ASIC

Australian Securities & Investments Commission

REGULATION IMPACT STATEMENT

Charitable investment fundraisers

July 2016

About this Regulation Impact Statement

This Regulation Impact Statement (RIS) addresses ASIC's proposals for updating Regulatory Guide 87 *Charities* (RG 87) and related class orders and instruments, and granting new conditional exemptions from the *Corporations Act 2001* (Corporations Act) available to certain charitable investment fundraisers.

What this Regulation Impact Statement is about

1 This Regulation Impact Statement (RIS) addresses ASIC's proposals for the renewal and update of the regulatory framework for charitable investment fundraisers under the *Corporations Act 2001* (Corporations Act). This framework is currently provided by provisions under the Corporations Act and associated relief in Class Order [CO 02/184] *Charitable investment schemes—fundraising*.

2 In developing our final position, we will further consider the regulatory and financial impact of our proposals. We are aiming to strike an appropriate balance between:

(a) maintaining, facilitating and improving the performance of the financial system and entities in it;

(b) promoting confident and informed participation by investors and consumers in the financial system; and

(c) administering the law effectively and with minimal procedural requirements.

3 This RIS sets out our assessment of the regulatory and financial impacts of our proposed policy and our achievement of this balance. It deals with:

(a) the exemptions proposed to apply to charitable investment fundraisers and the conditions under which the exemptions are proposed to apply; and

(b) impacts, costs and benefits of the proposals.

DRAFT

Contents

What this Regulation Impact Statement is about **2**

A Executive summary **4**
- ASIC's relief for charitable investment fundraisers 4
- ASIC's relief in practice 5
- Why is ASIC action needed? 7
- What policy options is ASIC considering? 11
- Consultation process 13
- Recommendation 13
- Implementation and evaluation 14

B Introduction **15**
- Background 15
- Assessing the problem 16
- Why is ASIC action needed? 20

C Options and impact analysis **23**
- Option 1: Modification to the existing exemptions (preferred option) 23
- Option 2: Remove all existing exemptions, except in some limited circumstances 36
- Option 3: Make no substantive change to the current policy (status quo) 38

D Consultation **41**
- First consultation—May 2013 41
- Follow-up consultation—January and February 2016 45

E Recommended option **48**
- Option 1 48
- Option 2 48
- Option 3 49

F Implementation and review **51**

G Regulatory Burden and Summary Cost Offset (RBCO) Estimate Table **52**
- Option 1 52
- Option 2 53
- Option 3 53

DRAFT

A Executive summary

ASIC's relief for charitable investment fundraisers

4 Charities in Australia raise funds to meet their charitable objectives through various means, including through the operation of, and issue of interests in, a managed investment scheme (a charitable scheme) and through the issue of debentures. These schemes are typically managed by entities known as charitable investment fundraisers, which provide investors with the ability to allocate funds towards the charitable investment fundraiser's charitable purpose. For some of these investors, financial profit to the investor is not the primary consideration in or motivation for making the investment. It is arguable that because of this, investors are unlikely to expect or require disclosures in compliance with the Corporations Act or the protection of the fundraising, managed investment, debenture or licensing provisions normally required by the Corporations Act.

5 Charitable investment fundraisers that fundraise by issuing debentures or interests in managed investment schemes currently have relief from the fundraising, managed investment, debenture and the Australian financial services (AFS) licensing provisions of the Corporations Act under [CO 02/184] and Regulatory Guide 87 *Charities* (RG 87), provided that they meet certain conditions. Charitable investment fundraisers that rely on ASIC's exemptions raise investment funds from both wholesale and retail clients. [CO 02/184] will sunset on 1 October 2016. One of the options (broadly, Option 2) that we have considered is to allow this class order to sunset, thereby causing the exemptive relief to terminate.

6 Based on our surveillance and consultation, we estimate that approximately 100 charitable investment fundraisers have relied (or have purported to rely) on ASIC's exemptions under [CO 02/184] in the past. We conducted an extensive surveillance and consultation in 2013 and found that, of the charities currently relying on ASIC exemptions or that may have relied on exemptions in the past, only 58 had lodged financial statements in the preceding financial year to enable them to continue to rely on the exemptions. In addition, some charities rely on relief on the basis of a sponsorship arrangement under existing policy. These charities appear to have undertaken the large majority of fundraising, currently holding over $7 billion in investment funds. This represents a very small component (approximately 0.26%) of the total funds under management in Australia which is currently estimated to be $2.633 trillion: see Managed Funds, Australia, Mar 2016 (Cat. No. 5655.0) on the Australian Bureau of Statistics website.

DRAFT

7 Our follow-up consultation, liaison and analysis in early 2016 have indicated that the number of charities that continue to rely on ASIC exemptions is approximately 90. Data produced by the Australian Prudential Regulation Authority (APRA) on Religious Charitable Development Funds (RCDFs) show that 59 RCDFs are currently listed in Banking exemption No. 2 of 2015 *Religious charitable development funds* (banking exemption order) and we understand that of these 55 rely on ASIC exemptions. We therefore calculate that the remaining 45 entities rely on ASIC exemptions but are not RCDFs and are significantly smaller (by size and funds under management) than the RCDFs.

Note: A charitable investment fundraiser is a charity, or person acting on behalf of a charity, that raises funds to support its purposes by issuing debentures (other than by way of certain limited offers) and/or interests in a managed investment scheme. It does this to raise investment funds (as distinct from donations) in order to carry out its operations.

8 Since our follow-up consultation, APRA has renewed and modified its existing banking exemption order that, from 1 January 2017, RCDFs are not permitted to issue at-call or short-term investments to retail, non-affiliate investors. The intention is that the prohibition will more clearly delineate the boundary between the prudentially regulated banking sector and entities (such as RCDFs) that are not prudentially regulated, to reduce the risk that a retail investor in a RCDF would confuse such an investment with an authorised deposit-taking institution (ADI) deposit or transactional ADI product.

ASIC's relief in practice

9 In 2010–11, ASIC conducted a desk-based surveillance project on charitable bodies, which included examination of the fundraising activities, financial services promotion, disclosure quality and financial position of major charitable investment fundraisers. Key findings included that:

(a) some charities appeared to market their products primarily on the basis of 'attractive returns', rather than the organisation's charitable purpose;

(b) some charities did not provide adequate disclosure about the nature of the product and the regulatory status of the charity, leading to concerns that investors were not fully informed about the nature of the product and the lack of regulatory oversight for their investments;

(c) some charities compared their products with the commercial characteristics of products issued by ADIs and used terms such as 'deposits' to describe their product, without emphasising that the charities themselves were not prudentially regulated; and

DRAFT

(d) some corporations or charitable schemes had a deficiency of current assets compared to current liabilities (or liquidity mismatch), although we note this does not necessarily imply insolvency.

10 These findings gave rise to concerns that the exemptions are operating in a manner inconsistent with the policy intent of the ASIC exemptions, and that the promotion practices of some charitable investment fundraisers may encourage investors to engage with these organisations as substitutes to banks, without the appropriate regulatory oversight, and contribute to some investors' failure to appreciate the risk profile of their investment.

11 We identified a need to assess whether the existing exemptions continue to align with our regulatory objectives of facilitating confident and informed investors. This arose from concerns surrounding:

(a) investor expectations about the level of regulatory oversight of charitable investment fundraisers, which may not reflect the actual degree of regulation; and

(b) the increasing prevalence, and the associated risks, of shadow banking in Australia.

12 We consulted on these issues in 2013 in Consultation Paper 207 *Charitable investment fundraisers* (CP 207) and proposed a number of additional and modified conditions or requirements that charitable investment fundraisers would be subject to under a new regime. We considered that these proposals would strike an appropriate balance between our core objectives of promoting confident and informed investors, while seeking to minimise any additional administrative and compliance costs for charitable investment fundraisers.

13 Following our public consultation in 2013, we delayed our consideration of the matter to take into account the report of the Financial System Inquiry commissioned by the Australian Government and the Government's response to its recommendations.

14 As [CO 02/184] is due to sunset on 1 October 2016 (see paragraphs 18–25), it was necessary for us to resume our policy work in relation to charitable investment fundraisers. We conducted a follow-up consultation in January and February 2016, having revised further some of the original proposals.

15 As discussed, in the intervening period, APRA has modified the existing banking exemption order with effect from 1 January 2017. This RIS is drafted on the basis that the modification to that order has taken effect.

DRAFT

Why is ASIC action needed?

16 ASIC's relief for charitable investment fundraisers contained in [CO 02/184] will sunset on 1 October 2016 if not remade before then. The current exemptive relief provided by ASIC is significant. If the relief were to lapse, the affected charitable investment fundraisers would be required to comply with the extensive requirements of the fundraising, managed investment, debenture, disclosure and licensing provisions normally required by the Corporations Act. This would cause a significant burden to industry.

17 We consider that there are two additional reasons that highlight the need for us to take action on the regulation of charitable investment fundraisers:

(a) the Government's reform agenda for the not-for-profit sector; and

(b) the reforms announced by APRA in March 2016.

The need to remake [CO 02/184] before it sunsets

18 In the absence of any action taken by ASIC, [CO 02/184] will sunset and the relief provided by the class order will no longer be available to charitable investment fundraisers. A failure by ASIC to continue relief for charitable investment fundraisers beyond the date on which [CO 02/184] will sunset would be highly detrimental to the viability of charitable fundraising activities, and would impose significant licensing and regulatory costs on charities seeking to continue raising funds from retail clients.

19 We have identified that many charitable investment fundraisers—including both debenture issuers and issuers of interests in a managed investment scheme—currently have, have had, or operate a charitable scheme that has a liquidity mismatch. While generally these charitable investment fundraisers have not experienced a level of demands for repayment that has resulted in default, a liquidity mismatch creates a risk that has the potential to result in significant delays in repayments or potential losses to investors if there are forced sales of assets.

20 To address this issue we consider it appropriate for ASIC to be consistent with APRA and impose restrictions on the issue of at-call or short-term investments, as this will reduce the extent of liquidity mismatches and the possibility of a run on investments, as investors would have only delayed withdrawal rights. Therefore, we propose to:

(a) prohibit the issue of at-call or short-term investments to retail clients not associated with the charitable investment fundraiser (non-associate retail clients); and

(b) restrict the issue of at-call or short-term investments to wholesale and associated investors when there has been the issue of at-call or short-term investments to any non-associate retail client.

DRAFT

21 We define an 'associate' of a charitable investment fundraiser as:

(a) a body constituted by or under the authority of a decision of the charity, or which is controlled by the charity;

(b) a person or body that constituted the charity or under whose authority the charity was constituted or that controls the charity;

(c) a charity with related charitable purposes that is the same as or similar to the charity;

(d) a person acting as a trustee of a trust for the charity or a charity with a related charitable purpose;

(e) a member of the clergy, an employee or a voluntary staff member who works for any person or body mentioned in paragraphs 21(a)–21(d); or

(f) a person undertaking training or education to enable them to be a person under paragraph 21(e) who receives money or money's worth from any person mentioned in paragraphs 21(a)–21(e).

22 The definition of 'associate' is broadly consistent with APRA's definition of 'affiliate', except that APRA does not currently include a general purpose test as in paragraph 21(c).

23 This proposal prevents retail clients from using their charitable investment fundraiser investment as a transactional facility, a behaviour which in the past has increased the difficulties faced by some investors of failed mortgage funds and debenture issuers.

24 This proposal also includes appropriate restrictions on charitable investment fundraisers that:

(a) have both retail clients and wholesale and associated investors; and

(b) issue at-call or short-term investments to their wholesale or associated investors.

25 The purpose of these restrictions is to address the risk of runs and investor losses resulting from an inability to meet investor demands due to a lack of liquid assets. Further, we consider that action on charitable investment fundraisers is necessary to bring the operation of charitable investment fundraisers in line with other comparable investment products in the market. In doing so, this will more closely align investor expectations around their investments with the actual level of regulatory oversight under which charitable investment fundraisers operate. This will ensure that investors more fully appreciate the risks of investing in charitable investment fundraisers.

DRAFT

Government reform agenda for the not-for-profit sector

26 In the 2011–12 federal budget, the Government committed to establishing the Australian Charities and Not-for-profits Commission (ACNC). It also committed to improving accountability, governance and transparency, and streamlining reporting obligations for the not-for-profit sector. The ACNC commenced operations on 3 December 2012. As the Government has been reviewing the operation of the non-for-profit sector, it is an appropriate time for ASIC to consider the operation of our existing relief.

27 Following our public consultation in 2013, we delayed our consideration of the matter to take into account the report of the Financial System Inquiry commissioned by the Australian Government and the Government's response to its recommendations.

APRA's position on charitable investment fundraisers

28 Some charities, referred to as RCDFs, currently have an exemption from the *Banking Act 1959* (Banking Act) granted by APRA, which broadly allows these organisations to conduct banking business without holding an ADI licence, provided that they comply with the conditions of the exemption. A number of charitable investment fundraisers relying on ASIC's exemptions are also RCDFs.

29 In March 2016, APRA released a response to submissions paper noting that it will remake the Banking Act exemption, with effect from 1 January 2017, with the following conditions:

(a) the use of terminology such as 'deposit' and 'at call' by RCDFs will not be permitted in relation to retail products or in marketing to retail clients;

(b) accounts offered to retail clients will be required to have a minimum 31-day term or call-period (but at-call and short-term investments of less than 31 days will be allowed for wholesale investors and affiliates, such as RCDF staff); and

(c) a prohibition on the use of transactional facilities (again with some exceptions allowed for wholesale investors and affiliates).

30 APRA has proposed a 12-month transition period for these conditions for existing investments of retail clients held at 31 December 2016. All retail products offered to retail business will be required to comply with immediate effect from 1 January 2017.

31 We consider it necessary for ASIC to make changes that are consistent with APRA's revised position on retail banking business. If we did not make such a change, there would be two conflicting regimes – one regime for RCDFs and another for non-RCDF charitable investment fundraisers permitting

DRAFT

these charitable investment fundraisers to continue to operate a retail banking business and raise short-term funds from retail clients. This may result in non-RCDF charitable investment fundraisers having a competitive advantage over RCDFs.

32 Our changes apply to both RCDF and non-RCDF charitable investment fundraisers. RCDF charitable investment fundraisers raise the majority of the investment funds, particularly funds from retail clients. The value of investment funds raised by non-RCDF charitable investment fundraisers is small relative to the size of the industry as a whole. Like APRA, we acknowledge that, ultimately, it may mean that some charitable investment fundraisers (whether RCDF or non-RCDF) will lose significant short-term funds from retail clients and may find it difficult to achieve their charitable objectives. However, due to the small relative size of the non-RCDF charitable investment fundraiser population, our changes are likely to have a narrower financial impact than APRA's changes.

33 Given our continuing concerns about investor protection and the lack of oversight, in addition to changes to address the issue of raising short-term funds from retail clients, we consider that in determining whether to renew, amend or allow the class order to lapse, it is appropriate to:

(a) include the additional requirements for obtaining a AFS licence with authorisations to provide financial services to retail clients (retail AFS licence); and

(b) require an investor acknowledgement, identification statement, financial reporting and breach reporting.

34 Again, we acknowledge that there will be additional costs associated with these changes but understand from responses provided through consultation that these costs will not be significant and, in any event, are justified by the enhanced regime in which the charitable investment fundraisers will operate.

35 In addition to aligning our requirements with APRA's, we are proposing to include a further requirement that charitable investment fundraisers are permitted to issue at-call or short-term investments and provide traditional banking products to wholesale investors and associates, provided that at the time of facilitating any repayment or redemption the fundraiser must not have reason to believe that allowing repayments of those at-call and short-term investments would materially increase the risk of the charitable investment fundraiser being unable to meet retail clients' repayment rights or on a winding up. That is, the obligation to facilitate repayment of at-call and short-term investments to wholesale clients and associates is subject to a liquidity overlay, where the charitable investment fundraiser must be certain it can facilitate all repayments in accordance with the relevant terms. We consider that, without such an overlay, a charitable investment fundraiser could be obliged to meet short-term withdrawal requests from wholesale

DRAFT

investors or associates but be prevented from preserving the asset pool to ensure retail investments can be repaid. Therefore, we consider it appropriate to adopt a slightly different position from APRA.

What policy options is ASIC considering?

36 To address the issues we identified in our sunsetting review of [CO 02/184], we have considered three regulatory options.

Option 1 (preferred approach)

37 Under Option 1, we propose to continue the exemptions in [CO 02/184] (other than the AFS licensing exemptions where funds are raised from retail clients) and impose additional requirements and conditions. We consider that this has the highest net benefit to the industry as a whole, given the factors discussed in this RIS.

38 We recommend Option 1 because we consider that this option strikes the appropriate balance between our core objectives of promoting confident and informed investors, while seeking to minimise any additional administrative and compliance costs for charitable investment fundraisers. We acknowledge that the loss of short-term retail funds for some fundraisers may impact their business significantly and ultimately reduce the ability of those fundraisers to achieve their charitable objects. However, please see paragraph 131-133 for an estimate of the likely financial impact and the justification for continuing with this proposal.

Option 2

39 Under Option 2, we propose to remove all existing exemptions (except exemptions from the AFS licensing requirements for fundraisers that only raise investment funds from associates). Proceeding with Option 2 will mean that charitable investment fundraisers that fundraise by issuing debentures or interests in charitable schemes must comply with all the fundraising, managed investment, debenture and, subject to some carve out, AFS licensing provisions of the Corporations Act. The relief from these provisions, currently provided in [CO 02/184], will no longer be available.

40 We would not specifically restrict the issue of short-term investments to retail clients. However, those RCDF charitable investment fundraisers (approximately half by number but a majority by assets under management) will be caught by the APRA proposal, discussed at paragraphs 28–35.

DRAFT

41 We do not recommend Option 2 because we consider that it is unduly burdensome and costly for the charitable bodies to comply with all of the provisions in the Corporations Act that would otherwise be applicable.

Option 3

42 Under Option 3, we propose to maintain the status quo with no substantive policy changes. We consider that maintaining the status quo would give industry certainty going forward and is likely to be welcomed by the charitable bodies.

43 We do not recommend Option 3 because we have real concerns that continuation of the exemptions will result in:

(a) failures of charitable investment fundraisers that fundraise in reliance of ASIC's exemptions;

(b) corresponding losses to investors; and

(c) a failure to address the increasing prevalence, and the associated risks, of shadow banking in Australia.

What is the likely net benefit of each option?

44 Option 1 will provide the most balanced compromise of allowing charitable investment fundraisers to continue operating under an exempted regime with minimal increases in costs, while also strengthening the protections afforded to investors. We recognise that costs will likely increase for charitable investment fundraisers; however, we consider this to be appropriate as this option will allow investors to help charities achieve their charitable objectives, while also reducing risks associated with shadow banking and aligning the regulatory regime of charitable investment fundraisers more closely with those of products in other similar markets.

45 Option 2 is likely to result in significantly increased costs for charitable investment fundraisers, and it is likely that this would result in a large number of charitable investment fundraisers electing to cease operating. This would damage the ability of charities to continue meeting their charitable objectives, and would deprive retail clients of the opportunity to provide financial support to their choice of charity while continuing to derive an investment return.

46 Option 3 is likely to be of benefit to the continued operation of charitable investment fundraisers. However, it will be at the expense of investors and the broader Australian investment landscape. A failure to take any action will likely increase the risk of charitable investment fundraisers encountering liquidity mismatches resulting in a greater prevalence of shadow banking and potential investor losses. Further, some investors will remain unaware of the risks of investing in charitable investment fundraisers due to a lack of

DRAFT

understanding of the product risk profile and the regulatory environment in which it operates.

Consultation process

47 We consulted in May 2013 on the two options in CP 207 and received comprehensive submissions from 22 organisations, as well as APRA and the ACNC: see paragraphs 185–189.

48 Based on the feedback received, we agreed that it remains appropriate to provide exemptions from key regulatory requirements under the Corporations Act to charitable investment fundraisers, provided these exemptions are subject to appropriate limitations and safeguards in the form of requirements or conditions. In response to the feedback about the requirements (or conditions), we considered it appropriate to maintain certain requirements and conditions, modify others and not apply some of the conditions—that is, we contemplated a modified version of the second option outlined in CP 207 (Option 1 of this RIS): see paragraphs 204–208.

49 Following our public consultation in 2013, we delayed our consideration of the matter to take into account the report of the Financial System Inquiry commissioned by the Australian Government and the Government's response to its recommendations. This response has now been made and we are now in a position to finalise our review of our policy.

50 In consideration of the time that had elapsed since the original consultation, we conducted follow-up consultation in January and February 2016 on Option 1. During this follow-up consultation, we received 13 written submissions and one verbal response. There was some support for the revised requirements in Option 1, but many submissions opposed the imposition of any additional requirements or conditions on charitable investment fundraisers, particularly the prohibition of at-call and short-term investments for non-associate retail clients because these could significantly impact resources that could be directed towards achieving the organisation's charitable objectives. However, since the expiry of the consultation, APRA has announced that it is prohibiting the issue, from 1 January 2017, by RCDFs of at-call and short-term investment fund to retail clients: see paragraphs 209–216.

Recommendation

51 We consider that Option 1 in this RIS is the best option. We consider it appropriate to remove some of the existing exemptions and impose additional conditions. We consider that this option strikes the appropriate

DRAFT

balance between our core objectives of promoting confident and informed investors, while seeking to minimise any additional administrative and compliance costs for charitable investment fundraisers.

Implementation and evaluation

52 The new policy will be implemented through an update to RG 87 and remaking [CO 02/184] into an ASIC instrument. We also propose to remake Class Order [CO 02/151] *School enrolment deposits* without substantive amendment.

Note: We consulted on the remake of [CO 02/151] in CP 207.

DRAFT

B Introduction

Background

ASIC's relief for charitable investment fundraisers

53 Currently, charitable investment fundraisers that fundraise by issuing debentures or interests in managed investment schemes are able to rely on relief from the fundraising, managed investment, debenture and AFS licensing provisions of the Corporations Act under [CO 02/184], provided that they meet certain conditions. This class order will sunset on 1 October 2016.

54 [CO 02/184] was originally released in light of the public benefits provided by assisting charitable organisations in pursuing their charitable objectives under an exempted licensing regime, as well as the differing expectations of regulatory protection by investors who are at least partly motivated by charitable objectives. It was recognised that the licensing regime was too administratively and financially burdensome to allow charitable organisations to effectively raise funds from retail clients in order to pursue their charitable objectives. It was felt that an exempted licensing regime would allow charitable organisations to raise funds from retail clients, while still requiring them to comply with some basic licensing requirements. This approach also provided investors with the opportunity to allocate their money towards investments that would assist charities in achieving their charitable objective.

55 Based on our surveillance and liaison, we estimate that approximately 90 charitable investment fundraisers rely on ASIC's exemptions in [CO 02/184]. We estimate that these charities cumulatively raised over $7 billion investment funds as at 2013. However, responses to our recent consultations have not allowed us to precisely calculate the current size of the industry. Based on submissions, it is our assessment that a minority (around 10) are responsible for raising the majority of the funds, including significant entities such as the Australian Catholic Bishops Conference, the Baptist Churches and the various Anglican Dioceses (all of which are RCDFs). Charitable investment fundraisers that rely on ASIC's exemptions raise investment funds from both wholesale and retail clients. We are aware that some organisations only accept investments from entities that are associated with the organisation.

56 In 2010–11, ASIC conducted a desk-based surveillance project on charitable bodies, which included examination of the fundraising activities, financial services promotion, disclosure quality and financial position of major charitable investment fundraisers. Key findings included that:

DRAFT

(a) some corporations or managed investment schemes had a deficiency of current assets compared to current liabilities, although we note this does not necessarily imply insolvency;

(b) some charities appear to market their products primarily on the basis of 'attractive returns' rather than the organisation's charitable purpose; and

(c) some charities compared their products with the commercial characteristics of products issued by ADIs and used terms such as 'deposits' to describe their product.

57 These findings gave rise to concerns that the exemptions are operating in a manner inconsistent with the policy intent of the exemptions, and that the promotion practices of some charitable investment fundraisers may encourage investors to engage with these organisations as substitutes to banks and contribute to some investors' failure to appreciate the risk profile of their investment.

58 Some charitable investment fundraisers, particularly organisations that raise money by issuing debentures with short-term maturity and on-lending investment funds, or by issuing interests with short withdrawal promises and providing finance to others or investing in illiquid assets, may also be regarded as having similar functions as banks as they absorb credit risk or engage in maturity transformation.

59 We released CP 207 in May 2013 in response to these findings. Following the release of CP 207, we have been in consultation with other governmental stakeholders, and in January and February 2016 we engaged further with certain respondents to CP 207.

60 This follow-up consultation sought further information on costs and the impacts of our proposals. We proposed providing certain renewed exemptions, subject to conditions, in order to allow continued charitable investment fundraising with reduced regulatory burdens (compared to those proposed in CP 207).

Assessing the problem

ASIC's review of [CO 02/184]

61 We conducted our review in response to:

(a) the collapse of a number of non-bank lending institutions;

(b) concern over the scope of 'shadow banking' activities in Australia;

(c) regulatory reform of non-bank lenders;

DRAFT

(d) the Government's broader reform agenda for the not-for-profit sector; and

(e) the imminent sunsetting of [CO 02/184].

Collapse of non-bank lenders

62 There have been a number of high-profile corporate collapses or industry exits in the non-bank lending sector in recent years.

63 During 2011–13, GR Finance, Provident Capital, Banksia Securities, Wickham Securities and Gippsland Secured Investments enter into external administration. Other entities that have exited the market in this period include Victorian Secured Investments and Southern Finance.

64 This level of industry turmoil has prompted other regulatory reviews, but is particularly significant in this context because a number of charitable investment fundraisers offer products of a similar type to those offered by some failed entities.

The shadow banking sector

65 'Shadow banking' describes a form of credit intermediation involving entities and activities outside the regular banking system. The global shadow banking system grew rapidly in the years leading up to the global financial crisis, and there has been a growing interest internationally in monitoring and assessing the risks posed by the shadow banking system.

66 In Australia, a significant proportion of the financial sector by assets comprises banks, credit unions, building societies, superannuation funds and insurers—all of which are prudentially regulated by APRA. The shadow banking sector consists of non-prudentially regulated institutions such as registered financial corporations, certain types of debenture issuers and investment funds (including some charitable investment fundraisers) that provide transactional accounts.

67 High-profile collapses of retail-funded shadow banks in Australia have increased the regulatory focus on shadow banking activities. The fact that these entities have been retail funded has the potential to significantly magnify the impact of the collapse, as the retail clients may suffer hardship. Failures of these entities can have significant regional impacts; particularly where investors have treated these products like regulated banking products, and may impact broader consumer confidence.

68 A particular risk of the shadow banking sector is that some entities operate businesses that may appear to investors to be a bank. For example, businesses may offer 'at-call accounts', which allow investors to withdraw their money at any time, and so appear to be a bank deposit account, even though they are not.

DRAFT

69 Some charitable investment fundraisers engage in a form of shadow banking, as they offer transactional accounts similar to those of banks, yet are not subject to the same regulatory oversight as banks. These factors can produce a mismatch in the risk profile of the products offered by shadow banking entities and the expectations of consumers who are investing money with these entities.

70 While to date there has been no failure in the charitable investment fundraiser sector in Australia, there have been cases of material losses recorded by religious bodies, including at least one RCDF. In addition, there have been collapses of religious bodies overseas, in Northern Ireland and Slovenia: see APRA's regulation impact statement *Banking exemption order for religious charitable development funds* (PDF 379 KB) (banking exemption order RIS).

71 The significant scale of investment funds managed by charitable investment fundraisers (approximately $7 billion) means that a major collapse or significant investor loss could affect investor confidence in charitable investments and financial products more generally.

Regulatory reform of non-bank lenders

72 Australian regulators have been tightening regulation of the shadow banking sector. For example, the Corporations Act has been extended to regulate margin lending, ASIC now licenses providers of consumer credit services, and the regulatory coverage of credit products under the National Credit Code (at Sch 1 to the *National Consumer Credit Protection Act 2009*) has been expanded to include investment property housing loans.

73 Under existing policy, there is a risk that investors of a failed charitable investment fundraiser may have made their investment with certain expectations about the level of regulatory oversight afforded to the charitable investment fundraiser, which does not reflect the actual degree of regulation.

74 Further, charitable investment fundraisers are not prudentially regulated bodies and disclosures do not highlight this fact, meaning investor expectations may not be consistent with the nature of the charitable investment fundraisers and their investment offerings.

75 There are concerns that the exemptions are operating in a manner inconsistent with their policy intent, and with other comparable investment products on the market. Further, the promotion practices of some charitable investment fundraisers may encourage investors to engage with these organisations as substitutes to banks, and result in some investors failing to appreciate the risk profile of their investment.

DRAFT

Reform of the not-for-profit sector

76 In the 2011–12 federal budget, the Government committed to establishing the ACNC. It also committed to improving accountability, governance and transparency, and streamlining reporting obligations for the not-for-profit sector. The ACNC commenced operation on 3 December 2012 under the *Australian Charities and Not-for-profits Commission Act 2012* (ACNC Act).

77 The objects of the ACNC Act are to:

(a) maintain, protect and enhance public trust and confidence in the not-for-profit sector;

(b) support and sustain a robust, vibrant, independent and innovative not-for-profit sector; and

(c) promote the reduction of unnecessary regulatory obligations on the sector.

The ACNC currently only regulates charities.

78 Registration under the ACNC Act is voluntary. A registered entity must meet minimum governance standards, comply with record keeping and reporting responsibilities and must notify the ACNC of certain changes. Relevantly, for each financial year, a registered entity must give the ACNC an 'annual information statement'. In addition, a registered entity with revenue of greater than $250,000 must prepare a financial report for each financial year, reviewed in accordance with the ACNC Act, and provide that report and reviewer's report to the Commissioner. The financial report must be audited if the entity's revenue exceeds $1 million, and the entity must provide the Commissioner with the auditor's report.

79 The ACNC's role also involves providing information, guidance and advice to charities and the public.

80 The Government also introduced the *Charities Act 2013* (Charities Act), which commenced on 1 January 2014. The Charities Act provides a definition of 'charity' and 'charitable purpose', which is to be used by all Commonwealth legislation. It provides the industry and public with certainty regarding the charitable status and charitable purpose of charitable investment fundraisers.

81 As the Government has been reviewing the operation of the not-for-profit sector, it is an appropriate time for ASIC to consider the operation of our existing relief for charitable investment fundraisers.

ASIC's current regulatory regime

82 There are two broad group exemptions available for charitable investment fundraisers under ASIC's regime:

DRAFT

(a) the 'individual charities' exemption; and

(b) the 'group charities' exemption.

83 A number of charitable investment fundraisers relying on ASIC's exemptions set out below are also RCDFs.

'Individual charities' exemption

84 Charitable investment fundraisers that fundraise by issuing debentures or interests in charitable schemes have relief from the fundraising, managed investment, debenture and AFS licensing provisions of the Corporations Act under [CO 02/184], if the charitable investment fundraiser:

(a) registers an identification statement with ASIC that contains the prescribed content;

(b) lodges financial information with ASIC on an annual basis; and

(c) satisfies certain disclosure requirements in its offer documents.

'Group charities' exemption

85 A group of charities that have common or related charitable objectives may also be exempted from the fundraising, managed investment, debenture and AFS licensing provisions of the Corporations Act if they are sponsored by an organisation approved by ASIC (the sponsor). Under this type of exemption, the sponsor is obliged under a deed poll to indemnify each sponsored charity against claims by investors in that entity, although such liability may be limited to the amount of money subscribed by investors plus interest accrued.

86 Guidance on the current individual charities exemption and the group charities exemption is contained in RG 87.

87 In addition, one related class order—[CO 02/151]—gives class exemption from certain fundraising, managed investment, debenture and licensing requirements of the Corporations Act for school enrolment deposits.

Why is ASIC action needed?

88 Our role includes investor protection, primarily to ensure that investors are confident and informed. It is our view that investors in charitable investment fundraisers may not be fully aware of the nature of the product or the status of the charitable investment fundraiser. We cannot assess whether disclosure influences investor behaviour in the charitable investment sector—for example, whether investors would invest less or not at all if they were made aware of the regulatory status of the fundraiser and the product offering—given that investors may invest primarily to facilitate the charitable

DRAFT

objectives. Nonetheless, we think it is desirable to enhance transparency around the matter. We are not proposing that the charitable investment fundraiser provides a fully compliant Product Disclosure Statement (PDS) or prospectus—as they would have to if not for [CO 02/184]. Rather, we are proposing to require the charitable investment fundraiser to make some relatively minor additional disclosures: see paragraph 123.

89 In addition to the reasons discussed at paragraphs 16–30, we make the following observations.

90 Charitable bodies engaged in investment fundraising, particularly those that raise money by issuing debentures or interests in charitable schemes with short withdrawal promises and providing finance to others or investing in illiquid assets, may be regarded as 'shadow banks' or entities that have some risks associated with shadow banks. This applies to the extent that those organisations absorb credit risk or engage in maturity transformation in that they provide investors with an opportunity to realise their investment before the underlying investments would ordinarily be realised.

91 Accordingly, the key aims of our proposals include ensuring:

(a) investors with charitable investment fundraisers (other than investors who are associates of the fundraiser) are confident and informed by:

(i) facilitating investor awareness of the risks associated with investment in an unregulated entity, including about the level of regulatory protection afforded to this type of investment; and

(ii) ensuring organisations relying on ASIC's exemptions for charitable investment fundraisers structure and promote their products in a way that is most likely to attract investors whose primary purpose for investment is to support the charitable purpose of the organisation rather than obtaining an attractive return; and

(b) competitive neutrality objectives are maintained by requiring charitable investment fundraisers that attract investors whose primary investment objective is to obtain repayment of their investment or achieve financial returns, rather than a charitable purpose, to comply with the regulatory regime applicable to commercial fundraisers.

92 We have observed that a number of charitable investment fundraisers relying on ASIC's exemptions market their products primarily on the basis of the product's commercial features rather than the charitable purpose. For example, the promotional materials of some charitable investment products are focused on highlighting the product's attractive returns or low fees.

93 Some charitable investment fundraisers relying on ASIC's exemptions may also appear bank-like to some investors—for example, organisations that:

(a) offer a variety of banking and investment products;

DRAFT

(b) regularly update investors regarding their product's financial performance without providing corresponding information about their charitable operations;

(c) have websites that appear to be like the websites of commercial operators; or

(d) compare their investment products directly with products issued by commercial fundraisers.

94 We consider that the structuring of charitable fundraising as an investment, coupled with the significant amount of funds raised through charitable investment fundraising and the focus on the financial performance of some charitable investment products, suggest that more significant investment protections are warranted.

95 Further, we consider that it is timely to review our policy on charitable investment fundraisers given the significant scale of investment funds raised in reliance on the existing exemptions and the fact that this policy has not been revisited for some time. Our proposals do not affect fundraising by way of donations.

DRAFT

C Options and impact analysis

96 We also consider that it is important to highlight risks that are associated with investments in charitable investment fundraisers by clearly differentiating these organisations from other fundraisers that are subject to APRA's prudential framework (such as ADIs) and, if charitable investment fundraisers continue to rely on ASIC's exemptions, to also differentiate their offerings from those made under the regulatory regime contained in the Corporations Act applying to fundraisers generally.

97 We consider that the options available to ASIC are:

(a) *Option 1*—Retain all existing exemptions, other than exemptions from the AFS licensing requirements of the Corporations Act for fundraisers that raise investment funds from retail clients, but impose a number of new conditions;

(b) *Option 2*—Allow the relief to lapse, except exemptions from the AFS licensing requirements of the Corporations Act for fundraisers that only raise investment funds from associates. This would remove all existing exemptions for new investment fundraising; and

(c) *Option 3*—Maintain the status quo. This would entail renewing the relevant class orders in their current form, without amendment, prior to the first sunset date of 1 October 2016.

98 After receiving industry feedback, our preferred option is a modification of the proposal set out in Option 1 above.

Option 1: Modification to the existing exemptions (preferred option)

99 Option 1 entails continuing the existing exemptions, other than the AFS licensing exemption if funds are raised from retail clients, while imposing a number of additional conditions.

Existing conditions

100 Currently, charitable investment fundraisers relying on the relief provided under [CO 02/184] must comply with three conditions, as outlined in paragraphs 101–106.

Disclosure requirements

101 This condition requires that all offer documents issued by charitable investment fundraisers include a statement to the effect that:

DRAFT

(a) investors should be aware that the charitable scheme is not subject to the normal requirement to have a disclosure document or PDS and be registered or have a trust deed under the Corporations Act;

(b) the scheme has not been examined or approved by ASIC; and

(c) the investment is designed for investors who wish to promote the charitable purpose of the relevant charity and for whom the considerations of profit are not of primary relevance in the investment decision.

102 Further, all promotional materials in respect of the charitable investment fundraiser must not state that the investment has been approved or examined by ASIC.

Lodgement of financial statements

103 This condition requires that a charitable investment fundraiser lodge certain financial information with ASIC within six months of the end of each financial year. Organisations that prepare audited financial statements must give a copy of the audited financial statements and the audit report to ASIC.

104 However, charities that are not otherwise required to prepare audited financial statements may lodge financial information in the form of a statement that sets out the funds outstanding under debentures or amount subscribed in relation to interests issued by it at the end of the financial year.

Lodgement of identification statement

105 This conditions requires that a charitable investment fundraiser lodge with ASIC an identification statement for the organisation, which outlines the following:

(a) the identity of the charity;

(b) the Australian Company Number, if applicable, or an Australian Business Number if one is held;

(c) details of incorporation, if the charity is an incorporated body other than a company;

(d) the names and addresses of all members, if the charity is an unincorporated body;

(e) a brief description of the scheme and its intended purpose; and

(f) the guarantees or promises, if any, made to or proposed to be made to holders of interests or debentures in the scheme.

106 In describing the scheme, charitable investment fundraisers should also include information on:

DRAFT

(a) what types of assets the scheme will invest in or, for a debenture issue, that the charity will hold to enable it to satisfy any liability;

(b) what countries those assets will be located in; and

(c) how compliance with the conditions attached to [CO 02/184] will be ensured.

New conditions

107 Under Option 1, the additional conditions to be imposed on charitable investment fundraisers are as follows:

(a) *Condition 1*—Charitable investment fundraisers that issue investments to non-associate retail clients from 1 January 2017 must have an AFS licence;

(b) *Condition 2*—Charitable investment fundraisers are:

  (i) from 1 January 2017, prohibited from issuing at-call or short-term investments and providing traditional banking products to non-associate retail clients; and

  (ii) from 1 January 2018, permitted to issue at-call or short-term investments and provide traditional banking products to wholesale investors and associates, unless paragraph 107(b)(iii) applies; and

  (iii) from 1 January 2018, where the charitable investment fundraiser issues an interest to at least one non-associate retail client, the charitable investment fundraiser is permitted to issue at-call or short-term investments and provide traditional banking products to wholesale investors and associates but, at the time of facilitating any repayment or redemption, it must not have reason to believe that allowing repayments of those at-call and short-term investments would materially increase the risk of the charitable investment fundraiser being unable to meet investors' repayment rights or on a winding up. That is, the obligation to facilitate repayment of at-call and short-term investments to wholesale clients and associates is subject to a liquidity overlay, where the charitable investment fundraiser must be certain it can facilitate all repayments in accordance with the relevant terms;

(c) *Condition 3*—Charitable investment fundraisers cannot use certain restricted terminology that might cause confusion with traditional banking products;

(d) *Condition 4*—Charitable investment fundraisers must obtain investor acknowledgement statements from non-associate retail clients;

(e) *Condition 5*—Charitable investment fundraisers must make certain disclosures to all investors and additional disclosures to non-associate retail clients;

DRAFT

(f) *Condition 6*—Charitable investment fundraisers must prepare and lodge financial statements with the ACNC or ASIC;

(g) *Condition 7*—Charitable investment fundraisers must lodge identification statements with new content requirements; and

(h) *Condition 8*—Charitable investment fundraisers must comply with breach reporting requirements, in relation to the matters set out in paragraphs 126–127.

108 The conditions would only apply to those entities contemplating new product offerings. Further, charitable investment fundraisers will be subject to a transitional period of approximately 18 months for the majority of new conditions, ending on 1 January 2018.

109 A description of each proposed condition is provided at paragraphs 110–127.

Condition 1: AFS licensing requirement

110 Under this proposed condition, issuers of interests in charitable schemes would have to hold an AFS licence and comply with the duties and obligations applicable to AFS licensees if they raise investment funds from any non-associate retail clients.

111 Charitable debenture issuers that would be required to hold an AFS licence under the Corporations Act, but for the existing exemptions under [CO 02/184], will also be required to hold an AFS licence if they raise investment funds from non-associate retail clients.

112 This proposed condition will not affect all charitable debenture issuers that fundraise from retail clients. Some debenture issuers are not required to hold an AFS licence to issue debentures. For more information, see Is there a licensing exemption available for the issue of debentures? on our website.

113 Further, this condition will not affect charitable investment fundraisers that:

(a) raise investment funds from wholesale investors only; or

(b) have only associate retail clients.

114 Charitable investment fundraisers that must hold an AFS licence are subject to additional regulation under the Corporations Act. This includes:

(a) general duties applicable to licensees;

(b) financial reporting obligations of licensees, including reporting on applicable financial requirements;

(c) a requirement to have a dispute resolution system for dealing with retail clients that satisfies the requirements of the Corporations Act; and

DRAFT

(d) a requirement to have adequate compensation arrangements for retail clients, which is generally met through professional indemnity insurance for the financial services business.

115 AFS licensees must also satisfy financial resource requirements. While specific financial resource requirements generally apply to responsible entities, because charitable investment fundraisers issuing interests in schemes will not be required to register the scheme under Ch 5C of the Corporations Act, the particular financial requirements applying to responsible entities will not apply.

Condition 2: Prohibition on issue of at-call or short-term investments and provision of traditional banking products

116 Earlier surveillances of the charitable investment fundraiser industry have identified a risk that some retail clients may use products offered by charitable investment fundraisers as transactional facilities, where they make regular payments into the account (e.g. salary payments) and then withdraw this money to meet daily expenses. These arrangements, along with products requiring repayment within 31 days, represent at-call or short-term investments, and may place certain investors at greater risk due to their misunderstanding of the risk profile of the charitable investment fundraiser, and the fact that it is not an ADI-equivalent entity.

117 Option 1 modifies our original proposal on this issue (as set out in CP 207) such that:

(a) charitable investment fundraisers cannot issue at-call or short-term investments to non-associate retail clients (i.e. fixed term deposits of 31 days or more are permissible);

(b) subject to paragraph 117(c), charitable investment fundraisers can issue at-call or short-term investments to wholesale investors and associates;

(c) where there is at least one retail, non-associate retail clients in the scheme, the charitable investment fundraiser can issue at-call or short-term investments to wholesale clients and associates but must not facilitate redemptions or repayments of these investments if they have reason to believe that allowing repayments of those investments would materially increase the risk of the charitable investment fundraiser being unable to meet investors' repayment rights or expectations or on a winding up. That is, the obligation to facilitate repayment of at-call and short-term investments to wholesale clients and associates is subject to a liquidity overlay where the charitable investment fundraiser must be certain it can facilitate all repayments, in accordance with the relevant terms.

118 Option 1 also proposes to restrict the provision of traditional banking products and transactional facilities—such as cheques, automatic teller

DRAFT

machine (ATM), electronic funds transfer at point of sale (EFTPOS) or BPAY facilities—consistent with the restriction of at-call and short-term investments, unless the charitable investment fundraiser has only wholesale clients or associates.

119 This condition seeks to address the shadow banking risks of charitable investment fundraiser activities by reducing the extent of liquidity mismatch. It also aims to prevent investors from using their charitable investment fundraiser investment as a transactional facility. We envisage that it will be the charitable investment fundraiser's responsibility to monitor liquidity and manage redemption requests appropriately.

120 In our follow-up consultation, we did consider whether we should revise our proposals to be consistent with APRA's current proposal—that is, to permit the issue of short-term and at-call investments to wholesale investors and associates without any restriction on repayment. However, we considered that this would give rise to a situation where a charitable investment fundraiser could be obliged to meet short-term withdrawal requests from wholesale investors or associates but be prevented from preserving the asset pool to ensure retail investments can be repaid. Therefore, we consider it appropriate to adopt a slightly different position from APRA.

Condition 3: Restricted terms

121 No charitable investment fundraiser may describe their product using the terms 'at call', 'deposit', or derivatives of these terms where this is not the case. This is because such terms would be misleading and possibly result in retail clients confusing products offered by charitable investment fundraisers with traditional banking products.

Condition 4: Investor acknowledgement requirement

122 Charitable investment fundraisers would not be able to issue investment products to a non-associate retail client until it receives a written statement indicating that the investor acknowledges the prescribed disclosures and understands they may be unable to withdraw their investment when expected or get some or all of their money back. Currently, there is no requirement for investors outside the charitable investment sector to provide such a statement. By contrast, however, issuers of interests in registered managed investment schemes and debentures must provide a compliant disclosure document which contains the disclosures required by the relevant provisions of the Corporations Act. As there is no requirement for a charitable investment fundraisers to provide any disclosure, other than that proposed in Condition 5, we consider that this is a necessary investor protection measure to ensure that the investor is aware of the terms on which they invest, in the absence of any formal disclosure document.

DRAFT

Condition 5: Additional disclosure requirements

123 All charitable investment fundraisers would be required to make prominent and additional disclosure to all investors (not limited to retail clients) regarding the risks of the investment in offer documents and promotional materials. Further, charitable investment fundraisers would be required to clearly disclose how investment funds are used to support the organisation's charitable purpose (e.g. it may be that it is not the investment, but rather the yield on investment, less the interest payable to investors, that is directed towards promoting the organisation's charitable purpose).

Condition 6: Financial reporting

124 Charitable investment fundraisers that accept new investment fundraising from non-associate retail clients would be required to prepare audited financial statements. Charitable investment fundraisers that issue interests in charitable schemes would also be required to prepare audited financial statements for the scheme. Financial statements and audit reports would need to be lodged with the ACNC or, if the ACNC framework does not require lodgement, with ASIC.

Condition 7: Identification statements

125 All charitable investment fundraisers, except those under the 'group charities' exemption under existing policy, would be required to lodge an identification statement with enhanced disclosures. As a condition of relying on ASIC's exemptions, a charitable investment fundraiser would need to:

(a) continue to meet the existing requirements in [CO 02/184] to lodge:

  (i) an identification statement with ASIC; and

  (ii) a supplementary or replacement identification statement when an identification statement needs correcting or updating;

(b) in addition to meeting the existing content requirements for identification statements under [CO 02/184], set out the following:

  (i) the charitable purpose of the organisation that will be disclosed to investors;

  (ii) whether investment funds will be raised by issue of debentures or interests in a charitable scheme and, if the latter, a clear identification of the scheme;

  (iii) whether the charitable investment fundraiser is required to hold an AFS licence and, if so, the AFS licence number of the organisation;

  (iv) whether the charitable investment fundraiser will be required to lodge audited financial statements with the ACNC and, for issuers of interests in a charitable scheme, whether it will be required to

DRAFT

lodge the scheme's audited financial statements with the ACNC; and

(v) the financial year of the charitable investment fundraiser and, for issuers of interests in a charitable scheme, the financial year of the scheme; and

(c) provide information about its affairs if requested by ASIC and assist ASIC in checking on its compliance.

Condition 8: Breach reporting

126 All charitable investment fundraisers would be required to report to ASIC in writing when a significant breach, or a likely significant breach, of a condition of relief occurs.

127 This would apply in addition to the breach reporting requirement of those charitable investment fundraisers which hold an AFS licence for retail offerings.

Cumulative impact of Option 1

Impact on industry

128 We acknowledge that the implementation of Option 1 may impact industry financially and administratively. Ultimately, this may reduce the returns payable to investors (because of the increased compliance costs of the charity) and reduce the volume and scope of the charitable work undertaken by those charitable fundraisers. We have discussed the increased costs to industry in paragraphs 131- and Section G. However, we consider that this impact is offset by the increased transparency, financial stability and consumer confidence that will be achieved by returning charitable investment fundraisers to a more appropriately regulated environment.

129 Except for Condition 2 (prohibiting at-call and short-term investments to non-associate retail clients), the proposed reforms will only affect charities that undertake new investment fundraising on or after the commencement date of the adopted reforms, which is proposed to be a period of over 12 months after the announcement of our updated policy.

130 We acknowledge that prohibiting the issue at-call and short-term investments to retail clients may have a significant negative impact on the business. The size of the impact of ASIC's proposal is dependent on the extent of the retail funding by those non-RCDF charitable investment fundraisers, relative to the size of the total funding as a whole.

131 Based on APRA's data from 2013, retail funding constituted approximately 17% of total funding of RCDFs and approximately 55% of that figure

DRAFT

appeared to be invested in at-call investments: see APRA's banking exemption order RIS. We have assumed that:

(a) for the purposes of our estimates, non-RCDF charitable investment fundraisers also have approximately 17% of retail money; and

(b) based on our total estimate of $7 billion in funds under management by charitable investment fundraisers including RCDFs, we have assumed that a significantly lower portion (say 10% of the $7 billion) is managed by non–RCDF charitable investment fundraisers and therefore not subject to APRA's banking exemption order.

132 From our conversations with APRA and industry, it appears that the RCDFs do raise a substantial majority of the total funds raised. Therefore [17% x 10% x 55% x $7 billion] = $65.45m in funding could be lost. Assuming there are 45 non-RCDF entities which rely on ASIC exemptions, this represents an average loss of $1.45m in funding per entity. In practice, the impact of this cost will not be uniform.

133 If our assumption is not correct and non-RCDFs contribute to a greater percentage than 10% of the total amount raised, it follows that a proportionally greater amount of funding would be lost (or conversely, if the non-RCDFs raise less than 10% of the total amount raised). For example:

(a) if non-RCDFs raised 20% of the total, applying the calculation in paragraph 132, [65.45 x 2] = $130.9m in funding could be lost;

(b) if non-RCDFs raised 5% of the total, [65.45/2] = $32.73m in funding could be lost.

134 Of course, the amounts raised by all charitable investment fundraisers will vary year to year and may depend on many variables, including the particular projects that the fundraisers propose to undertake. Several major organisations have noted that various loans may need to be refinanced, resulting in increased funding costs to the charitable investment fundraisers. This would potentially affect the amount of resources available to achieve charitable objectives. Several funds and loan offset accounts may need to be closed. Others noted that they would need to look for sources of funding other than retail clients. Several respondents noted that, although retail clients could convert their at-call investments to 31-day notice accounts, many may not be willing to do so as they have comfort that they will be repaid without constraints. This could result in the loss of those and related accounts. Ultimately, this could reduce the amount of funds available to the charitable investment fundraisers to achieve their charitable objectives.

135 Further, charitable investment fundraisers constitute only a small portion of the Australian charities population. Organisations that fundraise through donations only do not raise investment funds and are not affected by our proposals.

DRAFT

136 As such, the primary costs to a charitable investment fundraiser that proposes to continue in operation will be in relation to:

(a) the increased compliance and disclosure requirements; and

(b) any loss of or change to the short-term retail banking business.

137 Under Condition 1 (AFS licensing requirement), those charitable investment fundraisers that propose to offer or continue to offer interests to retail clients will need to obtaining and maintain an AFS licence to deal in relevant financial products. Depending on the number of offerings and the level of complexity, this may involve retaining a compliance professional, possibly on a part time or ad-hoc basis and the engagement of an auditor. For most participants in the financial services industry, we would not expect the cost of this to be more than $25,000 per entity in the first year and minimal costs of approximately $15,000 per year for subsequent years.

138 Of those 12 charitable investment fundraisers that provided a submission to our follow-up consultation in 2016, three proposed to apply for a retail AFS licence (25% of the total number of respondents), three already held an AFS licence and consider it is good governance to do so, and three will restructure their business so that they no longer offer investment products to retail clients. The remaining respondents did not comment on this issue.

139 Cost estimates provided by respondents ranged from an initial cost of $55,000 to obtain an AFS licence (with ongoing costs of $20,000 per year) to $300,000 initially (with $80,000 per year thereafter). This represents a 30% increase in compliance costs.

140 Figures submitted to Treasury for the regulation stocktake in 2014, which measured the costs of regulation for the financial advice industry, suggest that the cost of obtaining an AFS licence is approximately $21,600 initially with annual costs thereafter of approximately $15,000 per year. On the basis of these figures, the estimated cost of holding an AFS licence across a 10-year period would be approximately $156,600. These costs contemplate an AFS licence with authorisations to permit dealing only, and not authorisations to act as a responsible entity.

141 We have considered the submissions of respondents about estimated costs and notes that there is considerable divergence from the figures submitted to Treasury for the regulation stocktake. While the cost estimates for the regulation stocktake were provided in the context of the financial advice industry, we consider that the charitable investment fundraising industry is not so complex to explain the costs estimated by respondents or to justify such radical departure from figures that have been used as a basis for AFS licence costings since 2014.

142 We have applied an estimate of $25,000 for charitable investment fundraisers to obtain the AFS licence (an increase on the cost estimates used

DRAFT

in the financial advice industry to reflect potential complexities associated with licensing of charitable investment fundraisers) and ongoing compliance costs of $15,000 per year. On the basis of these figures, the estimated cost for charitable investment fundraisers of holding an AFS licence across a 10-year period would be approximately $160,000.

143 On the basis of the figures obtained during consultation, we estimate that only 16% of the 90 charitable investment fundraisers (i.e. 15 entities) are likely to apply for an AFS licence. As set out in paragraph 138, we would expect that the remainder either:

(a) already hold an AFS licence;

(b) only have wholesale clients and/or clients that are associates;

(c) may consolidate their activities to offer through one AFS licensee acting for multiple associated charities; or

(d) may restructure their business to only provide financial services to wholesale clients.

144 These AFS licensees will also be required to meet base level financial requirements associated with holding an AFS licence. We consider that these requirements are appropriate, given the protections they provide to retail clients, and that these requirements match those provided to investors in many other investment classes.

145 However, we stress that the requirement to obtain an AFS licence is not a new requirement. Rather, this is required by the Corporations Act and, but for the existing exemption in [CO 02/184], all charitable investment fundraisers would currently be required to hold an AFS licence either to deal in the investments or to operate a registered managed investment scheme.

146 Condition 2 (prohibition on issue of at-call or short-term investments and provision of traditional banking products) is likely to impact the type of investments that charities can offer to retail clients, and may result in the need to restructure and even close investment funds, the possibility of refinancing loans and a consequent loss of profit.

147 This condition will also ensure that retail clients are not using these charitable investment fundraisers as transactional facilities, and will better align their investment objectives with the risk profile of the investment. It is not possible for us to estimate the ultimate cost of this condition, given that the size, investment type and source of funding of each charitable scheme is different. We note that it is open to a charitable investment fundraiser to restructure its funds as entirely non-retail where this is viable.

148 Our proposal is consistent with APRA’s proposals to prohibit RCDFs from issuing investments with a term of less than 31 days to retail clients and to greatly restrict the provision of traditional banking products. However,

DRAFT

unlike APRA, we have taken the view that a charitable investment fundraiser with any non-associate retail clients can only issue investments with a term of less than 31 days to wholesale investors and associates provided the charitable investment fundraiser does not have reason to believe that allowing repayments would materially increase the risk of the charitable investment fundraiser being unable to meet investors' repayment rights on a winding up. That is, the obligation to facilitate repayment of at-call and short-term investments to wholesale clients and associates is subject to a liquidity overlay, where the charitable investment fundraiser must be certain it can facilitate all repayments, in accordance with the relevant terms. For a further discussion, please see paragraph 117.

149 Conditions 3–8 impose additional disclosure obligations on charitable investment fundraisers. However, we consider that these conditions are likely to impose minimal costs on charitable investment fundraisers—we estimate a collective impact of approximately $10,000 per entity per year for all conditions. These conditions will largely impose minor administrative requirements on charitable investment fundraisers, and will not require extensive resources to achieve and maintain compliance. For Condition 6, we acknowledge that this will impose more onerous financial reporting obligations on charitable investment fundraisers, particularly those with annual revenues of less than $1 million. For Condition 8, the reporting of breaches will be a zero cost item, assuming the charitable investment fundraiser is compliant. Where a breach does occur, the charitable investment fundraiser is likely to incur minimal compliance and management costs in identifying, rectifying and reporting the breach.

150 We consider that the increased administration burden and costs for Conditions 3–8 are justified by the fact that charitable investment fundraisers are permitted to accept investments from the public without complying with the applicable regulatory regimes. The promise of repayment or holding of assets for the investors benefits creates a need for more accountability.

Impact on consumers

151 We reiterate that we conducted a public consultation in 2013 and it was open to investors to comment directly on the proposals, although none did so. It was also open to respondents during the first and follow-up consultation to obtain consumer feedback and, indeed, several submissions have noted both the positive and negative impacts on investors.

152 On balance, we consider that consumers will benefit from Option 1 through the more stable and transparent regulatory environment in which charitable investment fundraisers will operate.

153 We consider that consumers will also benefit from Option 1 through increased disclosure provided by the additional disclosure requirement and

DRAFT

investor acknowledgement requirement. These requirements will ensure that investors are aware of the regulatory environment in which charitable investment fundraisers operate, provide greater information about the charitable investment fundraiser's charitable purpose, and ensure that investors understand the risks of their investment. We cannot predict whether the disclosures will influence investor behaviour—whether investors will be deterred from investing in the charitable investment fund, not influenced at all or more willing to invest. We would expect that, as investors are largely driven by the desire to contribute to the charitable objectives of the fundraiser; such disclosure is unlikely to have a negative influence on the prospective investor. Rather, there will be increased transparency around the regulatory and prudential status of the charitable investment fundraiser and the offer, which in and of itself is a desirable outcome.

154 It is likely that the prohibition on the issue of at-call or short-term investments will most significantly impact investors, as this will limit the type of investments that charitable investment fundraisers can offer to retail clients. In particular, this prohibition will remove the ability of investors to use products offered by charitable investment fundraisers as a substitute for traditional banking services. Nonetheless, we consider this would have a positive outcome for consumers as it may achieve differentiation between charitable investment fundraisers and banks in the minds of retail clients, and thus reduce the potential impact of a charitable investment fundraiser failing.

Impact on government

155 The implementation of Option 1 will result in a higher regulatory burden for ASIC in monitoring the activities and compliance of charitable investment fundraisers.

156 In particular, while it is likely that relatively few charitable investment fundraisers will require an AFS licence, this will impose additional licensing and ongoing monitoring responsibilities on ASIC. Further, in order to monitor broader compliance with the additional disclosure requirements, investor acknowledgement requirements and the restriction on the use of certain terms, ASIC will have to engage in surveillance activities of charitable investment fundraisers.

157 While the requirements of Option 1 will impose additional costs on ASIC and the government, it is not anticipated that these costs would be significant in light of the relatively small number of charitable investment fundraisers currently operating. It is considered that these costs are offset by the increased financial stability and consumer confidence that will be achieved by bringing charitable investment fundraisers into a more regulated environment.

DRAFT

158 In contrast to continuing relief in [CO 02/184], Option 1 would reduce to some degree the risk of failures of charitable investment fundraisers or their managed investment schemes. A failure would require additional regulatory resources and may lead to calls for the Government to compensate individuals who have lost their life savings.

Other impacts

159 We consider that Option 1 will cumulatively create a more transparent and effectively regulated environment for charitable investment fundraisers to operate in.

160 These measures will ensure that investors are provided with sufficient information to make well-informed decisions about the risks and the nature of their investments. In particular, limiting the use of charitable investment fundraisers as transactional accounts will ensure that investors are not using charitable investment fundraisers as a substitute to traditional banking services and, in doing so, potentially adding to financial instability due to liquidity mismatches.

161 Further, these amendments will ensure that ASIC can adequately monitor charitable investment fundraisers to ensure ongoing compliance with the law, and minimise the risk of financial instability arising out of shadow banking activities and failures in the industry.

Option 2: Remove all existing exemptions, except in some limited circumstances

162 In Option 2, we propose to remove all existing exemptions in [CO 02/184] for new investment fundraising, except exemptions from the AFS licensing requirements of the Corporations Act for charitable investment fundraisers that only raise investment funds from associates.

Impact on industry

163 For charitable investment fundraisers who remain in the industry, there would be significant increase in compliance costs for those fundraisers who would currently be entitled to rely on the exemptions in [CO 02/184]. These charitable investment fundraisers would incur the following costs associated with operating their business.

164 Where charitable investment fundraisers issue interests in a managed investment scheme, the charitable investment fundraisers will incur costs associated with:

DRAFT

(a) obtaining an AFS licence authorising it to operate as a responsible entity;

(b) engaging a custodian unless the charitable investment fundraiser has net tangible assets of at least $10 million;

(c) registering each scheme as a managed investment scheme;

(d) ensuring that the responsible entity and its officers comply with their duties under Ch 5C;

(e) preparing a constitution and compliance plan that meets requirements under Ch 5C;

(f) where less than half of the directors of the responsible entity are external directors, forming a compliance committee and engaging members (the majority of which must be external) for appointment to this committee;

(g) preparing and issuing PDSs and ongoing disclosure that meet the requirements of Pt 7.9 of the Corporations Act.

165 Where a charitable investment fundraiser issues debentures, the charitable investment fundraiser would also need to:

(a) obtain an AFS licence authorising it to deal in debentures, unless the 'self-dealing' exemption applies;

(b) enter into a trust deed and appoint an external debenture trustee under Pt 2L.1. It must also comply with ongoing duties and reporting requirements under Pt 2L.1; and

(c) prepare and issue a prospectus under Ch 6D and comply with continuous disclosure obligations under s675.

166 Some charitable investment fundraisers may determine that the costs involved in regularising their operations are too high to continue offering to retail clients.

167 In essence, all of the costs and impacts outlined in Option 1 would be amplified under this option, with all charitable investment fundraisers having to meet extensive and costly regulatory requirements. For the purposes of the cost estimates in Section G, we have assumed the cost of Option 2 will be at least double that of Option1. However. Conditions 2–6 of Option 1 would not take effect in Option 2, as these are conditions that fall outside the traditional AFS licensing regime. This would have little impact practically for charitable investment fundraisers as these requirements would be replaced by more burdensome AFS licensing requirements.

168 It is acknowledged that this option would not restrict the investment options available to charitable investment fundraisers—unlike that proposed in Option 1, where at-call and short-term investments would be prohibited.

DRAFT

This benefit is likely to be outweighed by the significant increase in costs associated with this option, and the resulting loss of investment funds.

169 Overall, we would anticipate the number of charitable investment fundraisers operating in this environment would reduce drastically as compared to Option 1 or 3 and, in conjunction with this, the pool of money invested in charitable investment fundraisers would fall significantly.

Impact on consumers

170 Where charitable investment fundraisers continue to remain in business and comply with all legal requirements, there will be an associated cost which is likely to be passed onto consumers, thereby affecting returns.

171 Where charitable investment fundraisers cease operating and commence winding up, consumers will no longer be able to invest in that charitable investment fundraiser or support those charitable purposes. Consumers may experience delays realising their investment or suffer shortfalls as a result of this winding up, especially where this is effected quickly.

Impact on government

172 There will be an increase in the assessment of licensing and compliance documentation lodged by charitable investment fundraiser who seek to regularise their operations. There will also be an increase in surveillance and enforcement work for non-compliant charitable investment fundraisers, possibly resulting in enforced winding up and fire sale of assets.

Other impacts

173 Arguably, this would create a more level playing field with non-charitable investment funds and structures. However, it may also remove charitable investment fundraisers from the market, and therefore reduce the opportunities for investors to participate in legitimately charitable purposes.

Option 3: Make no substantive change to the current policy (status quo)

174 Option 3 entails making no substantive changes to the current policy set out in RG 87 or [CO 02/184]. We would remake [CO 02/184] as an ASIC instrument before the sunsetting date of 1 October 2016.

DRAFT

Impact on industry

175 Since the regulatory framework will not be affected, we would expect that there would be no significant impact on affected charitable bodies. This option is likely to be welcomed since it provides industry with certainty without changing the status quo and necessitating an increase in compliance costs.

176 In particular, industry would avoid incurring a number of administrative and financial burdens. The primary cost to a charitable investment fundraiser that would not be incurred as compared to Option 1 is the need to obtain and maintain an AFS licence, as well as the need to cease issuing at-call or short-term investments to retail clients. We estimate that not implementing an AFS licensing requirement could save a charitable investment fundraiser:

(a) up to $25,000 in the first year; and

(b) up to $160,000 across a 10-year period.

177 Not having to place restrictions on the provision of at-call or short-term investments would likely allow industry to maintain their current investment profiles and, in doing so, maintain the profits and structure that they would lose under Option 1. However, the charitable investment fundraiser will be required to restrict any issue of at-call or short-term investment to retail clients under the proposed APRA requirement, where that charitable investment fundraiser is also a RCDF. APRA has stated that, of 57 RCDFs, 55 are also charitable investment fundraisers.

178 Conditions 3–8 of Option 1, while not highly burdensome, would have cost charitable investment fundraisers approximately $10,000 per entity collectively. Further to these costs would be the minor administrative requirements associated with their compliance. Under Option 3, none of the requirements would apply, thus saving charitable investment fundraisers approximately $10,000 per entity.

179 Under this option, certain charitable investment fundraisers would continue to have to produce audited financial reports for the ACNC. However, charitable investment fundraisers with smaller revenues or that meet the definition of a basic religious charity would continue to be exempted from this requirement. This continued exemption would allow these charitable investment fundraisers to save additional costs compared to the requirements of Option 1, which is a significant sum of money for a smaller charitable investment fundraiser with minimal revenue.

180 While Condition 8 in Option 1 is not likely to impose any costs on most charitable investment fundraisers, where a charitable investment fundraiser is in breach this would require minimal costs on the part of the charitable investment fundraiser to report the breach, since the cost of rectifying the breach exist regardless of the obligation to report it.

DRAFT

Impact on consumers

181 As above, this option would not change the current position. However, it would therefore not address some of the investor protection issues that we have identified during our review of the regulatory framework affecting charitable investment fundraisers.

182 We consider that this would not address a number of risks that currently face investors in this investment class. In particular, maintaining the status quo would not address the fact that many investors treat charitable investment fundraisers as transactional accounts in lieu of traditional banking products, and in doing so fail to understand the risks of charitable investment fundraisers. Further, consumers will not benefit from the protections afforded to them under a more heavily regulated regime, and the associated increase in transparency and stability.

Impact on government

183 As above, we expect that there would be no significant impact in the short-term. In the longer term, Option 3 would increase to some degree the risk of failures of charitable investment fundraisers compared to other options. A failure would require additional regulatory resources and may lead to calls for the Government to compensate individuals who have lost their life savings.

Other impacts

184 This would not address some of the financial stability and investor protection issues about which we have concerns and which may result in market and consumer detriment in the longer term if not appropriately addressed.

DRAFT

D Consultation

First consultation—May 2013

185 On 20 May 2013, ASIC released CP 207 outlining two options for amending exemptions currently available to charitable investment fundraisers under RG 87.

186 In CP 207 we consulted on our review of the exemptions that apply to charitable investment fundraisers to assess whether they align with our regulatory objectives of facilitating confident and informed investors and maintaining fair and efficient financial markets.

187 The fundraising activities of charitable investment fundraisers are already regulated under the Corporations Act, and ASIC has a robust regulatory regime for these entities already in place. In our review, we considered options to amend the exemptions already in place, and how those exemptions might be amended in the context of the Government's broader steps in both the fundraising and not-for-profit sectors.

188 Although our framework provides some regulatory oversight of charitable investment fundraisers, they remain at heart a charitable and market mechanism. We have not sought to change that.

189 Under the previous requirements, we were not required to prepare a RIS at this stage of the process. We presented our proposed changes in CP 207 for public comment. These were:

(a) a proposal to retain all existing exemptions (with some modification) for new investment fundraising but on the basis that they are only available if existing conditions and a number of new conditions are satisfied (Option 2 of CP 207); and

(b) a proposal to remove all existing exemptions for new investment fundraising, except exemptions from the AFS licensing requirements of the Corporations Act for fundraisers that only raise investment funds from associates (Option 1 of CP 207).

190 In this RIS, we also consider that there is a third option, Option 3, which is to maintain the status quo and make no substantive changes to the existing policy position. This was not raised in CP 207 but is discussed in this document as Option 3.

191 We received 22 submissions in response to CP 207, of which 16 were from RCDFs. Although a majority of the submissions were from church-affiliated charitable investment fundraisers, and we also received submissions from non-religious charitable investment fundraisers, an industry body and a

DRAFT

professional services provider. However, despite being a public consultation, we did not receive any response from individual investors in the funds. As investors did not raise any objections in submissions, this suggests they are generally supportive of our consultation proposals.

192 There was some support for the proposed requirements, but many submissions opposed the imposition of any additional requirements on charitable investment fundraisers because the adoption of either of the proposals could significantly impact resources that could be directed towards achieving the organisation's charitable objectives. Respondents were generally supportive of proposed conditions that they could easily individually satisfy.

193 In particular, there was little support for the proposed licensing provisions. Respondents noted the increased costs associated with this proposal. However, there was acknowledgement that such a proposal would result in improved governance, risk management, compliance and transparency in the sector. We consider that the protection afforded to retail clients under the licensing environment, as are available in other similarly regulated investments, justify the additional costs that will be borne by charitable investment fundraisers under this proposal.

194 Respondents were predominantly opposed to the proposed prohibition on the issue of at-call or short-term investments, on the basis that it would cause a significant loss of business and revenue for charitable investment fundraisers. We have since refined our proposal so that:

(a) at-call or short-term investments cannot be issued to retail investors; and

(b) at-call or short-term investments can be issued to wholesale and associate investors provided that the fundraisers can demonstrate an ability to repay wholesale/associate investors without impairing repayment rights of retail investors.

195 Four respondents noted that the loss of at-call funds would result in significant loss of liquidity for charitable objectives and that the proposal would be a serious disincentive to supporters who may wish to lend funds to fundraisers, as many supporters lend funds on the basis that it can be repaid quickly. Five respondents also considered the change unnecessary because the shadow banking risks associated with mismatched liquidity can be addressed by capital and liquidity requirements. Further, they argued that investor acknowledgement and additional disclosure requirements mitigate the potential for investors to mistake their investment in a charitable investment fundraiser to be 'bank-like', so investors would not be more protected than they already are. Five entities noted that at-call funds generally lower the cost of funding in general.

DRAFT

196 While we acknowledge these concerns, we consider that the benefits from addressing the risks associated with mismatches in current assets over current liabilities and the associated risks of shadow banking outweighed the downsides of this proposal. We consider that this proposal will provide charitable investment fundraisers with more certainty about their cash flows, as investments will no longer be as liquid and readily available for withdrawal.

197 Eight respondents were not opposed to the additional disclosures concerning the risks associated with the investments and how the charitable investment fundraiser is using investment funds to achieve its charitable objectives. There was some acceptance that the disclosures should be clear regarding the investor's inability to rely on regulatory protections. However, the majority did not feel that the disclosures were necessary or appropriate; indeed, many argued that the disclosures would overly focus on the risk of loss, not the degree of regulatory protection.

198 It was also proposed that charitable investment fundraisers would be required to acquire a written statement from investors acknowledging the prescribed disclosures and that they understand the risks of the investment. Respondents were generally supportive, although a number noted that they have procedures in place to ensure that redemptions can be met and that these are known risks in the market.

199 Of those that commented on this point, 13 respondents were supportive of ASIC's proposal to restrict the use of terms such as 'at call' or 'deposit', or derivatives of these terms.

200 We proposed that charitable investment fundraisers be required to prepare audited financial statements where they have investors other than associated investors, as well requiring that charitable investment fundraisers that issue interests in managed investment schemes must also prepare audited financial statements for the scheme. A number of submissions were supportive of this proposal, although noted that the requirements should be consistent with those of the ACNC framework. We acknowledge that this requirement will impose more onerous requirements than the ACNC framework on some charities; however, we consider this appropriate as charitable investment fundraisers are currently permitted to accept investments without complying with the normal regulatory regime. These requirements will provide greater accountability and transparency, while also bringing charitable investment fundraisers in line with the provisions in other market areas.

201 We proposed that charitable investment fundraisers will be required to report to ASIC in writing a significant breach, or a likely significant breach, of a condition of relief. Charitable investment fundraisers will also be required to provide an annual certification of compliance. Some respondents expressed concern with higher compliance costs, while a number were supportive of

DRAFT

the improvements it would bring to corporate governance in the sector. We do not consider that compliance costs are likely to be significant, as non-compliance will predominantly occur where there is a delay in the lodgement of financial statements. The intended outcome of this proposal is to identify those entities that may have systemic issues in meeting their disclosure obligations, thus mitigating any compliance costs for compliant charitable investment fundraisers.

202 We proposed that all charitable investment fundraisers, except those under the ‘group charities’ exemption, will be required to lodge an identification statement with enhanced disclosures. There was little concern expressed by respondents on this proposal.

203 In response to the feedback received, we have proposed implementing a modified version of Option 2 as outlined in CP 207 (designated Option 1 in this RIS). This amended option resulted in some proposed conditions being modified, as well as some of the proposed conditions no longer being implemented.

204 In particular, we had proposed imposing the following conditions as part of Option 2 in CP 207:

(a) minimum charitable assets;

(b) capital and liquidity requirements; and

(c) compliance audits.

205 In light of the feedback received, however, we have elected to remove these conditions. The minimum charitable assets condition was removed as respondents expressed concern with the restriction of investment choice or asset allocation, and noted that this is an inappropriate regulatory function. It is acknowledged that a common model used by charities derives a benefit from the spread on loans or management fees on assets, rather than the use of the assets themselves. We consider that disclosures otherwise proposed in Option 1 outlined in this RIS will provide investors with sufficient information concerning the nature of their investment with the charitable investment fundraiser.

206 Respondents were mixed in their feedback on the capital and liquidity requirements, with a number noting that this would be costly to monitor and enforce. In light of the feedback received, and in consideration of the costs and difficulty involved in enforcing this condition, we considered it appropriate to remove it. We acknowledge also that imposing such a condition would create significant unjustified costs for charitable investment fundraisers, given that there has been no serious history of investor loss.

DRAFT

207 In light of the removal of the minimum charitable asset and capital and liquidity conditions, we considered that there was no benefit in maintaining the compliance audit condition.

208 We consider that this approach strikes an appropriate balance between our core objectives of promoting confident and informed investors, while seeking to minimise any additional administrative and compliance costs for charitable investment fundraisers. As discussed, the matter was adjourned, no RIS was prepared and the proposals were not effected.

Follow-up consultation—January and February 2016

209 In response to the feedback received in the first round of consultation, and in order to seek more information, we conducted a targeted, follow-up consultation in January and February 2016. As we had already conducted a public consultation in 2013, we determined to approach the original respondents directly. In the further consultation, we proposed providing certain renewed exemptions, subject to conditions, in order to allow continued charitable investment fundraising with reduced regulatory burdens, while still safeguarding provisions to promote confident and informed investment appropriate to the nature of particular fundraising offers.

210 We presented our modified proposals of Option 1. As stated, we received 13 written submissions and one verbal response. A majority of the submissions were from church-affiliated charitable investment fundraisers. We did not, as expected, receive any response from individual investors in the funds. However, it was open to the respondents to canvass the views of their investors and, indeed, some of the submissions were able to comment from the perspective of investors and potential investors.

211 There was some support for the revised requirements, as some respondents already hold a retail AFS licence and others would not be impacted by the prohibition on short-term investments. However, submissions opposed the imposition of any additional regulations on charitable investment fundraisers because the adoption of either of the proposals could significantly impact resources that could be directed towards achieving the organisation's charitable objectives.

212 As before, respondents were mixed in their responses to the proposed licensing provisions, with 11 opposing the requirements, stating that the requirement to hold an AFS licence was disproportionate to the risk and in their view investors invested primarily to support the charitable objectives and not for investment purposes. Two did not agree with the change and planned to restructure their business to no longer accept retail investments.

DRAFT

Three of those 13 respondents currently hold an AFS licence and so are not impacted by the proposals.

213 Regarding the restriction on the issue of at-call or short-term investments and the restriction on the provision of traditional banking products, five respondents were very opposed to this proposal on the basis that it would cause a significant loss of business and revenue for charitable investment fundraisers, the total impact of which cannot be immediately estimated. They proposed that a more suitable way to manage the liquidity concerns was to impose requirements such as:

(a) liquidity and capital adequacy requirements where funds are raised from individuals;

(b) quarantining assets retail client assets;

(c) mandating capital and solvency triggers; and

(d) maturity profiling.

214 However, we emphasise that APRA has already proposed to prohibit the issue of at-call and short-term deposits to *retail* clients in RCDFs. ASIC's position is to also restrict the issue of at-call and short-term investments to *wholesale and associated* investors in the scheme where there are retail clients in the same scheme by imposing a liquidity overlay. In addition, we consider that the prohibition is required because the practice is a shadow banking activity, without appropriate prudential and regulatory oversight,

215 In relation to:

(a) additional disclosure requirements—several respondents did not agree with this requirement, explaining that it may unfairly alarm investors and reiterating that there has been no significant investment losses to date;

(b) investor acknowledgement requirement—several respondents did not comment on or opposed this requirement, whereas others queried the benefit; and

(c) the restriction of the use of terms such as 'at-call' or 'deposit', or derivatives of these terms—most respondents acknowledged that this restriction was appropriate in circumstances where the name did not accurately describe the product.

(d)

216 Generally, it was noted that such matters would divert resources away from achieving the charitable objectives.

217 Most respondents did not express specific opposition to the other requirements relating to:

(a) financial reporting;

DRAFT

(b) identification statements; and

(c) breach reporting.

However, as above, it was noted again that such matters would divert resources away from achieving the charitable objects.

218 We developed this RIS throughout and subsequent to the follow-up consultation. Our ultimate proposals and final RIS has ultimately been informed by the information and data provided by respondents.

219 Copies of CP 207 and of our Report 000 *Response to submissions on CP 207 Charitable investment fundraisers* (REP 000) are available from the ASIC website.

DRAFT

E Recommended option

Option 1

220 We recommend Option 1, being a modified version of that originally proposed as Option 2 in CP 207. Option 1 is also recommended to provide a consistent approach with APRA, which has already proposed to modify the existing banking exemption order and prohibit the issue of at-call and short-term investments to retail clients. We consider that this is the option with the highest net benefit, given the reasons set out at paragraphs 221–223 below and the potential cost and detriment to the charitable investment industry and its beneficiaries.

221 We consider that imposition of each of the Conditions 1–8 discussed in paragraph 107 is necessary to address the investor protection and financial stability concerns that were identified as part of our general review of the industry in 2013 and subsequently. We acknowledge that there will be an impact to industry, in addition to the costs that will be incurred because of the APRA proposal to modify the existing banking exemption order: see paragraphs 28-30.

222 The existing exemptions under RG 87 were provided on the basis that because of the differing expectations of regulatory protection by investors who are motivated at least partly by charitable objectives, charitable investment fundraisers should be largely relieved from the regulatory burden applicable to commercial fundraisers. We acknowledge that furthering charitable objectives may be in the public interest. However, there is a competing public interest in ensuring investors are confident and informed. When considering giving exemptions under the Corporations Act, we must consider the objectives of the relevant provisions of the Corporations Act and our obligations under the *Australian Securities and Investments Commission Act 2001* (ASIC Act) that relate to specific aspects of the public interest.

223 Modification, rather than removal, of the existing exemptions may be appropriate if we impose conditions that address the objectives of the exempted provisions in a manner more appropriate to this particular kind of fundraising.

Option 2

224 It is open to ASIC to allow [CO 02/184] to sunset (apart from part of the licensing exemption)—that is, the existing exemptive relief will cease and charitable investment fundraisers will be required to comply with the

DRAFT

extensive the fundraising, managed investment, debenture and remaining licensing provisions.

225 We do not consider that removing all exemptions in accordance with Option 2 is appropriate. This more onerous approach is unnecessarily burdensome and will significantly increase the costs of compliance, which is likely to deter some charitable investment fundraisers from entering or remaining in the business of charitable fundraising. We estimate that the cost of compliance will be at least double those of pursuing Option 1.

226 In any event, for both Option 2 and Option 3 (paragraphs 227–131) it would mean that there would be a duplicate regime where RCDFs (which are regulated by APRA) are not permitted to issue at-call and short-term investments but other non-RCDF charitable investment fundraisers would be permitted, resulting in an arbitrary and arguably unfair regime.. As a result, RCDFs would be competing directly but unequally with non-RCDFs for retail investment (as retail investors are still permitted to make at-call and short term investments in non-RCDFs) further threatening the fund raising efforts and charitable projects of such RCDFs. It is possible that this would divert both at-call and longer term retail money away from RCDFs, compounding the impact of APRA's Banking Act Exemption.

Option 3

227 We do not consider that maintaining the status quo, in accordance with Option 3, is advisable at this time, given prevailing concerns about investor protection and financial stability.

228 As discussed above, RCDFs would also be competing directly but unequally with non-RCDFs for retail investment, further threatening the fund raising efforts and charitable projects of such RCDFs. It is possible that this would divert both at-call and longer term retail money away from RCDFs, compounding the impact of APRA's Banking Act Exemption.

229 We have summarised the options in Table 1.

DRAFT

Table 1: Summary of options

Element	Option 1	Option 2	Option 3
Compliance costs and indicative indirect costs	Moderate costs across the industry. Significant potential loss of business for those non-RCDF entities that operate a retail banking business.	Significant costs for the industry, including the impact on RCDFs from the unequal treatment of non-RCDFs which would continue to be permitted to offer at-call retail investments. This may compound the impact of APRA's Banking Act Exemption, diverting funds away from RCDFs further and compromising their charitable efforts.	No immediate change. However, there would be an impact on RCDFs from the unequal treatment of non-RCDFs which would continue to be permitted to offer at-call retail investments. This may compound the impact of APRA's Banking Act Exemption, diverting funds away from RCDFs further and compromising their charitable efforts.
Leads to improved protection for retail clients.	Strong—meets this criteria	Strong—meets with criteria	Nil—does not meet this criteria
Overall	Moderate net benefit	Marginal net benefit	No change

DRAFT

F Implementation and review

230 The recommended option will be implemented using one instrument which will replace [CO 02/184].

231 The instrument will provide for the relief from the Corporations Act and describe the conditions that charitable bodies must comply with to invoke that relief.

232 In contrast to the existing [CO 02/184], the new instrument will require charitable investment fundraisers to:

(a) acquire an AFS licence to offer investments to retail clients;

(b) not issue at-call or short-term investments or provide traditional banking products to non-associate retail clients, and restrict the issue of these investments and provision of these products to wholesale investors and associates;

(c) not use certain terminology;

(d) obtain an investor acknowledgement from retail clients;

(e) make certain disclosures to all investors and additional disclosure to non-associate retail clients;

(f) meet financial reporting requirements;

(g) lodge an identification statement with new content requirements; and

(h) report breaches of the above conditions.

233 We also propose to remake the related class order [CO 02/151] as an ASIC instrument, which is otherwise due to sunset. In addition, we will update RG 87 to reflect the change in policy.

234 In terms of review, we expect to work with charitable investment fundraisers through the transition period and beyond, to help them in understand the requirements. We will be in a position to collect more data from charitable investment fundraisers in the expanded identification statements. We expect to conduct some form of review thereafter to assess compliance and the effect of the changes on the behaviours of the charitable investment industry.

DRAFT

G Regulatory Burden and Summary Cost Offset (RBCO) Estimate Table

235 We understand that approximately 100 charitable investment fundraisers have relied on [CO 02/184], based on our consultation with industry in 2013. However, based on the number of entities registered with APRA as RCDFs and the actual number of identification statements/sponsor arrangements we have received, we estimate that at any one time, no more than 90 entities are relying on [CO 02/184]. Therefore, we have estimated the following costs on the basis of there being:

(a) 90 charitable investment fundraisers affected by all changes besides the prohibition of retail at-call and short-term investments; and

(b) 45 charitable investment fundraisers not affected by the banking exemption order.

Option 1

Table 2: Costs of changes introduced by Option 1

Change	Costs per entity over 10 years	Total
Obtaining an AFS licence	An initial cost of $25,000, plus $15,000 per year for 9 years = **$160,000**	16% of 90 charitable investment fundraisers, multiplied by $160,000 = **$2.4m**
Loss of retail short-term and at-call deposits and retail transactional banking business to non-RCDF charitable investment fundraisers	We estimate this could result in a loss of funding per entity of $14.5m.[1]	$14.5m multiplied by 45 charitable investment fundraisers = **$652.5m**
Increased administrative requirements in Conditions 3–8	$10,000 multiplied by 10 years = **$100,000**	90 charitable investment fundraisers multiplied by $100,000 = **$9m**
All changes	**$14.76m**	**$663.9m**

Note 1: Total costs are based on 90 charitable investment fundraisers being affected.

[1] As stated in paragraphs 131to 133, based on APRA's data from 2013, retail funding constituted approximately 17% of total funding of RCDFs and approximately 55% of that figure appeared to be invested in at-call products. We have assumed that non-RCDF fundraisers also have approximately 17% of retail money. Further, based on our total estimate of $7 billion funds raising by charitable investment fundraisers, including RCDFs, it is likely that a significantly lower portion (approximately 10% of the $7 billion) is raised by those CIFs which are not RCDFs and therefore subject to APRA's Banking Exemption Order. Therefore, [17% x 10% x 55% x $7 billion] = $65.45m in funding could be lost. Assuming there are 45 non-RCDF entities which rely on ASIC exemptions, this represents an average loss of $1.45m in funding per entity or possibly a maximum of $14.5m per entity over 10 years. It is possible that non-RCDFs raise significantly less or more than the assumed figure of 10% - please see paragraph 21(e) for a sensitivity analysis around this figure.

DRAFT

Note 2: See paragraphs 131–**Error! Reference source not found.** for the basis of our estimate of the cost of the loss of retail short-term and at-call deposits and retail transactional banking business to non-RCDF charitable investment fundraisers.

236 For the reasons set out in paragraph 143, we have assumed that 16% of 90 charitable investment fundraisers (15 entities) will apply for a retail AFS licence.

Option 2

237 We would expect the costs imposed under Option 2 to be at least double the cost of Option 1 ($663.9 million multiplied by two equals $1.327 billion), since the charitable investment fundraiser will be required to, among other things:

(a) obtain an AFS licence authorising it to act as responsible entity of a registered scheme and operate a compliant responsible entity business;

(b) register with ASIC its charitable schemes as managed investment schemes; and

(c) prepare and maintain compliant PDSs for each scheme.

238 In addition there would be a duplicate regime where RCDFs regulated by APRA are not permitted to issue at-call and short-term investments but other charitable investment fundraisers which are not RCDFs would be permitted, resulting in an arbitrary and arguably unfair regime.

Option 3

239 Under Option 3, there would be no change in costs as the current relief settings would be maintained. In any event, it would mean that there would be a duplicate regime where RCDFs regulated by APRA are not permitted to issue at-call and short-term investments but other charitable investment fundraisers which are not RCDFs would be permitted, resulting in an arbitrary and arguably unfair regime.

DRAFT