability, that they ensure the issuer's disclosure is correct and current and that they are given more powers to request information from their clients.
- ASIC also proposes that the law is amended so that debenture issuers must engage their directors to report directly to the trustee twice per year and answer any reasonable questions a trustee asks.
- ASIC also wants the prospectus exemption for rolling over debentures to be amended so that retail debenture issuing lenders are required to provide a prospectus when existing retail investors make further debenture investments or roll over their debenture investments.

Submissions on CP 199 closed on 28 March 2013. Special Counsel, Chris Mee, led Finsia's submission to ASIC on the proposals.

Taxation

Board of Taxation report into venture capital released

The Federal Government has released the Board of Taxation's Review of taxation arrangements under the venture capital limited partnerships regime.

Please refer to the article by George Hodson above for further details.

Investment Manager Regime—Element 3

The Federal Government has released an exposure draft of legislation to implement the third and final element of the Investment Manager Regime (**IMR**).

This follows the enactment of the first two elements of the IMR in 2012 in the T*ax Law Amendment (Investment Manager Regime) Act 2012*.

As recommended by the Johnson Report, the purpose of Element 3 of the IMR is to provide tax certainty to widely held foreign managed funds investing in Australia. It will do this by aligning the tax treatment of certain income or gains made on revenue account with the treatment of comparable returns or gains made on capital account. It will only apply to funds domiciled in countries that are recognised by Australia as engaging in effective exchange of information.

The exposure draft legislation also seeks to address a number of issues raised by industry in relation to the operation of the first two elements of the regime.

Consultation closes on Friday 26 April 2013.

For further information, please click here to contact our national Funds Management & Financial Services team.