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The International Comparative Legal Guide to:

Public Investment Funds 2019

2nd Edition

A practical cross-border insight into public investment funds

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EDITORIAL

Welcome to the second edition of *The International Comparative Legal Guide to: Public Investment Funds*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of public investment funds.

It is divided into two main sections:

Four general chapters. These chapters are designed to provide readers with an overview of key issues affecting public investment funds, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in public investment funds laws and regulations in 17 jurisdictions. All chapters are written by leading public investment funds lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editors Gregory S. Rowland and Sarah E. Kim of Davis Polk & Wardwell LLP for their invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.

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PREFACE

Davis Polk & Wardwell LLP is honoured to serve as Contributing Editor for the second edition of *The International Comparative Legal Guide to: Public Investment Funds*, and it is my pleasure to have been invited to write this preface.

Publicly offered investment funds are subject to regulatory frameworks that, depending on the jurisdiction, impose comprehensive restrictions on how a fund is operated. The regulatory framework in the U.S., for example, imposes strict requirements on, among other things, a public investment fund's corporate governance, capital structure, portfolio investments, affiliated transactions, reporting and recordkeeping. The degree of regulation and the specifics of the requirements in each jurisdiction vary significantly, which is why a guide such as this is essential.

The second edition provides broad overviews of the general regulatory framework for public investment funds in 17 jurisdictions, as well as four general chapters on topics of particular interest.

As the regulations in the financial services industry continue to evolve in response to new developments and obstacles in financial systems globally, it will be important for legal professionals and industry participants to have up-to-date resources such as this guide for practical insight relating to different jurisdictions.

We hope that you find this guide useful in your practice, and we look forward to future editions of the guide going forward.

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1 Registration

1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Funds that are offered to retail clients will generally be required to be registered as a managed investment Fund under the *Corporations Act 2001* (*Cth*) (**Corporations Act**).

Most Australian Funds are trust structures, but partnerships, limited partnerships and investment contracts are also used, as well as stapled structures with combinations of trust and company structure investments held by each investor.

These structures are generally regulated as managed investment schemes (**MIS**) under the *Corporations Act and Corporations Regulations and Australian Securities and Investments Commission Act 2001* (**ASIC Act**), which are administered by the Australian Securities and Investments Commission (**ASIC**). MIS regulation includes:

- structural and operational requirements under Chapter 5C;
- advertising, market conduct, offering and issuing disclosure requirements under Chapter 7 and the ASIC Act;
- continuous disclosure requirements (Chapters 6 to 6CA and 7) and, for MIS listed on an exchange, takeovers and substantial holding regulation (Chapters 6); and
- Australian financial service licence (**AFSL**) requirements and regulation of dealers, advisers, Fund operators and market operators (Chapter 7).

A Fund will be a MIS if it is a scheme where:

- people contribute money or money's worth to acquire rights to benefits produced by the Fund;
- any of the contributions are pooled or used in common enterprise to produce financial benefits or property rights or interests for Fund members (as contributors or their transferees or assigns); and
- members do not have day-to-day control of the Fund's operation (even if they have a right to be consulted or to give directions).

Exceptions apply for Funds: (a) where all members and the operator are related bodies corporate; or (b) that have structural forms that are otherwise regulated, including bodies corporate, debentures and convertible notes, outsize partnerships (generally, professional partnerships, such as partnerships of accountants or lawyers) and Funds operated by Australian Depository Institutions (**ADIs**) (banks and other financial institutions) in the ordinary course of their banking business. ASIC also has power to grant exemptions or to modify the way that the MIS regulation applies.

If a Fund is a MIS then, unless all of the issues of interests in the Fund would not have needed a regulated product disclosure statement (**PDS**) under the Corporations Act (which is the case principally where the offers and issues are only to wholesale clients, not retail clients: see question 3.1 below), the Fund must be registered if: (a) it has more than 20 members (and when counting members there is: (i) a look through to the underlying members of trust investors where any beneficiaries of the investor trust are presently entitled to a share of the trust estate or income, or control the trustee; and (ii) aggregation across Funds as noted in (c) below); (b) it was promoted by a person or an associate of a person who, when the Fund was promoted was in the business of promoting MIS; or (c) ASIC has made a determination that the Fund is one of a group of closely related Funds that together have more than 20 members.

New regulation is proposed which would facilitate the use of corporate collective investment vehicles as an alternative to the current MIS and operate in a similar way to the regulation of MIS.

1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

To register a Fund, it must have:

(a) a public company responsible entity (**RE**) that is the sole operator of the Fund and an AFSL that authorises it to operate the Fund;

(b) unless at least 50% of the RE's board are external directors, a Fund Compliance Committee with at least 50% external members.

A director of the RE or member of a Compliance Committee is not external if that person is, or within the last two years has been, a senior manager or an employee of, substantially involved in a professional capacity or business dealings with, or has or is a relative or spouse of a person with a material interest in, the RE or a related body corporate;

(c) a name that is not the same as any other registered MIS;

(d) a Constitution that meets the requirements under the Corporations Act.

The Constitution must be enforceable and must contain "adequate provision" for specific matters, including:

- the consideration that is to be paid for any interest in the Fund;
- the Fund's investment and borrowing powers;

- if Fund members are to be able to withdraw from the Fund, the members' rights to withdraw. For illiquid Funds (those where at least 80% of the assets are not liquid – for instance, money, bank bills and marketable securities) a withdrawal procedure must be followed, as set out in the Corporations Act;
- the procedures the Fund's RE will have for handling complaints;
- winding up the Fund; and
- the RE's fees and indemnity payable out of the Fund property;

(e) a Compliance Plan that meets the requirements under the Corporations Act.

The Compliance Plan must set out what the RE will do to ensure that it complies with the Corporations Act and the Fund Constitution. Minimum requirements for the Compliance Plan include:

- ensuring Fund assets are separately identified and held;
- arrangements for a compliance committee, if one is needed (membership, when it meets, reports and recommendations to the RE, access to records and access to the Fund auditor);
- how often Fund property is valued;
- auditing the Plan; and
- record-keeping.

A registered company auditor must audit the RE's compliance with the Compliance Plan at least once a year. The Plan auditor and Fund auditor may not be the same person.

ASIC has power to require the RE to change and extend the Fund Compliance Plan and to call for information about the Plan.

Depending on its capital for the purposes of its AFSL requirements, the RE might also appoint a custodian to hold Fund property (see question 2.1, point (iii) below).

An application for registration of a Fund is to be made to ASIC by the RE in a prescribed form. The application is required to be lodged with: (a) a statement of compliance made by the directors of the RE; (b) the Fund's Constitution; and (c) the Fund's Compliance Plan. A Fund auditor and Compliance Plan auditor must be appointed and notified to ASIC.

ASIC must register the Fund within 14 days of the application being made, unless it appears to ASIC that the RE or lodged documents do not comply with the requirements of the Corporations Act.

1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

A Fund must not be operated if it is not registered when required. An application can be made by ASIC or an investor in the Fund to have it wound up if it has not been registered when required, and an investor may void their investment contract.

1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

A registered Fund must be operated only by its RE.

As the RE must be a public company, it must have at least three directors and at least two of those directors must ordinarily reside in Australia.

If an offshore entity engages in Fund offerings in Australia, then the foreign operator may be conducting business in Australia. If that is the case, then it must be registered as a foreign company under the Corporations Act and a local agent must be appointed.

Certain concessional exemptions from AFSL, Fund registration and disclosure requirements apply for offering UK, US, Hong Kong, Singapore, NZ or Jersey Funds in Australia where the operator is registered as a foreign company in Australia, and makes certain required disclosures to investors and to ASIC.

The Asia Region Funds Passport provides a multilateral framework between participating countries in the Asian region to facilitate the cross-border marketing of passport Funds across participating regions. As at 1 March 2019, Japan, Thailand and Australia are ready to receive registration applications from local prospective passport Funds and entry applications from foreign passport Funds.

In order to register as a foreign passport Fund in Australia, the operator of the foreign passport Fund must:

1. register the Fund in its home economy;
2. register itself as a foreign company in Australia; and
3. notify ASIC of its intention to offer the foreign passport Fund in Australia.

Notification is made by submitting an ASIC form 5303 "Notify intention to offer interests in a foreign Passport Fund in Australia", attach a copy of the PDS and any consents required to use the proposed name.

2 Regulatory Framework

2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

i. Governance

Registered MIS are subject to a high degree of regulation for which ASIC is the regulatory authority and issues various regulatory guides.

As noted in section 1 above, a registered Fund must have a complying Constitution, a complying Compliance Plan, a public company operator RE, auditors of the Fund and Compliance Plan and, if at least 50% of the RE board are not external, a Fund Compliance Committee.

The Fund Constitution sets out the rules governing the operation of the Fund with which the RE must comply, and the Constitution must at least contain adequate provisions about particular matters as noted in section 1 above.

The Corporations Act regulates various actions in relation to the registered Fund, including amendment of the Fund Constitution, removal and replacement of the RE, meetings of Fund members, annual and half-year Fund accounts, winding the Fund up, withdrawal by members from the Fund and ongoing reporting and disclosure.

The Compliance Plan for the Fund must specify adequate measures that the RE is to apply to ensure that the Fund is operated in accordance with its Constitution and the Corporations Act.

The RE in exercising its powers and carrying out its duties from whatever source has several duties under the Corporations Act, including:

(a) general obligations to act honestly; exercise the degree of care and skill that a reasonable person would exercise if they were in the RE's position; act in the best interests of the members, and give priority to the members' interests if there

is a conflict between the members' interests and the interests of the RE; treat members holding interests of the same class equally and those with different classes of interests fairly; and not to make use of information acquired by being the RE to gain an improper advantage for themselves or someone else or to cause detriment to the members;

(b) compliance obligations to ensure that the Fund Constitution and Compliance Plan meet the requirements of the Corporations Act; carry out its duties under the Fund Constitution; and comply with the Compliance Plan;

(c) obligations to separate, regularly value and preserve Fund property; and

(d) reporting breaches to the ASIC which had or are likely to have a materially adverse effect on the interests of Fund members. The reporting obligation also relates to breaches by the Compliance Committee, directors or employees of the RE, any auditor of the Compliance Plan or advisor and their representatives.

The RE can appoint agents and others but it is responsible to the Fund members for the appointees' acts, even if those acts are outside the scope of the appointee's authority.

The directors of the RE also have duties to the Fund members that override any conflicting duties to the members of the RE company. The directors must: act honestly; exercise the degree of care and skill that a reasonable person would exercise if they were in the officer's position; act in the best interests of the members, and give priority to the members' interests if there is a conflict between the members' interests and the interests of the RE; not make improper use of information or their position or to cause detriment to the members; and take all reasonable steps to ensure the RE complies with the Corporations Act, its licence conditions, the Fund Constitution and Compliance Plan.

If a director breaches these obligations, civil penalties apply so that the Court may order that the employee pay compensation where the contravention caused loss or damage to, or diminution in value of, the Fund property.

Employees of the RE have similar duties.

The Compliance Committee is appointed by the RE and is to monitor the extent of compliance by the RE with the Fund Compliance Plan, report to the RE about breaches of the Corporations Act or Fund Constitution, and report to ASIC if the Committee is of the view that the RE is not taking appropriate action to deal with any matter that the Committee has reported. The Committee must also assess the adequacy of the Compliance Plan at regular intervals and report to the RE any changes that the Committee considers should be made. Requested changes must also be reported to ASIC where they amount to a breach of the Corporations Act. The Committee has the authority to commission independent legal, accounting and professional advice or assistance at the reasonable expense of the RE and must also assist ASIC where ASIC conducts surveillance checks of the RE's compliance with the Constitution, the Compliance Plan and the Corporations Act.

A Compliance Plan auditor must be appointed by the RE. The auditor conducts an annual audit of compliance with the Compliance Plan, and provides a report to the RE (which the RE lodges with ASIC with its annual financial statements) and, in circumstances of continuing non-compliance, to ASIC.

Further authorisation or registration requirements may apply to certain types of Funds. For example, conditions apply under an RE's AFSL where the RE operates a primary production scheme. A Fund structured as a limited partnership must also be registered under the relevant State Partnership legislation. Moreover, Funds listed on the Australian Securities Exchange (**ASX**) must comply with the ASX Listing Rules and are under the regulation of the ASX as well as ASIC.

ii. Selection of investment adviser, and review and approval of investment advisory agreement

There are no specified requirements for the selection of Fund investment advisers; however, general duties of the RE (see question 2.1(i) above) affect the selection, review and approval of investment advisers, and particular types of Funds (for instance, superannuation Funds and certain government Funds) have particular requirements for the appointment of advisers.

iii. Capital structure

There are no capital structure requirements for a Fund. However, the RE operating the Fund must meet the capital requirements of its AFSL. AFSL conditions generally require the RE to be solvent with positive net assets, project and meet at least 12 months' cash-flow requirements for Fund operation, have professional indemnity insurance and maintain a required level of net tangible assets (**NTA**). The required NTA where Fund assets are held by a custodian that meets the financial requirements is cash or cash equivalents valued at least the greater of: (a) A$150,000; (b) 0.5% of the average Funds value; or (c) 10% of average RE revenue. The required NTA where Fund assets are not held by a custodian that meets the financial requirements is at least the greater of: (a) A$10 million; or (b) 10% of the RE's average revenue.

iv. Limits on portfolio investments

There are no limits on Fund portfolio investments, but the holding must be permitted by the Fund's Constitution. It is typical to include broad investment powers in the Constitution.

It should be noted that certain investors may have restrictions on investment in Funds with derivative or leverage exposure, and the nature of Fund investments can affect whether the Fund is categorised as "liquid" under the Corporations Act. If a registered Fund is not liquid then: (a) investor withdrawal from the Fund is restricted to *ad hoc* withdrawal offers from identified Fund sources; and (b) it is not a "simple managed investment scheme" and therefore a short-form PDS may not be used for Fund offers.

v. Conflicts of interest

The RE has a duty to act in the best interests of the Fund members and not its own interest (see question 2.1, point (i) above).

Strict restrictions apply to related party dealings by a registered Fund RE. Any related party dealing either from or which may endanger Fund property is not permitted unless it is at arm's length or less favourable (to the related party) terms or has the prior approval, in a meeting, of the Fund investors. In addition, under general law, a related party dealing is not permitted unless it is clearly authorised by the Fund Constitution.

Advisers are subject to a duty to act in the best interest of their client and limits on conflicted remuneration (see question 2.3 below).

Market conduct restrictions such as short-selling restrictions, insider trading and market manipulation prohibitions also affect the operations of the Fund RE and managers.

vi. Reporting and recordkeeping

In addition to the offer disclosure requirements referred to in section 3 below, ongoing and periodic reporting obligations apply for registered Funds.

The RE of a registered Fund must:

(a) give an investor confirmation of transactions about their investing and withdrawals, and a balance, value and transaction report for each reporting period (of up to one year);

(b) inform members or publish a notice of any material change or significant event in relation to the Fund, and comply with the continuous disclosure obligations where the Fund is a "disclosing entity" (generally, where there are at least 100 members or the Fund is listed); and

(c) file reports with ASIC in respect of the Fund, including: reports of significant breaches; annual audit reports for the Fund, the RE, the RE's AFSL and the Fund Compliance Plan; notice of any change of officers and "responsible managers" and "key persons", if any, noted on the RE's AFSL; an "in use" and "out of use" notice in relation to a PDS (as noted in section 3 below); and any other information requested by ASIC.

REs must also file certain reports with AUSTRAC/ATO for the purpose of anti-money laundering and counter terrorism, including suspicious matter reports.

vii. Other

Privacy, anti-money laundering and taxation (including income and capital gains tax, goods and services tax (**GST**) and stamp duty) legislation apply.

In addition to legislation and general law, listed Funds must comply with the Listing Rules. General trust law is particularly relevant for registered Funds as the Corporations Act provides that Fund property is held on trust for the Fund members and therefore registered Funds always involve at least a statutory trust.

2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Anyone who carries on a financial services business in Australia is usually required to hold an AFSL that is issued by ASIC under the Corporations Act.

A "financial services business" is a business of any of the following in relation to financial products:

(a) dealing – issuing, applying for, acquiring, varying or disposing of a financial product or arranging for such conduct. Self-dealing exceptions apply for some types of products;

(b) providing financial product advice – making a recommendation or statement of opinion or a report that is, or could reasonably be regarded as, intended to influence a person's decision about a financial product. Providing purely factual information is not advice. Advice is separated into general advice and personal advice. Personal advice is given when the recipient's objectives, financial situation or needs have been taken into account or a reasonable person might expect that to have been the case. All other advice is general advice. If personal advice is given to retail clients, then advisers must meet additional requirements;

(c) making a market – through a facility or at a place or otherwise, the person regularly states prices at which they propose to acquire or dispose of products on their own behalf and a person has a reasonable expectation that they will be able to regularly effect transactions at the stated prices. This is distinguished from operating a market (for which an authority is required) by the person accepting on their own behalf or on behalf of only one party to the transaction;

(d) operating a registered MIS; or

(e) providing a custodial or depositary service – an arrangement under which a product is held in trust for or on behalf of the client or the client's nominee.

Various exceptions from the requirement to hold an AFSL apply. For instance, conditional exemptions apply to some advisers and dealers (referred to as foreign financial service providers or FFSPs) with certain UK, US, Singapore, Hong Kong, German or Luxembourg local licences where their activities in Australia are confined to wholesale clients and they lodge various complying documents with ASIC and meet ongoing disclosure requirements both to their Australian wholesale clients and to ASIC. However, these exceptions have been under review and are due to expire in their current form, possibly as early as September 2019. It is unclear whether, or in what form, they may continue. It is possible that the current exemption will be replaced with a requirement for the FFSP to apply for a limited AFSL.

To obtain a regular AFSL, the proposed holder must meet capital adequacy, operational, education and experience requirements. An application must be made to ASIC, nominating responsible managers with required education and practical skills. The application must be lodged with a police check and bankruptcy check for nominated responsible managers and various proofs that establish the operational competencies of the applicant to provide the financial services sought to be authorised.

If an AFSL is granted, the holder has obligations, under the Corporations Act, requiring them to: operate their business efficiently, honestly and fairly; maintain the organisational competence; ensure their representatives comply, are competent and adequately trained; have adequate financial, technological and human resources to provide the financial services; maintain risk, conflict management, dispute resolution and compensation systems and arrangements for retail clients; and comply with the financial services laws and their AFSL.

2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

In addition to the restrictions associated with an AFSL holder's licence, restrictions apply to the conduct of advisers in marketing Funds as mentioned in section 3 below.

2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

There are no statutory or regulatory requirements or restrictions for Funds to invest in digital currencies.

3 Marketing of Public Funds

3.1 What regulatory frameworks apply to the marketing of public funds?

Marketing materials for Funds are regulated by the Corporations Act and the ASIC Act. In addition, requirements and restrictions under general law may also apply.

A PDS is required to be given to a retail client before they can be offered or issued an interest in a Fund that is a financial product, such as a MIS interest.

An investor is a retail client if they are not a wholesale client. Whether an investor is a wholesale client for this purpose depends on the amount that they invest in the Fund, the amount of money that the investor controls or the type of investor body. For instance, an entity is a wholesale client, and therefore not a retail client, if:

(a) the price or value of the Fund interests to be acquired is at least A$500,000 (excluding amounts borrowed from the Fund offeror or the offeror's associate);

(b) the Fund investment is provided for use in conjunction with a business that is not a small business (less than 100 employees for a goods manufacturing business, and otherwise, 20 employees);

(c) the investor provides a qualified accountant's certificate given within the preceding 24 months that the person had net assets of at least A$2.5 million or gross income for each of the last two years of at least A$250,000;

(d) the investor holds an AFSL, is a body regulated by the Australian Prudential Regulation Authority (**APRA**) (for instance, a bank), is registered under the Financial Corporations Act, is an exempt public authority or is a listed entity or one of the listed entity's related bodies corporate;

(e) the investor controls A$10 million or more or is the trustee of certain superannuation Funds where the Fund has net assets of at least A$10 million; or

(f) the investor is a body that carries on the business of investing in financial products, interests in land or other investments, and invests Funds raised from the public on terms which provide for use of the Funds raised for that purpose.

A PDS must be up to date and "clear, concise and effective" and must contain prescribed statements and disclose the following about the Fund: significant benefits and risks; costs, fees and charges; details about dispute resolution; significant taxation implications; details of payments that may affect returns; in some cases, information about the availability of accounts; and whether ethical considerations are taken into account in investing.

Elements of these requirements contain prescriptive details of the information to be disclosed and how it is to be disclosed.

A short-form PDS may be used if the Fund is both, a "simple managed investment scheme", i.e. one where the RE can reasonably expect to realise 80% of the Fund assets for market value within 10 days – and not classified as a hedge Fund in accordance with ASIC regulatory Guide 240 (or otherwise subject to particular benchmark disclosure by ASIC). A short-form PDS for a simple MIS must be no longer than eight pages and contain specified information about the RE, how the Fund works, benefits and risks, the Fund investments, fees and costs, tax and how to apply.

The application form for investment must be in, or accompany, the PDS.

A PDS is only lodged with ASIC if the Fund interests are to be tradeable on a financial market (such as the ASX). Otherwise, ASIC must be given an "in use" notice in a prescribed form within five business days after a PDS is first given and an "out of use" notice within five business days after the PDS ceases to be used.

For PDSs that are lodged with ASIC, there is an exposure period (of seven days after lodgement, subject to an extension by ASIC of up to 14 days) during which investments cannot be issued or sold.

In addition to the regulated disclosure document requirements referred to above, all financial products are subject to prohibitions under the Corporations Act, ASIC Act and general law against dishonest, misleading, deceptive and unconscionable conduct.

3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

An AFSL is generally required to be held by an entity that engages in marketing of Fund interests and thereby provides financial advice or deals in the financial product (see question 2.2 above). There are numerous exceptions to licensing requirements for particular circumstances – for instance, where advice is only provided to a related body or for certain offshore licensees who lodge various deeds and documents with ASIC and whose Australian clients are all wholesale clients, or where a Fund issues interests under an arrangement with an AFSL holding intermediary which offers to arrange for the issue on the terms of the offers.

A person providing services on behalf of an AFSL holder does not need their own AFSL, but must be appointed in writing as an authorised representative by the AFSL holder and the appointment notified to ASIC.

AFSL holders must comply with the financial and other conditions under their AFSL and general conduct conditions in the Corporations Act (see question 2.2 above).

3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

i. Distribution fees or other charges

Investment advisers may not be given or receive certain types of conflicted remuneration for retail client investments. Conflicted remuneration is any benefit, whether monetary or non-monetary, that, because of the nature of the benefit or the circumstances in which it is given: (a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or (b) could reasonably be expected to influence the financial product advice given to retail clients.

ii. Advertising

Advertising restrictions apply so the potential investors are aware of the Fund PDS and that they should consider the PDS before deciding whether to invest. Cold calling and anti-hawking restrictions regulate the way in which advertising and PDS material can be distributed.

Further, there are limited circumstances in which a Fund that needs to be registered as a MIS can be referred to prior to such registration.

iii. Investor suitability

There are currently no prescriptive investor suitability requirements for types of Funds that may be offered. However, care must be taken to ensure that there is no unconscionable or misleading or deceptive conduct in marketing Funds and that disclosure is clear, concise and effective for investors.

There is currently draft legislation being considered by the Australian government to introduce new rules that apply to the design and distribution of certain financial products: *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (**DDO and PIP Proposals**).

Under the DDO and PIP Proposals, product issuers (or sellers) would be required to prepare a written "target market determination" that, among other things, describes the class of retail clients that comprises the target market for the product (the target market) and specifies any conditions and restrictions on retail product distribution conduct. The DDO and PIP Proposals also gives ASIC new powers to ban certain products being marketed to retail clients.

iv. Custody of investor funds or securities

A custodian separate to the Fund RE is not required, but because capital adequacy requirements apply under the RE's AFSL if it holds certain Fund assets, it is usual to appoint a custodian of registered Fund assets (see question 2.1, point (iii) above).

3.4 Are there restrictions on to whom public funds may be marketed or sold?

Unregistered Funds may not be marketed to retail clients. They can only be marketed or sold to wholesale clients. Otherwise, there are currently no restrictions on to whom a Fund may be marketed or sold. The DDO and PIP Proposals (noted above at question 3.3, point (iii)) would impose additional requirements and restrictions on Funds being marketed to retail clients.

Care must also be taken to ensure that there is no unconscionable or misleading or deceptive conduct in marketing Funds and that disclosure is clear, concise and effective for investors.

Advisers providing personal advice must take care to ensure that the selection of the Fund for investment takes into account the financial circumstances, needs and objectives of the client and whether a Fund could meet those circumstances, needs and objectives.

3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

ASIC imposes requirements in respect of some Funds through conditions in the RE's AFSL. For instance, conditions are imposed pertaining to registration of real property interests that form the basis of primary production schemes.

4 Tax Treatment

4.1 What are the types of entities that can be public funds in your jurisdiction?

As mentioned in section 1 above, in Australia, most retail Funds are trusts. Trusts are defined as entities for tax purposes but are generally established and managed so that tax is paid by the investors, not the trust. This requires care in drafting the Fund Constitution and in managing the Fund accounts and distributions.

4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

Fund

Unit trusts are generally taxable on a flow-through basis, provided that the trustee (i.e. RE) distributes all trust income for each tax year. This treatment is not available if the RE carries on active business activities such that the trust is a trading trust as defined in the taxation legislation. Trading trusts are taxed as companies and taxed at the trading trust level.

Trusts whose activities constitute an "eligible investment business" are not trading trusts and may be taxed on a flow-through basis with the investors paying the tax. Activities such as investing in land for the purpose of deriving rent and investing or trading in various debt and equity securities and derivatives are generally considered to be eligible investment business.

Unlisted trusts which have less than 50 members are generally not considered to be public trusts and may be taxed on a flow-through basis even though they carry on a business other than an eligible investment business. The legislation also looks to the type of member so, for example, a trust in which one or more of certain types of tax-exempt entities hold more than 20% of the units would not pass this test, even if it had less than 50 members.

In some cases, securities in different entities are stapled; for example, with one entity carrying on an eligible investment business, such as holding land and leasing it to the other entity which carries on an active trading business (such as managing a toll road or a hotel). The entity carrying on the active business will be taxed as a company, either because it is a public trading trust or because it is a company. It is necessary to ensure an adequate split of profit between the entities, and in many cases, a tax ruling is obtained to confirm that the arrangements are acceptable to the Commissioner of Taxation. In March 2017, the Commonwealth Treasury released a consultation paper as part of its current review of the taxation treatment of stapled structures. Legislation was introduced on 20 September 2018 to deal with a number of issues relating to foreign investors including investors in MITs. It is proposed to tax certain MIT distributions at 30% where the underlying income is non-concessional MIT income as defined. This would include income received from a cross-stapled entity to the extent it includes trading income of that entity. The legislation is intended to be effective from 1 July 2019. However, it is subject to grandfathering provisions designed to extend the effective date for investments acquired before 27 March 2018 to 1 July 2026 (or later in some cases).

If the trust qualifies as a Managed Investment Trust (**MIT**), it may be able to make a capital account election and have its gains and losses treated on capital account.

MIT status requires satisfaction of a number of conditions, including conditions relating to the Australian residence of the trust and management of the trust's activities, its status under the Corporations Act provisions dealing with MIS and the spread of ownership of direct and indirect interests in the trust.

Certain MITs may elect to be treated as "Attribution MITs" or "AMITs" for Australian income tax purposes and if so, a separate taxation regime will apply. Under this regime (known as the **AMIT regime**), receipts and the character of those receipts are attributed to the members of the MIT and thereby aligning the commercial and tax consequences of the activities of the MIT and providing flow-through of income and tax offset amounts with particular characteristics to the members of the MIT.

Australia has an Investment Manager regime which seeks to ensure foreign Funds and their members are not disadvantaged by engaging Australian-based service providers and managers. Under these provisions, certain returns, gains, losses and deductions of widely held foreign Funds are disregarded where: (a) the returns or gains would otherwise be assessable income of the Fund only because they are attributable to a permanent establishment in Australia; and (b) that permanent establishment arises solely from the use of an Australian-based agent, manager or service provider. The main types of gains covered by these rules are Australian-sourced capital gains (other than gains related to interests in land and other limited cases) and foreign-sourced income and gains. There are proposals to extend this concession.

The Commonwealth Government has recently released exposure draft legislation as part of a consultation process for the introduction of two new collective investment vehicles (**CIV**) which are intended to be more internationally recognisable to foreign investors. These vehicles are: (1) a company (or corporate collective investment vehicle (**CCIV**)); and (2) a limited partnership, which in both instances meet certain legal and regulatory requirements.

The taxation treatment proposed for CIVs and CCIVs will broadly align with the AMIT regime which is a "character-flow through" model of taxation. Further exposure draft CCIV legislation was introduced on 17 January 2019 and consultations continued until 28 February 2019.

Australia has various systems of accruals rules. The Taxation of Financial Arrangements (**TOFA**) regime is mandatory for financial arrangements where the value of trust assets exceeds A$100 million. In addition, an election may be made for these rules to apply where the assets are valued at less than A$100 million. Transactions which are not covered by the TOFA regime may be taxed on an accruals basis where they have an eligible return; for example, a zero coupon bond where the income is deferred until the repayment date. Also, accruals rules may apply to some foreign investments made by Funds.

Goods and Services Tax

There are rules concerning the treatment of financial supplies which mean that Funds cannot fully recoup GST paid in relation to some financial supplies. Under regulations which commenced on 1 July 2012, trusts making financial supplies will receive reduced input tax credits (**RITC**) of 55%; in the case of supplies and in certain specified cases (for example, custodial services), an RITC of 75% of the GST paid.

Position of Resident Investors

The taxable income of the Fund is usually taxed to the investors in proportion to the distributions they receive. If the Fund has deductions or allowances that reduce its taxable income below its accounting income, then in some cases the amount distributed may exceed the amount of taxable income. This excess is commonly called a "tax-free" or "tax-deferred" distribution. Any such distribution will reduce the cost base of the units in the unit trust in the hands of the investors for capital gains tax purposes. Once the cost base in their units reaches zero, further tax-free distributions are taxed as capital gains in the hands of the investor.

It is also possible that the amount of taxable income attributable to an investor will exceed the actual cash distribution, although Funds usually seek to avoid this outcome.

Capital gains made by the trust may be passed through to investors and will retain that character in the hands of the investor and (if the trust has held the relevant asset for at least 12 months) may be eligible for discount capital gains tax treatment, depending on the type of entity the investor is (i.e. a 50% capital gains tax discount applies to an investor who is an individual, while a discount of 33.33% applies to a complying superannuation entity). The capital gains tax discount applies only to residents.

Resident investors are usually taxable on capital gains and capital losses made on disposal of their units. Such capital gains usually qualify for discount capital gains treatment for the units held by a natural person, superannuation Fund or trust for a period of 12 months or more.

Position of Non-Resident Investors

If the Fund qualifies as an MIT, non-resident investors will generally be taxed on distributions to them by way of a final withholding tax of 15%, provided they are resident in a country with a tax information exchange agreement with Australia. Distributions of non-concessional MIT income attract 30% withholding. Non-concessional MIT income includes income from residential property, from trading businesses, from agriculture and from cross-stapled entities.

Distributions of interest, royalties and dividends will be not be taxed at 15% but at their normal withholding rates – 10% in the case of interest and 0% in the case of franked dividends. If dividends are not franked under the dividend imputation rules, then normal dividend withholding tax rates will apply. These rates vary from 0% to 30% depending on the terms of any applicable treaty. Royalties are generally taxed at between 10% and 30%.

The tax position of gains and losses made by non-resident investors on disposal of their units varies depending on the nature of their investment.

If the non-resident investor holds their units on capital account, they are generally not taxed. However, if the Fund is land-rich (i.e. real property, including mining leases, exceeds 50% of the value of the Fund) and the investor holds more than 10% of the Fund, then they may be subject to Australian capital gains tax on any gains made on disposal of their units. Also, units held by a non-resident investor that are used in carrying on a business through a permanent establishment of the investor in Australia will be subject to capital gains tax on any gain made on their disposal.

Investments on revenue account, for example, investments made by a Fund for the purposes of short-term gain or as part of business activities, will be taxable in Australia, but subject to the operation of relevant tax treaties.

4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

See question 4.2 above regarding MITs, AMITs and CIVs (subject to them being legislated).

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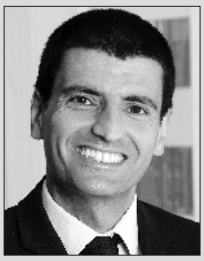

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Andy's recent experience includes representing and advising large public and private corporate groups, SMEs, family offices and high-wealth individuals, in a range of business sectors and investments.

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