AVCAL Government and Regulatory Update - November 2017

POLICY & ADVOCACY

INVESTOR ENGAGEMENT

CONNECTED COMMUNITY

Highlights:

- Deloitte Access Economics research – commissioned by AVCAL – reveals private equity-backed businesses contributed 2.6% to Australia's GDP, supported 327,000 FTE jobs, and accounted for 11% of total Australian employment growth in FY2016;
- AVCAL led the industry's response to Government on proposed changes to the FinTech regulatory regime, advocating for the lifting of current restrictions to support more investment;
- AVCAL supported Government reforms to resolve a range of ESVCLP and VCLP tax issues that were identified by our industry during the course of 2017.

Key regulatory, legal and tax issues

Over recent months, we have advocated on a number of important regulatory, legal and tax issues on behalf of the industry. Some of the highlights of our work are detailed below:

1. Deloitte Access Economics – contribution of private equity to the Australian economy

Deloitte Access Economics is currently finalising its research report analysing the economic contribution of private equity in Australia. As you will recall, the last edition of the report (released in March 2013) highlighted a number of key metrics that we have used extensively in our policy and advocacy work on behalf of the industry. The analysis focusses on the industry's role in supporting and growing employment across the economy, and through that, contributing to gross domestic product. Those metrics together help to paint a holistic picture of the role of our sector within the economy.

The 2017 economic analysis provides some valuable up-to-date insights, including:

- In FY2016, private-equity backed businesses contributed **$43 billion in total value** added to the economy – equal to **2.6% of Australian GDP**;
- Private equity-backed businesses **supported 327,000 FTE jobs** (172,000 directly, and 155,000 indirectly);
- In FY2016, private equity-backed businesses added almost 20,000 FTE jobs, accounting for **11% of total Australian employment growth** in FY2016;
- Private-equity backed businesses typically delivered **annual revenue growth of 20%**, while boosting the size of their workforce by 24%;
- More than 85% of private-equity businesses introduced some type of process or product innovation in FY2016; far greater than the average profile of non-PE backed businesses.

Over the year ahead, we plan to use the report's findings to help inform some of our key external stakeholders about the important role that our industry plays in growing the economy. One of our key strategies in this area will be a program of portfolio company site visits with members of parliament and GPs, to showcase how private equity investment transforms businesses through capital and strategic support. We will be in touch with GPs across Australia to seek their assistance in visiting portfolio companies in key electorates.

Thank you to all of our members who provided portfolio company data for the report.

2. ASIC Regulatory Guide 97 – fee and cost disclosure by super funds

As many of you will know, over the past four years we have worked closely with LP members to develop an industry response to the implementation of ASIC Regulatory Guide 97 which deals with the disclosure of fees and costs by super funds and other managed investment products issued to retail clients.

Following our extensive advocacy efforts in this area, ASIC agreed to clarify and amend aspects of its guidance that relate to the disclosure of private equity/venture capital fees and costs, including accounting for carried interest and transaction costs. ASIC's updated guidance, released 22 June 2017, is available here. The result was a significant improvement on the previous guidance, and will allow private equity and venture capital to compete on a more level footing to other asset classes. ASIC's FAQs 9-13 are of particular relevance.

The latest developments are that during November 2017, ASIC announced that:

- It would be extending its RG97 'facilitative compliance' period beyond 30 September 2017; and
- ASIC would be appointing an external expert to conduct a review of the fees and costs disclosure under RG97 to ensure that it is meeting its goal of greater transparency for consumers.

The external expert will consider the RG97 reforms and liaise with industry in order to make recommendations on any necessary changes required to improve transparency and comparability. The process is expected to conclude in the first half of 2018. In the interim, ASIC has stated that funds should provide accurate fee and cost information to consumers, and that ASIC will continue to take a facilitative compliance approach (with a focus on ensuring disclosure does not mislead consumers).

Once an external expert has been appointed, we will take an active role in representing the private equity and venture capital industry and superannuation funds as part of the review process.

3. FinTech – regulatory sandbox and changes to ESVCLP/VCLP investment restrictions

In November 2017, the Government released draft legislation to introduce a new FinTech regulatory sandbox which would provide some relief, with conditions, from the Australian Financial Services and Australian Credit Licensing regimes. We provided a submission in response to the reforms, emphasising the importance of a regime that delivers practical and commercial efficiencies that will support the growth of early stage FinTech businesses.

Separately, we have been working closely with Treasury on proposed changes to the ESVCLP and VCLP framework to explicitly permit investment into FinTech businesses. We expect to see more information from the Government in the period ahead about how feedback from industry has been taken into account in progressing these reforms.

4. ESVCLP and VCLP changes

We are also continuing to engage with Treasury on a package of proposed amendments aimed at further improving the ESVCLP and VCLP framework. These measures would complement the changes that came into effect on 1 July 2016, and the March 2017 amendments that extend CGT concessions to institutions which invest via interposed trusts.

AVCAL supported the draft legislation that was released by the Government earlier this month, addressing a number of the technical issues that we have previously raised with Treasury. Some of the key issues incorporated into these reforms include: clarifying the treatment of pre-owned shares, permitting investment by managed investment trusts (MITs) into AFOFs, and amending the definition of a public trading trust. Subject to the evolving Parliamentary schedule, the Government expects the reforms will be legislated before the end of the year.

In 2018, we will work closely with Treasury to resolve further outstanding matters, including the calculation of the 20% offshore concession by funds, and tax treatment of gains made in ESVCLP portfolio companies where the total asset value exceeds $250 million.

5. Productivity Commission review – competitiveness and efficiency in the superannuation system

Over recent weeks we have continued to actively participate in the Productivity Commission's review of the superannuation system. In August 2017, we put forward a detailed submission setting out the implications of regulation that further entrenches a singular focus on low cost products, while highlighting the important role that private equity and venture capital can play in delivering attractive after-fee returns as part of a balanced portfolio of investments.

The Productivity Commission is expected to release its draft report in early 2018, with a final report scheduled for release in June 2018.

6. ATO – negative control and the application of Division 6C

We are continuing to engage with the ATO in response to its draft framework document setting out its position on the question of negative control within the context of Division 6C of the Income Tax Assessment Act 1936. Working closely with leading tax experts in our industry and GPs, we have presented to the ATO a 'safe harbour' proposal which seeks to ensure that common VC veto rights would not breach the managed investment trust rules.

The ATO is expected to release revised draft guidance before the end of 2017, and we will liaise with members once that is available to ensure that the industry's views continue to be advanced as the ATO progresses towards finalisation of its position.

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