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ASX SUBMISSION TO REVIEW OF THE REGULATORY FRAMEWORK FOR MANAGED INVESTMENT SCHEMES – CONSULTATION PAPER

ASX appreciates the opportunity to provide input into Treasury’s review of the regulatory framework for managed investment schemes (MIS). Treasury’s regular review of the regulatory frameworks underpinning our financial system is an important tool in ensuring that the policy settings remain appropriate and fit for purpose, particularly as new types of products and risks emerge.

1. ASX’s interest in MIS regulation

ASX interacts with the regulatory framework for MIS predominately through facilitating the trading of interests in those schemes (units) on secondary markets operated by ASX.

The regulatory framework for MIS is a foundation upon which ASX’s rules, monitoring and compliance frameworks are built. Compliance with core legislative requirements is an inherent part of the framework applied by ASX when determining if products are appropriate for listing on its markets. For completeness, and in addition to the regulatory framework for MIS, ASIC has provided express regulatory guidance to Australian market operators in relation to its expectations regarding the admission of products to trading on licensed Australian exchanges.¹ This results in close interaction between the regulatory framework established under the Corporations Act and related regulations, legislative instruments and regulatory guidance, and ASX’s rules framework and procedures for admitting, trading and monitoring units in exchange traded products (ETPs).

ASX supports regulatory settings that promote market stability and improves confidence in Australian financial markets. This includes appropriate safeguards for investors, particularly those designed to protect retail investors. As many products offered on ASX markets are targeted primarily at retail investors, ASX seeks to ensure that its product offering is supported by a clear and consistent rule framework that safeguards the interests of investors, while at the same time providing issuers with flexibility to innovate.

Licensed exchanges are viewed by many, including ASIC, as a gatekeeper for the markets that they operate. Consequently, ASX has a keen interest in ensuring that appropriate safeguards are in place, particularly light of the increased retail investor participation in ETPs observed over the last decade.²

¹ See for example ASIC Information Sheet 230 *Exchange traded products: Admission Guidelines*.

² ASX’s 2023 Australian Investor Study identified that:

- > there has been a 13 per cent increase in investors in Australia since 2020, with 51 per cent of the adult population or 10.2 million Australians now holding assets or financial products other than their primary residence or non-SMSF superannuation;
- > Up to 20 per cent of investors are investing in exchange traded funds (ETFs), as one of the most affordable ways to enter the investment market and diversify holdings and a common choice for new investors (14 per cent of on-exchange investors selecting them as their first investment); and
- > ASX’s survey revealed that investors who start with ETFs tend to be younger (a median age of 28), and start with smaller portfolios (a median of \$46,500).

2. ASX's response to Treasury's consultation

ASX has not observed any deficiencies in the current regulatory framework for MIS, and as such this submission seeks to provide context to policymakers about the regulation of listed MIS from ASX's perspective when considering potential changes to the broader regulatory framework for MIS.

ASX welcomes the opportunity to provide further commentary on proposals for change as they are developed, or to provide additional information on the issues raised in this submission.

2.1. Background

A number of types of MIS have their units either listed or quoted on ASX operated markets, including exchange traded funds (ETFs), exchange traded managed funds (ETMFs), real estate investment trusts (REITs) and listed investment trusts (LITs). Where units in a scheme are admitted to trading on an ASX operated market, the operator (usually the responsible entity) must comply with applicable listing and operating rules.

As noted in the consultation paper, the total value of assets held by registered schemes is about \$1.8 trillion and there were 420 responsible entities operating 3656 registered schemes at the end of June 2022. For context, as at August 2023, there was approximately \$297 billion held in 346 various types of MIS admitted to trading on ASX markets.

Open-ended ETPs admitted to the AQUA Market

Open-ended MIS, such as ETFs, ETMFs and structured products are traded on the AQUA market. The AQUA market is a specialised market operated by ASX Limited for MIS where the underlying assets of these products comprise assets that have sufficient transparency to enable appropriate pricing during trading on ASX. Issuers of these types of MIS can create new units in the fund, meaning supply is not limited. These types of managed investment schemes have substantially continuous and uncapped facilities for issues and withdrawals, which are intended to ensure arbitrage opportunities to limit divergence between the market price and a price based on net asset value. AQUA Products are generally referred to as exchange traded products (ETPs).

Schemes with units quoted on the AQUA market and their issuers are subject to the AQUA Rules, which are contained in Schedule 10A to the ASX Operating Rules. The AQUA Rules cover a range of matters, including rules around the admission of products on ASX, product and issuer disclosure and liquidity.

As noted above, ASIC has described ASX's role in regard to exchange traded products as a 'gatekeeper', stating that licensed exchanges have responsibility to set and monitor continuing compliance with admission requirements for ETP issuers to ensure, to the extent that it is reasonably practicable to do so, their ETP market is fair, orderly and transparent.

The AQUA Rules rely on the MIS registration requirements and related regulatory framework to evaluate whether or not that a financial product or its issuer is acceptable for admission or approval to the AQUA market, including:

- > Under the current AQUA Rules,³ only interests in an ETF (ETF Securities), Managed Fund (Managed fund Products) or Structured Products are eligible for admission to the AQUA market.⁴ In the case of ETF Securities and Managed Fund Products, the relevant fund vehicle must be registered as a MIS with ASIC under Chapter 5C of the Corporations Act, unless a particular exception applies.⁵
- > An AQUA Product Issuer must hold all relevant AFS licence authorisations required under Chapter 7 of the Corporations Act for the purpose of the conduct of their business as an AQUA product issuer⁶ – this will generally include an authorisation to operate the relevant registered MIS scheme (or type of registered MIS), and comply with corresponding licence obligations.

³ ASX notes for completeness that it is currently consulting in relation to proposed rule amendments that would reclassify ETMFs as ETFs in response to updated regulatory guidance.

⁴ Refer to the definitions of AQUA Product, ETF, ETF Security, Managed Fund and Managed Fund Product in ASX Operating Rule [7100] and AQUA Rule 10A.3.

⁵ The scheme must either be: (i) exempted from the registration requirements by ASIC, or (ii) an open-ended managed investment company registered with the SEC under the Investment Company Act 1940 (USA) which has the economic features of a MIS

⁶ AQUA Rule 10A.2.1(a).

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- > An AQUA Product Issuer must meet certain requirements, including being able to demonstrate that they have adequate facilities, expertise, procedures, personnel and financial resources, echoing statutory licence obligations under sections 912A(1)(d) to (f) of the Corporations Act.

Closed-ended ETPs listed on the ASX market

Closed-ended MIS, such as LITs,⁷ are subject to the ASX Listing Rules, similar to listed companies. The key distinction between products admitted under the Listing Rules and those quoted under the AQUA Rules is the level of control and influence that the issuer has over the underlying instrument.

Schemes must be registered with ASIC, or exempt from registration, to be eligible for listing under the ASX Listing Rules.⁸

Operators of MIS listed on ASX markets are also expected to implement the ASX Corporate Governance Council's best practice guidelines or explain why not (the 'if not why not' approach). These guidelines cover such matters as ethical and responsible decision-making, integrity in financial reporting and timely and balanced disclosure, as well as risk management.

2.2. Wholesale client thresholds

As noted in the consultation paper, the distinction between retail and wholesale clients is relevant to the regulation of MIS, as schemes offered to retail clients must be registered with ASIC, in order to promote effective scheme governance and protect retail clients. The consultation paper also notes that the regulatory distinction between wholesale and retail clients is applicable to a range of circumstances that must be considered when contemplating any changes to the definitions. For example, the definitions of retail and wholesale client and in turn professional investor and sophisticated investor impact the licensing requirements for participants on the ASX markets.

ASX has previously made submissions to reviews of the Corporations Act regarding this matter. In particular, ASX has previously submitted that ASX trading participants should be considered as wholesale clients, professional investors and sophisticated investors as all trading participants are recognised as professional market participants and must meet stringent ASX admission criteria.

However, ASX is also conscious that the distinction between "retail clients" and "wholesale clients" is foundational for a broad range of matters under the Corporations Act and that any amendments to the existing wholesale client tests would have far reaching legal, regulatory and compliance implications for the financial services industry as a whole. These impacts would not be limited to the MIS or fund management industry.

With this in mind, ASX encourages standalone consultation on this issue to ensure that it is considered holistically and that feedback is sought from all affected stakeholders. ASX considers that a standalone consultation would enable Treasury to provide a more detailed and fulsome context for any proposed changes and to identify all possible impacts of reform in this space.

2.3. Acceptable traded scheme investments

The consultation paper notes that the registration of schemes by ASIC does not include the consideration of the suitability of a scheme's investment offering for retail clients. ASX has not observed evidence of need for reform to this process and notes that there a number of elements within the current framework that are designed to ensure that scheme offerings are appropriate for retail investors.

For schemes listed or quoted on ASX markets, admission requirements contained in the Listing Rules or AQUA Rules apply. For products quoted on AQUA market such as ETFs, the requirements for admission are contained in AQUA Rule 10A.3.3 (Requirements for Admission). In particular:

- > The capital value or distributions of the security must be linked to an approved type of acceptable Underlying Instrument. Acceptable Underlying Instruments are specified in AQUA Rule 10A.3.3(c) and include various listed financial products, indexes, currencies, commodities, debentures or bonds.

⁷ Unlike open-ended products, which can accept applications for new units continuously, Listed Investment Companies and LITs have fixed periods in which they can raise new capital, such as through an initial public offering or a subsequent capital raising such as a placement or entitlement offer.

⁸ See for example ASX Listing Rules 1.1 (Condition 5), 1.8 (Condition 8), 1.11 (Condition 8).

Additional requirements may apply where the issuer seeks to admit a product with a strategy that would rely on the use of derivatives (both exchange traded and over-the-counter (OTC)).

- > Certain types of Underlying Instruments are also proscribed under AQUA Rule 10A.3.3(d).

Under the AQUA Rules, managed funds and ETFs are required to have an investment mandate or similar document setting out the investment approach of the issuer. The investment mandate must be set out in the PDS or offer document for the product provided to ASX prior to its quotation. As part of the admission process for AQUA Products, ASX assesses the investment mandate for consistency with the acceptable underlying instrument requirement contained in AQUA Rule 10A.3.3(c) and whether it is an appropriate investment mandate for an AQUA Product.

LITs are referred to in the ASX Listing Rules collectively with Listed Investment Companies as “investment entities”. Admission requirements and processes for LITs under the Listing Rules are substantially different to the admission requirements and processes for AQUA Products under the AQUA Rules. The Listing Rules limit the type of investments a LIT (or its subsidiary) can make to listed and unlisted securities and derivatives, provided the trustee of the LIT does not also control those underlying assets.

Issuers of Listed Investment Products do not have any formal obligation under the Listing Rules to have an investment mandate, although as a practical matter they will generally set out something on this topic in their listing prospectus or PDS. As part of a recent consultation on ASX’s investment product offering (see 2.6 below), ASX sought feedback on whether the Listing Rules should require an entity applying for admission as a LIT to satisfy an admission condition that it have an investment mandate which is acceptable to ASX and which is set out in its listing prospectus or PDS. Respondents generally agreed that an investment mandate should be required; however questions were raised about the requirement for the mandate to be “acceptable” as determined by ASX.

ASIC has published *Information Sheet 230 Exchange traded products: Admission guidelines (INFO 230)*, which provides guidance for licensed exchanges that admit exchange traded products. It sets out principles to help ensure that admission and monitoring standards for ETPs continue to support fair, orderly and transparent markets, particularly in the context of ETPs that have unique or novel features. INFO 230 provides that licensed exchanges should be satisfied that the underlying assets of ETPs have robust and transparent pricing mechanisms.

INFO 230 also provides guidance regarding the assessment of specific underlying assets. For example, INFO 230 provides that licensed exchanges may determine that crypto-assets can be permissible underlying assets for ETPs admitted to their market. However, given the unique characteristics and risks of crypto-assets, ASIC expects market operators to carefully assess, on an individual basis, whether it is appropriate for a particular crypto-asset to be a permissible underlying asset for ETPs admitted to their market. Following engagement with stakeholders, ASX amended the AQUA Rules to establish a new category of permissible underlying assets for crypto-assets.

As mentioned in the consultation paper, the regulatory framework includes principle-based product governance measures to promote the responsible design and distribution of schemes to retail clients, namely the design and distribution obligations and ASIC’s product intervention powers. ASX considers that the current framework, combined with these product governance measures provides appropriate protection for investors while still enabling innovation in product offering.

2.4. Liquidity requirements

Under the ASX rules framework, issuers of ETPs have liquidity support obligations designed to enable investors to enter and exit these products at close to their net asset value (NAV). In order to be quoted on the AQUA market, ETPs are required to demonstrate to ASX that they can either:

- Ensure a ‘reasonable’ bid and volume is maintained in the market for 90 per cent of each trading day; or
- Have in place other arrangements (generally through an agreement with a market maker) so that maximum spread (being the offer price less the bid price) and minimum volume obligations are met as agreed to by ASX.

LITs do not have liquidity support obligations under the Listing Rules.

2.5. Unlisted managed funds (mFund)

ASX operates a settlement service (mFund) for unlisted managed funds that are not listed on, and do not have their units quoted on ASX. Units in unlisted managed funds that participate in that service (mFunds) are not quoted or traded on ASX. Instead, issues and redemptions of mFund units are notified to, and settled by, ASX Settlement via CHESSE.

An unlisted fund applying for admission to the mFund service must be either:

- > a simple MIS (as defined in the Corporations Regulations) that issues a shorter PDS, or
- > a MIS which is priced daily, redeemable generally within 10 business days, 80 per cent invested in liquid assets, and that has not suspended or cancelled investors' right to withdraw in the last two years.

mFund products must be issued by an approved product issuer under the AQUA Rules. Typically, an mFund issuer is a responsible entity that holds an AFS licence authorising it to act as a responsible entity of a registered MIS. mFund product issuers also need to demonstrate to ASX that they have adequate facilities, expertise, procedures, personnel and financial resources. mFunds are subject to the AQUA Rules, which include a number of amendments in respect of mFund in recognition of the non-traded nature of these products, including more flexible acceptability thresholds for Underlying Instruments by excluding mFund from AQUA Rules 10A.3.3(c) and (d).

In recent years, ASX has observed an increasing issuer and investor preference for ETPs as well as expansion of active ETPs in Australian markets. In July 2023, ASX sought feedback on a proposal to wind down and close the mFund service. ASX is collating the responses received from the consultation and will prepare a consultation response summarising feedback received from respondents and ASX's proposed next steps as a result of this consultation, expected to be issued in late 2023.

2.6. ASX consultation: Enhancing the ASX Investment Products Offering

In April 2022, ASX released a consultation paper⁹ seeking feedback on potential enhancements to the ASX Investment Products offering. The Consultation focused on potential improvements to the rules governing ASX's Investment Products and increasing consistency between the differing rule frameworks for the benefit of investors and issuers. The consultation solicited feedback on a number of matters covered in this submission, and which are relevant to the broader regulatory framework for MIS.

ASX published a summary of responses received to the consultation paper in September 2023. With the exception of changes to ETP naming conventions and the future of the mFund service, at this stage ASX has not proposed policy positions in response to the feedback. Given the volume and range of feedback provided, ASX will be considering and prioritising which aspects of the consultation it will seek to progress before releasing a second phase consultation.

3. Further information

ASX welcomes the opportunity to discuss the matters raised in this submission in more detail. If you have any questions, please contact Shelby Brinkley, Senior Policy Advisor [REDACTED] or myself on the details below.

Kind regards

[REDACTED]

Diane Lewis
GM, Regulatory Strategy and Executive Advisor

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⁹ The consultation paper is available here: <https://www.asx.com.au/content/dam/asx/about/regulations/public-consultations/2022/investment-products-phase-1-consultation-paper-final.pdf>