CAMAC enquiry – MIS - September 2011

My submission on the Discussion Paper is as an investor in a number of listed MISs, managed by various REs, which invested in real property and infrastructure: many of these have failed over the past 3 years. Thus my comments are based entirely on my experience with trust-based schemes.

This enquiry is welcome and long overdue. I do not comment on some of the detailed discussion in the Paper regarding the particular technical and administrative problems identified, including multiple entities in distress under one RE. However, the time is more than overdue to ask whether the MIS regime should be retained at all, or replaced with a regulatory regime that is much stronger, subject to higher capital requirements and a far better governance regime. The widespread failure of MISs has been remarkable, especially for listed entities that are supposed to be subject to the protections of the Listing Rules. (There have of course also been serious failures in the agribusiness sector, and I surmise that they may have been the main impetus behind this enquiry).

To the retail investor, it is hard to avoid the conclusion that the MIS regime was established to suit the preferences and convenience of product promoters and asset managers, not the rights and interests of investors. It has been far too easy for incompetent product promoters to raise public money, manage it poorly, charge high fees and gloss over major conflicts of interest, with little or no ability for the MIS investors to have any say in the management of their capital or hold the RE directors and managers to account: the only practical remedy was to sell on market.

The first paragraph in Section 1.1 notes the legal difficulties that can occur when an MIS suffers financial stress. I submit that these difficulties could in many cases have been mitigated, even if not eliminated, by having a far more robust governance structure that allowed for regular engagement (and accountability) between MIS managers and their investors.

Although page 5 states that the terms of reference do not include tax issues, I would like to draw attention to a major problem regarding a "declaration of no value" by liquidators/ administrators for capital gains tax purposes. This could easily be rectified by amending the tax legalisation. As an example, I held investments in two listed property trusts that were managed by Rubicon: both of those trusts, and others, went into Administration. In one case, the liquidators said that they were not able to give a notice in accordance with S 104-145, as the Scheme was not a company; in another case, the Administrator [a different insolvency firm] of the trust did issue such a "no value" declaration. These conflicting professional opinions are disturbing and add to investor frustration with the MIS regime.

Section 2.2.5 notes that the legislation does not mandate a particular type of structure; the Paper says that a distinction can be drawn between trust based and contract based MISs. Section 2.1 notes that listed MISs accounted for $116 Billion of market capitalisation. I expect that all of these, as well as some unlisted MISs, could be described as trust-based MISs, in contrast to contract-base schemes. As Section 2.2.5 acknowledged, the roles of MISs have expanded into areas similar to those of companies- on a very large scale over recent years.

Section 2.2.2 states that an MIS cannot operate without an RE, which must hold an Australian financial service licence. The MIS must also have a scheme constitution, a compliance plan, and in some instances a compliance committee. I submit that these requirements are too meagre and easy to satisfy, and have given rise to a "box-ticking" approach amongst some of the poorer REs. These requirements have been seen to be utterly inadequate; they have not prevented the failure of several large, listed MISs (amongst others), causing the loss of well over $10B of investors' capital. In many cases there were also substantial losses to lenders.

Chapter 5C requires an RE and its officers to act in the best interests of the scheme members, and give priority to the members' interests if a conflict arises; despite this legal obligation, there have been obvious cases where an RE has put its own interests first, or at least been reckless regarding the members' interests, especially when deciding to cause the MISs to buy further assets (and thereby either burdening the MISs with substantial debts to do so, or diluting members' interests through frequent and large equity raisings). The obvious incentive for the RE in such cases was the lure of transaction fees (to the RE or its related parties) on the acquisitions and higher annual management fees earned on the enlarged asset base. Most of the listed funds managed by Rubicon/Allco, Babcock& Brown and Macquarie Bank were powerful examples of this. These conflicts should have been abundantly clear to the REs and their officers, and the legislation seems not to have acted as any check on such conflicts.

During the years leading up to the GFC, there was a race for REs to buy property and infrastructure assets, to "bulk up" their asset management businesses. This competition caused MISs to buy overpriced assets and it would in practice have been very hard for individuals or groups of scheme members to have prevented or overturned the REs' decisions to make those asset purchases. Thus scheme members suffered twice over: first, from the payment of unnecessary fees and secondly, but much more importantly, through being forced to pay highly inflated prices for assets.

Since most of those purchases were financed by a high proportion of debt, the members' equity in those assets was quickly wiped out when the asset markets turned down in 2008 and later years. One cannot blame the huge losses of the GFC solely on the RE regime, but for these investors in property and infrastructure MISs, a substantial part of the losses could have been avoided if the conflict of interest provisions had been properly followed and policed. The civil remedies available to members for "mismanagement" of the MISs appear to be very limited in their scope.

The fundamental problem with the regime is that the members and management/ promoters of the MISs, through the RE, are disengaged from each other. The members of the MISs, even in listed schemes, do not have the right to appoint “their” directors or vote on the remuneration of directors and executives; nor do they have right to seek general meetings, except under the provisions of S 252. The S252 provisions are clearly designed to be an exception rather than the norm: in practice they would be difficult (and too slow) to organise for retail investors. How often have they been used in the last ten years?

In any case, they may only be instituted to propose and vote on a special or extraordinary resolution—not to seek a meeting for the benefit of information and discussion. [I acknowledge that in a few more enlightened cases, REs have voluntarily held annual information meetings, this is welcome, but should be compulsory, not a matter of choice.] In some cases, equity has been raised from investors through a prospectus and some years later the MIS has gone into Administration or liquidation without ever having held a members meeting; thus the directors and senior executives of the RE can, and have, overseen the destruction of billions of dollars of investor value without ever having faced their scheme members, whose capital they were supposed to be managing and safeguarding.

There is an exception to this, where the MIS’s capital structure comprises stapled securities that include shares in a company. In that case, members have been afforded the governance procedures of companies, including annual meetings and some voting rights. Even then, there is the strange distinction that members vote to approve the remuneration of directors of the *company*, but have no say in additional remuneration that the same (or other) individuals receive as payments from the *trust* components of the stapled security. Such a distinction is open to abuse.

7.1 Convening scheme meetings

I strongly agree with the view expressed in the Paper that “agms would provide a sense of cohesive ownership and provide an opportunity for members to raise matters with the RE without the need to propose a special or extraordinary resolution". An annual general meeting should be mandatory, at least for *listed* MISs. The Turnbull report recommendation that provision be made in the legislation for members to *request* the RE to call a general meeting does not go far enough: it should be an automatic obligation in return for having raised capital from the public.

There may be merit in stipulating some purposes for the meeting, but such a provision should not be exclusive. At a minimum, the RE should be required to make a presentation to members on the financial statements of the MIS for the most recent financial year and afford a reasonable opportunity for members to ask questions of the RE directors and executives about the MIS, its activities and prospects. It would also be fair to enable members to ask relevant questions of the auditor, as they can with a listed company.

ASIC should also be granted the power to convene members meetings.

Conclusion

I submit that listed MISs should be subject, as closely as practicable, to the same governance, voting and reporting requirements as for listed companies. It is unacceptable to investors that the degree of governance and engagement can be so different, between companies and trusts, merely because of the accident of the entity's capital structure. It would be strongly preferable to mandate such a process in legislation, rather than only by means of the Listing Rules. It is bad policy for the owners of a substantial part of the Australian listed market capitalisation to be treated as second class citizens. As far as possible, *unlisted* trust-based MISs should be subject to the same improved policies and principles.

Richard Wilkins
17 September 2011

ACI

Compliance • Risk • Governance
Education • Leadership • Recognition

Principal Members

September 23, 2011

Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

Via email: camac@camac.gov.au

ACI would like to take the opportunity to thank the Corporations and Markets Advisory Committee (CAMAC) for providing an opportunity to comment upon its Managed Investment Schemes (MIS) discussion paper.

ACI is the peak industry body for the practice of compliance, risk and governance in the Asia Pacific region. Our members are compliance, risk and governance professionals who are actively engaged in the private, professional services and Government sectors.

We note under section 1.3 of the discussion paper the request "to raise any other matters related to the operation of MISs that they consider call for legislative or other regulatory reform".

Parts 5c.4 and 5c.5 of the Corporations Act address Compliance Plan and the Compliance committee that a registered MIS must have. In general terms we support the need for an MIS to have a compliance plan, and possibly a compliance committee, however we question the fact that the MIS is not required to have a compliance officer or at the very least have a suitably qualified compliance professional undertake a review of the compliance plan to ensure it will meet the needs of the MIS and ensure it does not find itself in breach of its regulatory and legislative obligations in the future. Better still, ACI believes a compliance profession should be required to establish the plan in the first instance.

Further more, in section 601HG(1) of the Act states:

> "The responsible entity of a registered scheme must ensure that at all times a registered company auditor, an audit firm or an authorised audit company is engaged to audit compliance with the scheme's compliance plan in accordance with this section. This auditor, firm or company is referred to as the *auditor of the compliance plan*."

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ACI argues that the use of auditors to examine the MISs compliance with its compliance plan will only be effective in part. Compliance audits of this nature tend to be backward looking in nature and only provides the board, compliance committee or regulator with a degree of surety as to past performance over s stated period of time.

However, the use of a trained compliance professional to undertake a compliance review not only examines past activities, but will also stress test the current compliance framework and systems, as well as examining the culture of the MIS to ensure the MIS will withstand the rigours of future compliance events and stresses. From a regulatory and investor confidence perspective this level of assurance is of greater value than certification that past practices have fallen within agreed compliance parameters. This should be the level of surety regulators expect when attempting to ensure the robustness of Australia's MISs.

These arguments are further advanced in a publication produced by ACI entitled "Protocols for Reviewing and Assessing the Adequacy, Effectiveness and Efficiency of Compliance Programs" which has been attached to this submission.

Finally, ACI would recommend that Responsible Entity (RE) applicants should obtain a compliance expert's certification of their risk management and compliance arrangements prior to ASIC's issuance of the RE licence. ACI believes that this approach is consistent with not only similar approaches we have suggested in the past in respect to the issuing of an AFSL, but also with expectations of a growing number of industry participants.

Once again ACI would like to thank the Corporations and Markets Advisory Committee for providing an opportunity for ACI to make a submission on its MIS discussion paper. Should you require any additional information or seek clarification on the comments that appear in this submission please do not hesitate to contact ACI on +612 9290 1788.

Yours sincerely,

Martin Tolar
Chief Executive Officer

Australian **Compliance** Institute

CPR Protocols

Protocols for Reviewing and Assessing the Adequacy, Effectiveness and Efficiency of Compliance Programs

Foundation Members

May 2005

building integrity and trust

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Disclaimer

This document is not legal advice. Users should seek legal opinion as to the applicability of these protocols to their individual situation.

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Contents

1 INTRODUCTORY INFORMATION

1.1 Purpose of these protocols

The purpose of these protocols is to enable organisations and regulators to confidently rely on reports that are produced as a result of a compliance review. The aim of the protocols is to benchmark the quality, consistency, transparency and effectiveness of both the compliance review process as well as the resultant report.

The protocols have been specifically developed to enable organisations to:

- Better understand what is required of them when they are subject to a mandated compliance review as part of a regulator's enforcement outcome.
- Obtain more value from compliance reviews by being able to negotiate more effectively with external reviewers.
- More effectively plan and undertake internal reviews.

The aim of the protocols is also to provide regulators with:

- A set of procedures that can be incorporated or referred to in enforcement and surveillance activities.
- A response to concerns about the quality and consistency of compliance review reports.

The protocols have also been developed to enable the compliance industry to:

- Have a minimum standard for compliance programme reviews and reporting that will enable realistic comparison and benchmarking across organisations as to the effectiveness of compliance measures.
- Set competency benchmarks for persons undertaking reviews in order that compliance professionals can further develop the compliance profession's certification structure.

1.2 What is a compliance review?

A compliance review in these protocols means the undertaking of a process to assess the adequacy, effectiveness and efficiency of an organisation's compliance culture as well as its arrangements and measures to meet its regulatory requirements.

The process may assess the presence of these elements for the past, current and /or future. The scale and depth of a review will vary depending on its purpose. At the broadest level, a compliance review will apply compliance methodology and standards against the overall regulatory framework of an organisation, its business structures, culture, resource management, business and decision making processes, supervision, monitoring and reporting procedures and strategic direction.

A compliance review report is a document that contains detail of the scope and review process, analysis undertaken, levels of assurance, findings, opinions, recommendations as well as any qualifications.

Where a review is requested as a result of a known or suspected regulatory breach, the review may also investigate the cause of the breach and what other compliance issues such a failure may indicate. The subsequent report would contain recommended measures to reduce the risk of the breach occurring again and how those measures may do this.

1.3 Application of protocols

The protocols may be applied to the full range of compliance reviews however they have been drafted in contemplation of setting a minimum standard for compliance reviews and reports that are required from time to time by regulators in relation to enforcement actions.

The standard required by regulators is necessarily high because the report is often requested as part of enforcement activity. These reports are obtained to provide a level of assurance about the effectiveness of compliance arrangements in place and the ability of the organisation to comply with regulatory obligations going forward.

For other reviews whether conducted internally or by external parties the protocols should be seen as best practice for a broad compliance review. Accordingly for many reviews not all considerations in relation to each protocol will be relevant.

In particular it is acknowledged that many considerations will not be relevant for small organisations (less than 20 people).

In recognition of the potential different users, PART 2, " THE PROTOCOLS", is a stand alone section which allows the user to determine what is relevant to meet each protocol.

The protocols may be applied to any scale or type of review. Examples of the types of reviews where they may be applied include:

- Compliance with AS3806 "Compliance Programs";
- Compliance with specific regulatory obligations;
- Compliance with an industry Code of Practice; and
- Compliance with internal policies.

The scale of a review can range from the review of a single issue to a range of issues, or from an in-depth, to a high level review and may include the following:

- An organisation's commitment to compliance (cultural review);
- Existence of a broad compliance framework (high level program review);
- The effectiveness of a compliance framework to an agreed level of assurance (assurance or regulatory review); and/or
- The assessment of individual measures to determine ability to comply with specific obligations (specific obligation review).

The protocols may also be useful for organisations for use in conjunction with other internal monitoring processes, or for a compliance review of third parties under outsourcing or other contractual arrangements.

> **Caution**
>
> These protocols are aimed at the process of carrying out a compliance review and drafting a compliance review report. It is envisaged that compliance with the protocols may be used by an organisation or a regulator as a way to determine the adequacy of the review process. It is *not* envisaged that they be relied upon to determine whether any findings contained in a compliance review report are accurate. By following the protocols, the content and findings in the report should be able to be verified in some way. The quality and accuracy of the findings depend, amongst other things, on the skills of the reviewer and the level of cooperation from the organisation.

1.4 Why a review and not an audit?

The term "audit" has deliberately not been used in the protocols, even though it is acknowledged that the term "compliance audit" is often used to describe a compliance review process. A review process may use recognised audit procedures and principals, but the review process is intended to denote a different process to audits contemplated under the Corporations Act 2001. Audits of this nature are performed by registered auditors and are subject to the auditing standards and guidelines issued by the Australian Auditing and Assurance Standards Board.

There are key differences between an audit and a compliance review:

1. A compliance review often requires legal and other non-accounting skills to be applied. These skills may include the ability to:
   - analyse and understand a broad cross-section of legal obligations;
   - understand what frameworks, processes, and behaviour need to be in place for the organisation to comply with its obligations; and
   - assess whether the processes in place will enable compliance in the future.
2. An audit is usually intended to:
   - cover past events;
   - express a high level of assurance through a positive expression of opinion; and
   - determine a position over a specified period or at a point in time.
3. A review process may also cover an audit outcome but may also provide a view as to:
   - whether there are measures in place to enable compliance in the future;

- nature of an organisation's compliance culture; and
- the quality and effectiveness of an organisation's compliance programme and frameworks in light of its risk management frameworks and corporate governance processes.

Caution

The term "review" in these protocols does not necessarily have the same negative assurance meaning as used in Auditing Standards prepared by the Auditing and Assurance Standards Board.

1.5 How to use these protocols

This document is divided into 4 main parts:

Part 1	*Introductory Information* - provides background and explanation about the protocols.
Part 2	*The Protocols*- 12 outcomes that should be met
Part 3	*Considerations for each Protocol* – what to consider and helpful tips
Part 4	*Guidance for Reviewers* - contains specific guidance for reviewers.

The protocols are designed to help parties draft a review planning document and subsequent compliance report.

Each protocol describes an outcome that must be either incorporated in the review process and/or in the review report. Each protocol is then followed by guidance as well as a number of considerations that should take into account when addressing the protocol.

As each protocol is linked to the other protocols they should be read and applied as a whole however, to assist users, there is duplication in some guidance to enable each protocol to be as stand alone as possible. The protocols have not been designed as a "how to", rather they have been designed to help parties ask the right questions so that they can align expectations upfront and achieve a high quality outcome.

The protocols are not intended to provide guidance on how to analyse the information obtained during the review or detail what conclusions can be drawn from the existence of certain measures or certain structures or certain gaps. Analysis depends amongst other things on the skills, experience and knowledge of the reviewer.

1.6 Updating the protocols

The protocols will be updated and reviewed by the Australian Compliance Institute as needed, but as a minimum within 3 years. Any review will be based upon feedback of users to ensure the protocols remain relevant and facilitate the outcomes being sort.

Feedback should be sent to: CRP@compliance.org.au

2 THE TWELVE PROTOCOLS

First Protocol Scope

The review plan must state the reason for the review and clearly define its scope, including, what will and will not be reviewed and why, the type or level of review, the period to be covered, and what will happen if scope creep occurs.

It must also explain the reviewer's reporting obligation in the event they come across any issue or breach which is not part of the scope.

Finally, it must specify any limitations that apply to the circulation of the report to third parties.

Second Protocol Reliance

The review plan must state who will be relying on the compliance review report and for what purpose or purposes.

Third Protocol Assurance

The review plan must state the level of assurance that will be provided and any standard disclaimers that may appear in the compliance review report.

Fourth Protocol The Process Plan

The review plan must clearly describe the process that will be followed in relation to the management and administration of the review. Including who will be responsible, progress reporting, timing, and resources. The review plan must also state at what stage draft or interim reports will be provided to the organisation and how feedback on these reports will be recorded.

Fifth Protocol Limitations

The review plan must set out any limitations to conducting the review and the compliance review report must set out any limitations in preparing the report.

Sixth Protocol Information

The review plan must set out as far as possible what information will be reviewed and collected to form the factual basis of the compliance review report. The review report must describe in detail what information was actually reviewed, collected and relied upon to form the basis of the findings and/or recommendations.

Seventh Protocol — Methodology

The review plan must outline the methodologies that will used to review and collect the information that will form the basis of the compliance report. The review report must confirm use of the methodologies and disclose any variance from the methodology detailed in the review plan.

Eighth Protocol — Who Performs the Review

The compliance report must disclose all persons who performed the review including what part of the review they performed and what qualifications and experience enabled them to carry out that work.

Ninth Protocol — Basis

The compliance report must detail the basis of why the information reviewed caused the reviewer to make the findings, opinions or recommendations. This analysis must be complete and transparent.

Tenth Protocol — Level of Assistance

The review report must detail the level of assistance received by the reviewer from the organisation when conducting the review, including the level of assistance, from whom as well as any hindrance. The report must also detail any complaints or feedback received by the reviewer about the reviewer's methodology or approach.

Eleventh Protocol — Risks Going Forward

The review report must explain within the context of the review the risks to the ability of the organisation to comply going forward. The final report may also contain a response by the reviewee as to how each risk will be managed.

Twelfth Protocol — Present the Findings

The review report must contain findings, opinions and recommendations in a clear and easy to read format or table. The report (if agreed in the review plan) must also contain a plan for implementation of the recommendations.

3 CONSIDERATIONS FOR EACH PROTOCOL

First Protocol Scope

The review plan must state the reason for the review and clearly define its scope, including, what will and will not be reviewed and why, the type or level of review, the period to be covered, and what will happen if scope creep occurs.

It must also explain the reviewer's reporting obligation in the event they come across any issue or breach which is not part of the scope.

Finally, it must specify any limitations that apply to the circulation of the report to third parties.

Considerations

How does the reason for the review impact on its scope?

Background information which highlights why the review has been requested will help to limit the scope. The level of detail of background information will depend on the level of awareness of the review circumstances that the expected end-users of the report will have.

For example each of the following reasons for the review will have a different impact:

- Board/management request
- Regulatory requirement
- Regulatory enforcement (license conditions, enforceable undertakings, other)
- Takeover due diligence
- Parent company requirement
- Contractual requirement, eg as part of a loan or outsourcing agreement

What is the level of the review?

- High-level review of the compliance framework against AS 3806, including the existence of relevant documentation.
- Review of the elements of a compliance programme in place, including resources, positive compliance culture and high level reporting, review and monitoring. Are they in place and are they working, what are the issues and what are the gaps in reducing beaches?
- Review of detailed compliance measures to meet specific regulatory obligations. Are the compliance measures in place able to meet compliance obligations, now and in the future and why?

- Review of past compliance issues. What happened in the past and why?
- Is the review going to assess effectiveness as well as efficiency? Are the compliance measures effective going forward as well as efficient?
- Review of potential internal and external environmental impacts on the organisation's compliance measures. In looking at effectiveness, what potential changes will be taken into account in the future and is there a limitation on this period?
- An assessment of the, competency, understanding and behaviour required at board and management to meet obligations (eg managing conflicts of interest).

What is the period to be reviewed?

- Are existing compliance measures being reviewed only?
- Are measures in place over a certain period or past date being reviewed?

What other points should be considered?

- What is in and what is out of the review? For example, the review will cover monitoring and supervision procedures over outsourced service providers; though it will exclude procedures performed by the outsourced service provider.
- What will happen in the event of scope creep?
- How broad is the review? Eg, compliance by the whole entity with the Trade Practices Act from board level to call centre operators; or compliance of a regional cold storage operation with HACCP. That is, the scope should detail what aspects of operations and the business units of the entity that are to be reviewed.
- What does each stake holder expect from the review? Each may have a different expectation. What do they expect to know at the end of the review?
- What are the consequences if a review is not conducted?
- What assurance will be required about the effectiveness, as well as the efficiency, of the compliance measures and how will this impact on scope. A level of comfort may be able to be provided that the entity has measures in place that enable compliance, but are they so inefficient that compliance will be difficult to sustain?
- Is the assessment of internal and external impacts part of the review?
- If the review is to assess breaches, will the review cover why the breach occurred? What has been done to fix it, or can be done to fix it.
- Will the review look at, training, induction and human resource processes?

Does the review provide an opportunity to raise issues or breaches outside the scope?

- What is the responsibility of the reviewer in this event
- Should observations be contained in a separate document to be provided to the organisation being reviewed only?

What if the reviewer has some serious concerns while conducting the review?

- An independent board member may be the most appropriate person in this regard but in some instances disclosures must be reported in accord with State and Commonwealth corruption and whistleblower protection laws. Informing a business owner or board member may breach these laws.
- Procedures for handling information concerning fraud, corruption or other acts of a criminal nature uncovered by or reported to a reviewer must be prepared prior to the project commencing. The procedure must recognise the obligations under the State and Commonwealth laws relevant to the organisation being reviewed.

What third parties may review the report?

- Will it be viewed by auditors at some time in the future?
- Which regulators may have access to it?

Second Protocol Reliance

The review plan must state who will be relying on the compliance review report and for what purpose or purposes.

Considerations

Who is the report being prepared for?

- Identify all parties, both internal and external, who are likely to read and place reliance on the report. Understanding who will use the report and for what purpose will guide considerations on materiality and level of detail required.
- Who will be provided copies (boards, auditors)?

What are the potential liabilities to the reviewer as a result of this reliance?

- If a third party relies on the report is there any indemnification for the reviewer?
- How will the report be relied upon and what impact does this have for the liability of the reviewer?
- What indemnity for the reviewer may be appropriate?

Is there a way of limiting the reviewer liability?

- Determine what the consequences would be if the reviewer gets it wrong. Will the parties relying on the report require compensation? It may be appropriate to enter a "pre-nuptial" agreement with the reviewer to limit compensation, eg set a maximum of 10 times the fee for the review.
- Will professional indemnity insurance be required and if so how much? Will a copy of the policy be provided?

For example, where an organisation has agreed to obtain a compliance review as part of a regulatory action, then parties may agree that:

- the report is to be prepared for the organisation and will be provided to the organisation by the reviewer;
- the organisation will be responsible for providing the report to the regulator;
- the reviewer will only be liable to the organisation for any negligence in preparing the report;
- the reviewer will be under no obligation to disclose to the regulator any issues arising outside the scope of the review plan; and
- the regulated entity will be responsible for negotiating with the regulator the level of assurance to be provided in the report.

Third Protocol Assurance

The review plan must state the level of assurance that will be provided and any standard disclaimers that may appear in the compliance review report.

Guidance

This protocol is closely related to the previous protocol, as the level of assurance provided relates to how much reliance, or the type of reliance, parties will have in relation to the report.

Examples of assurance wordings that will accompany findings in the report should be provided in the review plan in order to avoid surprises later. Assurances may relate to, opinions as to whether compliance has occurred in the past and /or whether compliance measures in place will enable compliance in the future.

The more in-depth the review, the greater the level of assurance that can be provided. Where a review is high level it may be agreed that the report will not contain any assurances as to compliance, but merely recommendations.

Considerations

- How much responsibility is the reviewer prepared to take?
- What type of comfort is the organisation seeking in relation to their ability to comply in the future?
- Should different levels of assurance be provided in relation to different aspects of the review?
- Will it be negative assurance?
- Will it be positive assurance?
- Will it be a guarantee?
- Is an agreed upon procedures report more appropriate?

For some regulators the level of assurance in relation to compliance is not the issue, rather they rely more on the quality and transparency of the review process. The greater the review process is understood, the easier it is for the regulator to form their own view as to compliance issues. Accordingly, a level of assurance as to the ability to comply going forward may not be required, but rather an assurance that all agreed procedures in relation to the review were carried out and that certain compliance measures are in place may be more appropriate.

Helpful Hints

In order to minimise the expectation gap, prepare a draft wording similar to what is intended to be included in the report, and have the principal users of the report and the reviewer agree on the wording before the review commences.

Fourth Protocol The Process Plan

The review plan must clearly describe the process that will be followed in relation to the management and administration of the review. Including who will be responsible, progress reporting, timing, and resources. The review plan must also state at what stage draft or interim reports will be provided to the organisation and how feedback on these reports will be recorded.

Guidance

The level of planning for the review will depend on its type and scale. An in-depth far reaching review may have a large impact an organisations day to day activities. To manage this issue the review plan should be signed off by all parties before any work commences. The plan must be detailed enough in order that the organisation clearly understands the level of commitment it will need to provide throughout the review process.

Many reviews fail due to lack of assistance from within the organisation as well as poor planning by the reviewer. For this reason it is important that assistance be guaranteed through board and senior management support by their sign off of the review plan. It should also include a contact plan or meeting schedule in order that the reviewer can take into account commitments and feedback from staff within the organisation throughout the review process.

Considerations

In developing the process consider which of the following may be relevant:

The plan – high level:

- How will the project plan for the review be documented?
- Will the reviewer use a recognised project planning methodology?
- Who will sign off the review plan?
- Besides the decisions on scope, assurance, etc, what else will the plan contain?
- Who within the entity will sponsor or champion the review?
- How will access to relevant documents/records/staff be negotiated

Plan detail – resources:

- What resources, including specialists, will be needed? (include internal and external, eg IT specialist, industry analyst, administration, legal, accounting, etc)
- What will be impact of the review on the organisation? – When will it happen, how and what will be the cost in money, time and resources?
- How will the plan be communicated to the organisation's staff and management and how often will updates occur?
- Who will be the main contact throughout the review within the organisation?
- What information will be provided to the board and senior management about progress?
- Who will be accountable if the review is not completed within the timeframe?
- What site safety, inductions, procedures and security must the reviewer be aware of before entering the premises

Helpful Hints

A project leader should be appointed to "own" the project. This person should be responsible for drafting the review plan and be the main point of contact for all parties associated with the review. It is likely the project leader will be a senior member of the organisation being reviewed. Whether the project leader works within the operation under review or not will depend on the type of review and level of independence required.

The plan should contain milestones, action plans (if relevant), the names of persons that will need to be involved, risks, limitations, costs, timing, impacts and measures for success as well as a communication plan.

The draft or interim report:

- Will a draft or interim report be provided and if so, to whom and at what stage in the review? Will they have an opportunity to comment and if so on what?
- It is sometimes not appropriate for the organisation to be given an opportunity to review draft findings in the report as there may be the opportunity for the report to be sanitised before release, or at least create a perception the report may have been sanitised.
- However in most cases it is appropriate (even desirable) for the organisation to be provided with an opportunity to provide feedback on the factual basis contained in the report so that the accuracy of information can be checked before the report is finalised.
- Will a log of any amendments to the draft report be detailed in the final report?

Helpful Hint

If there are a number of drafts of the report, consider including a commentary explaining the basis for the changes from the previous draft so that all parties are comfortable with the amendments and have opportunity for comment.

The final report:

- What will the final report look like?
- Will it contain findings as well as recommendations on how to address issues?
- Will it contain a rectification plan detailing timing and areas or people responsible?
- Will the issues be rated in order of priority or risk?
- What methodology will be used to identify and categorise the risk of a compliance issue?
- Will the report be delivered to all parties at the same time or in an agreed order?
- How will the report be provided – hard copy, soft copy or both? Will it be numbered so that all copies are able to be identified.
- Will the reviewer be required to present the report verbally and be subject to questioning? If so, by whom – board, regulator or others?

Helpful Hint

It may be appropriate to release a report in two stages. The first report can cover the big issues so that all interested parties can make a start on any corrective action required while the detailed report is being finalised.

Fifth Protocol Limitations

The review plan must set out any limitations to conducting the review and the compliance review report must set out any limitations in preparing the report.

Guidance

Limitations may include limitations of scope due to unavailable staff and/or records, conflicts of interest, remuneration or time allowed. Limitations on scope may be unavoidable due to the timing and urgency of the report. These limitations should be identified by discussions between all parties when developing the review plan.

Considerations

The area of limitations can be quite complex. For example, it may be necessary to explain why the scope of the review limits the assurance or opinions that can be formed.

- Were there any limitations in preparing the report or in carrying out the review?
- Was there enough time?
- Were the right people available?
- Did the scope change?
- Was there enough board and management support?
- Was there enough access to systems and records?

Helpful Hints

Often it is helpful to explain what the review will not provide to the organisation. For example, it is unlikely that a review will be able to confirm for the board of an organisation that it is currently complying with all regulatory obligations continuously. Full, practical disclosure (not hidden behind legal or auditing jargon) about the limitations of the report is encouraged.

Sixth Protocol Information

The review plan must set out as far as possible what information will be reviewed and collected to form the factual basis of the compliance review report. The review report must describe in detail what information was actually reviewed, collected and relied upon to form the basis of the findings and/or recommendations.

Guidance

The quality, depth and accuracy of the information obtained are a vital part of any review. The quality of the information has a direct bearing on the ability of the reviewer to undertake an analysis to form a view. The report should disclose the processes, systems and documents reviewed, personnel interviewed, which reviewer performed the work, whether they were on-site and how long they were there performing this work.

This information will allow the reader to form a view as to whether the results of the review met the original objectives and identify any gaps in the review that may require further attention.

Liability issues should also be easier to deal with if the working papers clearly set out what work was done and why and how the results support the wording in the report.

Considerations

What information needs to be collected to make findings, form opinions or make recommendations?

What depth of information will allow them to assess for example the:

- Effectiveness of the compliance programme – what benchmark or standards?
- Presence of the necessary elements of the programme
- Level of the compliance culture
- Effective communication of the compliance policy
- Adequacy of compliance resources
- Quality of compliance of operational processes
- Adequacy of supervision & monitoring
- Effectiveness and truth of reporting

What was the source of the documentation and who provided it:

- What was the character of the document?
- Where did it come from?
- Who else has a copy?

How will the information be collected, recorded and stored:

- How will documents be managed, identified, recorded and stored? The collection of documents and recording of information must be able to stand up to close scrutiny. The time, date, method of delivery and source of any document must be recorded. Documents must be collected in such a way that they are easily identified. Where documents are reviewed ensure that there is a full description of the document.
- How will systems be described for ease of reference?
- How will answers to questions be documented?
- How will information provided during an interview be recorded? Will the conversations themselves be recorded or will another method be used.

Who will have access to the working papers?

Helpful Hints

It is suggested that the reviewer be provided with a secure area on the premises of the entity in order that all documents and files can be safely secured during the review process.

Seventh Protocol Methodology

The review plan must outline the methodologies that will used to review and collect the information that will form the basis of the compliance report. The review report must confirm use of the methodologies and disclose any variance from the methodology detailed in the review plan.

Guidance

Agreeing on the methodologies of how information will be collected is necessary as it supports the level of assurance that may be required. It also provides clear guidance to the reviewer by determining how the information will be collected, and from where, to allow the reviewer to obtain sufficient information to draft the report and formulate conclusions?

Considerations

Has the methodology been disclosed?

For example, have details of the following been provided where applicable:

- use of self assessment
- types of testing performed
- collecting and identifying data – how was this done?
- sampling basis, i.e. use of an appropriate statistical basis and method for selecting items for testing. The reviewer should record the reasons why the sample is representative of the population of items selected from. The basis of selection should reflect the purpose of the testing, eg if the issue that gave rise to the review only arises in transactions of a value less than $10,000, then the sample would be restricted to the population of transactions in this category.
- use of experts
- use of walk throughs
- observation of processes over a period of time
- scenario testing
- questionnaires or surveys
- substantive testing, i.e. vouch items directly to supporting evidence
- controls testing i.e. satisfy yourself the system of controls is adequate and is/has been operating effectively over the review period and will continue to do so. The objective is to be able to rely on the system of controls to pick up any errors in the operation under review and, on that basis, be satisfied the output from the operations is correct.

- industry quality controls, eg Hazard Analysis Critical Control Point (HACCP) systems.
- document review – what was read and what was sighted. Was the use of the document by the entity tested in practice?
- system review, eg use of dummy data, reliance on previous third party reports, use of experts.
- process review, eg walk through tests, review of procedures manuals, etc.
- recording information – in what style?
- methods of verification of information.

Choosing a Methodology

The reviewer should research the area of operations to be reviewed to provide them with sufficient knowledge of the business that will allow an effective and efficient review methodology to be developed.

The most appropriate methodology will depend on a number of factors, including:

- type of operations being reviewed, eg highly automated, technically complex, labour intensive, high volume of transactions, etc;
- level of assurance provided. A higher level of assurance will require more detailed work to provide more certainty that the results of the review accurately reflect the organisation's state of operations.
- scope of review, eg is it a high level review of a large operation, or a detailed review of a specific area of the entity's operations? Does it cover effectiveness and efficiency?
- time available to perform the review. If there is a short timeframe the methodology agreed up front may have to be based on less intensive testing, eg: analytical review, self assessment questionnaires, etc
- availability of entity staff. If key staff are not available alternative procedures may be required;
- records available;
- circumstances that gave rise to a requirement for a review.

If one of the reasons for the review was the reliability of certain records, the methodology may need to be developed to use other data to ascertain the organisation's true circumstances.

Quality of Evidence

The quality of evidence obtained from the review will be a direct result of the methodology used and will depend on the circumstances of the review.

An example of good quality evidence is confirmation obtained from independent third parties directly by the reviewer. Moving down the scale, independent confirmation obtained by the organisation would be of lower quality, while verbal representations by staff would usually be considered lower again.

This may not however be the case when considering issues such as corporate culture. In such a case it may be appropriate to use surveys or knowledge testing questionnaires to test the level of compliance knowledge throughout the organisation.

Helpful Hints

Consider obtaining information from the parties who initiated the review. They may have relevant information from previous investigations that gave rise to the review being requested. This could save significant time and cost for all parties involved, though is likely to require a release from the regulated entity that they do not have an issue with the reviewer discussing confidential matters with the regulator.

Eighth Protocol — Who Performs the Review

The compliance report must disclose all persons who performed the review including what part of the review they performed and what qualifications and experience enabled them to carry out that work.

Guidance

It is imperative that independent, suitably qualified and experienced reviewers design and carry out a review to be able to correctly analyse and interpret the review of information. In some instances specialist skills may be required, for example specialist industry knowledge, IT skills and administration skills.

Considerations

Reviewer capability and appropriateness

- why were they chosen?
- why are their skills, knowledge and experience relevant to the review?
- do they have the necessary independence?

Appointment of a Reviewer

- What process will be or was undertaken to appoint the reviewer?
- Was the review put out to tender?
- Who assessed the tender proposals?
- Has the independence of the reviewer been independently verified? Is it necessary to obtain references?
- Has the appointment process been transparent?

Where the approval of a reviewer must be approved by a third party or regulator that approval process must also be transparent.

Proper submissions should be made outlining all the relevant factors relating to the appointment of the reviewer in order to avoid personal preferences dictating who is appointed.

What skills, experience and knowledge are required?

The skills, knowledge and experience required needs to be determined once the scope has been agreed.

How relevant are the following?

- Level of understanding of the relevant law and how it applies to the entity,
- Level of understanding of the industry and its compliance frameworks,
- Level of understanding of administrative processes,
- Level of understanding of IT systems,
- Level of legal, actuarial, accounting, auditing skills,
- Any implications from the reviewer being part of the same industry,
- Compliance skills and knowledge,
- Level of practical knowledge and experience,
- Number of previous reviews conducted,
- Independence, conflicts of interest and details of any other services the reviewer has performed for the regulated entity and payment received,
- Where it is an internal review, how much control and input the reviewer had in the implementation of the compliance framework previously,
- Level of professional insurance required,
- Capacity to provide services and backup.

Some of the above will have little importance, while others will be crucial. It sometimes helps to rate the importance using a scale of one to ten in order that there is more of a chance to have a choice of qualified reviewers.

In certain circumstances it may be appropriate and more efficient to appoint a reviewer who is an employee of the organisation to make use of their knowledge and experience of the organisation's business. If additional comfort is required to satisfy any concerns about a perceived conflict of interest, a third party could be engaged to assess the review process that was followed.

Is there a power of veto in relation to the appointment of the reviewer?

This is an issue that must be discussed, particularly if a review is requested by a regulator. The question arises who should choose the reviewer. With set criteria this would seem simple enough, but sadly often preconceived views and personalities have an impact. The appointment of a reviewer should be an objective transparent process. Where the appointment of a reviewer is objected to, or one reviewer is chosen over another, the reasons must be documented. This will reduce the risk of bias by both the organisation and third parties including regulators.

Who is in the Review Team?

It is important to record all persons who took part in carrying out the review particularly where special expertise has been utilised. It must be made clear what the role of each reviewer was and what they actually did as part of the review. For example, there may be an instance where a reviewer has been contracted but in reality they only performed a project management or strategic role. In this instance it will be important to identify who actually carried out the review and what they did.

Independence and conflicts of interest

The key aspect to independence is the potential for a conflict of interest. Lack of independence is seen as an issue that may compromise any report. What it means to be independent will be different for different reviews. The level of independence will need to be agreed upfront and full disclosure made of any relationships or other potential conflicts. The higher the level of assurance required the more independent the reviewer must be.

The review plan should set out how conflicts of interest are to be disclosed by each party to the review and if any further due diligence is required. The plan should also cover processes to determine if any changes to the process plan or appointment of reviewer are required to address the conflict.

What it means to be independent or without conflict will be different for each review. The key is to define independence and potential conflicts in the context of the review up front. Where a review is being conducted as part of regulatory enforcement, the following may be considered to be *minimum requirements:*

The reviewer

- did not put the measures in place that they are reviewing.
- will not be the person given the responsibility of implementing recommendations in the report.
- has no prior informal association with the entity or any of the management.
- has no current or past professional relationship with the entity or its management at least in relation to matters related to the review.
- is not being remunerated by the entity in any other capacity.

Ninth Protocol Basis

The compliance report must detail the basis of why the information reviewed caused the reviewer to make the findings, opinions or recommendations. This analysis must be complete and transparent.

Guidance

The basis of the review is the reasons why findings were made, and opinions and recommendations provided. This is the key skill of any reviewer as it represents the analysis of the information obtained.

There are two processes to form the basis of a compliance report:

- the review of the information; and
- the analytical assessment of that information.

The reviewer must be able to show that all processes have been followed in forming the basis of the findings. The process may be contained in working documents which are kept by the reviewer.

A reviewer should be able to show why the presence of certain factors was relevant to the final findings. In this regard it is sometimes necessary to split the findings into those that are independently verifiable and those that are an opinion only.

Considerations

- Were there limitations in the information that would impact on the analysis?
- Were there any timing issues with the provision of the information?
- How has the examination of historical information been impacted by changes made by the organisation?
- How far can the information be relied upon?
- What qualifications need to be provided about the basis?

Recording the results

In order for the review to be independently verifiable and for the readers of the report to understand how the reviewer formed their views the reviewer must record the procedures performed in detail. This follows on from the Seventh Protocol "Methodology" and includes recording:

- sampling methodology used;
- documents reviewed;
- results of any testing;

- positions of people spoken to;
- which operations were visited and when;
- if work was completed on-site or remotely;
- how long the reviewer spent on-site and which review team members were involved; and
- questions asked in interviews and the answers received.

The above list is not exhaustive and the reviewer will need to use professional judgement as to the level of detail that is appropriate to the circumstances.

Helpful Hints

Depending on the type of the review and parties involved it may be useful at the start of the review for the reviewer to prepare a scoping paper setting out how the review is to be performed.

This may be essential if, once the review has commenced, the reviewer realises that it is not possible to complete the review in accordance with the process plan and needs to amend the approach. This should avoid disappointment from the amended approach not meeting the report users' requirements

Tenth Protocol Level of Assistance

The review report must detail the level of assistance received by the reviewer from the organisation when conducting the review, including the level of assistance, from whom as well as any hindrance. The report must also detail any complaints or feedback received by the reviewer about the reviewer's methodology or approach.

Considerations

What do you need?

Provide the organisation with a clear message of:

- what levels of personnel in the organisation are needed to help,
- how much of their time you estimate you will need; and
- when access is required.

What did you receive?

Disclose in the report how much assistance you received and who from.

- Was it helpful, was there any hindrance?
- If the reviewers were hindered was there a material impact on the review?

  This has implications on the scope and integrity of the report hence is very significant information for the end-user of the report.
- How will you rate the level of assistance?

  It will be important to define how levels of assistance will be defined or rated. Will it be a number out of 5 or words such as helpful to obstructive?

Some things to consider include:

- Access to documents – how quickly were they able to be retrieved?
- Access to managers and other key staff time – did they avoid the commitment or did they have other priorities?
- Free access to systems and files
- Access to administration or other relevant areas
- Openness of staff – were they concerned they might get into trouble?
- Availability of staff
- Access to records, including board records.
- How will you record and report obstructions?

If the level of assistance was poor it may indicate a number of factors including:

- a cultural problem;
- a lack of resources;
- an organisation in crisis;
- fear of retribution if seen co-operating with the reviewer;
- poor communication by the reviewer ; or
- the reviewer not following the agreed plan.

Any one of the above may assist in determining findings and may help support any negative conclusions in the report.

The difficulty in this area is gut reaction. What if the reviewer suspects they are being lied to and they know this will hamper them materially in performing the review?

To address this it is suggested that for each review the organisation provides not only a business owner but also a person that the reviewer can report any real obstructions to. An independent board member is often the most appropriate person in this regard however where the obstruction is very serious the reviewer must consider whistle blowing obligations under State and Commonwealth laws relevant to the organisation.

Ceasing the Review

There may be some instances where the reviewer must cease the review because of lack of support. This may be because the entity as lost confidence in the reviewer or they are concerned that the review will highlight issues that they would rather not be highlighted at the time.

Accordingly each review must have a defined and agreed exit strategy.

Eleventh Protocol Risks Going Forward

The review report must explain within the context of the review the risks to the ability of the organisation to comply going forward. The final report may also contain a response by the reviewee as to how each risk will be managed.

Considerations

- Explain the nature of the risk
- What is its likely impact of the risk?
- How serious is the risk?
- How can it be addressed?

Have you considered risks such as:

- a lack of compliance resources
- poor systems
- need for training
- a lack of compliance culture
- a lack of business ownership
- inflexibility of processes
- regulatory change
- uncertainty of regulatory approach
- lack of a link of compliance measures to risk management
- poor corporate governance
- conflicting or poorly drafted legislation

The report should include the reviewer's observations in respect of potential impacts on the compliance framework going forward. The report should explain:

- if the reviewer believes that the organisation has in place systems, resources, etc that enable them to comply with the law;
- if corporate culture is an issue; and
- what comfort there is that the organisation's management know what they are doing and that they want to improve?

All of the above factors will influence views on the risks to the organisation's ability to operate effectively and in compliance with the law on an ongoing basis. The difficulty will arise where it is apparent that there is little chance of the entity being able to address risk going forward. For example, a lack of: ▪ financial capability; or ▪ board and CEO capacity.
There may also be significant issues identified by the reviewer as risks to the compliance framework that may not be a current issue but will need to be addressed in the near future. Examples include: ▪ future planned changes to the organisation's activities; ▪ impending changes to external factors such as legislation or major customers; and ▪ over-reliance on key staff. When explaining the risk in a report it is particularly important to explain the basis for the comment as this will have an impact as assessing the likelihood of the risk occurring .

Twelfth Protocol Present the Findings

The review report must contain findings, opinions and recommendations in a clear and easy to read format or table. The report (if agreed in the review plan) must also contain a plan for implementation of the recommendations.

Considerations

Consider reporting using headings such as:

- findings
- weaknesses identified
- what the findings mean for the organisation
- response by the organisation /business heads to the report
- opportunities
- the way forward
- recommended actions
- as well as the subjects and issues contained in previous protocols and or specific requirements by regulators.

Who is the audience?

It is likely that the reviewer's report will be read by people who are unfamiliar with the background to the issues that gave rise to the review and the entity's activities and structure. This needs to be taken into account when deciding the level of detail required in the report.

Avoid padding and remember the document is a key communication document. Link the findings to the scope and group the findings if possible. Use of an index, contents page, executive summary and glossary are always helpful, as is numbering the paragraphs.

Is it going to a regulator?

Where the report is being presented to a regulator and the organisation is only permitted to see the final report, prepare the report in such a format that allows the organisation to provide specific comments on each part of the report (remember the process for issuing interim reports must be in the process plan).

Communicating recommendations

One of the more difficult issues is how to address the recommendations or suggestions for improvement. Placing theses recommendations in the same table as the findings may not always be the best approach as the recommendations may apply to a number of findings. In some instances it may be appropriate to place the recommendations on how to address issues or rectify them in a separate document, which becomes a planning document for the entity.

Separating compliance issues?

Some reports may require a separate section on limitations to addressing the compliance issues or rectifying them. This separate section may have limited circulation, for example the view may be that, in order to improve overall compliance the CEO will need to be removed, or the compliance manager is not up to the task. These comments clearly should not be in a widely circulated document.

Helpful Hints

Ensure that numbers of copies are recorded and who they are held by (you may want to number each copy). It may be necessary to recall all copies at a later date. Where a soft copy is provided, convert it into a secure PDF document if possible to avoid it being tampered with.

Ensure the cover page clearly states who it is addressed to, that it is private and confidential and that it cannot be copied or distributed unless agreed.

4 SPECIAL GUIDANCE FOR REVIEWERS

(Please note the following is not legal advice and is not intended to be relied on as such)

When a review is being conducted by an external party the issue of liability arises. As with any professional service there is contemplation that the service will be performed to a certain standard and, if that standard is not met, legal action may follow. The issue around liability becomes more complicated where more than one party will be relying on the compliance review report. Each situation will be different and will ultimately depend on the scope of the review and the relationship between the parties.

In determining the extent of a reviewer's labiality the following may be considered:

- Who is the reviewer liable to (or to whom do they have a duty)?
- To what extent are they liable (for what actions or non action can they be liable)?
- How much responsibility are they willing to accept including professional indemnity coverage?

In considering who the reviewer may be liable to, there may be an assumption that the only liability is to the person or organisation being reviewed. Where a review is part of a regulator's enforcement action, and as such the regulator may be relying on the report, there is a risk that the reviewer's liability may also extend to the regulator. This may be the case even where the organisation takes responsibility for providing the compliance report to the regulator.

Analogous issues have arisen where duties have been found to be owed to parties other than the client. In that regard, the reviewer needs to bear this potential expansion of liability to third parties in mind when framing the engagement and performing the review.

When considering the extent of potential liability, the following factors may be considered:

- scope of the review,
- who the report is being produced for?
- who will be relying on the report and for what purpose?
- level of assurance required, and
- what disclaimers or qualifications may be relied upon or acceptable?

Ultimately it is a matter to be determined in relation to each review. In some circumstances it may be appropriate to limit lability to the quality of the conduct of the review and not to the accuracy or reliability of the findings or assurances. However in the event that liability must be accepted for any findings and/or for assurances that the organisation will comply going forward, it may be appropriate, particularly where third parties will be relying on the report, for the reviewer to obtain some form of indemnity from the reviewed organisation.

4.1 Identifying and Managing Risks and Determining Costs

Each reviewer may need to consider what responsibility they are willing to accept in performing a review and how best they can limit their risks. In particular, the responsibly that may continue after a review is completed will need to be considered.

The level and extent of responsibility and risks may have a direct bearing on the amount to be charged.

In managing this risk a reviewer may consider the following:

- The extent of cover under their professional indemnity insurance (will it cover litigation costs?).
- The breadth of any indemnity they may need from the organisation reviewed. This may include indemnity for costs in answering subpoenas or producing working papers in litigation.
- What confidentiality agreements will need to be entered into?
- What approvals may be required from the entity to speak with its lawyers, auditors, service providers or the regulator? Further, what obligations arise for the reviewer to share these conversations with the entity?
- The extent to which the reviewer will need to arrange for potential compensation or reimbursement for costs associated with involvement in litigation or investigations after the review.
- How will working papers be stored and for how long. It is usual to ensure the records are kept for a minimum of seven years. This availability may be made known in the final report. The cost of this storage may also need to be considered.

4.2 Conflicts and Whistle Blowing

The identification, disclosure and management of conflicts must be considered before, during and after each review.

There will be instances where the conflicts are such that the reviewer is unable to conduct the review, particularly where independence is an issue.

Conflicts may also arise during a review which may necessitate some action by the reviewer. In particular, a reviewer may be placed in a conflict situation where pressure is placed upon the reviewer to delay, change or provide early warning of findings. This may conflict with the interests of other parties relying on the compliance report.

Often the motivation behind this pressure is a desire to start the rectification process before the report is delivered to other parties including regulators. Reviewers will need to address the potential for these conflicts in the review plan as well as detail what action they will take. There is a clear expectation by regulators that, where a review is undertaken as part of an enforcement action, the reviewer will report any such pressure to it.

Reviewers must also consider what action they would take in the event that they become aware of a serious breach or potential breach which is outside the scope of the review. In some circumstances the potential conflict arises between the interest of the client and the public interest.

While unlikely to be a common event it is a matter that may cause the following considerations as to the actions to be taken:

- Not reporting the breach may be a breach of the law by the reviewer.
- It is likely in most cases the reviewer may think there is a breach though will not have enough evidence to prove it. Finding further evidence may be outside the scope of the review.
- Reporting a breach may compromise the review process, as staff of the regulated entity may become less helpful, as they will try to protect themselves and colleagues.
- If the reviewer reports the matter to management of the reviewed entity for their attention/action, is that enough to discharge the reviewer's obligation?
- Should the possibility of such a finding and the reporting of it be covered in the engagement letter and/or review plan?
- Should a benchmark such as "in the public interest" be used as the overriding principal to advise a regulator directly?
- Should issues like the awareness of the entity of the breach or the deliberate hiding of the breach be factors that should be added?

GLOSSARY

Existence

Framework is documented, compliance responsibility is clear, operational procedures are recorded and accessible, monitoring and supervision of procedures is identified and recorded, there is evidence of reporting and breach management.

Quality

The framework being reviewed is both efficient and effective. That is as at a current point in time the reviewer can confirm that at a certain agreed level the framework is achieving compliance, was able to achieve compliance or will be able to in the future in relation to the scope of the obligations being reviewed.

Current Point in Time

The compliance framework within the existing organisational structure, current personnel, current products and services and existing regulatory regime. There may be a little bit of movement but it will depend on the effectiveness of the framework to stand up to changes.

Ongoing Compliance

The ability of the framework to enable compliance in the future at agreed levels and within agreed changes to the environment.

Past Compliance

A review of whether the framework was able to ensure compliance to an agreed level over an agreed period.

5 ACI Resources

5.1 Accreditation

ACI offers a multi level accreditation program for Compliance Professionals. This rigorous program sets high standards against which all applicants are judged. The program is unique in its recognition of the extensive range of skills needed to effectively manage compliance.

5.2 Education

ACI provides training at several levels on 27 subject areas including risk management, compliance framework and policy development and change leadership. An extensive range of on-line material is also being organised.

ACI has a fully integrated learning centre which can be accessed at learning.compliance.org.au

5.3 Events & Activities

ACI will run over 60 events in 6 cities over the next 12 months. Members and non-members are welcome

One of the major programs is the benchmarking of organisations which is an ongoing program.

5.3.1 National Conference

The National Conference is held each year in September. The program is designed to push the frontier of thinking on compliance practices.

5.3.2 Regulators' Conference

This unique event is designed to improve the relationship between regulator and regulated and to explore better practice in regulator operations.

5.4 Library

ACI has an extensive on-line library of articles that have been written on compliance over the last 9 years. These are available free to members from the web site at www.compliance.org.au

5.5 Membership

ACI has members from all sectors of the economy including members from many regulatory agencies. Our philosophy is one of engagement and dialogue. You can join on-line at www.compliance.org.au or call the office on 02 9290 1788.

ACI: building integrity and trust

Submission to CAMAC re MIS

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Paragraph 3.4.2 –The Proposed Legislative Reforms

1. **Reform 1 - identification and recording of the affairs of each MIS**

Questions

1.1 **Should the policy approach in Reform 1 be enacted?**

Reform 1 should be enacted but access to the register should also be available to members, a creditor of the scheme and any entity proposing to be appointed as replacement responsible entity or temporary responsible entity and not be limited an external administrator. The right of inspection should operate similar to the right of inspection of a members' register in s 173 of the *Corporations Act, 2001*.

The recommendation in 11.17 in *"Collective Investments: Other People's Money"* (**ALRC Report 65**) was that investors should be able to remove the scheme operator by the approval of the holders of more than 50% of the value of the voting interests in the scheme which recommendation is contained in the current legislation ([1]).

The ALRC Report 65 also recommended that:

> *"…. the court should have power, upon an application by the ASC, an investor or the scheme operator, or any of its directors, to appoint a person to act as the temporary scheme operator….*([2]).

This recommendation is also contained current legislation ([3]).

However these provisions are effectively rendered nugatory in practice where the proposed appointment is without the cooperation of the former responsible entity such as a hostile appointment by members or the current responsible entity is in external administration. This is because of the effect of the operation of the statutory novation principles in sections 601FS and 601FT of the *Corporations Act, 2001*.

The problem is illustrated by the decisions of Davies J in *BOSI Security Services Limited v Australia and New Zealand Banking Group Limited & Ors* [2011] VSC 255

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[1] *"Collective Investments: Other People's Money"* (**ALRC Report 65**) para 11.17 Vol 1; section 601FM of the *Corporations Act, 2001*

[2] ALRC Report 65 para 14.2 Volume 1

[3] section 601FN of the *Corporations Act, 2001* and reg 5C.2.02 of the *Corporations Regulations*

and the Federal Court Full Bench decision in *Huntley Management Limited v Australian Olives Limited* [2010] FCAFC 98.

It is likely to be impossible to find a responsible entity to take on the role as the new responsible entity or as temporary responsible entity, other than in circumstances where the current responsible entity is cooperative, because the proposed new or temporary responsible entity will be unable to carry out due diligence of the scheme to which it is proposed to be appointed. The proposed appointee simply will not know what rights, obligations and liabilities it will assume if it takes on that role before it accepts either appointment.

Further there may be agreements that affect the interests of members in a scheme in a way not understood by members.

For example the pro forma AFSL licence conditions requires that an instrument that confers the right, for the purpose of the scheme, to use the land on which any primary production will occur in the operation of the scheme, is lodged for registration under State or Territory land titles law, in the name of:

(a) the members collectively; or

(b) each member in relation to that portion of the land on which the primary production business in which the member has an interest is being conducted; or

(c) the custodian where it holds the interest as trustee for the members; or

(d) the licensee, either:

  (1) as trustee for the members; or

  (2) beneficially in the course of and in accordance with its duties as responsible entity; or

(e) any nominee of the members that is entitled to hold scheme property, where it holds the interest as trustee for the members; or

(f) a company, provided that, for the duration of the scheme:

  (1) all the issued shares in the company are held by all the members of the scheme;

  (2) the proportion of shares held by each member is the same as the proportion of interests in the scheme held by that member; and

  (3) the constitution of the company contains provisions that can only be modified by unanimous resolution of members of the company and that prohibit:

    (A) disposing of, or otherwise dealing with, the land in whole or part except after the primary production business to which the scheme relates is completed; and

(B) the conduct by the company of any business or activity other than the making of the land available for primary production to occur in the operation of the scheme or any other business or activity that the company may be required to conduct by law; or

(g) the custodian or another person as agent for the licensee for the purpose of the licensee holding the interest on trust for members.

This condition appears to be designed to protect the interests of members in a primary production scheme even if the responsible entity goes into external administration.

Members of the scheme may understand that this is the effect of the arrangements when in fact that is not the case under the actual documentation.

Firstly item (d)(2) is somewhat ambiguous. This condition was used by Timbercorp to confine its leases as being entered into by Timbercorp in its personal capacity and providing that such leases did not form part of scheme property. However this appear not to have been effective in law ([4]). Nevertheless the practice should not have been allowed in the first place.

Secondly often the registered interest does not in fact operate to protect investors. Although some registered interests are properly framed so that there cannot be a default event under the lease e.g. the responsible entity merely has an obligation to on-pay whatever is received from members, others are not so framed. For example, the registered interests might on their terms purportedly come to an end on the removal, administration or liquidation of the responsible entity or they might require payments to the lessor of amounts unconnected with contributions by the members of the scheme so that in the event of administration or liquidation of the responsible entity, there would be a default event entitling the lessor to terminate the registered interest.

The proposed recommendation, if access is not limited to an external administrator as recommended, but access is also available to a proposed replacement responsible entity or temporary responsible entity, will mean that a new or temporary responsible entity will be able to assess what rights, obligations and liabilities it will assume if it takes on that role before it accepts either appointment because it will know to what agreements the statutory novation principles will apply. By having access to this information, the powers given to members to remove and appoint a new responsible entity and the Court to appoint a temporary responsible entity will assume their intended wide operation. It will give power back to the members as originally intended by the legislation.

In relation to contracts affecting scheme property, it is submitted that members and incoming responsible entities ought to know the effect of these contracts on the members' interest in the scheme. The terms of such contracts might render the members' interests in the scheme of no practical effect. Therefore members should have access to these documents.

In addition, it is suggested that there should be a specific continuing disclosure obligation imposed on a responsible entity to lodge details of such agreements with

[4] *Huntley Management Limited v Timbercorp Securities Limited* [2010] FCA 576 (8 June 2010)

ASIC which obligation could be met by lodgement of the relevant form by the counterparty to the contract (although arguably the responsible entity should already be doing so if the interests in the scheme are ED securities ([5]) or not ED securities ([6])). A lodgement of such document could be deemed to have been entered on the register of agreements even if that has not been done. This would protect counterparties from any consequences of non-entry by the responsible entity.

1.2 **Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?**

It is submitted that the agreements register should be a definitive statement of all agreements entered into by an RE as operator of a particular MIS that are subject to the statutory novation or affect scheme property. If the agreement is not so recorded then there should be a provision that the agreement is not subject to the statutory novation principles in sections 601FS and 601FT of the Corporations Act, 2001. Further in the case of an agreement affecting scheme property, unless the agreement is registered on another public register such as a State or Territory land titles register, then the consequences should be that a new or temporary responsible entity of the scheme and the members should not be bound by such agreement unless it is recorded in the register.

1.3 **If yes:**

(a) **how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended?**

Counterparties can ensure that their agreements are included in the register contractually and by requiring proof of entry on the register of the agreement as a condition precedent to the commencement of the agreement.

There is no difficulty in counterparties ensuring other documents subject to a registration procedure being effected e.g. a charge over company assets under the Corporations Act, 2001 or an interest in land under the relevant State or Territory property title laws. There is no reason therefore why provisions cannot be inserted that enable this to be done in relation to scheme agreements.

It is suggested that this can be achieved by imposing a specific continuing disclosure obligation on a responsible entity to lodge details of agreements to which statutory novation or that affect scheme property with ASIC with the counterparty to the agreement having the right to lodge such continuing disclosure document with ASIC. There should be a deemed entry of such agreement in the register upon lodgement of such disclosure document. This will ensure that the counterparty can ensure compliance.

Since what is in the register may affect the counterparty's rights obviously they should have access to the register. If the record is incorrect then they should be able to apply to the Court to have the register rectified if the responsible entity does not do so.

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5 ss 111AD, 111AFA and 675 of the *Corporations Act, 2001*

6 s 1017B of the *Corporations Act, 2001*

(b) **what remedies should affected parties have for failure to include an agreement in the register and against whom?**

If the agreement is not registered then the consequences should be that:

(1) the statutory novation principles in section 601FS and 601FT will not apply to the agreement save at the election of an incoming responsible entity or temporary responsible entity; and,

(2) scheme property is not affected.

This is a powerful incentive on a counterparty to ensure compliance by the responsible entity with the obligation. It is not an onerous obligation on a counterparty because any agreement can be subject to a condition precedent that the agreement be recorded on the register and the counterparty can inspect the register to ensure compliance before the condition precedent is satisfied. Further if the counterparty had the alternative of lodging a continuing disclosure notice in relation to the agreement as suggested above, it could have absolute assurance of protection against the consequences of non-compliance.

The counterparty could also be given a statutory remedy for any loss or damage suffered by it as a result of the failure of the responsible entity to comply with the obligation to enter the agreement in the register both against the responsible entity and its directors.

2. **Reform 2: use of scheme property**

The property of a particular MIS can be used only for the purposes of that MIS.

Questions

2.1 **Should the policy approach in Reform 2 be enacted?**

It depends upon how far this is intended to go. Property of one MIS should not as a matter of principle be used to pay debts of another MIS. If this is what is intended then this reform should be proposed.

However there are circumstances where a blanket prohibition would be impracticable.

For example, in relation to agribusiness schemes where there are a series of similar Projects, carried out on separate parts of the one parcel of land, Project 1 might be carried out on a certain number of hectares on a lot and Project 2 might be carried out on another number of hectares on the same lot. However land title laws may prevent separate leases of the land with respect to each Project which means that there must be the one lease of land for both Projects even though the lease itself can deal with the separate Projects.

It may be moot as to what is scheme property in such an instance but nevertheless a prohibition on the use of the one lot for separate Projects would prevent efficient use of the land for different Projects.

A similar issue may arise where there are water licences to which access is required for a number of Projects on the one parcel of land to which the licence is applicable.

2.2 **Should there be any exceptions to Reform 2? If so, in what**

See comments in 2.1

2.3 **circumstances and for what reasons?**

See comments in 2.1

3. **Reform 3: informing MIS creditors of a change of RE**

Where the RE of an MIS changes, the new RE must give notice of that change to all counterparties included in the 'continuing agreements' section of the agreements register referred to in Reform 1, and to any other counterparty of which the new RE is aware or becomes aware.

Questions

3.1 **Should the policy approach in Reform 3 be enacted?**

This presently has to occur as a matter of practice due to the operation of the statutory novation provisions in ss 601FS and 601FT.

There does not seem to be any real value in this reform.

3.2 **What, if any, consequences should follow where an RE fails to inform a counterparty?**

No Comment

4. **Reform 4: rights of MIS creditors against scheme property**

4.1 **Should the policy approach in Reform 4 be enacted?**

There is a need for reform in this area but not in the way proposed.

The Explanatory Memorandum to the *Managed Investments Bill, 1997* said that the duties imposed on the responsible entity under the legislation were intended to reflect both the fundamental duties of a fiduciary as well as certain of the duties that were imposed on the management company and the trustee under the former prescribed interest provisions ([7]). There is also case law to support the proposition that the responsible entity of a registered scheme owes fiduciary duties to the members ([8]).

If the law was changed, creditors could be a party to a breach of fiduciary duty by the responsible entity to its members and yet be able to benefit from that breach by still having direct access to the scheme property when the responsible entity itself has no access due to that breach. Further responsible entities would not have to be concerned with breaches of fiduciary duties because even though there would be personal liability this may be of no value where the responsible entity has insufficient assets to meet that liability.

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7 Explanatory Memorandum to *Managed Investments Bill* at para 8.8.

8 *Re Australian Style Investments Pty Ltd* [2009] VSC 128 at [67]; *ASIC v A.B.C. Fund Managers Ltd (No 2)* [2001] VSC 383 at [124]; *Stacks Managed Investments Ltd* [2005] NSWSC 753; *ASIC v West* [2008] SASC 111 at [217].

Creditors should continue to have some responsibility for ensuring that they are not a party to any breach of duty by the responsible entity. Therefore to this extent no change in the law should be made.

However there does need to be some tidying up of the law in this area.

A responsible entity will have a right of indemnity with respect to a liability it has incurred in the proper performance of its duties to the extent of the right of indemnity that is set out in the constitution ([9]). However this must be a right of indemnity in fact rather than a theoretical right ([10]).

There are two lines of authority in relation to trusts where a corporate trustee is in insolvent liquidation and is a trustee of a number of trusts.

One view is that funds recovered under the trustee's right of indemnity out of property of any trust should be available for **all** creditors of that trustee ([11]).

Another view is that the funds recovered under the trustee's right of indemnity from the property of a particular trust should, in the first instance, be available only for those creditors who have dealt with the trustee as trustee of that particular trust ([12]).

Because of the uncertainty, the law does need to be reformed to set out the rights of creditors. It is submitted that it should be clarified to adopt the second line of authority namely the funds recovered under the responsible entity's right of indemnity from the property of a particular scheme should, in the first instance, be available only for those creditors who have dealt with the responsible entity as responsible entity of that particular scheme.

However the law should not be reformed to the detriment of members of the scheme by giving carte blanche to creditors to disregard the fiduciary duties of the responsible entity to its members.

4.2 **If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?**

If the amendment is made, which it is submitted that it ought not in the proposed form, then the creditors of an MIS should only include those persons claiming under an agreement that has been recorded in the agreements register to which see comments at paragraphs 1.1 and 1.2 above.

4.3 **Should the two related provisions also be adopted?**

These should be adopted in any event.

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9 s 601GA(2) of the *Corporations Act, 2001*.

10 *Australian Olive Holdings Pty Ltd v Huntley Management Limited* [2010] FCAFC 76 at [126], [128], [130] and [134].

11 *Re Enhill Pty Ltd* [1983] 1 VR 561.

12 *In re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99;

B. Paragraph 3.5

5. **Identifying Scheme Property**

Questions

5.1 **In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time?**

Similar to Reform 1, this should be kept and available to members and creditors of the scheme as well as entities proposing to become a responsible entity or temporary responsible entity of the scheme for the same reasons as discussed at paragraph 1.1 above. Members should have a right to know what property is "scheme property" and what property is "other property" in relation to the scheme. It is submitted that this should already be taking place under the disclosure obligations that presently apply a responsible entity. However the imposition of a specific obligation will draw attention to this matter.

5.2 **Who should have access to that register and through what process?**

Access to the register should be available to members, a creditor of the scheme, any entity proposing to be appointed as replacement responsible entity or temporary responsible entity and an external administrator.

C. Paragraph 3.6

6. **Identifying member transactions**

Questions

6.1 **Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members?**

This should already be a matter of disclosure to members under the general disclosure obligations of a responsible entity. However having a register will put this information in the one place and therefore this should be a requirement.

6.2 **Who should have access to that register and through what process?**

Access to the register should be available to members, a creditor of the scheme, any entity proposing to be appointed as replacement responsible entity or temporary responsible entity and an external administrator.

D. Paragraph 3.7

7. **Tort claims and statutory liability**

Questions

7.1 **Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE?**

No. The law is already sufficiently developed.

7.2 **In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?**

No comment.

E. Chapter 4

8. **Appointment of Replacement RE and Temporary RE**

Questions

8.1 **What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why**

The present extraordinary resolution is often hard to achieve due to member apathy. Even where the removal is supported by the existing responsible entity, member apathy can prevent the change taking place. It would be even more of a problem where a temporary responsible entity has been appointed because if member apathy prevents the resolution being passed the scheme will be wound up.

The Turnbull review recommended that for unlisted schemes, the current requirement for an extraordinary resolution to remove or appoint a RE should be replaced with either (but not both) of the following two alternatives:

(a) a special resolution (that is, 75% of the votes cast at a meeting); or

(b) a special resolution with the added requirement that the votes cast in favour of that resolution must constitute at least 25% of the total votes of scheme members ([13]).

It is submitted that the second of these recommendations ought to be imposed. On the one hand it overcomes some of the problems of member apathy but also ensures that there be some level of member involvement in the vote.

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13 *"Review of the Managed Investments Act 1998 Report"* - Malcolm Turnbull - December 2001 (**Turnbull Report**) – Recommendation 2 at para 2.3.1.

8.2 **What changes, if any, should be made to the powers of the court to appoint a TRE and why?**

It is submitted that the section 601FP should be amended to extend the grounds on which a temporary responsible entity can be appointed. It is suggested that:

(a) regulation 5C.2.02 should be incorporated into section 601FP as a reason for the appointment by the Court of a temporary responsible entity namely the application can also be made on the grounds that ASIC or the member reasonably believes that the appointment is necessary to protect scheme property or the interests of members of the scheme; and,

(b) another reason for the appointment of a temporary responsible entity is that the current responsible entity is in external administration.

There may be circumstances where it is proper to appoint a temporary responsible entity even though there is still a responsible entity.

An example would be in the case of an agribusiness scheme where plants have to be watered for example but the responsible entity is in administration and therefore unable at that time to attend to watering of the plants. By the time anything is done, the plants are dead.

This is a perfect example of when a temporary responsible entity should be appointed in order to protect the plants even though there is still a responsible entity.

8.3 **In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?**

This may be unnecessary if reform 1 and associated reforms at paragraphs 5 and 6 above are enacted. These reforms would enable a level of due diligence to be conducted to an extent in any event. At least with these reforms, a prospective new responsible entity will know the extent to which it will be bound to existing agreements under the statutory novation principles.

If the existing RE had an obligation to assist a prospective new RE to conduct due diligence, this could unnecessarily burden the existing RE with all and sundry having access to all of the due diligence material. It would also be open to abuse.

If this reform were to be enacted then the following protections ought to be put in place:

(a) the reasonable costs of the existing RE must be paid by the prospective new RE beforehand;

(b) there must be an absolute confidentiality obligation placed on the prospective new RE in relation to information obtained during the due diligence process.

F. Paragraph 4.4

9. **Eligibility to be a temporary RE**

Question

9.1 **Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?**

The ALRC Report recommended in relation to a Court appointed temporary responsible entity that:

> "*A court appointee need not hold a scheme operators licence or be incorporated. The court order should specify the terms and conditions of the appointment, including the powers and reporting obligations of the temporary scheme operator."* ([14])

This recommendation was not enacted.

There is a requirement that the responsible entity of a registered scheme must be a public company which holds an Australian financial services licence (**AFSL**). Although the sections says the AFSL must authorise the public company to operated "a managed investment scheme" the "a" has been interpreted to mean "the" managed investment scheme ([15]).

This poses a problem of finding a temporary responsible entity. There are a number of administrative practices of ASIC that make this a difficult task.

Firstly it is the general practice of ASIC not to issue a AFSL with an authorisation to operate schemes generally but to limit the authorisations to a specifically named scheme. This limits the available candidates for an appointment as new responsible entity or temporary responsible entity because many responsible entities which could perform the task only have AFSL that are limited to named schemes.

Secondly it can take a considerable period of time for ASIC to deal even with a licence variation to enable the appointment as a new responsible entity or temporary responsible entity. A matter of a few weeks for ASIC to attend to the application may be critical in some instances such as with the appointment of a temporary responsible entity.

In one case I was in attendance as an observer where an application had been made by a member to have one of my clients appointed as a temporary responsible entity even though the AFSL of that client at that time did not have the actual authorisation to operate that particular scheme (although it did have an authorisation to operate other agribusiness schemes).

in that matter the applicants had asked for an adjournment for three weeks to enable the application for variation to be made. Hely J examined the AFSL of my client and noted the other schemes already operated by my client and then stated that he would be "astounded" that if ASIC took that period of time and therefore considered that an

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[14] Op Cit 2

[15] s 601FA of the *Corporations Act, 2001*.

adjournment to the Friday of that week was sufficient for the licence variation to be made.

Unfortunately ASIC do take longer than that but in this case because His Honour's comments were drawn to the attention of ASIC whom I understand were also present before His Honour, the AFSL variation went through in record time.

Thirdly it is the practice of ASIC to only issue a letter indicating that in the absence of any further relevant information coming to the attention of ASIC and subject to lodgement with ASIC of evidence of the applicant's appointment as responsible entity of the relevant registered managed investment schemes in accordance with Chapter 5C of the Corporations Law – including the lodgement of forms relating to the change of responsible entity, ASIC is minded to grant the application.

This creates a problem because the proposed new responsible entity cannot be chosen by the members or appointed by the court if it does not hold an Australian financial services licence to operate that particular scheme ([16]). Any such appointment would be ineffective ([17]). One wonders how a Form 5107 may be lodged after which the AFSL is varied by ASIC when in fact the person lodging the form is asking ASIC to record an appointment that was ineffective at the time of the actual appointment.

The ALRC proposal is probably too wide. The problem would be that the TRE most likely is in the circumstances going to be the most appropriate person to take on the role of a permanent appointment during the 3 month period referred to in section 601FQ of the *Corporations Act, 2001* as it will have attained during that period the necessary knowledge concerning the current operation of the scheme.

However the ASIC administrative practices place an unnecessary hindrance where the exigencies of the circumstances require the appointment of a TRE. There are persons that hold an AFSL that may be limited to named schemes but would have the required organisational expertise to take on the relevant named scheme the subject of the application for the appointment of a TRE. The only hindrance to their appointment is the fact that they need to have the proposed scheme added to their AFSL, a requirement that takes some weeks to get approved, notwithstanding that a judge of the Federal Court would be "astounded" that it would take so long.

It is suggested that an appropriate person to be appointed as a temporary responsible entity would be a public company that holds an AFSL that authorises it to operate "**a**" in the sense of any managed investment scheme. With the cooperation of ASIC, that entity's AFSL should be able to be varied to add the named scheme in time for that entity to be appointed as the replacement RE pursuant to section 601FQ of the Corporations Act, 2001 within the statutory 3 month period.

To ensure that this can occur there should be a time limit placed on ASIC to deal with an application to vary the TRE's application to vary its AFSL to add an authorisation to operate the relevant scheme to enable the TRE to comply with the statutory 3 month period.

It is recommended that a Court appointed TRE should at least be a public company that holds an AFSL that entitles it to operate a particular scheme as almost certainly that TRE will have the organisational expertise and compliance systems in place to

[16] s 601FK of the *Corporations Act 2001.*

[17] *Huntley Management Limited v Australian Olives Limited (No 2)* [2009] FCA 686 at [12].

take on the TRE role. The 3 month period during which a meeting of members must be called should be sufficient for the TRE to obtain a variation of its AFSL to add that particular scheme in time to be appointed as the responsible entity at the meeting of members.

This varied procedure will increase the number of possible candidates for appointment as a TRE but still preserve the statutory obligations that are imposed on the holder of an AFSL in relation to the scheme.

G. Paragraph 4.4.2

10. **Outstanding obligations and liabilities of the outgoing RE**

Question

10.1 **What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?**

As observed in the Discussion Paper, any move to widen the pool of candidates who can be appointed as a TRE does not deal with the apparent central reason for the unwillingness of eligible entities to become a TRE, namely that by accepting that role (and therefore being able to exercise the rights transferred), they become personally liable for most of the obligations and liabilities of the former RE as operator of the scheme. Further as also observed by the Discussion Paper, there can also be considerable uncertainty about what rights and liabilities remain with the former RE, with consequences both for the TRE and external creditors ([18]).

It is submitted that the problem can be easily resolved by limiting the statutory novation principles in section 601FS and 601FT of the *Corporations Act,* 2001 so that a TRE or new responsible entity does not assume any liability of the former responsible entity to the extent that the scheme property is insufficient to meet such liability. Although this is a possible interpretation of the current provisions ([19]) the position is not clear. If this is the intention of the current provisions then all the suggested amendment does is clarify that position.

If this is not the intention of the current provisions, then it is submitted that it is not good policy to impose on a person who has not incurred a liability, a personal liability to meet any shortfall between the value of the scheme property out of which the incurred liability was to be met and the amount of that liability. If a person incurs a liability to the extent that there is insufficient scheme property out of which the liability can be met, then that person should meet the shortfall not a successor in title. The risk of incurring a liability to the extent that there is insufficient scheme property to meet that liability should fall on the person who incurred the original liability. A creditor should not get an advantage not available to general creditors of a debtor by having access to the assets of a third party who was not responsible for the original debt and did not guarantee and who was also not responsible for the fact that the value of the scheme property was insufficient to meet that liability. The liability for

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18 re *Stacks Managed Investments Ltd* [2005] NSWSC 753 (29 July 2005) at [15] and also see *Australian Olive Holdings Pty Ltd v Huntley Management Limited* [2010] FCAFC 76 (29 June 2010) where RE not bound by agreement entered into by former RE

19 *Stacks Managed Investments* Ibid

taking the risk should fall on the parties taking that risk namely the former responsible entity and the creditor.

It is submitted that limiting the current provisions in this way (which may have possibly been the intention in the first place) is still consistent with the clear rationale behind these provisions relating to the transfer of financial liabilities and obligations of an RE which was to protect scheme creditors, whose claims should not be extinguished or reduced merely because of a change of RE. Scheme creditors under this proposal are not extinguished as they will still be able to recover from the new RE, including a TRE, their debts to the extent that the former responsible entity was entitled to be indemnified out of the scheme property with respect to that liability and to the extent that such scheme property is sufficient to meet that right of indemnity. To the extent that it does not the creditors are not disadvantaged because the former responsible entity that incurred the debt in the first place will remain liable to the extent of any shortfall unless the former RE has limited its liability by contract.

It is in fact a practice of many responsible entities when dealing with third parties to seek to limit their liability to the extent of their right of indemnity out of scheme property and to the extent that there is scheme property available to meet that right of indemnity. The creditor is then at risk for any shortfall.

This suggestion to limit the liability of the new responsible entity to the extent that the scheme property is sufficient to meet that right of indemnity corresponds with this contractual practice adopted by the industry. The suggested amendment will provide statutory imprimatur to this practice.

The former responsible entity will remain liable for any liability to the extent that it has no legal right of indemnity against scheme property (as at present) or the scheme property is insufficient to meet that that right of indemnity (a possible but unknown interpretation of the current provision) although this would not interfere with the right of the former responsible entity to enter into contractual arrangements where it accepted personal liability beyond the extent to which it is entitled to be indemnified out of scheme property.

Further it is submitted that such a proposal does not disadvantage creditors. A creditor who is aware that they are dealing with a responsible entity of a scheme will know that their ability to recover the debt is limited to the value of the scheme property available to meet that debt and if they want additional personal liability imposed on the former responsible entity they can impose that personal liability by contract. A creditor who is not aware that they are dealing with a responsible entity of a scheme (which will not be the case if Reform 1 in the Discussion Paper is enacted), will believe that it is contracting with the responsible entity personally and therefore is of the view that the responsible entity has the capacity to meet that liability personally.

A creditor should not be extending credit to the extent that the creditor is not satisfied that the responsible entity is able to meet the liability either out of scheme property (if the creditor knows it is dealing with a responsible entity or personally (if the creditor does not know). If the creditor does extend credit when it is not so satisfied then it should bear the risk of non-recovery.

It makes no policy sense to impose a liability on a new responsible entity for a liability incurred by a former responsible entity where that liability cannot be met out of scheme property. The former responsible entity and the creditor should bear this risk not the new responsible entity

This amendment would remove the risk involved by an entity taking on the role of TRE. If the scheme property is insufficient to meet the liability, the TRE is not liable but remains with the former responsible entity to the extent of the shortfall.

Such an amendment avoids the problems of other alternatives suggested in the Discussion Paper.

H. Paragraph 4.4.3

11. **Duties of the TRE**

Question

11.1 **What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?**

It is submitted that the current duties and consequential liabilities of the TRE and its officers and employees that currently exist should remain in place. However it is suggested that the fact that the responsible entity is a TRE as a result of which the difficulties referred to in the Discussion Paper necessarily arise by reason of that position should be matters that a Court must take into account when exercising its power under section 1317S or 1318 of the *Corporations Act, 2001*. This would then give the Court power to consider these matters and appropriately relieve the TRE from liability in those circumstances.

I. Paragraph 4.4.4

12. **Remuneration of the TRE**

Question

12.1 **What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?**

In many cases the TRE can be remunerated under the terms of the current fee structure of the Constitution by operation of the statutory novation provisions in sections 601FS and 601FT of the *Corporations Act, 2001*. In such cases nothing needs to be done in regard to the remuneration of the TRE.

Difficulties would seem to only arise where the terms of the Constitution provide for fees to be paid in advance which have been paid in advance to the former RE and such fees are not apportionable ([20]).

It is suggested one way of dealing with this problem would be to give a Court power to determine the proportion of fees paid in advance to the former responsible entity for services to be performed as responsible entity after the date of its removal and to order the former responsible entity to pay such amount to the TRE or new responsible entity. A straight line apportionment may not necessarily be appropriate because say in a scheme involving a planting of trees this may occur within 18 months after the fees for that planting service are actually paid ([21]). This discretion would enable the

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[20] *Huntley Management Limited v Australian Olives Limited* [2010] FCAFC 98 (12 August 2010)

[21] section 394-10(1)(f) and (4) of the *Income Tax Assessment Act, 1997*

Court to appoint a referee under the Court rules to determine the appropriate apportionment of those fees. It is also unjust that a former responsible entity should retain fees for carrying out services that it is not to provide as a result of the appointment of the TRE or new RE.

Alternatively section 601GC(1) of the *Corporations Act, 2001* could be amended to enable an amendment to be made to the Constitution by the TRE that authorised the payment out of a reasonable fee to the TRE for carrying out its obligations as TRE until the scheme is either wound up of a new responsible entity is appointed.

As part of the proposal for appointment of a new RE, there could be a condition imposed by the TRE that any such appointment would be conditional upon the members passing a special resolution to amend the fee structure to ensure that the new responsible entity is paid for its ongoing obligations.

J. Paragraph 4.4.5

13. **The role of the TRE in relation to the future of the MIS**

Questions

13.1 **Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons?**

No.

13.2 **In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to:**

(a) **possible conflicts of interest faced by the TRE**

(b) **the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced)**

(c) **a TRE providing assistance to an external administrator?**

None. The 90 day period makes it almost certainly the position that the new RE will be the TRE. There is nothing to stop members putting an alternative. However the practice of ASIC in relation to grants of AFSL particularly the delays involved means that there is no real alternative in most circumstances other than for the TRE to become the new RE.

K. Paragraph 4.5

14. **Matters covered in the transfer of rights, obligations and liabilities of the RE**

14.1 **What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?**

These sections should be amended to clarify two issues raised by the current provisions in the following ways:

(a) the new responsible entity should only assume liabilities to the extent that the former responsible entity is entitled to be indemnified out of scheme property and then only to the extent that there is sufficient scheme property available out of which that right of indemnity may be satisfied (see discussion at paragraph 10.1 above); and,

(b) the former responsible entity should only be entitled to be paid fees to the extent that they relate to services to be performed prior to its removal as responsible entity so that where fees are paid in advance of the services to be performed the Court shall have the power to apportion those fees between the former responsible entity and the new responsible entity (see paragraph 12.1 above) unless the former responsible entity and the current responsible entity accept an apportionment on a day to day basis.

Section 601FS(2)(d) states the principle that any liability for which the former responsible entity could not have been indemnified out of the scheme property if it had remained the scheme's responsible entity is not a liability assumed by the new responsible entity but remains a liability of the former responsible entity. It is not clear whether this provision *"… refers only to a legal entitlement to indemnity, or also the existence of available assets from which the right of indemnity can be satisfied.."* ([22]).

It is submitted for the reasons referred to in paragraph 10.1 above that this provision should be made clear that this provision refers to *"…the existence of available assets from which the right of indemnity can be satisfied.."* ([23]).

Section 601FS(2)(a) states that any right of the former responsible entity to be paid fees for the performance of its functions before it ceased to be the responsible entity remains the right of the former responsible entity. This has been interpreted to mean that a responsible entity who is contractually entitled to be paid fees in advance of provision of the services for which such fees are required to be paid and such fees are not apportionable under the terms of the contract, is entitled to retain such fees ([24]). Such fees are clearly not for the performance of its functions before it was removed but nevertheless because of the provisions of the contract, the former responsible entity it unjustly enriched in that it is paid fees for services it no longer has to perform.

Such a proposal is also consistent with the policy of the legislation reflected in section 601GA(2) that any rights of a responsible entity to be paid fees must be available only in relation to the proper performance of its duties.

The current interpretation of section 601FS(2)(a) also acts as a "poison pill" to prevent dissatisfied investors from appointing a new responsible entity even though the intent of the legislation is to give them power to change the responsible entity.

Section 601FS(2)(a) needs to be amended so that the fees match the performance of the services. A straight line day to day adjustment may not always be appropriate so a Court should have the power to make an appropriate adjustment on a just and equitable basis having regard to the services to be performed over the period for which the fees have been paid in advance. However where a straight line day to day adjustment is appropriate the former responsible entity and the new responsible entity may agree on application of that apportionment method as an alternative to a Court application.

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[22] *Stacks* Op Cit 18

[23] Ibid

[24] Op Cit 20

L. Paragraph 4.6

15. **Remuneration where the RE is replaced**

Question

15.1 **What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?**

See paragraphs 12.1 and 14.1(b) above.

In summary, where a former responsible entity has been removed and replaced either with a TRE or a new RE and such former responsible entity has been paid fees in advance for services to be performed over a period of time that includes a period after the removal of the responsible entity, a Court should have the power to apportion such fee between the former responsible entity and the new RE or TRE on just and equitable terms having regard to the value of the services to be performed both before and after the removal of the former responsible entity for which the fee has been paid in advance and to order the former responsible entity to pay to the new RE or TRE the proportion of the fee applicable to the services to be performed by the new RE or TRE for the relevant period.

For a former RE to keep fees that were meant to cover the costs of performance of future services not only acts as a deterrent to replacement of a responsible entity with whom the members are dissatisfied but is unjust. The entitlement to any fee should be linked to the performance of the duties of the responsible entity.

For example with a forestry scheme, the fees may be collected in advance of establishment of the trees which only has to be within 18 months in order for the deduction for those fees to be available to the members. If a responsible entity was changed in this period the former RE would have the funds for these establishment services and not have to incur those expenses. The new RE would be unable to perform the services unless the members agreed to pay more monies. It would be unlikely that any new RE would take on the role without a payment of further fees.

This is totally unfair to members as well as any incoming RE.

It is also suggested that to the extent that any fees that are paid in advance of performance of the services to which they relate, the property of the responsible entity should be impressed with a statutory trust so that in the event of appointment of an external administrator, the proportion of the fees paid in advance would still be available for the benefit of the members of the scheme rather than general creditors. This would avoid the problem which arose in *Saker , in the matter of Great Southern Managers Australia Ltd (Receivers and Managers Appointed) (in liquidation)* [2010] FCA 1080 where the funds had in fact been set aside by the responsible entity for the performance of the services for which those fees were paid but were held not to be scheme property and therefore were only available to the general creditors and not the members of the scheme. This clearly defeated the intent of the arrangement which was to protect the members.

In its submission to the Turnbull Review, ASIC said that it was concerned that subsection 601GA(2) was ambiguous and failed to protect scheme members against questionable fee payment practices that had come to ASIC's attention. Modifications to the legislation were suggested by ASIC that would:

(a) impose a prohibition on all provisions, whether or not in a scheme's constitution, that provided for a fee or right of indemnity where the timing of payment or the entitlement to the indemnity related to a change in the RE as such "poison pill" provisions can operate to entrench an RE;

(b) clarify that the words, "in relation to the performance of its duties" (where they first occur in s 601GA(2)) relate both to "rights to be paid fees out of scheme property" and to "be indemnified out of scheme property for liabilities or expenses incurred";

(c) clarify that a RE may not receive fees or indemnities out of scheme property in advance of the proper performance of its duties;

(d) provide that, where a RE is required by subsection 601GA(2) to provide details in the scheme constitution in relation to rights the RE may have to be paid fees or to be indemnified out of scheme property, it also provides details where these rights relate to fees or indemnities to be paid out of any other source; and

(e) exclude any person other than the RE from having any right in respect of scheme property or against members (such as the payment of fees or the entitlement to an indemnity) for services provided in connection with the operation of the scheme.

The Turnbull Report noted that the protection of scheme property is obviously an important aspect of the legislation and therefore, the proposed legislative amendments, with one exception (see below), were considered necessary to resolve ambiguity and close off avoidance practices that have arisen in relation to the payment of fees and the claiming of indemnities.

The only exception related to ASIC's suggestion that a scheme constitution should be required to detail the rights of the RE to be paid fees or to claim an indemnity not only in relation to scheme property but also in relation to other sources not classified as scheme property.

As a result the review only recommended that section 601GA(2) be amended to ensure that payment of fees or a right to an indemnity cannot be claimed in advance of a RE's proper performance of its duties which of course does not deal with the problem of fees not paid out of scheme property but directly by members to the responsible entity.

With respect to the Turnbull Report, it is submitted that ASIC's suggestion that a scheme constitution should be required to detail the rights of the RE to be paid fees or to claim an indemnity not only in relation to scheme property but also in relation to other sources not classified as scheme property is appropriate. The most common problem with the payment of fees paid in advance of performance of duties arises in the case of agribusiness schemes where the fees are not paid out of scheme property. The fees are the personal property of the responsible entity. This is the reason why the former responsible entity has been able to keep these fees as illustrated in *Saker* and *Huntley Management Limited v Australian Olives Limited* [2010] FCAFC 98.

Any reform must address contractual payments made otherwise that out of scheme property as well as any fees paid from scheme property. Otherwise the problem that has arisen in practice will not be dealt with.

M. Paragraph 4.7

16. **Arrangements between an RE and external parties**

Question

16.1 **What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?**

Such arrangements do not as a matter of law prevent a change of responsible entity ([25]). However there are problems created with arrangements between an RE and external parties. Firstly such covenants interfere with the rights of members to change the RE which is a right recognised by statute. Secondly, members often will not know about such arrangements with the external parties and may unknowingly cause a breach of contract between the former RE and the external party by changing the RE.

It is recommended that a responsible entity be prohibited from entering into covenants that place restrictions on the responsible entity being replaced with a new responsible entity.

N. Chapter 5

17. **Restructuring a potentially viable MIS**

Questions

17.1 **Is there support in principle for the concept of a VA for an MIS?**

Although the ALRC Report 65 made recommendations in relation to this concept, the recommendation was not adopted. This may have been due to the complexities created by such a system.

It is submitted that this proposal creates too many issues and would overlay the current MIS regulation with an unnecessary complexity. As some of the following questions indicate there are difficulties with structuring a VA system.

It is submitted that if the other proposed reforms suggested above are adopted particularly in relation to the issues concerning the replacement of an RE and appointment of a TRE, many of the problems created by the current system which can result in schemes unnecessarily being wound up would be resolved without the need for a VA.

It would also impose an additional cost on members of the scheme. Undoubtedly in many cases even where a VA is appointed, the inevitable result would be that the scheme would be wound up in any event.

[25] *Macquarie Capital Advisers Ltd v Brisconnections Management Co Ltd (as responsible entity for the Brisconnections Investment Trust & the Brisconnections Holding Trust)* [2009] QSC 82

The other questions in this chapter concerning a VA are therefore not dealt with in this submission.

O. Chapter 6

18. **Overview of the winding up provisions**

Questions

18.1 **Are any changes needed to:**

(a) **the current circumstances where an MIS can be put into liquidation with/without the need for court approval • the provisions governing who can conduct the winding up?**

In this context:

(1) **should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why**

(2) **is there a need for a separate insolvency ground for winding up an MIS**

(3) **if so:**

(A) **how should the insolvency of an MIS be defined**

(B) **should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?**

The current system seems to be largely working. The courts have dealt with the issues adequately. Imposing new provisions would undo the current law and remove the flexibility which currently exists by allowing the courts to resolve any difficulties.

The only change it is submitted which ought to be made is in relation to section 601NC.

Section 601NC currently has a flaw. If a meeting is requisitioned by the members but the members do nothing at the meeting, effectively 5% of the members have prevented the scheme being wound up when the purpose of the scheme cannot be accomplished or has been accomplished. This then forces the responsible entity to expend further funds belonging to the members to have the scheme wound up by Court order.

The section should be amended so that the scheme may be wound up by the responsible entity not only if the members do not call a meeting within 28 days to consider the proposed winding up but also if they do not pass an extraordinary resolution directing the responsible entity not to wind up the scheme.

This will avoid a minority stalling the winding up of a scheme which needs to be wound up.

If this is rectified there is no need to amend the current law in relation to when a scheme should be wound up. If the scheme is "insolvent" in the colloquial sense ([26]) then winding up can be achieved either pursuant to section 601NC (without a minority preventing this occurring) or pursuant to section 601ND where the just and equitable ground has been widely interpreted to cover insolvency in the colloquial sense.

19. **Liquidation of an MIS where the RE is solvent**

Question

19.1 **Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?**

Just with section 601NC to which see answer to question 18.1.

20. **Whether MIS of an insolvent RE needs to be wound up**

Questions

20.1 **In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)?**

See answer at 17.1 so no comment is made.

20.2 **In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?**

See answer at 17.1 so no comment is made.

20.3 **If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome?**

In this context:

(a) **are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take responsibility for the liquidation of an MIS**

(b) **against what property might the claims of the RE liquidator and the MIS liquidator concerning their costs and expenses be claimed, and what would be their respective rights if the same property is involved?**

See answer at 17.1 so no comment is made.

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26 *Capelli v Shepard* [2010] VSCA 2 at [88]-[97].

21. **Options for an MIS liquidation process**

Question

21.1 **Would the process for liquidating an MIS be better provided for by:**

(a) **an extension of the powers of the court in s 601EE to all MISs, or**

(b) **a legislative procedure containing some or all of the elements discussed in Section 6.6 and for what reasons?**

The present case law appears to be sufficient to cover all circumstances for liquidating an MIS. The power in section 601ND given to a court is very wide and adding provisions may remove the wide discretion currently given to the courts to massage the winding up to suit the circumstances.

22. **Possible elements of an MIS liquidation procedure**

Questions

22.1 **What procedural provisions should there be for winding up an MIS and why?**

See answer to question 21.1 above so no comment is made.

22.2 **In particular, should a party conducting a winding up:**

(a) **have information-gathering and other investigative powers comparable to those of the liquidator of a company**

(b) **have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity?**

Yes but only if the RE is not conducting the winding up .

22.3 **Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating?**

No.

22.4 **Is there a need for any legislative procedures for winding up an MIS to be varied to take into account the particular characteristics of MIS structures (trusts, partnerships, contract-based MISs)? If so, what?**

No. See answer to question 21.1 above.

23. **Rights of priority creditors**

Questions

23.1 **Should there be a statutory order of priority in the winding up of an MIS?**

Yes.

23.2 **If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?**

It should include the remuneration and costs incurred by the liquidator of the MIS but this should be limited to those of the particular MIS to which the remuneration and costs relate.

24. **Voidable transactions**

Question

24.1 **Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those provisions?**

This does not appear to be necessary.

25. **Access to books of the MIS**

Question

25.1 **What provisions, if any, should be included to deal with access to books of the MIS?**

This seems to be adequately covered by the current section 247A of the Corporations Act, 2001.

26. **Court power to give directions**

Questions

26.1 **Should there be any changes to the current provisions by which the court can give directions, and, if so, what and why?**

No comment.

26.2 **In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?**

No Comment.

27. **Position of MIS members**

Questions

27.1 **What provision, if any, should be made for MIS members in the winding up of their scheme?**

Assuming the proposed reforms are passed that make it easier to replace an RE that is being wound up, then if the scheme is viable there would be no need to wind up the scheme. If the scheme is being wound up then members should have no greater rights than a shareholder of a company. No need for a change.

27.2 **Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?**

If the scheme is insolvent then the primary duty of the liquidator should be to the creditors of the scheme. However if the scheme is viable then the liquidator should have the same duties as an officer of a responsible entity in relation to the members.

28. **Unregistered MISs**

28.1 **Are the grounds for winding up a registered MIS (see Section 6.1.1) equally applicable to a lawful unregistered MIS?**

The Courts appear to have developed the law on winding up of unregistered scheme and it is sufficiently flexible enough to enable the Courts to handle any given circumstance or proposal.

28.2 **Should there be any provisions governing the procedure to be followed in winding up lawfully unregistered MISs and, if so, what?**

The law should be left as it is. The Courts appear to be able to deal with the various issues that have arisen.

29. **Unlawful unregistered MISs that are viable**

Question

29.1 **Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?**

The Courts appear to have been able to deal with this to enable this to occur. However it is messy and there should be some guide to the Courts and parties on how to rectify this problem without winding up a scheme that may otherwise be viable if it was adjusted to comply with the law.

30. **Unlawful unregistered MISs that are not viable**

Questions

30.1 **Should a former member of an MIS have standing to apply for the winding up of an unregistered MIS?**

There does not appear to be any justification for this.

30.2 **Should a creditor have standing to apply for the winding up of an unregistered MIS?**

Yes.

P. Chapter 7

31. **Convening scheme meetings**

Questions

31.1 **Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons?**

No.

31.2 **For what purposes, if any, should ASIC be granted the power to convene meetings of members?**

If the members are not prepared to call a meeting then there does not seem to be a need for ASIC to be given this power.

31.3 **Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?**

Yes. It seems odd that companies have to have an AGM but a scheme which is another form of statutory construct does not. This anomaly needs to be corrected.

32. **Cross - guarantees**

Question

32.1 **In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?**

No.

33. **Limited liability of MIS members**

Questions

33.1 **Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes?**

Most scheme constitutions attempt to do this. However it would be good if this was confirmed by statute.

33.2 **Should the limited liability principle be subject to any contrary provision in the scheme constitution?**

Yes provided that clear disclosure of this fact is made to potential investors in the PDS.

34. **Other Matters**

Question

34.1 **Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?**

(a) **section 601FJ**

An amendment needs to be made to section 601FJ of the *Corporations Act, 2001.* The current interpretation is that the record with ASIC is not conclusive that the new responsible entity has replaced the old responsible entity ([27]).

This means that there may be a lacuna between when the responsible entity is appointed by the members and when ASIC gets around to recording the change of responsible entity on its record. ASIC has tried to avoid the lacuna by referring to the effective date of change but this has no effect at law.

In one particular case, there was a gap between 17 December 2008 when the record of ASIC was changed and 21 January 2010 when the Federal Court dismissed the proceedings seeking to have the resolutions set aside ([28]). It is not clear what happens in this gap which is hardly a satisfactory result

(b) **Section 601NC**

This section enables the responsible entity to wind up the scheme if the purpose of the scheme has been accomplished or cannot be accomplished by giving notice to ASIC and the members. The section enables the required number of members to call a meeting to vote on an extraordinary resolution that the members propose about the winding up of the scheme. The section provides what happens if the members do not call a meeting. However it does not deal with what happens if the members do call a meeting and nothing results from the meeting either because the members do not put forward any extraordinary resolution that the members propose about the winding up of the scheme or no such resolution can be passed.

This leaves the responsible entity with a problem with the scheme particularly if the purpose of the scheme cannot be accomplished. It cannot retire because if the scheme is insolvent or non-viable there is no replacement responsible entity available. Its only recourse appears to be to apply to the Court to wind up the scheme on the just and equitable ground. This is an expensive and unnecessary procedure.

It is suggested that the responsible entity ought to be able to also wind up the Project if the members do call a meeting but at that meeting no extraordinary resolution that the members propose about the winding up of the scheme is passed other than that the scheme be wound up.

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[27] *Huntley Management Limited v Australian Olives Limited (No 2)* [2009] FCA 686.

[28] *Australian Olives Limited v Livadaras* [2008] FCA 1407.

Lawyers McCullough Robertson

Submission to CAMAC

Managed Investment Schemes Discussion Paper (June 2011)

Reform 1
Reform 1: identification and recording of the affairs of each MIS *Identification of agreements* Whenever an RE, as operator of an MIS, is a principal to a legally enforceable contract, arrangement or understanding ('agreement'), the RE must specify that this is the case and identify the MIS to the counterparty. The RE must include that information in any document constituting that agreement. Where the agreement involves more than one identified MIS, the RE must identify what part, or proportion, of the agreement is attributable to each MIS. *Recording of agreements* From the commencement of an MIS, the RE (including any replacement RE) must maintain an ongoing register for that MIS of all relevant agreements. The agreements register must be divided into a 'continuing agreements' section and a 'completed agreements' section. Details of each agreement (and any material variations to that agreement) must be included in the former section, until such time as all rights, obligations and liabilities of any party under that agreement have been discharged, after which the details of the agreement must be transferred to the latter section. The agreements register must be maintained throughout the life of the MIS, and be available to any external administrator of that MIS. No agreement, whether or not still on foot, may be deleted from the register (except where recorded by mistake).

Questions	Our feedback
Should the policy approach in Reform 1 be enacted? Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS? If yes: (a) how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended? (b) what remedies should affected parties have for failure to include an agreement in the register and against whom?	We consider it appropriate to request REs to specify in an agreement that they are acting in an RE capacity and identify the relevant MIS. We agree with the proposal to require REs to maintain an ongoing register for each MIS of all relevant agreements. However, we do not believe the register should be a definitive statement of all agreements entered into by an RE as operator of a particular MIS. The maintenance of a register should be an obligation of an RE, a breach of which constitutes a contravention of the Corporations Act. As the maintenance of a register may impose a significant administrative burden on REs, the register maintenance obligation could also be subject to a materiality threshold with only those agreements with a value above a specified dollar amount required to be recorded. Mandating through legislation that the register is a definitive statement of all

Questions	Our feedback
	agreements for that MIS is unduly onerous and unfair to counterparties to those agreements. For example, a counterparty, particularly if they are unfamiliar with the MIS regime, may not appreciate the RE is acting in that capacity, may not be aware of the RE's obligation to include the agreement on the register, and may not appreciate the consequences to the counterparty of the agreement not being included in the register. Also, counterparties would likely require regular inspections of the register in order to confirm their agreement is still recorded and these increased transaction costs would be passed to the RE and ultimately borne by scheme members. Therefore, the register will be of assistance in encouraging good practice by REs by ensuring agreements related to an MIS are accurately designated and recorded as such. However, ultimately liability issues should depend on terms of the relevant agreement and not its inclusion in, or omission from, a register.
If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.	Where the change of RE occurs by agreement, there should be no consequences. In the case of a hostile change of RE, say by the members, again the incoming RE accepts the role as RE subject to the inherent risks. In the case of the appointment of a temporary RE, this RE should be afforded an interim level of protection from being personally liable where the assets of the MIS are insufficient or a right of indemnity is lost due to the actions of the previous RE.

Reform 2	
Reform 2: use of scheme property The property of a particular MIS can be used only for the purposes of that MIS.	
Questions	**Our feedback**
Should the policy approach in Reform 2 be enacted? Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?	We generally support this reform. The exception should be that the property of a MIS can be used by another entity if that use is for value (similar to the requirements for related party transactions) or approved by MIS members.

Reform 3	
Reform 3: informing MIS creditors of a change of RE Where the RE of an MIS changes, the new RE must give notice of that change to all counterparties included in the 'continuing agreements' section of the agreements register referred to in Reform 1, and to any other counterparty of which the new RE is aware or becomes aware.	
Questions	**Our feedback**
Should the policy approach in Reform 3 be enacted? What, if any, consequences should follow where an RE fails to inform a counterparty?	No. We believe that counterparties can protect themselves by requiring in the contract that notice be given. Alternatively, counterparties can include a change of RE as a review or default event. Banks insist on a change of RE being an automatic event of default.

Reform 4
Reform 4: rights of MIS creditors against scheme property Only persons who have entered into an agreement with an RE as principal in its capacity as the operator of a particular MIS, and the RE in respect of its indemnity and other rights against the property of that MIS, will be the creditors of that MIS. Persons who have transacted with the RE in this capacity will have the right to claim directly against the property of that MIS, not through subrogation to the RE's right of indemnity against scheme property. **Related provisions** *1: Rights of MIS creditors against assets of the RE* In addition to their rights under Reform 4, all counterparties to arrangements with an RE as principal that refer to a particular MIS (as per Reform 1) may claim against any property of the RE that is not held in trust by the RE, except for those counterparties who agree to limit their rights of recovery to Reform 4. Property of the RE not held in trust would include any indemnity rights of the RE against the property of any MIS. *2: Rights of other creditors of the RE* Where an RE as principal enters into arrangements that do not refer to a particular MIS (as per Reform 1), the rights of counterparties are confined to property of the RE that is not held in trust by the RE.

Questions	Our feedback
Should the policy approach in Reform 4 be enacted? If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?	We support the creation of a right for persons who transacted with the RE in that capacity to claim directly against the property of that MIS, rather than by subrogation to the RE's right of indemnity against scheme property. Whether or not a creditor has contracted with the RE in that capacity should be determined by reference to the terms of the particular agreement and general

Questions	Our feedback
Should the two related provisions also be adopted?	contractual law principles. If the MIS is not disclosed, then creditors should be limited to the assets of the RE and the RE should not have a right of indemnity to the scheme assets. Whether or not a creditor has a right to claim against the RE personally should again be determined by reference to the terms of the particular agreement.
In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time? Who should have access to that register and through what process?	No. As acknowledged by CAMAC, the accounting standards require the accounting records to identify scheme property and we consider the imposition of a register of scheme property to be a duplication of information and consequently an unnecessary and onerous burden on REs.
Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members? Who should have access to that register and through what process?	We support the requirement for REs of contract-based MISs to maintain a register of arrangements entered into by the RE as agent for the MIS members. Each member of the MIS should be able to obtain details from the RE of agreements the RE has entered into on that member's behalf (and any variations of those agreements). We do not believe it appropriate for members generally, creditors, or other third parties to have access to this register.
Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE? In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?	A statutory clarification would need to provide certainty. We think it will be difficult for legislation to clearly define all circumstances in which an RE should, or should not, be entitled to exercise indemnity rights. Accordingly, we believe the better approach is to maintain the status quo and for guidance and clarification on the operation of the indemnity right to be provided by the courts over time. We do not believe tort claimants should have direct rights against the property of an MIS as this potentially places them in a better position than creditors (for example, a creditor who believes they were dealing with an RE in an MIS capacity but where this is not reflected in the agreement). Requiring tort claimants to claim against the MIS assets through subrogation to the RE's right of indemnity to scheme property ensures that the property of the MIS is protected against tort claimants where the claim arises in circumstances where the RE does not have a right of indemnity from the assets of the MIS.

Transfer of viable MIS – Part 4	
Questions	**Our feedback**
What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why? What changes, if any, should be made to the powers of the court to appoint a TRE and why? In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?	We do not consider the voting thresholds require amendment. If it is determined that the voting threshold be lowered then the RE and its associates should not be prevented from voting their interests in the scheme. Where a court appoints a TRE, that TRE should be provided with a grace period (as determined by the court and able to be extended by the court) for determining the liabilities of the previous RE and the likely liabilities of the TRE if the TRE is confirmed in the role. A TRE should not be personally liable for the liabilities of previous RE or MIS during this grace period. Under section 601FQ the TRE has an initial period of three months (which can be extended) and this should accord with the grace period for determining liability. We also recommend amending Part 5C to enable a court to appoint a TRE if members pass a resolution removing the RE but do not appoint a replacement RE at the same meeting, rather than requiring the scheme wound up (as currently required by section 601(e)(i)(d)). We do not believe an existing RE should have any obligation to assist a prospective new RE to conduct due diligence. If the change of RE is a 'friendly' transaction, it is usual for practice the outgoing RE to provide assistance to a prospective RE. However, in a 'contested' situation, a prospective RE should not be forced to provide assistance to its competitor - the prospective RE. This is similar to the takeover context, where there is no obligation upon a target to provide assistance to a bidder although assistance will generally be provided where it is a friendly takeover.
Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?	No. If a proposed TRE is not appropriately licensed then ASIC has the capacity to fast track the appropriate AFSL authorisations.
What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?	None.
What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?	None, other than as suggested above to provide a grace period where the TRE will not be personally liable while it evaluates the MIS.

Transfer of viable MIS – Part 4	
Questions	**Our feedback**
What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?	If the remuneration is insufficient then the court has the power to make the appropriate orders. In our view the *Huntley Management Limited Case* was peculiar to a tax effective managed investment scheme and not indicative of most schemes. Clarification or an acknowledgement of the court's power to make orders includes enabling a TRE to recover remuneration in priority to the claims of other creditors would also increase the readiness of entities to accept a TRE appointment.
Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons? In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to: (a) possible conflicts of interest faced by the TRE; (b) the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced); and (c) a TRE providing assistance to an external administrator?	None. If a voluntary administration regime was introduced for MISs, then the ability of an RE to appoint an administrator and any obligation on an RE to provide assistance to an administrator will also be rights and obligations exercisable by a TRE.
What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?	None, we believe the operation of sections 601FS and 601FT have been considered by the courts and interpreted broadly in accordance with the legislative intent.
What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?	The RE can only claim remuneration for the proper performance of its duties. We do not consider any changes to the statutory controls are necessary.
What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?	The internal and external arrangements entered into by the RE are appropriately dealt with by disclosure and ensuring the RE, when entering into the arrangements, is acting in the best interests of members. Section 601FC(1)(c) requires the RE to place the interests of members above the interests of the RE. In many instances unrelated counterparties may insist on buy out or termination rights on a change of RE. Termination rights are standard in banking facilities. Provided the counterparty is not a related party or associate we do not consider there should be any statutory controls. If the arrangements exist before the scheme is available to the public then appropriate disclosure to members is necessary so they can make an informed

Transfer of viable MIS – Part 4	
Questions	**Our feedback**
	investment decision. If the arrangements are entered into with related parties or associates after commencement of the scheme then member approval should be sought where required by the Corporations Act.

Restructuring a potentially viable MIS – Part 5	
Questions	**Our feedback**
Is there support in principle for the concept of a VA for an MIS? Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?	We support the concept of a VA for an MIS. The VA should only apply to creditors of the MIS and we note that creditors in this context would include the RE for any accrued and unpaid fees.
What types of matters concerning these parties should be included in the VA of an MIS? What should be the grounds for initiating the VA of an MIS? Who should be entitled to initiate the VA of an MIS? If the VA of an MIS is to involve classes other than MIS creditors: (a) in relation to any voting on a proposed MIS deed: (i) how should the classes entitled to vote on the MIS deed be determined? For instance, should it be left to the administrator to determine those classes, taking into account the extent to which the deed affects their interests; (ii) where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests; and (iii) should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it, (b) what should be the voting rules for any proposal that: (i) the MIS be wound up; or (ii) the MIS administration end and the MIS continue as before? In what circumstances, if any, should an MIS deed be able to override the rights of members under the constitution of the MIS or impose new obligations	We consider the VA should only be able to be undertaken by an external administrator, which is consistent with the VA for a company. The directors of the RE may consider the appointment of an external administrator as appropriate however the members should still be entitled to replace the incumbent RE with a new RE. We consider either the members or the RE should be able to initiate a VA. In our view members in an MIS should be treated in the same manner as shareholders in a company. The determination of classes, voting requirements and voting rules should be left to the administrator. An MIS deed should be able to override the rights of members under the MIS constitution but should not be able to impose new obligations on members (as opposed to impacting the rights of members which will be permitted).

Restructuring a potentially viable MIS – Part 5	
Questions	**Our feedback**
on those members?	
What, if any, legislative provision needs to be made to prevent duplicate VAs?	Where an RE goes into a VA, this creates an immediate conflict of interest. The RE and the creditors of the RE are likely to want the RE to remain the RE of the scheme as this will generate management fees which will support both the RE and the claims of its creditors. The members of the scheme (assuming the MIS is solvent) will most likely want a new RE appointed so the new RE can focus on the scheme and not be distracted by the VA of the RE. Whilst there is already the ability to apply to court for the appointment, consideration may be given to lowering the threshold for the replacement of the RE where the RE is in VA to an ordinary resolution. We submit there should be a separate VA for the RE and MIS unless the members and creditors of both the MIS and RE agree that a single VA be undertaken.
In the context of an MIS administration, should there be any change to the current requirements that only a registered liquidator can be an administrator and, if so, why?	No. We believe it is appropriate that only a registered liquidator should be an administrator of MIS.
Should an MIS administrator have similar powers to those of the administrator of a company? For what liabilities, if any, should an MIS administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?	Yes. We consider an MIS administrator should have the same liabilities and rights as an administrator under a company VA. The MIS administrator should have a right to claim directly against scheme property for activities undertaken in the proper performance of its duties.
Who should determine the remuneration of an MIS administrator or an MIS deed administrator? What, if any, classes of persons in addition to the MIS creditors should be involved and in what manner and for what reasons? What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?	We submit that the process for determining the remuneration of an MIS administrator should be the same as applies to a company administrator. Specifically, the remuneration should be determined by the creditors of MIS (excluding the responsible entity) and the MIS administrator should have the same priority rights to recover remuneration as a company administrator.
What powers should the court have in any VA of an MIS, and who should be entitled to apply to the court for this purpose?	We consider the MIS administrator, the RE, creditors, ASIC and MIS members should be entitled to apply to the court and the court should have to power to make any order it considers appropriate for an MIS VA .

Restructuring a potentially viable MIS – Part 5	
Questions	**Our feedback**
In what circumstances, if any, should there be a power to appoint a TRE to operate an MIS in the context of a VA of that MIS, and who should be able to exercise any such power?	The MIS administrator should have the ability to apply to court for the appointment of a TRE where the existing RE is unwilling or unable to act.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
Are any changes needed to: (a) the current circumstances where an MIS can be put into liquidation with/without the need for court approval; (b) the provisions governing who can conduct the winding up? In this context: (a) should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why; and (b) is there a need for a separate insolvency ground for winding up an MIS (c) if so: (i) how should the insolvency of an MIS be defined; and (ii) should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?	We consider the current thresholds as appropriate for the winding up of a solvent MIS. If the majority of members by value consider the winding up of the scheme is in their best interests then that is appropriate. The risk with an ordinary or special resolution threshold, is that a small but active minority of members may force a premature winding up of the scheme for their own benefit. The RE when recommending the winding up of the scheme must treat all members of the same class equally and between classes fairly. This same obligation is not imposed on the members. We believe the winding up of a solvent MIS should be undertaken by the RE. The winding up of an insolvent MIS should be undertaken by a liquidator and the VA of an MIS be undertaken by an external administrator (who is a registered liquidator). We support the inclusion of a separate insolvency ground for winding up an MIS. Whilst we acknowledge that an RE can rely on its rights to wind up an MIS where the purpose of the scheme cannot be accomplished, this ground requires a notification to be given to members and the ability for members to call a meeting. Accordingly, there is a risk the RE could be engaging in insolvent trading during the 28 day notice period and also that an insolvent MIS could incur further debts if members require a meeting to be held. Accordingly, we believe it is necessary for an RE to be able to wind up a scheme, without reference to members, where the MIS is insolvent. The test for an insolvency of an MIS should be based on the solvency test which applies to companies, namely that the RE forms the view that it will be unable to pay debts incurred in its capacity as a responsible entity of the MIS from the property of the MIS as those debts fall due and payable.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
	If an RE continues to operate an insolvent scheme then the RE is at risk of losing its right of indemnity or alternatively not having sufficient scheme assets to satisfy an indemnity claim.
Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?	We consider the RE is the best party to supervise the winding up of a solvent MIS (except where the MIS is in VA). It is in the interests of the RE to ensure the winding up process is performed efficiently, honestly and fairly. However, if the MIS is insolvent, we believe the winding up should be undertaken by a liquidator.
In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)? In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?	We consider the liquidation of an RE and an insolvent MIS should be undertaken separately, unless the members and creditors of both the RE and MIS agree for the liquidations to be undertaken together. If the RE is insolvent or under VA and: (a) the MIS is insolvent or in VA, the liquidation or administration should be undertaken by the liquidator or administrator (who must be a registered liquidator); or (b) the MIS is solvent, then the MIS could continue to operate under a new RE or TRE or be wound up by another RE appointed by the court or an administrator.
If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome? In this context: (a) are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take responsibility for the liquidation of an MIS; (b) against what property might the claims of the RE liquidator and the MIS liquidator concerning their costs and expenses be claimed, and what would be their respective rights if the same property is involved?	We consider that where the RE and the scheme are both in liquidation, a separate liquidator should be appointed for the RE and MIS unless the members and creditors of both the RE and MIS agree otherwise. Each liquidator will have their own roles and responsibilities and the potential for conflicts too great to allow one liquidator to run both liquidations. The MIS liquidator should be entitled to recover their costs and expenses from scheme property and the RE liquidator entitled to recover their costs and expenses from the assets of the RE. No conflict should arise, other than any disputes as to whether an asset is property of the MIS or RE. Such disputes should ultimately be determined by the courts. These obligations should be enshrined in legislation.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
Would the process for liquidating an MIS be better provided for by: (a) an extension of the powers of the court in s 601EE to all MISs; or (b) a legislative procedure containing some or all of the elements discussed in Section 6.6, and for what reasons?	We think both proposals have merit. However, we submit the better approach for liquidating an MIS is to introduce a legislative procedure containing the elements discussed in section 6.6. We believe a more prescriptive and detailed approach will provide greater certainty and clarity for the benefit of liquidators and REs. The procedural provisions discussed in section 6.6 should only apply to the winding up of an insolvent MIS and these powers would be exercised by the liquidator.
What procedural provisions should there be for winding up an MIS and why? In particular, should a party conducting a winding up: (a) have information-gathering and other investigative powers comparable to those of the liquidator of a company; and (b) have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity? Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating? Is there a need for any legislative procedures for winding up an MIS to be varied to take into account the particular characteristics of MIS structures trusts, partnerships, contract-based MISs)? If so, what?	We believe the liquidation process should be similar to that for companies. We do not support any party other than the incumbent RE undertaking a voluntary winding up of a solvent scheme (other than where the MIS is in VA, in which case the winding up will be undertaken by the administrator). In our view, the incumbent RE has the greatest interest in ensuring the interests of members of the scheme are appropriately dealt with on an orderly wind up. Further, we consider the incumbent RE would undertake the winding up in a more cost effective manner than a liquidator.
Should there be a statutory order of priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?	On a liquidation of an insolvent MIS or winding up on an MIS in VA, the priority for the liquidator or administrator's fees and costs should be the same as for companies.
Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those provisions?	Yes. It should follow that applicable to companies but only apply in the context of an insolvent MIS or an MIS in VA being wound up by the administrator.
What provisions, if any, should be included to deal with access to books of the MIS?	Access to books of the MIS in liquidation should be provided for in a similar manner to that applicable for companies.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
Should there be any changes to the current provisions by which the court can give directions, and, if so, what and why? In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?	We consider the court should be afforded wide discretion to make orders for the liquidation of an MIS. We believe the RE, creditors and members should be entitled to apply for orders concerning an MIS in liquidation.
What provision, if any, should be made for MIS members in the winding up of their scheme? Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?	The rights of members of an insolvent MIS should rank the same as shareholders in a company liquidation.
Are the grounds for winding up a registered MIS (see Section 6.1.1) equally applicable to a lawful unregistered MIS?	Yes.
Should there be any provisions governing the procedure to be followed in winding up lawfully unregistered MISs and, if so, what?	In the case of a lawful unregistered MIS the winding up process should be left to the members and the trustee. In the case of a solvent or insolvent unlawful unregistered MIS, then the courts are the appropriate avenue for the appointment of a liquidator external to the trustee (who operated the unlawful MIS) as the appropriate party to wind up its scheme. Alternatively, in the case of a solvent unlawful MIS, then a licensed RE could be appointed as a TRE with registration expedited assuming this is supported by the members.
Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?	No. ASIC already assists in this aspect by expediting the process.
Should a former member of an MIS have standing to apply for the winding up of an unregistered MIS? Should a creditor have standing to apply for the winding up of an unregistered MIS?	Yes. Yes.

Other matters – Part 7	
Questions	**Our feedback**
Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons? For what purposes, if any, should ASIC be granted the power to convene meetings of members? Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?	We submit that sections 252B and 252D should be extended to enable members to direct the RE to call, or to themselves call, a meeting of scheme members for the purpose of considering an ordinary resolution. Whilst the only ordinary resolution specified in the Corporations Act for an MIS is the change of a responsible entity for listed schemes, scheme constitutions may provide that certain decisions are to be determined by an ordinary resolution of members and the Corporations Act should facilitate the ability for members to call, or require the RE to call, a meeting in such circumstances. We do not believe ASIC should be granted the power to convene meetings of scheme members. Further, we do not believe it necessary for an annual general meeting to be introduced for MISs.
In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?	We support a prohibition on an RE granting a guarantee or indemnity in its capacity as RE of an MIS which is unrelated to the activities of the MIS, with ASIC having the power to provide exemptions in general or specific circumstances.
Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes? Should the limited liability principle be subject to any contrary provision in the scheme constitution?	Yes. The limited liability of members for the debts of the MIS should be clarified. The limited liability principle should not be able to be overridden by a contrary provision in the scheme constitution. This is because if appropriate disclosure is not made to members, they may not be aware of the fact they do not have the benefit of limited liability. Also, a member who joins a scheme may, contrary to their wishes, lose the benefit of limited liability if the scheme constitution is amended. No distinction should be drawn between active or passive MIS members, though limited liability should not apply for schemes where the RE is the agent for scheme members.
Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?	In light of the recent case of *City Pacific Ltd ACN 079 453 955 (as the responsible entity for the City Pacific First Mortgage Fund ARSN 088 139 477) and Anor v Bacon (as agent for the 'Requisitioning Members') and Others (No. 2)* [2009] FCA 772, the Government should clarify that section 601FM requires two resolutions to be put at meeting to change the responsible entity, one resolution relating to the removal and a separate resolution relating to the

Other matters – Part 7	
Questions	**Our feedback**
	appointment. The process for winding up an MIS requires a notice to be lodged with ASIC when the winding up commences and another notice lodged with ASIC when the winding up is completed. The winding up of a scheme can take a number of years. We understand ASIC's view is that upon lodgment of a notice commencing the winding up, the obligations of a responsible entity to prepare and lodge audited financial statements and for the compliance plan audit report to be prepared and lodged cease. In our view, any obligations of a responsible entity regarding an ongoing appointment of a compliance committee; the preparation, audit or review, lodgment and dispatch of financial statements; and preparation and lodgment of the compliance plan audit report during the winding up process should be clarified. The Government could consider drawing a distinction between a solvent MIS which is being wound up by the RE (where the financial reporting and audit obligations would continue until the winding up is completed) and insolvent schemes or MIS subject to VA (where these obligations would not apply during the winding up process). The obligation under section 601FC(1)(l) to report to ASIC certain breaches relating to a scheme as soon as practicable should be amended to impose a notification timeframe of as soon as practicable and within 10 business days. This will ensure the notification timeframe under section 601FM is the same as that applying under section 912D for significant breaches by responsible entities and other AFS licensees. The scope of section 208 as it applies to MISs (as set out in section 601LC) should be amended to only apply the benefits given to the responsible entity, an entity it controls or their respective related parties. Currently, section 208 applies to, for example, a benefit given by a responsible entity to an independent custodian given the custodian is an agent of, or person engaged by, the responsible entity and therefore caught by the scope of section 208. Technically, for an MIS, section 208 requires a responsible entity to consider the related party provisions, and document such consideration (for example, the application of the arm's length exemption), for any agreement relating to the MIS. We submit, consistently with the related party provisions applying to

Other matters – Part 7	
Questions	**Our feedback**
	public companies, that the application of Chapter 2E to MISs should be limited to benefits received by the RE, entities the RE controls and their respective related parties and not bonafide third parties unrelated to the RE.

Freehills

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By email
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30 September 2011

By email

Dear Mr Kluver

Submission on CAMAC discussion paper regarding managed investment schemes

Freehills is pleased to provide this submission on the Corporations and Markets Advisory Committee's (**CAMAC's**) discussion paper on Managed Investment Schemes (**MISs**) issued in June 2011 (**Discussion Paper**).

Our response does not purport to respond to all of the issues raised in the Discussion Paper. Rather, it focuses on some key issues, and discusses more generally some of the issues that we see in the MIS sector which impede restructures and responsible entity replacements, and create inefficiencies, for both solvent and insolvent MISs – particularly trust-based MISs.

We would be very happy to discuss with CAMAC any queries or comments on our submission, or on the Discussion Paper more generally.

1 Executive summary

(a) We agree that the issues raised by CAMAC in the Discussion Paper warrant serious consideration.

(b) However, we have concerns with a number of the proposals in the Discussion Paper. We believe that some of the proposals would be impractical or excessively expensive to implement, and we also are unconvinced that, taken as a whole, they effectively address the concerns raised in the Discussion Paper.

(c) In our view, a more effective way to address many of the concerns raised by the Discussion Paper would be to adopt a different (and, we acknowledge, ambitious) approach to reform, referred to as our **Alternative Proposal**. Put simply, we submit that reforms should be made to allow an MIS to become a separate "legal person" distinct from its responsible entity (**RE**). The RE would remain responsible for giving effect to the governance of the MIS (and could execute documents as agent for the MIS). However, the MIS could hold property, and sue and be sued, in its own right – hence avoiding both questions of co-mingling of property and also the complications that arise upon a change to or insolvency of the RE. This structure would also facilitate the liquidation or administration of an MIS, and would remove the legal uncertainty that surrounds an RE dealing with itself in more than one capacity. We have discussed this Alternative Proposal in section 2 of our submission.

Doc 10587447.16

(d) A discussion of some of our concerns with the reform proposals in the Discussion Paper, as well as commentary as to how our Alternative Proposal would more comprehensively address the relevant issues, is contained in section 3 of our submission.

(e) We have also discussed some additional proposed reforms which we submit would resolve other legislative problems which, in our view, currently impede RE changes and other MIS restructures. This discussion is included in section 4 of our submission.

2 Overview of Alternative Proposal

Our Alternative Proposal would involve amending the Corporations Act (and other relevant legislation such as tax laws) to provide as follows:

(a) Each registered MIS would retain its basic features as an MIS under the Corporations Act (in that the contributions of members of the MIS would be pooled or used in a common enterprise and the investors would not have day-to-day control of the operation of the MIS), however the MIS would be given status as a legal person, distinct from its RE. Reform to tax laws would be required to ensure that an MIS could still operate as a “flow through” entity for tax purposes in appropriate circumstances.

(b) Accordingly, the MIS would hold scheme property, and be a party to contracts, in its own right. It would have the capacity to sue and be sued.

(c) The RE would still perform the decision-making and governance function in respect of that MIS and would still be subject to the same duties under the Corporations Act and at general law. However, rather than entering into transactions as principal, the RE would enter into transactions solely as agent of the relevant MIS. Accordingly, the RE would not assume any rights or obligations under any contractual arrangements with third parties and such third parties would only have rights of recourse directly against the MIS, rather than the RE. The MIS itself (or any custodian/nominee acting on its behalf) would hold title to the MIS’s assets.

(d) The MIS would not have a board, or other decision-making organ, except for the RE.

(e) Each MIS would still have a scheme constitution, a compliance committee and a compliance plan and otherwise be subject to the regulatory requirements of Chapter 5C.

(f) The RE would still have the right to be indemnified out of scheme property under the terms of the MISs constitution and the Corporations Act, although we note that the RE’s rights of indemnification may need further clarification under the Corporations Act.

(g) All rights, obligations and liabilities which are incurred by the RE as agent of an MIS will rest with the MIS (provided that the RE does not do anything to assume personal liability under the general law principles of agency).

While undoubtedly an ambitious proposal, we see the Alternative Proposal as a more effective, efficient, and comprehensive way of addressing not only the matters raised in the Discussion Paper, but also a number other issues that emerge in practice for MISs, many of which we have discussed below.

Among other things, the Alternative Proposal would address the following:

(a) Assets, rights and liabilities of the MIS would be clearly identifiable and would not be intermingled with those of the RE or of other MISs.

(b) A change of RE would not have any effect on the assets or documents of the MIS, nor would it have any effect on counterparties.

(c) Similarly, the insolvency or liquidation of the RE would not have "contagion risk" for the MIS.

(d) The MIS's creditors would be entitled to pursue claims directly against the MIS rather than indirectly via the RE's right of indemnity.

(e) Insolvency of the MIS could be efficiently pursued through a straightforward administration process.

(f) By creating a distinct legal personality for MISs, legal uncertainties that can arise when an RE transacts with itself in another capacity would not arise.

3 Response to specific proposals in section 3 of the Discussion Paper

3.1 Reform 1: identification and recording of the affairs of each MIS

At a conceptual level, we agree that it is important that property of an MIS be properly identified. In our experience, most MISs (particularly trust-based MISs) do not fail materially in this respect.

However, we have serious concerns about the efficacy and advisability of Reform 1.

We consider that it is overly prescriptive to mandate a requirement that all documents specify the RE's capacity (though we note that most REs will do this as a matter of course anyway).

We consider that there are significant limitations associated with the proposal for REs to keep an agreement register. CAMAC has queried whether the agreements register *should be* a definitive statement of all agreements entered into by an RE as operator of a particular MIS. In our view, the question should, rather, be whether the agreements register *can be* treated as a definitive statement of all agreements entered into by an RE (given the likelihood of inaccuracies and omissions by virtue of the onerous nature of the task).

In our view, if such a register is to be mandated, counterparties to contracts with an RE should not have the right to be given access to the entire register, on the basis that the register will no doubt contain commercially sensitive information. At best, they should be given an extract of the register or confirmation from the RE that appropriate entries have been made in the register.

In terms of remedies for failure to include an agreement in the register, we do not agree that the enforceability of a contract should be dependent on that contract being entered in the register (for the reasons set out in the Discussion Paper). It could be that an incoming RE has a right of recourse against an outgoing RE for failing to enter an agreement into the register (although this provides limited comfort, particularly when considering scenarios involving the insolvency an outgoing RE).

In any event, it appears to us that the MISs which are most likely to give rise to concerns and problems (and hence are most likely to lead to restructures or RE changes) are those which are least likely to have complete and up-to-date registers. Hence a replacement RE or liquidator would receive little comfort in the situations they are most likely to encounter.

We also submit that our Alternative Proposal would resolve the concerns underpinning this proposal.

3.2 Reform 2: use of scheme property

Conceptually, we accept that an RE should not utilise resources of the MIS for its own purposes, or for purposes unconnected to the MIS. However, we submit that the existing law already regulates this area significantly – eg fiduciary principles and trust law more generally, Part 5C.7 of the Corporations Act and Chapter 10 of the ASX Listing Rules (for those MIS's that are listed). The conduct which CAMAC is concerned to prevent would generally be in breach of those existing laws.

If any additional regulation is proposed in this area, it will be critical to ensure that it is not excessively wide in application. For example, it would need to be made clear that the granting of guarantees or equity support arrangements by MISs in favour of their stapled or wholly owned entities (a common and perfectly proper practice) is not prevented. This is conceptually similar to our more detailed discussion in section 4.3 below about the proposal to restrict the giving of guarantees and indemnities by REs.

3.3 Reform 3: informing MIS creditors of a change of RE

We consider the proposal under Reform 3 to be unduly onerous on incoming REs – particularly if the MIS in question is involved in general business activities and has hundreds or thousands of minor trade creditors on short term arrangements. A change of RE is a public process, and it is already open to material creditors to monitor ASIC lodgements to see if an RE change is proposed in respect of an MIS which is a significant debtor. Hence we do not see any particular benefit arising from the notification process. Additionally, if there is to be a statutory requirement for MIS creditors to be informed of a change of RE, the obligation should be to take all reasonable steps to notify MIS creditors and counterparties (there also being some guidance on what is taken to be reasonable, particularly in circumstances where the new RE cannot locate certain creditors or counterparties of a MIS).

3.4 Reform 4: rights of MIS creditors against scheme property

We do not have a fundamental objection to the principles underpinning Reform 4. We do, however, consider that our Alternative Proposal is a preferable and more comprehensive way of dealing with this problem.

We also have some concern that the application of the Reform 4 merely to registered MISs would have the potential to confuse the market and to create inefficiencies – ie creditors and counterparties may not properly appreciate the fundamental differences that they face merely because a trust happens to be registered. We accept that our Alternative Proposal also suffers from this complication, but we submit that the structure in the Alternative Proposal would create an environment where differences would be more likely to be understood by creditors and counterparties.

To the extent that Reform 4 was to be adopted, we consider that the claimants able to benefit from the reform should not be limited merely to those whose claims are included on the agreements register. As discussed in section 3.1, we do not support the agreements register concept and we are concerned that the MISs most likely to be caught up in insolvency situations are those who are least likely to maintain such a register properly.

3.5 Other matters raised in section 3 of the Discussion Paper

In section 3.5 of the Discussion Paper, CAMAC has queried whether an RE should be required to establish and keep up to date a comprehensive register of scheme property. The same comments that we made in relation to the agreements register in section 1.2 of this submission apply to this proposal. If any such proposal were to be accepted, additional guidance should be given as to what constitutes ”scheme property” for this purpose. Is it simply any property which falls within the definition of “scheme property” contained in section 9 of the Corporations Act?

There should only be very limited rights of access to any register of scheme property, so as to protect and commercially sensitive information contained therein.

In response to the questions raised under section 3.7 of the Discussion Paper, we consider that there is considerable uncertainty as to when an RE is entitled to be indemnified out of scheme assets when it has incurred a liability in consequence of a common law of statutory breach. We would welcome clarification of this point.

In our view, the Alternative Proposal is the preferred approach to take in order to effectively address the issues which have been identified by CAMAC. Under that proposal tort claimants would have direct rights against the property of a MIS in all circumstances.

4 Discussion of more general issues facing MISs and REs, as contemplated by section 4 of the Discussion Paper

4.1 Uncertainty over the precise legal effect of a replacement of RE under sections 601FS and 601FT

In our experience, there is ambiguity in the precise legal effect of the statutory mechanisms in sections 601FS(1) and 601FT of the Corporations Act. In our view, this ambiguity can increase the perceived risk associated with a change of RE (whether in a solvent or insolvent scenario).

The ambiguity arises where clauses in material contracts relating to the MIS (eg shareholders agreements, supply contracts, or financing arrangements) contain “transfer restrictions” or “change of control” restrictions, which allow a counterparty to exercise certain rights (eg payment acceleration, termination, or pre-emptive rights) if there is a change in control of the MIS, or if the MIS purports to “dispose” of an asset (eg shares in a joint venture company).

The main issue is whether the statutory mechanism contained in the above provisions involves a “transfer” or “disposal” by the outgoing RE of its interest in the relevant asset (or the agreement to which the asset relates) to the replacement RE, or whether it simply causes the new RE to be inserted into the role of owner of the asset in place of the outgoing RE, without a “transfer” or “disposal” occurring.

As yet, the courts have not fully considered this matter. The Takeovers Panel case of AMP Shopping Centres considered the issue although the Panel did not find it necessary to decide whether the pre-emptive rights under the relevant shareholders agreement were in fact triggered by the proposal to change the RE of the relevant MIS. The Panel noted, however, that Senior Counsel for the parties had provided conflicting opinions as to whether a change in RE would trigger the shareholders agreement pre-emptive rights.

Over the last few years, there have been some court decisions which, on balance, have made it more likely that these Corporations Act provisions should be interpreted so that pre-emptive rights and other defaults are generally not triggered by an RE change. However, this conclusion is by no means certain.

There will, of course, always be clauses which contain express triggers upon a change of RE. While there is a policy question as to whether this is appropriate in any situation, we consider the more concerning scenario to be the far wider class of situations where a change of RE *might* give rise to a trigger event. In our view, this statutory ambiguity creates a level of risk which dissuades many parties from pursuing restructures or change of RE proposals. This has implications both for solvent and insolvent MISs and REs.

In our view, sections 601FS(1) and 601FT should be amended to expressly provide that, upon a change of RE, property of the RE automatically vests in, and becomes property of, the new RE without any transfer from the outgoing RE to the new RE.

Of course, this concern would also be addressed if our Alternative Proposal was adopted.

4.2 Convening scheme meetings

We agree that there should be provision for annual general meetings of scheme members for listed MISs, but not necessarily for unlisted MISs. Specified items of ordinary business should be consistent with those that would apply to a listed company.

If the Alternative Proposal were implemented, we consider that it would be appropriate for all MISs to have annual general meetings of scheme members to provide members with an opportunity to raise matters with the RE in respect of the operation of the MIS.

4.3 Cross-guarantees and indemnities

In our view, the proposals under ASIC Consultation Paper 140 *Responsible Entities: Financial Requirements* (September 2010) are likely to significantly restrict a wide variety of legitimate business activities, and their regulatory impact will be considerable.

The activities of REs in relation to a fund are already significantly regulated, including by the application of statutory and fiduciary duties (including the duty to act in the best interests of members), conflict rules and Chapter 2E Corporations Act (in relation to related party rules). Further, REs, as AFSL holders, are also subject to regulation as licensees, including the duty to act fairly, efficiently and honestly. Given the existing level of regulation, we consider that the proposed additional regulation of REs as referred to in section 7.2 of the Discussion Paper is unnecessary and imposes additional burdens which are not offset by corresponding benefits to members.

Giving guarantees and indemnities is a necessary and important business activity for most commercial entities. REs will be at a commercial and competitive disadvantage, compared to other commercial entities, under the proposals set out in section 7.2 of the Discussion Paper, which raises the potential that fund members will be disadvantaged too. This disadvantage comes into sharp focus in relation to REs' financing and credit arrangements because under standard financing arrangements in Australia, the head RE in a stapled group or an unstapled property trust structure will give a guarantee to the bank (in its capacity as RE) to facilitate the provision of finance to the stapled group. The proposed prohibition on an RE giving a guarantee (in its capacity as a RE) would prohibit these standard financing arrangements and so would:

- have a significant and adverse impact on the ability of REs to secure finance and access to credit and to continue current financing arrangements, all of which are needed to maintain the solvency of the fund; and
- increase the cost of raising funds and access to new capital, which costs will ultimately be met by the members of the fund.

We understand that the primary aim behind these proposals is to avoid "cross contamination" between an RE and its MISs, and between those MISs, in the event that one of them encounters financial difficulty.

However, in our view, the proposals approach the issue from the wrong direction. Rather than specifically identifying the problem and formulating a solution to address it, the proposals are wide-ranging "blanket" prohibitions on activities which are – on the whole – commercially legitimate.

While we understand that the proposals would expressly exclude various legitimate activities from the prohibition (and we have set out some suggestions below in this regard), in our view it is inevitable that lists of exclusions of this type will not be comprehensive – not everything will be thought of. This is another reason why we submit that it would be more appropriate for the prohibitions to be framed more narrowly in the first place, so that only the activities where regulation is warranted are prima facie regulated.

If, despite our submission, the proposals are implemented, then we consider that, at a minimum, the following sorts of activities should be excluded from the proposed guarantee and indemnity prohibitions:

- arrangements between an entity and another entity (treating a trust for this purpose as an "entity") which is wholly-owned (directly or indirectly) by the first entity;
- arrangements between stapled entities and arrangements between members of a stapled group (including entities which are wholly owned (directly or indirectly) by a stapled entity). This would be consistent with ASIC's usual approach, when considering applications for stapling relief, to treat a stapled group as a single economic entity. This would need to include one stapled entity (or other member of the stapled group) guaranteeing an obligation of another member of the stapled group.
- indemnities in favour of directors and officers;
- indemnities in favour of contractors and service providers; and

- guarantees and indemnities which support the payment of a purchase price, or performance of another obligation, by an entity in relation to which the RE is a member or shareholder. This would facilitate, for example, the provision of "parent" support to a joint venture entity which may have been set up by two or three REs to facilitate co-investments in property assets and which may not be substantially capitalised in its own right.

As you will see, the sorts of matters set out in the list above are wide-ranging. We expect that other industry participants would have their own lists of situations that should be excluded. This reinforces our submission that any list of exclusions will need to be very lengthy, will doubtlessly not be comprehensive, and will inadvertently and unnecessarily cause complications in doing business.

4.4 Limited liability of MIS members

In our view, the law on this point is largely settled – ie a properly constituted trust instrument can confer limited liability on trust beneficiaries. Hence we do not consider amendment of the law to be strictly necessary.

Nevertheless, we would welcome statutory confirmation of this position, subject to the following important proviso – namely, we consider that any such statutory confirmation should apply to *all* trusts, not just registered MISs. A specific statutory provision which confirms limited liability for only for members of registered MISs may give rise to doubt as to the current legal position that applies to unregistered trusts. We consider such a distinction between registered and unregistered trusts to be undesirable.

4.5 Voting restrictions in section 253E

A further matter which we think causes unnecessary complexity and uncertainty in relation to structural changes to MISs relates to section 253E of the Corporations Act. In our view, this uncertainty is a disincentive to pursue various restructures.

Section 253E provides as follows:

> *The responsible entity of a registered scheme and its associates are not entitled to vote their interest on a resolution at a meeting of the scheme's members if they have an interest in the resolution or matter other than as a member. However, if the scheme is listed, the responsible entity and its associates are entitled to vote their interest on resolutions to remove the responsible entity and choose a new responsible entity.*

The provision does not, however, prevent the RE and its associates voting as proxies for other members provided the instrument of appointment specifies how the proxy is to vote, and the proxy in fact votes in that way.

While there may be a legitimate legislative basis for disenfranchising REs (and their associates) in certain situations, we consider that this provision has an effect which is unintentionally broad and that it ambiguities within it create potential impediments to various proposals to restructure MISs.

There are a number of elements of section 253E which cause concern and uncertainty, namely:

- **Who must have an interest in order to be excluded from voting?** On one interpretation, only the particular members of the "associate group" *who themselves have an interest* should be excluded from voting. An alternate view is that *all* members of the "associate group" are to be excluded if *any* of them has an interest.
- **What is an "interest"?** Does it extend to interests held in another fiduciary capacity? This is a complicated and uncertain area. If an associate of an RE holds an interest in the MIS in a fiduciary capacity (and hence is not entitled to be self-interested in casting its vote), then does that associate have an "interest" and should it be excluded from voting? Does it matter if the relevant beneficiary has the power to direct the associate in relation to voting? Does it matter if the

relevant beneficiary is itself associated with the RE? Judicial consideration of these questions has not been comprehensive. Depending on the answers, then large components of a MIS's members' register can potentially be disenfranchised.

- **Who are the "associates" of the RE?** In order words, does the "general" test of association (found in section 11 and section 13 to 17 of the Corporations Act) apply, or does the "takeovers" definition in section 12 apply? Or does the answer change depending on the nature of the resolution being put to members? We think the answer is subject to doubt.

  In many instances, a person will be an associate under either test. However, one critical difference relates to the directors and secretaries of the RE (and of related bodies corporate of the RE). Only if the "general" test applies will these individuals be automatically precluded from voting.

  In our view, the "takeovers" definition should apply. Given that the purpose of excluding these votes is to ensure that the RE is not in a position to improperly interfere in the exercise of voting power by members, we consider that the application of a test which is based around identifying which persons should be grouped together when identifying the "control" of entities is appropriate.

  The class of entities who would be excluded from voting under this definition would also track the entities identified in any "substantial holder notice" lodged by those entities pursuant to section 671B of the Corporations Act.

- **If the RE's "associates" include its directors, and if the meeting is chaired by one of the directors of the RE, then what happens to undirected proxies held by the chair?** Again, the position is subject to doubt. This situation would not automatically arise if the "takeovers" definition applied.

Accordingly, we consider that section 253E should be amended to clarify:

- which particular members of a "associate group" should be excluded where any of them has an interest;
- that a person should not be excluded from voting under section 253E in respect of votes held in a fiduciary capacity, to the extent that beneficiaries are not associates of the RE. It should not be necessary for the beneficiary to have the right to direct the fiduciary in respect of the vote;
- that the "takeovers" definition in section 12 should expressly apply to the identification of the RE's associates;
- that, if the law is not amended to apply the "takeovers" definition, then it should be amended to expressly confirm that the chair of the meeting, even if he/she is an associate of the RE, is permitted to vote undirected proxies provided he/she does so in a manner consistent with that stated in the relevant notice of meeting.

We consider that these amendments would remove doubt when proposing various member resolutions to restructure MISs, and would reduce the risk for those promoting the resolutions who bear responsibility for ensuring that voting exclusions are applied properly.

We would be happy to discuss our submission further with you.

Yours sincerely

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Property Funds Association

Property Funds Association of Australia Inc.

Submission to CAMAC - Managed Investment Schemes Discussion Paper (June 2011)

This submission has been prepared and lodged on behalf of the Property Funds Association of Australia Inc. by:

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The Property Funds Association of Australia Inc. consents to the publication of our submission.

Submission to CAMAC

Managed Investment Schemes Discussion Paper (June 2011)

Reform 1

Reform 1: identification and recording of the affairs of each MIS

Identification of agreements

Whenever an RE, as operator of an MIS, is a principal to a legally enforceable contract, arrangement or understanding ('agreement'), the RE must specify that this is the case and identify the MIS to the counterparty. The RE must include that information in any document constituting that agreement. Where the agreement involves more than one identified MIS, the RE must identify what part, or proportion, of the agreement is attributable to each MIS.

Recording of agreements

From the commencement of an MIS, the RE (including any replacement RE) must maintain an ongoing register for that MIS of all relevant agreements.

The agreements register must be divided into a 'continuing agreements' section and a 'completed agreements' section. Details of each agreement (and any material variations to that agreement) must be included in the former section, until such time as all rights, obligations and liabilities of any party under that agreement have been discharged, after which the details of the agreement must be transferred to the latter section.

The agreements register must be maintained throughout the life of the MIS, and be available to any external administrator of that MIS.

No agreement, whether or not still on foot, may be deleted from the register (except where recorded by mistake).

Questions	Our feedback
Should the policy approach in Reform 1 be enacted? Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS? If yes: (a) how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended? (b) what remedies should affected parties have for failure to include an agreement in the register and against whom?	We see no urgent justification for this reform. When an RE enters into an agreement the agreement will stipulate whether the RE is entering into the agreement in its personal capacity or in its capacity as responsible entity of the relevant scheme. We do not consider a register of agreements will be of assistance as ultimately the liability issues will depend on the terms of the relevant agreement.
If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having	Where the change of RE occurs by agreement, there should be no consequences. In the case of a hostile change of RE, say by the members, again the incoming RE accepts the role as RE subject to the

registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.	inherent risks. In the case of the appointment of a temporary RE, this RE should be afforded an interim level of protection from being personally liable where the assets of the fund MIS are insufficient or a right of indemnity is lost due to the actions of the previous RE.

Reform 2	
Reform 2: use of scheme property The property of a particular MIS can be used only for the purposes of that MIS.	
Questions	**Our feedback**
Should the policy approach in Reform 2 be enacted? Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?	We generally support this reform. The exception would be that the property of a MIS could be used by another entity if that use is for value (similar to the requirements for related party transactions) or approved by MIS members.

Reform 3	
Reform 3: informing MIS creditors of a change of RE Where the RE of an MIS changes, the new RE must give notice of that change to all counterparties included in the 'continuing agreements' section of the agreements register referred to in Reform 1, and to any other counterparty of which the new RE is aware or becomes aware.	
Questions	**Our feedback**
Should the policy approach in Reform 3 be enacted? What, if any, consequences should follow where an RE fails to inform a counterparty?	We believe that counter parties can protect themselves by requiring in the contract that notice be given. Alternatively counter parties can include a change of RE as a review or default event. Banks insist on a change of RE being an automatic event of default.

Reform 4
Reform 4: rights of MIS creditors against scheme property Only persons who have entered into an agreement with an RE as principal in its capacity as the operator of a particular MIS, and the RE in respect of its indemnity and other rights against the property of that MIS, will be the creditors of that MIS. Persons who have transacted with the RE in this capacity will have the right to claim directly against the property of that MIS, not through subrogation

to the RE’s right of indemnity against scheme property.

Related provisions

1: Rights of MIS creditors against assets of the RE

In addition to their rights under Reform 4, all counterparties to arrangements with an RE as principal that refer to a particular MIS (as per Reform 1) may claim against any property of the RE that is not held in trust by the RE, except for those counterparties who agree to limit their rights of recovery to Reform 4. Property of the RE not held in trust would include any indemnity rights of the RE against the property of any MIS.

2: Rights of other creditors of the RE

Where an RE as principal enters into arrangements that do not refer to a particular MIS (as per Reform 1), the rights of counterparties are confined to property of the RE that is not held in trust by the RE.

Questions	**Our feedback**
Should the policy approach in Reform 4 be enacted? If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)? Should the two related provisions also be adopted?	We do not support the policy approach which Reform 4 represents. The access of creditors to MIS assets should be limited to where the contractual relationship clearly discloses the RE in its capacity as trustee/responsible entity of the MIS is the counterparty. If the MIS is not disclosed then creditors should be limited to the assets of the RE and the RE should not have a right of indemnity.
In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time? Who should have access to that register and through what process?	We do not support the requirement for the maintaining of a register.
Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members? Who should have access to that register and through what process?	We do not believe this is necessary.
Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE? In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?	A statutory clarification would add certainty. Tort claimants should have the same rights as other creditors with the exception that the rights of indemnity against scheme property should not be limited by the improper performance of the RE’s tasks. Whereas contractual creditors are in a position to protect themselves, tort creditors are not.

Transfer of viable MIS – Part 4	
Questions	**Our feedback**
What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why? What changes, if any, should be made to the powers of the court to appoint a TRE and why? In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?	We do not consider voting thresholds require amendment. If it is determined that the voting threshold be lowered then the RE and its associates should not be prevented from voting their interests in the scheme. Where a court appoints a TRE, that TRE should be provided with a grace period (as determined by the court and able to be extended by the court) for determining the liabilities of the previous RE and the likely liabilities of the TRE is the TRE is confirmed in the role. Under section 601FQ the TRE has an initial period of three months (which can be extended) and this should accord with the grace period for determining liability.
Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?	No. If a proposed TRE is not appropriately licensed then ASIC has the capacity to fast track the appropriate AFSL authorisations.
What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?	None.
What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?	None, other than as suggested above to deal with potential undisclosed liabilities.
What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?	If the remuneration is insufficient then the court has the power to make the appropriate orders. In our view the *Huntley Management Limited Case* was peculiar to a tax effective managed investment scheme and not indicative of most schemes.
Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons? In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to: (a) possible conflicts of interest faced by the TRE; (b) the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced); and	None.

(c) a TRE providing assistance to an external administrator?	
What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?	
What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?	The RE can only claim remuneration for the proper performance of its duties. We do not consider any changes to the statutory controls are necessary.
What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?	The internal and external arrangements entered into by the RE are appropriately dealt with by disclosure and ensuring the RE when entering into the arrangements is acting in the best interests of members. Section 601FC(1)(c) requires the RE to place the interests of members above the interest of the RE. In many instances unrelated counterparties may insist on buy out or termination rights on a change of RE. Termination rights are standard in banking facilities. Provided the counterparty is not a related party or associate we do not consider there should be any statutory controls. If the arrangements exist before the scheme is available to the public then appropriate disclosure to members is necessary so they can make an informed investment decision. If the arrangements are entered into after commencement of the scheme then member approval should be sought.

Restructuring a potentially viable MIS – Part 5	
Questions	**Our feedback**
Is there support in principle for the concept of a VA for an MIS? Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?	We support the concept of a VA for an MIS.
What types of matters concerning these parties should be included in the VA of an MIS? What should be the grounds for initiating the VA of an MIS? Who should be entitled to initiate the VA of an MIS? If the VA of an MIS is to involve classes other than MIS creditors: (d) in relation to any voting on a proposed MIS deed: (i) how should the classes entitled to vote on the MIS deed be determined? For instance, should it be left to the administrator to determine those classes, taking into account the extent to which the deed affects their interests; (ii) where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests; and (iii) should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it, (e) what should be the voting rules for any proposal that: (i) the MIS be wound up; or (ii) the MIS administration end and the MIS continue as before? In what circumstances, if any, should an MIS deed be able to override the rights of members under the constitution of the MIS or impose new obligations on those members?	We consider the members of the scheme in a VA could be given a choice of an external administrator or allowing another AFSL holder to conduct the administration. The directors of the RE may consider the appointment of an external administrator as appropriate however the members should still be entitled to replace the encumbent RE with a new RE. We consider either the members or the RE should be able to initiate a VA. In our view members in a scheme should be treated in the same manner as shareholders in a company. The determination of classes should be left to the administrator.
What, if any, legislative provision needs to be made to prevent duplicate VAs?	Where an RE goes into a VA, then this creates an immediate conflict of interest. The RE and the creditors of the RE are likely to want to the RE to remain the RE of the scheme as this will generate management fees which will both support the RE and the claims of creditors. The members of the scheme (assuming the scheme is solvent) will most likely want a new RE appointed so the new RE can focus on the scheme and not be distracted

Restructuring a potentially viable MIS – Part 5	
Questions	**Our feedback**
	by the VA of the RE. Whilst there is already the ability to apply to court for the appointment consideration may be given to lowering the threshold for the replacement of the RE where the RE is in VA to an ordinary resolution.
In the context of an MIS administration, should there be any change to the current requirements that only a registered liquidator can be an administrator and, if so, why?	An alternative to a registered liquidator would be another RE with the appropriate AFSL authorisations to run the MIS – provided this RE was say a TRE and the members then approved the appointment of the TRE.
Should an MIS administrator have similar powers to those of the administrator of a company? For what liabilities, if any, should an MIS administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?	Yes. We consider the MIS administrator/ TRE would have the same liabilities and rights as an administrator under a company VA.
Who should determine the remuneration of an MIS administrator or an MIS deed administrator? What, if any, classes of persons in addition to the MIS creditors should be involved and in what manner and for what reasons? What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?	The remuneration of the MIS administrator would be dictated by the existing MIS constitution. If the constitution did not contain sufficient remuneration then the MIS administrator could apply to the court for an order for additional funding from the MIS.
What powers should the court have in any VA of an MIS, and who should be entitled to apply to the court for this purpose?	We consider the MIS administrator, the RE, creditors, ASIC, and members should be entitle to apply to the court relevant to an MIS VA.
In what circumstances, if any, should there be a power to appoint a TRE to operate an MIS in the context of a VA of that MIS, and who should be able to exercise any such power?	Refer to our comments above.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
Are any changes needed to: (f) the current circumstances where an MIS can be put into liquidation with/without the need for court approval; (g) the provisions governing who can conduct the winding up? In this context: (h) should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why; and (i) is there a need for a separate insolvency ground for winding up an MIS (j) if so: (i) how should the insolvency of an MIS be defined; and (ii) should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?	We consider the current thresholds as appropriate. If the majority of members by value consider the winding up of the scheme is in their best interests then that is appropriate. The risk with an ordinary or special resolution threshold, is that a small but active minority of members may force a premature winding up of the scheme for their own benefit. The RE when recommending the winding up of the scheme must treat all members of the same class equally and between classes fairly. This same obligation is not imposed on the members. If an RE continues to operate an insolvent scheme then the RE is at risk of losing its right of indemnity or alternatively not having sufficient scheme assets to satisfy an indemnity claim.
Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?	We consider the RE is the best party to supervise the winding up of a scheme. It is in the interests of the RE to ensure the winding up process is performed efficiently, honestly and fairly.
In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)? In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?	In circumstances where the RE is insolvent or subject to VA, then the winding up should be conducted by another RE appointed by the court or members or alternatively the existing RE with the consent of the members.
If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome? In this context: (k) are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take	We consider that where the RE and the scheme are both being liquidated, the role of liquidation should not be undertaken by the same liquidator. Each liquidator will have their own roles and responsibilities and the potential for conflicts to great to allow one liquidator to run both liquidations.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
responsibility for the liquidation of an MIS; (l) against what property might the claims of the RE liquidator and the MIS liquidator concerning their costs and expenses be claimed, and what would be their respective rights if the same property is involved?	
Would the process for liquidating an MIS be better provided for by: (m) an extension of the powers of the court in s 601EE to all MISs; or (n) a legislative procedure containing some or all of the elements discussed in Section 6.6 and for what reasons?	We think both proposals have merit.
What procedural provisions should there be for winding up an MIS and why? In particular, should a party conducting a winding up: (o) have information-gathering and other investigative powers comparable to those of the liquidator of a company; and (p) have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity? Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating? Is there a need for any legislative procedures for winding up an MIS to be varied to take into account the particular characteristics of MIS structures trusts, partnerships, contract-based MISs)? If so, what?	We would support the liquidation process be similar to that of companies. We do not support any other party other than the incumbent RE undertaking a voluntary winding up of a solvent scheme. In our view the incumbent RE has the greatest interest in ensuring the interests of members of the scheme are appropriately dealt with on an orderly wind up. Further, we consider the incumbent RE would undertake the winding up in a more cost effective manner than a liquidator.
Should there be a statutory order of priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?	On a liquidation, the priority should be the same as for companies.
Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those	Yes. It should follow that applicable to companies.

Winding up non-viable MIS – Part 6	
Questions	**Our feedback**
provisions?	
What provisions, if any, should be included to deal with access to books of the MIS?	Access to books of the MIS should be provided for in a similar manner to that applicable for companies.
Should there be any changes to the current provisions by which the court can give directions, and, if so, what and why? In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?	We consider the court should be afforded wide discretion in make orders.
What provision, if any, should be made for MIS members in the winding up of their scheme? Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?	The rights of MIS members should rank the same as shareholders in a company liquidation.
Are the grounds for winding up a registered MIS (see Section 6.1.1) equally applicable to a lawful unregistered MIS?	Yes.
Should there be any provisions governing the procedure to be followed in winding up lawfully unregistered MISs and, if so, what?	In the case of lawful unregistered MIS the winding up process should be left to the members and the trustee. In the case of an unlawful unregistered MIS, then the courts are the appropriate avenue for the appointment of a liquidator external to the trustee (who operated the unlawful MIS) as the appropriate party to wind up an insolvent scheme. In the case of a solvent unlawful MIS, then a licensed RE should be appointed as a TRE with registration expedited assuming this is supported by the members.
Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?	No. ASIC already assists in this aspect by expediting the process.
Should a former member of an MIS have standing to apply for the winding up of an unregistered MIS? Should a creditor have standing to apply for the winding up of an unregistered MIS?	Yes. Yes.

Other matters – Part 7	
Questions	**Our feedback**
Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons? For what purposes, if any, should ASIC be granted the power to convene meetings of members? Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?	No.
In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?	The status of the ASIC initiative is unclear.
Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes? Should the limited liability principle be subject to any contrary provision in the scheme constitution?	Yes. The limited liability of members for the debts of the MIS should be clarified.
Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?	In light of the recent case of *City Pacific Ltd ACN 079 453 955 (as the responsible entity for the City Pacific First Mortgage Fund ARSN 088 139 477) and Anor v Bacon (as agent for the 'Requisitioning Members') and Others (No. 2)* [2009] FCA 772, the Government should clarify that section 601FM requires two resolutions to be put at meeting to change the responsible entity, one resolution relating to the removal and a separate resolution relating to the appointment. The process for winding up an MIS requires a notice to be lodged with ASIC when the winding up commences and another notice lodged with ASIC when the winding up is completed. The winding up of a scheme can take a number of years. We understand ASIC's view is that upon lodgment of a notice commencing the winding up, the obligations of a responsible entity to prepare and lodge audited financial statements and for the compliance plan audit report to be prepared and lodged cease.

Other matters – Part 7	
Questions	**Our feedback**
	In our view, any obligations of a responsible entity regarding an ongoing appointment of a compliance committee; the preparation, audit or review, lodgment and dispatch of financial statements; and preparation and lodgment of the compliance plan audit report during the winding up process should be clarified. The Government could consider drawing a distinction between a solvent MIS which is being wound up by the RE (where the financial reporting and audit obligations would continue until the winding up is completed) and insolvent schemes or MIS subject to VA (where these obligations would not apply during the winding up process). The obligation under section 601FC(1)(l) to report to ASIC certain breaches relating to a scheme as soon as practicable should be amended to impose a notification timeframe of as soon as practicable and within 10 business days. This will ensure the notification timeframe under section 601FM is the same as that applying under section 912D for significant breaches by responsible entities and other AFS licensees. The scope of section 208 as it applies to MISs (as set out in section 601LC) should be amended to only apply the benefits given to the responsible entity, an entity it controls or their respective related parties. Currently, section 208 applies to, for example, a benefit given by a responsible entity to an independent custodian given the custodian is an agent of, or person engaged by, the responsible entity and therefore caught by the scope of section 208. Technically, for an MIS, section 208 requires a responsible entity to consider the related party provisions, and document such consideration (for example, the application of the arm's length exemption), for any agreement relating to the MIS. We submit, consistently with the related party provisions applying to public companies, that the application of Chapter 2E to MISs should be limited to benefits received by the RE, entities the RE controls and their respective related parties and not bonafide third parties unrelated to the RE.

CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

30 September 2011

Mr John Kluver
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Dear John

Managed Investment Schemes

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Our members are involved in governance, corporate administration and compliance with the *Corporations Act* (the Act), including working for and with responsible entities (REs) and managed investment schemes (MIS).

CSA welcomes the opportunity to comment upon the Corporate and Markets Advisory Committee's (CAMAC) *Managed investment schemes: discussion paper* (the discussion paper) and generally agrees with the proposed key legislative reforms proposed. CSA notes that the discussion paper primarily deals with issues that arise with the failure of a MIS, that is, administration and insolvency issues.

CSA notes that CAMAC was also requested to examine other proposals to improve Chapter 5C of the *Corporations Act 2001 (Cth)* (the Act). CSA also notes the recommendations made by the Parliamentary Joint Committee on Corporations and Financial Services' (PJC) Report, entitled *Inquiry into aspects of agribusiness managed investment schemes*, released on 7 September 2009, and believes that Chapter 5C of the Act may be enhanced following consideration of governance and risk management in all aspects of the operations of MIS.

CSA's comments, therefore, are made in the view that the current consultation is an opportunity for CAMAC to also report on the need for good governance and risk management frameworks to be implemented in MIS. Such issues may be best dealt with through prudential regulation and the exercise by ASIC of its powers in assessing and granting an AFSL and/or approval as a Responsible Entity.

General comments

The unfortunate collapse of Timbercorp and Great Southern prompted the PJC to conduct an inquiry into the nature of agribusiness MIS, with reference to '…the need for any legislative or regulatory change[1]'. While the PJC Report touched on the ideas of ASIC monitoring the disclosure requirements, licensing and remuneration of MIS, the PJC Report did not directly assess transparency and accountability of a MIS's foundational and ongoing operations.

The issue has again arisen within the framework of the current discussion paper and the terms of reference outlined in the letter of 18 November 2010 from the Parliamentary Secretary to the Treasurer, the Honourable David Bradbury MP. CSA is of the view that the terms of reference to CAMAC do not fully address the transparency and accountability of a MIS's establishment and operation.

Chapter 3 of the discussion paper identifies the problems associated with the identification of 'transactions attributable to each MIS[2]', and the inability to clearly 'identify the affairs of each MIS and determine the rights of parties dealing with an RE as operator of the MIS[3]'. CSA contends that these considerations are primarily governance issues. This is embodied, for example, in the proposed legislative reform entitled *'Reform 1: identification and recording of the affairs of each MIS[4]'* which mirrors the ideals created by the relevant sections of the Act concerning the recording of particular documents and transactions.

CSA notes that elements of a governance framework are exemplified in the requirements for obtaining an Australian Financial Services Licence (AFSL) and compliance with section 912A of the Act. A MIS is required to advise the Australian Securities and Investment Commission (ASIC) about various aspects of risk management, compliance and conflicts of interest in order to obtain an AFSL. Yet despite this, the PJC Report still notes that MIS exhibit systematic uncertainties and potentially risk market failure, thereby requiring some form of further prudential regulation to be considered[5].

CSA, therefore, believes that more emphasis needs to be given to the importance of a good governance framework existing at the earlier stages of MIS formation and operations. CSA points to the changes in governance and risk management that occurred in listed companies with the introduction of the Australian Securities Exchange (ASX) Corporate Governance Council's *Corporate Governance Principles and Recommendations* (Principles and Recommendations) which recognise the importance of developing stakeholder and investor confidence in the Australian capital market[6]. A RE for a listed MIS is required to report against the Principles and Recommendations. This framework provides a practical guide for listed companies, irrespective of their size or industry, their investors, the wider market and the Australian community.

Nonetheless, the disclosures inherent in this reporting do not fully capture the risk management frameworks that may need to be implemented in order to counter the systemic uncertainties of MIS.

The importance of risk management and good governance at the front end of operations for a MIS and RE cannot be overemphasised. The delineation of roles, responsibilities and disclosures will ultimately benefit the operations of both the MIS and RE, particularly in the circumstances which the discussion paper seeks to address, that is where a RE or MIS is under financial stress.

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[1] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Aspects of agribusiness managed investment schemes*, (September 2009) [pg vii]

[2] Corporations and Markets Advisory Committee, Australian Government, *Managed investment schemes discussion paper* (June 2011) [pg 27]

[3] Ibid at [pg30]

[4] Ibid at [pg32]

[5] PJC Report, above n 1, at [pg 37]

[6] ASX Corporate Governance Council, Australian Securities Exchange, *Corporate Governance Principles and Recommendations*, 2nd ed with 2010 amendments, p 4

CSA notes, however, that usually by the time that financial stress is disclosed, it is too late. CSA submits that there would be great public benefit if ASIC was to introduce a requirement that any AFSL applicant, and especially where that applicant is to be authorised as an RE, must be able to demonstrate that it has an appropriate risk management and compliance framework in place and operational. Given the large volume of AFSL applicants that ASIC processes CSA submits that ASIC could effect this through requiring applicants to furnish a certificate from a registered auditor with relevant AFSL audit experience or a suitably qualified and experienced independent compliance expert.

CSA acknowledges that this will impose a small additional cost to the obtaining of an AFSL. However CSA submits that the public benefit of ensuring that applicants actually do have appropriate risk management and compliance frameworks in place before they can commence operations more than justifies the marginal cost increase.

CSA is of the view that the administration and insolvency issues canvassed in the discussion paper are extremely important, but would be disappointed should the opportunity not also be taken to consider the governance and risk management frameworks that could be implemented when MIS are first established.

We look forward to reading the final report and recommendations.

Yours sincerely

Tim Sheehy
CHIEF EXECUTIVE

Corporations and Markets Advisory Committee: Managed investment schemes

Submission by the Australian Securities and Investments Commission

September 2011

Contents

Introduction

1 The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to provide this submission to the Corporations and Market Advisory Committee's (CAMAC) review of the managed investment scheme industry.

2 ASIC supports the Australian Government's aims of reviewing the managed investment scheme legislative framework under Ch 5C of the *Corporations Act 2001* (Corporations Act) to improve its current workability, taking into account developments in practice since the present legislation was introduced over a decade ago.

3 ASIC's submission comments on various aspects of CAMAC's proposed measures for the implementation of these aims, as set out in its paper *Managed investment schemes* (Discussion Paper) issued in June 2011, that relate to ASIC's functions and responsibilities, in the interests of assisting the further development of these proposals. This includes comment on the impact of the proposals on the conduct of companies, registered managed investment schemes and external administrations, and the practical operation of the proposals in general. ASIC's submission does not relate to unregistered schemes unless expressly stated.

4 ASIC's submission is premised on the assumption that no changes are being made to:

(a) the current ability of a responsible entity to structure a managed investment scheme in any way they choose, rather than specifically as a trust; and

(b) the current taxation position in relation to some agribusiness schemes.

5 ASIC considers that, in responding to the questions raised in the Discussion Paper, it is necessary to divide managed investment schemes into three categories being:

(a) passive collective investment trusts;

(b) enterprise schemes; and

(c) time-sharing schemes.

6 This is because the role of the responsible entity, the nature of the members' interests and the effect of the insolvency of the responsible entity or the failure of the managed investment scheme (or both) on third parties is different for each category. Attempting to address the matters raised in the Discussion Paper on a generic basis across the three different categories may, ASIC thinks, result in unnecessary or inappropriate changes being made to the law and regulation of passive collective investment trusts, without adequately resolving the problems experienced in recent years in relation to failed enterprise schemes (largely agribusiness schemes).

7 The current definition of 'managed investment scheme' in the Corporations Act has two parts. The first, contained in paragraph (a), is the general definition. The second, in paragraph (b), covers time-sharing schemes. ASIC's proposal is that, without altering its overall scope and coverage, paragraph (a) of the definition be further split into two parts. The first would cover 'passive collective investment trusts'. The second would cover all other managed investment schemes currently caught by paragraph (a) of the definition, grouped under the name 'enterprise schemes'.

8 Under this proposal, a managed investment scheme would be classified as a 'passive collective investment trust' if it is structured as a unit trust and is not a 'public trading trust' for tax purposes. This limits the concept of a passive collective investment trust to those trusts that carry on eligible investment business. Importantly, this category:

(a) includes the majority of existing registered managed investment scheme (by number and by funds under management) including most 'orthodox' funds management products such as managed funds, A-REITs, unlisted property trusts, pooled mortgage funds, listed infrastructure schemes;

(b) mirrors the international concept of 'collective investment scheme' used by IOSCO and other transnational regulatory and standard-setting bodies; and

(c) assumes and uses established principles of trust law governing the relationship between members, the responsible entity and third parties.[1]

9 Importantly, for the purposes of the CAMAC Discussion Paper, passive collective investment trusts are not trading businesses.

10 The residual category would be 'enterprise schemes'. This covers everything else currently caught by the definition of managed investment scheme, including 'contract-based' schemes such as agribusiness schemes, property syndicates, contributory mortgage schemes, serviced strata schemes, horse racing and horse breeding syndicates, and investor directed portfolio services (IDPS). These managed investment schemes often involve an asset of the members being used in a common enterprise, rather than contributions being pooled for investment purposes. It would also include trading trusts.

11 ASIC's recent experience is that a lack of capacity of a responsible entity to meet the law or the failure of a managed investment scheme gives rise to significant difficulties and uncertainties where the scheme is an enterprise scheme. However, these difficulties and uncertainties are less when the scheme is a passive collective investment trust. This is due to two main

[1] For example, Professor Michael Bryan has observed that the 'principal advantage of the institutional trust as a framework for managing collective investments is that its fiduciary and prudential regime supply a ready-made set of 'default rules' which fill the gaps left by the trust instrument or the applicable regulatory scheme'. Professor Sarah Worthington notes that using a trust as a framework can also provide bankruptcy remoteness by putting the scheme assets beyond the reach of the operator's creditors on a winding up. See Pamela Hanrahan *Funds Management in Australia Officers' Duties and Liabilities* LexisNexis , pp. 19–20.

reasons. First, these trusts do not trade. Secondly, established principles of trust law apply to these trusts in determining the obligations of the responsible entity (or its successor) and the rights of members and third parties.

ASIC's submission

12 ASIC's submission is broken into the following sections:

(a) passive collective investment trusts (see Section A);

(b) enterprise schemes (see Section B);

(c) further regulatory observations (see Section C).

13 ASIC thinks, in answering the questions in the Discussion Paper, it is necessary to consider the different categories of a managed investment scheme separately. In some cases, the answer for different categories is the same. In others, it is different. ASIC's submission considers the position in relation to passive collective investment trusts and enterprise schemes, but does not consider time-sharing schemes. This is because it has no experiences with incapacitated responsible entities of time-sharing schemes or failed time-sharing schemes. ASIC also notes that the application of the Corporations Act to time-sharing schemes was considered by the Parliamentary Joint Committee on Corporations and Financial Services in 2006.

14 Sections A and B are further broken down into two situations:

(a) where a responsible entity lacking capacity operates a passive collective investment trust or enterprise scheme that is clearly viable at the point of incapacitation; and

(b) where a responsible entity lacking capacity operates a passive collective investment trust or enterprise scheme where it is unclear at the point of incapacitation of the entity whether the managed investment scheme is viable or not. The passive collective investment trust or enterprise scheme may subsequently be found to be either viable or unviable.

15 ASIC also considers that this further distinction is warranted in answering the questions in the Discussion Paper because the state of the managed investment scheme fundamentally affects the choices available to resolve the issues where a responsbile entity lacks capacity.

16 ASIC has focused on managed investment schemes in this situation. Responsible entities that have capacity can deal with passive collective investment trusts or enterprise schemes that could be unviable by either restructuring them or winding them up. An incapacitated responsible entity faced with the same situation faces impediments by virtue of its incapacity. A responsible entity can be considered incapacitated where:

(a) an insolvency practitioner is appointed to the entity, crystallising that it is unable to perform its role;

(b) the entity is breaching its Australian financial services (AFS) licence conditions, particularly financial, and is unable to remedy them;

(c) members want the entity removed because they have lost confidence in its ability to perform its role; or

(d) due to the complex group structuring, the entity becomes 'infected' by the financial difficulties of related parties within the corporate group and is unable to adequately perform its role.

Overview of ASIC's position

17 Possible ways to deal with the issues set out in this paper include restricting the structure of a managed investment scheme only to a passive collective investment trust.

18 Another option is change to the current taxation position for some agribusiness schemes that can prevent them being structured as a passive collective investment trust.

19 A further possibility is that paragraph (a) of the definition of managed investment scheme in s9 be further split into two parts. The first would cover passive collective investment trusts and the second would cover all other schemes currently caught by paragraph (a) of the definition, grouped under the name 'enterprise schemes'.

20 ASIC considers that the law is currently operating sufficiently for responsible entities that lack capacity where the passive collective investment trust is clearly viable and does not consider significant reforms are necessary for them. However, ASIC does suggest that some minor amendments to the legislation are made to enhance its operation.

21 ASIC recognises that there have been some deficiencies in the current legislative regime in relation to incapacitated responsible entites of passive collective investment trusts that may or not be viable at the point of incapacitation. However, ASIC notes that the Corporations Act, together with the principles of trust law, have demonstrated an ability to work to provide sufficient assistance in resolving issues associated with incapacitated responsible entities operating a passive collective investment trust if it is unclear at the point of incapacitation whether the scheme is viable. Due to the non-trading status of such a scheme, ASIC has concerns about the introduction of a voluntary administration regime. ASIC proposes that some minor amendments are made to the legislation to enhance it.

22 ASIC considers that there have been fundamental difficulties with the current legislative regime for incapacitated responsible entities of enterprise schemes that may or may not be viable at the point of incapacitation. The absence of the principles of trust law mean that there is no underlying framework to deal with the complex issues associated with such schemes. ASIC considers that substantive reforms are necessary for:

(a) determining and identifying the scheme property of an enterprise scheme; and

(b) introducing a voluntary administration regime.

23 ASIC has not experienced any situations where an incapacitated responsible entity is operating a clearly viable enterprise scheme, and for this reason does not propose any significant reforms in this situation. However, ASIC is supportive of reforms for determining and identifying scheme property of an enterprise scheme that is clearly viable.

24 ASIC also considers that some additional reforms of Ch 5C could improve the current legislative regime.

A Passive collective investment trusts

Key points

This section sets out ASIC's experiences and views in relation to passive collective investment trusts. A passive collective investment trust is structured as a unit trust and is not a 'public trading trust' for tax purposes. This concept is limited to those trusts that carry on eligible investment business.

ASIC's experiences and views are examined in the context of incapacitated responsible entities operating passive collective investment trusts:

- that are clearly viable at the point of incapacitation of the entity; and
- where viability is unclear at the point of incapacitation.

Incapacitated responsible entity and viable scheme

25 This section discusses the reform proposals in the situation where a responsible entity of a passive collective investment trust becomes incapacitated and it operates one or more schemes that are clearly viable.

Assets and scheme property

Current provisions

26 The key provision recognising a responsible entity's obligations in relation to the assets and property of a managed investment scheme is set out in s601FC(1)(i). Under this provision, a responsible entity must ensure that scheme property is clearly identified as scheme property and held separately from the property of the entity and property of any other scheme. Section 601FC(2) requires the responsible entity to hold scheme property in trust for scheme members.

27 Section 286 of the Corporations Act also has some impact on a scheme's assets and property. Under this provision, a registered managed investment scheme must keep written records that:

(a) correctly record and explain its transactions and financial position and performance; and

(b) would enable true and fair financial statements to be prepared and audited.

28 The obligation to keep financial records of transactions extends to transactions undertaken as a trustee.

ASIC's experiences

29 ASIC has not observed any significant difficulties with the law as it exists in relation to assets and scheme property for an incapacitated responsible entity that is operating one or more passive collective investment trusts that are clearly viable.

CAMAC Discussion Paper

30 ASIC considers the following areas for consultation in the Discussion Paper relate to assets and scheme property:

(a) identification of the scheme or schemes in all agreements and contracts entered into by the responsible entity on behalf of the scheme (see 3.4.2 of the Discussion Paper);

(b) maintenance of 'continuing agreements' and 'completed agreements' register (see 3.4.2 and 3.6 of the Discussion Paper);

(c) maintenance of a scheme property register (see 3.5 of the Discussion Paper);

(d) restricted use of scheme property for the purposes of that scheme (see 3.4.2 of the Discussion Paper);

(e) notification of a change of responsible entity by the replacement entity to all counterparties to all agreements and contracts entered into on behalf of the scheme (see 3.4.2 of the Discussion Paper);

(f) restriction of creditors of the scheme to those counterparties that have an agreement or contract entered into with the responsible entity as principal (see 3.4.2 of the Discussion Paper);

(g) restriction on direct claims against scheme property to those creditors identified in paragraph (f) above (see 3.4.2 of the Discussion Paper);

(h) restriction of counterparties' rights to claim against property of the responsible entity that is not held in trust by the entity where a responsible entity as principal enters into agreements or contracts that do not contain a reference to the particular scheme or schemes (see 3.4.2 of the Discussion Paper);

(i) indemnification by the responsible entity from direct claims against scheme property where there has been a common law or statutory breach by the entity (see 3.7 of the Discussion Paper); and

(j) direct claims in tort against scheme property (see 3.7 of the Discussion Paper).

ASIC's views

Identification of scheme agreements

31 ASIC is of the view that reforms to the existing provisions are not necessary for passive collective investment trusts. ASIC does not consider it is necessary to impose additional legislative obligations on a responsible entity of such a scheme to identify and record the affairs of the scheme. Generally, a responsible entity will include clauses in agreements or contracts it enters into on behalf of a managed investment scheme that refer to that scheme, including limitation of liability clauses. ASIC considers that this is generally sufficient for a counterparty to be on notice that the contract is entered into by the entity in its capacity as the responsible entity of a particular scheme. ASIC is also concerned that the proposed reform may also give rise to difficulties for responsible entities (e.g. in relation to market contracts) where the counterparty is not identified.

Scheme agreement and contract register

32 ASIC is concerned about proposals to require a responsible entity of a passive collective investment trust to set up and maintain a 'continuing agreements' and 'completed agreements' register. In ASIC's view, the requirement to set up and maintain registers would result in additional compliance and administrative costs and with limited regulatory benefit. ASIC recognises that setting up and maintaining a continuing agreements register may provide a quick reference for insolvency practitioners and potential temporary or replacement responsible entity of relevant agreements or contracts. However, ASIC does not consider that this benefit would outweigh the costs associated with setting up and maintaining such a register. ASIC also considers that the established principles of trust law are sufficient to address any difficulties or issues that may arise in relation to the identification and recording of the affairs of each scheme.

33 ASIC notes that s286 requires the responsible entity of a registered managed investment scheme to keep financial records that correctly explain transactions and the financial position and performance of the scheme in order to prepare true and fair financial statements. ASIC considers that this requirement is likely to ensure that records of most agreements and contracts will need to be kept by the responsible entity.

Use of scheme property

34 ASIC has not observed any deficiencies in the current legislative regime in relation to use of scheme property by the responsible entity of a passive collective investment trust. ASIC considers that the discretion of the responsible entity to use scheme property must already be exercised in the best interests of members. ASIC would be reluctant to unnecessarily

interfere with 'business judgement' of the responsible entity in the day-to-day operation of the trust.

Notification of change of responsible entity to counterparties

35 In ASIC's view, there is limited evidence to suggest that reform is necessary to impose a requirement that a replacement responsible entity notify all counterparties to agreements and contracts entered into on behalf of the passive collective investment trust of the change. Given the lack of evidence to suggest this has been problematic for trusts or their counterparties, ASIC considers the costs associated with notification may outweigh any regulatory benefit. Counterparties can include such a requirement contractually and the change of responsible entity is a matter of public record, ascertainable directly from ASIC's website.

36 If such a reform were to be implemented, ASIC also considers that it may be difficult for it to enforce.

Creditors

37 ASIC is concerned about the potential unintended consequences of:

(a) restricting the parties who can be creditors of the managed investment scheme;

(b) restricting the ability to claim directly against scheme property those creditors identified in paragraph (a) above; and

(c) restricting the right to claim against property of the responsible entity that is not held on trust by the entity where a responsible entity as principal enters into agreements or contracts that do not contain a reference to the particular scheme or schemes.

38 This is because any reforms would alter the rights of creditors of a passive collective investment trust that already exist under trust law. In ASIC's view, the principles of trust law as they apply to the rights of creditors of such a scheme are sufficient to resolve any difficulties or issues that may arise. ASIC is unaware of any evidence to suggest that the principles have proven deficient in this context. However, if such reforms were to be implemented, ASIC considers that there should be careful consideration and investigation of the potential consequences and effects of such reforms.

39 ASIC also notes that this proposal would produce complexity in light of the need for appropriate transitional arrangements.

Tort claims and statutory liability

40 ASIC is of the view that it would not be appropriate to have a specific regime for managed investment schemes. The current common law and statutory laws applicable to trusts should continue to be applied.

Mechanisms and arrangements to transfer a viable scheme

Current provisions

41 There are currently legislative provisions for replacing the responsible entity to avoid a viable scheme being without a responsible entity for any period of time. This includes the appointment of a temporary responsible entity as an interim measure while a new responsible entity is sought.

42 Scheme members may by resolution, at any time, replace a responsible entity, if there is an eligible entity willing to undertake that role: s601FM. For unlisted schemes, the removal and replacement resolutions must be extraordinary resolutions (requiring approval of at least 50% of the total votes that can be cast by members entitled to vote, whether or not cast): s252D.

43 If the members pass the resolution to remove the responsible entity but a resolution is not passed at the same meetings to appoint a new entity, under the current provisions, the scheme must be wound up: s601NE(1)(d).

44 If a new entity is appointed, the former responsible entity must hand over relevant books to the incoming entity and otherwise provide reasonable assistance to facilitate the change of entity: s601FR.

45 Under s601FS and 601FT, there is a deemed transfer of the rights, obligations and liabilities of the former responsible entity to the new entity and a novation of relevant documents.

46 The framework for a temporary responsible entity is designed to facilitate the transfer of a viable scheme where the original responsible entity is incapacitated and the members have been unable to find a suitable replacement entity. Only a court can appoint a temporary responsible entity.

47 The temporary responsible entity's role is to operate the scheme until a replacement entity can be found and appointed. The temporary responsible entity must call a meeting of members 'as soon as practicable and in any event within 3 months' of the appointment to choose a new responsible entity by extraordinary resolution: s601FQ(1). The temporary responsible entity may call more than one meeting if this is required, and may apply for an extension of time if required: s601FQ(2).

48 A temporary responsible entity, like any other responsible entity, must be a public company that holds an AFS licence authorising it to operate the type of scheme it is being appointed to: s601FA and 601FK.

49 The provisions applying to responsible entities equally apply to temporary responsible entities by virtue of the definition of responsible entity in s9 of the Corporations Act. A temporary responsible entity, its officers and

employees have statutory duties in operating the scheme, in the same manner as any other responsible entity and its personnel.

50 Section 601FD(1)(f) of the Corporations Act requires that an officer of the responsible entity of a registered managed investment scheme must take all steps that a reasonable person would take, if they were in the officer's position, to ensure that the responsible entity complies with the Corporations Act, any conditions imposed on the entity's AFS licence, the scheme's constitution and compliance plan.

51 Section 601FP of the Corporations Act provides that where an application is made to the court to appoint a new responsible entity on the retirement of the responsible entity or for the appointment of a temporary responsible entity, the court may, by order, appoint a company as the temporary responsible entity of a scheme if the court is satisfied that the appointment is in the interest of the members. Further, the court may make any further orders that it considers necessary: s601FP(2).

ASIC's experiences

52 ASIC has observed the following difficulties with the existing provisions in relation to the transfer of a clearly viable passive collective investment trust from its incapacitated responsible entity:

(a) *Meeting procedures for removal of incapacitated entity*: ASIC has observed difficulties involving proxies and Notices of Meetings in situations where the responsible entity has been incapacitated and another entity is seeking to become the responsible entity of the scheme without the endorsement of the Board of the incumbent entity. The Corporations Act does not preclude other parties from receiving proxies before providing them to the responsible entity. This can cause confusion among members about where to send the proxy and conflict over the actual or perceived validity of the proxies. Where there are questions over the validity of the proxies, this can result in court action and acts to prolong the disruption of the day to day operation of the scheme. There are limited requirements about the content of Notices of Meeting for the replacement of a responsible entity, which means that the content of this document is left to the discretion of the entity or member (in situations where members call a meeting to replace the responsible entity). The Corporations Act does not set out when an Explanatory Memorandum should be sent out with the result that Notices of Meetings can be sent out giving investors the required notice, but the Explanatory Memorandum follows sometimes afterward. This can result in members lodging proxies without the Explanatory Memorandum or without having sufficient time to consider the material before lodging a proxy.

(b) *Accessibility of documents*: In a situation where the operation of a scheme transfers from an insolvent responsible entity to another entity, ASIC has observed that the replacement entity often has difficulty gaining access to documents and information needed to properly perform the day-to-day operations of the scheme within a reasonable period of time. Primarily this is because documents and information about the scheme are regularly intermingled with documents and information about the responsible entity, which are in the possession of the insolvency practitioner. In ASIC's experience, the consequences of being unable to gain access to documents and information about the scheme within a reasonable period of time can include a prolonged period of uncertainty and anxiety for members, an inability to update members, an inability to prepare financial reports and missed opportunities to maximise the value of the interests.

(c) *Complexity of related party arrangements*: On occasion, the related party arrangements of an incapacitated responsible entity can add complexity to efforts to find a temporary responsible entity or replacement entity, particularly when those related parties may also be financially unstable or insolvent. ASIC is aware of large numbers of corporate groups involving responsible entities of passive collective investment trusts where related parties provide funding or management and administration services necessary for the entity to discharge its role. Often these related party arrangements have to be first reconstructed or unrelated service providers found in order that a viable scheme can be transferred to a replacement entity.

(d) *Poison pills*: There is no specific prohibition on the entrenchment of a responsible entity or preventing 'poison pills'. Over the years, ASIC has frequently observed constitutional provisions that seek to directly or indirectly make it more difficult for the responsible entity to be removed. 'Poison pills' may also be in agreements with other persons such as related parties of the entity. An example is a provision that triggers specific fees on a change of entity. In a situation where the responsible entity becomes incapacitated but the scheme is viable, such 'poison pills' make it much more difficult to effect a smooth transition to another entity.

(e) *Compliance with obligations*: An incapacitated responsible entity is required to comply with the obligations under the Corporations Act and its AFS licence at all times (including if it is insolvent) unless ASIC exempts it from compliance with those obligations. ASIC has observed a number of instances where responsible entities lacking capacity have had difficulty in complying with their AFS licence conditions:

   (i) ASIC has received a number of applications from incapacitated responsible entities (who do not have insolvency practitioners appointed) who are unable to comply with certain obligations under the Corporations Act or their AFS licence seeking exemptions from these obligations. The most common type of applications involve seeking exemptions from the requirement to hold professional indemnity insurance or meet the financial obligations imposed by their AFS licence.

(ii) ASIC has received a number of applications from administrators seeking various exemptions from obligations under the Corporations Act. The most common type of application involves seeking exemptions from the requirement to prepare and lodge financial reports for the financial year and compliance plan audits for the scheme. Generally, this relief is sought by the administrators where the scheme is viable because they have not had sufficient time to get the affairs of the responsible entity and the scheme in order. ASIC regularly grants case-by-case exemptions to allow administrators a period of six months from the date of appointment to prepare and lodge financial reports and compliance plan audits, irrespective of the date on which they are due.

(f) *Attracting a temporary responsible entity or replacement entity*: Generally, in ASIC's experience, a scheme that is viable and profitable will be an attractive target for a responsible entity looking to expand its portfolio. In these circumstances, an application to court for appointment of a temporary responsible entity is rare; rather, a meeting of members will be called to decide on the replacement entity. However, ASIC has observed some difficulties in attracting a suitably qualified and willing replacement responsible entity where the nature of the scheme being operated by the incapacitated entity is highly specialised or complex. This is because the pool of potential candidates is very small. Any potential candidate must be a public company that holds an AFS licence that authorises that particular scheme or that kind of scheme. In assessing whether to grant an AFS licence, ASIC is required to examine (among other things) the competence of the AFS licence applicant in being able to operate a scheme of that type. In circumstances where a temporary and/or replacement responsible entity cannot be found, a passive collective investment trust that is viable and profitable will need to be wound up.

CAMAC Discussion Paper

53 ASIC considers the following areas for consultation in the CAMAC Discussion Paper relate to arrangements and mechanisms to transfer a viable managed investment scheme:

(a) voting at a meeting of members to consider the removal of a responsible entity of an unlisted scheme by the members of that scheme (see 4.2.3 of the Discussion Paper);

(b) the powers of the court to appoint a temporary responsible entity (see 4.2.3 of the Discussion Paper);

(c) eligibility to act as a temporary responsible entity (see 4.4.1 of the Discussion Paper);

(d) obligations of the responsible entity to assist a prospective temporary responsible entity or replacement entity to conduct due diligence (see 4.4.3 of the Discussion Paper);

(e) transfer of liabilities and obligations from the responsible entity to the temporary responsible entity or replacement entity (see 4.4.2 and 4.5 of the Discussion Paper);

(f) role, duties and obligations of a temporary responsible entity and its officers (see 4.4.3 and 4.4.5 of the Discussion Paper);

(g) remuneration of the temporary responsible entity (see 4.4.4 and 4.6 of the Discussion Paper); and

(h) entrenchment of the responsible entity (see 4.7 of the Discussion Paper).

ASIC's view

Voting to consider removal of a responsible entity

54 ASIC considers that the requirement for an extraordinary resolution to replace a responsible entity is too high a threshold to be met before members can replace a responsible entity of a passive collective investment trust (or other type of managed investment scheme).

55 ASIC notes that a recommendation of the *Review of the Managed Investments Act 1998* (2001) (MIA Review) was to change the current requirement for an extraordinary resolution with a simple resolution with the added requirement the votes cast in favour must constitute at least 25% of the total votes of managed investment scheme members. ASIC would support the implementation of this recommendation as an additional alternative to an extraordinary resolution.

56 On the basis of its experiences, ASIC recommends that consideration be given to the following reforms for meetings of members of passive collective investment trusts (and managed investment schemes generally):

(a) A members' meeting should only be able to be adjourned for a specified period, subject to application to the court to continue the adjournment.

(b) A Notice of Meeting to replace a responsible entity should be required to be accompanied by an Explanatory Memorandum containing certain information. However, ASIC does not consider that a failure by a member to provide the responsible entity with an Explanatory Memorandum that contains certain information should allow the entity to avoid the obligation to send the Notice of Meeting and Explanatory Memorandum.

(c) Proxies should be returnable to the entity calling the meeting.

Power to appoint a temporary responsible entity

57 ASIC notes there have been issues with the interpretation of reg 5C.2.02 of the Corporations Regulations 2001 (Corporations Regulations) where there is a question over whether the court has the power to appoint a temporary responsible entity under that regulation. The regulation states that someone may apply to the court; however, there is no reference to the court having the power to entertain any such application or the court's power in considering the application.

Application for appointment of temporary responsible entity

58 ASIC considers that the court should have the power to appoint a temporary responsible entity to a passive collective investment trust (or any other type of viable managed investment scheme) whenever it is in the best interests of members or would be reasonable to safeguard scheme property. In ASIC's view, this power should be accompanied by a reform that allows the court to make any order it thinks fit, including orders giving access to books and records of the scheme. This is to address difficulties with the narrow scope of the power to make orders currently bestowed on the court, without having to envisage every potential order that may be necessary for different circumstances.

59 ASIC also considers that a power to make such an application to the court should be vested in the responsible entity, ASIC or any member in the event that members pass a resolution to remove the responsible entity but fail to pass a resolution to appoint a replacement entity.

Eligibility to be a temporary responsible entity

60 ASIC considers that the key consideration for the appointment of a temporary responsible entity to a passive collective investment trust (or any other type of viable managed investment scheme) should be whether the person is suitably qualified in order to perform the role.

61 Given the previous difficulties in finding suitable and willing temporary responsible entities, ASIC would welcome an increase in the class of eligible appointees to assist in maximising the potential for an appointment of a temporary responsible entity to a viable scheme.

62 Based on its experience, ASIC can see no reason why a registered liquidator should not be eligible to be appointed as a temporary responsible entity to carry out the operation of the scheme until a suitably qualified and willing replacement

entity can be found to take over the operation of the scheme. In ASIC's view, the role of the temporary responsible entity of a scheme in these circumstances is similar to the role performed by a voluntary administrator of a company.

Obligations for the future of a scheme

63 There have been very few appointments of temporary responsible entities to passive collective investment trusts, which means there is limited evidence to support changes to the existing duties and obligations of such an entity. However, ASIC considers that it may be worth considering a reform to impose a specific duty on the temporary responsible entity to give reasonable access to books and records of the passive collective investment trust (or other type of viable managed investment scheme) to any potential candidate for a replacement entity. This is to ensure that all possible candidates have equal opportunity to determine whether they wish to seek appointment by the members as a replacement entity. As currently drafted, a temporary responsible entity may have a commercial advantage in seeking appointment by the members as a replacement entity.

Transfer of liabilities and obligations

64 ASIC notes the decision *Huntley Management Limited v Timbercorp Securities Limited* [2010] FCA 576 at [69], set out at paragraph 4.4.2 of the Discussion Paper and considers the court's decision would apply in the context of passive collective investment trusts.

65 ASIC considers that there is limited evidence to support significant reforms to the current provisions for the transfer of obligations and liabilities of the responsible entity to a temporary responsible entity or replacement entity where there is a viable passive collective investment trust. However, ASIC notes that acting as a temporary responsible entity might be made more palatable by reforms aimed at ensuring such an entity is liable only for liabilities incurred by that entity in its capacity as the responsible entity of the scheme and pre-existing liabilities only to the value of scheme property after satisfaction of the liabilities incurred by the entity in that capacity. This could potentially widen the pool of willing candidates.

66 ASIC understands that s601FS and 601FT of the Corporations Act are used frequently by responsible entities of viable passive collective investment trusts who are affecting a corporate reorganisation to transfer rights, liabilities and obligations to a replacement entity without executing a deed of assignment. For this reason, ASIC would not support reforms to remove the effect of these provisions in their entirety. ASIC is also concerned that reforms to s601FS and 601FT may have unintended consequences that could impact on this legitimate commercial practice.

Role, duties and obligations

67 As stated above, there have been very few appointments of temporary responsible entities to passive collective investment trusts, which means there is limited evidence to support changes to the existing duties and obligations of such an entity. However, ASIC notes that s601FP of the Corporations Act appears to be narrower in power than s447A. ASIC is of the view that consideration should be given to reforms that clarify the extent of the power of the court to make orders that impact on the role, duties and obligations of a temporary responsible entity under s601FP of the Corporations Act.

Remuneration

68 ASIC notes that there are no legislative provisions that specifically address the remuneration of a temporary responsible entity. In theory, a responsible entity could include specific provisions about the remuneration of such an entity in the constitution of a scheme. However, ASIC has never observed this in practice, and questions whether it would be practicable for the industry.

69 ASIC considers that the current provisions on the interim role played by the temporary responsible entity in temporarily operating a managed investment scheme are similar to the type of role played by an administrator of a company. There are provisions on the remuneration of an administrator of a company. For this reason ASIC considers it may be appropriate for reforms to be considered that specifically address the remuneration of a temporary responsible entity. In ASIC's view, there are several options that could be considered:

(a) the remuneration that a temporary responsible entity is to receive is determined by a resolution of the members of the scheme; or

(b) if the members fail to agree on the remuneration, it will be determined by the court having regard to the terms on which the appointment is made.

Entrenchment

70 Based on the difficulties observed in replacing incapacitated responsible entities, ASIC supports reforms to prohibit arrangements that have the effect of entrenching the responsible entity. This includes a prohibition on 'poison pills' which discourage members from replacing the responsible entity by virtue of significant disincentives for removal (e.g. constitutional provisions which require the scheme to pay the responsible entity a large lump sum if they are replaced).

71 ASIC also notes that the MIA Review recommended that the Corporations Act should ensure that payment of fees or a right to an indemnity cannot be

claimed in advance of a responsible entity's proper performance of its duties. ASIC remains supportive of reforms being made to ensure that an entity cannot do this. ASIC considers that all fees should only be payable after proper performance of the relevant duties. In ASIC's view, this would still allow fees to accrue (e.g. an entry fee can be waived for so long as the entity remains in office or on winding up). ASIC also considers that the responsible entity should ensure that appropriate disclosure is made to the members.

Incapacitated responsible entity and potentially unviable scheme

72 This section discusses the proposals in the situation where a responsible entity is incapacitated and it operates one or more managed investment schemes and it is unclear whether the scheme(s) are viable or not.

Assets and scheme property

Current provisions

73 The provisions relating to assets and scheme property have been set out in paragraphs 26–28 of this submission.

ASIC's experience

74 ASIC has not observed any significant difficulties with the law as it exists in relation to assets and scheme property in the situation of an incapacitated responsible entity of a potentially unviable passive collective investment trust.

CAMAC Discussion Paper

75 ASIC considers the following areas for consultation in the Discussion Paper relate to assets and scheme property:

(a) identification of the scheme or schemes in all agreements and contracts entered into by the responsible entity on behalf of the scheme(s) (see 3.4.2 of the Discussion Paper);

(b) maintenance of 'continuing agreements' and 'completed agreements' register (see 3.4.2 and of the Discussion Paper);

(c) maintenance of a scheme property register and register of all arrangements entered into by the responsible entity as agent of the members (see 3.5 and 3.6 of the Discussion Paper);

(d) restricted use of scheme property for the purposes of that scheme (see 3.4.2 of the Discussion Paper);

(e) notification of a change of responsible entity by the replacement entity to all counterparties to all agreements and contracts entered into on behalf of the scheme (see 3.4.2 of the Discussion Paper);

(f) restriction of creditors of the scheme to those counterparties that have an agreement or contract entered into with the responsible entity as principal (see 3.4.2 of the Discussion Paper);

(g) restriction on direct claim against scheme property to those creditors identified in paragraph (f) above (see 3.4.2 of the Discussion Paper);

(h) restriction of counterparties' rights to claim against property of the responsible entity that is not held in trust by the entity where a responsible entity as principal enters into agreements or contracts that do not contain a reference to the particular scheme or schemes (see 3.4.2 of the Discussion Paper);

(i) indemnification by the responsible entity from scheme property where there has been a common law or statutory breach by the entity (see 3.7 of the Discussion Paper); and

(j) direct claims in tort against scheme property (see 3.7 of the Discussion Paper).

ASIC's views

76 ASIC considers that the views expressed in paragraphs 31–40 in relation to an incapacitated responsible entity operating a viable passive collective investment trust also apply to an incapacitated entity operating a potentially unviable scheme.

Determining viability and restructuring

Current provisions

77 There are no specific statutory provisions which assist in determining whether managed investment scheme is viable. This is left to the judgement of the responsible entity or an insolvency practitioner.

78 There are also few provisions which are of assistance in restructuring an unviable passive collective investment trust (or managed investment scheme generally). Unlike companies, there are no provisions that permit a managed investment scheme to conduct a scheme of arrangement and no voluntary administration regime.

ASIC's experiences

79 ASIC has observed the following difficulties with the existing provisions in the situation of an incapacitated responsible entity of a passive collective investment trust operating one or more schemes that are potentially unviable

where viability needs to be determined and the passive collective investment trust can be restructured:

(a) *Attracting a replacement entity*: In most cases, ASIC has considered the appointment of a temporary responsible entity in the context of enterprise schemes. However, ASIC has considered making application to appoint a temporary responsible entity to a passive collective investment trust in three instances. In two of these cases, ASIC found it difficult to find a willing temporary responsible entity or replacement entity in situations where the viability of the scheme was uncertain. In the other case, while the proposed temporary responsible entity preferred to take on only the viable scheme, it was reluctantly willing to be appointed to all the schemes including the unviable schemes. ASIC's experience is reflected in the following views:

   (i) Section 601FS and 601FT act as a hurdle to finding a temporary or replacement entity because of the uncertainty in knowing the extent of the liabilities incurred by the former responsible entity that will transfer across on assuming its role. The only way for a potential temporary responsible entity or replacement entity to be certain of the liabilities that will transfer across is to undertake due diligence. However, this is almost always impractical due to the inability to gain sufficient access to the necessary documents and information to perform due diligence to the necessary level. There is no current legislative mechanism for a potential temporary responsible entity or replacement entity to limit their liability.

   (ii) The lack of a moratorium for the period of appointment of a temporary responsible entity if the winding up of the scheme has not commenced has been a deterrent for potential candidates. This is due to concern that any claims or actions by creditors during the period of appointment would distract them from the task at hand and use valuable resources.

   (iii) An inability to ensure that fees and expenses of a temporary responsible entity or replacement entity are paid in priority acts as a deterrent for potential candidates. A suitably qualified candidate simply will not act if it cannot guarantee that it will be paid to do so.

   (iv) There may be significant unrectified breaches in relation to the managed investment scheme. As the breaches remain ongoing, a temporary responsible entity will automatically be in breach of the Corporations Act on assuming operation of the scheme. Attempting to rectify these breaches can be time consuming and might distract any potential candidate from their primary task.

(b) *Complexity of multi-scheme arrangements*: Often a potentially viable passive collective investment trust is part of a suite of managed investment schemes operated by the same responsible entity or entities in the same corporate group. In these situations, the other group schemes or entities often hold units in, or control, the passive collective investment trust. ASIC has observed difficulties with this when a members' meeting is required to restructure. Often the other schemes or entities will be unable to vote their unitholding because of voting restrictions under s253E of the Corporations Act. ASIC understands that, in this situation, many related parties feel that members of the other schemes are being disenfranchised from the decision-making process.

(c) *Compliance with obligations*: ASIC has received a number of applications from insolvency practitioners seeking various exemptions from obligations under the Corporations Act. Again, the most common type of application involves seeking exemptions from the requirement to prepare and lodge financial reports and compliance plan audits for the managed investment scheme. However, in circumstances where there is doubt about the viability of the scheme, the relief is generally sought for two reasons. Firstly, the insolvency practitioner has not had sufficient time to get the affairs of the responsible entity and scheme in order. Secondly, the costs of compliance with these obligations may need to be borne by the insolvency practitioner personally as there may be insufficient assets in the scheme to enable indemnification. ASIC may grant permanent relief from these obligations if it is satisfied that there is no value left in the scheme. However, where ASIC cannot be satisfied in this way, it would normally refuse relief. This is because ASIC considers there is regulatory value in the users of these reports having up to date information about the scheme's position.

(d) *Conflicts between duties and obligations*: Where an insolvency practitioner is appointed to a responsible entity, there is potential for conflicts to arise between the duties the insolvency practitioner owes to creditors of the entity and the performance of their role as responsible entity. In ASIC's view, the insolvency practitioner effectively wears 'two hats' in discharging their obligations. ASIC has observed difficulties in relation to conflicts most commonly in the context of enterprise schemes. However, it is aware of similar conflicts that arose in several appointments of responsible entities to passive collective investment trusts. In these cases, the insolvency practitioner has either had to seek legal advice or orders from the court about how to proceed.

(e) *Complexity of restructuring*: In ASIC's experience, the restructure of a potentially viable passive collective investment trust can be complex. In most cases, the restructure will be effected with a combination of constitutional modifications, members' meetings, asset sales or shifting assets into another vehicle. Often, it is accompanied by the issue of a significant number of units in the scheme to creditors, which dilutes existing members.

(f) ASIC has observed similar difficulties in relation to the complexity of related party arrangements and meeting procedures for responsible entities as with incapacitated responsible entities of clearly viable passive collective investment trusts.

(g) *Handling of complaints*: Where an administrator or liquidator has been appointed to a responsible entity, an issue has been raised about whether a stay of proceedings under s440D and 471B extends to restrict any binding determination of members' complaints by the entity's external dispute resolution (EDR) scheme, unless the administrator or liquidator consents. This raises issues of whether the administrator or liquidator should be diverted from its functions to assist the EDR scheme in the assessment of complaints, the role of an independent body or person to assess complaints and the need for members' complaints to be appropriately resolved.

CAMAC Discussion Paper

80 ASIC considers the following areas for consultation in the Discussion Paper relate to restructuring a potentially viable passive collective investment trust:

(a) the introduction of a voluntary administration regime for managed investment schemes (see 5.4.7 of the Discussion Paper);

(b) powers to initiate a voluntary administration of a scheme (see 5.4.7 and 5.5.5 of the Discussion Paper);

(c) classes of persons to whom a voluntary administration regime for managed investment schemes would apply (see 5.4.7 of the Discussion Paper); and

(d) conduct of a voluntary administration (see 5.5.1, 5.5.2, 5.5.3 and 5.5.4 of the Discussion Paper).

ASIC's view

81 In ASIC's view, the purpose behind the voluntary administration regime that currently applies to companies with reference to s435A is to maximise the chances of the business continuing into existence or, if that is not possible, obtain a better return for creditors and members than would result from an immediate winding up of the company. Given the purpose behind this regime, ASIC considers that reforms that introduce a voluntary administration regime for passive collective investment trusts may not necessarily be appropriate. This is because these schemes are trusts and unable to trade on their own as a business for taxation reasons.

82 ASIC notes that, in most cases, the responsible entity of a potentially unviable managed investment scheme will be initially subject to voluntary administration, and so some of the benefits of this regime may be indirectly obtained by the passive collective investment trust.

83 ASIC considers that there is limited evidence to suggest that a voluntary administration regime is necessary for passive collective investment trusts.

84 However, if reforms to introduce a voluntary administration regime for these schemes are considered appropriate, ASIC considers that:

(a) a voluntary administrator of a passive collective investment trust should be a person who is suitably qualified to perform the role;

(b) the members of the scheme should be enfranchised in the decision making process about the future of the scheme; and

(c) there should be some independent oversight (e.g. approval by members or the court) over the remuneration of the voluntary administrator.

85 ASIC also notes that additional tools in a voluntary administration regime could include the imposition of mandatory moratorium upon appointment of an administrator.

Winding up

Current provisions

86 Part 5C.9 sets out the relevant provisions in relation to the winding up of managed investment scheme. The ways in which a scheme may be wound up include the following:

(a) *In accordance with the scheme's constitution*: A scheme’s constitution may provide that the scheme is to be wound up at a specified time or in specified circumstances or when a specified event happens (s601NA).

(b) *By resolution*: Members of the scheme may pass an extraordinary resolution directing the responsible entity to wind up the scheme (s601NB).

(c) *Notice by the responsible entity*: The responsible entity may give notice to wind up the scheme if it considers that the purpose of the scheme has been accomplished or cannot be accomplished. Where winding up is at the election of the responsible entity, it must give notice to the members and ASIC of its intention to wind up the scheme and, unless the required number of members requests a meeting in accordance with Div 1 of Pt 2G.4 of the Corporations Act within 28 days of the notice, may proceed to winding up (s601NC).

(d) *The court may direct the responsible entity to wind up the scheme*: The court may make orders directing that a responsible entity wind up the scheme:

(i) if the court thinks it is just and equitable that it be wound up; or

(ii) within three months before the application for the order was made, execution or other process was issued on a judgment, decree or order obtained in a court (whether an Australian court or not) in favour of a creditor of, and against, the responsible entity in its capacity as the responsible entity of the scheme and the execution or process has been returned unsatisfied (s601ND).

87 Such an application may be made by the responsible entity, a director of the entity (a creditor may also apply through this avenue), a member of the scheme, or ASIC.

88 The court may make other orders about a winding up including:

(a) appointing a person other than a responsible entity to be responsible for the winding up of the scheme in accordance with its constitution, if the court thinks it is necessary to do so (including for the reasons that the responsible entity has ceased to exist or is not properly discharging its obligations in relation to the winding up (s601NF(1)); and

(b) giving directions on how the scheme should be wound up if the court thinks it's necessary to do so (including if the provision in the constitution are inadequate or impracticable).[2] This includes, for example, how the costs and expenses of winding up a scheme are to be paid.

89 An application for the above orders may be made by the responsible entity, a director of the entity, a member, or ASIC: s601NF(3).

90 In the absence of another person being appointed to wind up the scheme, the responsible entity is required to ensure that the scheme is wound up in accordance with its constitution and any orders under s601NF(2).

ASIC's experiences

91 ASIC has not observed any significant difficulties with the law as it exists in relation to the winding up of passive collective investment trusts. However, ASIC has observed some frustration for members of these schemes with the current 28-day period for members to call a meeting to consider winding up a scheme under s601NC. Given the process that is required to call a members' meeting, a period of 28 days is often insufficient for members to

[2] Section 601NF(2) power:

- is extended to authorising a direction that the responsible entity may expend its own assets on the winding up notwithstanding diminishing funds available to creditors (*Re Rubicon Asset Management Ltd* (admin appointed) (2009));
- does not permit the court to impose a new legislative regime on the winding up of a particular scheme. It does not allow a court by order to impose duties on third parties and to affect third parties' rights by directing that the provisions of the Corporations Act for the winding up of companies be applied to the winding up of registered schemes (*Re application of Stacks Managed Investments Ltd (as responsible entity of Premium Mortgage Income Fund)* (2005) 219 ALR 532);
- is not necessary to appoint directors as 'liquidators' of the scheme as those persons could instead be appointed as agent of the responsible entity (*Re application of Stacks Managed Investments Ltd (as responsible entity of Premium Mortgage Income Fund)*(2005)); and
- includes direction given under s601NF(2) that the liquidators of an income fund are justified in making a distribution in specie of the ordinary units in the mortgage fund and of the litigation recovery right units *(City Pacific Limited, in the matter of City Pacific Income Fund* [2011] FCA).

properly organise themselves. There is also a concern that a responsible entity may avoid the requirement for a members' meeting by prescribing a time or circumstances under s601NA when the entity may wind up the scheme without the need for a members' meeting.

CAMAC Discussion Paper

92 ASIC considers the following areas for consultation in the Discussion Paper relate to arrangements and mechanisms to transfer a viable managed investment scheme:

(a) initiation of the winding up of scheme (see 6.1.4 of the Discussion Paper);

(b) procedural aspects of conduct of a winding up of a scheme (see 6.2, 6.4.7, 6.6.2, 6.6.4, 6.6.5 and 6.6.6 of the Discussion Paper);

(c) duties and obligations in a winding up (see 6.6.2 of the Discussion Paper); and

(d) priority in winding up (see 6.6.3 of the Discussion Paper).

ASIC's views

Initiating a winding up

93 ASIC considers that the current provisions for winding up a passive collective investment trust, together with relevant case law, are generally working appropriately. However, ASIC is of the view that some reforms to the current provisions for winding up such a scheme (and other types of managed investment schemes) might be warranted.

94 In ASIC's experience, a period of 28 days has not proven to be a sufficient period for members to go through the procedure required to call a members' meeting. This is particularly the case if the scheme has a large number of members. If the responsible entity wishes to wind up the scheme under s601NC, ASIC believes that consideration should be given to either:

(a) extending the 28-day period in which members can call a meeting to consider the winding up; or

(b) an approach that allows members to respond directly to the responsible entity on the notification within a certain timeframe concerning whether they would like a meeting to consider the winding up.

95 In ASIC's view, a court should have the power to order a passive collective investment trust (or any other type of managed investment scheme) to be wound up if the court is not satisfied there are reasonable grounds to believe that creditors of the scheme will be able to be paid their entitlements in full when due or is satisfied that scheme's purpose cannot be accomplished. However, ASIC does not consider that unsatisfied execution should continue as a ground for winding up.

96 ASIC does not consider that reforms should be introduced prohibiting the administrator or liquidator of a responsible entity from making application to the court to have a scheme wound up. In ASIC's view, a broad power to apply to court for such orders should exist. The court, on the basis of the evidence before it, can determine whether such orders should be made.

97 ASIC is of the view that consideration should be given to ensuring that the power of the courts to make orders under s601NF of the Corporations Act is as broad as possible. This will allow the court to make appropriate matters without the legislators having to envisage all of the difficulties that may present in the winding up of a scheme.

Procedural matters

98 Again, ASIC considers that the current provisions for winding up a passive collective investment trust, together with relevant case law, are generally working appropriately.

99 However, if any reforms were to be considered in relation to procedural matters associated with winding up such a scheme, ASIC is of the view that the person conducting the winding up:

(a) could have information-gathering and other investigative powers comparable to those of the liquidator of a company;

(b) should have obligations to report to ASIC that are comparable to those of the liquidator of a company, including in relation to possible unlawful activity; and

(c) could be subject to a 'cab rank' rule, similar to the rule for official liquidators, to ensure no difficulties arise in the future in finding a person willing to act to wind up a passive collective investment trust where the scheme may not have sufficient assets to pay the costs of that person. However, the 'cab rank' should only include those insolvency practitioners that have sufficient experience and resources to undertake this work.

100 As noted in paragraph 97, ASIC is of the view that the court should have the power to make any order appropriate for the winding up of a passive collective investment trust (and any other type of managed investment scheme).

101 Page 104 of the Discussion Paper refers to a joint report by the Australian Law Reform Commission (ALRC) and the Companies and Securities Advisory Committee (CASAC)[3] (ALRC/CASAC Report) and that it recommended 'a prohibition on a responsible entity issuing or accepting new subscriptions related to a particular managed investment scheme after the

[3] Corporations and Markets Advisory Committee, *Collective Investments: Managing other people's mon*ey, Report No. 65, Australian Law Reform Commission, 1993.

termination of the scheme without leave of the court or carrying on business of the scheme except so far as the scheme liquidator permits for the better winding up of the scheme'. ASIC notes that s601NE(3) provides that interests must not be issued in a registered managed investment scheme at a time after the responsible entity has become obliged to ensure the scheme is wound up, or after the scheme has started to be wound up.

Duties and obligations in a winding up

102 To ensure transparency in the liquidation process, ASIC is of the view that reforms might be considered to provide a power to creditors, members and ASIC to inspect the liquidator's books, such as records in relation to the scheme, receipts and payments.

103 ASIC is also of the view that some thought should be given to whether insolvency practitioners should be officers of the responsible entity for the purposes of s601FD.

Rights of priority creditors

104 ASIC considers that principles of trust law, together with the scheme's constitution, have been sufficient to assist in determining the priority of persons in the event of a winding up of a passive collective investment trust. As such, ASIC is of the view that there is currently no need for a statutory order of priority in the winding up of such a scheme.

105 However, ASIC recommends that reforms are introduced to make it clear that the reasonable remuneration of any person appointed by the court to wind up the scheme should have priority.

Unregistered schemes

106 ASIC does not consider any reform is needed for the winding up of a managed investment scheme that is not registered and not required to be registered.

B Enterprise schemes

Key points

This section sets out ASIC's experiences and views in relation to enterprise schemes. Enterprise schemes often involve members' assets being used in a common enterprise (rather than pooled), and can include agribusiness schemes, property syndicates, contributory mortgage schemes, serviced strata schemes, horse racing and horse breeding syndicates and IDPS.

ASIC's experiences and views are examined in the context of incapacitated responsible entities operating enterprise schemes:

- that are clearly viable at the point of incapacitation of the responsible entity; and
- where viability is unclear at the point of incapacitation.

ASIC's recent experiences with enterprise schemes have solely arisen in the context of agribusiness schemes.

Incapacitated responsible entity and potentially unviable scheme

107 This section discusses the proposals in the situation where a responsible entity is incapacitated and it operates one or more enterprise schemes and it is unclear whether they are viable or not.

Assets and scheme property

Current provisions

108 The provisions relating to assets and scheme property have been set out in paragraphs 26–28.

ASIC's experience

109 In almost every instance where there is an incapacitated responsible entity of this type of potentially unviable enterprise scheme, ASIC has observed difficulties in relation to assets and scheme property. The fundamental difficulty is the ability to determine what scheme property is, and what it is not, in an enterprise scheme. This is complex. Insolvency practitioners and the courts have also had to grapple with identifying whether property used in connection with the enterprise scheme is scheme property, the property of the responsible entity or the property of members. ASIC considers that the current provisions for scheme property, together with the taxation of agribusiness and other enterprises carried on under some enterprise schemes, may have contributed to these difficulties with enterprise schemes.

CAMAC Discussion Paper

110 ASIC considers the following areas for consultation in the Discussion Paper relate to assets and scheme property:

(a) identification of the scheme or schemes in all agreements and contracts entered into by the responsible entity on behalf of the scheme(s) (see 3.4.2 of the Discussion Paper);

(b) maintenance of 'continuing agreements' and 'completed agreements' register (see 3.4.3and 3.6 of the Discussion Paper);

(c) restricted use of scheme property for the purposes of that scheme (see 3.4.2 of the Discussion Paper);

(d) notification of a change of responsible entity by the replacement entity to all counterparties to all agreements and contracts entered into on behalf of the scheme (see 3.4.2 of the Discussion Paper);

(e) restriction of creditors of the scheme to those counterparties that have an agreement or contract entered into with the responsible entity as principal of the scheme (see 3.4.2 of the Discussion Paper);

(f) restriction on direct claim against scheme property to those creditors identified in paragraph (e) above (see 3.4.2 and 3.5 of the Discussion Paper);

(g) restriction of counterparties' rights to claim against property of the responsible entity that is not held in trust by the entity where a responsible entity as principal enters into agreements or contracts that do not contain a reference to the particular scheme or schemes (see 3.4.2 of the Discussion Paper;

(h) indemnification by the responsible entity from scheme property where there has been a common law or statutory breach by the entity (see 3.7 of the Discussion Paper); and

(i) direct claims in tort against scheme property (see 3.7 of the Discussion Paper).

ASIC's views

Identification of scheme agreements

111 Based on its experiences, ASIC considers that there is some merit in requiring a responsible entity to identify and record the affairs of the enterprise scheme. This record could then be used to assist determining what is part of the overall 'program or plan of action' making up the enterprise scheme.

Scheme agreement and contract register

112 ASIC supports reforms to introduce a system for recording agreements connected to enterprise schemes. Based on its experiences, ASIC believes it would be beneficial to have a requirement, in relation to each enterprise scheme, that the responsible entity maintain a register of the executory contracts that together make up the scheme (e.g. the contracts under which any part of the program or plan of action for the enterprise scheme is carried out).

113 In ASIC's view, a register for the relevant enterprise scheme would have the following benefits:

(a) It could assist members, creditors, ASIC and the courts in defining the limits and content of an enterprise scheme, both when it is established and during its life.

(b) It could be used to define or delineate the rights, obligations, liabilities and documents to which s601FS and 601FT should apply.

(c) Contracts on the register could be treated as 'within scope' of an enterprise scheme for the purposes of a voluntary administration or a winding up.

114 If such a reform is enacted, ASIC considers:

(a) it should be accompanied by a corresponding obligation imposed on a responsible entity to ensure the register is accurate and up-to-date;

(b) any person affected by a mistake in the register should be able to make an application for it to be corrected; and

(c) the register should be a public document with a right of inspection similar to the provisions of s173 of the Corporations Act on the right to inspect particular registered managed investment scheme registers.

Identification of and use of scheme property

115 ASIC is concerned that reforms proposed addressing the identification of scheme property may not adequately address the problems that result from 'commingling' of assets in some enterprise schemes. In ASIC's view, this problem arises as the result of money contributed by members in agribusiness schemes to the responsible entity (often for taxation purposes) being immediately paid over to the entity (or its agents or other persons engaged in relation to the scheme). It is then considered revenue of the responsible entity or such person, as opposed to remaining scheme property to provide sufficient funds for the continuing operation of the particular scheme as required. ASIC considers that the money applied is not 'property of a particular enterprise scheme' once paid to the responsible entity or such person, but rather it belongs to the entity or such person and is used by it to carry on its business. One option would to remove taxation incentives for this structure. Equivalent taxation benefits could be provided in a more

conventional corporate or trust structure if this was thought desirable. Alternatively, if no reforms are implemented in relation to the taxation position of enterprise schemes, ASIC recommends that consideration is given to reforms that require:

(a) each enterprise scheme to have its own responsible entity that is not engaged in any other business (e.g. is not a responsible entity of any other scheme); and/or

(b) the responsible entity to be precluded from paying dividends until termination; and/or

(c) an amount reasonably likely to be required to pay for any further operations of the enterprise scheme without funding from the responsible entity to be kept in a trust account with an approved Australian deposit-taking institution (ADI).

Creditors

116 ASIC considers that the following reforms may be unnecessary if reforms are introduced that make it clear which arrangements form part of the enterprise scheme:

(a) restricting the parties who can be creditors of the scheme;

(b) restricting the ability to claim directly against scheme property for those creditors identified in paragraph (a) above; and

(c) restricting the right to claim against property of the responsibility that is not held in trust by the entity where a responsible entity as principal enters into agreements or contracts that do not contain a reference to the particular scheme or schemes.

117 However, if such reforms were to be implemented, ASIC considers that there should be careful consideration of the potential consequences and effects of them. ASIC is also of the view that it may be difficult to negate any limitation of liability for contracts before the commencement of any reforms.

Determining viability and restructuring

Current provisions

118 The provisions relating to assets and scheme property have been set out in paragraphs 26–28.

ASIC’s experience

119 In ASIC’s experience, every instance where there is an incapacitated responsible entity of this type of enterprise scheme will require the viability of the enterprise scheme to be determined. ASIC has observed the following difficulties with the existing provisions in this situation:

(a) *Complexity of related party arrangements*: In ASIC's experience, enterprise schemes commonly involve high levels of related party arrangements, particularly service arrangements. When a responsible entity becomes incapacitated, often its related party service providers also become incapacitated. These related party arrangements add complexity to the efforts of an insolvency practitioner in transferring viable, or winding up unviable, enterprise schemes. Often new service providers also need to be found so that a scheme may continue. ASIC has also observed instances where attempts are made to entrench related party service providers in the overall operation of the scheme.

(b) *Funding model and cross-subsidisation*: Fee structures differ among enterprise schemes. Most types of agribusiness schemes require an up-front fee from members. In ASIC's experience, those fee structures rely solely, or to a large extent, on up-front payments that require the responsible entity to absorb a sustained period of negative cash flow until the scheme produces sufficient income to meet its costs. To continue an agribusiness scheme as a going concern, the responsible entity must have sources of revenue to fund its ongoing operations and working capital requirements. Where the entity is reliant on scheme sales for a substantial part of revenue for working capital, an interruption to this sales revenue could have significant implications for the entity, and its ability to fulfil its contractual obligations owed to members. If sales reduce suddenly, the responsible entity or insolvency practitioner may not have sufficient reserves to perform the day to day task associated with operating the enterprise scheme.

(c) *Compliance with obligations*: ASIC has received applications from insolvency practitioners seeking various exemptions from obligations under the Corporations Act and the responsible entity's AFS licence. The most common type of application involves seeking exemptions from the requirement to conduct compliance plan audits for the scheme, hold the required level of net tangible assets, maintain professional indemnity insurance and prepare and lodge financial reports for the responsible entity and scheme. Generally, this relief is sought in the following two cases:

   (i) Relief may be sought by the administrators where the scheme is viable because they have not had sufficient time to get the affairs of the responsible entity and the scheme in order. ASIC regularly grants case-by-case exemptions to allow administrators a period of six months from the date of appointment to prepare and lodge financial reports and compliance plan audits, irrespective of the date on which they are due.

   (ii) Relief may be sought by insolvency practitioners where the costs of compliance with these obligations may need to be borne by the insolvency practitioner personally as there may be insufficient assets in the scheme to enable indemnification. ASIC may grant permanent relief from these obligations if it is satisfied that there is no value left in the scheme. However, where ASIC cannot be satisfied in this way, it would normally refuse relief. This is because ASIC considers there is regulatory value in the users of these reports having up to date information about the scheme's position.

ASIC is also aware of one instance where insolvency practitioners have made application to the court requesting orders that they do not have to comply with certain obligations under the Corporations Act and the AFS licence of the responsible entity. Again, these applications have involved compliance with the requirement to have the compliance plan audited and prepare and lodge financial reports for the entity and scheme. ASIC understands that the orders were granted.

(d) *Tension in role of insolvency practitioner*: When the responsible entity of an enterprise scheme goes into external administration, control of it and its operations passes from the directors to the insolvency practitioners appointed to conduct the administration. Administrators and liquidators of a responsible entity often balance acting in the best interests of the both the entity and the members of the scheme. When a company is insolvent, the interests of its creditors come to the fore. Secured creditors of some types of enterprise schemes (e.g. agribusiness schemes) often have security over the land that is used by members. The secured creditors will generally have a significant commercial interest in 'un-encumbering' the land over which they have security. External administrators of the responsible entity have to manage the competing claims of secured creditors, whose ultimate interest may be having the scheme (which relates to the land) wound up if the effect is to free the land from these encumbrances and members, whose ultimate interest is to realise the long term production of their crops.

(e) *Disputes between receivers and managers and administrators or liquidators*: ASIC has observed several disputes between the receivers and managers and administrators over matters such as the entitlement of the administrators in their capacity as the responsible entity to use money invoiced from members after the appointment of the receivers and managers, the valuation of scheme property and assets, the accuracy of information sent to members and the rights of the administrators and receivers and managers to property associated with the enterprise schemes and apportionment of assets of the enterprise schemes.

(f) *Attracting replacement entity*: ASIC has regularly observed potential temporary responsible entities or replacement entities express interest in taking over the operation of enterprise schemes. However, none of these potential candidates have proceeded to take on this role where an enterprise scheme is 'insolvent' or unviable. In ASIC's experience, the reasons behind this include the following:

(i) The effect of s601FS and 601FT in an enterprise scheme where the extent of the liabilities and obligations are extensive or, at the least, uncertain can discourage potential candidates. The transfer of liability to any temporary responsible entity or replacement entity impedes willing candidates from seeking appointment in these circumstances. In ASIC's experience, ascertaining a true picture of the liabilities and obligations in an enterprise scheme is highly complex due to the nature of the scheme and determining what is part of it. In addition, a potential candidate will almost always find an inability to gain sufficient access to the necessary documents and information to perform due diligence to a sufficient level. There is no current legislative mechanism for a potential temporary responsible entity or replacement entity to limit their liability.

(ii) An inability to ensure that fees and expenses of a temporary responsible entity or replacement entity are paid in priority also can act as a deterrent for potential candidates.

(iii) The arrangements connected with the enterprise scheme are so uncertain as to make it incredibly difficult for a temporary responsible entity or replacement entity to bring any reasonable order to it.

(iv) Where the nature of the enterprise scheme being operated by the incapacitated responsible entity is highly specialised or complex, this has meant that there is only a small pool of potential candidates.

120 ASIC also understands that the administrators have had difficulty in finding suitably qualified and willing candidates because of the complexity of the enterprise schemes. In the absence of finding a replacement entity, the enterprise schemes may need to be wound up. Members are cognisant of this and have proposed a restructure that will see a management company appointed to manage the day to day operations with the administrators to continue in the official role as a responsible entity.

CAMAC Discussion Paper

121 ASIC considers the following areas for consultation in the Discussion Paper relate to restructuring a potentially viable enterprise scheme:

(a) introduction of a voluntary administration regime for managed investment schemes (see 5.4.7 of the Discussion Paper);

(b) powers to initiate a voluntary administration of a scheme (see 5.4.7 and 5.5.5 of the Discussion Paper);

(c) classes of persons to whom a voluntary administration regime would apply (see 5.4.7 of the Discussion Paper); and

(d) conduct of a voluntary administration (see 5.5.1, 5.5.2, 5.5.3 and 5.5.4 of the Discussion Paper).

ASIC's views

Introduction of a voluntary administration regime

122 ASIC considers that reforms to introduce a voluntary administration regime for enterprise schemes are warranted. In ASIC's view, a voluntary administration regime would have benefits for an enterprise scheme where members generally hold proprietary or contractual interests in property used in connection with the scheme and third parties may have legal rights over those interests. Many of the issues arising from the rights of members in enterprise schemes are currently only being solved, if at all, by court applications that raise complex legal problems. In ASIC's view, a reason for this is because enterprise schemes are not structured as trusts and do not have the benefit of the established principles of trust law.

123 However, ASIC notes that if existing provisions are grandfathered for enterprise schemes already in existence, then the reforms will have limited practical value for a significant period of time. This is particularly affected by the limited numbers of enterprise schemes that ASIC has registered recently.

124 ASIC would support the inclusion of a provision in Ch 5C that states that the voluntary administration provisions in Pt 5.3A of the Corporations Act apply (with modification) to enterprise schemes. The modifications required to apply the provisions of Pt 5.3A to enterprise schemes could be included in the Corporations Regulations.

125 The effect would be very similar to existing administrations for companies as:

(a) a moratorium would be put in place when the voluntary administration commences;

(b) there would be a first meeting at which members could vote to remove the administrator and appoint a committee;

(c) the administrator would investigate the enterprise schemes affairs and form an opinion as to the future of the scheme and then report to members;

(d) there would be a second meeting at which the members could decide the future of the scheme including liquidation, a deed of arrangement (including changes to the priority of claims) or ending the voluntary administration and allowing the scheme to trade on;

(e) the court would have broad powers as to how the part would operate, to give directions to administrators, as to the validity of appointments and as to the supervision of administrators (s447A–E); and

(f) the remuneration of the administrator would be determined by agreement with the committee, by resolution of members or if there is no agreement resolution by the court (s449E(3)).

Powers to initiate a voluntary administration

126 ASIC would support legislative provisions that provided the court may make the appointment, upon application by ASIC or members of the scheme.

Conduct of voluntary administration

127 ASIC considers that the views expressed in paragraphs 84–85 apply equally to enterprise schemes.

128 In ASIC's view, a mandatory moratorium period should provide an opportunity for the parties to agreements that form part of the enterprise scheme to renegotiate them if this will enable the enterprise scheme to continue to operate producing a better return over time to all those parties.

129 On the basis of its experience, ASIC would be supportive of a mandatory moratorium on the enforcement of pre-existing creditors' rights (including secured) either during the period of appointment of a voluntary administrator or some other prescribed or court-determined time for enterprise schemes. A moratorium for a certain period would allow time for the administrator to assess viability and either source a replacement responsible entity or begin a restructure, wind down or wind up of the enterprise scheme. ASIC considers that any provisions should be similar to the provisions in relation to moratoriums on the appointment of an administrator to a company, including that it is the subject of court oversight.

130 If reforms were introduced to facilitate a moratorium and they were to apply to enterprise schemes already in existence, ASIC recommends that advice is obtained about whether this would amount to acquisition other than on just terms.

131 ASIC considers that a voluntary administration regime for enterprise schemes (or any other type of managed investment scheme) should only apply where an insolvency practitioner is appointed to the responsible entity. In ASIC's view, allowing the appointment of an administrator to an enterprise scheme in circumstances where the responsible entity is functional will undermine the entity's intended role and obligations. ASIC considers that a functional responsible entity should be responsible for determining the viability of an enterprise scheme and deciding whether it should be restructured, wound down or wound up.

132 Based on its experiences, ASIC has no reason to object to limiting the role of the administrator of an enterprise scheme to a person who is a registered liquidator. ASIC notes that they are required to have professional indemnity insurance cover and systems to conduct the administration and in a company context regularly employ persons with specialist skills to operate the company, or some aspect of it where necessary. However, as noted above in paragraph 84, ASIC considers that the most important criteria for

appointment as an administrator to a managed investment scheme should be that the person is suitably qualified to perform the role.

133 ASIC considers that a key function of the administrator should be to put options to the members about the future of the enterprise scheme in a similar way to the process that applies in a voluntary administration regime for companies. If the enterprise scheme is potentially viable, members should vote on the future of the enterprise scheme and a replacement responsible entity be considered. If the enterprise scheme is not viable, then it should be wound down or wound up.

134 ASIC supports the recommendation in the ALRC/CASAC Report that the court should have similar powers to its general discretionary power under s447A of the Corporations Act to make such orders as it thinks appropriate about how provisions in relation to the voluntary administration regime should apply, on application by:

(a) the responsible entity;

(b) a creditor of the responsible entity;

(c) the administrator of the scheme;

(d) ASIC; or

(e) any other interested party.

Powers and liabilities of the administrator

135 ASIC is of the view that the administrator of an enterprise scheme should:

(a) have similar powers to those of an administrator of a company;

(b) have an indemnity out of the scheme property for the debts they have lawfully incurred; and

(c) not have the ability to appoint a temporary responsible entity to an enterprise scheme (although have the power to assist in the transition to a replacement entity).

Winding up

Current provisions

136 The provisions relating to winding up have been set out in paragraphs 86 and 90.

ASIC's experience

137 ASIC has observed the following difficulties with the existing provisions in relation to winding up these enterprise schemes:

(a) *Effect on ownership rights*: The ‘project of plan or action’ of an enterprise scheme is constituted and conducted through a series of interlocking contracts, which are structured to ensure the activities carried on by the member come within the terms of any relevant rulings or requirements (e.g. a taxation product ruling). The winding up of a managed investment scheme involves unwinding these contracts. In ASIC's experience, the affect on ownership rights under these contracts is not always clear as a matter of law.

(b) *No restriction on business model or structure*: Chapter 5C of the Corporations Act does not mandate that a managed investment scheme is structured in a particular way. Where a scheme is structured as a passive collective investment trust and the responsible entity purports to incur a debt as trustee, the established principles of trust law apply. To the extent that there are any regulatory gaps in Ch 5C of the Corporations Act, these principles can supplement that regime. An enterprise scheme is generally not structured as a trust for taxation reasons and cannot have recourse to the established principles of trust law. Instead, the rights of members of the enterprise scheme will be governed by the contractual arrangements with each party.

(c) *Prolonged operation of an unviable scheme*: ASIC has regularly observed situations where some members seek to prolong the continuation of a clearly unviable enterprise scheme. In ASIC's experience, members seek to do this to avoid crystallisation of loss associated with their investments (particularly the loss of taxation deduction) and the need to repay any money borrowed in order to invest and interest accrued.

CAMAC Discussion Paper

138 ASIC considers the following areas for consultation in the Discussion Paper relate to winding up an enterprise scheme:

(a) initiation of winding up of a scheme (see 6.1.4 of the Discussion Paper);

(b) procedural aspects of conduct of a winding up of a scheme (see 6.2, 6.4.7, 6.6.2, 6.6.4, 6.6.5 and 6.6.6 of the Discussion Paper);

(c) duties and obligations in a winding up (see 6.6.2 and 6.6.5 of the Discussion Paper); and

(d) priority in winding up (see 6.6.3 of the Discussion Paper).

ASIC's views

Initiating a winding up

139 ASIC considers that the current provisions for initiating a winding up of an enterprise scheme, together with relevant case law, are generally working appropriately. ASIC considers that the views expressed in paragraphs 93–97 apply equally to enterprise schemes.

Procedural matters

140 ASIC considers that the current provisions for procedures associated with the winding up of an enterprise scheme, together with relevant case law, are generally working appropriately. ASIC considers that the views expressed in paragraphs 98–101 apply equally to enterprise schemes.

Duties and obligations in a winding up

141 ASIC considers that the views expressed in paragraphs 102–103 apply equally to enterprise schemes.

Rights of priority creditors

142 As noted above, Ch 5C of the Corporations Act does not mandate that a managed investment scheme be structured in a particular way. Where a scheme is structured as a passive collective investment trust and the responsible entity purports to incur a debt as trustee, the established principles of trust law can apply. To the extent that there are any regulatory gaps in Ch 5C of the Corporations Act, these principles can supplement that regime. An enterprise scheme is usually not structured as a trust (generally for taxation reasons) and cannot have recourse to the established principles of trust law. Instead, the rights of members of the enterprise scheme will be governed by the contractual arrangements with each party.

Incapacitated responsible entity and viable scheme

143 ASIC does not propose to substantively address any of the areas for discussion in the Discussion Paper in the situation where a responsible entity is incapacitated and it operates one or more enterprise schemes that are clearly viable at the point of incapacitation. This is because ASIC has not observed any situations where this has occurred. While ASIC has observed some situations in which enterprise schemes are subsequently determined to be viable, viability is not known at the point of incapacitation. However, ASIC considers its views in relation to assets and scheme property in paragraphs 111–117 could also apply where there is an incapacitated responsible entity and a viable scheme.

C Other regulatory reforms

Key points

This section specifically sets out ASIC's views about the areas for consultation in the Discussion Paper in relation to:

- convening meetings, cross-guarantees and limited liability for members of a scheme raised in the Discussion Paper; and
- any further reforms to Ch 5C of the Corporations Act.

Convening meetings

144 ASIC does not currently consider there is sufficient evidence to warrant reforms:

(a) to enable it to have the power to call a meeting of members;

(b) for members to requisition a general meeting. ASIC considers that the member already has an ability to raise any questions directly with the responsible entity and if they are unsatisfied with the response to make a complaint to the entity; and

(c) for an annual general meeting to be held for managed investment schemes. In ASIC's view, the costs associated with this would outweigh the regulatory benefit. ASIC considers that the structure of managed investment schemes is designed to be used for passive investments and as such cohesion among members is as necessary or relevant as for companies. ASIC also considers that such a scheme is designed so that members are placing confidence in the responsible entity to effect its investment strategy.

Cross-guarantees

145 ASIC released Consultation Paper 140 *Responsible entities: Financial requirements* (CP 140) in 2010 setting out issues for consultation on the financial requirements for responsible entities. CP 140 included proposals for restricting cross-guarantees for these entities. ASIC received a number of submissions and is currently in the process of a finalising a new regulatory guide that specifically addresses the financial requirements of these entities, including the use of cross-guarantees.

146 ASIC is of the view that no further legislation is required in this area.

Limited liability of members

147 ASIC would support reforms to provide that, if the constitution limited the liability of members, this limitation would have effect, except in relation to any member who was aware, when acquiring interests in the managed investment scheme, that the scheme would not be able to pay creditors the amount to which they would be entitled (but for any limitation of liability to the assets of the scheme).

Further regulatory reform options

148 ASIC wishes to take this opportunity to raise a number of submissions that ASIC has previously made about the relevant legislation that have not been enacted.

MIA Review

149 ASIC made a number of submissions to the MIA Review, which as yet have not been enacted. In particular, ASIC continues to support the proposals set out in 5.2.1, 5.2.2, 5.2.4 and 5.2.5 of Section 5.2 ‘Law reform proposals supported’.

150 Based on its experiences, ASIC considers that the amendment proposed in 5.2.7 should be amended to replace s601GA(1)(a) with a requirement that the responsible entity must prepare in writing and keep a unit pricing policy. The unit pricing policy should protect against unfairness and unreasonable dilution.

151 ASIC considers that the regulations set out in 5.2.8 should be incorporated into Ch 5C of the Corporations Act with regard to the following:

(a) *Regulation 5C.11.06*: ASIC notes that the intention of this regulation is to make it clear that the responsible entity must first make good the loss, and not wait for a recovery. It should also be made clear that if after making good the loss to the registered managed investment scheme, the responsible entity recovers money from an agent, the money recovered can be kept by it.

(b) *Regulation 5C.11.05A*: ASIC notes this has since been amended again and the new version should now be incorporated in the Corporations Act.

152 ASIC supports the further consideration of the following law reform proposals set out in Section 5.3 subject to the following comments.

153 In relation to 5.3.1 of the report:

(a) ASIC notes that where a person is winding up a registered managed investment scheme in accordance with the order of the court, they may operate the scheme even though they are not acting on behalf of the responsible entity. However, in relation to an agribusiness scheme, for example, it should be clear that any forestry manager is acting on the entity's behalf in providing its services.

(b) ASIC is of the view that s601FC(2) should be replaced by a duty on the responsible entity that when it holds scheme property it holds scheme property for the members and that it ensures that any other person who holds scheme property should hold it for the entity. Further, it should be clarified that the beneficial interest in scheme property held by the responsible entity, when another person holds the scheme property, is itself scheme property.

154 In relation to 5.3.2, ASIC supports the rationale for the proposed amendment to paragraph (e) of the definition notwithstanding the repeal of s601FC(4). ASIC is of the view that the concern is not about the lack of regulation of a wholesale trust, but rather a trust selected by retail clients under a custodial arrangement.

Treasury Consultation Paper 2002

155 As noted above, ASIC made a number of submissions to the MIA Review and subsequent consultation paper issued by Treasury that it continues to support.

156 ASIC has also subsequently formed the following views in relation to the following aspects:

(a) *Consideration of potential amendments to s601ED(2)*: ASIC notes that it is arguably unclear whether s601ED(2) applies where a Product Disclosure Statement (PDS) is given under s1012C or 1012IA. ASIC is of the view that s601ED(2) should apply whenever a PDS is required to be given under s1012C or 1012IA, unless the responsible entity has taken all reasonable steps to preclude this from happening. It is appropriate to prevent avoidance, for the same reason that these provisions seek to prevent avoidance of the PDS provisions. ASIC is of the view that there should be no need for a presumption, and that it should just apply to any sale unless a PDS has been prepared, and is publicly available free of charge from the issuer, together with a statement from the issuer that is it not at any time while it is published by the issuer defective for s1021A. ASIC notes that the problem about the interaction between the older Pt 6D and s601ED(2) is no longer relevant.

(b) *Consideration of potential amendments to s601GA(2)*: ASIC is of the view that s601GA(2) should be clarified so as to enable the responsible entity to still be entitled to its fees if it breaches its obligations, and can make good the loss including by way of set off.

Other submissions

157 ASIC has raised the following issue with other parties. CAMAC may wish to also consider whether these issues might be addressed by legislative reform:

(a) *Definition of managed investment scheme*: ASIC is concerned with the court's interpretation of the definition of 'managed investment scheme' in *In Re Lawloan Mortgages Pty Ltd* [2002] QSC 302. In *Lawloan*, the court found a loan scheme in which subsets of investors contributed to separate loans was not a managed investment scheme because it lacked the characterising feature that 'the benefits produced by a pooling of funds in a given managed investment scheme must be capable of flowing to all, not a sub-set of the members of the managed investment scheme': para [78]. The feature lacking was said to be the use of the funds in a 'common enterprise'. ASIC is concerned that this interpretation creates a significant risk of avoidance by arranging the scheme so that some members obtain a benefit that does not flow to all members.

(b) *Enhancements to the provisions in relation to compliance committees*: ASIC has made a number of submissions to various inquiries[4] suggesting enhancements could be made to the membership and conduct of compliance committees. ASIC considers such reforms are still warranted.

(c) *Enhancements to the provisions in relation to compliance plans*: ASIC has made a number of submissions to various inquiries suggesting that enhancements should be made to improve the content of compliance plans. ASIC considers such reforms are still warranted.

(d) *Enhancements to the provisions in relation to compliance plan audits and auditors*: ASIC has made a number of submissions to various inquiries suggesting that enhancements could be made to ensure competency of compliance plan auditors and ensure a suitable standard of compliance plan audit is conducted. ASIC considers such reforms are still warranted.

Other matters

Constitutional amendments

158 ASIC has observed that a number of responsible entities have taken a broad interpretation of the requirements in s601GC of the Corporations Act and deemed various amendments as 'not adverse to members rights' in circumstances where it is arguable that the amendments could adversely affect members right. For example, ASIC is aware of circumstances where

[4] See, for example, ASIC's submission to the Parliamentary Joint Committee for Corporations and Financial Services into Trio Capital and ASIC's response to the Parliamentary Joint Committee on Corporations and Financial Services into the MIA Review's recommendations.

amendments have been made to constitutions to include new fees payable to the responsible entity out of scheme property and to impose significant discounts for pricing of interests issued in respect of rights issues. While the recent decision in *Premium Income Fund Action Group Incorporated & Anor v Wellington Capital Ltd & Ors* [2011] FCA 698 would appear to support that such amendments may be adverse to members' rights, additional legislative guidance on this issue may also help protect investors.

159 ASIC suggests that consideration should be given to amending this provision so that a members' meeting is required except in limited circumstances (e.g. where it will not be adverse from the viewpoint of any member). This provision could also require that the responsible entity is required to give notification to members similar to that required under s601NC where the amendment does not fall within the limited circumstances.

Additional observations

160 In addition to the above, ASIC proposes the following amendments could be made to improve Ch 5C of the Corporations Act.

(a) A specific duty could be imposed on responsible entities so that for any transactions they enter into in relation to a managed investment scheme, they act in the best interests of members. This would be in line with the Financial Sector Assessment Program recommendation, with which the Australian jurisdiction has agreed it would comply.

(b) For issues under a PDS to which s1016C (minimum subscription) applies, s1017E also applies. Section 1017E of the Corporations Act would apply to the money, but the obligation to return it would be excluded as this is addressed by s1016E.

(c) There is no requirement for interests in a registered managed investment scheme to be certificated. In ASIC's experience, this is in line with industry practice, and serves limited regulatory benefit.

(d) ASIC should be given exemption and modification powers over Pt2G.4. This may be used in appropriate cases (e.g. to vary strict procedural requirements). Currently, ASIC can use its powers of exemption and modification under Ch 5C to exempt a responsible entity from select requirements in Pt 2G.4. However, this can only occur in limited circumstances and requires overly complex instruments to be drafted.

(e) Section 601EB could be amended to provide that ASIC may, but is not required to, examine the constitution or compliance plan lodged with a registration application. This will facilitate ASIC taking a risk-based approach to assessment, and in addition is consistent with the absence of any requirement for ASIC assessment of amendments to the constitution or compliance plan. ASIC notes that the purpose behind a regime requiring registration by ASIC of managed investment schemes is to ensure that all collective investment arrangements that receive investments from retail investors are clearly identifiable for regulatory and general information purposes.[5]

(f) For s601ED(1), a person should be taken to be in the business of promoting managed investment schemes if they have promoted schemes that have in total 100 members at the time the offer for the relevant scheme occurs. ASIC has regularly experienced difficulties in identifying if someone is in the business of promoting a managed investment scheme and the use of a specific threshold would provide more certainty for regulatory enforcement purposes.

(g) The onus for establishing that a managed investment scheme does not have to be registered because of s601ED(2) should be changed to be on the person asserting it (i.e. the defendant). This may make it easier for ASIC to take regulatory action against promoters and operators of 'illegal' managed investment schemes.

(h) Section 601FB(2) should be amended to make it clear that the responsible entity is to be attributed with the acts and omissions of agents and persons it engaged, for the purposes of the Corporations Act and the ASIC Act (not merely liability to members). This may assist ASIC in taking regulatory action.

(i) Section 601FF should also require that agents and other persons engaged by a responsible entity must take all reasonable steps to assist ASIC in carrying out a compliance check. This may make it easier for ASIC to conduct investigations.

(j) Part 5C.6 should be drafted (including the heading) to clarify that it applies to allowing members to withdraw, whether under a right to do so or otherwise. It should provide that a withdrawal notice must be given to the member by sending to an address (including an electronic address) that has been provided as the member's address for the purposes of the managed investment scheme. ASIC is of the view that any notification by posting on the responsible entity's website should be considered in a relief framework.

[5] Corporations and Markets Advisory Committee, *Collective Investments: Managing other people's mon*ey, Report No. 65, Australian Law Reform Commission, 1993.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an Australian financial services licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
ALRC	Australian Law Reform Commission
ALRC/CASAC Report	*Collective investments: Other people's money* (ALRC Report, No 65, 1993).
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
CAMAC	Corporations and Markets Advisory Committee
CASAC	Corporations and Securities Advisory Committee
Ch 7 (for example)	A chapter of the Corporations Act (in this example numbered 7)
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
CP 140 (for example)	An ASIC consultation paper (in this example numbered 140)
Discussion Paper	CAMAC's proposed measures for the implementation of the Australian Government's aims for reviewing the managed investment scheme legislative framework, as set out in its paper *Managed investment schemes* (2011)
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
MIA Review	*Review of the Managed Investments Act 1988* (2001)
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
reg 7.6.04 (for example)	A regulation of the Corporations Regulations (in this example numbered 7.6.04)
s311 (for example)	A section of the Corporations Act (in this example numbered 766E), unless otherwise specified

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Attention Mr John Kluver

Dear Sir

Submission in relation to CAMAC's Discussion Paper *Managed Investment Schemes*

We refer to CAMAC's Discussion Paper, *Managed Investment Schemes* issued in June 2011, and we wish to make the following submissions.

General comments

1. Many of the recommendations and issues raised by CAMAC are specific to managed investment schemes that are contract-based, in particular those schemes operating in the agricultural sector. As such, it is worth considering whether any law reforms should draw distinctions between managed investment schemes that are contract-based from those that are trust-based. Further, we also think there may be merit in having a dual regime whereby agricultural managed investment schemes are subject to additional more targeted regulation than schemes which invest in other asset classes (which would continue to be regulated under the existing Chapter 5C provisions). This is because many of the proposed reforms would adversely impact trust-based retail funds by imposing additional compliance burdens, even though these schemes have not been identified as the source of the perceived need for regulatory reform.

2. In addition, by way of general observation, care should be given to imposing law reforms that are based on corporations laws on trust-based schemes. That is, as many managed investment schemes are established as trusts, any uncritical application of corporations law principles in the area of trust law will lead to increased complication in respect the laws applying to trust-based managed investment schemes. Further, an uncritical application of some corporate law principles to trust-based schemes may lead to unintended or absurd consequences, in particular where the distinction between the trustee and the trust is not appropriately recognised and accommodated. Further, it has been recognised in other contexts (notably, superannuation) that trust law provides a protective framework that is beneficial to investors and imposes high standards of conduct on trustees. In framing any proposed reforms, it will be important to ensure that these protections are not undermined.

3. The Discussion Paper states (at paragraph 3.3) that "[t]he use of multi-function REs to operate MISs can create problems and uncertainties about identifying the affairs of each MIS that have not been fully addressed in the legislation, which only gives limited recognition of this type of RE". In our opinion, the view expressed, that the law does not already address the possibility of responsible entities operating more than one scheme is unjustified. The existing Chapter 5C duties to exercise care and diligence (section 601FC(1)(b)), to act in members' best interests (section 601FC(1)(c)) and to identify scheme property and keep it separate (section 601FC(1)(i)) would impose a duty on the responsible entity to maintain adequate records so that the affairs of each MIS can be readily identified. It would appear to the us that the regulatory issue is not the ability of the law to accommodate the position of responsible entities that operate more than one scheme, but rather, the compliance of particular responsible entities with their duties under the law and the regulatory oversight of them by ASIC.

4. We also consider that CAMAC should consider generally the appropriateness of the "managed investment scheme" definition, which is fundamental to the regime in Chapter 5C. Recent case law and enforcement actions by ASIC have sought to classify a wide variety of "schemes", many of which would not fall within the ordinarily understood concept of a collective investment vehicle, as managed investment schemes. The sheer breadth of the definition creates considerable uncertainty. CAMAC should also give consideration to the different types of scheme that exist, and the extent to which tailoring is appropriate to cater for these differences. For example, listed schemes tend to be very different from unlisted schemes, and it may be appropriate for the legislation to accommodate these differences.

Specific comments

5. In relation to a Reform 1, we think that this proposed legislative reform is likely to add significantly to the compliance burden on responsible entities. In our view, an increased compliance burden will:

   (a) not necessarily result in improved investor outcomes, especially where additional regulation can do little to change the appetite for regulatory compliance by otherwise non-complying responsible entities. In this regard, it should be noted that section 601FC(1)(i) already imposes a requirement on responsible entities to ensure that scheme property is clearly identified as scheme property and held separately from the property of a responsible entity and property of any other scheme; and

   (b) result increased administration costs that would be passed onto investors.

   The legal effect, if any, of not maintaining the register would be a key policy issue if this reform were to be implemented.

6. In relation to Reforms 1 and 2, should such reforms be enacted, care should be taken to ensure that they do not unintentionally prohibit or restrict the current ability of responsible entities to invest collectively with other investors (including other schemes) in pooled investment vehicles such as unit trusts or to arrange for custodians to hold assets of different schemes in an omnibus arrangement.

7. In relation to Reform 3, while we would regard as it useful to require a new responsible entity to give such a notice, this reform may not be of utility if Reform 1 is not enacted. The giving of a such a notice, however, does not of itself change legal relations or provide additional legal protections to any person.

8. In relation to Reform 4, we note that this reform will radically alter trust law because it will replace the existing legal regime in relation to a creditor's right of subrogation to the

potential significant detriment of investors. The right of subrogation affords investors some protection because it means that scheme property should not be available to meet liabilities that are incurred by a responsible entity in breach of trust. A trust structure provides an opportunity to impose limits on the powers of the trustee/responsible entity for the benefit of investors, and for those limits to be enforced, not only against the trustee/responsible entity but also, scheme creditors. To illustrate this, under the current law, a scheme could be registered with a constitution that permits investment only in cash and like investments and prohibits borrowing. Investors can invest in reliance on these protections. Under the current law, if the responsible entity acted outside the scope of its powers by borrowing money to invest in an unauthorised investment, the lender may not have access to trust property to discharge the loan, since the borrowing was beyond the power of the responsible entity/trustee. Under the proposed reform, the creditor would be protected (and investors exposed to new and unmanageable risks) in circumstances where the creditor could easily have identified the restrictions by examining the scheme constitution. In our view, this reform tips the scales too heavily in favour of creditors and removes some of the inherent trust law protections currently available to investors in trusts.

9. In relation to the proposal to enact a kind of voluntary administration procedure in respect of potentially viable managed investment schemes along the lines of Part 5.3A of the Corporations Act, we take the view that there is merit in exploring this proposal. Details of such a regime would need to be worked out, taking into account inherent differences between managed investment schemes and companies. For example, the extent to which the responsible entity has ongoing duties (statutory or otherwise) in respect of a scheme that is under voluntary administration will need to be made clear in the legislation, including the ongoing responsibilities of the responsible entity as the holder of an Australian financial services licence that authorises it to operate the particular scheme under voluntary administration.

10. In relation to convening scheme meetings, we think that it would be of benefit if the law could be clarified to modify the quorum and voting requirements so as to exclude the votes (or voting entitlements) of members that are ineligible or otherwise unable to vote (for example, where the units are held by or on behalf of the operator of an invested directed portfolio service in circumstances where the IDPS operator is not required to vote in relation to securities forming part of the investor's portfolio). Such restrictions on voting can frustrate the investor protections in the Corporations Act 2001 regarding, say, the passing of extraordinary resolutions to appoint a new responsible entity under section 601FL.

11. In relation to the liability of members of a managed investment scheme, we think that it would be of benefit to prospective investors, and to the industry generally, if the Corporations Act 2001 were to be changed to expressly state that the liability of members is limited to unpaid amounts of the issue price of an interest in a scheme, along similar lines to that provided in section 516 of the Corporations Act.

12. Recent case law, such as *Premium Income Fund Action Group v Wellington Capital* [2011] FCA 698, has highlighted the very restrictive nature of the modification power in section 601GC of the Corporations Act. In particular, the case highlights that responsible entities may be unable to effect amendments to a scheme constitution in a timely fashion or at all, notwithstanding that the amendments are considered to be in the best interests of scheme members, if the amendment in some (possibly even minor) way could be regarded as adversely affecting the "rights" of members. This, in combination with the restrictive provisions relating to the issue price of scheme interests, has made it difficult for responsible entities to raise equity capital in recent times. We think it would be beneficial for section 601GC to be reformulated to provide greater flexibility for responsible entities to make modifications that are considered to be in the best interests of members.

13. In late 2009, Treasury released a paper *"Product Rationalisation of Managed Investment Schemes and Life Insurance Products – Proposals Paper".* That paper identified that there are significant hurdles to a responsible entity seeking to merge schemes, even where that is considered to be in the best interests of members. We think there would be merit in amending Chapter 5C to include a regime for merging schemes, as this would provide an alternative to scheme termination for schemes that are of insufficient size.

If you have any queries about this memorandum, please contact us.

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5 October 2011

Corporations and Markets Advisory Committee
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Attention: Mr John Kluver

[By email to: john.kluver@camac.gov.au]

Dear Mr Kluver

RE: Managed Investment Schemes Discussion Paper

Introduction

1. The Trust Company has more than 125 years experience in providing financial services and since 1954 has acted as a corporate trustee and custodian. The Trust Company is well respected and well known in the marketplace as a provider of responsible entity (**RE**) and corporate trustee services and has been acting as an RE for its own internally managed schemes and for externally managed schemes since the introduction of the *Managed Investments Act* in 1998.

2. The Trust Company, through its wholly owned subsidiary companies, currently acts as RE for over 60 managed investment schemes with approximately $9 billion of assets under supervision. The Trust Company provides professional RE services to a number of externally managed schemes through a number of different commercial partners.

3. We have recently taken on several roles as RE where the previous RE of the relevant scheme was in financial difficulty. We are fully aware of the distressing consequences for members of managed investment schemes arising out of RE insolvency and examples of our appointments have included:

   - Max Trust (formerly operated by an RE within the failed Allco Finance Group);
   - Australian Wholesale Property Fund (formerly operated by an RE within the failed Allco Finance Group);
   - Absolute Capital Yield Securities Fund (formerly operated by Absolute Capital Limited (administrators appointed)); and
   - 10 managed investment schemes formerly operated by Trio Capital Limited (in liquidation).

4. In all of these situations, The Trust Company (with the support of various service providers) has been able to largely normalise the operation of the managed investment schemes affected by RE insolvency. We therefore have a degree of experience in replacing insolvent REs and the issues involved. However, there are many circumstances where we would not be prepared to replace an insolvent RE given the high risks of the replacement process presently set out in the

Corporations Act, even where the underlying managed investment scheme would appear to be solvent.

5. The Trust Company is pleased to respond to the issues raised in the CAMAC Discussion Paper. We have structured the enclosed submission in three sections. Section 1 sets out some general concerns in relation to the managed investment scheme regime and gatekeeper accountability. Section 2 deals specifically with replacing REs and the weaknesses of the current temporary RE regime. Section 3 addresses certain other issues raised in the CAMAC Discussion Paper.

Yours faithfully,

Rupert Smoker
Head of Responsible Entity Services

Section 1: General concerns with the managed investment scheme regime and gatekeeper accountability

6. Trio Capital, Great Southern and Timbercorp are all examples of where the single responsible entity regime has compromised the interests of investors. In other words, investor protection has been compromised by the lack of independence implicit in the "single responsible entity regime" ushered in by the *Managed Investments Act*. In particular, the independent decision-making requirements in the single responsible entity regime have been shown to be inadequate. The independent directors of an RE are pitted against the resources and interests of the company that appoints them, pays them and can remove them. If a properly formed compliance committee (with external members) is in place, a majority of independent directors is not even needed. However, a compliance committee does not provide any real-time monitoring or check on the RE's actions and is similarly lacking in independence.

7. The single responsible entity regime is a source of, at a minimum, consternation, if not strong aversion from many overseas institutional investors, especially in the UK and Europe. Even when the scheme sponsor possesses an excellent pedigree, many institutional investors from these jurisdictions will not invest in any vehicle that does not have an independent trustee. The potential for conflict in the single responsible entity regime is perceived to be unacceptable by many foreign investors and the regime flies in the face of what is regarded as internationally accepted investment standards. Over the longer term it will manifest in less portfolio investment money coming into the Australian market. To that extent, the country will be worse off.

Gatekeeper accountability

8. The managed investment scheme regime contemplates a number of gatekeepers appointed by the RE with specific functions designed to ensure the interests of investors in the scheme are protected. These gatekeepers include:

   - an auditor appointed to review the financial statements of a managed investment scheme;
   - an auditor appointed to review an RE's compliance with the compliance plan of a managed investment scheme; and
   - a compliance committee (if the board of the RE is not independent) charged with reviewing the RE's compliance with the compliance plan.

9. In order for these gatekeepers to ensure the highest possible standards it is an imperative that those who incur losses as a result of gatekeeper negligence are able to seek compensation for that loss. This is a particularly relevant issue in relation to auditors. At present, there is uncertainty as to whether the members of a scheme have any direct rights of recourse against these gatekeepers for negligence. Any rights of recourse are likely to be only available to the RE who engages the gatekeeper. As noted below these rights of the RE may be limited by a cap on liability.

10. Claims against auditors for negligence will be limited to 10 times the engagement fee paid on commencement of the audit services by virtue of section 3 of the Accountants Scheme, which is a scheme approved under the *Professional Standards* legislation. That legislation applies to all claims, whether arising in tort, contract or under statute. The effect of the cap is such that where significant losses occur (such as those experienced with the collapse of Trio Capital), it would be uncommercial to commence a claim in negligence because the limit of the potential damages that would be available.

THE TRUST COMPANY

Section 2: Weaknesses of the temporary RE regime

11. The global financial crisis provided the first real test of the single responsible entity regime's ability to cope with general turmoil on financial markets. For example, the widespread freezing of the mortgage fund sector saw REs invoking the protections of the non-liquid provisions set out in Chapter 5C.6 of the *Corporations Act* for the first time. Conceived after the property fund collapses in the early 1990s, the non-liquid provisions of Chapter 5C allowed REs to cease meeting redemption requests and avoid the need for asset fire-sales. Also, numerous external administrators appointed over REs have sought various Court directions as to how to wind up schemes that cannot pay their debts.

12. During the GFC, while some previously "un-touched" parts of Chapter 5C were being used repeatedly, the provisions relating to the appointment of temporary REs remained unused. At first blush, with the number of insolvent REs[1] in the market, it would seem that the non-appointment of temporary REs was an abdication of duties by the insolvent RE, the Australian Securities and Investments Commission (**ASIC**) or even the members of the scheme. However, when an assessment is made of the temporary RE provisions, it is quite clear that despite best intentions, Chapter 5C does not appropriately accommodate for the circumstances prevailing at the very point in time where a change in RE is needed. As such, the temporary RE provisions are obsolete or requiring reform.

13. While both section 601FN of the *Corporations Act* and regulation 5C.2.02 of the *Corporations Regulations* provide standing to certain people to apply to Court for the appointment of the temporary RE, there are other important provisions that flow from a change of RE. As ASIC noted in its submission *In the Matter of Timbercorp*[2]:

    "A new or temporary responsible entity takes on the full suite of statutory responsibilities for a scheme. This means that a new or temporary responsible entity must have the necessary resources to operate the scheme."

14. Section 601FS of the *Corporations Act* provides that if the RE of a registered scheme changes, the rights, obligations and liabilities of the former RE in relation to the scheme become rights, obligations and liabilities of the new RE. In practice, this means all scheme-level liabilities properly incurred novate across to the temporary RE, as do any rights the RE had such as the right to charge fees. Whilst the question as to whether a temporary RE is subject to section 601FS is not free from doubt, ASIC has recently offered its opinion on this matter in its *Timbercorp* submission that a temporary RE is subject to section 601FS.

[1] Timbercorp, Great Southern, Rubicon Asset Management, Record Funds Management, FEA, Trio Capital Limited, Environinvest, Austcorp for example.
[2] ASIC's submission in the matter of *Timbercorp Securities Limited* (http://www.timbercorp.com.au/userdocs/1/kordamentha/courtolive/asicjuly.pdf)

15. The mechanics of the appointment of a temporary RE is something which has been considered by Justice Barret. In an extra-judicial paper delivered in 2008[3], His Honour noted:

> *"If there is going to be an appointment of a temporary responsible entity, there must first be some qualified company willing to be appointed, even if only temporarily. That, I suggest, will be a problem. When a new responsible entity takes office, it becomes, under s 601FS, the statutory inheritor of the rights, obligations and liabilities of the old responsible entity in relation to the scheme. In our postulated situation, the successor will come to owe the debts that brought the old responsible entity undone and to have the rights of recoupment that were insufficient to allow it to continue. Simple replacement of the responsible entity in liquidation therefore does not seem a practical possibility. The automatic vesting of the non-viable combination of liabilities and inadequate rights of recoupment must mean that, in the real world, there will never be a new responsible entity."*

16. Justice Barret's argument is that it is commercially unlikely that, where an RE is insolvent, a temporary RE will be unable to improve the position of a scheme or its members. Where an RE is insolvent it would be difficult to understand the motivation of a party prepared to act as a temporary RE under the current legislative regime. In all likelihood the temporary RE would be unable to adequately recover the costs of operating the schemes. The incoming RE would face the same solvency challenges of the previous RE.

17. It is possible to conceive of some circumstances where a temporary RE is able to be appointed to remove a solvent RE. For example, where ASIC cancels the AFSL of the existing RE for reasons other than that RE's failure to meet financial requirements of the AFSL. However such situations are rare.

18. It is therefore understandable that in recent years neither ASIC nor any scheme member has asked the Court to appoint a temporary RE. These parties are then faced with two circumstances, (1) where no licensed RE is prepared to consent to be a temporary RE, or (2) a party whose consent to act as RE is founded on commercial irrationality.

19. In 1993 CAMAC and the Australian Law Reform Commission produced a report entitled "Collective Investments: Other People's Money"[4]. The report's recommendations formed the basis of the *Managed Investment Act*. A key recommendation of the report supported the temporary RE regime and suggested that the voluntary administration procedure in Pt 5.3A of the *Corporations Law* should be adapted to permit an administrator to be appointed to deal with the affairs of an insolvent scheme and a temporary RE be entitled to appoint the

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[3] "Insolvency of registered managed investment schemes" delivered to the Banking and Financial Services Law Association, Queenstown, New Zealand, July 2008.
[4] Australian Law Reform Commission, *Collective Investments: Other People's Money*, Report No 65 (1993) 14.20

voluntary administrator[5]. In our opinion, this was a sensible suggestion and we would support the adoption of a voluntary administration regime for insolvent schemes.

20. In our view, the temporary RE provisions of the *Corporations Act* should be made more flexible to enable their use to protect the rights of members in financially distressed situations. To ensure that the process can be initiated without the current limitations and in order to ensure that the temporary RE role can be assumed by candidates with confidence, two key changes need to be made:

    - the power of the Court needs to be enhanced to confer broader powers to make appointments and orders to facilitate a more flexible approach to the appointment of a temporary RE, including orders as to fees; and
    - existing responsible entities should be able to be compelled to provide information to a prospective temporary RE to enable the conduct of due diligence. Whilst it is appropriate that this power be conferred by order of the Court, failure to enable an appropriate review is likely to mean that potential candidates will be unwilling to assume the role.

21. We believe that certain protections should be afforded to temporary REs to enable professional, experienced and licensed organisations to assume the role of temporary RE. In particular, temporary REs should have the following protections:

- it is critical that the temporary RE is not exposed personally in the event of a deficiency of the schemes assets to liabilities because of its appointment as temporary RE. The best way to achieve this is to permit a moratorium from the effect of statutory novation of scheme liabilities for a period of time to allow the temporary RE to assess whether a scheme can continue to operate, or should be wound up. Other suggested options are too complex and in some cases may give the temporary RE a discretion which would be unacceptable to commercial lenders, to the extent that it gives the temporary RE an election not to be bound by an obligation if to do so would be in the best interests of members;
- if the proposal to introduce a managed investment scheme voluntary administration regime is accepted, it should be subject to the rights of the temporary RE. Furthermore, during the period of the appointment of the temporary RE only the temporary RE should have the right to initiate a voluntary administration so as to ensure that its role as temporary RE is not subject to being defeated by competing interests;
- sufficient time to analyse the scheme/s the temporary RE takes over. At present the 3 month time frame imposed on temporary REs is too short for a such an assessment;
- the ability to, if the temporary RE considers the scheme assets cannot support the scheme's liabilities, appoint an external administrator to administer the assets and liabilities of the scheme. In such circumstances, it is desirable that the temporary RE has an ongoing role to act in the best interests of the members of the scheme and to monitor the activities of the external

[5] Ibid 8.13

administrator. The temporary RE would have the role of distributing any returns to members of the scheme if a return resulted from the administration; and

- certainty as to fees for the services of the temporary RE in priority to other creditors of the scheme, and in particular unsecured creditors of the scheme.

22. If these circumstances were to be supported by the temporary RE legislative regime, members of schemes affected by insolvent REs would have a higher likelihood of avoiding the devastating effect on their investments because of an insolvent RE. The temporary RE would takeover with certainty, establish whether the scheme had a future and then run the scheme accordingly, or appoint an external administrator if the scheme was insolvent.

23. It is also appropriate that the eligibility to perform the role of temporary RE continues to be limited to public companies authorised by ASIC to operate managed investment schemes. In contrast to the insolvency profession (whose primary focus is to creditors), a RE is accustomed and obliged to act in the best interest of members of managed investment schemes. REs are familiar with the compliance regime of Chapter 5C of the *Corporations Act*, and are able to continue certain necessary activities like following a compliance plan and maintaining a compliance committee. In addition, the temporary nature of the envisaged role is deliberate to ensure that an expeditious determination is made of what is in the best interests of the scheme and its members. Provision is made in the *Corporations Act* that the temporary RE can assume a permanent role and we would suggest that most temporary RE’s would be willing to undertake the temporary role in prospect of being able to continue for the longer term. Permitting a person who could not be authorised to conduct the role of responsible entity in the long term would ensure at the very minimum, significant disruption to the management of the scheme at least twice in a short period.

Section 3: Other issues raised by the CAMAC Discussion Paper

24. In response to certain other matters noted in the CAMAC Discussion Paper we make the following comments:

Identification and recording of the affairs of each MIS (section 3.4.2 of Discussion Paper)

25. In respect of the proposals to require REs to maintain an ongoing register of all relevant agreements, we submit this is an unnecessary codification of an existing obligation that requires REs to operate a managed investment scheme with the degree of care and diligence of a reasonable person (section 601FC(1)(b) of the *Corporations Act*).

26. It seems apparent from the various failed agribusiness managed investment schemes that in the case of such schemes there was usually a myriad of complicated contracts and contractual rights that have proven difficult to reconcile. Distinguishing between the rights of creditors and members of agribusiness schemes has proven to be costly as various interested stakeholders have had to pursue their claims through complex court processes. We submit that these agribusiness scheme examples are a very small subset of the population of managed investment schemes representing only $5 billion of a market worth around $600 billion. Issues in relation to poor record keeping and confusion as to the relevant contractual arrangements appear to be specific to contract-based managed investment schemes which bear little resemblance to ordinary unit trust schemes. To impose additional compliance obligations (relating to maintaining a register of contracts and agreements) on REs of unit trust-based schemes would create a significant compliance burden which is unnecessary. Similar observations apply to the proposal regarding maintaining a comprehensive register of scheme property as set out in section 3.5 of the Discussion Paper.

27. In the absence of evidence that section 601FR of the *Corporations Act* is not appropriately ensuring replacement REs have access to all information necessary to operate a scheme, CAMAC should avoid placing additional technical burdens on REs of unit trust schemes.

Rights of MIS creditors against scheme property (section 3.4.2 – Reform 4)

28. The purpose of these proposed changes is not clear and they are likely to have a significant effect with little or no apparent benefit. It cannot be the case that only persons who have entered into an agreement with the RE as principal in its capacity as the operator of a particular managed investment scheme will be creditors of the managed investment scheme. There are any number of ways a person can become a creditor of the managed investment scheme (see, for example, the discussion of tort liability in section 3.7).

29. The proposal that persons who have contracted with the RE in this capacity will have the right to claim directly against the trust property introduces an entirely novel

concept which in practical terms will have significant ramifications. By way of example, banks taking security over a trust's assets are particularly cautious as to how the trustee's right of indemnity and lien over trust assets will impact on their security, and similarly the trustee is concerned to ensure that the trustee's lien is permitted by the bank so as to not breach any negative pledge contained in the security. The proposal as expressed in the Discussion Paper appears to suggest a right to claim directly against the trust assets. As this claim bypasses the trustee, it cannot be a claim *in personam* but rather a claim *in rem*, because if it were a claim in personam it would be no different in effect to a subrogation claim. The difficulties this would pose for the trustee and others seeking to deal with the trust assets would be significant. It is suggested that the present arrangements would not be enhanced by this proposal.

Tort claims and statutory liability (section 3.7 of Discussion Paper)

30. We do not believe that it is necessary to clarify the circumstances in which an RE should or should not be entitled to obtain an indemnity from the property of the managed investment scheme in consequence of some common law or statutory breach of the RE. The general law principles that govern a trustee's right of indemnity are sufficient to deal with the issues that arise in respect of such matters.

Arrangements between an RE and external parties (section 4.7 of Discussion Paper)

31. An RE should not make any agreement with an external party that is conditional upon that RE remaining as operator of a particular managed investment scheme as such an action is clearly contrary to the best interests of members of the scheme. However given that such an action is contrary to the best interests of members, it could be argued that to do so would already be prohibited by the operation of Chapter 5C which requires the RE to act in the best interests of members.

ASIC power to convene scheme meetings (section 7.1 of Discussion Paper)

32. We see no reason to object to the suggestion that ASIC may call a meeting if it has a compelling reason to do so and reasonably considers that this is in the best interest of members of a scheme.

Cross-Guarantees (section 7.2 of Discussion Paper)

33. We support the position adopted by ASIC in its consultation paper CP 140. It is important that REs are required to be financially robust so that they can do their job. Unfortunately, the GFC demonstrated the harm that can be done when REs fail.

34. Australia's financial services market was designed to have porous barriers to entry. Its designers, members of the Wallis Inquiry (and the Campbell Inquiry before it), believed that policy settings to promote a free market system based on competition would improve efficiency and performance. It no doubt did and Australia's financial economy has prospered since. However, it is within a free market system that risky

commercial ventures can and will fail. In such circumstances it is important that there is a strong, viable RE able to represent the interests of affected investors.

35. Presently, there are a number of issues with the regulatory capital regime for REs. These include:

- capital requirements for REs were set in 1998 and there has been no adjustment for the growth of the value of money since then;
- REs can presently satisfy their capital requirements by relying heavily on associated entities for financial assistance (as was the case with all of the REs within the Allco Group); and
- the market has tended to opt for the most minimal acceptable amount of regulatory capital required, which in many cases means the RE is a $1 company reliant on a financial undertaking from another party.

36. For too long REs have been able to manage billions of dollars without having sufficient capital backing preserved for the benefit of members if the RE experiences financial distress. The Trust Company considers the amendments to the regulatory capital requirements contemplated in CP140 to be an important enhancement to the existing regulation. These suggestions contemplated in CP140 would provide the following benefits:

- REs would need to be of greater financial strength comparable to international counter-parts if they are to act as an RE in Australia. Thus there is more “skin in the game”;
- they provide for a base amount of capital available for the protection of members of a scheme if an RE should fail; and
- they better reflect the intentions of section 912A(1)(d) of the *Corporations Act* which requires AFSL licensees (such as REs) to maintain adequate financial resources.

37. Another aspect of ASIC’s new policy that has caused the funds management industry consternation is the fact that REs will be required to provision capital in respect of other activities they pursue beyond acting as an RE. We think that ASIC is correct on this point. If an RE wanted to engage in non-RE activities, those activities should also be recognised by way of additional capital requirements. Those activities are equally likely to threaten the RE’s ability to discharge its obligations to registered schemes. If an RE ran a proprietary derivatives trading business, and there is no reason why it couldn’t, surely that RE should be required to hold further capital.

38. REs are important to most Australians as fiduciary guardians of their investments and retirement savings. ASIC’s proposals are a step forward in ensuring these entities have a minimal level of financial backing to support their continuing obligations based on risk. There are still many imperfections in how managed funds are governed and regulated, but these new requirements should result in improved circumstances for those investors who entrust their money with other people.

39. In developing these proposals, it will be important to ensure that the provisions of a guarantee by an RE of the obligations of a sub-trust are not prohibited, as such guarantees are often an important component of a funding package and are clearly not to the detriment of members.

Limitation of liability of members of a managed investment scheme (section 7.3 of Discussion Paper)

40. The Trust Company supports a statutory limited liability for scheme members. Whilst most scheme constitutions expressly limit scheme member liability, it is desirable that legislation puts this issue beyond doubt. This would provide more confidence in Australia's capital markets by international standards.

Managed Investment Schemes – Discussion Paper

Property Council of Australia
October , 2011

The Proposed Legislative Reforms

Reform 1—Identification and recording of the affairs of each MIS

Reform 1 proposes that a Responsible Entity (RE) disclose to its counterparties (in any agreements with the RE) the MIS to which the agreement relates. The RE must also record the details of all agreements relating to each MIS in a register which must be made available to any external administrator of that MIS.

The Property Council is not opposed to the introduction of an agreements register. However, this is a minor reform which will have an associated modest cost and impact on the administration of an RE.

In agreements with counterparties, REs invariably already disclose the MIS to which the agreements relate - even if only to include the RE's limitation of liability clause which refers to the specific Managed Investment Scheme (MIS).

To the extent the introduction of the agreements register is intended to assist in the identification of the assets of a specific MIS, we question whether amendments are necessary. An RE is already required (by section 601FC(1)(i) of the *Corporations Act 2001*) to ensure that scheme property is clearly identified as scheme property and held separately from property of the RE and any other MIS.

Requiring disclosure obligations upon outgoing REs and related consequences would be useful. To the extent an agreements register formed part of such a mandatory disclosure package, we support its introduction.

However, consideration needs to be given to additional information that should be disclosed by an outgoing RE to enable a potential new RE to assess the position of the MIS, and whether mandatory disclosure of that information and time frames for disclosure should be introduced.

In answer to the specific questions posed in relation to Reform 1, our views are as follows:

- We do not oppose proposed Reform 1. However, consideration should be given to whether the proposed agreements register should form part of a wider package of disclosure obligations upon a former or outgoing RE.
- The agreements register should not be a definitive statement of all agreements entered into by an RE as operator of a particular MIS.

  This proposal could make the role of a temporary or permanent RE more attractive in that the rights, obligations and liabilities which pass to a new RE would be clearly and definitively identified. However, it could also result in the position of a counterparty being adversely affected in circumstances beyond the counterparty's control. For example, if an RE were to breach the agreements register provisions by failing to register (or keep registered) a counterparty's agreement.

  This could result in the unequal and unfair treatment of counterparties. It would be risky to put the fate of a counterparty's rights at the whim of a register intended to be maintained internally by an RE. Allowing counterparties rights to view and seek amendment to an agreements register is not an acceptable method of protecting a counterparty's rights as it places the onus on the counterparty to ensure the RE has and continues to comply with the legislation.

- We agree that a new RE should have a right to claim against a former RE (or its officers) for loss suffered as a consequence of the former RE failing to properly adhere to any mandatory disclosure requirements that may be adopted, such as an agreements register.

Reform 2—Use of scheme property

Reform 2 proposes that the property of a particular MIS can be used only for the purposes of that MIS.

Our comments on the specific questions posed in relation to Reform 2 follow:

- The policy approach in Reform 2 should not be enacted. As it is currently proposed, there could be unintended consequences. For example, the constitution of some MIS's have a broad investment mandate which would ordinarily permit an RE to lend funds on commercial terms to another MIS operated by the same RE.

  Proposed Reform 2 could prohibit this on the basis the funds are being used for the purpose of the borrower MIS. In some circumstances it may be difficult to identify where the purpose of an MIS ends and another purpose starts.

- It is unlikely sufficient exemptions to Reform 2 could be identified to enable all current legitimate investment practices, permitted under an MIS's constitution, to continue.

Reform 3—Informing MIS creditors of a change of RE

Reform 3 proposes a requirement that a new RE must notify the counterparties listed in the proposed agreements register of its appointment as the new RE.

We do not oppose this requirement as it will require only minor additional administration.

Reform 4—Rights of MIS creditors against scheme property

Reform 4 proposes a fundamental change to the current law in that it is proposed that creditors of an MIS be given a right to directly access the assets of the MIS to satisfy debts owed to it by the RE in relation to that MIS. This contrasts to the present position of the creditor only having access to those assets if the RE first has a right to be indemnified from the MIS assets and the creditor has a right to be subrogated to the RE's indemnity.

We agree that there is a need to balance the rights of creditors with those of the members of an MIS. However, there is no basis for departing from the current position as regards a creditor's rights of recovery.

Proceeding with Reform 4 would blur the existing trust relationship enjoyed by the RE and its members to that similar to a corporation. We see no legitimate reason for the change.

Transfer of a viable MIS

We do not consider the voting threshold to remove an RE requires lowering. The voting threshold was deliberately set at a high threshold due to the consequences of changing an RE.

Changes are required to the Temporary Responsible Entity (TRE) provisions to overcome reticence to take on a replacement RE role caused by the statutory novation of scheme liabilities and obligations. However, the proposal that a TRE can 'cherry pick' which liabilities it inherits is not sound policy. Instead, a moratorium on creditors' recovery rights should be adopted as it will allow an opportunity for necessary due diligence. A reasonable moratorium period can achieve an optimum balance of the rights of creditors to be able to enforce their contractual rights against the rights of scheme investors to be given the opportunity for their scheme to continue under the operation of a new and solvent RE.

The *Corporations Act 2001* should be amended to provide that ASIC be obliged to appoint a TRE to a scheme once the current RE becomes externally administered. The Parliamentary Joint Committee on Corporations and Financial Services into agribusiness managed investment schemes recommended a similar requirement. However, in its report to the Government the Committee incorrectly referred to a scheme becoming insolvent, not the RE.

The *Corporations Act 2001* should also be amended to give ASIC broader power to apply to the court for the appointment of a TRE, including where ASIC believes the appointment is necessary to protect scheme assets or is in the interests of scheme members. Whilst the Corporations Regulations currently give ASIC that power (see regulation 5C.02.2) there is no power for the court to actually appoint a TRE pursuant to that provision.

The potential pool of TREs should not be so large as to extend beyond entities that hold an Australian financial services licence. However, the licence need not authorise the operation of the scheme in question. It can be a licence which authorises the operation of managed investment schemes of any kind, provided the TRE obtains the required authorisation if, and by the time, it becomes the permanent RE.

Restructuring a potentially viable MIS

We support the implementation of a voluntary administration regime to permit an external administrator to be appointed to deal with the affairs of a financially stressed but potentially viable MIS.

Where the current RE of a financially stressed but potentially viable MIS is itself in voluntary administration, it should be a matter for the TRE to appoint an administrator to the MIS (if the TRE had formed the view the scheme could not pay its debts as and when they fell due).

Where an RE is not insolvent, but one of the schemes is in financial difficulty, the existing law enables members to vote out the RE if dissatisfied with its performance. The voluntary administration regime should only apply when both the RE and its scheme(s) is/are in financial difficulty.

ALLITON SECURITIES

Introduction and background

The terms of Reference of the CAMAC review include the following:

1. examine whether the current statutory framework is adequate for the winding up of MIS, and agribusinesses in particular, and whether it provides the necessary guidance for liquidators, creditors, investors and growers;

2. advise what legislative amendments should be made if the current legislative framework does not provide the necessary legislative tools with respect to the arrangements for dealing with non-viable MIS;

3. examine whether the current temporary RE framework enables the transfer of viable MIS businesses where the original RE is under financial stress, and if not whether it should be reformed or replaced;

4. examine whether REs are unable to restructure a financially viable MIS and advise if the current legislative methods available to companies under the Corporations Act should be adapted to managed schemes; and

5. examine other proposals to improve Chapter 5C, including in relation to: convening scheme meetings; cross-guarantees entered into by REs on behalf of other group members; and statutory limited liability.

The focus of this submission will be dealing with matters under Terms of Reference number 5 as it is the Author's view that effective action to improve Chapter 5C and appropriately applying existing provisions of the managed Investments Act 1988 would minimise the likelihood of events occurring that would warrant action under Terms of Reference 1- 4. However, in this submission CAMAC will find comment and recommendations on each of the above Terms of Reference.

Overview

From the outset the Author wished to express his extreme disappointment that the events that led to the collapse of agri-MIS companies, Timbercorp, Great Southern, the Rewards Group, Willmott Forests and FEA were allowed to manifest themselves to the point where all of the above companies have gone into receivership with the likely loss of many billions of dollars of share holder and investor value.

While there was and potentially still remains, fundamental structural and operational flaws in the business model of agri-MIS the reality now is that the damage has been done, with investor confidence shattered to the point that it is difficult to see in the foreseeable future any growth in the agri-MIS sector and quite possibly further contraction to the point where there will only be 'niche' operators left. To understand why this is the case it is important to examine the key aspects of how agri-MIS companies operated their business models and the 'design flaws' inherent in these models including:

- the parent entity looking to utilise available funds raised from investor's initial and where relevant, on going contributions, as a source of cash flow to meet it's own operational requirements (including funding debt commitments) and short – medium term corporate growth plans

- investor's being exposed to the 'corporate risks' of the parent entity, as opposed to the corporate risks of the Responsible Entity established to manage their project and the management and agricultural risks associated with operating the project to which they invested

- non – disclosure to investors of the inherent corporate risks associated with the business model that allows the parent entity to access available investor funds held by the RE for purposes other than for supporting the establishment and management of their project (**as described in the Scheme Constitution and intended within the operations of the Managed Investments Act 2008)**

- the ability of secured creditors to obtain cross guarantees that effectively secure funds and/or property that has been funded and developed through investor contributions, with investors having little or no rights to a return from any subsequent sale of such property by receivers or liquidators
  (note: investor contributions by law, were meant to be held in trust – this would have prevented the banks from using scheme funds as cross guarantees or in the event of a receivership the receivers using scheme property to the benefit of the secured creditors).

The following table illustrate one of the major cash flow problems in the Agri-MIS business model operated by the MIS companies. The figures presented are based on the cash flow requirements, inputs and outputs on a per hectare basis for managing a blue gum forestry estate:

What investor contribution represents	**Cash Per hectare**	**Taxable position of Parent Entity per hectare**	**What contribution represents**
initial 'up-front' contribution provided by investors	+ $9,000	+$9,000	gross income - from investor contribution
How the Upfront Investor Contribution is accounted for by the Parent Entity			
Expenditure by the RE in overheads (initial planting & establishment (yr 1)	- $2,000	- $2,000	overheads yr 1 – fully tax deductible
Contribution to land acquisition (capital expense)	- $2,000		Not a tax deductible expense
Management Reserve Fund (MRF) proportion of investors initial upfront contribution that was put aside for use in subsequent years of the project (typically yrs 2-3)	-$2,000		Treated as income to the Parent Entity for tax purposes
Cash balance (ie Initial Investor Contribution less: • overheads • land acquisition • MRF	+$3,000	+$7,000	

What contribution represents	**Cash Per hectare**	**Taxable position of company per hectare**	**What contribution represents**
initial 'up-front' contribution of investors	+ $9,000	+$9,000	gross income- from investor contribution
How the Upfront Investor Contribution is accounted for by the Parent Entity			
Expenditure in overheads (initial planting & establishment (yr 1)	- $2,000	- $2,000	overheads yr 1 – fully tax deductible
land acquisition (capital expense)	- $2,000		Not a tax deductible expense to the parent company
Management Reserve Fund (MRF) proportion of investors initial upfront contribution that was put aside for use in subsequent years of the project (typically yrs 2-3)	-$2,000		Treated as income to the Parent Entity for tax purposes
Cash balance (ie Initial Investor Contribution less: • overheads • land acquisition • MRF	+$3,000	+$7,000	
Assessable income for tax purposes	+7,000	+$7,000	
Tax paid at 30%	-$2,100	-$2,100	
Less cash outlays: - operational expenditure (overheads) - capital expenditure (land acquisition or contingency for future lease payments) - MRF (funds held in trust for Project benefit and not available to Parent Entity)	-$2,000 -$2,000 -$2,000	Covered in net income -$2,000 No MRF	
balance of cash available to **Parent Entity** from initial 'up – front' investor contribution (ie 'free cash flow')	+$900	+$2,900	

By way of example, Great Southern Limited's earlier Blue Gum projects established a Maintenance Reserve Fund (MRF) which retained in trust, a proportion of investor's upfront contributions (ie $9,000/hectare), which would be allocated to future expenditure in the relevant project as and when the need arose. The problem with the establishment of the MRF in its present form is 2 fold namely:

i. contributions to the MRF were treated as 'income' under the Tax Act in the company returns for Great Southern limited, therefore it was required to pay 30% of the MRF in tax when submitting its corporate tax return

ii. funds inside the MRF were effectively quarantined so despite having a tax liability of the balance of funds held in the MRF, Great Southern would not have had access to this cash to pay the tax liability.

Based on the figures in the previous table, Great Southern was faced with the following scenarios

- establish an MRF (which protected a proportion of the investor's contributions)

- pay company tax on the MRF and net taxable income ($9,000 less $2,000 spent on establishing trees). Note that expenditure on acquiring land is a capital expense and not deductible to the company

- have only $900/hectare 'free cash flow' from the original $9,000/hectare investor contribution after paying tax, allocating funds into the MRF and payment for land acquisition or future lease payment obligations

- not establish an MRF, pay a higher tax liability on the net taxable income/hectare but have access to more free cash flow ($2,900/hectare in the example in the table).

Establishment of a Maintenance Reserve Fund to protect Investor contributions and support cash flow requirements

Based on the above scenarios it is in some ways easy to understand why companies like Great Southern abandoned the concept of establishing the MRF, even though it offered a layer of protect for investors (particularly in the event of a receivership), as it had a negative impact on the parent company's own cash flow requirements.

The MRF should be a trust account, with the RE appointed as trustees to manage the disbursement of funds according to the requirements of the Scheme Constitution (ie to establish and maintain the farm operations of the relevant project)

Having said that, the Author's view is that a combination of:

- **<u>amendments to the Tax Act to treat the MRF in the same way Farm Management Deposits are treated</u> (ie tax deductible until they are withdrawn)**

- creation of a number of income producing 'company owned' agri –project resources'

- modest debt levels and

- a more judicious approach to its medium to longer term expansion program

would ensure sufficient cash flow to meet the corporate obligations and business objectives of Agri-MIS companies without risking the viability of projects or requiring the banks to call in receivers.

While the parent entities that established agri-MIS projects contributed to their own downfall because of their over dependence of investor contributions to support cash flow, Federal Governments and the regulators (ATO and ASIC) should share some of the responsibility for their inaction and carelessness in contributing to the cash flow pressures that preceded the corporate collapses of Timbercorp, Great Southern, the Rewards Group, Willmott Forests and FEA.

On 21 December 2006 the then Minister for Revenue announced that the Australian Taxation Office ('the ATO') would no longer issue product rulings for investments in agribusiness managed investment schemes. Subsequent to this announcement the ATO sought to run a test case in the Federal Court where it presented arguments that investors in non- forestry MIS projects were not entitled to tax deductions for their upfront or ongoing contributions.

While it is a matter for the public record that the Court unanimously disagreed with the ATO and allowed tax deductions to be claimed for non-forestry projects, the uncertainty at the time surrounding agri-MIS led to the following commercial outcomes:

- MIS sales plummeted to unsustainable levels as investors and their advisers shied away from investing in agri-MIS while future tax deductibility was in question. While the Courts decision allowed subsequent projects to be issued with product rulings, the decline in interest in MIS that followed the decline in investor confidence had a major negative impact on the cash flow of agri-MIS companies

- publicly listed agri- MIS companies saw their share price drop sharply on the Australian Stock Exchange.

These circumstances resulted in the Agri-MIS companies entering into the period of the Global Financial Crisis is a considerably weakened condition, coupled with unsympathetic banks [1] , which contributed to the inevitable collapse of these companies, with tragic economic consequences for shareholders and investors alike [2].

In addition, it is submitted that ASIC, as corporate regulator, should have been aware of the structural and management shortcomings of many of the MIS projects, particularly as it has the power under the Managed Investments Act 1988 to ensure investor contributions were only available for the purposes in which they were provided by the investor, that is, to support the establishment and operation of the investor's project.

1. The Author's view is that the Australian banks that lent money to the agri-MIS companies should have been more supportive of these companies through the GFC instead of calling in receiver managers. The active support the Federal Government gave these same banks through the GFC both in terms of providing the Bank Guarantee and its public support of the banks is an example of how industry, Government and the community appropriately worked together to support a sector and prevent the erosion of significant economic value in the Australian economy.

2 The scale and magnitude of the economic losses forgone following the collapse of Timbercorp, Great Southern, Rewards Group, Willmott Forest and FEA would run into billions of dollars.

The loss to the Federal Government in terms of tax revenue foregone from future gross harvest proceeds is estimated to be in the order of $1 billion (ie 70,000 investors with an average initial investment contribution of $40,000; assuming net harvest return over the life of a project to be 3 times initial contribution, taxed at 30% and after factoring in some recovery of plantation income from the replacement of GSMAL by Gunns Plantation).

The net investor economic loss (after deducting tax that would otherwise have been 'paid' and factoring in some recovery of plantation income from the replacement of GSMAL by Gunns Plantation) would be in the order of $4 Billion.

The economic losses experienced by shareholders and note holders is more difficult to estimate, but based on reasonable market value estimates of assets owned collectively by Timbercorp, Great Southern, Rewards Group, Willmott Forest and FEA the erosion of shareholder value would be in the order of $2 billion.

The Managed Investment Act 1988 (MIA 1988) sets out the rights and obligations of the investors/growers and the duties of the RE, which are governed by the constitution of the MIS ('Constitution') and the Corporations Act. The Constitution must also be lodged with ASIC.

It also identifies a specific audit role for ASIC.

It is submitted that the current operations of the MIA 1988 already provide a legislative framework and discipline to ensure that investor contributions under the custodianship and/or management of the Responsible Entity (RE) are not placed at risk where the parent company is experiencing cash flow problems and/or seeks to use investor contributions to enter into 'cross collateral' arrangements with its financiers to secure its own short or long term funding requirements.

The following is an extract of the MIA1988 (emphasis added):

The constitution of the MIS

The rights and obligations of the investors/growers and the duties of the RE are governed by the constitution of the MIS ('Constitution') and the Corporations Act. The Constitution must be lodged with **ASIC.**

The Constitution must state the following:

(a) the consideration required to be paid by an investor to acquire an interest in the MIS project;

(b) the power of the RE to make investments and dealing with MIS property;

(c) how complaints of investors/growers may be dealt with; and

(d) the process for winding up the scheme.

In addition the Constitution will provide that the MIS property will be held **on trust** for the benefit of the investor and, if required, will state whether the investment funds are held by the RE or a Custodian.

The Author submits that where the MIA 1988 requires the RE to hold MIS property on trust that this includes investor contributions. Attached to this report is a copy of the scheme Constitution for the Great Southern Plantations 2004 project. The following definition and terms are described under 'Application Fund':

"**Application Fund** means in relation to the Project the application fund formed under this Constitution and includes (a) "the sum paid into the relevant **trust** bank account by the Responsible Entity pursuant to clause 3.3 (b)" (emphasis added).

It is the Author's view that the RE and in fact the parent company (given that in the case of Timbercorp, Great Southern, The Rewards Group, Willmott Forests and FEA the RE was established by the parent company), were bound by the law under the MIA 1988 **not** to use investor funds for purposes other than to support the project within which the investor sought to invest.

The fact that this was not revealed to investors at any stage prior to or subsequent to investing is in the Author's view a major breach of the requirements of the RE under the MIA 1998 and a major breach of non disclosure under the Corporations Act and as required by ASIC under the terms of a PDS and subsequently, through the regulatory regime that exists in the provision of giving financial advice (as agri-MIS is in effect a financial 'product').

It is also hard to understand how, if an RE is bound by the terms of its Scheme Constitution and governed by the requirements stipulated in an Act of Parliament that MIS investors found themselves in a situation where their contributions to scheme projects become the property of receiver managers (and ultimately the banks where cross guarantees were provided by the parent company that owned the RE) **when the funds were meant to be held in trust.** Under trust law the appointor has the ultimate control of the trust but in practice it is the trustee that decides how and when funds are allocated, according to the terms of the trust deed. Ordinarily, under the arrangements intended within the MIA 1988 and Scheme Constitutions under trust law principles, one would expect that investor funds are under the control of the trustee (eg the RE) and not accessible to any other party nor can effective control be handed over to a receiver.

Duties and responsibilities of the Responsible Entity

I refer CAMAC to the following sections of the MIA 1998 (emphasis added):

601FC Duties of responsible entity

(1) In exercising its powers and carrying out its duties, the responsible entity of a registered scheme must:

(a) act honestly; and

(b) exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position; and

(c) act in the best interests of the members and**, if there is a conflict** between the members' interests and its own interests, **give priority to the members' interests**; and

(d) treat the members who hold interests of the same class equally and members who hold interests of different classes fairly; and

(e) not make use of information acquired through being the responsible entity in order to:

(i) gain an improper advantage for itself or another person; or

(ii) cause detriment to the members of the scheme; and

(f) ensure that the scheme's constitution meets the requirements of sections 601GA and 601GB; and

(g) ensure that the scheme's compliance plan meets the requirements of section 601HA; and

(h) comply with the scheme's compliance plan; and

(i) ensure that scheme property is:

(i) clearly identified as scheme property; and

(ii) held separately from property of the responsible entity and property of any other scheme; and

(j) ensure that the scheme property is valued at regular intervals appropriate to the nature of the property; and

(k) ensure that all payments out of the scheme property are made in accordance with the scheme's constitution and this Law; and

(l) report to the ASC any breach of this Law that:

(i) relates to the scheme; and

(ii) has had, or is likely to have, a materially adverse effect on the interests of members;

as soon as practicable after it becomes aware of the breach; and

(m) carry out or comply with any other duty, not inconsistent with this Law, that is conferred on the responsible entity by the scheme's constitution.

Note: Subsection (1) is a civil penalty provision as defined by section 1317DA and Part 9.4B provides for civil and criminal consequences of contravening it.

(2) The responsible entity holds scheme property **on trust** for scheme members.

Note: Under subsection 601FB(2), the responsible entity may appoint an agent to hold scheme property separately from other property.

(3) A duty of the responsible entity under subsection (1) or (2) overrides any conflicting duty an officer or employee of the responsible entity has under section 232.

Investment of scheme property in other managed investment schemes

(4) The responsible entity may only invest scheme property, or keep scheme property invested, in another managed investment scheme if that other scheme is registered under this Chapter.

Clause 1 (c) in my view would always be breached in situations where a receiver manager also assumes the role of the RE. While Receiver Managers have stated to investors that they are aware of the potential conflict of interest and would manage this conflict appropriately, the reality is that they are appointed by their secured creditors and not by the investors. **Investors would always be in a perpetual 'tug of war' with the receivers over who owns what funds, how, where and why they should be spent and the ultimate beneficiary of such expenditure and who are the beneficiaries of the sale of scheme assets where such assets are sold before the due termination date of the project.** Faced with the choice of nominating whether to spend available funds to keep a project viable or to reduce outstanding debt liabilities owed to secured creditors it is not hard to see which way a receiver manager would turn. How does or should a receiver manager reconcile that with Clause 1 (c)?

It should be pointed out that this would be less of an issue if as the MIA 1998 states, investor contributions were held in a trust account.

In addition, the Corporations Act should be amended to prevent a receiver manager from automatically assuming the dual role of RE and receiver manager in control of scheme assets and to protect the integrity and accountability of the continuing management of scheme property and allocation of funds that may be available to continue projects until alternative commercial arrangements can be established and enacted.

ASIC Powers – it's duties and responsibilities

The question must be asked of the regulator, ASIC, as to how, if it has the power to review or audit what the RE is doing, was it unaware that there may have been MIS projects established where investor contributions were not held in trust? (eg simply being held in a bank account).

To quote a report from the Timbercorp Receivers, KordaMentha, dated 28 September 2010:

" each scheme had separate financial budgets however as the funding was provided via a central bank account these budgets were not always adhered to"... " The use of fees and expenses collected in relation to one Scheme to fund the operations of another inevitably resulted in the original funds not being used for the purpose for which they were originally raised".

I refer CAMAC to the following extract of the MIA 1988:

601FF Surveillance checks by ASC

(1) The ASC may, from time to time, check whether the responsible entity of a registered scheme is complying with the scheme's constitution and compliance plan and with this Law.

Note: For this purpose the ASC may exercise the powers set out in Division 3 of Part 3 of the *Australian Securities Commission Act 1989*.

(2) The responsible entity and its officers must take all reasonable steps to assist the ASC in carrying out a check under subsection (1).

Clearly, ASIC has existing powers, indeed it was its current duty, to check that the RE had established the scheme in accordance to the provisions of the MIA 1998 and the relevant Scheme Constitution (which is submitted to ASIC). I submit that had ASIC done its job in this regard, it would have discovered that most of the arrangements for protecting investor contributions were in breach of the Act and the very Scheme Constitutions to which REs were bound, that is:

- **investor funds were not held in trust and therefore exposed investors to risks that were neither disclosed to the Investors, nor permitted at law**

  and

- **the Scheme Constitution does not allow for Scheme contributions to be used to support other projects or indeed the cash flow shortcomings of the parent entity.**

In August 2010 a Senate Select Committee reporting on its inquiry into food production in Australia examined Managed Investment Schemes. On page 38 of the Committee's final report the then Commissioner, now Chairman of ASIC Greg Medcraft reportedly stated to the Inquiry the following:

"...the Corporations Act regime is premised on an economic philosophy that markets drive efficiencies and markets operate most efficiently when there is a minimum of regulatory intervention, hence the regime administered by ASIC is designed to promote market integrity and consumer protection solely through the conduct and disclosure regulation. Of course, conduct and disclosure regulation does not involve any guarantee that regulated products and institutions will not fail and that promises made to retail investors will be met.

ASIC informed the Committee that it is the responsibility of the regulator to ensure that an MIS constitution and compliance plan meets the requirements of the Corporations Act, and that disclosure material is not misleading or deceptive. It is then for investors to make their own judgment about the MIS business model and likely performance of the investment. Not being a prudential regulator, ASIC stated that it can have a limited preventative role.

"Inevitably, ASIC come in after a collapse has occurred. We are there as an oversight body to see the law is complied with and, as such, we will often arrive at the scene of the accident—that is, after the accident has occurred and to see who caused it. Our powers are limited to act ahead of time. For example, we do not have power to regulate capital adequacy or to prohibit certain business models." Mr Medcaft stated to the Inquiry.

The Author submits that ASIC <u>does</u> have a role to prevent 'the car crash from happening' and while he agrees that it is not ASIC's role to try and shield investors and shareholders from the outcome of business and/ or investment decisions of corporations, clearly in the case of Managed Investment Schemes ASIC does have a direct role to enforce the compliance requirements of RE's as defined by the relevant legislation and regulations to which ASIC itself is meant to administer.

Had it done the job that it was meant to do under section 601FF of the MIA 1998, ASIC would have discovered that investor contributions were not being held in trust and taken the appropriate steps to ensure that investors were not left vulnerable to misappropriation or misuse of their contributions for purposes other than for the establishment and ongoing operation of the relevant MIS project. Further, such action would have eliminated any legal argument of the banks or receivers laying claims to ownership of any outstanding funds held in bank accounts by the RE or any of it's operating subsidiaries at the time of appointment of the receiver.

One need look no further than the debacle that has unfolded in the agri-MIS receiverships involving Timbercorp, Great Southern, the Rewards Group, Willmott Forests and FEA and the myriad of court proceedings that have ensued, resulting in little to no recovery for investors of the balance of any of their investment contributions or any value from the sale of the <u>very assets that these funds helped create</u> (such as olive trees, vines, supply contracts etc).

It is obscene that investors were being exposed to a corporate risk of the parent company and that this was neither adequately disclosed or more to the point, **through poorly structured commercial and operational arrangements between the parent company and its RE was allowed to manifest itself** to the extent that the corporate shortcomings of the parent had a devastating financial impact on the operations of the RE. In my view, most Agri-MIS projects would otherwise have remained viable had investors (ie their investment contributions to projects) been 'quarantined' from these corporate risks of the parent.

Amendments to legislation viz a viz investors' rights under the Corporations Act and Managed Investments Act 1988

Notwithstanding the Author's genuine desire to see appropriate legislative changes to correct the significant shortcomings of the Corporations Act with respect to the rights of investors in MIS projects compared with the rights and powers of secured creditors, one can't help but feel that corrective action is somewhat 'too little too late.

In the Author's view it is an indictment on the Federal Parliament that it sat back and did nothing to protect the interest of MIS investors while secured creditors were able to use their rights under a receivership to effectively procure assets and benefit solely from the disposal of the assets that MIS investors helped to create.

Given the environment within which this occurred (tax uncertainty driven by the ATO, the impact of the GFC and unwillingness of the regulator and politicians to step in to assist investors to minimise their losses or help them resurrect projects) one can't help but feel that the Parliament was never genuine about looking after the interests of investors.

To close the stable door after the horse has bolted is of little comfort to the tens of thousands of investors, shareholders and note holders of Timbercorp, Great Southern, Rewards Group, Willmott Forest and FEA or the other casualty of the collapse of MIS, the employees of these companies, who collectively are owed many millions of dollars in entitlements.

The following extract from Wilmott Forests Administrators Q&A circular to growers (MIS Investors) dated 24 Nov 2010 highlights that investors in a receivership or under administration have no clear, defined status:

"Are grower investors considered creditors of the Willmott Group?

This is a legal question which needs to be determined on the facts of each case. In certain circumstances grower investors may be entitled to claim as an unsecured creditor. At this stage the Administrators have not made any determination as to whether growers are creditors."

Clearly the mechanics of the Corporations Act in its current form and the regulatory regime that is the domain of receiver managers is inappropriate for dealing with the ongoing management of MIS projects placed in administration or receivership**. Investors rights should not sit secondary to those of secured creditors, particularly as <u>the sum total of investor contributions to projects would in all cases be far greater than the loans provided by financiers</u> (remembering that in practice these contributions also supported the cash flow of the parent entity that was placed in receivership).**

The problem with allowing receivers to take control over agricultural assets is that unlike other types of assets, such as factories, buildings, equipment or vehicles, to <u>reduce or cease all together expenditure on biological assets immediately reduces their value</u>, which in turn minimises the asset's resale value and forces the receivers to sell more assets than otherwise may be necessary, to retire debt owed to secured creditors.

In addition, this has a compounding effect in that the overall value of the enterprise as a going concern is compromised, as invariably receivers will look to those assets that they can sell quickly to retire as much of the debt as possible rather than to manage income generated from the ongoing use of the assets or sale of assets to meet the original loan repayment arrangements entered into by the parent company and its financiers.

The Author submits that at least one MIS company, Great Southern Ltd, had ownership of sufficient MIS assets, non MIS assets and value created in its supply contracts that had it been given sufficient time to manage its way as a going concern <u>under administration</u> the company would not have collapsed and at least some investor and shareholder value would have been retained. The date Great Southern Ltd appointed administrators was 16 May 2009. On 18 May 2009 (a mere 2 days later), the secured creditors appointed the receivers; hardly time for the administrators to take effective control of the business to make this assessment in the <u>best interests of the shareholders, investors and employees.</u>

The Author's view is that it is a bit rich of the banks to have lost patience with Agri-MIS companies regarding their ability or plans to retire debt through assets sales at a time when the company was also in the middle of the GFC and as stated earlier, experiencing a decline in sales of MIS which in part were driven by circumstances that were not of its making. One does wonder where our banks would be now if the Federal Treasurer had lost patience with them over their involvement in the GFC and decided not to assist them through the provision of the bank guarantee.

It is a feature of the operations of the Corporations Act that when a company goes into receivership the receivers have no obligation to shareholders or investors – their obligation is to the secured creditors and as in the case of Great Southern, any previous contractual arrangements with its financiers can be ignored so that outstanding debt can be paid pack ahead of pre arranged repayment schedules. In addition, any plans the parent entity has to repay debt can be scuttled if the secured creditors decide to call in the receivers.

This above point can be highlighted from examination of the following statement which appeared in the 2008 Annual Report of Great Southern:

Liquidity, Funding and Capital Management
In November 2008 the Group drew down $30,000,000 in corporate bank debt for cash flow management purposes bringing the total amount of club bank corporate borrowings to $380 million at the date of this report. This facility contains representations and warranties, financial covenants, undertakings and other terms and conditions customarily found in financing agreements of this kind. The main financial covenant is the ratio of senior (excludes TREES and structured finance debt) debt to specified operating cash flow (as defined) which is measured at the March half-year and the September full year. The ability of the Group to operate within this covenant is dependant upon the generation of operating cash flow, primarily achieved from MIS sales; or from the reduction in senior debt, primarily achieved from asset sales. The Group expects to operate within this covenant at the next measurement date (31 March 2009) however as detailed in note 1(b) of the financial statements there is currently some uncertainty over a number of matters that could impact this covenant calculation, including for example the level of future MIS sales.

Of the total amount outstanding, $105,000,000 ***is <u>due for repayment or refinancing in October 2009</u>.(emphasis added)*** *The ability of the Group to refinance this debt is uncertain at this time given the ongoing credit market volatility and the uncertain outlook for 2009 MIS sales. If refinancing is not forthcoming then the Group expects that a level of asset sales, including cattle business assets should the scheme proposals relating to the two cattle projects be successful, will be required in 2009 with the proceeds used in part or whole to repay corporate bank.*

Author's note: The Receivers to Great Southern were appointed on 18 May 2009.

Further, the appointment of receivers triggered a sequence of events that contributed to the immediate loss of economic value (eg supply contracts being extinguished).

The Author's recent experience as a member of the Creditors' Committee of Great Southern established by the administrators appointed by Great Southern and the dealings and activities of the receivers appointed by the banks highlights a number of problems with the Corporations Act with respect to the appointment of administrators and the subsequent appointment of receivers:

- a lack of transparency as to how MIS assets are being managed by receivers, what funds if any are being spent to maintain projects and how decisions are made as to whether to support ongoing projects

- how non MIS assets are managed and the desire of receivers to sell these assets off to retire debt when they may be integral to the value of the overall business as a going concern

- the incorrect assumption that these are incompatible or mutually exclusive events

- the inherent conflict of interest that existed between the Receivers acting as an RE (in the best interest of investors) and acting in their role as receiver for the secured creditors (acting in the best interests of the banks)

- that the Act itself allows receivers to behave differently to that of existing directors of the company where the proceeds of the disposal of an asset are used solely to retire debt and not apportioned to ensure that sufficient funds are provided to also help maintain agri MIS projects

- the fact that the relationship between the parent company and the RE prior to the appointment of a receiver was such that the parent company would have attempted to secure funding from its own sources (other than external finance) to allow the RE to continue to support investor projects. That relationship and understanding was effectively broken the day receivers are appointed.

While Agri MIS projects are 'stand alone' businesses the reality is that there is often a sharing of resources (land, labour and capital) that applies across projects and to isolate the projects in a receivership in terms of what is 'viable' ignores the reality of the business model. In the Author's view, the pressure and demands that would be placed on a receivership allows no room to entertain this concept and that an appropriate legislative fix is the only effective redress.

The Author recommends that CAMAC refer to the principles under Chapter 11 of the United States Bankruptcy Code to develop amendments to the Corporations Act to ensure that when companies such as those that operate agri- MIS get into difficulties that rather than 'destroy' shareholder and investor value, which the current receiverships involving Timbercorp and Great Southern have done, that Australia establishes a legislative framework that seeks to help these companies trade out of their problems without favouring secured creditors over unsecured creditors, or ignoring the rights of secured creditors and investors in agri-projects.

The US system works very well and is a good model – far better than the disastrous outcomes that shareholders and investors have found with Timbercorp and Great Southern (and I fear, soon to replicate itself with the remaining agri business in receivership). It is not too late to protect the interests of these investors if the Federal Government is serious about common sense policy with respect to the much need reforms in this area to the Corporations Act.

With due acknowledgment to Wikipedia, the following is an summary of the key features of Chapter 11 of the US Bankruptcy Act:

"When a business is unable to service its debt or pay its creditors, the business or its creditors can file with a federal bankruptcy court for protection under either Chapter 7 or Chapter 11.

In Chapter 7, the business ceases operations, a trustee sells all of its assets, and then distributes the proceeds to its creditors. Any residual amount is returned to the owners of the company. In Chapter 11, in most instances the debtor remains in control of its business operations as a *debtor in possession*, and is subject to the oversight and jurisdiction of the court.

The chapter 11 plan

Chapter 11 usually results in reorganization of the debtor's business or personal assets and debts, but can also be used as a mechanism for liquidation. Debtors may "emerge" from a Chapter 11 bankruptcy within a few months or within several years, depending on the size and complexity of the bankruptcy. The Bankruptcy Code accomplishes this objective through the use of a bankruptcy plan. With some exceptions, the plan may be proposed by any party in interest. Interested creditors then vote for a plan.

Confirmation

If the judge approves the reorganization plan and if the creditors all agree the plan can be confirmed. If at least one class of creditors votes against the plan and thus objects, the plan may nonetheless be confirmed if the requirements of cramdown are met (a cramdown is the involuntary imposition by a court of a reorganization plan over the objection of some classes of creditors). In order to be confirmed over their objection the plan must not discriminate against that class of creditors and the plan is fair and equitable to that class.

Upon its confirmation, the plan becomes binding and identifies the treatment of debts and operations of the business for the duration of the plan.

Debtors in Chapter 11 have the exclusive right to propose a plan of reorganization for a period of time (in most cases 120 days). After that time has elapsed, creditors may also propose plans. Plans must satisfy a number of criteria in order to be 'confirmed' by the bankruptcy court. Among other things, creditors must vote to approve the plan of reorganization. If a plan cannot be confirmed, the court may either convert the case to a liquidation under Chapter 7, or, if in the best interests of the creditors and the estate, the case may be dismissed resulting in a return to the status quo before bankruptcy. If the case is dismissed, creditors will look to non-bankruptcy law in order to satisfy their claims".

The Author would be please to discuss this submission in detail with members of CAMAC or any subsequent inquiries as required.

Yours sincerely

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7 October 2011

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

By Email Only

Email: john.kluver@camac.gov.au

By Post and Email

Dear Sir/Madam

FINANCIAL SERVICES COUNCIL SUBMISSION TO CAMAC - *MANAGED INVESTMENT SCHEMES* DISCUSSION PAPER

The Financial Services Council ("**FSC**") represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 128 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalization of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC thanks CAMAC for the opportunity, and extension of time, to comment on the CAMAC *Managed Investment Schemes Discussion Paper* (June 2011) (the "**CAMAC Paper**").

Executive Summary

The FSC does not believe that the collapse, during the Global Financial Crisis ("**GFC**"), of some managed investment schemes ("**MIS**" or "**scheme**") and their responsible entities ("**RE**") is attributable to any material failure in the regulation of managed investment schemes under Chapter 5C of the *Corporations Act 2001* (Cth) ("**Corporations Act**"). Rather, the predominant cause of scheme failures during the GFC was the use of certain business models found wanting during the GFC (such as certain highly leveraged models and/or business models reliant on continually rising asset prices).

The FSC believes that Chapter 5C has and does operate as an effective regulatory regime, and withstood the test of the pressures of the recent GFC. By way of example, generally the provisions of Part 5C.6 served their purpose to protect investors during enormous market volatility, by providing a framework of managed withdrawal offers without the necessity for "fire sales" of assets.

While we think there is room for improvement in the MIS regime (as for any significant legislative regime in place for more than a decade), we do not believe there is any evidence to support the requirement for wholesale reform of the MIS regulatory regime.

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Regulation of MISs includes:

- an approval process in respect of both the licensing of responsible entities and the registration of managed investment schemes;
- financial resource requirements (including capital and cash flow requirements, which are proposed to be further enhanced by ASIC[1]); and
- compensation requirements (generally held in the form of PI insurance cover)[2].

We believe that Australia continues to have an enviable financial services regulatory regime and track record.

Our submission outlines a number of areas where we believe there is room for improvement to ensure that Australia's regulation of collective investments continues to be highly regarded internationally. The CAMAC Paper is understandably heavily insolvency focussed (given the terms of reference to CAMAC) and distinguishes between trust-based MIS and contract-based MIS. Among FSC members, trust-based MIS are the pre-dominant MIS structure. Hence this submission focusses on trust-based MIS. While this submission responds to some (but not all) specific questions in the CAMAC Paper, it also provides recommendations in relation to some aspects of the regulation of MIS generally (as invited by CAMAC on pages 6 and 117 of the CAMAC Paper, which invited comments related to the regulation of MIS generally). This submission does not purport to be a comprehensive review of all aspects of MIS.

The application of trust law principles[3] for trust-based MIS is very well established, understood and accepted as a matter of market practice, where RE creditors engaging with a trustee (such as an RE) look to the trustee's right of indemnity as the route to access trust assets. Unsecured creditors have rights and choices (it is not correct to suggest they do not have rights). Unsecured creditors have a right to be subrogated to the RE/trustee's right of indemnity, and to the extent of this subrogation right, unsecured creditors rank ahead of members. Creditors generally also have the choice to consider instead becoming a secured creditor if they wish to seek a direct proprietary interest in trust/MIS assets. We point out that an RE/trustee is not an agent for members (so unlikely agency, it is the trustee with whom the creditor contracts, not the members of the MIS)[4].

We agree it is important to have an orderly wind-up of an insolvent scheme or an orderly transition where the RE becomes insolvent. We also acknowledge that while insolvency

[1] See ASIC Consultation Paper 140 *Responsible entities: Financial requirements* (September 2010).

[2] As part of the Government's Future of Financial Advice reforms, the compensation arrangements are currently subject to review. FSC has made a submission (June 2011) to the consultation paper *Review of compensation arrangements for consumers of financial services – Consultation Paper by Richard St. John (April 2011).* FSC would be pleased to provide CAMAC with a copy of FSC's submission on request.

[3] The trust law principles are also reflected in section 601FC(2). Section 601FC(2) applies to all registered MIS, that is, trust-based MIS and contract-based MIS. We do not discuss the application of section 601FC(2) to contract-based MIS as there may be factual complexity in respect of some contract-based MIS as to those aspects of the scheme constituting scheme property (as opposed to a collateral contract notionally outside the scheme). In trust-based schemes, the property the subject of the trust and MIS is clearly identified and identifiable in practice.

[4] This submission does not discuss the complexities with some contract based-MIS where there may be factual and practical complexity in ascertaining what is scheme property (held on trust, by virtue of section 601FC(2) if nothing else) and what is not part of scheme property but a collateral arrangement to which the member (not in the capacity as an MIS member) is subject (perhaps as principal for which another party is agent).

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principles applicable to companies are subject to a well established legislative regime, the winding up of *insolvent* REs and/or "*insolvent*"[5] MIS involve a complex interplay of Chapter 5C of the Corporations Act, company law and trust law, and that the Corporations Act does not have a tailored insolvency regime accommodating these complexities. However, any consideration of tailoring an insolvency regime applicable to companies (being companies which do not also act as an RE/trustee) to MIS requires very thorough and careful consideration so as to ensure established and well understood trust law principles are not supplanted and that the protection to members of trust-based MIS are not sub-ordinated by any MIS tailored insolvency regime compared to the current position.

Also, any change to the legislative regime needs to be justified from a cost-benefit analysis, and for the reasons set out in this submission, we consider that the burden imposed by some of the proposed changes for consideration set out in the CAMAC Paper would be disproportionate to the regulatory benefit received. Moreover, if the Parliament is considering significant regulatory reform to the existing MIS regime, we believe that there are issues such as product rationalisation, which have a more significant effect on the industry as a whole (rather than a small sector of the industry that experienced collapses during the GFC), which should be given greater priority than many of the proposals canvassed in the CAMAC Paper. The benefits of an effective product rationalisation regime include better outcomes for consumers resulting from reduced operational risk, access to more modern and innovative products (such as those taking advantage of e-commerce enhancements to enable improved customer convenience) and enhanced competitiveness. FSC has made numerous submissions relating to the need for product rationalisation mechanisms for MIS and we would be happy to provide a copy of these submissions to CAMAC on request.

Our detailed comments are set out in our detailed submission attached. These comments cover:

1. The role of ASIC in issuing licences and monitoring REs.

2. The need for product rationalisation mechanisms to encourage cost efficient and competitive products, and to avoid the proliferation of legacy products (and the related operational risk entailed therein).

3. Our concerns about any changes to MIS regulation (such as introducing *direct* access of unsecured creditors to MIS assets) which would undermine or further sub-ordinate the rights of members versus creditors. Such changes will make Australia's MIS regime less attractive to investors, including foreign investors, and the later particularly is relevant to Government policy (welcomed by us) to encourage Australia as a regional financial services centre.

4. The efficiencies and necessity for multi-function REs to leverage high quality skills/resources, in light of the highly competitive financial services environment and increasing industry consolidation.

5. The impending increased capital adequacy requirements for REs, which provides further investor protection.

[5] The reference to an "insolvent" MIS is used in a colloquial sense, as an MIS does not, for these purposes, have a separate legal personality, it being the RE/trustee which enters into contracts and transactions, albeit as a trustee/RE for an MIS. A more accurate descriptor for an "insolvent MIS" may be a "financially unviable MIS".

6. Proposed tax improvements in relation to managed investment trusts, and current reviews in respect of a potential Australian CIV (collective investments) taxation regime. These are designed to enhance the efficiency and international competiveness of Australia's collective investments regime.

7. The need to avoid prescriptive, cumbersome and impractical mandated contractual register regimes which are not necessary in light of the obligations of REs (and any commercial operator, such as any company) to keep proper records.

8. The need for statutory clarification of the limited liability of scheme unitholders (analogous to the limited liability of company shareholders).

9. Responses to some of the specific questions contained in the CAMAC Paper (not otherwise answered in our responses referred in sections 1 to 8 above).

We would welcome the opportunity to further discuss our submission with you at a time of your convenience. If you have any questions on our submission, please feel free to call Stephen Judge on 9299 3022.

Yours sincerely

STEPHEN JUDGE
General Counsel

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1. The role of ASIC in issuing licences and monitoring REs

An operator of a registered scheme is required to obtain an Australian financial services licence from ASIC, and satisfy capital and other resourcing requirements. Responsible managers of REs must satisfy skill and propriety requirements. Further, ASIC as regulator oversees compliance by responsible entities with Chapter 5C.

There is no need to make material changes to these requirements. ASIC has broad powers and regulatory tools at its disposal to monitor responsible entities and schemes. Also, ASIC may impose licence conditions before issuing an Australian financial services licence and these may be tailored to a particular regulatory objective. Further under the Government's Future of Financial Advice reforms, ASIC's powers in relation to granting a licence and suspending or cancelling a licence (and issuing banning orders) are proposed to be widened. These proposals are contained in the recently released Exposure Draft *Corporations Amendment (Future of Financial Advice) Bill* 2011. These changes will further enhance ASIC's powers to supervise responsible entities.

FSC considers that enhanced regulatory outcomes can be achieved within the current regulatory framework. For example, by ensuring that ASIC is adequately resourced and therefore able to allocate sufficient resources in licensing REs and undertaking suitably targeted surveillance in respect of licensees generally (including REs).

Further, the Future of Financial Advice reforms will remove incentive arrangements (such as large commissions paid by product issuers to financial advisers which have been associated with some of the MISs which collapsed during the GFC).

2. The need for MIS product rationalisation mechanisms to encourage cost efficient and competitive products, and to avoid the proliferation of legacy products (and related operational risks)

Product rationalisation is a key issue for the managed funds industry as a whole. It is important for responsible entities to be able to consolidate products in a cost effective manner so that greater efficiencies and economies of scale can be provided over the long term, for the benefit of investors. Therefore we consider that the design of any legislative reform should take into account these important considerations and facilitate product rationalisation objectives as well as the orderly winding up of insolvent schemes and responsible entities.

FSC (previously named the Investment & Financial Services Association ("**IFSA**")) has prepared numerous submissions over the years on the need for an MIS product rationalisation legal framework. Most recently, IFSA lodged a submission in February 2010 to Treasury in response to Treasury's *Product Rationalisation of Managed Investment Schemes and Life Insurance Products Proposals Paper* (December 2009). FSC would be pleased to provide these submissions on request. FSC considers it a higher priority to facilitate MIS product rationalisation (which has been the subject of proposals prior to the GFC) than certain of the proposals under consideration in the CAMAC Paper, which while important to address difficulties in the work out of insolvent schemes, represent isolated business model failures, as opposed to a failure of the MIS regime. Nonetheless, we acknowledge the need to introduce a more facilitative regime for the work out of insolvent schemes.

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CAMAC Question (Page 117 CAMAC Paper)

Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?

FSC Response – MIS Product Rationalisation:

For the reasons set out above, and as further set out in numerous FSC/IFSA submissions (available on request) over the years, there is a need to implement an MIS product rationalisation regime so as to assist improved outcomes for consumers resulting from reduced operational risk, access to more modern and innovative products (such as those taking advantage of e-commerce enhancements to enable improved customer convenience) and enhanced competitiveness. With the priorities arising from the GFC abating somewhat, we urge Treasury and Government to finalise consultation on, and ultimately, implement an MIS product rationalisation regime.

3. Our concerns with any changes to MIS regulation (such as introducing *direct* access of unsecured creditors to MIS assets) which would sub-ordinate the rights of members versus creditors. Such changes will make Australia's MIS regime less attractive to investors, including foreign investors.

Over recent years the Australian Government has devoted significant resources into developing policy and legislation that will promote Australia as a regional financial services centre and make Australian managed funds more attractive to foreign investors, particularly with regard to taxation (for example, the managed investment trust (MIT) reforms). Foreign investors seeking to include Australian managed funds in their portfolio will review their rights and liabilities as an investor, as well as the tax consequences of their investment.

The opportunity for the Australian managed funds industry to capitalise on the benefit of recent and continuing tax reforms could be adversely affected if the law is changed to give an enhanced priority to scheme creditors over the interests of members, because prospective members (i.e. potential offshore investors in Australian MIS) may form the view that the investment will not be worthwhile due to the enhanced priority provided to unsecured creditors of an MIS. FSC does not support any amendment to the regulation of trust-based MISs which would provide direct access (as opposed to access via subrogation to the RE/trustee's right of indemnity) of unsecured MIS/trust creditors to MIS/trust assets. Such an amendment would amount to a radical reduction of the protection and rights of trust beneficiaries (i.e. MIS members) and established trust law.

For example, as a principle of trust law (relevant to trust-based MIS), if a trustee (i.e. the RE of a trust-based MIS) breaches trust and therefore does not have access to the trustee's right of indemnity out of the trust fund (i.e. the MIS) assets, the assets of the trust may not be accessed by the trustee to meet any liability incurred in breach of trust. That is, in that case, the unitholder/investor/member of the trust-based MIS will not have the assets of the MIS taken to meet a liability of the trustee/RE incurred in breach of trust. If, instead, unsecured trust creditors are given a direct right of access to assets of the trust-based MIS (not dependent on the maintenance of the trustee/RE's right of indemnity), then unitholder/investor/member's will have their interest in the MIS reduced to the extent of the creditor's direct right of access

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notwithstanding the RE/trustee's breach of trust. Under current law the creditor would not have a right of access to trust assets and would be left to claim against the trustee's personal assets.

Any change to allow creditor's direct access to MIS assets would change the risk sharing (as between members of schemes and unsecured creditors of the RE/MIS). Apart from overturning basic trust law principles, such a change could have material adverse implications for the attraction of Australian MIS as a form of investment for foreign investors, as these investors, well advised, would be advised that such direct access of (otherwise, unsecured) creditors to trust/MIS assets is not dependent on the trustee/RE complying with its trustee/RE duties, and this is clearly inappropriate and at odds with basic trust law principles.

The principles of entering into a transaction with a disclosed trustee are well understood. Namely, a counterparty to a trustee relies on and ordinarily would undertake due diligence and obtain representations from the trustee in respect of the trustee's indemnity out of trust assets. Banks and financial markets counterparties, for example, are well aware of this and hence negotiate for representations from the trustee/RE that the trustee/RE will not do anything which would cause the trustee/RE to lose its right of indemnity. Just as the *Sons of Gwalia* decision sent shockwaves amongst lenders, FSC considers that an amendment to trust law principles relating to subverting the protection of MIS members and providing unsecured creditors direct access to trust assets, would be a very disturbing development to members of MIS who rely on a trustee to comply with its duties in order to access what is beneficially the member's assets.

Rather, MIS unsecured creditors access to MIS (trust) assets should depend on RE/trustee's acting properly (i.e. should depend on a trustee's legal right of indemnity out of scheme assets). If an RE/trustee breaches trust, MIS members (i.e. unitholders) should be protected (as they are under current trust law) and not be sub-ordinated to third parties (creditors dealing with an RE/trustee). Trust creditors (for example, banks and ISDA (financial markets) counterparties) know how to undertake due diligence when dealing with an RE/trustee and know what representations to ask as a risk mitigant.

FSC Recommendation: In summary, FSC does not consider there has been such a market failure to justify any change to the relationship between, and access to rights against trust assets, by RE/trustees, members and unsecured trust creditors. We do not support a change to unsecured creditor rights to provide direct access to assets held beneficially for MIS members. This is particularly given a trustee is not an agent for beneficiaries and unsecured creditors prior to contracting with a trustee may undertake due diligence in respect of the trustee and the trust.

4. The efficiencies and necessity for multi-function REs to leverage high quality skills/resources, in light of the highly competitive financial services environment and increasing industry consolidation

It is common practice for an RE to act as RE of more than one fund. Certainly with industry consolidation and the competitive financial services environment, it would be inefficient to run separate REs for separate MIS.

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Multi-function REs are able to avail of synergies obtained by applying a common compliance and operational model to multiple funds. There are clear Corporations Act duties on REs to keep assets of each MIS separate.

Multi-function REs are an appropriate and efficient structure allowing REs to obtain scale and operate at a lower cost and therefore offer competitive products.

Large well resourced multi-function REs (including REs which form part of a conglomerate) are also often better placed in terms of their organisational competencies and access to resources on short notice, to manage MIS during periods of higher market stress and volatility. While all REs have the ability to seek the direction of the courts under relevant state based Trustee Acts in order to resolve difficult issues, it would be more common for larger conglomerates to have the resourcing across the conglomerate to urgently do so (that is not to say, smaller REs can and do not do so).

To the extent any MIS collapses involve inappropriate use of scheme property or use of scheme property for another scheme (unless authorised by the constitution and/or contractual arrangements), this would not be in compliance with RE duties. We do not consider that any reform is required to address multi-function REs. The law in relation to use of scheme property by REs applies to all REs (whether a multi-function RE or an RE of a single fund).

5. The impending increased capital adequacy requirements for REs, which provides further investor protection in dealing with a well capitalised RE (and hence there is no need for wholesale reform of the MIS regime)

ASIC proposes revising the financial requirements that apply to REs, as foreshadowed in Consultation Paper 140 *Responsible entities: financial requirements* (**CP 140**). The stated policy objectives of these changes include:

(a) limiting the risk that an RE will become insolvent; and
(b) providing some level of assurance that, if the RE fails, there is sufficient money available for the orderly transition to a new RE or to wind up the scheme.

(See paragraph 5 of CP 140.)

Assuming that these changes have their desired impact, then the probability and incidence of scheme and RE failure should be reduced. Therefore the type of wholesale reform of Chapter 5C of the Corporations Act proposed in the CAMAC Paper should not be necessary.

Additional support is provided by the requirement for REs to have adequate insurance arrangements to be in place[6].

The above arrangements provide protection to members. Creditors also take the benefit of arrangements in relation to capital adequacy of REs since in addition to the

[6] Section 912B Corporations Act, *Corporations Regulations 2001* (Cth) 7.6.02AAA and ASIC Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees*. Also see footnote 2 above. The compensation arrangements are currently subject to review. FSC has made a submission (June 2011) to the consultation paper *Review of compensation arrangements for consumers of financial services – Consultation Paper by Richard St. John (April 2011).*

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creditor's right of subrogation to the RE/trustee's right of indemnity out of scheme assets, to the extent the subrogation does not exist unsecured creditors also benefit from the "personal" balance sheet (i.e. the RE capital requirements) of the RE to meet claims to the extent the unsecured creditor is not subrogated.

Considered together these measures promote the best interests of the members whilst addressing issues regarding RE insolvency and scheme failure and reflect an appropriate balance between the interests of MIS members and unsecured creditors.

6. Proposed tax improvements in relation to managed investment trusts, and current reviews in respect of a potential Australian CIV (collective investments) taxation regime. These are designed to enhance the efficiency and international competiveness of Australia's collective investments regime

As noted previously, over recent years the Australian Government has devoted significant resources into developing policy and legislation that will promote Australia as a regional financial services centre and make Australian managed funds more attractive to foreign investors, particularly with regard to taxation. These include reforms to withholding tax, capital elections for MIS and the current Board of Taxation's review into a collective investments taxation regime. These changes and proposals are designed to enhance the efficiency and international competitiveness of Australia's collective investment regime, and to also support Australia being a preferred location to establish a funds management business in the Asian region. The relevance of all this, is that it is important that any changes to the regulation of MIS not undermine (or unsettle) these initiatives which have been years in the making. Any changes to the regulation of MIS should only occur if there is a regulatory gap to be addressed and the benefits of the additional regulation exceed the costs. We do not consider there has been evidence of a regulatory regime gap in the MIS regime requiring wholesale changes to the regime.

The MIS industry is also concerned to ensure tax and competitive neutrality of any new measures introduced. It may be premature to initiate MIS regime changes before properly taking into account the tax and competitive neutrality ramifications of such changes. In any event, we don't see the need for material changes to the MIS regime.

7. The need to avoid prescriptive, cumbersome and impractical mandated contractual register regimes which are not necessary in light of the obligations of REs (and any commercial operator)

Requiring REs to maintain a contractual register is not necessary as each RE will have its own document management system relating to contracts entered into. A statutory register duplicates existing systems REs (as for any company) have in place in respect of contracts entered into. The form of document management is something which should not be prescribed (as it is not for companies which are not REs).

CAMAC Questions/Reforms (page 32 CAMAC Paper)

Reform 1: identification and recording of the affairs of each MIS
Identification of agreements
Recording of agreements

We do not support the prescriptive mandating of contractual registers. RE duties (for example, duties to act in the best interest of members) and simple good corporate practice requires proper records. It is up to REs (as for any corporate) as to how they keep records. The imposition of a statutory contractual register will impose compliance for compliance sake. A statutory register is highly likely to be in addition to (and duplicate) existing document management procedures. A requirement for REs to maintain a register of contracts entered into as an RE of each scheme is not supported. Existing RE duties are sufficient. A statutory contractual register is unnecessary, duplicates existing arrangements, is prescriptive, imposes a disproportionate compliance burden and is unnecessary for REs which comply with their existing duties.

While we agree that it is prudent and good practice for the RE of a registered scheme to keep records that enable the scheme property and affairs to be identified, we do not consider that it is necessary to impose a prescriptive statutory contracts register as a legislative requirement. To the extent that insolvency of a corporate (whether an RE or any other company) involves an urgent fact finding exercise by the external administrator, it is not likely that imposing a statutory register will be a panacea. It would be dangerous for an external administrator to simply refer to a statutory register without ascertaining the terms of the contracts, and without some assessment of the accuracy of the register.

Chapter 7 of the Corporations Act was intended to regulate the financial services industry in a 'principles based' manner, which involves prescribing governing principles in the legislation, supplemented by ASIC policy guidance on the types of arrangements that should be encouraged, and avoided, for the purposes of conforming with those principles. Similarly, Chapter 5C imposes duties on the RE and the RE is then required to conduct the scheme and its business consistently with those duties.

We consider that the manner of record-keeping adopted by the RE is a matter for the RE in light of its RE duties. The RE is obliged to comply with its duty under s601FC(1)(i) of the Corporations Act to ensure that scheme property is correctly identified as scheme property and held separately from the property of the RE and the property of other schemes. Rather than by imposing a separate legislative prescriptive obligation, we consider RE's complying with their duties are able to ascertain the assets and contracts of any MIS (without the duplication of existing processes and document management procedures which a statutory contractual register will entail, as that register will not do away with RE's existing document management retention systems and processes).

We also note that section 988A of the Corporations Act already requires a licensee to keep financial records that correctly record and explain the transactions and financial services business that they carry on.

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Further, on some occasions it is not always entirely clear if a contract is entered into in an RE capacity as opposed to on the RE's own account (being a contract required to "run its business" of being an RE). Such an example might be certain mailing/print house agreements. Usually this would be on the RE's own account (to operate its RE business) but one could envisage scenarios where it is entered into as RE of the fund. The RE may enter contracts in its personal capacity, but expenses may then be incurred under the contract for particular funds and the RE may (if authorised under the MIS constitution) seek reimbursement from the relevant MIS for a (or a portion of a) particular expense. Other examples of contracts for which it may not be entirely clear as to whether it is entered into as RE of an MIS (or by the RE solely in its RE capacity to operate its RE business) include research rating arrangements. Hence, any statutory contractual register, apart from being duplicative, would be at risk of different views being formed as to whether certain contracts, at the margin, are entered into as RE (or for the benefit of the MIS) or otherwise. Not having a statutory register (and not having to undertake the analysis as to the capacity of the RE when entering a contract) does not do away with the fact that a company (such as an RE) operating its business prudently (and in light of RE duties) will still be able to access the contract as needed.

For some agreements, such as ISDA Master Agreements, it is common industry practice for the agreement to cover multiple MIS and the MIS covered by the agreement may change from time to time (for example, when an MIS decides to use a new financial markets counterparty to trade with). Maintaining statutory contractual register each time a master agreement is updated to remove or add an MIS is cumbersome, particularly for master agreements (not just ISDA Master Agreements) covering a large number of MIS.

Further, the statutory contractual register could be difficult to maintain to the extent that an agreement or contract could well include each contract or confirmation to buy or sell securities (such as for equity funds and bond funds). Some schemes would undertake hundreds of trades over a period of time and to require this in the register would be a significant compliance challenge.

Additional issues with a statutory contractual register, include what is the consequence of the register being out of date or not current? Would the register be prima facie evidence of the existence of the contract? We suggest that the statutory register would be nothing but a first step in the review by an external administrator (and its advisors) of an RE, as ultimately the terms of the relevant contracts will need to be reviewed and sourced. REs complying with their duties will be able to source the contracts. REs which do not comply with their duties are highly unlikely to have accurately maintained a statutory contractual register as well as be able to source the underlying contracts. The more likely scenario is the register is not kept up to date but the contracts may or may not be able to be found.

We have set above all the logistical difficulties of duplicating existing processes by introducing (just for REs but not for other companies) a statutory contractual register.

Summary, FSC does not support the introduction of a statutory contractual register for REs because it duplicates the REs existing document management procedures, and is not likely to address the concern it is designed to achieve (i.e. to solve the difficulty of ascertaining and locating contracts).

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8. The need for statutory clarification of the limited liability of scheme unitholders (analogous to the limited liability of company shareholders).

> ***CAMAC Question (page 117 of CAMAC Paper)***
>
> *Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes?*
>
> *Should the limited liability principle be subject to any contrary provision in the scheme constitution?*

We consider that certainly for trust-based registered managed investment schemes, it is appropriate that, subject to specific terms in the scheme constitution to the contrary, there be statutory clarification that the liability of members of registered schemes is limited to the contributions made to the scheme. Providing this clarification is consistent with promoting confidence in the Australian managed funds market and should assist in attracting foreign capital to Australian managed funds.

We note that the Companies and Securities Advisory Committee (as CAMAC was then called), recommended a form of limited liability in its March 2000 Report to the *Minister for Financial Services and Regulation on Liability of Members of Managed Investment Schemes*. That Committee's preferred option was a form of limited liability except to the extent of any contrary scheme provision[7].

It may also be appropriate to consider limited liability for unregistered schemes but we think that would require further consideration as to whether an unregulated trust (or an MIS which is not subject to the regulation applicable to a registered scheme) ought to be the subject of a statutory limitation of liability for members. We do not conclude on the matter for unregistered schemes but would be pleased to consider further if further consideration is to be given as to whether limited liability is appropriate for any MIS other than registered schemes.

We make no comment on whether it is or is not appropriate for limited liability for contract-based MIS or any other non-trust based MIS, because of the variety of non-trust based MIS which may exist (these include contract-based MIS, as well as MIS which may not ordinarily be seen as a matter requiring collective investments regulation but which are caught[8] within the very wide definition of a "managed investment scheme" in section 9 of the Corporations Act, and are not within any of the applicable exemptions from that definition).

Statutory clarification of limited liability for members of registered MIS will provide certainty. This will assist in the attractiveness of MIS as a savings and/or investment vehicle and also further assist foreign investment in light of the certainty for foreign

7 Companies and Securities Advisory Committee *Report to the Minister for Financial Services Regulation on Liability of Members of Managed Investment Schemes* (March 2000), page 10, accessed on 6 October 2011 at http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2000/$file/Liability_of_members_of_MIS,_March_2000.pdf

8 An example of the wide ambit of the definition of "managed investment schemes" is the recent court decision which held that litigation funding arrangements were within the Corporations Act definition.

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investors into Australian MIS. This is because absent the statutory clarification, a well advised foreign investor would be informed that while it is generally expected (and perhaps assumed) that liability of trust-based schemes is generally limited to contributions to the scheme made by members, there is no absolute certainty in this regard as the matter has not been definitively determined in the courts.

Any statutory limited liability for registered MIS members should be subject to an express contrary provision in the constitution and in such case the PDS for the scheme should provide a clear, concise and effective explanation of the legal position (that is, that any statutory limitation of liability did not apply in that case).

Further consideration is required as to whether or not a distinction is required between passive and active MIS members for the purposes of any statutory limitation of liability for members of a registered MIS. We note though, that the definition of a "managed investment scheme" in section 9 of the Corporations Act implies passive investment in the sense the definition requires that the member not have day to day control over the operation of the scheme.

The benefit of any statutory limitation on the liability of MIS members should not be negated, diminished or conditional on any additional direct recourse to the assets of an MIS given to unsecured creditors.

Summary, FSC supports the statutory clarification of limitation of liability for members of registered MIS, and that the statutory limitation of liability ought to apply subject to any express provisions in the scheme constitution to the contrary. The statutory clarification of limited liability for registered MIS members should not be "traded off" with providing direct access by unsecured creditors to MIS/scheme assets.

9. Response to some of the specific questions contained in the CAMAC Paper (not otherwise answered in our responses referred in sections 1 to 8 above

CAMAC Reform 3: informing MIS creditors of a change of RE (page 35 CAMAC Paper)

Where the RE of an MIS changes, the new RE must give notice of that change to all counterparties included in the 'continuing agreements' section of the agreements register referred to in Reform 1, and to any other counterparty of which the new RE is aware or becomes aware.

We consider that the arrangements in respect of service providers or counterparties to an RE (operating as RE) are largely a matter for the relevant contractual arrangement between the RE and the service provider or counterparty. It may not be appropriate to prescribe any notice requirements. We note that it is currently the case that a counterparty may negotiate terms with an RE that will require notice to be given and/or the counterparty's consent obtained to any change of RE. The existing law enables creditor counterparties to sufficiently protect their position.

In fact, the statutory novation mechanism (sections 601FS/601FT) does not require notice as a condition of statutory novation (although the statutory novation only occurs in respect of rights, obligations and liabilities which are capable of having effect after the change of RE). The legislative purpose of sections 601FS and 601FT was to make the transition to a new RE a smooth and non-disruptive one and provide certainty and protection for contractual counterparties.

We do not agree with statutory prescription *requiring* notice of a change of RE. This should be left to contracting counterparties (RE, service providers and/or other contractual counterparties) to negotiate these requirements. While it would be common practice for REs to inform counterparties of statutory novation for certain material contracts, section 601FS/601FT does not require that and provides a useful mechanism to deal with a change of RE. That is, section 601FS/FT along with any specifically negotiated contractual notice requirements suffice.

As a matter of practice, it would be common in any event for prudent REs to engage with contractual counterparties providing material services to the fund, before changing RE, not necessarily because contractual consent or notice is required (although it may be) but as a matter of prudence to avoid any discussion with the contractual counterparty as to whether or not section 601FS/601FT applied.

The statutory novation provided by section 601FS/601FT is useful in transmitting rights from the old RE to the new RE, particularly where the RE has numerous contracts in place for the MIS, in a seamless manner.

FSC Recommendation: We do not consider that reform is necessary to prescribe notice requirements for a change in RE, and the proposed reform will, in some circumstances, impose notice requirements where none is currently provided for or needed (in light of section 601FS/FT providing a statutory novation from the old RE to the new RE where such contracts are capable of having that effect).

CAMAC Reform 4: rights of MIS creditors against scheme property (Page 35 CAMAC Paper)

Only persons who have entered into an agreement with an RE as principal in its capacity as the operator of a particular MIS, and the RE in respect of its indemnity and other rights against the property of that MIS, will be the creditors of that MIS. Persons who have transacted with the RE in this capacity will have the right to claim directly against the property of that MIS, not through subrogation to the RE's right of indemnity against scheme property.

As the CAMAC Paper notes (page 36), this proposed reform involves a fundamental change from the current position concerning the recovery rights of unsecured creditors of an MIS. Reform 4 would give unsecured creditors a direct right against scheme property, applicable whether or not the RE was acting within power in entering into an agreement. The CAMAC Paper (page 36) states that Reform 4 would more closely align the rights of MIS creditors with those of corporate creditors (pursuant to the indoor management rule). It would benefit unsecured creditors of an MIS over MIS members. We disagree with Reform 4 because (as the CAMAC Paper acknowledges implicitly) the proposed reform sub-ordinates current rights of MIS investors in trust-based schemes compared to the current position of those MIS investors under trust law. We disagree that the corporate context (indoor management rule) constitutes an appropriate analogy to support a reform that trusts should also allow creditor rights irrespective of whether the trustee retains its trust indemnity. We consider this an example of inappropriate

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application of company law principles to a trust law context (and is part of the reason why, elsewhere in this submission, we stress the need for much care and consideration in seeking to apply corporate law (for example, current company law voluntary administration procedures) to a trust law context.

Firstly, in the case of trust-based schemes at least, REs/trustees are not agents of MIS members. MIS creditors are not transacting with MIS members, they transact with the RE/trustee. Secondly, MIS involve passive investment by scheme members in that scheme members must not have day to day control over the operation of the scheme in order for it to constitute a "managed investment scheme"[9]. To allow scheme assets to be directly accessed by a trust creditor where the trustee is not empowered to transact undermines basic trust law principles designed to protect beneficiaries (here, scheme members who also are – necessarily[10] – passive investors). Thirdly, while MIS members are not in a position, at the time a proposed creditor seeks to transact with an RE/trustee to "check" and due diligence the trustee is complying with its trust duties, a creditor voluntarily considering entering into a transaction with a disclosed trustee/RE is in a position to undertake enquires as to the status of the trustee, the trustee's personal assets, the trustee's indemnity and obtain trustee representations. The Investment Manager's Supplement in respect of ISDA Master Agreements, for example, reflects these aspects of contracting with a trustee. Counterparties to trusts are well aware of the need to consider these matters before transacting with a trustee (and unsecured creditors can choose to not transact if not sufficiently satisfied in respect of these trust law matters).

FSC supports retention of current trust law in relation to dealings between a trustee and unsecured creditors. Essentially unsecured creditors contract with the trustee as a legal entity and the recourse of such creditors to MIS/trust assets is via exercise of the trustee's right of indemnity or subrogation to that right. Unsecured creditors may undertake enquiries and due diligence before transacting with the trustee.

It is common practice for counterparties (such as banks either lending to any trust (including trust-based registered schemes) or entering derivatives with a trust) to undertake due diligence as to the status of the trust, the trustee, and the net assets of the trust. Further, it is common practice for counterparties to obtain representations from the RE/trustee designed to provide comfort to the counterparty that the transactions by the RE/trustee are binding and that the RE/trustee retains its trustee right of indemnity.

We consider that it is a matter for parties contracting with an RE/trustee to undertake enquiries and be aware of the position of the RE and the trust.

We do not think it is necessary for the legislation to prescribe specific rights of MIS creditors against scheme property. Further, any such prescription in the registered MIS space may result in an inconsistency in relation to creditor rights against a trust which is a registered managed investment scheme and creditor rights for the multitude of other trusts which are not registered managed investment schemes, such as deceased estates, wholesale unregistered managed investment schemes, private wealth trusts, family trusts and securitisation trusts. This will add unnecessary and inappropriate complexity in respect of trusts and creditor rights. Counterparties (i.e. relevantly, unsecured creditors) to contracts involving a trust which is disclosed (as contracted by a

9 Section 9 Corporations Act, definition of "managed investment scheme".

10 Section 9 Corporations Act, definition of "managed investment scheme", which provides one criteria for an MIS is that members do not have day to day control of the operation of the scheme.

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trustee) ought undertake enquiries in relation to counterparty risk (on the trustee and trust assets), just as a trustee ought undertake enquiries when contracting with its counterparties (such as listed companies, private companies, joint ventures and partnerships, and other trusts (including registered MIS)). Each type of legal structure has its own counterparty risk and due diligence ramifications.

Further, in the case of trust-based schemes, amending the rights of MIS creditors against scheme property will impinge on and supersede many years of trust law and principles of transacting with a trustee. These principles are clear in that a contract is entered into by the trustee, and it is then a contractual matter for the trustee and its contracting counterparty as to whether the recourse of the contracting counterparty is limited to the extent of the trustee's right of indemnity. Numerous variations to this may be agreed between a trustee and any person the trustee contracts with.

Further information in relation to FSC not supporting Reform 4, is set out under point 3 from page 6 of this submission, under the heading relating to "Our concerns with any changes to MIS regulation (such as introducing *direct* access of unsecured creditors to MIS assets) which would sub-ordinate the rights of members versus creditors."

Summary of FSC Response to Reform 4: FSC supports retention of current trust law principles which are well known and understand in the market. Conversely, FSC does not support Reform 4 or any other changes to further sub-ordinate MIS members to unsecured creditors (and any changes to introduce *direct* access by unsecured creditors to trust/MIS assets has that effect). FSC does not support *direct* access to trust assets by unsecured creditors (as opposed to creditor's access via the trustee's right of indemnity). Creditors' subrogation rights to the trustee's indemnity already sub-ordinate MIS members, and unsecured creditors ought make enquiry in relation to the trustee indemnity.

CAMAC Questions (Page 40 of CAMAC Paper)

In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time?

Who should have access to that register and through what process?

There are varying structures of registered MISs (and not all registered MIS structures necessarily involve trusts). This is an advantage of the flexible MIS regime in Chapter 5C.

We consider that specific record keeping requirements for an RE (including contractual requirements) ought not be prescribed. Rather, it is simply a matter for the RE to appropriately track and record the arrangements and assets of the registered MIS. For example, financial scheme MIS such as global share funds, could potentially have hundreds of assets (shares). As these asset holdings change, REs are required to record the assets, and changes by virtue of numerous existing RE obligations. Just as for Reform 1 (CAMAC proposal to introduce a statutory contractual register for schemes), any requirement to impose a statutory asset register is simply unnecessary for REs complying with existing statutory duties and duties as a trustee to be in a

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position to identify trust/scheme property and to keep scheme property separate from the RE's own property.

It is also common for REs to outsource responsibility for custody of the assets to a custodian. Custodians maintain their own client records for each RE and scheme. Imposing this obligation on the RE would result in duplication of record-keeping.

CAMAC Question (Page 48 of CAMAC Paper)

Question
In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

Our response below is in the context of situations where both the RE and MIS are solvent. We have not provided specific comment in relation to insolvency of an RE or scheme.

As is currently industry practice, in the usual case of an agreed (or "friendly") change of RE, the outgoing and incoming RE would ordinarily contractually agree the appropriate and detailed "handover" arrangements. This is usually part of the process of obtaining the new RE's consent to becoming RE. In any event, in any change of RE, the outgoing RE is subject to the requirement to act in the best interests of members and implicit in that is that an outgoing RE needs to provide appropriate assistance and transition (for the benefit of MIS members) in respect of any change of RE. Therefore we consider that it is not necessary for the Corporations Act to make provision for a specific obligation of this nature.

CAMAC Questions (Page 61 of CAMAC Paper)

Questions
Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons?
In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to:
• possible conflicts of interest faced by the TRE
• the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced)
• a TRE providing assistance to an external administrator?

Voluntary administration regime for MIS?

We preface our comments below by acknowledging that the voluntary administration ("**VA**") procedure for companies provides an opportunity for a "workout" where there is a possibility of a VA resulting in a better return for unsecured creditors and potentially, shareholders of the company. We acknowledge there is no VA arrangement for MIS *per se* (as opposed to a VA applicable to a company which happens to be a trustee/RE).

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Any imposition of a corporate voluntary administration "workout" procedures to MIS, while potentially worthy of further consideration, would need to be very carefully considered. Care is required when seeking to transplant company law concepts to a trust law environment. It is essential that if it were appropriate to adopt a VA procedure for MIS, that any concepts applied to that MIS VA procedure are consistent with, complement, and do not vary trust law principles. This includes ensuring that the fundamental trust law principle that the beneficiaries of trusts are quarantined and protected from breaches of trust by the trustee, and the corollary that unsecured creditors recourse is to the trustee (and subrogation to the trustee's indemnity) rather than direct access to trust assets. If direct access to trust assets is sought, then that should be via a secured arrangement (i.e. as a secured, as opposed to an unsecured, creditor).

Further consultation would be required in relation to any consideration of adopting a VA regime for MIS.

Changes to the role of TRE

The difficult position for a TRE is that they are subject to RE duties without the opportunity to undertake proper due diligence. Further consideration should be given to protecting a TRE from liability in respect of contracts entered into by the old RE and protecting the TRE from suit for a moratorium period, where the TRE acts in good faith. If this was considered appropriate, further consultation would be required.

Consideration should also be given to providing some priority or protection to TRE's for fees and expenses where they become a TRE of a scheme, or at least priority for a certain period (perhaps similar to the priority rights available to certain insolvency practitioners).

We agree that consideration is required to balance the competing objectives of ensuring a TRE acts in the best interests of members, but is not unfairly exposed to RE liability where it has no or limited opportunity to undertake due diligence in relation to the position and contracts of the MIS.

CAMAC Questions (Page 66 of CAMAC Paper)

Question

What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?

Government should not be prescribing specific remuneration arrangements as the prescription of arrangements in statute would introduce a distortion of the market, and pricing is a matter for the competitive market, and the financial services market is competitive. Similarly, it is inappropriate to cap or set statutory controls on RE remuneration. This is more so when there is no indication of such a market failure to justify consideration of Government intervention in RE remuneration (unlike say utilities pricing for which there is a policy reason for some Government control on pricing, or recent developments in executive remuneration, which even in the later is subject to a

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principles based and disclosure regulation, rather than a cap on ongoing executive remuneration).

FSC Summary: Government intervention in controlling RE remuneration is simply not warranted. We agree, however, that RE remuneration should be disclosed in accordance with current disclosure requirements.

CAMAC Questions (Page 67 of CAMAC Paper)

Question

What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?

It is common, usual and expected that a lender may request conditions on loans which allow the lender to require repayment if the existing RE is to change. From a bank/lender's perspective providing significant funding to an RE/trustee, it sees the identity of the RE/trustee as a relevant factor in credit and counterparty exposures and risk. Statutory controls on arrangements such as these will introduce distortion in the market, may potentially reduce funding availability for REs (i.e. a bank may not lend if it is subject to a statutory control prohibiting a condition that the loan may be recalled if the RE changes). Such statutory controls, in addition to potential impacts on the ability of REs to raise funding (or potentially, the price at which a bank/lender will provide funding), may give rise to a range of other potentially distortive implications such as reducing the ability of MIS to trade with financial markets counterparties (such as an equity fund acquiring a derivative to hedge against further market movements).

Summary: FSC does not agree it is necessary or appropriate to impose statutory controls on contractual arrangements conditional on a particular RE remaining RE.

CAMAC Question (Page 95 CAMAC Paper)

Question

Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?

We consider that the discretion for an RE to wind up an MIS on occurrence of an event (e.g. the giving of notice provided for in the constitution) should not be disturbed. As a general comment, there should be no new restrictions on winding up solvent registered MIS. That is, Part 5C.9 of the Corporations Act, trustee common law duties and statutory RE duties are sufficient in respect of the wind up or termination of solvent schemes. We make no comment on the situation of a wind up of "insolvent" (or more accurately, financially unviable) schemes, other than to say that whatever reforms are considered in respect of *any* schemes should not disturb the existing rights of members of MIS as discussed throughout this submission.

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We are not aware there any difficulties with the current regulation of the wind up of solvent schemes. In fact, we consider that in respect of the wind up of solvent schemes (and particularly, trust-based MIS), the flexibility provided by Part 5C.9, general law and trust law is appropriate to deal with the multiple types of MIS trust arrangements. FSC does not consider any changes are necessary to the current provisions (and general law) dealing with the winding up of solvent MIS by a solvent RE.

> ***CAMAC Questions (Page 106 CAMAC Paper)***
>
> ***CAMAC Questions***
> *What procedural provisions should there be for winding up an MIS and why?*
>
> *In particular, should a party conducting a winding up:*
> *• have information-gathering and other investigative powers comparable to those of the liquidator of a company*
> *• have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity?*
>
> *Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS?*
>
> *Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating?*
>
> *Is there a need for any legislative procedures for winding up an MIS to be varied to take into account the particular characteristics of MIS structures (trusts, partnerships, contract-based MISs)? If so, what?*

We consider it restrictive and unnecessary to disallow a solvent RE/trustee to make decisions in relation to the wind up of a trust, and implement the wind up. As a general principle, the RE/trustee is best placed to undertake the wind up. To the extent there have been difficulties with some failed schemes, we suggest that requiring a third party to wind up a scheme is disproportionate to any benefit and unnecessary. Further, in a wind up, REs are subject to trust law obligations and statutory RE obligations. In a trust context we are not aware of any issues with wind ups by a solvent RE of schemes (whether the scheme is financially viable or not) in accordance with Part 5C.9, trust law and RE duties. For example, an RE may wind up a scheme because the fund size is too small causing diseconomies for members.

Further, requiring a third party to wind up schemes will increase costs to members and reduce the return available to members (for a financially viable scheme) and reduce the return available to creditors of the scheme (for a financially unviable scheme). Also, introducing a third party in addition to the RE, into the wind up process, dilutes accountability in that without the third party it is clear the RE solely is accountable, whereas with a third party, there may be disputes as to who is accountable for aspects of the wind up.

There is no need for any additional reporting requirements in respect of the wind up of a scheme as the current disclosure requirements and Part 5C.9 are sufficient.

In relation to winding up ordered by the Court under Section 601ND, in certain factual situations where there is a dispute between members it may be difficult for members to

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resolve the dispute and the most appropriate solution may well be simply to wind up the scheme. The "just and equitable" ground is subject to matters of interpretation (section 601ND(1)(a)). We suggest that further consideration be given to whether it is appropriate to include an additional and more objective ground for a Court ordered winding-up, being where there is a dispute which cannot be resolved between the members of the scheme. We suggest that if this was considered appropriate it would be an additional limb to the existing section 601ND(1)(a) "just and equitable" ground (albeit we accept that the suggested additional limb may to a degree overlap with the existing "just and equitable ground").

In summary, we do not consider there is any need to impose additional costs by not allowing a solvent RE to wind up schemes, having regard to RE duties and Part 5C.9 of the Corporations Act. Nor is it necessary for any additional reporting requirements in respect of the wind up of an MIS. Consideration should be given to whether or not there should be any further grounds for a court ordered wind up under section 601ND in addition to the "just and equitable" ground

CAMAC Question (Page 111 CAMAC Paper)

Question
Are the grounds for winding up a registered MIS equally applicable to a lawful unregistered MIS?

Trust law suffices for unregistered schemes. No specific additional regulation is required in addition to existing trust law and various Trustee Acts. Sophisticated investors can negotiate tailored arrangements relating to winding up, if they consider appropriate.

CAMAC Question (Page 111 CAMAC Paper)

Question
Should there be any provisions governing the procedure to be followed in winding up lawfully unregistered MISs and, if so, what?

No. The winding up of unregistered MISs (such as a wholesale unit trust) is a matter to be governed by trustee fiduciary duties, other common law trustee duties, the trust deed and any other documents relevant to the arrangements and agreed between the trustee and the unitholders. We do not consider there is any need for any additional provisions governing the wind up procedures for lawfully unregistered MISs.

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CAMAC Question (Page 114 CAMAC Paper)

Questions
Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons?

For what purposes, if any, should ASIC be granted the power to convene meetings of members?

Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?

Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons?

Under section 252F of the Corporations Act, at least 21 days notice must be given of a meeting of members of a registered scheme. We suggest that, in certain situations, this is a long period, where there is necessity in the interests of members to call a meeting earlier. Consideration should be given to shortening this requirement to 14 days (perhaps with conditions such as the RE forming the view reasonably, that a shorter notice period is considered reasonably necessary and appropriate and in the best interests of investors) as very often members (or an RE) do wish to attend to some matters on an expedited basis where it is clearly in the best interest of the members. We suggest 14 days is a more appropriate period, particularly for matters requiring expedition.

Under section 252L of the Corporations Act, members can give notice to an RE to call a meeting of members, but currently where a notice has been given to an RE to call a meeting, there is no provision in the Corporations Act for that notice to be withdrawn. Circumstances may change, the members may have come to some form of agreement or the reason for calling a meeting may no longer be applicable. We suggest that there should be a provision for a member to be able to withdraw the notice so that the meeting can be cancelled (and unnecessary meeting costs avoided) if the meeting is no longer required.

Should ASIC be given the power to convene scheme meetings?

The calling of meetings is a matter for members, the RE and the courts, as currently regulated by the Corporations Act. We do not consider that calling scheme members is a matter for a regulator (including ASIC). For these reasons, simply, ASIC should not be granted the power to convene meetings of members.

Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?

AGMs for registered MIS involve costs. We consider that AGMs for registered schemes are not necessary, and would involve the imposition of costs on scheme members for no material benefit. We do not consider it likely that many unitholders will attend AGMs. Some MIS may even have difficulty obtaining a quorum for an AGM. Even extraordinary general meetings of unitholders (such as to approve constitutional modifications under section 601GC(1)(a)) are often only attended by a very small proportion of unitholders.

We consider AGMs would be a large cost imposition on scheme members (and/or REs and product providers) not demanded by members. There is no need for AGMs. Scheme

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members receive PDSs, continuous disclosure (or significant event reports) and periodic statements (retail clients). AGMs are not necessary from a cost/benefit perspective.

> ***CAMAC Question (Page 115 CAMAC Paper)***
>
> ***Question***
> *In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?*

It is important to note that guarantees and indemnities provided by the RE in its capacity as RE of a scheme are an ordinary and normal part of its business.

The FSC therefore does not support proposals which provide arbitrary restrictions on guarantees (including cross-guarantees) or indemnities by REs. An RE is already subject to obligations that ensure it must only provide guarantees and indemnities when doing so is in the best interests of members of the scheme (restrictions on related party transactions under Part 5C.7 also apply to the giving of indemnities and guarantees).

A prohibition on giving guarantees and restrictions on giving indemnities in its capacity as RE would, in many cases, be adverse to the commercial interests of an MIS and its members. We also do not understand the rationale (as proposed in ASICs Consultation Paper 140 *Responsible entities: Financial requirements*) for introducing differential requirements on REs of multiple schemes with respect to prohibitions on giving guarantees in their personal capacity.

In relation to the proposed prohibition on indemnities (contained in ASIC Consultation Paper 140), in the normal course, a responsible entity will enter into agreements, on behalf of a scheme, and those agreements will commonly provide for the responsible entity to indemnify the other contracting parties where the responsible entity fails to meet its obligations under the agreements. In fact, it would be uncommon to find a material contract which does not contain indemnities given by both parties to the material contract. Any restriction on the responsible entity providing indemnities will limit the RE's ability to negotiate contracts for the relevant registered scheme, and impact on terms provided and pricing which is likely to not be in the best interests of scheme members.

> ***CAMAC Question (Page 117 CAMAC Paper)***
>
> ***Question***
> *Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?*

Chapter 5C improvements - Property of a corporation and receivers

Where a custodian or RE holds property on trust (e.g. for a registered or unregistered scheme), unintended consequences can arise when a receiver is appointed pursuant to a charge relating to the trust property. Property held on trust by the custodian or RE is "property of a corporation" (that is, property of the custodian), because "property of a corporation" is broadly defined in section 9 of the Corporations Act as "any legal or equitable

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estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action”.

Section 427 of the Corporations Act requires that where a receiver of “property of a corporation” is appointed, notice of the appointment must be lodged with ASIC within 7 days (Form 504). When the Form 504 is lodged with ASIC and processed by ASIC, the letters “EXAD” (meaning under external administration) will appear against the custodian or RE company’s name when a search of the company name is done on the ASIC website. In addition, section 428 requires that when a receiver of “property of a corporation” is appointed, the corporation (being the custodian or RE) must set out in every public document and negotiable instrument, after the name of the company first appears, that a receiver or receiver and manager has been appointed.

This presents a problem for a solvent custodian or solvent RE of an insolvent scheme (or a scheme in financial difficulty) that results in the appointment of a receiver to the scheme asset. The regulatory regime applies as though a receiver has been appointed in respect of an asset that belongs to the custodian or RE company, when the asset belongs (in a beneficial sense) to the scheme/members rather than the custodian or RE company, and there has been no personal payment default of the custodian or RE company.

The outcome is particularly unfair for a custodian, who only holds property of the relevant scheme as bare trustee and deals with the property only in accordance with the proper instructions of their client.

We would request that consideration be given to this issue as part of any overhaul of insolvency provisions as they apply to MISs.

CAMAC Question (Page 117 CAMAC Paper)

Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?

Lodgement of Charges by RE/trustees – clarity about capacity where a secured interest is provided by the RE/trustee

This point is similar to the discussion above about receivers, namely the distinction between the RE’s own personal assets, and that of the scheme. We support current proposals which intend to make the relevant forms for registration of security interests under the Personal Property and Securities Act regime clear where a security interest relates to assets of a fund/trust or MIS. This relates to secured creditors within the meaning of the PPSA (not unsecured creditors). This clarity will ensure that person’s reviewing the PPSA register will be able to quickly ascertain that the security relates to fund/trust assets rather than the balance sheet/personal assets of the RE/trustee. This will reduce the circumstances of persons skimming the register (and not reading the lodged details in full) and incorrectly assuming the RE has charged its own personal assets.

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CAMAC Question (Page 117 CAMAC Paper)   *Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?*

Chapter 5C improvements - Review of Scheme registration process with a view to considering further streamlining

Section 601EB of the Corporations Act requires ASIC to register a scheme within 14 days of lodgement provided the applicable statutory criteria are met.

While generally the scheme registration process, including interaction between the RE or proposed RE and ASIC, works reasonably well, we consider it would be worthwhile for ASIC to undertake a review of the scheme registration review process to assess if there is an opportunity for further streamlining.

The registration process requires a responsible entity to lodge a *signed* constitution, and for the directors to sign an ASIC form declaring that the lodged constitution complies with sections 601GA and 601GB of the Corporations Act.[11]

On occasions, a proposed RE and ASIC may hold different views as to whether or not some constitutional provisions meet the Corporations Act requirements applicable to registered scheme constitutions. Alternatively, ASIC may make suggestions to amend the constitution to put the matter beyond date. As a practice, when this occurs, the ASIC request for amendment or clarification to the (already signed and lodged) constitution may occur on day 10, 11, 12 or 13 of the 14 day registration period. While ASIC are constrained by the statutory timeframe, this situation then requires the RE to urgently amend the constitution (by a signed constitutional amendment) to meet ASICs concern (and the RE will not always agree that an amendment is required but the practicalities are often that the RE will accede to ASIC's requirement, suggestion or request). This then requires the RE to urgently draft a deed amendment, consider various legal requirements around deed amendments (such as whether the amendment would be adverse to existing unitholders, such as a lawfully unregistered scheme with existing wholesale unitholders, then seeking to be registered) and/or any stamp duty and/or taxation implications of the deed amendment, and then also have to obtain urgent access to directors to execute the deed amendment. In a conglomerate it cannot be assumed that directors are necessarily available without much notice.

While the 14 day registration period should not be changed, we recommend that ASIC consult with industry as to whether the situation described above may be avoided or reduced. We accept that any improvements would need to balance the need for RE directors to "sign-off" on compliance of the constitution with the Corporations Act, but avoid the need for the initial constitution to be signed followed by an urgent "fix it" deed amendment within the 14 day registration period. One possible solution may be for an opportunity (perhaps an ASIC practice or policy) of the RE being able to lodged a final but unsigned constitution with an ASIC form 5103; ASIC could then confirm that the scheme will

11 See ASIC Form 5103 *Directors' statement relating to the application for registration of a managed investment scheme.* For more information on the ASIC scheme registration process see page 122 (Appendix 3) of the ASIC Submission (September 2011) to the Parliamentary Joint Committee Inquiry into the collapse of Trio Capital. The submissions to the Inquiry (including the ASIC submission) are available at http://www.aph.gov.au/senate/committee/corporations_ctte/trio/submissions.htm (accessed 7 October 2011).

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be registered provided the executed constitution is identical to the lodged unsigned version (or amendments required by ASIC are made). That way, the RE can sign the initial/establishment constitution once (rather than potentially signing 2 constitutional documents within a 14 day period).

Recommendation: ASIC consult with industry as to refinements to the scheme registration process to reduce the circumstances of REs sometimes being required to sign two constitutional documents (and obtain directors twice, and on very short notice) in a 14 day period when establishing a scheme. Whether or not any amendments would be required to Chapter 5C would depend on the nature of the refinements. We suggest that ASIC could adopt this recommendation simply by formalising a policy of reviewing unsigned constitutions, perhaps subject to ASIC discretions and a requirement for the relevant ASIC forms to be updated to include a certification that the signed final and registered constitution is identical to the unsigned version approved by ASIC (or approved by ASIC with amendments required by ASIC and the RE).

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10 October 2011

By email: john.kluver@camac.gov.au

Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

Dear Advisory Committee/Legal Committee members,

Discussion Paper: Managed Investment Schemes

We refer to the Corporations and Markets Advisory Committee *Discussion Paper: Managed Investment Schemes* and your request for feedback.

We act for a broad range of financial services clients including responsible entities in the Australian market place. We act for boutique, mid-sized and large responsible entities some of which are single scheme but most of which are multi-scheme responsible entities. We have also assisted stakeholders in the insolvency or restructuring of a number of registered managed investment schemes.

This letter sets out our responses (which are a combination of our own views and those of our clients) to your specific proposals and questions.

In this letter we use the terms defined in the Discussion Paper and do not define them again here.

We respond to most but not all questions raised in the Discussion Paper.

1. Reform 1: Identification and recording of the affairs of each MIS

Questions

A. Should the Policy approach in Reform 1 be enacted?

B. Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?

If yes:

- **how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstance, if any, should they have a means to have the register amended?**

- **what remedies should affected parties have for failure to include an agreement in the register and against whom?**

If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.

Response

1.1 We consider that the policy approach in Reform 1 could be enacted in relation to contract-based MISs only. To impose the maintenance of an agreement register across *all* MISs is unnecessary.

1.2 ***Identification of agreements***: We consider it is largely market practice for responsible entities to enter into contractual arrangements in their capacity of a specific scheme (or schemes) and state that this is the case in the document(s) constituting the agreement. We consider that this proposal would clarify the position.

1.3 ***Recording of agreements – register not a definitive statement***: We agree that REs of contract-based MISs should keep a register of all agreements. An agreement register need not be kept by REs for *all* MISs.

1.4 We do not agree that such register should be a definitive statement of all agreements entered into by an RE – that should remain a question of fact. A counterparty should not be potentially disadvantaged merely because an agreement was not inserted in the register. We consider that a former RE should be responsible to a new RE for any *loss* caused by not recoding a particular agreement but consider that liability for "any amount paid to a counterparty in consequence of the former RE not having registered an agreement" may, in some circumstances, result in the MIS being unjustly enriched e.g. unit registry fees paid under an unrecorded agreement are still a valid expense of the MIS. The former RE can be separately dealt with for breaching its statutory record keeping obligation.

2. Reform 2: Use of Scheme Property

Questions

A. Should the Policy approach in Reform 2 be enacted?

B. Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?

Response

2.1 We consider that Reform 2 is largely a restatement of the current law i.e. using scheme property for a purpose not in connection with the MIS (whether the constitution prescribes it or not) would be a breach of trust. If CAMAC consider the existing law needs clarification then the policy approach in Reform 2 could be enacted.

3. Reform 3: Informing MIS creditors of a change of RE

Questions

A. Should the Policy approach in Reform 3 be enacted?

B. What, if any, consequences should follow where an RE fails to inform a counterparty?

Response

3.1 We do not have a particularly strong view about enacting Reform 3. We do not consider a notification requirement to be a particularly large burden on an RE particularly where a register of agreements is maintained.

3.2 In our experience many agreements of an RE in relation to a MIS will have regular (e.g. annual) review provisions, involve service level requirements to be met and otherwise require the RE to deal with the counterparty in some form from time to time. Despite the statutory novation that occurs pursuant to s601FS we have observed in most cases that deeds of novation and/or addendums/supplements are entered between the new RE and the contract counterparty in any event as a matter of course. A notification may mean that such agreements are novated, supplemented or otherwise clarified sooner.

4. Reform 4: Rights of MIS creditors against scheme property

Questions

A. Should the Policy approach in Reform 4 be enacted?

B. If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?

C. Should the two related provisions also be adopted?

Response

4.1 We do not agree with this proposal and suggest that present arrangements would not be enhanced by the introduction of Reform 4. In fact they could be further complicated.

4.2 Persons who have entered into an agreement with the RE as principal in its capacity as the operator of a particular MIS cannot be the only creditors of that MIS. Creditors can arise in other ways e.g. by tort. Limiting the creditors of a particular MIS to a certain class and having other creditors of the RE more generally (perhaps with rights to the property of the scheme via the RE's right of indemnity) does not advance the current position in any way.

4.3 The proposal that creditors whom have contracted with the RE in a certain way will have a right to claim directly from the assets of the scheme is completely novel. It disrupts long established trusts law. We consider the proposal would have significant ramifications for no practical benefit. While the proposal by passes the RE, presumably the RE will still need to be involved (or at least be an active observer) in the relevant claim to assess the validity and quantum of the claim and its likely impact on scheme property when the RE is dealing with the scheme's assets. Once the RE loses its guardianship role of the assets then the effective nature of the trust structure starts to be eroded.

4.4 Further, the reform would tend to result in a “race to the bottom” by contractual counterparties and creditors of the RE to commence execution or other enforcement proceedings against scheme property, resulting in the potential of a multiplicity of execution and enforcement proceedings.

4.5 Finally, a direct right of recourse would increase the prospect of creditors of the RE receiving, in substance, unfair preferences; the direct right of recourse may be expected to result in numerous creditors of a financially distressed RE attempting to take enforcement action against scheme property in the short period prior to its formal external administration.

4.6 For the same reasons, the related provisions to Reform 4 should not be pursued.

4.7 It would be an opportune time, however, to consider whether or not the position taken in *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99 should be expressly considered in the context of MIS. That is, stakeholders in MIS insolvencies would, in our experience, be assisted by a clarification of the proper approach to distribution by a liquidator of the proceeds of realisation of an insolvent RE's right of indemnity amongst MIS and non-MIS creditors of the RE. This might be the subject of a separate review.

5. 3 Proposed key Legislative reforms

3.5 Identifying scheme property

Questions

A. In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time?

B. Who should have access to that register and through what process?

Response

5.1 We consider the RE's existing obligation under section 601FC(1)(i)(i) & (ii) to clearly identify scheme property and hold it separately from other property of the responsible entity is sufficient in this regard. In our view to satisfy this obligation the RE should already maintain comprehensive records in relation to scheme property. We do not consider there is any particular benefit in having a register available for third parties to access.

3.6 Identifying member transactions

Questions

A. Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members?

B. Who should have access to that register and through what process?

Response

5.2 This requirement could be part of Reform 1. A register of arrangements could be kept in the same way as an agreement register. Members could have a right to inspect the register.

5.3 However, some of the difficulties identified in the Discussion Paper to which this question relates may also be addressed by reforms in relation to financial services licensing and ASIC's related powers, education requirements and ASIC regulatory guidance.

3.7 Tort claims and statutory liability

Questions

A. Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE?

B. In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?

Response

5.4 We do not believe that it is necessary to clarify the circumstances in which an RE should or should not be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach of the RE. The general law principles that govern a trustee's right of indemnity are sufficient to deal with the issues that arise in respect of such matters.

5.5 In considering the rights of creditors of a RE whose claim arises from a breach of a duty of care owed in tort by the RE to that creditor, it is important to not conflate a consideration of the RE's liability to the creditor and a consideration of the RE's duties to the scheme members. Those are separate considerations. A breach by the RE of a duty of care to a third party may not involve breach by the RE of a duty owed to scheme members. So much is made clear by the decisions referred to in section 3.7 of the Discussion Paper.

5.6 The contemplated clarification is not necessary because the duties owed by the RE to scheme members are clearly set out in the *Corporations Act*, the scheme constitution and equitable principles; the occasions when the RE as a trustee loses its right of indemnity from the scheme property are similarly clear from those sources.

6. 4 Transfer of a viable MIS

4.4 Issues concerning the TRE

4.4.1 Eligibility to be a TRE

Question

Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?

4.4.2 Outstanding obligations and liabilities of the outgoing RE

What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?

6.1 The statutory novation of obligations and liabilities of an incumbent RE to a new RE is problematic; that novation stifles any market in RE services, and tends to cause viable MIS to fail for want of an alternative to a failed RE.[1] A prudent, qualified RE and its officers will be reluctant to accept an appointment as a TRE or replacement RE without extensive due diligence into the MIS. In practice, this means that in situations of urgency it will not be practically possible to obtain consent from a qualified entity, such as a trust company, to accept an appointment as a TRE or replacement RE.

6.2 More fundamentally, however, it means that there will be instances where, having regard to the liabilities and obligations that will be inherited upon its appointment as TRE or replacement RE, no qualified entity will be willing to accept such an appointment.

6.3 A clearly viable option would be adoption of the procedure available to APRA under Part 17 of the *Superannuation Industry (Supervision) Act*. This procedure could readily be imported into Chapter 5C of the *Corporations Act* by:

(a) Inserting a provision whereby ASIC and has administrative power to remove a RE that no longer complies with the requirements of the *Corporations Act* or that appears to ASIC or the Court to be involved in conduct that may result in the financial position of the scheme becoming unsatisfactory.[2]

(b) Granting ASIC administrative power to appoint a TRE or replacement RE.[3]

(c) Providing ASIC with power to determine the terms of the appointment of the temporary or replacement RE, including as to what rights and liabilities of the incumbent RE will be novated to the new RE, and how the new RE will conduct its trusteeship of the scheme assets.[4]

6.4 The attraction of that arrangement is that similar provisions in the context of regulated superannuation trusts have been tried and tested in the administration of Trio with success.

6.5 A further attraction of this approach is that it would potentially minimise or even avoid the need for court applications in the course of appointment of a temporary RE; this may be expected to reduce costs and delay in the process.

6.6 Further to those changes, clear policy guidance from ASIC as to how the exemptions and modifications power in section 601QA of the *Corporations Act* will be exercised in connection with appointment of a TRE is needed. That guidance would best come in the form of a Regulatory Guide, and might deal with relevant considerations such as the broad types of modifications that may be considered, the stakeholders whose interests will be relevant to an exercise of the power, and the evidence that ASIC will require in connection with a modification/exemption application made for the purposes of section 601QA.

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[1] See D Walter "Managed investment schemes – suggested reforms the power to appoint a temporary responsible entity" (2011) 23 A Insol J 12
[2] See section 133 of the *Superannuation Industry (Supervision) Act* 1993 (Cth)
[3] See section 134 of the *Superannuation Industry (Supervision) Act*
[4] See sections 135 and 141 of the *Superannuation Industry (Supervision) Act*

6.7 Such policy guidance from ASIC should be provided, irrespective of whether or not other reforms of Chapter 5C are pursued. That is because increased use of the power in section 601QA is a further option for how the TRE procedure might be better and more frequently utilised in practice.

6.8 For example, if there was a clear basis in a published regulatory document for applying for exemptions/modifications from ASIC having the effect of:

(a) limiting the statutory novation of liabilities to the extent only of available scheme assets; and/or

(b) imposing an enforcement moratorium on scheme creditors during the period of the temporary RE's appointment similar to that provided in Part 5.3A of the *Corporations Act*,

(c) then the use of the temporary RE procedure may have much greater efficacy in practice. It may be noted that exemptions/modifications of this kind would be consistent with the arrangements discussed in the 1993 CAMAC Report (see above).

6.9 There are, however, alternatives that ought to be considered. The first is that, rather than adopting the procedure provided by *Superannuation Industry (Supervision) Act*, the existing provisions of Chapter 5C might be amended to make the TRE role or appointment as a replacement RE more attractive to professional trustee companies. For example, Chapter 5C might be amended, such that:

(a) The TRE or replacement RE continues to have the rights and liabilities of the incumbent RE novated to it upon its appointment; but

(b) The liability of the TRE or replacement RE is limited to the realisable value of the scheme property, with scheme creditors being prohibited from pursuing the TRE for any amounts not able to be paid out of the value of those assets; and

(c) The TRE (or replacement RE) and its officers, while obliged to bring the scheme into compliance with the *Corporations Act*, the obligation to do so does not sound in any civil or criminal responsibility in the TRE (or replacement RE) or its officers for failures to do so; and

(d) There is a "back up" statutory TRE or replacement RE, controlled by ASIC, which may be appointed in the event that there is no qualified entity willing to accept an appointment as temporary RE. ASIC would then have power, for example, to appoint external professionals (such as registered liquidators and their firms) to provide management services to the statutory TRE or replacement RE.

6.10 Those arrangements could also be supplemented by an amendment to section 601FP(2) of the *Corporations Act*, to clarify the scope of the power granted to the Court under that sub-section; for example, rather than a statutory limitation of liability being automatic, the ambit of section 601FP(2) could be expressly widened so as to contemplate an order by a Court to that effect should the Court be satisfied that it is just and equitable to do so.

6.11 That procedure would, however, be problematic for creditors of the scheme; the operation of any limitation of liability would effectively require that scheme creditors await realisation of scheme assets until they are able to be paid, rather than being in a position to immediately demand payment from the RE (whether or not scheme assets are readily available to meet those demands). It may be noted, however, that REs typically seek to limit their liability to creditors in this manner by contract, so that this statute-imposed disadvantage to creditors most likely does not substantially erode existing market practice. Further, it is necessary to consider that the present unlimited liability of a TRE or replacement RE for existing debts of the MIS seems to be a dominant disincentive to qualified entities accepting appointments as TREs or replacement REs, and that a statutory limitation would be an effective means of removing that disincentive.

6.12 A final option is that the Court more frequently use its inherent jurisdiction to appoint receivers to property, and that this inherent jurisdiction be supplemented by a prescribed procedure in Chapter 5C of the *Corporations Act*. For example, provisions could be inserted into the legislation whereby an interim receiver could be temporarily appointed to a RE for the purpose of investigating and stabilising the scheme's affairs, with a statutory moratorium in the meantime against enforcement by scheme creditors against the scheme assets. This "interim receiver" approach has been used in relation to, for example, the Atlantic 3 Financial schemes.

6.13 This approach seems problematic. The appointment of a receiver does not seem to be a solution to the difficulties of a scheme with a failed RE; the receiver could at most be mandated to investigate the circumstances of the MIS and to (perhaps) realise its assets. Those activities would not promote the sustainment of the MIS in the longer term, with a view to stabilisation of the scheme, and continuation of its activities (with a view to a better return to both creditors and members).

6.14 The clear benefit of this approach, however, is that it could be a relatively quick and cheap means of allowing ASIC and the Court to review the affairs of a MIS or RE in difficulty. It may be that this approach could be used in tandem with the streamlined TRE or replacement RE procedures outlined above; an interim receiver might be appointed as an initial step, with it then being possible to use the more drastic measure of replacement of the RE if the receiver finds that the incumbent RE has engaged in misconduct itself or was otherwise not fit to remain in office.

4.4.3 Duties of the TRE

Question

A. What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees,

and for what reasons?

6.15 Because of the threat of civil and criminal penalties for REs and their officers for breach of certain provisions of the *Corporations Act* (particularly sections 601FC, 601FD and 601FE), it is important in order for the TRE procedure to have any efficacy that potential the duties and liabilities of TREs be carefully considered.

6.16 Consistently with the matters outlined above in relation to section 4.4.2, it would be sensible for either ASIC or the Court (or both) to have power to define or limit the duties and liabilities of a TRE in particular circumstances. Given the wide variety of circumstances in which a TRE may be appointed, it is not desirable that the *Corporations Act* be particularly prescriptive as to what those duties and liabilities will be; there may be instances where, for example, it is desirable that a TRE remain in office for some time (such as in the case of a particularly large or complex scheme), such that the duties of the TRE may properly be more fulsome, whereas a short-term appointment may justify a simplified approach to the duties of the TRE.

4.4.4 Remuneration of the TRE

Question

A. What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?

6.17 Section 601FP(2) of the *Corporations Act* should be amended to provide the Court with an express power to fix remuneration for a TRE.

6.18 That is because, for the reasons discussed in the discussion paper, it is important in maintaining an ability to rescue viable schemes from poor management or mismanagement that a market for TRE services exists. An important aspect of such a market may be expected to be potential TREs' confidence of being remunerated properly for their services.

6.19 While the power in section 601FP(2) is wide (and is probably sufficient to empower the court to deal with the question of TRE remuneration), there is no harm in describing some of the particular orders that may be made by the Court pursuant to that power, such as orders dealing with TRE remuneration. This amendment may also be an occasion for other particular orders to be identified as being within the power under section 601FP(2), such as those discussed above in relation to scheme liabilities novated to the TRE from the incumbent RE.

4.4.5 The role of the TRE in relation to the future of the MIS

Questions

A. Are any changes regarding the role of the TRE in the future of the MIS

necessary or beneficial and, if so, for what reasons?

B. In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to:

- **possible conflicts of interest faced by the TRE**
- **the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced)**
- **a TRE providing assistance to an external administrator?**

6.20 For the reasons set out below in relation to section 5.4.7, a "voluntary administration" procedure should not be adopted in relation to MIS, such that the question in section 4.4.5 is to some extent irrelevant.

6.21 Dealing with potential conflicts of interest in relation to the appointment of a replacement RE, however, there is no legislative amendment necessary to address the matter. A TRE, like any other trustee, owes fiduciary and (at least some) statutory duties to MIS members; there is no need for the *Corporations Act* to be prescriptive as to what steps should be taken by a TRE in the course of searching for a replacement RE. Indeed, because of the wide range of circumstances that may result in the appointment of a TRE, and the subsequent nature of the TRE's role, it would be unproductive to attempt to prescribe how a TRE should manage a conflict of interest of this kind. This concern would best be dealt with by education requirements for TREs, together with policy guidance from ASIC.

4.5 Matters covered in the transfer of rights, obligations and liabilities

Question

A. What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?

Response

6.22 Sections 601FS and 601FT ought to be revisited, with a view to clarifying their intended effect. This clarification is critical to the encouragement of a strong market for RE services (with the goal of generally improving the quality of those RE services).

6.23 It is not within the scope of this paper to suggest how that legislation ought to be amended; the intended effect of sections 601FS and 601FT is a policy decision. It should be noted, however, that consistent with the discussion above, those sections ought to be made subject to either Court or ASIC adjustment.

7. 5 Restructuring a potentially viable MIS

5.4 Elements of a VA for an MIS

5.4.7 New RE

Questions

A. Is there support in principle for the concept of a VA for an MIS?

B. Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?

C. What types of matters concerning these parties should be included in the VA of an MIS?

D. What should be the grounds for initiating the VA of an MIS?

E. Who should be entitled to initiate the VA of an MIS?

F. If the VA of an MIS is to involve classes other than MIS creditors:

- **in relation to any voting on a proposed MIS deed:**
  - **how should the classes entitled to vote on the MIS deed be determined? For instance, should it be left to the administrator to determine those classes, taking into account the extent to which the deed affects their interests**
  - **where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests**
  - **should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it**
- **what should be the voting rules for any proposal that:**
  - **the MIS be wound up, or**
  - **the MIS administration end and the MIS continue as before?**

G. In what circumstances, if any, should an MIS deed be able to override the rights of members under the constitution of the MIS or impose new obligations on those members?

Response

7.1 A voluntary administration procedure should not be adopted in relation to MISs.

7.2 Fundamentally, the availability of a VA procedure in relation to a MIS entrenches a legal myth or misunderstanding about trusts generally; a MIS (like any trust) is not a separate legal entity and cannot be separately administered.

7.3 Instead, the procedures suggested above should be considered; those procedures recognise the peculiarity of the MIS (trust) concept, and deal with that peculiarity in a more cost- and time-effective manner than would be achievable by a voluntary administration procedure.

5.5 Other matters relevant to the VA of an MIS

5.5.1 Avoiding duplicate VAs

Question

A. What, if any, legislative provision needs to be made to prevent duplicate VAs?

Response

7.4 In circumstances where the VAs of a MIS and RE are each creditor-driven processes, the relative creditor groups should be able to determine the extent to which the VAs overlap (in the sense of their being a common appointee to both VAs). The preferable approach would be to allow MIS creditors or RE creditors, by a majority by number and value, to determine whether or not a common VA should continue in office or should be replaced (for either the VA or MIS) with an independent VA.

7.5 In addition, there ought to be power for a Court to replace a VA of a MIS on cause shown by a MIS creditor or member (or some similar test), in order to avoid any actual or perceived conflict between the VA's role as VA of the RE and VA of the MIS.

5.5.2 Who can be an MIS administrator

Question

A. In the context of an MIS administration, should there be any change to the current requirements that only a registered liquidator can be an administrator and, if so, why?

Response

7.6 A registered liquidator ought to be the only person eligible to take an appointment as a voluntary administrator of a MIS. The procedure, if implemented, may be expected to be no different to the existing voluntary administration procedure in Part 5.3A of the *Corporations Act*, where only registered liquidators are eligible to accept appointments as administrators. It follows that the persons eligible to accept appointments under the proposed new procedure ought to be the same as those presently eligible to accept appointments under the existing procedure.

7.7 It is worth noting that separate enquiries are considering an expansion of the persons who may become registered liquidators. This response does not consider those separate considerations.

5.5.3 Powers and liabilities of the MIS administrator **Questions:** **A. Should an MIS administrator have similar powers to those of the administrator of a company?** **B. For what liabilities, if any, should an MIS administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?**

Response

7.8 The question of a MIS administrator's powers raises a central difficulty of the proposal that a VA procedure be introduced in relation to MIS.

7.9 A MIS is, at most, a bundle of rights and obligations of different people (particularly, the RE and the scheme members) in relation to certain identified property. The MIS is not a separate entity capable of "management" and cannot appoint an "agent" in the way that a company may appoint an agent. Accordingly, the powers of a voluntary administrator appointed to a company under Part 5.3A of the *Corporations Act* to manage the company's affairs and to act as its agent are essentially foreign to the context of a MIS. At most, a VA of a MIS may be expected to have similar powers to a court-appointed receiver in relation to the scheme property.

These difficulties highlight the unattractiveness of a VA procedure for MIS. The suggestions made earlier in this paper are, in our opinion, more attractive.

5.5.4 Remuneration of the MIS administrator **Questions:** **A. Who should determine the remuneration of an MIS administrator or an MIS deed administrator?** **B. What, if any, classes of persons in addition to the MIS creditors should be involved and in what manner and for what reasons?**

C. What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?

Response

7.10 The proposed MIS voluntary administration procedure should follow the remuneration approval regime employed in relation to the voluntary administration procedure in Part 5.3A of the *Corporations Act*.

5.5.5 Court powers

Question

D. What powers should the court have in any VA of an MIS, and who should be entitled to apply to the court for this purpose?

Response

7.11 In the event that a voluntary administration procedure is introduced for MIS, it will be prudent for a power in the nature of the power of section 447A of the *Corporations Act* to be incorporated into that procedure. That is because of the wide array of circumstances that may arise in the course of a MIS voluntary administration, which are incapable of precise definition and pre-emption.

5.5.6 Need for an ongoing RE

Question

A. What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?

Response

7.12 Particularly in the instance of viable MIS, it is desirable that the MIS be placed in the best position possible to continue with the MIS through to its intended completion. For a viable MIS, this is clearly more likely to achieve value for both MIS creditors and members. The presence of a viable, operating TRE or replacement RE is essential to that objective being achieved.

7.13 It follows that there should be power to appoint a TRE or replacement RE to a MIS in voluntary administration.

7.14 The persons able to appoint that TRE should be either MIS creditors or the Court. Being a creditor-driven process, it is commonsense that MIS creditors should have that power. Similarly, in circumstances where, for example, there may be a deadlock amongst the creditors, or where there is a breakdown in relations between creditors and scheme members, it would be prudent for the Court to have power to resolve that deadlock or breakdown through having a power to appoint a TRE or replacement RE.

8. 6 Winding up a non-viable MIS

6.1 Overview of the winding up provisions

6.1.4 Application to practice

Questions

A. Are any changes needed to:

- **the current circumstances where an MIS can be put into liquidation with/without the need for court approval**
- **the provisions governing who can conduct the winding up?**

B. In this context:

- **should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why is there a need for a separate insolvency ground for winding up an MIS**
- **if so:**
  - **how should the insolvency of an MIS be defined**
  - **should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?**

Response

8.1 In our experience, there is no need for reform to these aspects of the winding up provisions in Chapter 5C of the *Corporations Act*. The Courts' willingness to apply the "just and equitable" ground for winding up "insolvent" negates any need for a separate insolvency ground for winding up. Moreover, the insertion of an insolvency ground is conceptually difficult to delimit because of the difficulties with defining the "insolvency" of a trust, which has no separate legal personality from its trustee and which trustee will typically limit its liability to creditors to the assets of the trust (making the traditional concept of cash-flow insolvency difficult to apply to a trustee or trust).

8.2 It may be noted that he availability of Court power to appoint particular persons to be responsible for the winding up of identified MIS (aside from the RE itself) is sufficient to ensure that qualified persons are available to assist with such a winding up.

6.2 Liquidation of an MIS where the RE is solvent

Question

A. Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?

Response

8.3 In our experience, there is no need for reform to these aspects of the winding up provisions in Chapter 5C of the *Corporations Act*. The focus of any reform in this area of Chapter 5C should, in our view, be on improved financial services licensing processes (including ongoing monitoring) and the expansion of ASIC's powers in that regard, education requirements and ASIC policy guidance. In addition, the regulation of an orderly winding up of a MIS would be assisted by a practice or guidance note from ASIC, setting out either benchmark or best practice guidance for a winding up.

6.4 Combined or separate liquidators

6.4.7 Current power to initiate a separate liquidation

Questions

A. In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)?

B. In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?

C. If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome?

D. In this context:

- **are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take responsibility for the liquidation of an MIS**
- **against what property might the claims of the RE liquidator and the MIS liquidator concerning their costs and expenses be claimed, and what would be their respective rights if the same property is involved?**

Response

8.4 In the event that creditors have determined that the VAs of a MIS and RE should be conducted separately, or together (as discussed above), it will be most efficient for that approach to be continued into the liquidation of the MIS and RE. That is, the status quo in the VAs should be followed into the liquidations.

8.5 It would, in our view, be sensible for either or both of the creditors or the Court to retain power to (a) combine two separate liquidations of the MIS or RE, or (b) separate common liquidations of the MIS and RE. That is because, for example, there may be instances where perceived conflicts of interest that prompted separate VAs become irrelevant in the context of a liquidation, or *vice versa*. The likely increased cost of separate liquidations means that it is proper that creditors or the Court have power to mitigate that cost by appointing a common liquidator.

8.6 At the same time, it is likely that conflicts of interest for the insolvency appointees will become more pointed at the liquidation stage (because of the need to adjudicate proofs, and realise and distribute assets, including the benefit of the RE's indemnity and lien), such that creditors and the Court should maintain powers to separate the liquidations.

8.7 In our experience, there are no changes needed to the existing power of the Court to appoint persons to wind up (or supervise the winding up) of a MIS.

8.8 In the event of separate liquidators being appointed to a MIS and RE, it will be appropriate to identify the basis for their respective recourse to the scheme property for payment of their remuneration and expenses, particularly in circumstances where that scheme property is not sufficient to pay in full the remuneration and expenses of the two appointees. In our view, a *pro rata* approach may be the most fair and reasonable, whereby each liquidator has her/his remuneration and expenses paid *pro rata* from the scheme property.

6.5 Options for an MIS liquidation Process

Questions

A. Would the process for liquidating an MIS be better provided for by:

- **an extension of the powers of the court in s 601EE to all MISs,, or**
- **a legislative procedure containing some or all of the elements discussed in Section 6.6**

and for what reasons?

Response

8.9 An expansion of the existing power of the Court to all MIS being wound up is justified. That is because such an expansion would merely clarify the existing uncertainty as to the intended power of the Court to provide guidance in the case of a MIS liquidation. Further, because of the difficulties that may be confronted in winding up a MIS, it is proper that the persons responsible for that winding up and other stakeholders in that process have available to them the assistance of the Court. As well, on one view, an expansion of the power of the Court under the *Corporations Act* would simply repeat in relation to the particular situation of a MIS the powers already available to Courts generally under the State trustee legislation.

8.10 At first blush, the introduction of a legislative winding up procedure featuring the elements discussed in section 6.6 of the discussion paper is unattractive; as stated above, because the MIS is not a separate legal entity, the proposition that there needs to be a procedure separate from the procedure applicable to the insolvent trustee/RE is counter-intuitive.

8.11 In our view, however, there is merit in further considering the possibility of a standard winding up procedure for a MIS. That is because it may decrease or eliminate the need for Court involvement in the winding up process; involving the Court does tend to increase costs and delays the progression of the winding up to conclusion.

8.12 The introduction of a winding up procedure may also enable certain policy objectives pursued in the company winding up provisions to be equally applied to MIS. For example, a priority payments waterfall would enable employee creditors of a MIS to also take priority in the distribution of assets of the MIS (rather than, on one view, standing on an equal footing with all other MIS creditors).

6.6 Possible elements of an MIS liquidation procedure

6.6.2 procedural matters

Questions

A. What procedural provisions should there be for winding up an MIS and why?

B. In particular, should a party conducting a winding up:

- **have information-gathering and other investigative powers comparable to those of the liquidator of a company**
- **have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity?**

C. Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating?

D. Is there a need for any legislative procedures for winding up an MIS to be

varied to take into account the particular characteristics of MIS structures (trusts, partnerships, contract-based MISs)? If so, what?

Response

8.13 To the extent that a statutory procedure for the winding up of a MIS is adopted, we support the inclusion of matters such as those outlined in section 6.6.2 of the discussion paper.

8.14 We particularly support the inclusion of information-gathering and investigative powers. In our experience, it is often a key concern of stakeholders in a failed MIS (creditors and members) that the reasons for failure of the scheme be fully investigated; it is proper that the liquidator be able (should she/he think fit) to conduct investigations independent of the RE's liquidator with a view to satisfying those demands of affected stakeholders.

8.15 We also support the MIS liquidator having obligations to report to ASIC of the kind already imposed on company liquidators (e.g. section 533 of the *Corporations Act*). Again, the reporting of wrongful activity to ASIC is, in our experience, of particular concern to stakeholders in a MIS insolvency and it is commonsense for their to be formal procedures for that reporting to take place.

8.16 There is not necessarily a difficult in a RE having these powers of investigation. Practically, however, a RE will probably not itself have the expertise to exercise those powers in a manner that is as effective as they might be exercised by an expert insolvency practitioner. That said, it will always be open to a RE winding up a MIS to appoint advisers (insolvency practitioners and lawyers, for example) to assist it in exercising those powers in an effective manner. In those circumstances, we do not think there is any insurmountable difficulty with a RE having powers of investigation of the kind discussed in the discussion paper.

8.17 It would be necessary, of course, for any such powers to be subject to Court or ASIC supervision; there is always the prospect of abuse of investigative powers (such as public examination and requirements for production of documents), and those powers should be checked by a corresponding power of ASIC or the Court to control their exercise by a liquidator of a MIS.

6.6.3 Rights of priority creditors

Question

A. Should there be a statutory order of priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?

Response

8.18 In our view, it would alleviate confusion and be conducive of appropriately qualified insolvency practitioners agreeing to accept appointments as liquidators of REs and MIS that a statutory order of priority similar to that in section 556 of the *Corporations Act* be introduced into any winding up procedure for MIS.

6.6.4 Voidable transactions

Question

A. Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those provisions?

Response

8.19 We do not think that separate voidable transaction provisions for a MIS winding up ought to be included; the MIS is not a separate legal entity and does not itself enter into transactions.

To the extent that any voidable transactions were entered into in relation to the MIS, the liquidator of the RE for that MIS may pursue recovery of those voidable transactions. It may be that the most pertinent legislative reform would be to clarify that the proceeds of any recovery that relate to a transaction affecting scheme property should first be distributed by the RE's liquidator to MIS creditors, and then to scheme creditors.

6.6.6 Access to books of the MIS

Question

A. What provisions, if any, should be included to deal with access to books of the MIS?

Response

8.20 [Insert]In our view, a liquidator of a MIS should have similar obligations in relation to access to books of the MIS as are imposed on a liquidator of a company.

6.6.6 Court power to give directions

Questions

A. Should there be any changes to the current provisions by which the court can give directions, and, if so, what and why?

B. In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the

MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?

Response

8.21 As stated above, we consider that the Court should have a wide power to give directions in relation to the winding up of a MIS. Those powers might also be expanded to include powers like those in the State trustee legislation to make directions binding on MIS members in circumstances where notice of the direction is served on those persons.

8.22 This includes an ability of the Court to make directions of its own motion. Where a MIS liquidation is effectively similar to a court-ordered winding up, there is no reason for why a Court ought not be able to control the MIS liquidator in a manner similar to the manner in which it may control a court-appointed liquidator by providing guidance and direction.

8.23 Inclusion of a provision in the nature of section 447A of the *Corporations Act* would be a helpful addition to the proposed winding up procedure. Eligible applicants for relief under section 447A should be limited to the liquidator, MIS creditors and ASIC.

6.6.7 Position of MIS members

Questions

A. What provision, if any, should be made for MIS members in the winding up of their scheme?

B. Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?

Response

8.24 As a general proposition, in the winding up of a MIS members' interests should be subordinated to the interests of MIS creditors. That said, this situation may vary where, for example, a MIS member is effectively in the position of a MIS creditor because the relevant MIS is "contract based" (such as an agribusiness MIS). In those "contract based" MISs, it will be open to MIS members to participate in the winding up as creditors by, for example, attending creditors' meetings and seeking to be appointed to committees of inspection.

8.25 Aside from the instance of MIS members also being MIS creditors, we do not think that there should be any separate representative body for MIS members in a winding up of the MIS. A liquidator of a MIS will act in the best interests of the MIS generally, which includes the interests of members, but it must be recognised that those members' interests (as effectively, "equity") are subordinated to the interests of creditors.

8.26 It follows that the liquidator of a MIS should not have any separate duties to MIS members.

6.7 Unregistered MISs

6.7.1 Unlawful unregistered MISs

Questions

A. Are the grounds for winding up a registered MIS (see Section 6.1.1) equally applicable to a lawful unregistered MIS?

B. Should there be any provisions governing the procedure to be followed in winding up lawfully unregistered MISs and, if so, what?

Response

8.27 In circumstances where the policy decision has been made to not have lawful unregistered MIS within the purview of Chapter 5C of the *Corporations Act*, we think it preferable that the winding up provisions of Chapter 5C continue to be inapplicable to lawfully unregistered MIS. The State laws generally applicable to trusts, agencies and partnerships will remain available to members of those MIS, and to the extent that the trustee of the unregistered MIS is a company the *Corporations Act* provisions for the insolvency of that corporate trustee will also be applicable.

6.7.2 Unlawful unregistered MISs that are viable

Question

A. Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?

Response

8.28 We do not think that there is any need for reform in this area.

6.7.3 Unlawful unregistered MISs that are not viable

Questions

A. Should a former member of an MIS have standing to apply for the winding up

of an unregistered MIS?

B. Should a creditor have standing to apply for the winding up of an unregistered MIS?

Response

8.29 In circumstances where a member has exited the MIS in question, that person's interest in the MIS is doubtful and there should therefore be no standing for that person to apply for the MIS to be wound up.

8.30 A person, however, who is entitled to be registered as a member of an unregistered MIS ought to have standing to apply for that MIS to be wound up.

8.31 Similarly, a creditor of an unregistered MIS ought to have standing to apply for the winding up of that MIS; this is particularly because of the possibility that there may be no RE of that unregistered MIS.

9. 7 Other Matters

7.4 Other Matters

Question

A. Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?

Response

9.1 We refer you to the discussion above in paragraph 6.1*ff* for some suggested improvements to how financially stressed MIS may be better managed.

* * * * * * * * * *

We would be pleased to discuss any aspect of our submissions with your further.

Yours sincerely,

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IPA
building professional excellence

7 October 2011

Mr John Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001
By email: john.kluver@camac.gov.au

Our ref: IPA MIS submission final

Dear Mr Kluver

Managed Investment Schemes Discussion Paper

We refer to the discussion paper on Managed Investment Schemes (MIS) released by CAMAC during June 2011. The IPA appreciates the opportunity to provide its views on this important topic.

The IPA is the peak professional body representing liquidators registered under the Corporations Act and trustees registered under the Bankruptcy Act. The IPA has 1,914 members, of whom over 430 are registered liquidators. Our membership also includes students, lawyers, financiers, academics and others with an interest in insolvency.

Our submission is focused on the outcomes, implications and difficulties of dealing with distressed MISs and Responsible Entities (REs) and the winding up or restructuring of those entities. Our members have been closely involved with a number of distressed large MISs and REs, both by their appointment to these entities and as legal advisers to the insolvency practitioners concerned, and we bring this practical experience to this submission.

We note at the outset that our submission primarily focuses on contract-based "enterprise" MISs rather than trust-based "investment" MISs. Specifically, our focus and comments are primarily in relation to agribusiness based MISs, as this is where the experience of our members primarily arises.

Issues with distressed MISs

The IPA recognises the value of MISs as a relatively inexpensive way to raise funds for investment purposes. While the MIS and RE operate as expected, they continue to demonstrate the features of a sound investment vehicle.

However, it is not until an MIS and/or RE becomes distressed that the inherent difficulties with the MIS trust based structure become obvious.

The Australian insolvency system seeks to:

- provide certainty of process in the event that an entity becomes insolvent; and

- place creditors rights first, before the rights of the investors/ shareholders in an insolvent entity.

From our experience trust structures do not fit easily within the traditionally accepted mechanisms and outcomes of insolvency. Trusts can give rise to particular complexities and can produce outcomes which are not what one would necessarily expect if the same investment had been undertaken in a purely corporate structure. For example:

- In the insolvency of a company, the interests of shareholder investors sit behind the interests of creditors. This is not necessarily the case with investors in a distressed MIS who can variously be considered as beneficiaries of a trust, creditors (as a result of breaches by the RE), and even as holding direct proprietary rights.

- The complexity and lack of clarity around investor rights can result in substantial legal disputes and the costs of these disputes is to the detriment of creditors, and ultimately investors themselves.

- There is currently no quick and cost effective mechanism for distressed MISs to be wound up. An insolvent RE will usually be incapable of performing its role but nonetheless continues to owe various duties to investors, whereas investors themselves are usually loath to wind up the scheme if there is any prospect (however remote) that the scheme can be restructured with a new RE. Accordingly, some schemes remain in something of a "state of suspended animation" for significant periods of time until, usually, the Court has to intervene.

We have included a case study at Annexure A outlining the position and outcome with respect to certain agribusiness MISs operated by of the Timbercorp Group (in this case involving the cultivation of almonds). This case study demonstrates clearly:

- the differing position of investors in an MIS versus an ordinary shareholder in a company;

- the differing position of investors depending on which scheme they entered into; and

- the complexity of the MIS investment structure to be dealt with in the insolvency process.

It is not in anyone's interests for the outcomes of the insolvency process to be uncertain, but this is certainly our experience with the recent MIS failures.

It is possible that the difficulties encountered by our members have arisen largely because the MISs have been undertaking a complex trading operation. These issues may not be as obvious in a trust based "investment" MIS such as a property investment trust.

While the IPA has undertaken to respond to each of the questions raised in the discussion paper (Annexure B), it is our opinion that there is a fundamental question that goes unasked. That is, whether an MIS (or, for that matter, any trust structure) is an appropriate investment vehicle for complex trading operations, particularly in the agribusiness arena? We suggest not, principally for the reasons that such structures bring an inappropriate level of uncertainty to the insolvency process. We go further to say that the recent spate of collapses of MISs in this area, and the extraordinary cost, complexity, delay and proliferation of court applications that have accompanied those collapses, supports our conclusion.

As is noted in the discussion paper, the use of MISs has largely become so popular due to the taxation consequences, or benefits, that such an arrangement can bring. While we are not taxation experts, it is our recommendation that steps be taken to encourage investment in traditional corporate structures where an established system exists for dealing with enterprises in financial difficulties, rather than trying to "fix" MISs.

In particular, it is apparent to us that many of the suggested reforms proposed by the paper (such as identifying and recording separately the affairs of each MIS and allowing certain creditors a direct right of access to the MIS's assets) are an attempt at creating a quasi "separate legal entity" for each MIS. It is our opinion that an actual corporate structure is a better way to achieve this.

If MISs are retained, we recognise the importance of establishing a regime to deal with financially distressed MISs. However, we believe that the paper fails to recognise the complexity of real life MIS structures where schemes with a common RE do not necessarily stand alone, but rather are reliant on other schemes operated by the common RE; and where the RE is not the only company involved (refer to Annexure A for an example of this). Often there is a complex corporate group structure involving numerous companies each with a different role all interconnected by various agreements and arrangements. Rescuing potentially viable MISs is not simply a matter of identifying the MIS and finding an alternate RE.

In this regard, a voluntary administration arrangement, an arrangement similar to a Part 5.1 Scheme of Arrangement or a judicial manager (of the type set out in the Insurance Act) appointment may have merit, particularly if it provides for a basic framework with the flexibility of the court's involvement, if required, to quickly determine whether a scheme can be restructured so as to become viable and, if not, to be wound up. Furthermore, due to the varied natures of MISs (ie trust based "investment" MISs versus contract based "enterprise" MISs), any framework needs to be flexible enough to account for this.

However, there are particular issues with MISs that need to be considered in this context:

- who is the administration to benefit – members or creditors? Creditors and members' interests can sometime be diametrically opposed – creditors are looking for payment, whereas members want protection of their investment and the MIS (and associated tax benefits) to continue. Whilst one could argue that this is the same position with shareholders and creditors in the insolvency of a company, there is an essential difference between shareholders of a company and the members of a MIS. Members of a MIS are beneficiaries of a trust that may have a proprietary interest in the scheme assets, whereas a shareholder has no direct proprietary interest in the assets of the company. A voluntary administration of a company is aimed at benefiting creditors with a potential benefit for shareholders if the company is able to continue. Should the VA of a MIS put creditors' interests ahead of the interests of the scheme members? A single insolvency practitioner appointed to both an RE and an MIS will face conflict between their duties to creditors and members if this issue is not resolved. Arguably, an insolvency practitioner solely appointed to the MIS may face similar conflict issues.

- The structure of MISs means that actions taken by an RE can void its indemnity rights against the trust assets resulting in those assets potentially not being available to meet creditor claims. This would appear to be an unfavourable outcome from a creditor's perspective, with an undue benefit to members of the scheme. This would not be the outcome in a corporate insolvency, where the company would remain liable for its creditors and any steps taken to avoid creditors could result in recovery action. The next question is whether the conduct that has led to the insolvency of the RE means that the RE acted outside of its authority or inappropriately thus voiding the indemnity rights? Again the issue of conflict for an insolvency practitioner arises.

- If a voting arrangement is to form part of the administration process, there is the issue of who is to vote - creditors, members or both – if members are entitled to vote, what is the appropriate amount of their claim; whether there should be classes and how a hung vote could be resolved?. We suggest that the traditional use of a casting vote by an administrator where there is a hung vote would be problematic in this context as an insolvency practitioner would be potentially forced to choose between the interests of members and the interests of creditors. The number of members in an MIS could also mean that if they are entitled to vote with creditors, that they could control the outcome of any voting due to sheer numbers, to the detriment of the third party creditors.

Several of the above issues revolve around the status of members of the MIS in any restructuring of a scheme. This uncertainty does not arise in a corporate administration. If MISs are to be retained, this uncertainty needs to be resolved. We suggest that in order to be consistent with other insolvency administrations in Australia that resolution must be in the interests of creditors.

General MIS reforms

If the MIS structure is retained, we go further to suggest that consideration needs to be given to possible legislative improvements that may actually reduce the number of failures, or reduce the severity of the failure. In our opinion, product disclosure statements/ MIS Constitutions should be required to include certain mandatory provisions dealing with:

- the standard, quantity and regularity of information provided to investors;
- powers of investors;
- what is scheme property, and the nature of investor rights with respect to that property;
- the nature and extent of the RE's indemnity from scheme assets;
- powers of the RE;
- treatment of funds received by REs for multiple MISs from investors that are currently commonly "swept" into a central general fund;
- the level of anticipated borrowings by the RE for the purposes of the scheme, the security to be provided for those borrowings and the priority between that security and investor interests; and
- importantly, priorities between classes of creditors/investors in the event of the scheme being wound up.

Conclusion

In conclusion, we would like to reiterate that while we recognise the role that is played by MIS structures to provide a relatively inexpensive means of raising investment funds, experience suggests that it is not a suitable vehicle for complex trading operations, notwithstanding the potential tax benefits, for the following reasons:

- trusts make the insolvency process overly complicated with an outcome not necessarily in line with what would be an expected outcome in the insolvency of a company;
- the role of members in the insolvency of an MIS is confused and fraught with conflict largely due to the fact that they may have additional rights (including direct proprietary rights to scheme assets) that a shareholder in a company does not have;
- MIS structures are, in reality, extremely complex, involving much more than simply an MIS and an RE. This complexity is usually tax driven. The existence of multiple MISs operated by one RE complicates the matter even further; AND

- Many of the suggested reforms seek to overcome these problems by treating an MIS as a separate legal entity, which in turn raises further complexities and public policy considerations.

Should you wish to discuss any aspect of our submission, please do not hesitate to contact Ms Kim Arnold, IPA Technical Director, on 02 4283 2402.

Yours faithfully

Denise North
Chief Executive

Annexure A - Complexities of MISs

Case Study: Timbercorp Almond Projects – demonstrating different nature of investors proprietary rights depending on the terms of the scheme documents

Facts:

- Investors ("Growers") invested in Timbercorp Almond Projects which (as the name suggests) involved the commercial cultivation of almond trees.-
- While the Growers owned the almond crop, the assets used in the Almond Projects (i.e. land, trees, capital works and water licences) (Almond Assets) at all times remained the property of Almond Land (a Timbercorp entity).
- Carefully structured so that the Growers' contributions were on revenue account (and thus fully tax deductible), not capital in nature.
- The Almond Assets had been mortgaged to Timbercorp's financiers (but subject to Grower rights).
- Almond Projects were bought to an end on 2 December 2009 when the Almond Assets were sold on an unencumbered basis to Olam Orchards for approximately $128 million (Fund).
- Litigation to determine competing claims to the Fund between the Growers and financiers.

Issues for determination:

- Was it necessary for Growers to show they had a proprietary interest in the Almond Assets to be able to claim on the Fund?
- If so, did they have such an interest?
- Given that the Projects could not continue under the existing structure, did the Growers' rights have any real value immediately prior to the Projects being bought to an end?
- If they had value, how was this to be calculated?

Held:

Nature of Grower Rights

- Growers had to establish their entitlement to the Fund
- This required them to show that they held rights of a proprietary nature in the Assets sold to Olam
- 2002 Almond Projects:
    - Rights acquired by Growers included:
        - right to grow almonds using Almond Land's trees
        - right to manage the orchards
        - right to harvest the almonds

        - right to 90% of sale proceeds from the harvests
        - a limited licence to use and occupy Almond Land's orchards, including the water licences, for this purpose
    - Therefore rights only contractual in nature and 2002 Growers had no claim on the Fund

- 2005, 2006 & 2007 Almond Projects:
    - Rights acquired by Growers included:
        - Instead of a licence Growers obtained a sub-lease of identifiable areas of Almond Land's land
        - This included the relevant trees and capital works but importantly not the water licences which were the subject of a separate grant of licence
        - Under the sub-leases the Growers obtained a proprietary interest in the land, trees and capital works
        - Under the grant of licence regarding the water licences, the Growers rights were only contractual in nature
    - Therefore Growers only had a claim on the Fund referable to land, trees and capital works
    - Value of Grower Rights
        - Projects could not have continued under their existing structures and were at risk of "imminent and inevitable termination":
        - all of the Projects required significant cash contributions well beyond the annual payments to be made by Growers - the Timbercorp group was insolvent and could not fund these
        - operating and capital expenses of each Project were expected to exceed the anticipated 2010 harvest returns
        - orchards were at risk of wastage and impairment
        - Therefore Growers rights had no value under the current structure
        - Could the Projects be re-structured to be made viable?
            - Growers argued that Projects would have continued to full term if they had been restructured
            - Akin to a "loss of opportunity" claim
            - Opportunity lost must be established on the balance of probabilities
            - Once the opportunity has been established, the value of its loss is ascertained by degree of likelihood of it occurring
            - Court was satisfied that there was a "chance" of a restructure

- The Growers had put forward Huntley Management Limited (HML) as an RE that would have been prepared to take over the Almond Projects subject to certain terms and conditions

- Court concluded on the evidence before it that the obstacles in the way of HML becoming RE were "insuperable" (timing issue, need for someone to purchase the land subject to the growers rights, simply finding a replacement RE would not save the projects if they were otherwise unviable, s 601FS and FT issues, tax position)

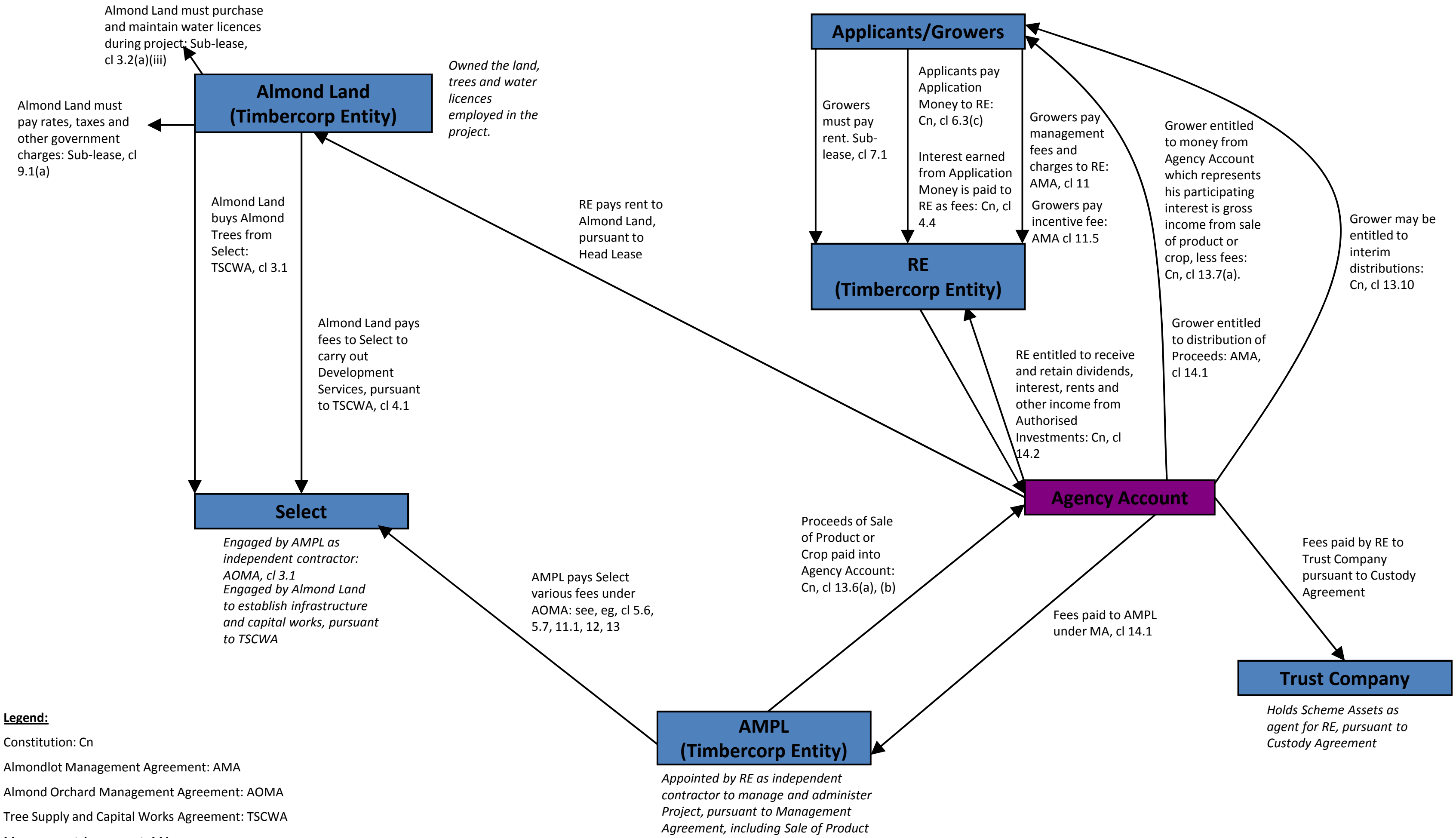
  - "Any prospect that the Projects would have been continued was wishful thinking and unfounded in the reality of the situation that the Growers found themselves in, regrettable as it was".

Conclusion:

- Both groups of growers were unsuccessful in establishing any entitlement to the Fund – but for different reasons. There was significant litigation and lengthy delay to reach this determination (which is currently on appeal).

- This case study demonstrates the complexity of dealing with investors in MISs and how investors in different schemes (even if similar in nature) can have differing rights.

Example: Money flow diagram for 2005-2007 Timbercorp Almond Projects



Legend:

Constitution: Cn

Almondlot Management Agreement: AMA

Almond Orchard Management Agreement: AOMA

Tree Supply and Capital Works Agreement: TSCWA

Management Agreement: MA

Annexure B - Managed Investment Schemes

CAMAC Discussion Paper – Response to questions raised in the discussion paper

Question / Reform	Response
Reform 1: identification and recording of the affairs of each MIS *Identification of agreements* Whenever an RE, as operator of an MIS, is a principal to a legally enforceable contract, arrangement or understanding (‘agreement’), the RE must specify that this is the case and identify the MIS to the counterparty. The RE must include that information in any document constituting that agreement. Where the agreement involves more than one identified MIS, the RE must identify what part, or proportion, of the agreement is attributable to each MIS. *Recording of agreements* From the commencement of an MIS, the RE (including any replacement RE) must maintain an ongoing register for that MIS of all relevant agreements. The agreements register must be divided into a ‘continuing agreements’ section and a ‘completed agreements’ section. Details of each agreement (and any material variations to that agreement) must be included in the former section, until such time as all rights, obligations and liabilities of any party under that agreement have been discharged, after which the details of the agreement must be transferred to the latter section. The agreements register must be maintained throughout the life of the MIS, and be available to any external administrator of that MIS. No agreement, whether or not still on foot, may be deleted from the register (except where recorded by mistake).	 Yes Yes. However, we suggest that there be a materiality threshold, below which recording is not required (full details below).
Should the policy approach in Reform 1 be enacted? Should the agreements register be a definitive	Yes. We agree that such a register would increase clarity and improve creditor rights. Yes. However, we suggest that a materiality

Question / Reform	Response
statement of all agreements entered into by an RE as operator of a particular MIS? If yes: • how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended? • what remedies should affected parties have for failure to include an agreement in the register and against whom?	limit be imposed so that only agreements over a particular threshold need to be included on the register. In order to have a right to claim directly against the MIS assets a creditor would have to either be: • below the materiality threshold and thus not required to be included on the register. OR • on the register, or provide evidence that they have taken steps to have the register corrected after identifying that they are not on the register (ie. have served a formal request to this effect on the RE). Creditors would need to have a right of access to the register on making a request to the RE. This process would be linked to the "call for claims" proposal to quantify claims against the MIS that could be undertaken by either the: • TRE during the transition to a new RE, • the new RE within a certain period of their appointment (if there was no TRE); or • the insolvency practitioner appointed to the MIS. The "call for claims" process would provide a process similar to calling for proofs of debt in a liquidation that would allow for quantification of the claims against the MIS. Claims that are not on the register or not lodged within the "call for claims" process would be excluded (on the basis that there is compliance with a statutory process for the calling for claims by the TRE/RE/insolvency practitioner).
If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.	The more definitive the register the better. However, creditors should not be disadvantaged by the RE's failure to undertake its duties. Accordingly, the process outlined above will ensure that if a creditor follows the appropriate process, it can preserve its right to claim directly against the MIS. If the creditor does not follow the process and the RE fails to include an agreement in the register, then the creditor will only have a claim against the RE personally for the amounts owing under the agreement, with no right of indemnity against the MIS's assets.

Question / Reform	Response
	We note that the statutory novation provisions under the Corporations Act would have to be aligned to these new provisions for the process to work as intended.
Reform 2: use of scheme property The property of a particular MIS can be used only for the purposes of that MIS.	 Yes
Should the policy approach in Reform 2 be enacted? Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?	Yes. No exceptions.
Reform 3: informing MIS creditors of a change of RE Where the RE of an MIS changes, the new RE must give notice of that change to all counterparties included in the 'continuing agreements' section of the agreements register referred to in Reform 1, and to any other counterparty of which the new RE is aware or becomes aware.	 Yes. Suggest that this also involve some form of public advertisement or notice process. Would include any counterparties identified during the "call for claims" process.
Should the policy approach in Reform 3 be enacted? What, if any, consequences should follow where an RE fails to inform a counterparty?	Yes We are of the opinion that this should be dealt with as part of the normal contractual relationship between the parties (eg the counterparty could impose a contractual obligation on the incumbent RE to notify it of any change of RE, such that the incumbent RE is liable (in its personal capacity) for any loss and damage caused by a failure to comply with this obligation). However, we would not disagree with the imposition of a statutory requirement with a penalty for non-compliance.
Reform 4: rights of MIS creditors against scheme property Only persons who have entered into an agreement with an RE as principal in its capacity	 Yes

Question / Reform	Response
as the operator of a particular MIS, and the RE in respect of its indemnity and other rights against the property of that MIS, will be the creditors of that MIS. Persons who have transacted with the RE in this capacity will have the right to claim directly against the property of that MIS, not through subrogation to the RE's right of indemnity against scheme property.	 Yes

Question / Reform	Response
Related provisions *1: Rights of MIS creditors against assets of the RE* In addition to their rights under Reform 4, all counterparties to arrangements with an RE as principal that refer to a particular MIS (as per Reform 1) may claim against any property of the RE that is not held in trust by the RE, except for those counterparties who agree to limit their rights of recovery to Reform 4. Property of the RE not held in trust would include any indemnity rights of the RE against the property of any MIS. *2: Rights of other creditors of the RE* Where an RE as principal enters into arrangements that do not refer to a particular MIS (as per Reform 1), the rights of counterparties are confined to property of the RE that is not held in trust by the RE.	The result of this is that for each MIS, claims would be made against its property by its creditors directly and by the RE under its indemnity right, assumedly for any outstanding remuneration and any debts that it has paid or incurred on behalf of the MIS. Rules to prevent "double-proving" would need to apply. Creditors with a right to claim against the particular MIS trust property held by the RE would then also have a right to claim directly against the RE as well (unless contractually excluded). We agree, however a consequence of this would be that an insolvency of an RE could never be finalised until the position of all of its MISs are finalised. Yes, there is an obligation on the parties to the contract to ensure that the correct parties to the contract (including any MISs) are recorded in the agreement. Significant issue to be resolved: is the RE's right of indemnity a quasi-security interest such that it has priority over unsecured creditor claims? Furthermore, how would this potential priority fit with the remuneration and expenses claims of any administrator, liquidator or new RE. Trust law suggests that the outgoing RE would have a priority in these circumstances. This may be a significant obstacle to an administrator, liquidator or new RE agreeing to take the appointment.
Should the policy approach in Reform 4 be enacted? If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?	Yes Only those persons claiming under an agreement that has been recorded in the agreements register. However, we have proposed a threshold level for registration of agreements. Creditors under the threshold, who we propose do not have to have their agreements registered, should have a right to be able to claim directly against the MIS property once they satisfy a "call

Question / Reform	Response
Should the two related provisions also be adopted?	for claims" type process that would prove their claim against the MIS. All agreements above the proposed threshold must be included on the register to have a direct claim, unless a creditor with an unregistered agreement can demonstrate that they have taken steps to have the register corrected (ie. have served a formal request to this effect on the RE),in which case that creditor should also have a right to claim against the MIS assets. Yes
In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time? Who should have access to that register and through what process?	Yes Members of the scheme on written request. Potential TRE. Potential replacement RE during the due diligence process. Administrator or Liquidator of MIS
Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members? Who should have access to that register and through what process?	Yes Members of the scheme on written request. Potential TRE. Potential replacement RE during the due diligence process. Creditors on request to the RE Administrator or liquidator of MIS
Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE? In what circumstances, if any, and for what	No, continue to rely on established case law. We consider this issue to be less relevant should creditors have direct rights of access to MIS assets. The nature of tort claimants is different to

Question / Reform	Response
reasons, should tort claimants have direct rights against the property of an MIS?	contractual creditors. The register at reform 1 records agreements that the RE/MIS enters into voluntarily, and the purpose of the register is to provide transparency. Tort claims are rarely incurred voluntarily and the fact and quantum of the claim may not always be known to the RE until sometime after they arise (and thus cannot be included on any register of obligations). Whether the tort arises as a result of the RE's breach of trust should also in our view remain a relevant consideration as to whether the tort claimant has access to the MIS assets (via the RE's right of indemnity). Accordingly, it is our opinion that the treatment of tort claimants should remain unchanged.
What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why? What changes, if any, should be made to the powers of the court to appoint a TRE and why?	For the purposes of the removal of an RE, appointment of a new RE, appointment of a TRE, or passing a vote of no confidence (refer below)a special resolution (75% of votes cast at a meeting) is required, with the added requirement that votes cast in favour must constitute at least 25% of the total votes of scheme members. We are addressing generally who should be able to appoint a TRE. We see the TRE as an interim role (3 months unless extended by application to the court), appointed for the purpose of maintaining the MIS while determining whether a new RE can be located or whether the MIS should be placed into some form of insolvency administration. The following parties should be able to appoint a TRE: • members on the passing of a special resolution (refer above); or • the Court. The court should not have the power to appoint a TRE if an RE is removed without a replacement RE being appointed in its place. An MIS should not be able to exist, even for a short time, without an RE. However, as an alternative to removing the incumbent RE when a replacement has not yet been found, the members should be able to pass

Question / Reform	Response
	a vote of no confidence in the incumbent RE (by special resolution). The RE remains in office but then must assist any parties interested in becoming the new RE or TRE with their due diligence. Another vote at a meeting subsequent to the due diligence process would then have to be passed by members to appoint the new RE or TRE (or, in the latter case, by an application to the court). There would have to be controls around confidentiality and eligibility to express interest to be the new RE / TRE. This would have the added benefit of the RE only having to assist potential new REs or TREs once a vote of no confidence is passed.
In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?	An RE should also have an obligation to generally assist any replacement RE or TRE once appointed, or any insolvency practitioner appointed to the MIS.
Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?	Yes it should be amended to include registered liquidators. We envisage that the role of the TRE is different to that of the RE with more of a caretaker role while it is determined whether a new permanent RE can be found and appointed (or a formal insolvency administration commenced). If the MIS is in financial distress, this would be a similar role that an IP takes when determining whether a business can be sold as a going concern. The IP continues to run the business with the aim of finding a new owner. With an MIS, the IP will maintain the operations of the MIS whilst looking for a new RE. If a new RE cannot be found, the role of the IP could then transition to a formal insolvency administration.
What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?	We agree with option ii) provided in the paper. The TRE should have limited liability. However, our agreement is on the basis that the appointment of the TRE is of a limited duration (3 months, or longer by application to the court), and as result, there would be a reduced scope for the incurring of excessive liabilities and remuneration that may have priority over the pre-existing liabilities of the original RE (refer to page 4 for a discussion on the priority of the RE indemnity).

Question / Reform	Response
What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?	The duties of the TRE should be able to be amended by the Court taking into account the circumstances of the particular MIS. The TRE should be treated as an interim role maintaining the MIS until such time as a new RE is appointed or the scheme is placed into formal insolvency administration.
What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?	For a Court appointed TRE the Court should be able to make the necessary orders regarding the TRE's remuneration. For a member appointed TRE, similar provisions to those governing the remuneration of voluntary administrators should apply. The priority of the TRE's is subject to the resolution of the issue of the priority of the RE's indemnity (refer page 4).
Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons? In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to: • possible conflicts of interest faced by the TRE • the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced) • a TRE providing assistance to an external administrator?	The TRE should have a role in the appointment of an MIS administrator. In the role of TRE, the TRE is in a position to assess the financial health of the MIS and make a decision as to whether the appointment of an administrator is necessary. The TRE should have the right to make the appointment, but it should be subject to the same restraints as a corporate appointment, ie. a determination that the MIS is insolvent, or likely to become insolvent at some future time. The TRE would be able to appoint itself as MIS administrator (assuming eligibility) but then the court or creditors would have to confirm the appointment. The potential for a conflict of interest in these circumstances would need to be balanced against the TRE's detailed knowledge of the MIS' affairs. Where an MIS administrator replaces the TRE or RE, he or she can commercially engage either the TRE or RE to assist the administrator at a cost to the administration if such assistance is required. This would be similar to an insolvency practitioner engaging a person who happens to be a director to assist with the operation of the business in a corporate insolvency.
What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason	As noted above, the statutory novation provisions would need to be amended so that the incoming RE only assumes those liabilities

Question / Reform	Response
	recorded in the register (subject to the exceptions noted regarding materiality and an unregistered creditor who has taken steps to be registered).
What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?	We agree with the Turnbull Report's recommendation that the payment of fees or the right to an indemnity cannot be claimed in advance of an RE's proper performance of its duties. The debt to be recovered under the indemnity must have been paid or the service provided by the RE for the RE to be entitled to be paid.
What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?	This would be a standard feature of many debt facilities in order to make the debt due and payable in the event of a change of the RE. Lenders do not include such a clause to prevent the changing of an RE. They include it to protect their debt position and to ensure that the new RE is acceptable to them from a credit risk perspective. Presumably any potential replacement RE will seek to negotiate directly with the lender for a continuation of the debt facility upon their appointment. We do not believe that it is appropriate for there to be any statutory controls in these circumstances.
Is there support in principle for the concept of a VA for an MIS? Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS? What types of matters concerning these parties should be included in the VA of an MIS? What should be the grounds for initiating the VA of an MIS?	Yes, though consideration should also be given to a court controlled Scheme similar to Part 5.1 or a Judicial Manager of the type set out in the Insurance Act. Yes, to be able to effect a restructure the VA must also apply to scheme members. Furthermore, classes are essential to protect the rights of creditors if members are to be allowed to participate and vote. Without separating members into a separate class from creditors, members would be able to "outvote" creditors in most situations due to sheer numbers. As discussed in the paper at 5.4.4 The RE or TRE should have a role in the appointment of an MIS administrator. In the

Question / Reform	Response
Who should be entitled to initiate the VA of an MIS?	role of RE or TRE, the RE or TRE is in a position to assess the financial health of the MIS and make a decision as to whether the appointment of an administrator is necessary. The RE or TRE should have the right to make the appointment, but it should be subject to the same restraints as a corporate appointment, ie. a determination that the entity is insolvent, or likely to become insolvency at some future time. The RE, TRE or any other stipulated person should also have the right to apply to the court for the appointment of a VA. The Court could consider the solvency of the MIS and whether the appointment of a VA would be in the general interests of creditors and members of the MIS. Members of the MIS could resolve by special resolution that an administrator be appointed. A Liquidator of an MIS should also have the right to appoint an administrator in the same circumstances as a liquidator of a company can.
If the VA of an MIS is to involve classes other than MIS creditors: • in relation to any voting on a proposed MIS deed: o how should the classes entitled to vote on the MIS deed be determined? For instance, should it be left to the administrator to determine those classes, taking into account the extent to which the deed affects their interests	We see that there is only likely to be two classes – members and creditors. We envisage that there may be situations where a member may also be a creditor. To prevent the situation of members "voting out" creditors due to numbers, a provision will be required to prevent a member from being treated as a creditor in respect of debts related to their investment (eg. a Sons of Gwalia type provision recently introduced for companies). To account for any situations where there may be more than these two classes, the MIS administrator should have the ability to seek assistance of the court.
o where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests	Whole deed
o should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it	All classes need to vote in favour for a deed to come into force. Once accepted the Deed binds all parties, unless they vote in favour.
• what should be the voting rules for any proposal that: o the MIS be wound up, or	Each class should pass the resolution with a simple majority of number and value (same as VA of a company).

Question / Reform	Response
o the MIS administration end and the MIS continue as before? In what circumstances, if any, should an MIS deed be able to override the rights of members under the constitution of the MIS or impose new obligations on those members?	If a resolution accepting a deed proposal or ending the administration is not passed, the default position should be the winding up of the MIS. This is on the basis that the MIS was determined to be insolvent or likely to become insolvent at some future time on the appointment of the administrator. There is an additional issue of the administrator having to manage conflicts between the members and creditors where a particular course of action may be beneficial to one group but not necessarily beneficial to the other. Where the deed is passed (this would indicate acceptance by the requisite number of the class of members)
What, if any, legislative provision needs to be made to prevent duplicate VAs?	We agree with the comment in the options paper that where both the RE and MIS are in some form of external administration they should be treated separately. With the scheme property and all claims by MIS creditors being dealt with in the administration of the MIS. Note however, that MIS creditors may also have a claim directly against the RE (suggested reform 4) unless they contract not to. As a result, they may be entitled to also participate as creditors in the administration of the RE. We agree with the requirement for the sharing of information.
In the context of an MIS administration, should there be any change to the current requirements that only a registered liquidator can be an administrator and, if so, why?	No. Insolvency administrations should be undertaken by registered liquidators. The administrator is able to engage any expert assistance required.
Should an MIS administrator have similar powers to those of the administrator of a company? For what liabilities, if any, should an MIS administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?	Yes. We agree with the comments made in the paper. The liabilities as stated in the paper, which mirror that of voluntary administrators of companies. The administrator should be indemnified from scheme property and that

Question / Reform	Response
	indemnity would have priority over any direct claims of pre-appointment MIS unsecured creditors (reform 4). See our comments above (page 4) regarding the priority position of the outgoing RE's right of indemnity.
Who should determine the remuneration of an MIS administrator or an MIS deed administrator? What, if any, classes of persons in addition to the MIS creditors should be involved and in what manner and for what reasons? What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?	Whoever is entitled to vote for the deed should have the right to vote to approve the administrator's remuneration. The priority provisions should mirror the applicable provisions for voluntary administration / deed administration of companies as much as possible.
What powers should the court have in any VA of an MIS, and who should be entitled to apply to the court for this purpose?	We agree with the ALRC / CASAC approach.
In what circumstances, if any, should there be a power to appoint a TRE to operate an MIS in the context of a VA of that MIS, and who should be able to exercise any such power?	The administrator will be in control of the MIS during the VA (instead of a RE or TRE). Assistance as required can be engaged by the administrator. The administrator (through the terms of the Deed) or the court should be able to appoint a TRE or RE to a MIS subject to a deed. This would be similar to a company being returned to the control of its directors once a Deed of Company Arrangement is entered into.
Are any changes needed to: • the current circumstances where an MIS can be put into liquidation with/without the need for court approval • the provisions governing who can conduct the winding up? In this context: • should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why	It is arguable that all windings up of MISs should be undertaken by a suitably qualified third party, being a registered liquidator. Where all creditors will be paid in full, from either MIS property or by the RE, then it may reasonable for the RE to attend to the winding up (analogous to a Members' Voluntary Winding up of a proprietary company – s532 – where the requirement to be a registered liquidator does not apply). An RE could not act to wind up the MIS where it itself is insolvent. All windings up of MISs where the RE is insolvent should be undertaken by a registered

Question / Reform	Response
• is there a need for a separate insolvency ground for winding up an MIS • if so: o how should the insolvency of an MIS be defined o should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?	liquidator. Additional points: • creditors of MIS should be able to apply to the Court to have the scheme wound up in insolvency; • the threshold for members to resolve to wind up a scheme should match that of a resolution to replace the RE etc (we propose 75% of votes cast at a meeting, with the added requirement that votes cast in favour must constitute at least 25% of the total votes of scheme members); • the mechanism for an RE to initiate the winding-up of a scheme under s601NC is cumbersome and effectively subject to member veto. If the reforms are introduced, in practice it no doubt will be superseded by a RE simply appointing a VA. Query whether therefore this mechanism should be retained. If the suggested reforms are implemented so that creditors have a direct claim against the MIS, the solvency of an MIS can be assessed in the same way as a corporate entity using the traditional cash flow test (ie. can the MIS meet its debts as and when they become due and payable?)
Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?	Where all creditors will be paid in full, from either MIS property or by the RE, then it may be reasonable for the RE to attend to the winding up (analogous to a Members' Voluntary Winding up of a proprietary company – s532 – where the requirement to be a registered liquidator does not apply). An RE could not act to wind up the MIS where it itself is insolvent. All windings up of MISs where the RE is insolvent should be undertaken by a registered liquidator.
In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)?	The amendments proposed via suggested reforms 1 to 4 are suggestive of the creation of a quasi "separate entity" for each MIS. Taking these reforms, and the potential conflicts that

Question / Reform	Response
In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS? If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome? In this context: • are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take responsibility for the liquidation of an MIS • against what property might the claims of the RE liquidator and the MIS liquidator concerning their costs and expenses be claimed, and what would be their respective rights if the same property is involved?	would be faced by a practitioner administering both liquidations, we are of the view that separate liquidations are most appropriate. Alternatively, the appointment of a special purpose liquidator to attend to the matters of conflict may be a more cost effective solution. Claims of the RE liquidator will be met from the property of the RE. Claims of the MIS liquidator will be met from the property of the MIS. In these circumstances we reiterate our comments on page 4 regarding the potential priority of the RE's right of indemnity against scheme assets.
Would the process for liquidating an MIS be better provided for by: • an extension of the powers of the court in s 601EE to all MISs, or • a legislative procedure containing some or all of the elements discussed in Section 6.6 and for what reasons?	A legislative structure, that mirrors as much as possible the corporate insolvency provisions, with the ability to seek court directions (s 479).
What procedural provisions should there be for winding up an MIS and why? In particular, should a party conducting a winding up: • have information gathering and other investigative powers comparable to those of the liquidator of a company • have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity? Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating? Is there a need for any legislative procedures for	We support the suggestions made in the ALRC / CASAC report. Yes Yes No - an RE should only be able to wind up an MIS where all creditors will be paid in full, either from MIS property or by the RE (ie. solvent winding up).

Question / Reform	Response
winding up an MIS to be varied to take into account the particular characteristics of MIS structures (trusts, partnerships, contract-based MISs)? If so, what?	We suggest that the basic structure be the same for all MISs, but that there be scope for the liquidator to seek directions from the court.
Should there be a statutory order of priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?	Yes, it should mirror the priority provisions for a liquidation as much as possible. See, however, our comments above (page 4) regarding the priority position of the outgoing RE's right of indemnity.
Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those provisions?	Yes, particularly if the reforms are implemented and a MIS's money is used to pay another MIS's creditors or the RE's non-MIS related creditors. Transactions undertaken by the RE should be examined to ensure their appropriateness.
What provisions, if any, should be included to deal with access to books of the MIS?	Yes, access should be available to the RE (or the external administrator of the RE). Investors and creditors should be subject to the equivalent restrictions to section 486 in a liquidation.
Should there be any changes to the current provisions by which the court can give directions, and, if so, what and why? In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?	In a restructure (MIS administration) flexibility is important and therefore a provision similar to s447A is needed. However, in a liquidation, there is no restructure and there should be a focus on certainty of the process rather than flexibility and thus only a section similar to 479 in the liquidation of a company is required.
What provision, if any, should be made for MIS members in the winding up of their scheme? Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?	In a winding up members should be treated akin to shareholders as the scheme cannot be salvaged. They would only be entitled to any surplus after payment in full of creditors and the expenses of the winding up. The liquidator should not owe them any specific duty beyond his/ her general fiduciary duties to the scheme.
Are the grounds for winding up a registered MIS (see Section 6.1.1) equally applicable to a lawful unregistered MIS?	Yes
Should there be any provisions governing the	Yes – should mirror provisions for registered

Question / Reform	Response
procedure to be followed in winding up lawfully unregistered MISs and, if so, what?	MISs (see our comments above)
Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?	Yes. The automatic winding up of these schemes may not be in the interest of members. We suggest that the VA procedure be available for such schemes so that the administrator can determine whether the scheme is in fact viable, and explore whether it can be restructured so as to be compliant with the legislative regime. Should this be the case, the restructure would be effected by way of a deed of arrangement for the MIS, with control ultimately being returned under the deed to a new RE or TRE.
Should a former member of an MIS have standing to apply for the winding up of an unregistered MIS? Should a creditor have standing to apply for the winding up of an unregistered MIS?	Yes, but only in a situation where they have a claim against the MIS. Consideration should be given to requirements for notification of other parties that may be affected by what is sought in the application. Yes but query how this would operate in practice. To be a direct creditor of the unregistered scheme the relevant agreement would need to be registered but, of course, no such register is likely to be maintained where there is no RE and no registered scheme. Accordingly, the creditor will need to establish that their agreement was entered into in relation to, or for the purposes of, the unregistered scheme.
Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons? For what purposes, if any, should ASIC be granted the power to convene meetings of members? Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?	As these are not insolvency related issues, the IPA offers no comment.
In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by	No, as an observation, it is not usually the provision of a guarantee that leads to the insolvency of an RE but rather its reliance on

Question / Reform	Response
REs and, if so, for what reasons?	funding from other entities in its corporate group.
Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes? Should the limited liability principle be subject to any contrary provision in the scheme constitution?	As these are not insolvency related issues, the IPA offers no comment. However, as an aside, limited liability sits uneasily with the concept of members being "growers" with direct rights to cultivate their trees, which concept underpins the tax effectiveness of their investment. In any event, most constitutions will exclude personal liability beyond the liability to make the annual contributions required for the purposes of the scheme. Where those payments are not made, the member usually just forfeits their investment, or the outstanding contributions (plus interest) are deducted from their ultimate payout.
Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?	Please refer to our submission letter. One additional comment we would make is that there should be an equivalent provision to section 545(1) in the winding up of an MIS.

Allens Arthur Robinson

Submission to the Corporations and Markets Advisory Committee

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CAMAC Discussion Paper on Managed Investment Schemes

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Table of Contents

1. Introduction

Allens Arthur Robinson welcomes the opportunity to comment on CAMAC's Discussion Paper of June 2011 on *Managed Investment Schemes* (the ***Discussion Paper***).

We have approached our submission from both:

(a) a policy perspective – that is, do the possible reforms set out in the Discussion Paper appropriately address the issues that were highlighted by the recent managed investment scheme (***MIS***) collapses?; and

(b) a more practical perspective – that is, what will be the likely direct impact of such reforms on operators of MISs and other parties who invest in or contract with MISs?

We respond to Chapters 3 – 7 of the Discussion Paper in Sections 3 – 7 (respectively) below.

2. Preliminary remarks

A key theme that is highlighted in the Discussion Paper and that underpins many of our responses in this submission is the distinction between, what are described in the Discussion Paper as, 'trust-based' or 'pooled' schemes, on the one hand, and 'contract-based' or 'common enterprise' schemes, on the other.

In our view, this distinction is at the heart of the dilemma caused by the recent MIS collapses. A regulatory or legislative response that overlooks this distinction, and that instead seeks to impose a set of rules uniformly to both trust-based and contract-based schemes, would be flawed. Indeed, in our view, this would be likely to increase, rather than reduce, the complexity and uncertainty that presently exists.

The Discussion Paper makes the following comments regarding contract-based schemes:

> The 'scheme' in that case is not a pool of assets under management, but rather the common enterprise carried out over time in accordance with those contracts… In that type of MIS, complex problems can arise in determining the nature of the rights of MIS members, and what, if anything, constitutes the property of the scheme.

These problems are compounded by the *Corporations Act* framework which, despite not mandating a particular legal structure, relies on concepts such as 'scheme property', which are predicated on a trust-based structure, and goes so far as to impose a statutory trust over all scheme property (s601FC(2)). This means that, when a contract-based scheme collapses, the statutory mechanisms that are intended to facilitate winding up, or otherwise rehabilitating, the scheme, have proved to be of limited utility, as they assume a trust-based structure.

The recent MIS collapses have occurred predominantly in the contract-based agribusiness MIS sector. The insolvencies of Great Southern, Timbercorp, Rewards, Environinvest, FEA and Willmott Forests during 2007 – 2010 each involved entities that acted as responsible entities (***REs***) of agribusiness MISs being placed into a form of insolvency administration. The complexity that followed involved the MIS itself: that is, whether the MIS could survive the insolvency of the RE, and the identification and evaluation of the rights of the various stakeholders in relation to the MIS.

By contrast, in the non-agribusiness sector, there were fewer examples of REs becoming insolvent or, where they did become insolvent, there was less uncertainty about the status and future of the MIS itself. In most cases, the MIS was either wound up, or was able to 'rehabilitate' itself through a change of RE or restructure – in the Schedule we have referred to some examples.

The unique features of the contract-based agribusiness MISs meant that the statutory tools available either to wind up, or to rehabilitate, a scheme were not as readily available to those schemes as they were to the trust-based schemes. For example:

- the uncertainty surrounding statutory novation of liabilities on a change of RE of a contract-based scheme, where the capacity in which the RE incurred liabilities was often blurred, limited the attractiveness of the RE role to prospective replacement REs;
- the difficulty in identifying the 'scheme property' of contract-based schemes, compounded by the statutory trust over 'scheme property' imposed by s601FC(2), created uncertainty in ascertaining the (often competing) rights of investors and other stakeholders, such as secured creditors, over property connected to the scheme; and
- the mechanisms available to wind up a scheme proved to be very limited in the context of agribusiness MISs, to which traditional trust-based tests of 'solvency' (ie, the availability of assets to indemnify the trustee for liabilities incurred) were not suitable.

In the Schedule we have also set out some of the unique features of the contract-based agribusiness MISs that we see as having contributed to the collapse of those schemes and the complexities that followed as a consequence of their legal structure.

The Australian Securities and Investments Commission (***ASIC***) has required some types of contract-based MISs (for example, serviced strata title schemes and time-sharing schemes) to be structured and operated in accordance with tailored regulatory frameworks (set out in class orders) that recognise the particular contractual arrangements and features of those schemes. However, ASIC has not done so for agribusiness MISs. Instead, it has been necessary to 'shoe-horn' into the *Corporations Act* regime arrangements that do not naturally exhibit the characteristics contemplated by the statutory framework. A further tension in the design of agribusiness MISs has been the need for these schemes to be carefully structured so as to ensure that contributions by investors are of a revenue nature and therefore tax deductible.

As Judd J remarked in *Re Environinvest Limited (No 4)* [2010] VSC 549:

> 'Wherever ultimate responsibility for the collapses may reside, it is difficult to overlook structural flaws in the design and regulation of managed investment schemes. These flaws

facilitated investment strategies, management practices and decisions, regulatory attitudes and revenue policies which together conspired to cause huge financial loss to investors, the revenue, banks and other financial institutions, and the communities in which the schemes were operated.'

The reforms proposed in the Discussion Paper respond directly to some of the specific issues that arose in the context of the agribusiness MIS collapses as a result of the unique business models, cash flow requirements, taxation objectives and contractual arrangements that characterise those schemes. However, to the extent that the reforms apply to all MISs and are not limited to contract-based agribusiness MISs, we believe that their ability to address the more fundamental imperfections that exist in particular MIS structures will be weakened. In our view:

(a) the proposals – particularly those in Chapters 5 and 6 - do not all have the same relevance for trust-based MISs, where the legal and regulatory concepts are more clearly understood. We agree with the statement in section 1.1 of the Discussion Paper, that *'[t]he problems that have arisen in recent years in part reflect difficulties experienced in particular commercial sectors, or with particular MIS structures.'* The collapse of trust-based schemes was not attended by the same problems as those which attended the agribusiness MIS collapses; and

(b) the proposals aimed at introducing a statutory regime for dealing with MIS-related insolvencies are likely to be unworkable in the context of contract-based schemes, and unnecessary in the context of trust-based schemes.

We expand on these issues in our detailed submissions below.

For these reasons, we would encourage CAMAC to adopt the approach recommended by the Parliamentary Joint Committee on Corporations and Financial Services in its *Inquiry into financial products and services in Australia* (November 2009)[1] and, if any immediate regulatory reforms are considered essential to deal with the issues which attended agribusiness MISs, to limit the application of those reforms to that sector of the industry (or contract-based schemes in general).

In our view, instead of introducing additional statutory requirements and procedures that will apply to all MISs irrespective of their legal structure, the preferred regulatory response would be to focus on those schemes that do not conform with the trust-based structure contemplated by the statutory framework and, therefore, are not able to utilise the statutory tools and protections currently available to other schemes under the *Corporations Act* in the event of a collapse. The response may be to introduce specific reforms, or tailored regulatory regimes, for those arrangements, with a view to addressing the structural flaws,

[1] At paragraph 6.153, the Inquiry states: 'The committee also noted that it would discuss any need for additional capital adequacy oversight of agribusiness MIS in this report, having wanted to see if similar product safety issues emerged during this inquiry that might influence the committee's recommendation. Ultimately, the committee has concluded that improving the regulation of financial advice in relation to financial products is more effective than regulators attempting to ensure, through additional regulation, that products are 'safe' for investors. Notwithstanding this and the fact that ASIC is not a prudential regulator, the committee is of the view that the unique nature of agribusiness MIS warrants some regulatory intervention to ensure that these schemes do not, over time, develop a ponzi-like character by relying on new product sales to prop up existing schemes. Accordingly, the committee recommends that, as part of their licence conditions, ASIC require agribusiness MIS licensees to demonstrate that they have sufficient working capital to meet current obligations.'

complexities and uncertainties to which the recent collapses gave rise. That said, given the well-publicised difficulties that contract-based schemes have endured since 2007, further investigation may show that they will not form a significant part of the MIS sector in future, raising the question whether wholesale reforms for a dwindling sector are necessary or appropriate.

3. Chapter 3: Proposed key legislative reforms

This chapter proposes a number of key legislative reforms which are intended to improve the identification of the affairs of each MIS, place controls on the use of scheme property of each MIS and clarify the rights of creditors.

In this Section, we respond to the questions included in the Chapter (having regard to the information and views expressed in the Chapter itself).

3.1 Reform 1: identification and recording of the affairs of each MIS

Should the policy approach in Reform 1 be enacted?

We are cautiously supportive of the policy approach in Reform 1. We do query the utility of the register without a related obligation to maintain a copy of each agreement to be provided with the register in limited circumstances.

However, we see the register as a tool that would serve a narrow purpose of assisting REs, members, external administrators, and others who have dealings with the MIS, to identify agreements attributable to each MIS, particularly where the RE of the MIS operates other MISs, or undertakes activities in its personal capacity. For example, the register would be useful to a new RE in identifying the agreements it has inherited, as well as to an external administrator in operating the scheme (where the RE has become insolvent) . We would not support the introduction of a register if its purpose was to alter the legal position of counterparties or the effect of the statutory novation provisions of the *Corporations Act* on a change of RE.

If the reform is to be introduced, will REs of existing MISs be required to compile a register for each MIS? If so, it will be necessary to afford REs a transitional period to comply.

Also, it is not clear from the Discussion Paper whether the agreements register will need to specify only those agreements that it has entered into in its capacity as responsible entity of the scheme, or whether the register will also need to include agreements that 'relate to the scheme' (within the meaning of section 601FS). This was a key issue in the agribusiness MIS collapses, where the structure of the schemes meant that the RE would typically enter into contracts (including contracts with growers) in its 'personal' capacity, but those contracts 'related to' the scheme (and were, therefore, subject to statutory novation).

Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?

If yes:

- *how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended?*
- *what remedies should affected parties have for failure to include an agreement in the register and against whom?*

If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.

If the policy rationale behind Reform 1 is to be effective, then the RE must be obliged to enter all agreements to which it is a party in respect of a particular MIS into the register. It will be necessary to consider the mandatory contents of the register having regard to the RE's confidentiality obligations which may be owed to counterparties to agreements. If the purpose of Reform 1 is to be achieved, it seems to us that the Register should include relevant change of control triggers.

Counterparties should have a statutory right to require the RE to produce an extract of the register showing pertinent details of its agreement with the RE in respect of the MIS, with a statutory right to require errors in the register to be corrected.

Compliance with obligations imposed on REs in respect of Reform 1 could be monitored as part of the annual compliance plan audit.

However, we do not believe that the agreements register should operate as a definitive statement of all agreements entered into by an RE as operator of the particular MIS, including for the purposes of the statutory novation provisions in sections 601FS and 601FT of the *Corporations Act*. The statutory novation provisions should operate independently of the agreements register and the agreements register should not determine the rights, liabilities and obligations that are transferred to the new RE by law. Any failure by the RE to comply with the obligations imposed under Reform 1 should not invalidate the agreement or the RE's right of indemnity in respect of liabilities incurred under the agreement. Nor should a new RE have a statutory right to claim against a former RE for any amount paid to a counterparty in consequence of the former RE not having registered an agreement. We submit that non-compliance should be dealt with by the imposition of civil penalties on the RE, its officers or employees.

We have reservations about the circumstances in which a person may have a right to request a copy of the contracts register or seek to inspect the register. We submit that there needs to be a proper purpose overlay to any inspection right in the same way as there is for inspections of member registers and company books and records. Confidential information in contracts will need to be protected and it may be necessary to allow counterparties to require that confidential information which may be required to be included in the register must be redacted before inspection rights or copies are afforded to third parties.

We also submit that access to the register should be limited to ASIC, the MIS and RE auditors, the MIS compliance plan auditor, members, external administrators of the RE and proposed temporary REs. We do not support access to the register for a third party which may be seeking to procure the replacement of the RE in adversarial circumstances.

We question why only material variations need to be included in the register. If the register is to assist in providing a complete picture of the operation of an MIS, then all variations should be recorded.

For many agreements, counterparties may have continuing obligations long after active duties under the agreements have ceased (for example, continuing obligations of indemnity). In these circumstances, it is unlikely that agreements will readily be able to be recategorised as completed. Perhaps the register needs to distinguish contracts with active performance obligations, those with contingent liabilities and those which are completed.

3.2 Reform 2: use of scheme property

Should the policy approach in Reform 2 be enacted?

We support this policy reform and are of the view that Chapter 5C and general trust law already impose this requirement on REs. It is also consistent with section 601GA(2) of the *Corporations Act*, which says that if the RE is to have any rights to be indemnified out of scheme property for liabilities or expenses incurred in relation to the performance of its duties, those rights must be specified in the scheme's constitution and must be available only in relation to the proper performance of those duties.

In our view, a key issue is the definition of 'scheme property' itself. As noted in section 3.5 of the Discussion Paper, although this concept is well understood in trust based schemes, this is certainly not the case in contract-based schemes, particularly having regard to the statutory trust imposed over scheme property under section 601FC(2). We consider that the meaning of 'scheme property' as it applies to contract-based MISs, including agribusiness MISs, requires urgent clarification, as this uncertainty has been the basis for much of the complexity in the collapse of those structures. We comment further in Section 5.2 below.

Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?

It may be necessary to provide exceptions to this reform for stapled MIS, which are usually permitted under relief granted by ASIC, to treat the stapled MIS as a single entity for many day to day operational purposes.

3.3 Reform 3: informing MIS creditors of a change of RE

Should the policy approach in Reform 3 be enacted? What, if any, consequences should follow where an RE fails to inform a counterparty?

We do not support this reform. In our view, notification requirements should be dealt with contractually and not by statutory obligation.

3.4 Reform 4: rights of MIS creditors against scheme property

Should the policy approach in Reform 4 be enacted?

We support this reform. It reflects the reality of the approach to contracting taken by most REs and can only advantage counterparties, which would no longer be reliant on the RE's right of indemnity being preserved, in order to have liabilities satisfied from MIS assets. It is likely to increase the speed with which contracts can be negotiated as the reform will obviate the need for inclusion and negotiation of RE capacity and limitation clauses in contracts.

How would the right of the counterparty be characterised, and what mechanisms would be introduced to facilitate direct access to MIS assets?

If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?

In our view, the rights of creditors should not be limited to those persons claiming under an agreement that has been recorded in the agreements register. There may be any manner of reasons why a contract has not been recorded in the register and limiting counterparty rights in this way would be unreasonably prejudicial.

Should the two related provisions also be adopted?

The related provisions are broadly acceptable but will need significant thought and refinement. We would support legislating the form of words which must be used in an agreement to ensure that the counterparty may have recourse directly to assets of the MIS.

What is proposed in relation to issues of priority as between the RE's claim under its right of indemnity or recoupment and the counterparty's claim, where the counterparty has agreed to limit its recourse to the assets of an MIS? The RE, as a trustee, has a proprietary interest in the MIS assets supporting its right of indemnity and recoupment, which has priority over the interests of members and may have priority over other creditors unless displaced by agreement.

The position of counterparties under multi-MIS contracts will need to be carefully considered. It is not unusual for a multi-MIS RE and a counterparty to enter into an agreement which specifies that the RE enters into the agreement in its capacity as RE of MISs agreed from time to time between the parties. The agreement will not identify particular MISs but the intention of the parties will be very clear. If related provision 2 is adopted, it will need to accommodate contracts of this nature.

3.5 Identifying scheme property

In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time?

Trustees under trust law have a duty to keep and render an account of the trust to beneficiaries. A schedule of property should form part of the trust accounts maintained by the RE. Accordingly, the obligation of an RE of an MIS to keep a register of MIS property should not need to be replicated in statute.

We think that the real issue here is in identifying what does, or should, constitute scheme property in the first place. It is a definitional issue and requiring the RE to maintain a register does not overcome the structural issues which have been apparent in contract based MIS (as noted in Section 3.2 above).

Who should have access to that register and through what process?

We do not support the creation of statutory obligation to maintain a register of scheme property. If such an obligation is imposed, we think that access to the register will need to be quite limited. REs place significant value on their trading and investment strategies, and it is possible to reverse engineer a strategy from observing asset positions over time. Making asset registers freely available has the potential to damage the intellectual property of REs.

3.6 Identifying member transactions

Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members? Who should have access to that register and through what process?

We question the benefit of this reform, which has the potential to apply more widely than just to contract based schemes. Depending on how the requirement was framed, it has the potential to pick up the exercise of powers by an RE as agent/attorney of MIS members in implementing schemes of arrangements involving MIS, other MIS mergers and acquisitions and disposals of interests in MIS where, for example, a holder breaches a holding limit set out in the constitution.

3.7 Tort claims and statutory liability

Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE?

The availability of the RE's right of indemnity in circumstances of the 'proper performance' of its duties is uncertain and we support the refinement of circumstances in which indemnity is and is not available. Perhaps it would be helpful to mirror the indemnity provisions of section 56 of the *Superannuation Industry (Supervision) Act 1993* (Cth) which permit a right of indemnity from assets of a superannuation entity except where the trustee has been dishonest, or has intentionally or recklessly failed to exercise the requisite degree of care and diligence, or for liabilities in the nature of monetary penalties under a civil penalty order.

In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?

It is not clear to us why the current law is inadequate. We also query why tort claims should be singled out for special focus. What of non-contractual claims by contractual counterparties and others (for example, claims under statute)?

4. Chapter 4: Transfer of a viable MIS

The key issues in Chapter 4 of the Discussion Paper are:

> …whether the current temporary responsible entity (***TRE***) framework enables the transfer of a viable MIS business where the original RE is under financial stress, and, if not, whether that framework should be reformed or replaced.

Our comments and suggestions regarding Chapter 4 are made in the context of our general observations in Section 2 above and our submission on Chapters 5 and 6 of the Discussion Paper below.

For the purposes of our comments on this Chapter, we will assume that the proposal to establish a kind of voluntary administration for schemes will not be implemented.

4.1 Summary of submissions on Chapter 4

In our view, the current temporary responsible entity framework serves no useful purpose and it should be repealed or substantially amended. As far as we know, it has never been used.

A key problem with the current regime is that the financial rewards for becoming a TRE are significantly outweighed by the risks. This will be very difficult to overcome but if the TRE framework is to be retained, we submit that it should include the following features:

- The TRE's role – more limited than a permanent RE - should be set out explicitly in the legislation. For example, the role of a TRE could be:
    - to manage the scheme on a day-to-day basis with the aim, to the extent possible, of ensuring the scheme is operating efficiently and as intended; and
    - to find and put forward for appointment a permanent RE as soon as practicable (or, if that is not possible, wind up the scheme).

  The general duties of an RE would still apply but be construed in the context of the TRE's role. In addition, some further protections should be afforded TREs to take into account the risks of replacing an RE in distress.
- A much wider group of people should be eligible to act as TREs than is currently the case.
- TREs should be able to charge fees on a basis that differs from the fees set out in the scheme's constitution (subject to some supervision about what those fees are).
- The Court's powers regarding TREs should be extended significantly, including by giving the Court power to:
    - require the incumbent current RE to provide any information needed to facilitate the appointment of the TRE; and

- provide directions when the TRE proposes to do anything (or refrain from doing something) where the TRE is concerned it may be exposing itself to liability for breach of duty or a claim by a third party.

4.2 Questions in Chapter 4

In this Section we answer each of the questions included in the Chapter (having regard to the information and views expressed in the Chapter itself).

What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why?

In our view, the current rules for removal of an RE strike a fair balance between the reasonable commercial interests of the RE and those of investors. We believe that the current rules have broadly been accepted by market participants. This is subject to clarifying various technical and procedural aspects of those rules.[2] We don't see any particular benefit or policy rationale supporting change. The conclusions to the contrary in the Turnbull Report were made 'on balance' and not supported by any compelling argument or in response to submissions from industry participants or investors.

What changes, if any, should be made to the powers of the Court to appoint a TRE and why?

As is pointed out in the Discussion Paper, the scope of the Court's powers in relation to TREs is unclear and may be quite limited. We therefore believe that there is merit in expanding and clarifying the circumstances in which a Court can appoint a TRE. In particular:

- the Court should have wide power to make orders ancillary to the appointment power, and regulation 5C.2.02 should be amended to give the Court an express power to act pursuant to an application under that regulation; and
- any such appointment should override the requirement that failure to appoint a replacement RE leads to winding up (section 601NE(1)(d)).

As was suggested in the article by David Walter referred to in the Discussion Paper[3] it may also be worth considering giving ASIC power to appoint a TRE, at least where there are objectively ascertainable reasons for doing so (such as where the RE fails to meet the base criteria for being an RE under section 601FA). However, there may be constitutional difficulties with this proposal.

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

The powers conferred on the Court should extend to the Court being able to require a current RE to provide any information needed to facilitate the appointment of the TRE.

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[2] See section 2.3 of the Turnbull Report.

[3] 'Managed Investment Schemes –suggested reforms to the power to appoint a temporary responsible entity' in the Australian Insolvency Journal, Jan-March, 2011 at page 12 (***Walter***).

As noted in relation to Reform 1 in Section 3.1 above, if the requirement to maintain an agreements register is introduced, we have proposed that access to the register should be available to a proposed TRE.

In relation to replacement REs (other than TREs), it may also be worth considering amending sections 601FL(2) and 601FM(2) so that the resolutions effecting the change of RE can be conditional on specific matters, for example, on the incoming RE undertaking a due diligence review of the scheme (with limits on how long this would take). The assistance provisions in section 601FR could be amended to support this. However, there are likely to be issues of confidentiality, especially if the appointment does not proceed. This is an argument against conditional appointments and we think that, at least, additional provisions would be needed to address this issue, for example, a statutory duty of confidence or carve-outs from the disclosure obligations of the outgoing RE.

Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?

As noted in the Discussion Paper, this question is greatly affected by the related questions of the scope of the role of the TRE, its obligations and liabilities. However, we see no compelling principle that supports the view that a TRE must meet all the regulatory requirements for a 'normal' responsible entity. As section 601FQ already makes clear, the primary aim of a TRE is to find a replacement and the period of a TRE's involvement is meant to be relatively brief.

As noted in the Discussion Paper, the Turnbull Report recommended that official liquidators be allowed to act as TREs. However, receivers, insolvency experts, investment advisers and others may well have the expertise required. We therefore believe it is preferable to allow more flexibility about who could act as a TRE by allowing the Court to appoint anyone it considers appropriate in the circumstances. Another, complementary, approach might be to authorise ASIC to prepare a register of people willing to be TREs, meeting criteria set out in regulations or in an ASIC Regulatory Guide.

What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?

This is one of the most difficult questions regarding TREs. There are, at least, three significant issues here:

- the potential liabilities that can arise for the incoming RE (as noted in section 4.4.2 of the Discussion Paper);
- the practical difficulties in identifying scheme assets, 'perfecting' transfer of them (including stamp duty and tax) and generally assessing the effect of the change of RE (for example, regarding debt obligations and pre-emptive rights); and
- the complexity of many registered schemes means it will take considerable resources to establish what needs to be done to manage the scheme effectively and efficiently.

In Section 3 above, we've provided comments on the proposals in Chapter 3. The risks regarding potential liabilities can be over-stated, again because of agribusiness scheme collapses where the capacities of the RE were blurred if not confused. Also, for the TRE to properly hand over to a new responsible entity, the TRE needs to have resolved all these issues. However, we agree that exposure to liabilities is likely to be a major disincentive for TREs and that some additional protections should be afforded them. We suggest a combination of the following:

- a limitation of liabilities of the kind suggested in the Discussion Paper at 4.4.2(ii);
- Court powers to relieve a TRE of liability of the kind suggested in the Discussion Paper at 4.4.2(iii); and
- Court powers to provide directions when the TRE proposes to do anything (or refrain from doing something) where the TRE is concerned it may be exposing itself to liability for breach of duty or a claim by a third party.

What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?

For the reasons set out in the Discussion Paper, we believe that the duties of a TRE and its officers should be modified to reflect the TRE's more limited role. One way this could be done is to introduce the idea of specifying the role of the TRE and providing that its statutory (and common law) duties must be considered within the context of that role. As suggested above, the role is already indicated in the current provisions – to find a replacement and permanent RE as soon as possible. The TRE's role could be more explicitly stated to be to:

- manage the scheme on a day-to-day basis and with the aim of ensuring the scheme is operating efficiently and as intended, to the extent possible; and
- find and put forward for appointment a permanent RE as soon as practicable (or, if that is not possible, wind up the scheme).

As suggested above, the TRE should also be able to approach the Court for directions.

What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?

Remuneration is, in our view, a key issue for the TRE regime. When a scheme is established, fees are usually developed on the assumption that the RE will be in that position for a long time. Accordingly, people are employed and systems developed on the basis that the considerable expense involved will be recouped over time. None of this applies to a TRE. Put simply, there is a mismatch between the risks and rewards for a TRE. In our view, this is a significant reason behind the failure of the current regime.

It is relatively easy to identify the problem but harder to find a clear solution. The Discussion Paper suggests the Court be given 'an explicit power to make orders setting out the remuneration arrangements for a TRE, such as a Court-determined daily rate' (section 4.4.4 at page 59). We agree with this but believe that some effort should be made to assist the Court. In the absence of anyone else, and to avoid delays, this may have to be ASIC. One possible approach would be for TREs to submit their standard fee arrangements when seeking approval by ASIC as TREs.

Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons?

In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to:

- *possible conflicts of interest faced by the TRE*
- *the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced)*
- *a TRE providing assistance to an external administrator?*

The risk of conflicts of interest need to balanced with the practical objective of having as many people as possible willing to be a TRE. It should be remembered that the TRE will, subject to the modifications we've suggested, still be subject to the general duties of an RE. Also, if, as we've suggested, a wider group of people are able to be TREs, then the risk of conflict is also reduced because the TRE will not be able to be the replacement RE. Our comments in relation to remuneration are also relevant here.

As to voluntary administration generally, see our submissions regarding Chapter 5 below.

What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?

In relation to TREs, please see our specific comments above in relation to the transfer of obligations and liabilities of the outgoing RE to the TRE.

In relation to incoming responsible entities other than TREs, we agree with the comment in section 4.5 of the Discussion Paper that 'what is transferred pursuant to [sections 601FS and 601FT] can become a matter of uncertainty or dispute'. The ambiguity arises because the types of liabilities that are transferred are those which are 'in relation to the scheme' and for which the RE has a right of indemnity out of the scheme property. These concepts are fairly well understood (and applied) in trust-based schemes, but they present significant risks for prospective incoming REs of contract-based schemes, particularly agribusiness schemes. This is because, as noted in Section 2 above, the RE of an agribusiness MIS may enter into contracts 'in relation to the scheme' in its personal capacity and, given the 'blurring' of the RE and personal capacities, it may be (and, indeed, often is) the case that the scheme's constitution gives the RE a right of indemnity in respect of liabilities incurred under such contracts.

Even in trust-based schemes, there are some aspects of sections 601FS and 601FT that could be clarified – for example, the effect of the statutory novation provisions on contracts that 'relate to' more than one scheme, where a change of RE occurs only for some of those schemes.

The issues arising under sections 601FS and 601FT are starkly different for trust-based and contract-based (agribusiness) schemes. Therefore, any reforms that are proposed in relation to these sections will need to deal specifically with the unique issues presented by the different types of MIS structures.

What if any statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reason?

The issues regarding remuneration identified in section 4.6 of the Discussion Paper arose in the context of agribusiness schemes. Therefore, our general observations about such schemes apply. Furthermore:

- in the context of a TRE, as discussed above, a more flexible approach is required in any case; and
- in the context of a replacement RE, the incoming RE can seek amendments to the scheme's constitution to alter or clarify fee arrangements.

We do not see that the Turnbull Report recommendations add very much to the general requirement regarding proper performance of duties, especially when combined with a trustee's general law duties. Also, the more specific requirements recommended by the Turnbull Report may have unintended consequences.

What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?

As a matter of principle, we do not believe it is appropriate or necessary to attempt to limit how an RE contracts with third parties given that the RE has extensive statutory and, generally, common law duties. As a practical matter, attempts to do so will generally fail or create economic distortions (or both).

The example given as a source of concern in section 4.7 of the Discussion Paper is that 'an RE may enter into a contractual arrangement whereby the counterparty will provide debt facilities to it in relation to a particular MIS, on condition that the RE does not change or any change is approved in advance by the counterparty'. It will usually be the financier who imposes this requirement (if it was the RE it would generally be in breach of its duties). If the financier could not have the benefit of such a covenant they would do one, or possibly both, of the following things:

- increase the interest rate or fees payable by the RE (out of the fund) to compensate the financier for the increased risk of the loan (as perceived by the financier); or
- insist on other covenants which had a similar effect or were more onerous.

5. Chapter 5: Restructuring a potentially viable MIS

The key issues in Chapter 5 of the Discussion Paper are:

> …whether REs are unable to restructure a financially viable MIS and whether the current legislative methods available to companies under the *Corporations Act* should be adapted to MISs. [Chapter 5] discusses a possible procedure, based on corporate voluntary administration, to permit a financially stressed but potentially viable MIS to continue to operate rather than be wound up.

Our comments and suggestions regarding Chapter 5 are made in the context of our general observations in Section 2 above.

5.1 Summary of submissions on Chapter 5

In our view the proposals in Chapter 5 aimed at introducing a voluntary administration (***VA***) regime for potentially viable MISs are likely to be unworkable in the context of contract-based schemes and unnecessary in the context of trust-based schemes.

To the extent that the appointment of an administrator is practical or necessary – and as already stated we consider that it is not - the system of judicial management provided for in Division 1 of Part 8 of the *Life Insurance Act 1995* (or a variation of that regime) may offer an alternative to VA. Under this system the Court may appoint an independent person to investigate and report to the Court on the viability of the MIS, following which the Court may make orders giving effect to the recommendations of the judicial manager.

Similarly, if the TRE regime is improved in the manner discussed in Section 4 above, it could also provide a suitable framework for restructuring a potentially viable MIS.

5.2 Questions in Chapter 5

The questions in Chapter 5 all assume an affirmative answer to the first question, namely:

> *Is there support in principle for the concept of a VA for an MIS?*

For the reasons set out below (and having regard to the information and views expressed in the Chapter itself) we do not support the concept of a VA for an MIS. For that reason we have not answered each of the subsequent questions.

As set out in some detail in Section 2 above and the Schedule, the recent difficulties experienced by MISs – to which the Discussion Paper is responding - have occurred predominantly in the agribusiness MIS sector. These schemes are typically contract-based, comprising a matrix of contractual arrangements between members, the RE and other group entities, rather than the more characteristic unit trust structure. This has two important implications.

- First, as noted in section 5.2.4 of the Discussion Paper, there has been longstanding uncertainty about the meaning of 'scheme property' (as defined in section 9 of the Act) in the context of these schemes. The section 9 definition of 'scheme property' is appropriate for trust-based schemes as it represents the assets that are held on trust (in accordance with section 601FC(2) of the Act) for the members of the trust. It does not sit comfortably with contract-based schemes and, for many years, the identification and valuation of the 'scheme property' of a contract-based MIS at a particular point in time has been an area of considerable debate.

- Second, as recognised in section 5.4.4 of the Discussion Paper, the complexity of contract-based schemes can make it difficult to identify the rights and interests of creditors, members, the RE and third parties, and to reconcile these rights and interests when they are in competition with one another.

A corporate VA imposes a general moratorium on the rights of creditors, pending an opportunity for them to consider whether to enter into a compromise or other arrangement with the company. As the Discussion Paper notes in section 5.4.1, a VA procedure for a potentially viable MIS *'may need to apply to a broader range of parties…and encompass a broader range of transactions involving those parties, than would be the case in a corporate VA.'* It goes further in the same paragraph to say the following:

> The experience of some recent MIS failures points to the need to embrace a wider notion of what matters should be included in the voluntary administration of an MIS, **to avoid attempts at rehabilitation being frustrated by individuals seeking to assert claims outside this process**. [Our emphasis.]

The difficulty in identifying with any certainty the ambit of a contract-based scheme and the competing rights and interests of relevant parties - a difficulty exemplified by the questions in section 5.4.7 of the Discussion Paper - poses a dilemma that, in our view, would make a VA regime for contract-based schemes unworkable:

- On the one hand, a narrower definition exposes any VA regime to the risk identified in the Discussion Paper: that an individual may seek to frustrate the process by asserting a claim not brought within the process. In our view, given the uncertainty of the ambit of contract-based MISs - which has been demonstrated by the wealth of litigation following the failure of the agribusiness schemes - this is a real risk.
- On the other hand, while 'embracing a wider notion' of what matters should be included in the scheme may avoid the threat posed by frustrating individuals (because, we assume, they would be 'inside the tent'), it would significantly complicate the VA of a contract-based scheme. For example, if a moratorium is applied to creditors and members, and a draft deed is proposed by the MIS administrator providing for a compromise of the proprietary rights of members, who would vote on the deed? Given that a compromise of proprietary rights requires consent, we assume that MIS members would have a vote, as would creditors. Given that the interests of members and creditors are likely to be diametrically opposed, how much weight would their respective votes carry? Paragraph 5.4.5 the Discussion Paper notes that '[a]ffected parties would have the right to challenge an MIS deed on the ground that it is unfairly prejudicial to, or discriminatory against, them.' Given their competing interests, it is not unreasonable to expect that either members or creditors would seek to challenge any deed contrary to their interests, reintroducing the delay, expense and uncertainty that the VA regime seeks to avoid.

Of broader consideration is whether contract-based MISs are likely to continue to be a significant part of the MIS sector in future. The well-publicised collapses of the agribusiness MISs and the litigation that followed have identified the flaws inherent in contract-based MISs. This begs the question whether the development of a necessarily complicated VA regime for MISs is justified to attempt to deal with a problem presented by an MIS structure on the wane.

In contrast with contract-based MISs, potentially viable trust-based MISs have been able to restructure without the apparent need for a VA regime. They have been able to do this generally either by way of the replacement of the RE or a restructure of the scheme, notwithstanding the financial difficulties experienced by the corporate groups of which the relevant REs were part. We have cited a number of examples in the Schedule, and repeat them here for convenience:

- in the case of the Babcock & Brown insolvency, the REs in the group did not become insolvent and instead there was a restructure of the various registered schemes;
- in the case of the Allco Group insolvency, two REs in the group did become insolvent, but this was several months after the insolvency of the parent company and in those cases the schemes were either restructured (with a new RE) or wound up because of their own scheme-related debts;
- in the case of Octaviar Limited (formerly MFS Limited), the entity in the group that acted as RE (Octaviar Investment Management Limited) did not become insolvent as it had been sold prior to the appointment of administrators to Octaviar Limited; and
- in the case of the Absolute Capital Group, voluntary administrators were appointed to the RE, but members passed resolutions approving the appointment of a new RE to undertake the winding up of the scheme.

In our view there is demonstrably no need to develop a VA regime for trust-based schemes.

5.3 A possible alternative: judicial management

Under the *Life Insurance Act 1995* the Court may, on application by the relevant regulator (APRA) or the company itself, appoint a judicial manager if (for example) it is satisfied that there are reasonable grounds for believing that the financial position or management of the company may be unsatisfactory. Management of the company vests in the judicial manager. As soon as possible after starting to manage the company, the judicial manager must file a report with the Court setting out his or her recommendations in relation to the company, including:

- to transfer the business to another company;
- to allow the company to carry on after a period of judicial management;
- to wind up the company; or
- to take such other action as the judicial manager considers desirable.

The Court may make orders giving effect to the recommendations of the judicial manager. Those orders are binding on all parties and take effect despite anything in the constituent documents of the company.

In our view a form of VA is not workable in the case of contract-based MISs and not necessary in the case of trust-based schemes. However, to the extent that some form of administration is considered desirable notwithstanding our view, we consider that the judicial management procedure may offer a better approach to the problems described in Section 5.2 above:

- First, as the judicial manager is appointed by and reports to the Court, and its recommendations form the subject of a Court order which binds all parties, the practical difficulties presented by the competing claims of creditors and members in the context of a VA are, to an extent, dealt with.
  - We expect the manager and the Court would have regard to these competing claims and attempt to reconcile them – in much the same way as the judicial manager of an insurance company would need to have regard to and reconcile the competing claims of policyholders and creditors.
  - The practical difficulties associated with a vote on an MIS deed under a VA (ie, who should vote and how much weight should each vote carry?) are avoided.
  - The rights of interested parties are protected as the Court would need to hear and take account of any objections to orders under consideration.
- Second, even though a judicial management regime would make it no easier to identify the scheme property of contract-based schemes, a judicial manager could, once appointed, investigate the scheme as a whole and take into account all property he or she considered to form part of scheme property. To the extent that any party considered that property had been improperly included in or excluded from that definition, that party could object to its inclusion or exclusion at the Court hearing considering the judicial manager's recommendations.

With some adjustments[4], and with the improvements discussed in Section 4 above, the TRE framework may be used to replicate a funds-specific judicial management regime, providing an almost ready-made and practical solution to the problem which the proposed VA regime seeks to solve.

[4] For example, allowing potential TREs to be drawn from a broader pool of candidates (including insolvency practitioners)

6. Chapter 6: Winding up a non-viable MIS

The key issues in Chapter 6 of the Discussion Paper are:

> …whether the current statutory framework is adequate for the winding up of MISs, whether that framework provides the necessary guidance for liquidators, creditors, investors and growers, and whether legislative amendments should be made if the current legislative framework does not provide the necessary legislative tools with respect to the arrangements for dealing with non-viable MISs.

Our comments and suggestions regarding Chapter 6 are made in the context of our general observations in Section 2 above.

In this Section we answer each of the questions included in the Chapter (having regard to the information and views expressed in the Chapter itself).

6.1 Grounds for winding up an MIS

Are any changes needed to:

- *the current circumstances where an MIS can be put into liquidation with / without the need for Court approval?*
- *the provisions governing who can conduct the winding up?*

As discussed in more detail below, we would support the introduction of a separate insolvency ground for winding up an MIS. To date, the Courts have relied on the 'just and equitable' ground for winding up an MIS (s601ND(1)(a)) in circumstances where the RE of the MIS is insolvent or the MIS itself is not financially viable. However, this test has not been applied consistently by the Courts and, therefore, there is a need for greater certainty as to the factors that are relevant in determining whether an MIS should be wound up on insolvency-related grounds.

Other than this, we consider that the existing grounds for winding up an MIS, with or without the need for Court approval, are adequate. In particular, section 601NE(1)(a) of the *Corporations Act* provides that the RE must ensure that the scheme is wound up if the scheme's constitution provides that the scheme is to be wound up at a specified time, in specified circumstances or on the happening of a specified event and that time is reached, those circumstances occur or that event occurs. It is common for constitutions of trust-based schemes to give the RE the power to declare that the scheme be wound up at any time (subject to the RE acting in the best interests of members). If the RE becomes insolvent, this power may be exercised by the external administrator appointed to the RE. Constitutions for agribusiness MISs do not typically give the RE this power, which is why other grounds for winding up those schemes (in particular, the 'just and equitable' ground) were relied on following the collapse of those schemes.

In light of the existing power of the Court (under section 601NF) to appoint a person other than the RE to take responsibility for ensuring that an MIS is wound up in accordance with the scheme's constitution and any orders of the Court, and to make directions about how a scheme is to be wound, we do not consider that any legislative changes are needed to expand the category of persons who may conduct the winding up of an MIS.

Should there be any changes to the procedures / thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why?

We assume this question relates to section 601NC, which allows the RE to propose that the scheme be wound up if its purpose has been accomplished or cannot be accomplished, provided the RE gives members the opportunity to call a meeting of members to consider the winding up proposal.

We do think some aspects of this procedure could be clarified by legislative amendment:

- As drafted, section 601NC does not specify the subject matter of the resolution that would need to be considered by members who call a meeting in response to a notification by the RE under this section. Subsection 601NC(2)(b) says that the purpose of the meeting is to 'consider the proposed winding up of the scheme and to vote on any extraordinary resolution members propose about the winding up of the scheme'. Nor does the section explain the consequences of that extraordinary resolution being passed, or failing. It is therefore possible for members who oppose the winding up to structure the resolution in a way that thwarts the RE's ability to proceed with the winding up, even if a majority of members do not oppose the winding up.
- There is also no express prohibition on members convening a meeting to obstruct the winding up following the expiry of the 28 notice period. This is particularly problematic given that the winding up process is not deemed to automatically commence upon the expiry of the 28 day period; rather, it will only begin when the RE takes positive steps to embark on the process (*Ex part PWL (formerly Palandri Wines Ltd) (admins appointed) [No 2]* [2008] WASC 232). In *Westralia Property Management Ltd (as RE of the Broadwater Busselton Property Syndicate Managed Investment Scheme v Davison)* [2006] WASCA 203, the Court permitted members of the scheme to convene a meeting of members more than three months after the expiry of the 28 day notice period. The meeting was convened to consider resolutions to remove and replace the RE and to terminate the winding up process. In relation to the latter resolution, the Court held that, although it may not be possible to terminate a winding up, some useful purpose could still be accomplished by holding the meeting.

Is there any need for a separate insolvency ground for winding up an MIS? If so:

- *how should the insolvency of an MIS be defined?*
- *Should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?*

As noted above, we do think there is merit in introducing a specific ground for winding up an MIS based on insolvency considerations. We think this could be incorporated into the existing 'just and equitable' ground (in section 601ND(1)(a)), by setting out insolvency-related factors to which the Court could have regard in determining whether the scheme should be wound up. Those factors would vary depending on the structure of the scheme, which is consistent with the approach that has been taken by the Courts in applying the 'just and equitable' test.

For trust-based schemes, the 'insolvency' of a trust is a short-hand concept for the trust having insufficient assets to indemnify the trustee for liabilities incurred by the trustee in that capacity.

However, the Courts have held that this concept of insolvency is too narrow when applied to contract-based schemes (*Shepard and Mentha in their capacity as receivers and managers of Environinvest Ltd (in liq) v Downey in his capacity as liquidator of Environinvest Ltd (in liq)* [2009] VSC 33) (***Environinvest 2009***). In *Capelli v Shepard and others* [2010] VSCA 2 (***Environinvest 2010***), the Court of Appeal held that it was just and equitable for an agribusiness MIS to be wound up, having regard to the following interrelated factors:

- the non-viability of the scheme (ie, in the sense that the liabilities referable to it cannot be satisfied as they fall due from its income or readily realisable assets);
- the related insolvency of the RE;
- the RE's inability to fund the continued operation of the scheme;
- the unavailability of any replacement RE; and
- the consequent breakdown of the original scheme arrangements set out in the offer document.

In addition, we believe that an application to wind up an MIS on insolvency grounds should be able to be made by a creditor of the RE (in its capacity as RE of the scheme). Currently, an application to wind up an MIS on just and equitable grounds can only be made by the RE (or its external administrator), a director of the RE, a member of the scheme or ASIC.

As noted in section 6.1.2 of the Discussion Paper, section 601ND(1)(b) does give a creditor of the RE (in its capacity as RE of the scheme), with an unsatisfied execution on a Court order, the right to apply to the Court for the scheme to be wound up. However, before bringing the winding up application, the creditor would need to apply to the Court for a judgment against the RE, which would then need to be unsatisfied. We are not aware of this ground for winding up ever having been utilised by a scheme creditor, which is not surprising given the time and cost it would take to activate the right.

6.2 Winding up an MIS where RE is solvent

<u>Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?</u>

Again, the distinction between trust-based and contract-based schemes is relevant here.

In relation to schemes that are structured as trusts, the constitution of the scheme will typically contain a 'winding up' clause, which regulates the process by which a registered scheme is to be wound up. As noted in section 6.6.1 of the Discussion Paper, in *Re application of Stacks Managed Investments Ltd (as responsible entity of Premium*

Mortgage Income Fund) [2005] NSWSC 753 (***Stacks***), it was held, in relation to a trust-based scheme, that:

> … what is envisaged by the winding up of a scheme is the realisation of its property, the payment by the responsible entity of liabilities incurred on behalf of the scheme or the retention by it of funds with which to meet its liabilities, the ascertainment of the members' entitlements, and the distribution of the trust assets to the members in accordance with their entitlements.

However, this form of winding up assumes there is a pool of assets to be realised and distributed and, therefore, is not appropriate for contract-based schemes which do not involved the pooling of assets. (Despite this, many agribusiness MISs nevertheless replicate the standard 'trust winding up' clauses in their constitutions, which produces additional complexity.) In *ASIC v Tasman Investment Management Limited* [2006] NSWSC 943, Austin J commented that:

> Care must be taken to avoid any unreflective application of company law ideas to enterprises organised as managed investment schemes, whether registered or unregistered. As White J pointed out in *Stacks Managed Investments Ltd* (2005) 219 ALR 532, the nature of the winding-up process depends on what it is that is being wound up. Thus, the winding up of a trust is quite a different thing from the winding up of a company, in terms of such matters as the rights of 'scheme creditors' and investors… Other analytical frameworks apply to the winding-up of a scheme based on partnership, and a scheme based on contractual arrangements.

Given that there is no single method by which an MIS may be wound up, and this will vary from scheme to scheme depending on its structure, we do not consider that it would be prudent, or helpful, to prescribe a winding up process for all schemes in the *Corporations Act*. In this regard, the following comments from the *Stacks* case (also extracted in section 6.5 of the Discussion Paper) are instructive:

> In my view, parliament deliberately did not apply the regime for the winding up of companies to the winding up of registered schemes. It could have, but it did not, provide for the appointment of a liquidator to the affairs of a registered scheme, who is independent of the responsible entity. It could have, but it did not, make the provisions which regulate the winding up of companies applicable to the winding up of registered schemes, including, for example, the power to apply to the Court for the issue of examination summonses. It did not give the Court powers of the kind described in s447A in relation to administrations and deeds of company arrangement.

Although we do not think that the *Corporations Act* should prescribe the manner in which an MIS is to be wound up, we do think there may be some merit in expanding (or otherwise clarifying) section 601GA(1)(d) of the *Corporations Act*, which provides that a scheme constitution must make adequate provision for 'winding up the scheme'. Perhaps this could be expanded by adding the words *', including the process by which the scheme will be wound up'*.

6.3 Winding up an MIS where RE is insolvent

<u>*In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)?*</u>

For the reasons set out in Section 5 above, we do not support the concept of a VA for an MIS.

In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?

We think the answer to this question will vary from case to case, including based on the structure of the MIS. Therefore, we do not consider this to be a matter that should be prescribed by legislation.

In agribusiness MISs, for example, it is often very difficult, and a matter of contention between stakeholders, whether an asset, right or liability of the RE attaches to the RE in its personal capacity or in its capacity as RE of the scheme. In those circumstances, it would be impossible to separate the liquidation of the RE from that of the scheme.

We consider that the powers of the Court, under section 601NF, to make orders relating to the winding up of a scheme are adequate to deal with any conflict, or other procedural matter, that may necessitate separating the liquidation processes, on a case by case basis.

6.4 Winding up process

Would the process for liquidating an MIS be better provided for by an extension of the powers of the Court in section 601EE to all MISs?

We do not consider that it would be appropriate for the Court's powers under section 601NF (which relates to winding up lawfully registered schemes) to be identical to (or as broad as) the Court's powers under section 601EE (which relates to winding up unlawful unregistered schemes). The Court ought to have a greater degree of remedial latitude when winding up unlawful schemes.

Section 601NF(2) specifically cites, as an example of where the Court may consider it 'necessary' to make orders for the winding up of a registered scheme, where the provisions in the scheme's constitution are inadequate or impracticable. We consider this to be sufficiently broad in the context of winding up a registered scheme.

6.5 Possible elements of an MIS liquidation procedure

What procedural provisions should there be for winding up an MIS and why?

We question the benefit of incorporating the procedural provisions outlined in sections 6.6.2 (information-gathering and investigative powers, ASIC reporting obligations), 6.6.4 (voidable transactions), 6.6.5 (access to books of the MIS), 6.6.6 (Court power to give directions) into the *Corporations Act* framework for winding up an MIS. We doubt that these procedures would provide any significant improvement to the process for winding up an MIS, but would instead produce further complexity (especially with respect to contract-based schemes).

These procedures are designed for a corporate VA regime and would not be suitable for an MIS.

This is also consistent with our view, explained in Section 6.2, that the *Corporations Act* should not prescribe the method by which an MIS is wound up.

Should there be a statutory order or priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?

We see this question as being linked to the proposal in Chapter 7 regarding the limited liability of MIS members. Although we consider this concept to be worthy of further consideration, this would again need to be evaluated separately for trust-based and contract-based schemes. If a statutory order of priority were to be introduced for MISs, we would not expect it to be as complex as the order of priority for corporations, given that MISs are not separate legal entities (eg, MISs do not have employees).

It may be that the order of priority for MISs should be something that is specified in each scheme's constitution, as part of the winding up provisions.

Another complex issue that requires further analysis is the impact of the *Sons of Gwalia* decision on managed investment schemes (as acknowledged in CAMAC's Report in 2008 on *Shareholder Claims Against Insolvent Companies*).

What provision, if any, should be made for MIS members in the winding up of their scheme? Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?

In the circumstances described in section 6.6.7 of the Discussion Paper, we consider that a member could apply to the Court under section 601NF for suitable orders or directions (for example, to appoint a special purpose liquidator).

We also note that, based on a recent Federal Court case (*Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers & Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed)* [2010] FCA 1274), a receiver appointed over an RE may not necessarily be an 'officer' of the RE, despite the section 9 definition of 'officer'.

6.6 Lawful unregistered MISs

Are the grounds for winding up a registered MIS equally applicable to a lawful unregistered MIS?

Lawful unregistered MISs are not subject to regulation under the *Corporations Act* (other than in relation to licensing matters). Therefore, it would be unusual for legislative provisions dealing only with the winding up of such schemes to be introduced.

Typically, lawful unregistered MISs do not need to be registered because they are only marketed to 'wholesale clients'. This is on the basis that such clients are sophisticated enough to make an investment without the regulatory protections that are afforded to 'retail clients'. It would be inconsistent with this policy rationale to introduce regulatory requirements for such schemes (even if they are limited to winding up provisions).

Given our response to this first question, we have not provided responses to the remaining questions in section 6.7 (which assume an affirmative answer to the first question).

7. Chapter 7: Other matters

This chapter examines proposals concerning convening scheme meetings, cross-guarantees entered into by REs on behalf of other group members and statutory limited liability of scheme members on the winding up of a scheme. It also invites submissions on any other matters concerning the general operation of Chapter 5C of the *Corporations Act*.

7.1 Convening scheme meetings

Should there be any changes to the grounds on which the RE, the members or the Court can call meetings of members and, if so, for what reasons?

In our view, no changes are required to the grounds on which the RE, the members or the Court can call meetings of members. We believe the current regime for calling meetings of members of a scheme strikes a fair balance between the reasonable commercial interests of the RE and those of investors.

There is one technical issue relating to the calling of scheme meetings that we believe should be addressed, in order to allow REs of unlisted schemes with a small number of members to respond to time critical situations in a timely manner. This relates to shortening the notice period for meetings, with the consent of all members.

Under sections 252F and 252G(1)(a) of the *Corporations Act*, at least 21 days' written notice must be given of a meeting of members of a scheme, to each member of the scheme entitled to vote at the meeting. Section 252F of the *Corporations Act* provides that the scheme's constitution may specify a longer minimum period of notice.

However, unlike the company-equivalent section 249H(2) of the *Corporations Act*, which permits a company to call a meeting on less than 21 days' notice with the agreement of members, it is not possible to shorten the notice period for a meeting of members of a registered scheme.

We submit that a provision similar to subsection 249H(2) of the *Corporations Act* should apply to meetings of members of unlisted registered schemes to allow for calling meetings of members within a shorter period of time.

For what purpose, if any, should ASIC be granted the power to convene meetings of members?

We do not support the proposal to grant ASIC the power to convene meetings of members.

In our view, the threshold number or percentage of members that can require the RE to call a meeting of members under section 252B(1) of the *Corporations Act*, or that can themselves call and arrange to hold a meeting of the scheme's members under section 252D(1), is appropriate. It empowers a relatively small quorum of members to call, or require the RE to call, a meeting of members to consider matters concerning the operation of the scheme that require the approval of members by a special or extraordinary resolution (or, in the case of a listed scheme, an ordinary resolution to consider the removal of the RE – ASIC Class Order 01/1541).

Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated.

We do not think it is necessary to statutorily oblige REs of registered schemes to hold annual general meetings. Unlike public companies, there are unlikely to be recurring items of business (such as the election of directors) that will need to be considered by members on an annual basis. Furthermore, the cost of holding annual general meetings will ultimately be borne by members as an expense of the fund.

7.2 Cross-guarantees – Reform 7.2

In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?

In 2010, we made submissions in response to ASIC's Consultation Paper 140 on *Responsible Entities: Financial Requirements* (***CP 140***). In our submissions, we did not agree with the proposals in B1 of CP 140, which have been reproduced in section 7.2 of the Discussion Paper, that an RE should:

(a) be prohibited from providing guarantees in its capacity as the RE of a scheme;

(b) where the RE manages more than one scheme, be prohibited from providing guarantees in its personal capacity; and

(c) be restricted from providing indemnities in its capacity as the RE of a scheme other than indemnities in relation to that scheme's default.

Our concerns with these proposals were, and continue to be, multi-faceted.

First, proposals (a) and (c) refer to the RE providing guarantees and indemnities *in its capacity as RE of a scheme*. We do not see how liabilities incurred by the RE in its RE capacity (that is, where the RE's liability has been effectively limited to the assets of the scheme) are relevant to the RE's personal financial position, including the risk that it may become insolvent. Such liabilities affect the financial position of the scheme, not the RE of the scheme. Furthermore:

(a) If an RE were to provide a guarantee or indemnity in its RE capacity, it would only be permitted to do so in accordance with its fiduciary and statutory duties, including duties to act in the best interests of the members of the scheme and to prefer the members' interests over its own interests in the event that they are in conflict. The requirements that apply to related party transactions in Part 5C.7 of the *Corporations Act* also regulate the basis on which these arrangements may be entered into. We do not believe any further regulatory intervention (in the form of a blanket prohibition) would provide any additional protection for members. Nor do we agree with the comment in the Discussion Paper that the existing legal protections for scheme property may prove illusory, given the opportunity for scheme promoters when designing schemes to draw up constitutions permitting the RE to provide guarantees and indemnities out of scheme property that are unrelated to the activities of that scheme: section 601GA(2)(b) clearly states that an RE may only be indemnified out of scheme property for liabilities incurred in relation to the proper performance of its duties.

(b) We are particularly concerned about the proposed restriction on an RE providing indemnities in its capacity as RE of a scheme, other than indemnities in relation to that scheme's default. The scope of this restriction is potentially very broad, extending to any contractual indemnity provided by an RE in connection with the scheme, including in standard service and management contracts. For example, custodians appointed by REs typically require an indemnity from the RE (in its RE capacity) in respect of any liabilities incurred by the custodian in properly performing functions under the custody agreement. The proposed restriction would prevent REs from being able to provide standard contractual indemnities of that nature. It would also necessitate an extensive review of all current documentation to ensure that such indemnities have not previously been provided.

(c) The proposals in (a) and (c) above also present practical impediments for stapled groups, where it is common for the RE, in its capacity as RE of the stapled trust, to provide financial benefits (including loans or guarantees) to the stapled company. ASIC has typically granted relief from the related party transaction provisions of the *Corporations Act* to enable such intra-group transactions to occur, on the basis that stapled groups operate as a single economic entity.

(d) The proposals in (a) and (c) above would also impede REs of schemes undertaking fundraising through the issue of hybrid instruments in the manner which has traditionally been used. REs of listed schemes or schemes in stapled groups have established new registered schemes (***hybrid schemes***) which issue debt-like instruments that are convertible into equity interests in the listed scheme or stapled group in certain circumstances. The RE of the listed scheme or scheme in the stapled group provides guarantees and indemnities in respect of the hybrid scheme.

(e) In the agribusiness MIS context, there is a greater risk that liabilities (including guarantees and indemnities) incurred by the RE may be held to have been incurred 'in its RE capacity' (and therefore inherited by a new RE under the statutory novation mechanism in section 601FS of the *Corporations Act*) even if that capacity is not expressly stated. This was the case in *Syncap Management (Rural) Australia Ltd v Lyford and anor* [2004] FCA 1352, where it was held that debt obligations of the former RE were inherited by, and enforceable against, the new RE because, based on the particular factual context, those obligations were 'in relation to the scheme' (for the purposes of section 601FS(1)) and were liabilities for which the RE could have been indemnified out of scheme property (for the purposes of section 601FS(2)(d)). If the proposed restrictions on REs giving guarantees and indemnities in their RE capacity are intended to address this risk, this should be clarified and are in any event likely to be relevant only to contract-based agribusiness MISs.

(f) There was little detail in CP 140 as to the transitional arrangements that would apply and how existing contractual arrangements are intended to be treated, including the impact that this will have on counterparties to those arrangements.

Secondly, under proposal (b) of CP 140, REs would be prohibited from providing guarantees (and, we assume, indemnities) in their personal capacity. Our key concern with this proposal is that its stated objective (namely, to maximise the likelihood that REs will survive the insolvency of a related entity or third party) overlooks the following factors:

(a) Under the current regulatory framework, entities that perform RE functions may operate as part of their broader corporate group and undertake commercial activities unrelated to managing registered schemes. This was acknowledged in CP 140 and was one of the grounds on which ASIC's proposals in CP 140 regarding NTA requirements were developed. This is a legitimate business model that is entirely consistent with the 'single responsible entity' regime. Funds management groups have established their business operations in this manner and have entered into contractual arrangements with third parties, and accessed debt from financiers, on this basis. To require these businesses to 'unwind' these arrangements and establish special purpose 'remote' vehicles to perform RE functions would represent a major regulatory shift and a new move by ASIC towards prudential supervision of REs.

(b) As a practical example, a licensee which is authorised to act as an RE and also authorised to operate individually managed accounts for institutional clients under investment management agreements (***IMAs***) would effectively be prevented from carrying on its IMA business given that IMAs would generally contain indemnities in favour of the client.

(c) There is also the impact on third parties who have contracted with REs on this basis, including financiers who have advanced funding to corporate groups on the condition that they obtain guarantees from the group's REs that generated the funds management revenue. As above, there is little detail in CP 140 as to the transitional arrangements that will apply and how existing contractual arrangements are intended to be treated, including the impact that this will have on counterparties to those arrangements. As a matter of law, we cannot see how existing contractual arrangements could be unwound in those circumstances.

(d) More generally, in our view the proposal to restrict REs from providing guarantees in their personal capacity responds to the recent MIS insolvencies from a very narrow perspective – that is, to reduce the risk that an RE will become insolvent. We believe the focus should instead be on developing mechanisms to ensure that, if the insolvency of an RE cannot be avoided, there are effective procedures available to deal with the insolvency and protect the interests of all stakeholders, including scheme members. Furthermore, the provision of personal guarantees is only one way in which an RE may become insolvent. An RE could borrow, or incur other liabilities, in its own right. Therefore, imposing a restriction on the provision of personal guarantees would not, of itself, materially reduce the risk of an RE becoming insolvent.

(e) Finally, in light of the recent MIS collapses, it is questionable whether the insolvency of the RE was, of itself, a significant impediment to the winding up of the schemes or the transition to a new RE. As noted in the Schedule, in the non-agribusiness MIS context, the insolvency of a parent company did not necessarily (or frequently) result in the insolvency of the RE. In the context of the agribusiness MISs, where the schemes relied extensively on the services and financial resources of other group entities, any 'quarantining' of the RE from insolvency is unlikely to have had a significant impact from an investor protection perspective. Again, the complexities that emerged from those insolvencies related more to the absence of a statutory regime for MIS insolvencies, and the uncertainties relating to the procedures for changing REs, than to the insolvency *per se* of the RE.

In light of the above, we do not support ASIC's initiative in CP 140 and nor do we think there should be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs.

7.3 Limited liability of MIS members

Except for schemes where the RE is an agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs?

We are supportive of the introduction of a statutory limitation of liability for members of trust-based schemes, to the effect that members of an MIS should have limited liability for scheme debts that remain outstanding on the winding up of an MIS, in the same manner as shareholders of a company limited by shares (under section 516 of the *Corporations Act*).

A statutory limitation of liability will remove the need to rely on general trust law principles, which require a limitation clause to be included in the scheme's constitution: under general trust law principles, a beneficiary of a trust may be personally and proportionately liable to the trustee of the trust for liabilities incurred in the proper administration of a trust[5]. It is settled law, however, that where that liability does exist, it may be excluded or limited by an express provision contained in the trust instrument (subject to certain exceptions, such as where the use of the clause is contrary to public policy and where the beneficiary has authorised the trustee to enter into a transaction not within the scope of the trust, or has ratified such a transaction).

Like section 516, the statutory limitation of liability should limit the liability of members of a trust-based scheme to the amount (if any) unpaid on the units (or other interests) in the scheme in respect of which the member is liable.

However, we do not believe that members of all registered schemes should have the benefit of the statutory limitation of liability. As the limitation of liability will codify general trust law principles, it should extend only to those schemes structured as trusts.

Contract-based agribusiness MISs, for example, require investors to pay fees and other expenses for the cultivation of the relevant crop or trees, in respect of which those investors are typically entitled to a tax deduction. A statutory limitation of liability would seem contrary to that business model and investment objective.

If so, should distinctions be made between different classes of passive or active MIS members, and for what purposes?

[5] *Hardoon v Belilios* [1901] AC 118 at 124-5.

As noted above, we do not think that the statutory limitation of liability should extend to investors in MISs that are not structured as trusts, such as agribusiness MISs.

Should the limitation of liability principle be subject to any contrary provision in the scheme constitution?

The statutory limitation of liability principle which we support, as outlined above, should not be overridden by contrary provisions in a scheme's constitution. We submit that investors, in particular retail investors, invest in registered MISs in order to access the protection and certainty that registration of the MIS and the application of Chapter 5C of the *Corporations Act* provides.

7.4 Other matters

Should any other legislation amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?

Set out below are our submissions on some aspects of the MIS regulatory regime which, in our experience, have given rise to ambiguity and uncertainty, and which could benefit from legislative amendment. We note that a number of our submissions relate to chapters of the *Corporations Act* other than Chapter 5C but which, nonetheless, impact on the efficacy of the general MIS regime.

(a) Section 253E – Responsible Entity and associates cannot vote if interested in resolution

Section 253E regulates voting by the responsible entity of a registered managed investment scheme where the responsible entity or its associates are members of that scheme. It has proved to be a very difficult section to apply and a number of important elements of the section remain unclear. Given the significance of this voting restriction, we submit that there would be merit in amending section 253E to address these uncertainties.

In particular:

- There is still some uncertainty around the appropriate definition of 'associate', as used in section 253E. Recent case law indicates that, for the purposes of section 253E, 'associate' has the meaning given in section 12 of the *Corporations Act* (rather than the meaning given in sections 11 and 15).[6] However, this would mean that directors of the RE would not be considered 'associates' for section 253E purposes.
- Section 253E disqualifies the RE and its associates from voting if '*they* have an interest in the resolution *or matter* other than as a member'. The use of 'they' is ambiguous, as it could suggest that an associate, for example, would be disqualified from voting if the RE had an interest in the resolution, even if the associate itself had no such interest. Again, there is recent case law that suggests that the words 'if *they* have an interest' is a reference only to the interest of the entity voting and do not include the

[6] *Re Great Southern Managers Australia Ltd* [2009] VSC 557.

interest of the RE.[7] However, that is not immediately clear from the drafting. The reference to 'matter' in section 253E is also unclear as there is no corresponding reference to 'matter' in the opening words of the section. It has the undesirable potential to expand the range of 'interests' that would disqualify the RE or its associate from voting to interests that have no bearing on the resolution being considered.

- It is common for the RE, or an associate of the RE, to hold interests in a scheme in a fiduciary capacity – for example, as RE or trustee for another scheme or trust. It is arguable that, in such cases, the RE (or its associate) should not be disqualified from voting under section 253E because it is not 'their' interest (within the meaning of section 253E) that they are voting. To disqualify the RE (or its associate) from voting would disenfranchise the members of the scheme or trust for which the RE (or associate) is holding the investment. However, recent case law[8] has rejected that argument, at least in circumstances where the RE itself holds the interest in the scheme. It is not clear whether this would also be the case where the RE's associate, but not the RE itself, held the interest.

(b) Section 601FM – Timing of consent by new RE

The point in time by which a proposed RE is required to consent to becoming the scheme's RE is not entirely clear under section 601FM:

- Section 601FM(2) refers to the members voting on a resolution to remove the RE and, at the same meeting, choosing a company to be the new RE 'that consents, in writing, to becoming the scheme's RE'. This suggests that the incoming RE needs to have consented at or before the meeting.
- However, section 601FM(4) indicates that it may be possible for there to be a gap in time between the date of the meeting and the date on which the consent is given. This is because it prohibits the notification of a change of RE being lodged with ASIC within the usual 2 business day period 'unless the consent referred to in [section 601FM(2)] has been given before the notice is lodged'.

This issue is significant because, if the replacement RE is required to give unconditional consent to the become the scheme's RE at or before the meeting, it will need to be committed to step into the shoes of the RE and (by virtue of the statutory novation provisions in ss601FS and 601FT of the *Corporations Act*) assume the liabilities and obligations of the former RE, at the date the resolution is put to members.

Furthermore, under section 601NE(1)(d) of the *Corporations Act*, the RE must wind up the scheme if the members pass a resolution removing the RE but do not, at the

[7] *Re Great Southern Managers Australia Ltd* [2009] VSC 557.

[8] *Everest Capital Ltd as trustee of the EBI Income Fund v Trust Company Ltd* (2010) 238 FLR 246.

same meeting, pass a resolution choosing a company to be the new RE *that consents to becoming the scheme's RE*.

We think the timing requirement for the new RE's consent should be clarified by legislative amendment.

(c) Subsection 601PA(2)(b) – When a managed investment scheme may be deregistered

Subsection 601PA(2)(b) provides that an RE may apply to ASIC to deregister a scheme if, because of subsection 601ED(2), the scheme is not required to be registered and all members agree that the scheme should be deregistered.

An issue arises from the fact that subsection 601ED(2) makes reference to issues 'that have been made' and therefore appears to relate to historical issues. Accordingly, it is unclear whether an RE can rely on subsection 601PA(2) to deregister a scheme that initially issued interests to retail clients (and therefore did not fall within the registration exemption in subsection 601ED(2)) but subsequently (ie, at the time of the deregistration application) has only wholesale clients.

Unless this is the intention of the subsection, we submit that subsection 601PA(2)(b) be modified to clarify that the reference to section 601ED(2) in that subsection does not relate to historical issues of interests.

(d) Statutory confirmation that REs can contract with themselves in different capacities

A common provision in constitutions of registered schemes is one which expressly permits the RE (in its personal capacity or in any capacity other than as trustee and responsible entity of the relevant scheme) to deal with the RE (as trustee and responsible entity of the scheme) including by being interested in any contract, transaction or matter with the RE (as trustee and responsible entity of the scheme).

We submit that a statutory provision should be included in the *Corporations Act* confirming that the RE is permitted to contract with itself in a different capacity.

Schedule – Recent MIS collapses

1. The recent MIS insolvencies have occurred predominantly in the agribusiness MIS sector. The insolvencies of Great Southern, Timbercorp, Rewards, Environinvest, FEA and Willmott Forests Groups during 2007 – 2010 each involved entities that acted as REs of agribusiness MISs being placed into a form of insolvency administration.
2. In the non-agribusiness MIS sector, there were fewer examples of subsidiaries that acted as RE becoming insolvent where there was an insolvency of the broader group. For example:
   (a) in the case of the Babcock & Brown insolvency, the REs in the group did not become insolvent and instead there was a restructure of the various registered schemes[9];
   (b) in the case of the Allco Group insolvency, two REs in the group did become insolvent, but this was several months after the insolvency of the parent company and in those cases the schemes were either restructured (with a new RE) or wound up because of their own scheme-related debts[10];

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[9] On 13 March 2009, administrators were appointed to Babcock & Brown Limited (***BBL***). Babcock & Brown Japan Property Management Limited (***BBJPML***), a subsidiary of BBL to which administrators or receivers were not appointed, was the RE of Babcock & Brown Japan Trust (***BJT***). On 2 April 2009, an agreement was concluded for the internalisation of the management rights of BJT. BJT is now known as 'Astro Japan Property Trust'. Babcock & Brown Residential Land Partners Services Limited (***BBRLPSL***), another subsidiary of BBL to which administrators or receivers were not appointed, was the RE of Babcock & Brown Residential Land Partners Trust (***BLP***). During 2009, an agreement was concluded for the internalisation of the management rights of BLP. BLP is now known as 'RCL Group Trust'. Babcock & Brown Investor Services Limited, another subsidiary of BBL to which administrators or receivers were not appointed, was the RE of Babcock & Brown Infrastructure Trust (which was stapled to Babcock & Brown Infrastructure Limited and, together, known as Babcock & Brown Infrastructure (***BBI***)). In August 2009, BBI agreed the terms of separation from Babcock & Brown and the internalisation of its management. BBI is now known as 'Prime Infrastructure'.

[10] On 14 November 2008, administrators were appointed to certain companies in the Allco Group, including the ASX listed parent company Allco Finance Group Limited (***AFG***). Allco Managed Investments Funds Limited (***AMIFL***), a subsidiary of AFG to which administrators or receivers were not appointed, was the RE of a number of registered schemes, including the Allco Hybrid Investment Trust (which has since been wound up) and the Allco Max Securities and Mortgage Trust (***AMSMT***). On 16 April 2009, AMIFL convened a meeting of unitholders of AMSMT to consider certain resolutions, including a resolution to replace AMIFL as RE of AMSMT with a new RE (Permanent Investment Management Limited). Those resolutions were approved on 18 June 2009. AMSMT is now known as 'Max Trust'. Record Funds Management Limited (***RFML***), another subsidiary of AFG, was the RE of a number of registered schemes, including Allco Wholesale Property Fund (now known as the Australian Wholesale Property Fund and operated by a new RE), Red Property Trust (which has been wound up) and Record Realty Trust (***RRT***). Administrators or receivers were not appointed to RFML at the time AFG become insolvent. On 1 April 2009, RFML in its capacity as RE of RRT advised that it was served with a notice of default by BOS International (***BOSI***) demanding immediate payment of all sums owing by RRT, and BOSI subsequently appointed receivers to the assets of RFML in its capacity as RE of RRT. Rubicon Asset Management Limited (***RAML***), another subsidiary of AFG, was the RE of Rubicon America Trust, Rubicon Japan Trust and Rubicon Europe Trust (the ***Rubicon Trusts***). Although administrators and receivers were not appointed to RAML at the time administrators were appointed to AFG, on 19 February 2009, administrators were appointed following a number of events, including RAML's inability to replace its investment management insurance policy. On 27 August 2009, the administrators of RAML announced that they intended to approach the NSW Supreme Court to apply for orders under section 601ND of the Act that the Rubicon Trusts be wound up on just and equitable grounds. Those orders were granted on 8 October 2009, based on a number of factors

(c) in the case of Octaviar Limited (formerly MFS Limited), the entity in the group that acted as RE (Octaviar Investment Management Limited) did not become insolvent as it had been sold prior to the appointment of administrators to Octaviar Limited;

(d) in the case of the Absolute Capital Group, voluntary administrators were appointed to the subsidiary that performed the RE role (Absolute Capital Limited), but members passed resolutions approving the appointment of a new RE (Permanent Investment Management Limited) to undertake the winding up of the scheme.

3. The issues that emerged in the context of the agribusiness MIS collapses were unique in the following ways:

(a) these schemes are typically contract-based, comprising a matrix of contractual arrangements between members, the RE and other group entities, rather than the more characteristic unit trust structure;

(b) members' initial contributions generally comprise rent and management fees, payable under the relevant contracts to group entities, rather than contributions of a capital nature that remain within the scheme or that are used to acquire assets of the scheme;

(c) as a result, there has been longstanding uncertainty about the meaning of 'scheme property' (as defined in section 9 of the *Corporations Act 2001* (Cth) (the ***Act***)) in the context of these schemes. The section 9 definition of 'scheme property' is appropriate for trust-based schemes as it represents the assets that are held on trust (in accordance with section 601FC(2) of the Act) for the members of the trust. However, it does not sit comfortably with contract-based schemes, such as agribusiness MISs, and for many years, the identification and valuation of the 'scheme property' of an agribusiness MIS at a particular point in time has been an area of considerable debate[11];

(d) unlike REs of trust-based schemes, the REs of agribusiness MISs do not typically derive significant fees themselves (ie, for performing RE management functions) - fees of that nature would not be consistent with the tax treatment of these schemes. Rather, fees generally take the form of rent and management fees paid to other group entities (ie, the landowning entity and management company), which may be passed on to external parties;

including the 'insolvency' of the Rubicon Trusts (on both a net asset and cashflow basis) and the fact that no replacement REs could be found to replace RAML. There were no contradictors to the winding up application.

[11] To some extent, these issues have recently been examined by the Courts (in the context of agribusiness MISs) in *Hance v Commissioner of Taxation* [2008] FCAFC 196; *Shepard and Mark Francis Xavier Mentha in their capacity as receivers and managers of Environinvest Ltd v James Patrick Downey in his capacity as liquidator of Environinvest Ltd* [2009] VSC 33; *Treecorp Australia Ltd (in liq) v Dwyer* [2009] FCA 278; *Capelli v Shepard* [2010] VSCA 2; *Huntley Management Ltd v Timbercorp Securities Limited* [2010] FCA 576; *Saker re Great Southern Managers Australia Ltd* [2010] FCA 1080. The issue was also identified in December 2001 (in the related context of section 601FC(2)) in the *Review of the Managed Investments Act 1998* (paragraph 5.3.1): '…It has been argued that [section 601FC(2)] should be redrafted to remove any confusion over whether or not a scheme is intended to be constituted as a trust with the RE as a trustee of scheme property for scheme members… Given the importance of this provision and the legal complexities involved, a more in-depth exploration of the issues is thought necessary before taking further action.'

(e) importantly, these fees are either invoiced to members annually only, or are deferred until the time of harvest (which may be many years after the commencement of the scheme) and deducted from the sale proceeds at that time. This means that the RE and other group members must subsidise the significant ongoing costs of the scheme (including plantation management, maintenance and insurance costs) from their own resources until they are reimbursed, either from the annual invoicing process or at the time of harvest.[12] This raises significant cash flow concerns, particularly where there is an intervening insolvency. By contrast, in the case of a trust-based scheme, fees are generally deducted from the assets or income of the scheme on a periodic basis and the RE has a right of indemnity out of trust assets on an ongoing basis in respect of scheme expenditure;

(f) the RE is typically expressed to be a party to the underlying contractual arrangements, including leases and management agreements, 'in its personal capacity'. This has raised various questions, including the extent to which those contracts are subject to statutory novation to a replacement RE under section 601FS of the Act. Also, as agribusiness MISs are not typically structured as trusts, and given the uncertainties surrounding 'scheme property' (discussed above), the distinction between the RE acting in its personal capacity and in its 'RE capacity' is not always clear;[13] and

(g) many of the above features of agribusiness MISs have been put in place to satisfy the requirements for tax deductibility of expenditure in connection with agribusiness MISs[14] (which does not apply to other types of MISs).

[12] These cash flow issues were referred to extensively in the *Inquiry into aspects of agribusiness managed investment schemes* by the Parliamentary Joint Committee on Corporations and Financial Services in September 2009.

[13] These issues were considered in *Huntley Management Ltd v Timbercorp Securities Limited* [2010] FCA 576.

[14] The taxation regime that applies to agribusiness MISs was also referred to extensively in the *Inquiry into aspects of agribusiness managed investment schemes* by the Parliamentary Joint Committee on Corporations and Financial Services in September 2009.

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Corporations and Markets Advisory Committee (CAMAC)

Managed Investment Schemes

Submissions

1 Introduction

We welcome CAMAC's comprehensive review of the managed investment schemes (**MIS**) industry in the discussion paper titled "Managed Investment Schemes" released by CAMAC in June 2011 (**Discussion Paper**).

We act for many participants in the financial services industry including responsible entities (**RE**) of wholesale and retail trust-based investment MIS (including outsourced trustees and REs), Australian superannuation trustees and overseas operators looking to expand in Australia. Therefore, we welcome the opportunity to comment on the issues raised in the Discussion Paper and the submissions in this paper reflect our firm's own views.

We have not made submissions on each issue raised in the Discussion Paper. Rather, we have focussed on some of the specific issues of key concern to our clients. The issues we have focussed on are:

- Reform 1: Identification and recording of the affairs of each MIS - do not support;
- Reform 2: Use of scheme property - support;
- Reform 3: Informing MIS creditors of a change of RE - support;
- Transfer of a viable MIS - changing the RE and appointment of a TRE (Chapter 4) - voting requirements to change RE should change;
- Restructuring a potentially viable MIS and Submissions on restructuring a potentially viable MIS and winding up a non-viable MIS - Elements of a VA for an MIS (Chapters 5 and 6) - suggest completely new framework;
- Other matters:
    - cross-guarantees (Chapter 7) - do not support; and
    - limited liability of MIS members (Chapter 7) - support.

2 Preliminary observation: trust-based investment MIS vs contract-based enterprise MIS

A number of the specific issues raised in the Discussion Paper arise from the use of the "trust" as the structure within which certain types of MIS operate.

In our view:

- while the MIS structure operates appropriately and efficiently in relation to trust-based investment MISs, in our experience it can be problematic for contract-based "enterprise" MIS in insolvency scenarios;
- the application of insolvency laws to a contract-based enterprise MIS is complex and uncertain, leading to considerable cost and delay for all involved;
- the MIS structure is arguably inappropriate for contract-based enterprise schemes (e.g. agribusiness schemes); and
- contract-based enterprise MIS should be subject to a different regulatory framework from trust-based investment MIS.

In light of these views, our submissions in this paper focus on the implications of the proposed reforms on trust-based investment MISs.

3 Submissions on specific reforms

(a) Reform 1: Identification and recording of the affairs of each MIS

Section 3.4.2

> Should the policy approach in Reform 1 be enacted?
>
> Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?
>
> If yes:
>
> - how could counterparties ensure that their agreements are included in the register? For instance should they have a right of access to the register? Also in what circumstances, if any, should they have a means to have the register amended?
> - what remedies should affected parties have for failure to include an agreement in the register and against whom?
>
> If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.

Submission:

We do not support the policy approach in Reform 1, because the proposals are both unnecessary and unduly onerous. Our specific concerns are:

- An RE should always identify itself as the operator of an MIS in any agreement it enters into in its capacity as RE, and identify the relevant MIS (or, where an agreement relates to more than one MIS, the relevant part of the agreement that relates to each MIS) - this represents current best practice.
- An RE should, in accordance with its existing general record keeping obligations, maintain a list of agreements it enters into in its capacity as RE of a given MIS, ensuring that it keeps on top of contract management (required under section 601HA(1)(e) of the Corporations Act 2001 (Cth (**Act**)).
- The proposals will require REs to incur significant additional compliance, technology and maintenance costs (which ultimately will be passed on to the members of the scheme). Moreover, for REs of multiple schemes (e.g. outsourced REs), there will potentially be thousands of documents on the register.
- An agreements register should not be a definitive statement of all agreements entered into by an RE as operator of an MIS.

If the agreements register requirement is made mandatory, then some additional comments are:

- The contents of the agreements register will need to be carefully considered. For instance, if scheme rights and liabilities cease on replacement of an RE, then they are not subject to the statutory novation under sections 601FS and 601FT of the Act. Accordingly, it may be important to include this information in an agreements register, to avoid misleading an incoming RE. Also, if the content of an agreements register is incorrect or misleading, liability would sit with the former RE, which may not be useful if the former RE is insolvent.
- Given the effect of the statutory novation, any prudent incoming RE should conduct due diligence on the agreements to which the current RE is party, rather than blindly relying on the register. An incoming RE would be assuming liability for the accuracy of the register going forward, so it will be incumbent on a prudent incoming RE to do due diligence from this perspective as well.
- Therefore, not only is this proposal of limited use, particularly for a TRE, but it adds another potential liability where there is little time for a new RE to carry out due diligence on the register .
- If liability is to be transferred to the incoming RE or TRE, on its appointment the incoming RE or TRE will need to rectify and update the agreements register. Responsibility for this following a change of RE, and any subsequent liabilities which arise for a failure to do

so, will also be an issue for an incoming RE or TRE and an additional administrative burden. The former RE should remain liable for any deficiencies in the register and should be required to provide all reasonable assistance to an incoming RE or TRE in correcting the register.

- Any penalties should be proportionate to the extent and significance of the RE's omission(s). It would be inappropriate to expose directors and other officers to personal liability under section 601FD(1)(f) of the Act for a breach of this requirement.

- Failure to record an agreement on the register should not affect the enforceability of that agreement. Otherwise this would unfairly penalise both innocent third parties who have contracted with the RE and MIS members, by depriving them of any benefits under those agreements.

- Any penalty which affects the Australian financial services (**AFS**) licence of the offending RE may also have the unintended consequence of the RE no longer having an appropriate AFS licence to operate the relevant MIS.

- Any remedy against the former RE for failure to record an agreement or update the register would not be useful for a TRE or a new RE if the former RE is insolvent. For instance, while a statutory indemnity from the former RE in favour of the incoming RE or TRE would only provide useful protection where the former RE is solvent.

(b) **Reform 2: Use of scheme property**

Section 3.4.2

Should the policy approach in Reform 2 be enacted? Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?

We support the policy approach in Reform 2. In our view, a statutory requirement that the property of a particular MIS must only be used for the purposes of that MIS is appropriate.

However, we would suggest two exceptions:

- The first is so that REs of multiple MISs should be permitted to engage in 'block-booked transactions', in accordance with current ASIC policy. This is because:

    - Block-booked transactions are a common investment method adopted by REs and investment managers for multiple MISs with similar mandates. They involve the RE or investment manager pooling the assets of MISs to purchase tangible assets provided they are appropriately accounted for. Normally this involves entering into a particular trade on behalf of one or more of those MISs (known as the 'contract group') and allocating parts of the trade among the MISs before, at the time of or after the trade has been entered into.

- Executing transactions in this way provides the contract group with many efficiencies and cost saving benefits.

- The second exception would be in the case of "sub-trusts", that is, where one MIS is in effect a wholly-owned sub-trust of another MIS.

Lastly, we note that the duties of an RE under s601FC act as a safeguard for the members of each MIS to ensure that the RE will act honestly, with care and diligence and in accordance with the compliance plan when dealing with the property of an MIS.

(c) **Reform 3: Informing MIS creditors of a change of RE**

Section 3.4.2

Should the policy approach in Reform 3 be enacted? What, if any consequences should follow where an RE fails to inform a counterparty?

We agree with the proposal. This is because:

- It would be helpful for counterparties to ongoing agreements with an RE of a particular MIS to be notified of a change in the RE, and therefore a change in their counterparty to that agreement, by virtue of the operation of the statutory novation in section 601FS.

- As CAMAC has noted, this will assist counterparties to agreements with an RE to enforce their rights against the RE.

However, a failure by an RE to inform a counterparty of a change of RE should not affect the validity or enforceability of the relevant agreement.

In terms of penalties for failure to notify:

- An incoming RE should have a sufficient period of time (for example 60 days) to notify counterparties of the change in RE before any penalties are to apply.

- The incoming RE should be personally liable for any penalties for a failure to notify, which should also be proportionate to the extent of the failure to notify. For example, it would be appropriate to limit any penalty to a nominal fine in respect of each agreement.

(d) **Tort claims and statutory liability**

Section 3.7

Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE?

In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?

Submission:

We do not consider it necessary to clarify the circumstances in which an RE should or should not be able to claim under its right of indemnity. This is because:

- Despite minor differences in the decisions of the New South Wales and Victorian Courts of Appeal cited in the Discussion Paper (*Gatsios* and *Nolan*), the circumstances in which a trustee is entitled to the benefit of an indemnity from the assets of the trust fund are sufficiently clear at common law.

- Leaving aside any particular terms of the trust instrument affecting the scope of the right of indemnity, it is clear that a trustee will generally not be so entitled where it if found to have acted in breach of trust, which includes:

  - breaching the terms of the trust deed (*Youyang v Minter Ellison* (2003) 212 CLR 484, at [32]); and

  - failing to meet the required standard of care in the exercise of its powers (*Fouche v The Superannuation Fund Board* (1952) 88 CLR 609). In this regard, however, the Victorian Court of Appeal (at [53] of *Nolan*) preferred a more lenient approach to that of the NSW Court of Appeal (at [14] and [47] of *Gatsios*).

  - The position is also fairly clear under- statute: section 601GA(2)(b) of the Act states that the right of indemnity must be available only in relation to the proper performance of the RE's duties. It is reasonably clear that the RE's conduct of its duties must accord with the obligations required of it in respect of the scheme under s 601FC(1) of the Act, under the constitution and under the applicable general law of trusts, in order for the right of indemnity to apply to such conduct.

  - It is unnecessary to amend the law to provide for tort claimants to have direct rights against MIS property - it is accepted in both *Gatsios* and *Nolan* that commission of a tort does not deprive the trustee of its indemnity, at least where there is no breach of the trustee's duty of prudence in the conduct complained of. For this reason it seems unlikely that a victim of a tort committed by a RE might be deprived of their ability to claim damages by the inability of the RE to pay the liability from the assets of the MIS.

4 Submissions on transfer of a viable MIS

(a) Dismissal of the RE by the members and retirement by the RE

Section 4.2.3

What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why?

What changes, if any should be made to the powers of the court to appoint a TRE and why?

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why?

Submission:

The voting requirements for the removal of an RE and approval of a replacement need to be changed. In our view:

- The threshold for removal of an RE or approval of a replacement RE by members should be lowered to that of a special resolution.
- The requirement that members of an unlisted MIS pass an extraordinary resolution[1] to remove or approve the replacement of an RE, hinders the efficient operation of registered MISs and is contrary to members' interests. In particular, it is a material impediment to facilitating a change of RE, which may be in members' best interests.
- This high threshold is particularly significant for the many widely held MISs which have a large proportion of members comprising Investor Directed Portfolio Services (**IDPS**) platforms and/or IDPS-like services (including master trusts and wrap accounts). Such platforms commonly have a policy of refraining from engaging in corporate actions in the MISs they hold interests in for retail investors. As a result, many platforms will refrain from voting on resolutions to remove the RE.
- Therefore, where a large proportion of members do not vote, it can be very difficult to carry an extraordinary resolution.

[1] An extraordinary resolution requires that at least 50% of all the votes that may be cast by members entitled to vote (including members not present in person or by proxy) must be cast in favour of the resolution.

- The current requirement for an extraordinary resolution has the effect of potentially entrenching an RE. It would be preferable if the threshold for removal were to be lower, to create a better check and balance on an RE, so that it faces a more realistic prospect of being dismissed if the majority of members consider it is not the best candidate for operating the MIS.

- We think that a special resolution is the appropriate threshold, given that other issues relating to an MIS of equivalent significance to the removal or replacement of an RE, such as approving amendments to the MIS's constitution, have the same threshold.

- In the context of an RE's voluntary retirement, an even better and more flexible outcome could be to adopt an approach consistent with the MIS winding up mechanism under Chapter 5C. We propose that this would only apply where an RE wishes to retire. In these circumstances REs should be empowered under the Act to elect to retire by giving notice to members, on the condition that the outgoing RE proposes a replacement RE. Members' interests would be protected by both the election to retire and the selection of a replacement RE being subject to the outgoing RE's prevailing obligation to act in members' best interests.

- Such a regime of RE voluntary retirement by simple notice to members would:

  - solve the impasse created where passive/abstaining members prevent voting requirements from being met; and

  - benefits MIS where the incumbent RE would otherwise be entrenched, even though an alternate RE could bring efficiencies for the administration and operation of the MIS as well as better investment performance.

- We note that the voting requirement for the dismissal of an RE of a listed MIS requires only an ordinary resolution. Historically this is in accordance with ASX Listing Rule 13.3 (now deleted). We do not consider it necessary to apply the same threshold for an unlisted MIS. This is because we support the approach suggested in the *Review of the Managed Investments Act 1998* (2001) Turnbull Report, which acknowledged that the distinction between listed and unlisted schemes had been intended by parliament (in CLERP).

- Lastly, legislative reform is required to clarify the meaning of "associate" as it applies to the voting restrictions in section 253E. Section 253E prohibits an RE and its "associates" from voting their interest if they have an interest in the resolution or matter other than as member[2].

- However, there appears to be some level of confusion as to the meaning of "associate" for the purposes of the voting restrictions in

[2] Subject to the exception that, where the MIS is listed, the RE and its "associates" may vote on a resolution to remove the RE and appointment a new RE.

section 253E and, in particular, whether the appropriate test is that set out in section 12 or that contained in sections 11 and 12. For example, in the Victorian Supreme Court decision of *Great Southern Managers Australia Ltd (Receivers and Managers appointed)(in Liq)*[3] Davies J noted that section 12 clearly applies for the purpose of section 253E. However, in the more recent New South Wales Supreme Court decision in *Everest Capital Ltd (as trustee of the EBI Income Fund) v Trust Company Ltd and Others*[4] White J accepted that if section 253E is applicable, section 15 applies. We therefore encourage CAMAC to take this opportunity to seek to clarify the definition of "associate" within the context of section 253E.

What changes, if any should be made to the powers of the court to appoint a TRE and why?

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

We submit that, in addition to our comments in section 5 below:

- Section 601FM should be extended to provide the court with the express power to appoint a TRE under section 601FP in circumstances where MIS members have voted to remove the RE but no new RE has been appointed. While a member of an MIS or ASIC may apply to the court under regulation 5C.2.02 of the Corporations Regulations 2001 (Cth) for the appointment of a TRE, the power of the court to appoint a TRE in circumstances where MIS members have voted to remove the RE and no new RE has been appointed is uncertain.

- This is particularly significant where the Act requires that a MIS be wound up in circumstances where scheme members have passed a resolution to remove the RE but do not at the same meeting pass a resolution appointing a new RE which has consented to that appointment. For example, this situation may arise in circumstances where MIS members who are dissatisfied with the incumbent RE have voted to remove the RE and either:

  - no alternative RE is available at that time;

  - members have not formed a consensus as to who to appoint as the new RE;

  - the proposed new RE has not had sufficient time to undertake necessary due diligence enquiries to consent to that appointment; or

  - the necessary voting requirements for the appointment of a new RE have not been satisfied. The likelihood of this situation arising in relation to unlisted MISs is increased

[3] *Great Southern Managers Australia Ltd (Receivers and Managers appointed)(in Liq)* [2009] VSC 557
[4] *Everest Capital Ltd (as trustee of the EBI Income Fund) v Trust Company Ltd and Others* (2010) 77 ACSR 371

while the Act requires the high threshold of an extraordinary resolution to appoint a new RE.

- An existing RE should be required to provide a proposed new RE with access to the books and records of the MIS in circumstances where a meeting of MIS members has been convened for the purposes of either:
  - members choosing a new RE following the retirement of the existing RE; or
  - members voting to remove the RE and choose another entity to be the new RE.
- Currently, a former RE is only required to provide the books of the MIS to a new RE once the new RE has been appointed. However, by not having access to this information prior to its appointment, a proposed new RE cannot ascertain the nature and extent of the obligations and liabilities it will inherit by virtue of the statutory novation under the Act.
- This provides a significant obstacle in entities agreeing to become the new RE of a MIS, particularly where the former RE is insolvent. Allowing a potential new RE access to the books and records of the RE after a meeting of MIS members has been called will allow a new RE the opportunity to undertake the necessary due diligence enquiries prior to that meeting. This may also reduce the length of time for which a TRE may need to be appointed where, following those inquiries, the new RE is comfortable to consent to its appointment at that meeting.

(b) **Eligibility to be a TRE**

Section 4.4.1

Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reasons?

Submission:

The role of a TRE is to operate an MIS (albeit for an interim period). Accordingly, a TRE should be able to satisfy the requirements for being an RE, including being a public company and holding an AFS licence (including appropriate authorisations and capital requirements to operate the particular type of MIS).

(c) **Outstanding obligations and liabilities of the outgoing RE**

Section 4.4.2

What, if any, changes should be made to the current provisions concerning the transfer obligations and liabilities of the outgoing RE to the TRE, and for what reasons?

Submission:

The purpose of a TRE is to operate a viable MIS for an interim period until a new RE can be found, for example if the existing RE becomes insolvent or wishes to retire.

However, the effect of the statutory novation under section 601FS is that, on its appointment, a TRE assumes the pre-existing obligations and liabilities properly incurred by the former RE. This is particularly problematic where a TRE is required at short notice (e.g. in an insolvency situation) and has had little opportunity to undertake necessary due diligence enquiries prior to its appointment.

There is a clear policy rationale for the transfer of existing financial liabilities and obligations to a TRE to protect the existing interests of scheme creditors. However, the operation of section 601FS provides a compelling disincentive for an entity to accept a TRE appointment.

In our view:

- A TRE should be responsible for any liabilities that it incurs in that capacity, so that counterparties can confidently contract with the TRE. This is important to ensure the continued operation of the MIS during the interim period of the TRE's appointment.
- It is unduly burdensome for a TRE to be exposed to the pre-existing obligations and liabilities of the former RE during this interim period.
- While a TRE should be liable for the liabilities it incurs during its appointment, it should only inherit pre-existing liabilities of a MIS to the extent that the TRE can be indemnified for those liabilities out of the MIS assets.
- This would ensure that a TRE would not be personally liable for a deficiency in the MIS assets attributable to the former RE, while still allowing the TRE to enter into commercial agreements to ensure the ongoing viability of the MIS until a new RE is appointed.
- Existing creditors should be able to claim against the former RE personally in respect of any pre-existing liabilities which the former RE cannot recover from the MIS assets through its right of indemnity.
- Whilst this would disadvantage creditors in circumstances where the former RE is insolvent, it should be balanced against the significant risks faced by a TRE on assuming the pre-existing liabilities of the

former RE beyond those for which it may be indemnified for out of the MIS assets. It also needs to be considered in light of the potential for the TRE's appointment to allow a viable MIS with an insolvent RE to continue to operate for the benefit of members and creditors alike.

- As an alternative, there could be a mandatory moratorium on the enforcement by creditors and other third parties of any pre-existing liabilities, until a new RE is appointed or the MIS is placed into external administration.
- This moratorium would provide a TRE with added protection from personal liability for pre-existing liabilities incurred by the former RE. However, the disadvantage of this approach is that the solvency of the creditors of the MIS may be jeopardised if they are unable to seek payment of the MIS' debts to them during the moratorium.

(d) **Duties of the TRE**

Section 4.4.3

What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?

Submission:

In our view, a TRE and its officers and employees should be exempt from any liability where the MIS constitution and/or compliance plan is found to be defective and for any actions taken in bringing those documents into compliance with the Corporations Act.

- On its appointment a TRE must comply with a number of statutory duties including ensure that the MIS constitution and compliance plan meet the Act's requirements. Similarly, the TRE's officers must ensure that the TRE complies with these requirements. We think this is appropriate - although the purpose of appointing a TRE is to operate an MIS for an interim period, the TRE and its officers and employees should be subject to those statutory duties applicable to the TRE's actions while it is operating the MIS. For example, the TRE and its offers should be required to act honestly and in the best interests of MIS members.
- However, the obligation to ensure that the MIS constitution and compliance plan meet the requirements of the Act is particularly onerous for a TRE and its officers. This is because:
    - Any contraventions will have ordinarily arisen through the actions of a former RE.
    - Where a TRE is appointed at short notice, it can be difficult for a TRE and its officers and employees to understand the extent of

any breaches of this obligation by the former RE and the likely impact on the TRE.

5 Submissions on restructuring a potentially viable MIS and winding up a non-viable MIS - elements of a VA for an MIS

Section 5.4

Is there support in principle for the concept of a VA for an MIS? Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?

Submission:

We do not support the concept of a voluntary administration (**VA**) for an MIS. A VA is not appropriate for an MIS, for the reasons which we have set out below.

Rather, we suggest the following arrangements should be implemented in various insolvency scenarios involving MIS and REs:

No.	Scenario	Who is appointed and for whom	Rationale/comments
1	Insolvent RE + solvent scheme	Administrator appointed to RE. TRE appointed to operate scheme.	The affairs of the insolvent RE will be managed by the administrator. A TRE is appointed to replace the RE (which, by virtue of its insolvency, is not capable of operating the scheme).
2	Solvent RE + insolvent scheme	Judicial manager appointed to represent scheme members. Insolvency practitioner appointed to represent creditors. RE either remains in place or is replaced by TRE - holds MIS assets and acts on direction of judicial manager. RE may need to be relieved of certain usual RE duties, to the extent that they conflict with directions of judicial manager. No receiver is appointed to	There are numerous conflicts inherent in this scenario: between members and creditors; and between the RE as a creditor (by virtue of its right of indemnity out of the MIS assets) and other creditors and the members. Due to these conflicts, there need to be 2 independent "champions" of the members and creditors' conflicting interests. The administration process should be subject to court oversight to ensure all parties' interests are appropriately protected.

No.	Scenario	Who is appointed and for whom	Rationale/comments
		the RE.	The judicial manager appointed should be appropriately qualified and experienced to understand the nature of an MIS and the duties of an RE.
3	Insolvent RE + insolvent scheme	Administrator appointed to RE. TRE/insolvency practitioner appointed to operate scheme and represent scheme creditors - holds MIS assets and acts on direction of judicial manager. TRE may need to be relieved of certain usual RE duties, to the extent that they conflict with directions of judicial manager. Judicial manager appointed to represent scheme members.	As per 2 above. In addition: - As the RE is insolvent, it is not capable of operating the scheme, and so it should be replaced with either a TRE or an insolvency practitioner. - If an insolvency practitioner is appointed instead of a TRE, that practitioner should be appropriately qualified and experienced to operate the MIS and understand the nature of an MIS and the duties of an RE.

We do not favour a VA for an insolvent MIS for the following reasons:

- It is unclear whose interests the voluntary administrator would be expected to serve in controlling the VA of the MIS.

- While in a corporate insolvency the duty of the administrator is to look after the interests of all stakeholders, the position of creditors is regarded as paramount. It is unclear how this would work in the context of an MIS where the usual position would be that members' interests should be paramount. The issue is, therefore, who will look after the interests of members.

- The second insolvency scenario described above is particularly challenging for multi-scheme REs, especially where the RE is an outsourced RE. Currently the practice appears to be to appoint a receiver to the RE, which not only has reputational consequences but would affect all of the other MIS of which it is RE. Furthermore, the appointment of a receiver could potentially trigger cross-default provisions in other financing documents to which the RE is party in its capacity as RE of other unrelated MIS.

- There are inherent conflicts between the interests of creditors and members. While this is also the position in relation to a company, the practical position is quite different: when a company is insolvent, the administrator effectively ignores the interests of members. It is doubtful that this is what is intended to be achieved by applying a proposed VA regime to an insolvent MIS.

- Moreover, in the case of an insolvent scheme, there are further conflicts between the personal interests of the RE, which is a creditor (given its right of indemnity out of the assets of the MIS), the other creditors and members.

- It is likely that the outcome of a VA process would be, as is the case with companies, a formal or informal liquidation of assets (even if structured, as is the case with many insolvent companies, under the guise of a deed of company arrangement). This is because creditors are unlikely to be supportive of any restructuring of the scheme for the benefit of members, wanting instead to identify the swiftest way that the assets of the MIS can be liquidated so that they may be repaid their debts.

- There is a better structure than a VA for the insolvent administration of an MIS. That structure exists in the case of insolvent insurance companies (and insolvent banks) where the Insurance Act (and Banking Act) contains a procedure known as judicial management.

- Just as prudential policy considerations have led to the establishment of specific regimes for banks and insurance companies, so too the public interests involved in MIS support the existence of a separate, tailored procedure to deal with the complexities associated with their insolvency.

- The advantages of a judicial management structure tailored appropriately for MIS are:

    - A practitioner would be appointed to administer the affairs of the insolvent scheme exclusively from the perspective of the interests of members.

    - The appointed practitioner will have no conflict in his duties, having "tunnel vision" for the interests of members. If the RE is solvent, then it would itself be very interested in protecting its right of indemnity in respect of debts it has incurred on account of the scheme. In this respect, the RE is a creditor of the MIS and has a conflict of interest with the other creditors. Therefore, it is appropriate that an insolvency practitioner is appointed to look out for the interests of the MIS creditors.

    - Alternatively, if the RE is also insolvent and has had an administrator or liquidator appointed to it, that administrator or liquidator would look after the interests of the RE's creditors and a separate TRE or appropriately qualified insolvency practitioner would be appointed to look after the interests of the MIS creditors and act as RE of the MIS.

- As is the case under the Insurance Act and Banking Act, there would be an imperative that the appointed practitioner(s) report to the court on options for the MIS within a relatively short period (which can be extended by the court, where necessary). This is important as the court has direct supervisory control over the practitioner(s), ensuring that all options for restructuring, recapitalisation or liquidation are examined and reported on expeditiously.

- The practitioner(s) would have a duty to report to the court on options, and other stakeholders, such as the RE, would have a right to be heard when that report is presented. The court could then direct either that meetings of scheme members be convened in order to implement a restructure or recapitalisation, or the court could order that the MIS be wound up.

6 Submissions on other matters

(a) Cross-guarantees

Section 7.2

In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?

Submission:

In November 2010, we assisted the Financial Services Council in providing submissions to ASIC in relation to ASIC's Consultation Paper 140 (**CP140**) on this point and other matters.

While ASIC has not officially published any outcomes of its consultation on CP140, we had understood that in relation to this point, ASIC indicated that industry commentary had caused ASIC to rethink this proposal.

We do not agree with the cross guarantee proposal in CP140. In our view that there is no need for any further form of regulation concerning the provision of cross-guarantees or indemnities by REs. This is because:

- The issues that are attempted to be dealt with by the proposal are already adequately covered by the general fiduciary duties of a trustee, and the provisions of the Act, including an RE's obligation to act in the best interests of members, the related party provisions (Part 5C.7) and the duties of directors and officers of an RE to act in the best interests of members.

- An RE should not be prevented from entering into a commercial transaction if it has have formed the view that it is acting in the best interests of the members of the scheme.

- The proposal in CP140 is too broad and will inappropriately inhibit an RE's ability to enter into normal commercial transactions. Indemnities are standard to commercial contracting, and a restriction on indemnities will require a significant review of commercial agreements entered into by REs.

(b) **Limited liability of MIS members**

Section 7.3

Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes? Should the limited liability principle be subject to any contrary provision in the scheme constitution?

Submission:

The question of liability of scheme members in MISs was addressed in the Companies and Securities Advisory Committee's report to the Minister for Financial Services and Regulation on Liability of Members of Managed Investment Schemes dated March 2000 (**CASAC Report**).

We support the approach taken in the CASAC Report, in particular that there should be a statutory limitation of liability for scheme members.

Current industry practice is to address the question of liability of members in an MIS in the scheme constitution. In our view:

- Introducing a statutory limitation of liability would give greater protection and certainty to both members and creditors of an MIS.

- As scheme members by definition do not have day-to-day control of the operation of the MIS, they should not be held personally liable for debts incurred by the RE.

- Any statutory regime limiting liability of MIS members should not be subject to any contrary provision in the MIS constitution. One advantage of a statutory regime is to introduce increased certainty, and this would be undermined if the position could be reversed in the scheme constitution.

In conclusion, we thank CAMAC for the opportunity to respond to the Discussion Paper and would be happy to answer any questions on our submissions.

Henry Davis York
14 October 2011

This submission has been prepared by members of the Financial Services Group and members of the Business Recovery and Insolvency group at Henry Davis York.

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CAMAC Discussion Paper—Managed Investment Schemes—June 2011

Submission

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CONTENTS

EXECUTIVE SUMMARY

McMahon Clarke Legal (MCL) is pleased to provide a submission to the Corporations and Markets Advisory Committee (CAMAC) discussion paper Managed Investment Schemes (June 2011).

The key points in our submission are as follows:

(a) The onset of the global financial crisis showed a marked gap in the provisions of the *Corporations Act 2001* in relation to managed investment schemes (MIS), namely the lack of regulation of responsible entities (RE's) and MIS in financial difficulty.

(b) Three of the four specific legislative reforms proposed in the discussion paper (identification and recording of MIS affairs, quarantine of scheme assets and notifying creditors of a change of RE) are peripheral reforms which will have a modest cost and administrative impact. However, whilst MCL does not oppose Reforms 1 and 3, MCL does not support proposed reform 2 as it is likely to result in restrictions being placed on an RE's operation of an MIS beyond what is reasonable and acceptable.

(c) MCL does not support proposed Reform 4 which would have the affect of providing a creditor of an RE, in relation to a particular MIS, direct access to assets of the MIS to satisfy debts owed to it by the RE. Whilst MCL appreciates the need to balance the rights of both members and creditors of an MIS, it can see no reason for the proposed amendments which would alter the status quo and current protections afforded to members of an MIS where an RE has acted outside the scope of its power so as to negate its right of indemnity over scheme assets.

(d) MCL welcomes and supports amendment to the current provisions regarding appointment of a temporary responsible entity (TRE) to encourage more REs to accept appointments as TREs and to widen the scope and responsibility of the Australian Securities and Investment Commission (ASIC) to appoint a TRE.

(e) However, the proposal that a TRE can ‘cherry pick’ which liabilities it inherits is not sound policy. Instead, a moratorium on creditors’ recovery rights should be adopted as it will allow an opportunity for necessary due diligence. A reasonable moratorium period can achieve an optimum balance between the rights of creditors to be able to enforce their contractual rights on the one hand and, on the other, the rights of scheme investors to be given the opportunity for their scheme to continue under the operation of a new and solvent RE.

(f) MCL is of the view that more specific mandatory disclosure requirements of existing RE to TRE and possibly potential REs would aid in increasing the availability of willing TREs and replacement REs and shorten the time required by TREs and potential replacement REs to assess the viability of the MIS. MCL believes that the introduction of an agreements register is but one area of disclosure that would be of benefit and other necessary disclosures should be considered further.

(g) MCL welcomes and supports the introduction of a regime similar to the voluntary administration regime in place for corporations to enable the continued existence of a MIS which may be financially stressed but potentially viable and whose current RE may itself be financially distressed or contemplating exercising its powers to wind up the MIS.

1. About McMahon Clarke Legal

McMahon Clarke Legal was established in 1994 and has been active in the managed investments sector since its inception. Our clients include managers and trustees under the former prescribed interest regime (the predecessor to the managed investment laws) and we now act for responsible entities, custodians and other stakeholders operating in the managed investment sector.

We have been very focused on legislative reform, particularly in the area of managed investment schemes. The firm has written two books *Everything you need to know about property syndication: explaining the myths surrounding illegal property syndicates* and *Everything you need to know about agricultural investment prospectuses: establishing a project under the Managed Investments Act 1998*. Our former and current partners have filled executive roles within industry associations including the *Australian Direct Property Investment Association*, the *Managed Investments Industry Association* and the *Australian Shared Ownership and Fractional Association Limited*.

The firm also produces regular newsletters with a managed investment focus and speaks extensively at external conferences, our own seminars and to the media.

We have most recently prepared submissions in response to the following:

(a) ASIC consultation paper 142 *Related party transactions*.

(b) ASIC consultation paper 141 *Mortgage schemes: Strengthening the disclosure benchmarks*.

(c) ASIC consultation paper 140 *Responsible entities: Financial requirements*.

(d) ASIC consultation paper 133 *Agribusiness managed investment schemes: improving disclosure for retail investors*.

(e) ASIC consultation paper 123 *Debentures: strengthening the disclosure benchmarks*.

(f) Submission on the *Corporations Amendment No. 2 Bill 2010*.

(g) Submission to the Commonwealth Treasury on the draft *Corporations Amendment Regulations 2009* and example product disclosure statement.

(h) ASIC consultation paper 100 *Unlisted property schemes: improving disclosure for retail investors*.

(i) ASIC consultation paper 99 *Mortgage schemes: improving disclosure for retail investors*.

(j) ASIC consultation paper 89 *Unlisted, unrated debentures: improving disclosure for retail investors*.

(k) ASIC consultation paper 81 *Management rights schemes*.

(l) Parliamentary Joint Committee on Corporations and Financial Services: Inquiry into agribusiness managed investment schemes.

(m) ASIC consultation paper 163 *Unlisted property schemes: update to RG 46.*

2. The proposed key legislative reforms

2.1 Reform 1—identification and recording of the affairs of each MIS

(a) Reform 1 proposes that an RE disclose to its counterparties in any agreements with the RE the MIS to which the agreement relates. The RE must also record the details of all agreements relating to each MIS in a register which must be made available to any external administrator of that MIS.

(b) MCL is not against the introduction of an agreements register. MCL considers this to be a peripheral reform which will have a modest cost and administrative impact.

(c) However, it is our experience that REs already invariably disclose in agreements with counterparties the MIS to which the agreements relate, even if only to include the RE's limitation of liability clause which refers to the specific MIS.

(d) Furthermore, to the extent the introduction of the agreements register is intended to assist in the ready identification of the assets of a specific MIS, we query whether such amendments are necessary in light of the fact an RE is already required (by section 601FC(1)(i) of the *Corporations Act 2001*) to ensure that scheme property is clearly identified as scheme property and held separately from property of the RE and any other MIS.

(e) Imposing some disclosure obligations upon outgoing REs and related consequences would provide some useful benefits and, to the extent an agreements register formed part of such a mandatory disclosure package, MCL supports its introduction.

(f) However, MCL recommends that consideration be given to what other information ought to be disclosed by an outgoing RE to enable a potential new RE to assess the position of the MIS and whether mandatory disclosure of that information and time frames for disclosure should be introduced.

(g) In answer to the specific questions posed in relation to Reform 1, MCL responds as follows:

(i) MCL is not against proposed Reform 1. However consideration should be given to whether the proposed agreements register should form part of a wider package of disclosure obligations upon a former or outgoing RE.

(ii) The agreements register should not be a definitive statement of all agreements entered into by an RE as operator of a particular MIS.

(iii) This proposal may make the job of a temporary or permanent RE more attractive, in that the rights, obligations and liabilities which pass to a new RE would be clearly and definitively identified. However, it could also result in the position of a counterparty being adversely affected in circumstances beyond the counterparty's control if, for example, an RE were to breach the agreements register provisions by failing to register (or keep registered) a counterparty's agreement. This could result in the unequal and unfair treatment of counterparties. It would be risky to put the fate of a counterparty's rights at the whim of a register intended to be maintained internally by an RE. Allowing counterparties rights to view and seek amendment to an agreements register is not an acceptable method of protecting a counterparty's rights as it places the onus on the counterparty to ensure the RE has and continues to comply with the legislation.

(iv) MCL agrees that a new RE should have a right to claim against a former RE (or its officers) for loss suffered as a consequence of the former RE failing to properly adhere to any mandatory disclosure requirements that may be adopted such as an agreements register.

2.2 Reform 2—use of scheme property

(a) Reform 2 proposes that the property of a particular MIS can be used only for the purposes of that MIS.

(b) In answer to the specific questions posed in relation to Reform 2, MCL responds as follows:

(i) MCL does not agree that the policy approach in Reform 2 should be enacted. As it is currently proposed, there may be some unintended consequences and accordingly, it should be considered in more detail.

By way of example, the constitution of some MIS may have a broad investment mandate which would ordinarily permit an RE, for example, to lend funds on commercial terms to another MIS operated by the same RE. Proposed Reform 2 may prohibit this on the basis the funds are being used for the purpose of the borrower MIS. In some circumstances it may be difficult to identify where the purpose of an MIS ends and another purpose starts.

(ii) It is unlikely sufficient exemptions to Reform 2 could be identified to enable all current legitimate investment practices, permitted under an MIS' constitution, to continue.

2.3 Reform 3—informing MIS creditors of a change of RE

Reform 3 proposes a requirement that a new RE must notify the counterparties listed in the proposed agreements register of its appointment as new RE. MCL would not object to a requirement of that nature and would consider it to be only a minor administrative burden.

2.4 Reform 4—rights of MIS creditors against scheme property

(a) Reform 4 proposes a fundamental change to the current law in that it is proposed that creditors of an MIS will be given a right to directly access the assets of the MIS to satisfy debts owed to it by the RE in relation to that MIS rather than, as is the present position, the creditor only having access to those assets if the RE first has a right to be indemnified from the MIS assets and the creditor has a right to be subrogated to the RE's indemnity.

(b) MCL agrees that there is a need to balance the rights of creditors with those of the members of an MIS. However MCL sees no basis for departing from the current position with respect to a creditor's rights of recovery.

(c) Proceeding with Reform 4 would blur the existing trust relationship enjoyed by the RE and its members to one akin to, but not actually, that of a corporation and its members and MCL can see no legitimate reason for that change.

3. Transfer of a viable MIS

(a) MCL does not consider the voting threshold to remove an RE requires lowering. Parliament intended that the threshold was high given the consequences and implications for an RE of its removal.

(b) MCL agrees that changes are required to the TRE provisions to overcome reticence to take on a replacement RE role caused by the statutory novation of scheme liabilities and obligations. However, the proposal that a TRE can 'cherry pick' which liabilities it inherits is not sound policy. Instead, a moratorium on creditors' recovery rights should be adopted as it will allow an opportunity for necessary due diligence. A reasonable moratorium period can achieve an optimum balance of the rights of creditors to be able to enforce their contractual rights against the rights of scheme investors to be given the opportunity for their scheme to continue under the operation of a new and solvent RE.

(c) The *Corporations Act 2001* should be amended to provide that ASIC be obliged to appoint a TRE to a scheme once the current RE becomes externally administered. The Parliamentary Joint Committee on Corporations and Financial Services into agribusiness managed investment schemes recommended something similar although, with respect, in its report to the government the Committee inaccurately referred to a scheme becoming insolvent, not the RE.

(d) The *Corporations Act 2001* should also be amended to give ASIC broader power to apply to the court for the appointment of a TRE, including where ASIC believes the appointment is necessary to protect scheme assets or is in the interests of scheme members. Whilst the Corporations Regulations currently give ASIC that power (see regulation 5C.02.2) there is no power for the court to actually appoint a TRE pursuant to that provision.

(e) The potential pool of TREs should not be so large as to extend beyond entities that hold an Australian financial services licence. Parliament and ASIC have seen fit to prescribe minimum requirements which must be met before a licence is granted and the integrity of the approval process should be maintained. However, we submit the appointee need not hold a licence authorising the operation of the scheme or scheme type in question. Instead, it should be adequate that the potential TRE is a licensee who holds a licence which authorises the operation of managed investment schemes of any kind, provided the TRE obtains the required authorisation if, and by the time, it becomes the permanent RE.

4. Restructuring a potentially viable MIS

(a) MCL supports the implementation of a voluntary administration like regime to permit an external administrator to be appointed to deal with the affairs of a financially stressed but potentially viable MIS. It will be a decision for the RE at the time, whether that be the incumbent or a TRE.

(b) Where the current RE of a financially stressed but potentially viable MIS is itself in voluntary administration, it would be a matter for the TRE to appoint an administrator to the MIS if the TRE had formed the view the scheme could not pay its debts as and when they fell due. This presupposes a TRE has been appointed by ASIC under the reform promoted under section 3(c) above.

(c) There will of course be circumstances where the RE is not insolvent, but one or more of its schemes is in financial difficulty. It is our view the existing law on replacement of REs is an adequate measure enabling members to vote out the RE if they are dissatisfied with its performance. If the moratorium period suggested under paragraph 3(b) is implemented, then the pool of available TREs should increase, which, in turn, will give members greater choice of change. It would then again be up to the TRE whether a voluntary administrator is appointed to the scheme.

(d) If a TRE is not appointed because the incumbent RE remains solvent and has not been removed by investors, then it is a matter for that RE, having regard to its statutory and fiduciary obligations, to determine whether an external administrator be appointed to the scheme in question.

5. Conclusion

MCL supports the need for reform of the law in relation to MISs that are financially stressed.

We are, in principle, supportive of many of the proposals in the CAMAC paper, although believe some of the specific proposed legislative changes should be part of a broader reform package.

We are firmly of the view a moratorium on creditors' recovery rights following the appointment of a TRE is a required reform.

We thank CAMAC for considering the issues raised in this submission. If you would like any clarification on our submission or to discuss any aspect of it, then please contact—

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PRIMARY SECURITIES LTD

Our Ref: PSL / Submissions

7 November 2011

Convenor
Advisory Committee
Managed Investment Schemes
Corporations and Markets Advisory Committee

Managed Investment Schemes

Dear Madam

Submission re Discussion Paper: Managed Investment Schemes

Primary Securities Ltd is a responsible entity, being part of the Primary group of four responsible entities, the others being Australian Growth Managers Limited, Primary Compass Ltd and Primary RE Ltd.

Responsible entities in the Primary Group have been amongst the most active in the rescue or attempted rescue of "Grower" investors in agricultural schemes and in resultant litigation. We have been involved in rescue or attempted rescue of Growers in Australian Growth, Australian Olives, Timbercorp, Templegate, Treecorp, Great Southern, Willmott Forests and FEA schemes and the rescue of Unit Holders in the Fernvale Unit Trust. One of our responsible entities has also experienced what happens when a receiver is appointed over a listed property scheme with stapled securities.

We are certainly qualified and experienced for the purpose of commenting on the questions and issues raised in the Discussion Paper.

Preliminary comments

The "Current Position" at the beginning of the Discussion Paper needs to be commented on in a few places:

Contributions of scheme members (pages 11 and 12)

Contributions of money or money's worth to the scheme are scheme property. However, there is a question as to whether management fees or lease fees paid to the responsible entity under management contracts or leases fall into this category.

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Also, there is a question as to whether or not fees paid directly by scheme members to the responsible entity are paid "out of scheme property". If they are not, then does section 601GA(2)(b) apply to such fees?

Our view is that annual fees once received are not scheme property as they are received by the responsible entity as income. On the other hand, unpaid annual fees are commonly regarded as scheme property. Hence you might have the strange situation in which a creditor could claim rights in relation to unpaid annual fees but not over the fees themselves once paid.

Rights in the property that the member retains (page 12)

The Discussion Paper rightly refers to Note 1 to section 9 definition of scheme property. It is appropriate to comment here that in *Re Environinvest* (2009) 69 ACSR 530, Judd J found that "scheme property" includes the trees even though they may be owned by the individual scheme members on whose lots the trees grow and are not pooled.

Contracts entered into between scheme members and third parties (page 12, page 27 and elsewhere)

We note that you make a distinction between contracts entered into by the responsible entity as principal and contracts entered into by the responsible entity with third parties as agent for scheme members. We assume you do not mean contracts merely entered into under power of attorney.

In agricultural schemes, contracts entered into by scheme members are these days usually only with the responsible entity and not by the responsible entity as agent for scheme members with third parties. This may have been different 12 years ago when leases and third party management agreements were often direct to Growers with the responsible entity having an overseeing role. Since 2003, ASIC has insisted on all management contracts with scheme members being with the responsible entity and not third parties (to avoid suggestions that the third parties were operating the scheme without a licence in breach of section 601FA). Many responsible entities including Primary Securities Ltd were asked to change their contractual arrangements for some agricultural schemes. Around the same time, responsible entities were required to register the interest of Growers on the title (effectively requiring the responsible entity to be the head-lessee in trust for Growers or in their capacity as responsible entity). Also, since Financial Services Reform, section 925F has possibly prevented non-licensees from taking any fees (including rent) from scheme members.

Hence for these various reasons, the practice for the last six years or so has been that there are no contracts between scheme members and third parties (although schemes set up prior to that time still include such contracts). Nowadays, property owners will lease to the responsible entity who will sub-lease to Growers. The Growers also enter into a management agreement with the responsible entity which may or may not sub-contract to a third party.

The distinction between contracts entered into by the responsible entity as principal and contracts entered into by the responsible entity as agent for scheme members is now obsolete.

The trustee's right to an indemnity (page 20)

Even in serious cases of failure by a responsible entity or trustee, such as negligence or misleading and deceptive conduct, the responsible entity or trustee may still be entitled to be indemnified: e.g. *Re Chennell* (1878) 8 Ch 492; *Turner v Hancock* (1882) 20 CH D 303; *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd (in liq)* [2002] ATPR 41-864.

This means that it will be very rare for an incoming responsible entity to be able to argue that a liability of the previous responsible entity has not been novated.

Relationship with receivers and liquidators

There are questions you do not deal with as to the relationship between a new responsible entity and the receivers (or liquidators) of the previous responsible entity.

There is the question as to whether or not the new responsible entity is obliged to pay for the costs of the receivers in complying with requests of the new responsible entity under sections 601FR. We ask for documents and are often met with the response: We have no money, pay us and we will give you what you want. We argue that the statutory obligation to cooperate with the new responsible entity should be without payment of fees.

Also there is the unanswered question as to whether or not receivers take on the duties of the responsible entity in relation to any payments they make from the bank account of the scheme or other dealings they undertake in relation to scheme assets when acting in the role of the responsible entity. In the Great Southern Vineyard schemes, the receivers paid $1.71m in fees to themselves (for the former responsible entity) from the Growers' proceeds accounts the day before we were appointed. We have claimed repayment on the basis that there were setoffs which should have been applied by the receivers. The receivers have responded that they were merely collecting debts owed to the bank out of the scheme accounts. The matter is being negotiated.

Our view is that receivers and liquidators in relation to a responsible entity should not be permitted to exercise the powers of responsible entity because they are in a position of conflict.

These problems might be avoided if scheme members were able to appoint a TRE or if receivers were prohibited from exercising responsible entity powers because of conflict issues, or further, because they have not been approved by ASIC as officers of the responsible entity for the purpose of running the responsible entity.

Other issues: Poison pills, Lack of information, Proxy Gathering and Change of auditors

You do not deal with all the problems that arise when scheme investors are seeking to replace an incumbent responsible entity with a new responsible entity. I refer to my paper "Suggestions to increase competition and reduce costs for investors in managed investment schemes: A submission to Treasury" prepared last year. I refer to the sections headed "Poison Pills", "Lack of Information""Proxy Gathering" and "Change of Auditors" as issues you do not appear to deal with. The other sections of that paper are referred to below.

Reform 1: Contract Register

We support the requirement that contracts entered into by a responsible entity in relation to a scheme should be entered into by the responsible entity in its capacity as responsible entity for the scheme, identifying the MIS. This has always been our practice. We also always include the AFSL of the responsible entity at the beginning of contracts.

We do not support the proposal for a contract register. That is not to say that the purpose behind the proposal is not well intentioned, it is just that it will cause too many problems for responsible entities and counterparties.

The main reason we do not support this requirement is the cost involved to all parties. Having a regime whereby all contracts with a responsible entity must be entered in a register is such a massive change of what is normally required commercially for contracts that we think this policy would be enormously expensive to administer. Every contract, no matter how small would have to be entered into the contract register via overseeing lawyers for all parties (at great cost to all parties). The proposal is possibly even dangerous to counterparties and could lead to all kinds of injustices if through human error, contracts were not registered when they should have been.

On some schemes we operate (for example the Templegate forestry schemes) in our capacity as responsible entity we enter into many day to day of contracts for the construction of roads, employment of officers and consultants, forestry reports, insurance and forestry work: clearing, felling, sale of timber, etc.

The task of registration could be circumvented by subcontracting to a management company. We do not have a management company and do not wish to have one because we want to be transparent to investors who would be suspicious if we formed a separate management company. The responsible entity is audited but a management company would not be. Having to have a contracts register for these schemes would be a night-mare for us as responsible entity and for the parties with whom we contract!

If the responsible entity also had to keep a register of all contracts entered into as agent for scheme members, the night-mare would be multiplied as there are separate 600 lease and management agreements for the Templegate schemes entered into in 1988 when the scheme began.

Your proposal for a register of contracts entered into between scheme members and third parties is inappropriate for the reasons set out above as there should no longer be any contracts entered into directly between scheme members and third parties. Perhaps you are concerned with situations where the responsible entity enters into a contract in its own name but as agent for scheme members. What schemes are you referring to? We are not aware of any agricultural scheme where the responsible entity contracts with third parties in its own name but does so as agent for scheme members.

Another reason for opposing the proposal is that it would not necessarily assist a potential replacement responsible entity in identifying material contracts. Our experience of taking over schemes is that the former responsible entities have either been very limited in what they consider are scheme contracts (to preserve the interest of banks), or alternatively expansive (in an effort to terrify an incoming responsible entity). Most contracts entered into by a responsible entity are with related companies in the same corporate group, hence the responsible entity might pick and choose which contracts it considers scheme contracts and which it does not, according to what suits the group not the Growers.

You would be aware that both Timbercorp and Great Southern bent over backwards to restrict the extent of scheme contracts. They wanted to be able to offer security over scheme land and all their rights to the land to their banks and therefore Timbercorp for example contracted head-leases "in its personal capacity", anything other than as trustee for the Growers (which would result in the head-leases being scheme property). Their compliance committees seem to have accepted this practice without comment. This meant that essential scheme contracts and property would never have been entered into a contracts register or property register. And it led to chaos and litigation when the Growers tried to rescue the schemes and claim that the head-leases were scheme property.

Some companies (Willmott Forests and FEA) went into liquidation with their scheme contractual arrangements in complete chaos, with much uncertainty as to the line of title in relation to leases to Growers and what is or is not scheme property. In these cases, a register of contracts might work to the detriment of Growers who are seeking to enforce their rights if important contracts are not in any register.

The reverse applies when an incumbent responsible entity is trying to create poison pills for any potential replacement responsible entity.

Great Southern Managers Australia Limited entered into a timber marketing agreement with a related company in order to maintain control of marketing should any replacement responsible entity be appointed. This contract would certainly have appeared on any contract register, and yet was a related party contract not approved by Growers and was arguably void.

In the case of Australian Olives, the incumbent responsible entity entered into a water rights agreement with a related company which required payment of $100,000 per scheme to that company on 1 July each year. Had there been a requirement for a contract register, this particular incumbent responsible entity would most certainly have entered this contract into the contract register, and yet in *Re Huntley Management Ltd; Australian Olive Holdings Pty Ltd v Huntley Management Ltd* (2009) 76 ACSR 256, the Court held that the contract was **not** novated to the new responsible entity. [I might add that Primary Securities Ltd was the responsible entity which the Growers first asked to consent to takeover of the Australian Olives schemes. Once we saw this water rights agreement, we baulked at becoming responsible entity and the Growers then went to Huntley Management Ltd.]

On quite a few occasions, lawyers representing the receivers of both Great Southern and Timbercorp took great pains to explain to Primary Securities Ltd in both correspondence and in cross examination in open court that if we took over any of their schemes, we would be burdened with the entire debt of hundreds of millions of dollars the subject of charges entered into by the incumbent responsible entities in favour of the banks. Had there been a requirement to enter contracts into a register, you would find all charges entered into the register because the lawyers for banks are so thorough. Yet such charges are very unlikely to be scheme contracts.

In other words, having a register would not have solved the problems we have experienced on taking over schemes and would simply add a huge administrative burden and more mystification to what is already a difficult job when schemes are taken over.

Scheme Property Register

We do not support this proposal for the same reasons that we do not support the proposal for a contract register.

[It is strange that the requirement in section 601FC(1)(i) does not also prevent mixing of scheme property with property of any person, why limit it to personal assets of the RE and property of any other MIS?]

Reform 2: Use of Scheme Property only for MIS

We support this proposal.

Since its formation in 1999, Primary Securities Ltd has had a strict policy of never borrowing or creating charges except in relation to a particular MIS and for the purposes of that MIS. Had we been responsible entity of Australian Growth, Australian Olives, Timbercorp, Templegate, Great Southern, Willmott Forests or FEA, we would have **never** entered into charges in favour of any bank for any purpose. We have had this policy because we formed the view that to enter into any borrowing or charge for purposes unrelated to a particular scheme would have been in breach of our duty of care and diligence to the Growers in the schemes. There was always the potential for the borrowing or charge to interfere with our proper running of the schemes for which we were responsible.

Tort claims

There is certainly a danger of investors being subject to tort claims in relation to some schemes. For example in film schemes where investors take film copyright, the investors arfe theoretically liable to legal action if the film is in breach of copyright.

In agricultural schemes, Primary Securities Ltd has been concerned at the possibility of tort claims by employees of contractors who are working on the land leased for a scheme. In theory, an individual "grower" leasing a defined Woodlot or Vinelot upon which an employee or a subcontractor's employee is injured in an accident could sue the occupier of the Woodlot or Vinelot, namely the individual "grower" as well as the grower's contractor, the responsible entity. As part of our compliance procedures, we insist on seeing workers' compensation policies in relation to all sub-contractors.

Reform 3: Informing creditors of a change of Responsible Entity

We support this proposal (though not linked to any particular register, and not confined to creditors). We have some experience of counterparties ignoring the statutory novation of contracts. We would go further and permit the new responsible entity to do this in the name of the previous responsible entity.

Each time we take over an agricultural scheme which has been insolvent, we find that the scheme bank accounts and leases are all controlled by receivers or liquidators for the former responsible entity who will not give them up, believing that they have some right to continue to control these accounts. Refer for example to the recent decision: *Saker, in the matter of Great Southern Managers Australia Ltd (Receivers and Managers Appointed)(In Liquidation)(No. 3)* [2011] FCA 1192. Dealing with this has been very expensive in some schemes. In the Templegate schemes, we had to commence proceedings against the liquidator in the Federal Court to claim money in bank accounts clearly designated as scheme accounts, even bank accounts described with the name of the scheme and designated as "trust" accounts.

Reform 4: Rights of MIS creditors against scheme property

The Discussion Paper might assume that such rights would give protection to third party creditors as there would be a source of recovery of scheme debts. However it should be borne in mind that some agricultural schemes have no scheme property, or there is scheme property only at the end of the scheme or for some periods in a year. For example, a vineyard scheme may have no scheme property until there are saleable grapes.

By virtue of the decision of Judd J in *Re Environinvest* (2009) 69 ACSR 530, "scheme property" includes the trees even though they may be owned by the individual scheme members on whose lots the trees grow. However it is not practicable to suggest that any creditor might have rights against growing trees as there is little or no market for growing trees. Further, any attempt to enforce some right against growing trees would operate to the detriment of the individual grower who owns those trees. The trees belong to that grower and the loss of the trees by that grower is not necessarily shared by all growers.

Would creditor rights apply to fees? I refer to the notes at the beginning of the paper on whether or not fees are scheme property. We would argue that once received, fees belong to the responsible entity and are not scheme property. If unpaid fees are scheme property, you might have the strange situation in which a creditor could claim rights in relation to unpaid annual fees but not over the fees themselves once paid.

If there are rights against scheme property, they might best be in the nature of a lien as is frequently claimed by receivers who carry out work in relation to an insolvent scheme. This would mean that the creditors cannot force the sale of assets which might not have a ready market in order to satisfy their claim.

There could be priority questions if more than one creditor claims rights against scheme property, how will these be dealt with?

If enforceability depended on registration, it might be unfair to a third party which enters into a contract with a responsible entity in relation to a scheme (e.g. to maintain or harvest) but without reference to a particular scheme. Suppose a third party contracted to maintain or harvest in relation to plantations the subject of a number of schemes. Why should that third party not also have the protection of a lien or other security if the contract was clearly entered into in relation to the scheme. This point applies to the situation where a responsible entity might enter into contracts with counterparties for two or more schemes.

Courts should have the power to partition contracts with third parties where the contract has been entered into in relation to a number of schemes.

We cannot see any situation in which creditors would or should have contractual rights directly against scheme members (except where leases are for historic reasons still direct to Growers). We commented on this at the beginning of our letter.

Changes to voting rights for dismissal of an RE and other issues

The requirement for 50% of all votes is a huge barrier to takeover. Even when the incumbent responsible entity is insolvent and its receivers plan to terminate the scheme as a result of which investors could lose everything, it is difficult to get to 50%.

An incumbent responsible entity should have an obligation to provide information to any potential responsible entity which has the support of at least 5% of members.

Rather than repeat things I have said before, I attach my submission to treasury already referred to. I refer you to the headings "Takeover meeting requirements" and "Lack of Information".

Temporary responsible entity (TRE)

We have been asked many times to be a TRE. We have always refused except on only one occasion. That occasion was the Fernvale Unit Trust MIS where on the application of unit holders, Primary Securities Ltd was appointed TRE by the Supreme Court of Western Australia pursuant to sections 601FN and 601FP of the Corporations Act following a period of 8 years when the previous responsible entity had been in liquidation and the trust had been in receivership. As a consequence of the receivership / liquidation, the 600 unit holders in this small trust had not been reported to in that entire 8 years, income had been earned (and taken by the receivers for the bank), unit holders had an annual tax obligation which they knew nothing about, and no trust tax returns were submitted. Primary Securities Ltd took over to find that the receivers refused to hand over any documents and the liquidator had none. In the face of all these difficulties, we were appointed permanent responsible entity (on a vote from unit holders), recreated accounts from the receivers' returns, completed financial statements and tax returns, corrected the unit holders' tax position for all years of income, managed the property and then sold the property and we are now winding up the scheme. Making it easier to be appointed TRE could have meant that these unit holders were represented during those 8 years of silence.

The main reasons why the appointment of a TRE is often not appropriate are:

1. The fees specified in the Constitution are inappropriate. See question below in relation to remuneration.

2. The powers specified in the Constitution for acting as responsible entity are also usually inadequate for the task of being responsible entity or TRE of an insolvent scheme with hostile relations with liquidators and receivers. There may also need to be a thorough review and re-wording of powers so that the TRE is able to properly represent the investors and do everything that may be required to protect their interests. We prefer to come in at the same time as Constitutional amendments are approved which provide for us to have appropriate fees, indemnities and powers. Perhaps a court should have the right to give the TRE additional powers as required.

3. As you point out, the liabilities and obligations are either not known (and cannot without cooperation of the previous responsible entity be known) or are of such amount that it is not possible to become responsible entity. For example, in one of the Timbercorp Olive schemes rent was payable by the responsible entity of more than

$1m per year and there was no certainty that the investors / growers would be supportive to the extent of funding that rent.

4. If at the end of the three month period of being TRE, there are insufficient votes to get over the huge 50% of all votes hurdle, the scheme must be terminated, and termination of some schemes, particularly agricultural schemes, can operate as a fraud on the investors because some other party picks up the fruits of their expenditure, the plantation or orchard and scheme members lose everything. The risk of this for scheme investors is often so high as to outweigh the advantages of putting in a TRE. Appointment of a TRE is the first step down a pathway to total loss. This problem may be partly removed by changing the voting requirements for a change of responsible entity.

5. Once appointed TRE, the TRE cannot retire.

6. The poorly worded Regulation 5C.2.02 means that any appointment under that Regulation in a litigious situation is bound to be challenged.

Question: Should the eligibility for becoming a TRE be amended?

No. A responsible entity licence is one of the most difficult to obtain. This is because so many skills are needed to operate managed investment schemes. It is inappropriate to appoint anyone to operate a managed investment scheme even on a temporary basis who does not have these skills. Liquidators and receivers do not have the skills and understanding required to operate a managed investment scheme.

What is needed is to make it less dangerous to be appointed when the former responsible entity is insolvent (if not the scheme as well).

There are plenty of responsible entities. And we for example have been available to be appointed to almost every insolvent scheme if it had not been so dangerous.

If anything, we would argue that the task of being a TRE is often so fraught with risks, issues, complexity, breaches and long outstanding tasks and non-compliance that ONLY responsible entities with experience in taking over schemes of the same type should be permitted to be temporary responsible entities.

ASIC Licensing does have additional concerns and requirements for responsible entities taking over schemes. We have had a dialogue with ASIC over these matters for more than 12 months. Following these extensive discussions between ourselves and personnel in ASIC surveillance and Licensing, ASIC now requires a great deal of us as proposed new responsible entity of any scheme before a takeover. Our standard compliance plan includes matters relevant to the takeover of schemes and the risks involved and how we deal with these risks and non-compliance. See the extracts attached.

Prior to takeover of an agricultural scheme, we conduct careful due diligence and prepare a full takeover report in relation to a wide variety of subjects relating to the scheme (many of which have been negotiated with ASIC Policy). This report includes a legal risks analysis and is reviewed by ASIC Licensing before the relevant scheme is added to our AFSL. A typical takeover report deals with matters such as: a detailed analysis of the scheme, its structure and operations, assets, valuation and viability, NTA issues, inadequacies, register issues, AFSL compliance issues, non-compliance issues, default issues, agreement breach issues, a legal contractual and risks analysis (including title, head-leases and sub-contracts), any issues relating to lack of information to complete due diligence and how that information might be obtained, land searches, rates and taxes issues, local council issues, fire insurance issues, public risk insurance issues, infrastructure insurance issues, PI insurance issues, strategy for the scheme, projected cash flow for the scheme and responsible entity, meeting issues to effect a change of responsible entity, the agreement with Grower representatives or proposed manager, whether or not a manager will be required, the form of management agreement if one is to be appointed etc.

Hence the system already does take into account the problems and issues of scheme takeovers when a licensed and experienced responsible entity is involved. In the circumstances, suggesting that unlicensed parties might be more appropriate to be involved in scheme takeovers is inappropriate and is inviting risk and danger for all involved in the scheme. This is a task for professional responsible entities working with ASIC to carefully assess the risks and consequences for scheme investors of takeover.

Question: What if any changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outstanding RE to the TRE, and for what reasons?

Schemes should be treated for all purposes as separate entities with the same facilities as companies. Hence schemes of arrangement should be possible and administrators.

We agree that the power of the court to make directions could be expanded to deal with the transfer of obligations and liabilities.

A TRE should not be liable for historic liabilities except to the value of the scheme property available **in liquid form**. Otherwise the TRE could be stepping into instant bankruptcy.

Refer to our comments above in relation to what is and is not scheme property. A typical forestry scheme may have scheme property in the form of trees worth $10m but no money. The figure of $10m may only be an estimate by a forester of today's discounted cash flow value after a further ten years' growth less expenditure and harvest costs. Under your proposal, the TRE could therefore be liable to pay debts of $10m on appointment but have no means to pay those debts because the trees cannot readily be sold. Having the assets but not the cash is of course insolvency.

We agree that a moratorium for a limited period might be desirable. That period should not have any limit by date, but terminate upon the appointment of a permanent responsible entity.

A temporary RE would have to continue to operate the scheme, and start to attempt to fix outstanding obligations in terms of making the rights of scheme members secure, recovering property to which they are entitled, bringing accounts up to date and so forth. It requires the fullest powers.

Question: What changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reason?

As replacement responsible entity, we have found that we are sometimes held accountable by ASIC for the omissions and defaults of the previous responsible entity. For example, the view of ASIC is that **we** should report as breaches all of the failings of the previous responsible entity as if they were our breaches. We do not accept this view because we see our role as being to fix these breaches and not to have to report them as if they were ours. We find for example we are invoiced late fees when we submit financial statements or other returns which a previous responsible entity (or its receivers) have failed to complete or submit. Either the Corporations Act or policy should be amended to relieve the incoming responsible entity of any liability for these failures and any fees or penalties.

Other matters are dealt with in the next section.

Question: What if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?

The fees specified in the Constitution for acting as responsible entity in a normal situation of a functioning solvent scheme are usually inadequate for the task of being responsible entity or TRE of an insolvent scheme with hostile relations with liquidators and receivers. To protect the TRE, there needs to be a mechanism to give the responsible entity reasonable fees or invoicing the scheme members for fees for the work to be done. Or perhaps this could be resolved in the form of court orders made on appointment.

Question: Are there changes regarding the role of the TRE in the future of the MIS necessary or beneficial, and if so, for what reasons (commenting on conflicts, interaction with administrator etc)?

What if it is in the interest of scheme members not to terminate the scheme but to continue the temporary RE, even indefinitely? There should be provision for this.

We do not see a problem in the TRE putting itself up as a candidate for permanent RE. Why else would a responsible entity be willing to be TRE? No responsible entity wants to have to become familiar with a scheme just for a limited period like 3 months. It is strange that the Discussion Paper should be concerned with the possibility that a TRE might entrench itself and become permanent responsible entity. A far greater issue is the fact that permanent responsible entities are entrenched by the hurdles to takeover referred to in the attached Submission to Treasury.

We would also argue that a TRE should be eligible to be administrator of any scheme. We see no problem in the TRE appointing itself, given the statutory duties on responsible entities and the requirement to act in the best interest of scheme members if there is a conflict.

Question: What amendments are needed to clarify the operation of sections 601FS and 601FT, and for what reason?

Sections 601FS and 601FT are not the only provisions relevant on takeover. Section 601FC(2) also has to be considered as it deems scheme property to be held by the responsible entity and adds to effect of sections 601FS and 601FT in causing a novation on appointment of a new responsible entity.

The right to "books" relating to the scheme (section 601FR) should also be mentioned. What is covered by the word "books" is most unclear. Refer to the definition in section 9. On almost all schemes we have taken over, we have had great difficulty recovering files, correspondence, board minutes, compliance committee minutes and other records relating to schemes, not to mention financial records.

There are a number of issues involving sections 601FS and 601FT, including the following:

- It is unclear what the difference is between "liabilities" and "obligations", and why the previous responsible entity remains liable only for liabilities for which it could not have been indemnified out of the scheme property had it remained responsible entity, but not obligations for which it could not have been indemnified out of the scheme property had it remained responsible entity. Our interpretation is that "obligations" are the statutory and contractual obligations on the part of the responsible entity to members under the Corporations Act and under the Constitution and other scheme documents; and "liabilities" are debts and other obligations in favour of third parties.

- As you point out, it is difficult to know what circumstances might operate to deny the previous responsible entity its right of indemnity. The onus is on whichever is sued, the former or new responsible entity to show that the liability is one for which the former responsible entity could not have been indemnified out of the scheme property had it remained responsible entity. This is a difficult onus to discharge as referred to at the beginning of this letter.

- Despite the "economical way" in which the takeover provisions are drafted, there is still doubt about their meaning. There seem to be an increasing number of situations in which the courts find that contracts or rights are not novated. You mention some of these cases in your Discussion Paper including one in which we were closely involved: *Primary RE Ltd v Great Southern Property Holdings Ltd (recs & mgrs apptd)(in liq)* [2011] VSC 242..

- There is a question as to whether or not insurance policies would be contracts which have to be entered into the register or not. We have had arguments with the receivers of Great Southern over the question as to whether their fire and public risk insurance policies novated to us when we took over various schemes. The policy taken out by the receivers was terminable if the responsible entity ceased to be responsible entity.

- There is another question as to whether or not contracts such as head-leases for more than one scheme or for a scheme and land held personally would novate as to the part which relates to the scheme. The receivers of Great Southern argue that these contracts do not novate even though they are held by the former responsible entity. This is an issue which has been the subject of comment in at least two cases: *Huntley Management Ltd v Timbercorp Securities Ltd* [2010] FCA 576, (holding that novation applied); *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd)(in liq) [2011] VSC 242 (holding that novation did not apply)*.

- Section 601FT is linked with section 601FS so there is a question as to whether or not novation only occurs in relation to rights, obligations and liabilities in documents "to which the former responsible entity is a party".

- What is the position in relation to bank accounts? If the former responsible entity holds bank accounts in relation to a scheme, should not these immediately be novated to the new responsible entity? Presumably, any bank would resist such a proposal. In

> the Templegate schemes, the liquidator hung on to all bank accounts of the Templegate schemes, failed to recognise any novation and forced Primary Securities Ltd to commence proceedings for a declaration that the accounts were novated. The matter is still not resolved.

Much of the conflict we have experienced is with receivers and liquidators who see no duty to scheme members. On most takeovers, we find that "books" are kept by the receivers who (notwithstanding section 601FR) will not give anything to us unless we pay them, which we sometimes refuse to do if we think it is in the interest of scheme members not to pay. In the case of Great Southern, the receivers informed us that most records were on a computer which had been leased by Great Southern at a rate of thousands of dollars a month, and the receivers were going to return the computer and all records would be destroyed. There was nothing we could do to recover the relevant part of the records relating to the schemes. In the case of the Fernvale Unit Trust, the receivers threw out all scheme files as they were not required for the receivership.

Question: What if any statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reason?

Primary Securities Ltd has always had a strict policy in relation to its own schemes that annual fees received in agricultural schemes should not be paid into the responsible entity's general account (as was the practice of Great Southern, Timbercorp and AOL) but should be placed into a fees account and then used only for the purposes of the relevant scheme over the course of the period for which the fees were paid, consistent with the cash flow requirements of the scheme.

We see this obligation arising under section 601GA(2)(b). In other words, the receipt of fees is coupled with a statutory obligation to use those fees only for the proper performance of scheme duties. Such a statutory obligation means that fees must be accounted for and treated a little like trust funds, though there is no trust. However, there is doubt as to whether or not section 601GA(2)(b) does create such an obligation or is it merely an obligation to include certain provisions in a Constitution.

It would be helpful if section 601GA(2)(b) could be transformed into an actual obligation on the part of a responsible entity to use scheme funds only for the proper performance of scheme duties. This should be coupled with an obligation on the part of an incumbent responsible entity to hold and pay unexpended fees to any replacement responsible entity.

Question: What if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?

These should be prohibited. If they have the effect of limiting the benefit of contracts (such as insurance policies), it is contrary to the interest of scheme members that such contracts terminate if the responsible entity were to change. If they have the effect of imposing liabilities on the new responsible entity, such contracts should be prohibited as against public policy because they operate as a poison pill hindering takeover of the scheme.

See the discussion on "Poison Pills" in the attached submission to Treasury.

The Balance of the Discussion Paper

We support the remaining parts of the Discussion Paper but they are more of interest to insolvency practitioners rather than responsible entities.

We will confine our remaining comments to a few issues:

Convening meetings

We support having annual general meetings.

Cross guarantees

Any rule requiring all companies in a listed company group to issue cross guarantees should exclude responsible entities.

An alternative is to leave the cross guarantee rules in place but prevent responsible entitgies from entering into them, and thereby require the major agribusiness companies to use an independent responsible entity. Why did they not appoint an independent responsible entity to solve this problem in the past? Because they knew that the responsible entity would be doing things which were not in the best interest of growers but were in the interest of the group, such as selling produce to other companies in the group on favourable terms.

Limited liability of MIS members

A nice idea but if the liability of agricultural scheme members were to be limited, we doubt that the ATO would issue a product ruling because the Growers are not at risk or the arrangement might create a limited partnership and be taxed as a company.

Yours faithfully
PRIMARY SECURITIES LTD

Robert Garton Smith
Managing Director

Submission to CAMAC

Managed Investment Schemes

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1 Introduction

1.1 Submission

1.1.1 This submission is in response to the Corporations and Markets Advisory Committee's Managed Investment Schemes Discussion Paper (**Discussion Paper**).

1.2 Outline of Submission

1.2.1 There are a number of serious issues facing the future of managed investment schemes (**MIS**) and the MIS industry.

1.2.2 Many of these arise because of shortcomings of the statutory and regulatory regime governing MIS and the MIS industry. A number of these shortcomings are identified and discussed in the Discussion Paper. In particular, we note the issues identified concerning the regulatory and statutory framework for dealing with distressed and/or insolvent responsible entities (**REs**) and MIS, which we consider requires careful and considered reform. However, there are a number of other issues facing the MIS industry which are not addressed in the Discussion Paper and which we submit must also be considered as part of any legislative reform.

1.2.3 A substantial portion of the Discussion Paper is concerned with the operation of MIS from the perspective of creditors. In our submission we have sought to amplify the perspective of members and REs and also bring into discussion the impacts of any reform on the broader investment community and financial services industry.

1.2.4 Similarly, much of the Discussion Paper appears to be responding to the difficulties faced by insolvency practitioners (which we refer to generally as 'liquidators') in the recent insolvencies of agricultural MIS (**Agri MIS**). In our submission, many of these difficulties arose from liquidators attempting to treat the MIS like companies and treat members like shareholders, operating as they were within the statutory insolvency regime applying to companies and the REs to which they were appointed.

1.2.5 Members of MIS have different rights to members of companies, and the differences between MIS and companies are a source of important diversity of investment opportunity in the financial services sector. In our view, this diversity should not be sacrificed in the interest of commercial certainty or simplicity for creditors. Steps to address the inadequacy of the current legislative insolvency regime in respect of MIS should acknowledge the fundamental elements of MIS and their differences to corporations, rather than attempt to dissolve the differences between an interest in an MIS and a share in company in order to reshape a square peg to fit into a round and, perhaps for some, convenient hole.

1.2.6 We agree that greater certainty for all parties is required to address the legal, structural and regulatory issues identified in the Discussion Paper and in this submission. We consider that all parties involved in the MIS industry would benefit from such certainty. However we consider that if any of these parties require greater protection, it is the unsophisticated and disparate members of MIS. We consider that the difficulties encountered in the aftermath of the collapse of Agri MIS will, to a large extent, be understood as a function of particular historic circumstances. Accordingly, we submit that reforms to the industry as a whole must be tempered by an awareness of their implications across the entire MIS and broader financial services industry, and not be focused solely upon curing ills in one sector at one time.

1.2.7 Our substantive submission is structured as follows:

a. Section 2 details our recent experience in relation to MIS;

b. Section 3 provides general comments and observations on MIS and the Discussion Paper based on our experience;

c. Section 4 provides a detailed response to each of Chapters 2 to 7 of the Discussion Paper; and

d. Section 5 provides detailed discussion of various matters raised in response to the final question in the Discussion Paper.

1.2.8 We hope that our contribution will provide an additional and useful perspective on the issues facing the MIS industry.

1.2.9 Should you have any queries regarding any aspect of our submission or require any further information please do not hesitate to contact Dan Mackay on 03 8681 4424 or at Dan.Mackay@clarendonlawyers.com.au.

1.2.10 The following defined terms are used in this submission:

a. **Act** means *Corporations Act 2001*;

b. **AFSL** means Australian Financial Services licence;

c. **ASIC** means Australian Securities and Investments Commission;

d. **ATO** means Australian Tax Office;

e. **RE** means responsible entity; and

f. **Regulations** means *Corporations Regulations 2001*.

1.2.11 Other terms are defined in context.

2 Our Experience

2.1 Overview

2.1.1 Clarendon Lawyers is a corporate and commercial law firm with significant experience in relation to MIS including establishment, restructures, takeovers and disputes.

2.1.2 We have acted for REs, financial advisors, retail and institutional investors and a number of investor representative groups. In doing so we have gained a unique perspective on issues facing the MIS industry from both the member and fund manager perspective.

2.1.3 In the last three years we have had extensive experience in matters relating to MIS. Our experience in related legal proceedings is detailed in Schedule 1. We have also been involved in a number of takeovers, restructures and refinancing of distressed trust based and contract based MIS.

2.2 Trust based MIS

2.2.1 As detailed in Schedule 1, Clarendon Lawyers has acted for:

a. The trustee of the superannuation fund which instigated the dispute that was resolved in *ING Funds Management Ltd v ANZ Nominees Ltd; ING Funds Management Ltd v Professional Associations Superannuation Ltd* [2009] NSWSC 243; and

b. Centuria Capital Limited (then Century Funds Management Limited) (**Centuria**) in relation to the replacement of Lachlan REIT Limited (a subsidiary of Becton Property Group) as responsible entity of two unlisted property trusts, the Becton Office Fund No 2 and Becton Diversified Direct Property Fund.

2.2.2 In addition, Clarendon Lawyers presently acts for a number of clients in respect of failed or distressed unlisted property trusts in matters which are not in the public domain. In these matters, we are investigating potential contraventions of the Act, law of trusts and general law by former and present responsible entities, with a view to obtaining compensation or recovering losses or trust property for the relevant MIS and/or its members.

2.3 Contract based MIS

2.3.1 As detailed in Schedule 1, Clarendon Lawyers has had significant involvement in matters relating to the collapse of Agri MIS.

2.3.2 Our work in this area has primarily involved acting for investor (grower) representative groups, namely Timbercorp Growers Group, Save My Trees & Save My Tiwi Trees Inc (Great Southern), Willmott Growers Group Inc, Rewards Growers Advocacy Group, and FEA Growers Group Inc.

2.3.3 The MIS in each of these matters were operated within a corporate group in which some or all of the members became financially distressed and/or insolvent, with contagion bringing about the collapse of the Group. Issues we have observed in relation to such corporate group structures (what we term Complex Group MIS) are discussed at 3.1 below. As a result of group, or group member failure, all MIS operated by the Group have been imperilled and members are facing or have suffered substantial losses, even where the MIS of which they are members and/or the underlying assets are viable.

3 General comments and observations on MIS and the Discussion Paper

3.1 Complex Group MIS

3.1.1 In our experience the most complex and problematic issues have arisen in relation to agricultural MIS with a multi-function RE that is part of a corporate structure in which, typically, related parties of the RE provide contracted management services, own assets on which the agricultural activity occurs and/or provide finance to the group and members of various MIS within the group (**Complex Group MIS**)[1].

3.1.2 In our experience, Complex Group MIS have involved a number of significant but largely unidentified and/or undisclosed risks. These have included group and/or related party cashflow (insolvency) risk, group finance risk, structural risk, legal and regulatory risk and contagion risk. A number of these risks are interrelated and result from complex and poorly understood structuring and documentation.

3.1.3 The incidence of complex and highly problematic legal issues is presently extremely high as a result of the cascading collapses of Agri MIS and their operators over the period 2008 to late 2010.

3.1.4 Many of these ‘complex legal issues’ have arisen because of structural flaws in complex and untested MIS structures and as a result of ‘financial engineering’ occurring within the prevailing taxation regime at the time of establishment. The potential consequences of these overly complex and over-engineered structures were largely unknown.

3.1.5 In the future, MIS establishment will be informed by the experiences of the past two years. Lawyers, accountants and corporate advisors will seek to avoid repeating the mistakes of a decade or so ago and seek to avoid unnecessary complexity or uncertainty of structure, and or provide contingencies for unexpected issues that may arise. Investors and advisors are likely to eschew overly complex structures.

3.1.6 We submit that caution should be taken in enacting wide-ranging legislative reform as a direct response to these extreme events. To the extent that they are an historical accident, far reaching reform to address them will be of limited utility if future structuring is properly informed by ‘lessons learnt’, whilst any adverse impacts of reforms on the MIS industry will be permanent.

3.2 Members informational disadvantage

3.2.1 Typically MIS, in particular Complex Group MIS, involve a number of participants – financiers who are large Australian and International banks, product issuers, operators and promoters, corporate advisors, top and mid tier legal advisors, ‘Big Four’ and mid tier accountants, financial advisors, investors and regulators - through administration of the corporate, financial services, and taxation laws that govern MIS, and more directly through the registration of MIS by ASIC and the issue of product rulings by the ATO.

3.2.2 Of all commercial participants, investors are the least sophisticated and are at the greatest informational disadvantage. As such, they are heavily reliant upon the proper functioning of the regulatory system. They are also reliant upon financial advisors and research houses, who themselves are at an informational disadvantage to participants on the ‘inside’.

3.2.3 It should also be noted that comparatively, as a group, it is investors who have suffered most as a result of the massive losses occasioned by the recent failures of MIS.

3.2.4 While market and economic factors were the initiating causes, the losses suffered by retail investors have been contributed to by failures of the disclosure regime, gatekeepers and financial services regulation.

[1] See Bigmore QC, G and Neil Hannan *Issues arising out of winding up managed investment schemes* Insolvency Law Bulletin October 2010 42 for a succinct summary of the characteristics of such MIS.

3.2.5 Moreover, these losses are now being compounded by the reaction from the financial services industry, government and regulatory bodies, and the legal community to these investments and the position of investors in them.

3.2.6 Products are dismissed as toxic. Responses to the morass of legal difficulties have been overly pragmatic, often at the expense of members. Of even greater concern is an apparent increasing disregard for the position of investors in these products who have suffered or are suffering losses. This appears to be driven by a negative perception of these investors because of the tax-effectiveness of certain products and the apparent tax-driven nature of the original investment.

3.2.7 A few factors are important to note in this respect:

a. First, the drivers of a particular investment are varied. Generation of income, and generation, preservation and/or protection of capital are equally valid investment drivers. A long-term shareholding to generate capital and income, is just as valid an investment as an option or future to hedge currency risk, and equally valid as an MIS investment to preserve capital through access beneficial tax outcomes and generate income and capital over the life of the project;

b. Secondly, and perhaps most importantly, such negative perceptions ignore the fact that the forestry investments were an integral part of Plantations for Australia: The 2020 Vision, a strategic partnership between Federal, State and Territory governments and the plantation timber growing and processing industries. They also delivered significant ancillary benefits to other service industries in rural communities; and

c. Thirdly, while ATO Product Rulings give no assurance that products are commercially viable, viability of a project is a relevant factor to the ATO's decision to give a Product Ruling.

3.2.8 Reforms to the MIS legislative framework should be informed by this reality.

3.2.9 If investors are to bear more risk than there needs to be much greater transparency with respect to relevant arrangements and documentation and the effectiveness of the disclosure regime.

3.2.10 Consideration must also be given to whether shifting risk to investors is an appropriate response to the failure of counterparties to manage credit risk with respect to REs. We submit that this would not be an appropriate response and would have a detrimental impact on the investment industry and the diversity of the Australian investment landscape.

3.3 Members' Rights

3.3.1 Significant aspects of the Discussion Paper are concerned with the rights of creditors, and a number of the proposed reforms are aimed at enhancing their rights. In particular, chapters 2 and 3 are concerned with enhancing the rights of creditors against scheme assets and even against scheme members personally.

3.3.2 In contrast, the Discussion Paper contains little discussion of members' rights, or proposals to directly enhance or protect those rights. The reality of the collapse of a number of significant Agri MIS for investors has been stark. Some investors have seen a small return from the sale of scheme assets in the winding up of the MIS. A large number have suffered total loss of investment.[2] In no way could the outcome of the collapse of these MIS, or the practical application of the regulatory and legal regime governing MIS, be seen to favour investors as against other stakeholders.

3.3.3 It appears that the relative advantage in a winding up scenario of a beneficiary of a trust in comparison to a shareholder of a company is presented in the Discussion Paper as a basis for the reduction of a beneficiary's rights in the event of an insolvency. We do not consider this to be a valid justification for elevating creditors' rights and we are concerned that despite the significant impact of MIS failures on investors and the profound loss of invested capital, insufficient attention is being directed at the underlying issues from a members' perspective.

3.3.4 We agree that greater certainty for all parties is required to address the legal, structural and regulatory issues identified in the Discussion Paper and in this submission. We consider that all parties involved in the MIS industry would benefit from such certainty. However we consider that if any of these parties

[2] For example: members of the Great Southern Plantations 2007 project invested approximately $132 million. Land on which trees funded by their investment was growing was sold in early 2011 with no return to investors and they suffered total loss of investment.

require greater protection, it is the unsophisticated and disparate members and not sophisticated creditors.

3.4 Significance of MIS industry and effect of reforms

3.4.1 The size and complexity of the MIS industry is indicative of its importance as a capital provider to a number of key industries with the Australian economy and society. In addition, it provides important diversity in an investor's portfolio from the relatively saturated Australian equities market.

3.4.2 As we have noted above, the most complex and problematic issues have arisen during the recent spate of high profile collapses of agricultural Complex Group MIS. These cases have involved complex, novel and previously unforeseen issues.

3.4.3 It appears that the issues observed in these matters are a key driver of the Discussion Paper and underpin many of the proposed reforms.

3.4.4 What we submit must be acknowledged are the peculiar circumstances in which these MIS have collapsed and these issues crystallised – the relevant periods of the economic cycle, changes in the prevailing tax environment, drought, an acceleration in complexity of MIS structuring and the Global Financial Crisis. With time, and as development and structuring of Complex Group MIS is informed by the experiences of the last three years, it is likely that this period and the collapses it entailed will increasingly be viewed within its particular historical context.

3.4.5 Whilst these experiences must be utilised to improve and strengthen the legislative regime, at the same time, the desire to implement fundamental reforms with wide-ranging effects to the MIS industry must be tempered by the recognition that they are a response, at least in part, to 'long tail' events. The desire for wide-ranging reforms to target this extreme sample must be tempered by the recognition that fundamental changes to MIS will have potentially negative impacts on the MIS industry as a whole, and may be a direct response to historically isolated problems.

3.4.6 Any reforms to the law relating to MIS must bear in mind the MIS industry's importance as a capital provider, and potential adverse impact reforms may have on the MIS industry's ability to attract and deliver capital. If reforms are to be made which will have a detrimental effect on the MIS industry's ability to attract investment, alternative source of capital for these industries must be identified, or there is a risk of negative outcomes for a number of industries and sectors.

3.4.7 We consider that certain potential reforms raised by the Discussion Paper would have a devastating effect on the funds management and MIS industry and seriously diminish the MIS industry's capacity as a capital provider. In particular, we are greatly concerned by the potential negative impact of reforms which enhance the rights of creditors against scheme assets and which could result in scheme members being personally liable.

3.4.8 Such proposed reforms merely shift the burden of the credit risk of the RE as counterparty from creditors to members. No proper and considered justification for why this should happen is provided in the Discussion Paper.

4 Detailed Response to Discussion Paper

4.1 Overview

4.1.1 We provide the following detailed response to the Discussion Paper on a chapter by chapter basis commencing at chapter 2.

4.1.2 We have responded by reference to the relevant subject sections on which we comment, and in direct response to the proposed reforms and questions which we address.

4.2 Chapter 2 – Current Position

4.2.1 We make the following response to Chapter 2 of the Discussion Paper:

2.2.2 Regulation of an MIS

Replacement of the RE

We do not agree with the statement on page 17 of the Discussion Paper that the ostensible purpose of section 601FS of the Act is to ensure that the rights of creditors are not affected where the RE of an MIS changes. It is not borne out by inspection of the section and nor supported by paragraph 8.37 of the Explanatory Memorandum to the *Managed Investments Bill* 1997.

We refer to section 4.4 below where we discuss the purpose of sections 601FS and 601FT in response to the question posed in section 4.3 of the Discussion Paper.

2.2.3 The RE transacting as operator of an MIS

Rights of unsecured counterparties

We refer to the comment on page 22 of the Discussion Paper:

> *In consequence, creditors have no access to scheme property in relation to transactions where the RE has acted in such a way that it has no right of indemnity against that property.*

This is an inherent risk for a counterparty to an agreement with an RE. While the crystallisation of these risks has led to significant observed losses by creditors of MIS recently (in particular in relation to Agri MIS) these risks were not unknown. They are an essential element of the counterparty risk presented by an RE and are based on sound trust law principles.

The indemnity and subrogation principles discussed are an incentive to a potential counterparty to satisfy itself that an RE has the power to enter into the contemplated transaction and has the necessary rights of indemnity. We note in this respect that MIS constitutions are publicly available and a commercial party engaging in a significant transaction with an RE would typically require copies of other documents including a PDS.

Removing this risk by extending the right of indemnification creates a moral hazard. Third parties could potentially be involved in breaches of RE duties with impunity. Such a position is inconsistent with existing provisions relating to persons being involved in the breach of an RE's duties.[3] Moreover, its effect would be to shift risk to members who, as discussed above, are least adequately resourced to understand and act according to such risks.

2.2.4 External controls

At page 23 the Discussion Paper notes the application of the takeover and compulsory acquisition provisions of the Act to the acquisition of interests in listed MIS and that attempts to entrench an RE of a listed MIS may amount to unacceptable circumstances for the purposes of Chapter 6. As noted above, there are no explicit prohibitions of entrenching provisions in relation to unlisted MIS. We consider this to be a gap in the law requiring statutory enactment to prohibit entrenchment, and discuss this further in section 5.3 below.

4.3 Chapter 3 – Proposed key legislative reforms

4.3.1 We make the following response to Chapter 3 of the Discussion Paper:

3.1 Need for legislative reforms

Our experience accords with the observation made on page 25 of the Discussion Paper regarding the entwinement of the affairs of MIS and the issues this causes.

Delay is an especially serious issue for MIS viability. Typically with a contract-based agricultural Complex Group MIS there will be various MIS with differing levels of viability. The insolvency of the RE will prevent maintenance of the plantations or crops while the external administration of the RE is conducted and the entanglement unwound.

As time passes without expenditure on the plantations or crops their condition and viability will naturally deteriorate. Viable MIS may become borderline, and borderline MIS unviable, detrimentally affecting the ability to replace the insolvent or distressed RE and continue the MIS.

3.3 Problems in practice

[3] Subsections 601FC(5) and (6).

In our experience the most significant issues of the type identified on page 25 of the Discussion Paper arise in relation to Complex Group MIS, which may be either operated by ‘multi-function internal REs’ or ‘interconnected MISs’.

3.3.1 Need to identify the transactions attributable to each MIS

The absence of a statutory requirement to identify the capacity in which an RE transacts is a significant omission from the legislative framework and one requiring remedy.

However, the mere introduction of such a legislative requirement will not ensure compliance with it. There will continue to be REs who fail to identify the appropriate capacity, or incorrectly identify that capacity, when transacting. Disputes will still arise. In our opinion, the onus should remain on the party with whom the RE is transacting to satisfy itself that the RE is acting within its capacity as identified. Many counterparties to arrangements with REs are highly sophisticated participants in the commercial system with significant assets at their disposal to assess credit risk of the RE. The onus must be placed on them to utilise the publicly available information and perform adequate ‘due diligence’ enquiries of the RE.

We suggest this could be achieved by the codification of a presumption, in the absence of clarity of the capacity in which an RE transacted, in favour of members in resolving any dispute or interpreting the effect of any document. Such a presumption would shift the burden onto the counterparty as well as the RE, and operate as a significant incentive to counterparties to ensure the propriety and clarity of transactions they undertake with REs.

In recognition that not all counterparties will be highly sophisticated investors, the presumption could apply to the extent the counterparty has taken reasonable steps commensurate with their size and sophistication and the size and complexity of the transaction.

3.4 Proposed legislative reforms

3.4.2 The proposed legislative reforms

Reform 1: identification and recording of the affairs of each MIS

Questions

Should the policy approach in Reform 1 be enacted?

We support in principle the enactment of the policy approach in Reform 1.

We agree that the obligations outlined for REs for identification of agreements should be implemented.

We consider that failure to record an agreement should be an offence under the Act and responsibility for such failures should be extended to directors and compliance staff.

The compliance auditor should also be required to audit the agreements register on an annual basis and report any breaches or suspected breaches to ASIC.

We consider that the enactment of this reform should also place an onus on the counterparty to the agreement to satisfy itself that the RE has complied with its obligations for identification of agreements. Failure to take reasonable steps to satisfy itself may affect the counterparty’s ability to enforce the agreement or to seek compensation or damages in relation to it.

We consider that the Agreements Register should be available to members under similar provision to section 173 of the Act and available to the public on payment of a fee. Members’ access to particular agreements would then be governed by section 247A of the Act.

We submit that the Agreements Register should be lodged with and/or maintained by ASIC with copies of the underlying documents being lodged with ASIC electronically within a specified period after execution. The listing of documents lodged would then form a publicly available register. The documents underlying the ‘register’, whilst having been lodged with ASIC would not be accessible, but would form a central independent record of all agreements affecting MIS. This would also enhance ASIC’s ability to ensure compliance with the Corporations Law through access to the underlying documents.

Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?

If yes:

- ***how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended?***
- ***what remedies should affected parties have for failure to include an agreement in the register and against whom?***

If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.

In a practical sense a 'definitive' register is attractive.

However, assuming the counterparty has undertaken reasonable enquiries to satisfy itself that the RE with whom it is transacting is doing so in a proper capacity it seems inappropriate to punish a counterparty for the RE's failure to record the agreement as required.

Conversely, if the register were maintained by ASIC and publicly available, any counterparty could conduct a search at the expiration of a specified period. If the agreement were not lodged by then, the counterparty could approach the RE to ensure compliance and/or lodge a breach notice with ASIC which may have the affect of preserving the counterparty's rights as if the agreement were recorded until such time as it is.

We agree that the RE's failure to comply with its recording obligations shouldn't jeopardise the members' rights to benefits of that agreement. However, if the counterparty were afforded ability to address a failure to record the agreement this may reduce the risk posed to members.

We note that rights against a former RE, if that former RE is insolvent or under financial distress, will be largely worthless and ineffective.

Reform 2: use of scheme property

Questions

Should the policy approach in Reform 2 be enacted?

We strongly support enactment of Reform 2.

Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?

We do not consider there should be any exceptions. Exceptions create considerable problems in the change of RE of one scheme and not the other. This has proved to be a fatal flaw in a number of Agri MIS where a single headlease covers multiple schemes, only some of which are viable. By way of example, in one matter in which we were involved, members of a viable MIS were unable to change the RE of the MIS because the receivers of the landlords threatened to terminate the shared lease for non-performance of obligations under the lease in relation to the non-viable schemes.

Reform 3: informing MIS creditors of a change of RE

Questions

Should the policy approach in Reform 3 be enacted?

We see no reason why this policy approach should not be enacted however we are unsure of what practical benefit it will achieve.

The RE of an MIS is information publicly available from ASIC. Counterparties can avail themselves of simple alert functions that would bring any change of RE to their attention. Further, it is highly likely that parties providing services to the MIS under continuing agreements would be contacted by the RE prior to or following the change of RE.

It is unclear what practical benefit would be achieved by this notification process.

What, if any, consequences should follow where an RE fails to inform a counterparty?

We refer to our comments above.

Reform 4: rights of MIS creditors against scheme property

Questions

Should the policy approach in Reform 4 be enacted?

Proposed Reform 4, as noted in the Discussion Paper, involves a fundamental change to the nature of trusts and MIS, however, the Discussion Paper provides little by way of explanation of the necessity or desirability for such a change or justification as to why such a profound alteration to the framework of MIS should occur.

Page 36 of the Discussion Paper states:

> *At the time the MIS regime was introduced, collective investment schemes did not involve a large number of investors or members and did not involve significant amounts of money. Today, as a result of various factors discussed earlier, MISs have become a significant part of the economy and many schemes are large commercial enterprises. This may require a review of the legislative balance between the members of an MIS and its creditors.*

Factual observations alone concerning the growth of the MIS industry do not provide a reason to effect fundamental reform of MIS.

Page 36 of the Discussion Paper further states:

> *...the reform would more closely align the rights of MIS creditors with those of corporate creditors.... It would benefit creditors of an MIS over MIS members.* ***The rationale for this change is the typically commercial nature of investment as well as enterprise MISs.*** *(emphasis added)*

The rationale appears to be that as MIS are growing in size and complexity, and can rival certain corporations, the same rights as those of corporate creditors should be given to MIS creditors, at the expense of members.

This rationale ignores the fundamental differences between trusts / MIS and corporations.

It also ignores the differences between the position of members of MIS and shareholders in a publicly listed company (the obvious alternative corporate investment vehicle for such investors).

A number of trust-based MIS, in which the RE transacts as principal, are unlisted. The RE of these MIS, unlike public listed companies, is not subject to continuous disclosure obligations, and members of these unlisted MIS are unable to trade their interests into a liquid market.

As we have noted above in section 3.2 above, in our opinion, members are at a significant disadvantage to other parties involved in MIS, and there is no justification for shifting responsibility for the credit risk posed by an RE to members form the counterparty.

Such suggested reforms ignore this disadvantage and seek to absolve counterparties from responsibility for their dealings in relation to MIS. The fact is that MIS are peculiar legal structures akin to trusts. It well understood that they are different from bodies corporate transacting on their own behalf, and that they transact subject to restrictions imposed by the constitution and other documents of the MIS.

MIS constitutions are publicly available. In our opinion, PDS and supplementary PDS should be required to be lodged with ASIC and made publicly available. Counterparties should investigate the terms of trust of the RE with whom they are considering transacting, both through enquiries of the RE and their own.

We refer to the following comment at page 29 of the Discussion Paper:

However, once an RE goes into external administration, the outcome where the RE cannot make an indemnity claim is that the affected counterparties of the RE have no means of recovery against the property of the MIS. On one view, such an outcome would constitute a diminution of creditor rights that is out of step with the nature of many commercially based MISs.

It goes on to contrast this scenario with the 'indoor management' rule for companies.

While the reduction of REs and trustees to the status of companies may create the benefit of simplicity for creditors, we reiterate that we do not consider that this is a sufficient basis for doing so.

The rules relating to indemnification are an essential feature of a trust. It reflects the essential difference between the interests of a beneficiary of a trust and a shareholder of a company. A shareholder has no interest in a company's property.[4] It has merely a contractual right against the company (a chose in action). A beneficiary has a proprietary right in property held on trust by a trustee.[5] Because of the beneficiary's proprietary right, a trustee's rights of indemnification out of trust property is necessarily limited. This proprietary right is also the basis of different tax treatment to companies. These are well established principles of law.

We reiterate our comments in relation to section 3.3.1 about the need for counterparties to take responsibility for the credit risk they accept and conduct appropriate due diligence on the RE.

We can see no reason why the applicable restriction on a trustee's right of indemnity where it has acted beyond power or otherwise improperly against trust property should be removed. Such a change would effect a fundamental change to the very nature of MIS. It should not be done without a broader investigation into the role of MIS in the Australian economy.

From a policy perspective, it is unclear why the beneficiaries should bear the brunt of the RE's breach of trust rather than counterparties that are parties to the offending transaction. The counterparty has discretion as to whether or not it will transact. It can investigate and undertake due diligence. The members have no such control over their situation. Members have no day-to-day control over the affairs and transactions of the RE and can resort only to the limited statutory rights under part 2G.4 of the Act to influence the direction of the MIS. Members have limited capacity to pursue REs for compensation for losses. There is a clear imbalance in resources between an RE and a member, and members' access to external dispute resolution schemes is severely limited by the exclusion of complaints relating to the 'management of the fund or scheme as a whole'.[6]

This discussion also raises the issue of the adequacy of professional indemnity and/or directors' and officers' insurance policies held by REs, which we identify as a significant issue facing MIS and discuss further in section 5.5 below.

An adequate regime of insurance cover would mitigate losses of counterparties where the RE represented that it was acting within its right of indemnity but was not.

We do not think the law should be reformed to transfer credit risk to members. It would increase the risk of investing in this sector such that it would become unviable, even with a substantially increased minimum professional indemnity cover required of an RE.

We also refer to the comment at page 31 that:

The proposed legislative reforms seek to respond to the issues raised above, which can significantly affect the operation of a viable, potentially viable and non-viable MIS.

We note that the Discussion Paper does not explain how the limitation on the rights of creditors to recover against scheme property in circumstances where the RE has no right of indemnity 'significantly affect the operation of a viable, potentially viable and non-viable MIS.'

We also refer to the further comment at page 31:

These legislative reforms are also central to the process of treating MISs in a similar manner to corporations.

[4] *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL Ir).
[5] *Costa & Duppe Properties Pty Ltd v Duppe* [1986] VR 90.
[6] For example: cl5.1(i) of the Financial Ombudsman Service's *Terms of Reference*.

There is little discussion in the Discussion Paper of why this process is appropriate or necessary. It is also not apparent in the Terms of Reference that this assumption is to be made by CAMAC. To the contrary, there appears to be an emphasis in the Terms of Reference on ensuring “the confident participation of retail investors in MIS”. Treating REs in a similar manner to companies would not achieve this.

Before such fundamental reform is contemplated we consider careful investigation of the potential impact of such reforms on the viability of the MIS industry, and in turn the diversity of investments available in the Australian market should be conducted, so that the full implications of such changes beyond simplification and certainty for creditors are properly understood. The Discussion Paper does not provide such analysis.

In summary, we strongly oppose enactment of Reform 4.

We consider that it will have a significant detrimental effect on the MIS industry and compromises the rights of members for the benefit of creditors, displaying an underlying bias for which no justification has been provided.

Should such an enactment be made we consider that the removal of the restriction should be subject to exceptions where:

- The creditor is on constructive notice of the breach of trust by the RE;
- the creditor has been wilfully blind to the breach of trust by the RE; and/or
- The creditor in transacting with the RE has failed to take reasonable steps to satisfy it that the RE is transacting within the terms of its trust.

Further, should the reform be enacted then the right of recovery against MIS property held on trust should be subject to exhaustion of any property held by the RE in its personal capacity.

If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?

Subject to the exceptions detailed in the preceding section, the removal of the restriction should only apply to those appearing in the Agreements register, consistent with the matters raised in our response to Reform 1.

3.4.3 Application of the proposed legislative reforms

General application

Page 38 of the Discussion Paper states that:

> *The proposed reforms are not intended to interfere with the usual practices for running a viable MIS. Rather, the aim is to ensure the clear and separate identification of the affairs of each MIS operated by a multi-function RE and the rights of creditors of each MIS.*

In our opinion, Reform 4 would do nothing to ensure the above.

Rather than ‘ensuring the rights of creditors’ what this reform would achieve is a significant expansion of the ability of creditors to recover.

Creditors’ rights are presently clear in that they are limited to the right of indemnity of the RE. The reform is fundamentally altering, rather than ‘clarifying’, these rights.

As noted, the reforms will have a significant impact on the participants in MIS under financial stress. That impact will primarily be borne by members. The reforms seek to break down the fundamental feature of MIS being the separation between the RE as trustee of the MIS and the MIS itself, such that parties transacting with the RE gain access to the trust, even where the terms or particulars of that transaction are beyond the trust.

No clear rationale has been provided for the fundamental alteration of creditors rights from derivative to direct as against the MIS.

There are vague references to the increasing similarity between MIS and corporate enterprises. However, beyond high level statements of this nature, there is no evidence provided as to this increased similarity, nor examples of such given. To the extent that this is anecdotally accurate, the actual prevalence of this confluence is unclear.

Irrespective of the prevalence or otherwise, there is no explanation of how this fact (if it is correct) warrants a fundamental change to the nature of MIS.

We also note that these proposed reforms are intended to apply to MIS where the RE does not contract as agent for the member, but transacts as principal (typically a trust based scheme). In our experience, the largest and most complex MIS have been contract-based MIS. Indeed, the most problematic collapses in respect of untangling members and creditors rights in relation to property have been the various high-profile agricultural Complex Group MIS, the majority of which are contract based schemes. We are concerned that the problems encountered in respect of these contract-based schemes may be driving proposed reforms such as Reform 4, despite the fact that Reform 4 would not address the issues in that context.

We think it would be beneficial for worked examples of instances where it is contended that this reform would address serious issues relating to distressed trust-based schemes to be developed and considered to assist assessment of the actual potential effectiveness of this proposed reform. In addition, quantitative and qualitative analysis of the size and nature of trust-based MIS, and rate and nature of failure, should underpin any such reform if it is to be enacted.

In addition, the relevant issue arises only where there has been a breach of trust by the RE. Breach of trust is the core issue. The suggested reforms appear designed to cure the negative impact of a breach of trust for counterparties transacting with the delinquent RE at the expense of members. We think a better solution would be aimed at addressing the underlying issue being the prevalence of breaches of trust. An effective and efficient framework for the enforcement of the law may be a preferable means of treating the cause rather than effect. This would place the onus on various participants to take responsibility, including ASIC, in addition to counterparties and other participants.

We also note in this respect that a member is at a significant disadvantage to counterparties (and other participants) to police the conduct of the RE and determine whether breaches of trust may be about to or have occurred. They do not have any knowledge or practical access to relevant documents. They don’t have the ability to conduct due diligence as a potential transactional counterparty does. This suggests the burden of ensuring the RE is acting within trust should remain with counterparties and the burden of failures remain with them also.

Finally, we note there is no obligation on counterparties to transact with MIS and assume the associated risks. Whether they do, is ultimately their business decision.

Application to service providers

If these reforms are to be enacted then we consider employees should have priority rights against the MIS as creditors for unpaid entitlements where those entitlements accrued in relation to work relating to the affairs of the MIS.

We note it is presently proposed that they be excluded from recovering against the MIS.

Creditor remedies against MIS members

We note that at present members of MIS (other than contract-based MIS where members are parties to agreements with third parties or the RE has transacted as agent) have no liability for any debts incurred by the RE – counterparties to such agreements have recourse only against the RE, and the RE only its right of indemnity against the MIS for liabilities properly incurred.

We oppose any change to this situation and strongly oppose Reform 4 as discussed below.

If the position remains as is, then we see no utility in a statutory limited liability for such members.

If the position were to change, such as proposed by Reform 4, we consider that statutory limited liability for members should be enacted.

3.5 Identifying scheme property

Questions

In addition to any accounting requirement, should an RE be required, from the commencement of an MIS, to establish a comprehensive register of scheme property, to be kept up to date by whoever is the RE from time to time?

We consider this to be a worthwhile change, however, note that the accuracy or validity of such a register cannot be guaranteed.

We think consideration should be given to whether the RE should be required to lodge with ASIC, or alternatively, ASIC maintains such a register. As noted above, this would have the benefits of placing the relevant information into the hands of an independent party and would facilitate access to it.

Who should have access to that register and through what process?

We do not consider it is necessary to maintain the confidentiality of the register, as the information on the register would largely be publicly available albeit not through a single repository. Also, it is hard to see how a MIS could suffer from disclosure of such information.

We think a process similar to that provided by section 173 of the Act would be suitable.

As we note in section 5.4 below, we have encountered difficulties with REs failing to comply with valid requests made under section 173 of the Act. This can frustrate attempts by members to obtain relevant information and communicate with other members regarding the management of the MIS.

We note that if ASIC maintained the register it could provide copies of it to parties on the payment of the applicable fee removing the possibility of recalcitrance.

3.6 Identifying member transactions

Questions

Should an RE be required, from the commencement of an MIS, to establish a comprehensive register of all arrangements entered into by the RE as agent of the MIS members?

We have observed in agricultural contract-based Complex Group MIS serious deficiency in the record keeping of the RE such that key contractual documents executed by members of by the RE as agent for members are unable to be located and doubt surrounds whether they were ever executed.

With this in mind we endorse an obligation on an RE to maintain a comprehensive register of all arrangements entered into by the RE as agent of the MIS members.

Who should have access to that register and through what process?

We refer to our comments above.

3.7 Tort claims and statutory liability

Questions

Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE?

We consider it is necessary to clarify these circumstances.

Section 601FC is poorly drafted and has not been properly enforced in the registration of schemes. This has led to the ‘ponzi-like’ incidents in certain Agri MIS where all contributions are paid immediately as remuneration to the relevant RE, thus ceasing to be scheme property. This resulted in many Growers in later schemes incurring loans, paying planting fees which were lost on the insolvency of the group without trees ever being planted.

Errors in the drafting of section 601FC of the Act were previously highlighted by ASIC in their submission to the Review of the *Managed Investments Act 1998*.

The law in relation to a trustee's rights of indemnity in case of breach of trust is complex and we consider that all stakeholders would benefit from statutory clarification consistent with trust law principles.

In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?

We consider that this is not appropriate in any circumstances or for any reason.

4.4 Chapter 4 – Transfer of a Viable MIS

4.4.1 We agree with the observations in the Discussion Paper regarding the difficulties posed by the uncertainty of liabilities that will be assumed by an RE and the need for due diligence (sometimes time-consuming) to be conducted.

4.4.2 We reiterate our support for Reform 1 to assist with this process and transparency of a MIS's affairs. We also consider that implementation of a requirement that REs maintain a register of all agreements they execute as agent for members would also assist a potential TRE in assessing the role it would be assuming and in the process of seeking a replacement RE.

4.4.3 The Discussion Paper identifies a major problem in practice, being the difficulty with appointing a TRE to operate a viable scheme where the incumbent RE is in financial distress. The Discussion Paper notes that this is generally due to uncertainty on behalf of the potential TRE as to what liabilities it will be stepping into, and the necessity for the TRE to conduct substantial due diligence before taking any such 'step'. The Discussion Paper also notes that other issues can arise in the process of changing an RE concerning the determination of what rights, obligations and liabilities will transfer to the RE, and also the remuneration rights of that entity.

4.4.4 A more fundamental threshold issue relates to the circumstances in which the TRE will be appointed. We note in this respect the inherent tension between a liquidator seeking to retire as RE and relinquish control of a MIS and its assets, and its duty to maximise returns for creditors.

4.4.5 The Discussion Paper focuses on a situation where a multi function RE comes into financial stress and certain of the schemes to which it is appointed are or may be viable. It is important to note the fundamental conflict that can arise for insolvency practitioners appointed to the RE's of Complex Group MIS and related entities in the corporate group. The reality in practice is that with the majority of entities in the group insolvent and where there is cross-collateralisation amongst the members of the group and the RE or REs within the group, assets essential to the operation of the MIS, whether or not they are scheme property, are an important potential source of recovery for the creditors of the group.

4.4.6 This is important to note at the outset because of its relevance to the means by which a TRE may be appointed and by whom.

4.4.7 We make the following response to Chapter 4 of the Discussion Paper:

4.2 Changing the RE

4.2.2 Where application can be made for appointment of a TRE

Voluntary retirement of the RE & Ineligibility to remain as RE

We suggest that where the RE has been placed in external administration it should be open for the administrator to apply to the court for appointment of a TRE.

General provision

We note the observations in the Discussion Paper regarding the uncertain ambit of this provision.

4.2.3 Where application cannot be made for appointment of a TRE

Dismissal of the RE by the members

Obtaining the requisite votes to pass an extraordinary resolution to remove an RE is an onerous task and is rarely undertaken without the consent of a replacement RE having already been obtained. In most cases, it is the replacement RE who underpins the campaign for their appointment.

We acknowledge, however, the ‘catch 22’ this places members in, especially in terms of the observed difficulties with the conduct of due diligence by a potential replacement RE.

The onus must remain on members to consider the future of the MIS before commencing a process for removal of the RE. Any circumstances promoting the removal of an RE without a replacement RE or TRE being appointed at the same time should be discouraged because of the uncertainty and disruption this places on the MIS.[7] Winding-up by default in this circumstance should be avoided.[8]

If reforms as discussed in the Discussion Paper regarding the position of TREs in respect of the liabilities of MIS to which they may be appointed are enacted then we consider it will be easier for members to obtain consent from a party to act as TRE than it would be to obtain consent to become replacement RE. This is a desirable outcome.

We raise for consideration the question of whether members should be able to remove the RE of a MIS and appoint a TRE by voting at a meeting. Such provision would appear to address the anomaly where the requisite threshold level of members support removal of the current RE, no replacement RE is available (most likely because of the issues identified in section 4.1 of the Discussion Paper), a TRE has consented to appointment but the members are unable to effect this change through the meeting process.

However, there are problems with a potential power for members to appoint a TRE.

It is likely resort to court will be necessary either before or after the meeting. A court application is likely to be required subsequent to the members’ meeting to validate certain terms of the appointment relating to remuneration and, more significantly, to address the status of the liabilities incurred by the former RE in respect of the TRE’s appointment (as discussed in our response to section 4.4.2 of the Discussion Paper below). It may be that the TRE’s consent and appointment is conditional on the court approving the proposed remuneration and liability position. This means that uncertainty remains until court validation occurs, if it does.

It may be that if members are to have such a right to replace the RE with a TRE, court approval for the appointment and its terms must first be obtained before proceeding to the meeting.

Prior court approval would seem a more attractive a proposition than post meeting application to the court with the uncertainty that entails, however, we note the expense of the court process and the potential for the prior court approval process in some cases to become a ‘battleground’ between the proponents of the appointment, the TRE and the incumbent in the pre meeting period.

It should also be acknowledged that reforms to simplify the process for appointment of TREs and reduce the risks associated with such appointment may, because of natural conservatism on behalf of prospective REs, lead to them consenting only to become TRE with a view to later appointment as RE if adverse issues are not identified in the TRE period, resulting in the appointment of TREs in circumstances where an interim or caretaker period may not actually be necessary.

Questions

What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why?

We consider that the current threshold of an extraordinary resolution for removal of an RE of an unlisted MIS is too high.

We consider it should be replaced with a requirement of a special resolution, which at least 25% of votes that may be cast by members at the meeting have been voted in favour of.

We discuss in further detail below the difficulties facing members of unlisted MIS in removing and replacing the RE of a MIS, including the difficulties posed by the requirement for extraordinary resolutions.

We submit that in order to achieve effective member engagement and influence of a MIS’s management and direction (through control of the RE) it should be lowered as we describe above.

[7] The uncertainty and disruption to an MIS caused when there is an urgent legal challenge to the validity of the convening of a meeting or passage of resolutions at that meeting for removal and replacement of the incumbent RE is analogous.
[8] If the intention of the members is to have the scheme wound up they can put such a resolution to a meeting and if passed the RE is obliged to do so.

What changes, if any, should be made to the powers of the court to appoint a TRE and why?

We consider that express provision should be made in the Act for appointment of a TRE by the court where:

- The RE, a member or ASIC has applied for the appointment on the basis that the application is necessary to protect scheme property or is in the interests of members; and
- The court considers the appointment is necessary to protect scheme property, or is in the interests of members.

We also refer to our discussion above regarding the potential for members to seek to appoint a TRE.

We agree with the comment in footnote 112 of the Discussion Paper that doubt exists in relation to regulation 5C.2.02 of the Regulations.

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

In theory, an incumbent RE should assist a potential replacement RE to conduct due diligence, consistent with its obligations under subsection 601FC(1)(c) of the Act. In reality, as observed by the Honourable Justice Judd of the Victorian Supreme Court in *Lachlan Reit Limited v Garnaut & Ors*[9], an incumbent RE facing its removal is in a position of 'profound, irreconcilable conflict'. In our experience, despite an incumbent RE's duties under the Act, that incumbent will do as little as possible to assist a potential replacement RE with due diligence. Often the confidential nature of documents and relationships will be relied upon by the incumbent RE to prevent production or inspection, or to prevent the potential replacement RE from entering into discussions with counterparties to agreements with the RE, typically a financier. We refer to our comments at paragraph 5.2.6 below and to our response to section 4.7 of the Discussion Paper below).

We also note there is a genuine tension in requiring an incumbent RE to assist with the process of its own potential removal, beyond passivity in the process.

There is also a need to prevent spurious investigations or 'tyre-kicking' by predatory fund managers looking for over-capitalised MIS which can cause unnecessary expense to the MIS and distraction for the RE.

We anticipate that some of this conflict could be resolved through the implementation of reform 1 and a statutory process for access to certain documents.

In addition, a general power conferred on the court to order an RE to do anything the court considers appropriate in the interests of members in respect of due diligence by a potential replacement may be beneficial.

For example, in a situation where the incumbent RE is refusing to consent to the potential replacement entering into discussion with a financier (and where there is a inhibitive 'event of default' clause in the facility) regarding their attitude to replacement, application could be made to the court for an order that the incumbent RE consent and ancillary orders that the confidence of the arrangement be maintained by the potential replacement.

4.4 Issues concerning the TRE

4.4.1 Eligibility to be a TRE

Question

Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?

We refer to section 601FQ of the Act and note that a TRE's role is essentially that of attempting to effect an MIS 'workout'. This could involve simple transitional duties of conducting due diligence and facilitating a replacement or a more involved assessment of the MIS and its potential viability.

[9] [2010] VSC 399 at [27].

Insolvency practitioners with experience in MIS and the relevant underlying industry of the MIS are well placed to conduct this role and we consider that eligibility criteria should be adjusted to account for the 'workout' aspect and the availability of skilled practitioners.

At the same time, however, we do not think it appropriate to extend TRE beyond the framework of the AFSL regime. We think it is important that an entity acting and transacting as RE be maintained within this framework.

We propose that the AFSL regime be modified to provide for AFSLs to be granted to entities authorising them to act as TREs of certain types of MIS.

Such authorisations could recognise the interim and 'caretaker' nature of the TRE role and its 'workout' element. Lower thresholds could be applied to entities seeking only a limited authorisation to operate as TRE of certain classes of MIS. Such AFSLs should be available to suitably qualified entities beyond the traditional fund manager paradigm, in particular insolvency practitioners. We also consider that the application process for a limited TRE AFSL could be streamlined to reduce cost and administrative burden in recognition of the specific role to be undertaken.

Obviously, a TRE authorisation could be obtained by any suitably qualified existing AFSL holder who already has authorisation to operate MIS as RE.

In some cases a 'full-service' and established fund manager would be the most appropriate TRE. In other cases, potentially of high distress of the former RE or questions as to viability of the MIS, a limited function TRE with workout skills and experience would be more appropriate.

This change would allow the pool of candidates to be widened to utilise a wider skill set and provide flexibility whilst maintaining the integrity of the regulatory regime for operators of MIS, and avoiding the considerable costs incurred by insolvency practitioners, claimed against scheme property by way of a lien and ratified by the courts.[10]

4.4.2 Outstanding obligations and liabilities of the outgoing RE

Question

What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?

Election by the TRE

We consider the process of election is unlikely to work in practice. On what basis would a TRE elect which liabilities it would be bound by? On what basis should it choose between creditors which have access to MIS assets through it? Does this preference afford priority in practice? Presumably, they would elect liabilities to the limit of the indemnity provided by the MIS assets and this would appear to devolve into the *Limited Liability* option. Inherent conservatism is likely to result in liabilities not being elected if there is any doubt surrounding them or the limit of the indemnity. What if the TRE chooses a liability which it turns out was not properly incurred and for which the TRE can have no recourse to MIS assets whilst a different liability properly incurred may have been relegated to a claim against the former RE due to its non-election.

In addition to these practical difficulties we consider it will result in delay and, for the period of such delay, uncertainty.

Limited liability of incoming TRE

This proposal is more practical, however, we note the following potential issue.

In many circumstances where a TRE is appointed the outgoing RE will be under financial distress. If this policy proposal is implemented, it could lead to a 'race to the bottom' by creditors concerned they will be relegated to claiming against the distressed or insolvent RE where there are insufficient assets remaining to satisfy its indemnity (after satisfaction of liabilities incurred by the TRE), resulting in creditors seeking to enforce securities or otherwise recover liabilities against the TRE. This could

[10] For example, *Thackray & Ors v Gunns Plantations Limited & Ors* [2011] VSC 380 (11 August 2011), where a lien of almost $14 million was approved in relation to 10 MIS.

destabilise the MIS and the TRE and cause significant distraction to the TRE due to involvement in litigation. A form of moratorium may be a necessary adjunct to such a policy.

Court power

We are concerned that utilising a court process for determining these issues would be complex, time-consuming and costly.

It may be that in particularly complex circumstances application can be made to the court for orders under the existing (or any amended) general power of the court, however, we do not consider that this should be the starting point.

Moratorium

We support this policy initiative.

We do not consider the argument against it, noted in the Discussion Paper compelling. In many circumstances it is unclear whether a MIS is viable or in what circumstances it is viable. The TRE approach is in the interests of both members and creditors given that it seeks to maximise the prospects of continuing a scheme rather than liquidation, which is likely to lead to a shortfall to creditors.

4.4.3 Duties of the TRE

Question

What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?

We agree that a process by which the TRE is required to review and remedy the entire compliance framework of the former RE and the MIS is unduly burdensome and counterproductive given the nature of the TRE's role.

In relation to the identified policy option of the court adjusting statutory duties of the TRE and its officers, we consider this too may be overly burdensome on the TRE and the court and may necessitate a mini-compliance review in advance of appointment, and further applications for relief after appointment as issues come to light.

An alternative approach would be to absolve the TRE for a specified period (ordinarily the period of their appointment except in exceptional circumstances where the appointment was inordinately lengthy) from liability under statutory duties to the extent they were pre-existing at the time of their appointment.

If the period of appointment was extended or became lengthy then limited remedial work could be required by the court as a requirement of extension (ie to mitigate risks).

4.4.4 Remuneration of the TRE

Question

What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?

We support the implementation of statutory or other provision regarding the remuneration of TREs which will promote willingness of parties to be appointed TRE.

For this reason, we support giving the court explicit power to make orders regarding the TRE's remuneration including approval of rates.

We also question whether consideration should be given to priority payment of TRE fees in any subsequent winding-up, similar to that provided to liquidators, provided that those fees were reasonably and necessarily incurred in their appointment.

This would provide TREs with comfort that their fees would be met in cases where the viability or solvency of the MIS was in question (and where, arguably, a TRE may be most required).

We would envisage a process whereby court approval of rates was required before or at the time of appointment, and subsequent court approval of the payment of fees and expenses prior to their payment.

Alternatively, s601GA could be amended to require a scheme constitution to contain provisions not only in relation to the winding up of the scheme but also in relation to funding if a TRE is appointed to the scheme.

4.4.5 The role of the TRE in relation to the future of the MIS

Questions

Are any changes regarding the role of the TRE in the future of the MIS necessary or beneficial and, if so, for what reasons?

In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to:

- ***possible conflicts of interest faced by the TRE***
- ***the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced)***
- ***a TRE providing assistance to an external administrator?***

Conflict of interest

If the eligibility requirements to act as a TRE are amended as outlined in our response above to the question posed in section 4.4.1 of the Discussion Paper then we consider there will be, broadly speaking, two types of TRE appointment:

- TREs who assume the role to undertake a primarily ‘caretaker’ or ‘workout’ function with no desire to be appointed RE at the end of temporary appointment. There is no conflict issues in this scenario; and
- TREs who assume the role with a desire to transition to appointment as RE.

There is a potential for a conflict of interest to arise as outlined in the Discussion Paper in relation to the second scenario. However, in light of the obvious benefits of facilitating the TRE appointment process, in our opinion that risk must be accepted and mechanisms put in place to attempt to manage or mitigate that risk.

Express provision could be inserted into the Act requiring TREs to take all reasonable steps to facilitate the identification of and consideration by members of alternative REs, including assisting potential replacement REs in conducting due diligence.

Through court appointment, if necessary, orders to this effect could be made.

In addition, a dissatisfied potential replacement RE, member or ASIC could apply to the court for orders as required to facilitate compliance with this obligation.

Alteration of eligibility requirements may lead to more appointments by ‘caretaker’ or ‘workout’ TREs to facilitate a process and fund manager or full service REs who desire to become replacement RE may be content to allow such an appointment to occur and utilise access to information via the TRE to develop a replacement proposal for members to consider.

Interaction with VA for MIS

We consider that a TRE is best placed to understand and act upon the particular circumstances of the MIS and should have a role in the appointment of an MIS administrator.

There are circumstances where the TRE is perfectly placed to make the appointment on its own initiative, and in such cases the court process would be an unnecessary delay and cost. Conversely, there are also circumstances in which a unilateral appointment may be inappropriate.

There is merit in both unilateral and court-ordered appointment.

If the TRE is granted unilateral rights then the TRE should be subject to legislative constraints similar to those provided by subsection 436B(1) of the Act. In addition, it may be appropriate for a TRE to have a right of appointment where it thinks the MIS’s purpose cannot be achieved.

We strongly support a restriction in the form of subsection 436B(2) of the Act in this respect to avoid risk of conflict affecting the MIS administrator appointment process.

4.5 Matters covered in the transfer of rights, obligations and liabilities

Question

What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?

The effect of sections 601FS and 601FT of the Act are extremely important in relation to the restructure and continuation of MIS, in particular where legal or equitable rights of a former RE are intrinsic to a replacement RE's ability to continue the MIS. However, there is uncertainty as to the effect of these sections.

Scope of novation

In the decision of the New South Wales Supreme Court in *Investa Properties* [2001] NSWCA 1089 (***Investa***) at [11] the Honourable Justice Barrett held (cited at page 63 of the Discussion Paper):

> *Sections 601FS(1) and 601FT(1) are drafted in a particularly economical way. They appear intended to cause an incoming responsible entity to step into the shoes of its predecessor.*

Similarly, in the decision of the Federal Court where the Honourable Justice Rares in *Huntley Management Limited v Timbercorp Securities Limited* [2010] FCA 576 (***Huntley***) at [45] (cited at page 63 of the Discussion Paper) held:

> *It is vital that the words "rights, obligations and liabilities" in Div 3 of Pt 5C.2 be given a broad construction so as to achieve the evident legislative purpose of facilitating an immediate and seamless change of the responsible entity of a scheme whenever ASIC records the new entity's name in its record of registration.*

In contrast, in the recent decision of the Victorian Supreme Court in *Primary RE Ltd v Great Southern Property Holdings Ltd & Ors (recs & mgrs apptd) (in liq)* [2011] VSC 242 (***Primary RE Ltd***), Honourable Justice Judd held at [178]:

> *To extend the scope of operation of s 601FS and 601FT, to substitute a new Responsible Entity as a party to a validly terminated agreement would, in my view, require clear words. Section 601FT should, in my view, be construed so as to confine its operation to operative agreements, extant at the time of the change in Responsible Entity. If there are rights after termination, they may be captured under s 601FS.*

In reaching this decision, Judd J observed[11]:

> *Primary alleged that as a consequence of its appointment as Responsible Entity for the 2007 Scheme, it became entitled to the 'rights, obligations and liabilities' of the tenant in relation to the 2007 Scheme. That much is obviously correct. It went on to submit that it had the right to attack the validity of the notices of default and termination, and to claim relief against forfeiture in the event that the terminations were upheld.*
>
> *...*
>
> *... The issue in this part of the case is whether the Corporations Act provisions had the effect of transferring to Primary any 'right' that the tenant might have had to apply for relief against forfeiture. If the tenant's opportunity to make such an application was a 'right' capable of transfer by reason of the operation of the Corporations Act provisions, did such a right exist in the circumstances of this case?*
>
> *...*

[11] *Primary RE Ltd* at [168]; [170]; [172-4]; [179].

The landlords submitted that the right to make application for relief against forfeiture was not a 'right' that transferred under s 601FS. They submitted that it was a bare, unassignable, right to sue, and in the absence of clear words, should not be included amongst other well recognised rights of a Responsible Entity. They submitted that whatever be the scope of the word 'rights' in s 601FS, it did not include the bare right to litigate.

The landlords contrasted the use of the term 'rights' in s 601FS with other provisions in the Corporations Act, where that word was used and followed by words of expansion. The definitions of 'interest' and 'managed investment scheme' in s 9 are examples. They also referred to s 413(4) which provides,

> *"liabilities" includes duties of any description, including duties that are of a personal character or are incapable under the general law of being assigned or performed vicariously.*
>
> *"property" includes rights and powers of any description, including rights and powers that are of a personal character and are incapable under the general law of being assigned or performed vicariously.*

The definition of 'property', in the context of a provision to facilitate reconstruction and amalgamation of companies and groups, extended the concept of rights and powers in a manner which deliberately and expressly included rights and powers that were of a personal character, incapable under the general law of being assigned or performed vicariously. The landlords submitted that such an extension provided an example of what would be required to express a legislative intention that any right to make application for relief against forfeiture would transfer under s 601FS.

...

To extend the scope of operation of s 601FS and 601FT, to substitute a new Responsible Entity as a party to a validly terminated agreement would, in my view, require clear words. Section 601FT should, in my view, be construed so as to confine its operation to operative agreements, extant at the time of the change in Responsible Entity. If there are rights after termination, they may be captured under s 601FS.

I am of the opinion that the opportunity to apply to the court for relief against forfeiture under s 146(2), and the related provisions in each State, is confined to the person against whom the 'lessor is proceeding, by action or otherwise, to enforce or has enforced without the aid of a court…' a right of re-entry or forfeiture. The landlords took no such step against Primary and the tenant took no step to obtain relief, and is not an applicant for relief in this proceeding. The extended meaning of 'lessee' in s 146(5) does not assist Primary. As Primary did not assume the position of lessee under the terminated leases, it is not in a position to rely upon s 146(2) to make its application.

We consider, in order to achieve the purpose of sections 601FS and 601FT as identified by Rares J in *Huntley*, 'rights' should include 'rights' of the nature considered by considered by Judd J in *Primary RE Ltd*. We consider that the legislation should be either amended with 'clear words' expressly including such rights within the ambit of sections 601FS and 601FT, or preferably be amended to reinforce the breadth to be given to the meaning of those words.

We think it is important that the uncertainty evidenced by the contrast between the above decisions be clarified to facilitate replacement and continuation of MIS, in particular those in distress or adversely affected by the collapse of the corporate group to which their RE belongs or the insolvency of their RE.

We also consider that amendments could be made to clarify the interaction of sections 601FS and FT and the extent to which the principle stated in *Australian Olive Holdings Pty Limited v Huntley Management Limited, in the matter of Huntley Management Limited* [2009] FCA 1479 at [85] and approved on appeal is applicable. The principle is that the 'rights, obligations and liabilities' referred to in section 601FS of the Act are limited to those capable of having effect after a change of RE, as reflected in the language of subsection 601FT(1)(b) of the Act. There is potential for the application of this principle to be inconsistent with the operation of subsection 1336(3) of the Act.[12] It also could be applied to the considerable disadvantage of investors in circumstances where an RE has mixed scheme property across different schemes. A classic example of this is where an RE has entered into a lease in respect of multiple schemes. If there is a change of RE in one of the affected schemes, the law should clearly provide for division of the lease.

Finally, amendments should be made to clarify the effect of subsection 601FS(2)(d) of the Act. The issue identified in *Stacks Managed Investments Ltd* is referred to on page 52 of the Discussion Paper. However a further uncertainty arises regarding whether 'could not have been indemnified out of the scheme property' refers to a right alone or both a right and a financial capacity (ie whether there was sufficient scheme property for the indemnity to be satisfied).

Purpose

In properly interpreting the effect of sections 601FS and 601FT of the Act it is important to understand their purpose.

On page 17 of the Discussion Paper it states:

> *Where an RE is replaced, the rights, obligations and liabilities of the outgoing RE are transferred to the incoming RE (including any TRE) through a statutory novation process. The ostensible purpose of this provision is to ensure that the rights of creditors are not affected where the RE of an MIS changes.*

Similar comments are made elsewhere in the Discussion Paper.

In our opinion, the purpose of these provisions is to ensure the effective continuation of the MIS after a change of RE – to ensure the continuity of the legal and contractual relationships which underpin the MIS. This extends to all relationships, including those involving members and creditors, with the MIS and its RE. In contrast to comments in the Discussion Paper as to their purpose, we do not consider they are intended to elevate one class of relationship above another, nor specifically to protect the rights of creditors above those of others.

Such an interpretation is consistent with the comments of Barrett J in *Investa* at [11] and Rares J in *Huntley* at [45] cited above.

We note that the Explanatory Memorandum to the *Managed Investments Bill 1997*,[13] and other secondary materials, are of limited utility in assessing the intended purpose of enactment of these sections.

Potential reform

Any legislative reform to clarify the effect of sections 601FS and 601FT of the Act must carefully consider the intended purpose of those provisions, and bear this in mind when the effect of the reform on all parties involved or connected with an MIS are considered.

4.6 Remuneration where RE replaced

Question

What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?

Based on our experience in a number of matters we are extremely concerned by the potential for entrenching provisions to restrict members' practical ability to change RE or to create uncertainty surrounding a change such as to discourage a potential RE from consent to appointment or members from seeking to exercise their statutory rights.

[12] Refer to the statement by Rares J in *Huntley Management Limited v Timbercorp Securities Limited* [2010] FCA 576 at [44] ". . . any property right requiring registration, such as in Torrens title land, held by the former responsible entity will vest in equity in the new responsible entity immediately on the creation of the new ASIC record by force of Div 3 of Pt 5C.2, but will only vest in law when it is registered (see s 1336(3))."

[13] Section 8.37 of the Explanatory Memorandum states, in respect of section 601FS: 'The purpose of the section is to ensure that the former entity has the right to be reimbursed for expenses properly outlaid, or liabilities incurred, on behalf of the scheme'. This explains the purpose of section 601FS(2)(b), however, does not assist in determining the legislative intention behind section 601FS(1).

We discuss entrenching provision in detail in section 5.3 below .

We consider that the type of financial arrangements discussed in section 4.4 and considered in *Huntley* and *Saker, in the matter of Great Southern Managers Australia Ltd (receivers and managers appointed) (in liquidation)* [2010] FCA 1080 are in effect entrenching provisions and discourage exercise of members' statutory rights. As we discuss in section 5.3 below, we believe explicit prohibitions on entrenchment, in particular in relation to RE fees, should be included in the Act.

We submit that this should include express prohibition on RE fees being paid in advance.

4.7 Arrangements between an RE and external parties

Question

What, if any, statutory controls should be placed on arrangements that are conditional on a particular RE remaining as operator of a particular MIS?

We have observed a number of MIS with finance facilities under which either the calling of a members' meeting to consider the removal and replacement of the RE, or the passage of such resolutions, is an event of default under the facility. Such mechanism present a structural inhibition to a change of RE and discourage exercise of members' rights because of the risk at which exercise of those rights would place the assets of the MIS.

Such mechanisms have also been heavily relied upon by incumbent REs in defending a hostile replacement of them as RE.

At first instance it appears easy to understand why a financier needs to be able to determine who it is lending money to. However, in most of the cases we have observed recourse under security for the facility is limited to the RE's indemnity from the MIS, rendering irrelevant the replacement RE's financial capacity as a directly relevant matter for the financier. In response, it could be argued that as in the event of default the financier must recover from the MIS's assets, it should be able to withdraw finance if it is not satisfied of the replacement RE's credentials to manage and maintain those assets.

What we have observed in practice is that typically it is a stable and well capitalised manager (RE), often with a proven track record in managing enterprises of the nature of the relevant MIS, that is being proposed to replace a distressed RE and/or an RE who is underperforming in managing the MIS. The replacement is often better credentialed and presents a lower risk to the financier than the incumbent.

In matters with which we have been involved or have observed where there have been inhibitive default clauses, the financier has not exercised its security upon the technical event of default, but has stood passive during the lead up to the meeting. Following replacement the financier has willingly negotiated regarding extension or refinancing with the replacement RE.

This fact may seem to suggest that in reality such clauses are not a significant hindrance to a change of RE. However, there will always remain the risk of exercise of security.

In addition, the technical 'event of default' has been used by incumbent REs during the 'dialogue' in the lead up to the meeting to argue against their replacement and as a basis for characterising the actions of the requisitioning members and proposed replacement as high risk and/or reckless. See for example, communications made by Opus Capital Limited (**Opus**) to members of the Opus Income & Capital Fund No 21 (**Opus 21**) in relation to Centuria's proposed replacement of Opus as Opus 21's RE.

We consider that entry into agreements which place indirect restrictions on the exercise of members' statutory rights is inconsistent with an RE's obligations under section 601FC of the Act. Notwithstanding the legality or otherwise of such agreements, they have been readily entered into.

We submit such agreements present a significant disincentive and practical impediment to replacement of an RE of a MIS and should be explicitly prohibited in the Act.

4.5 Chapter 5 – Restructuring a potentially viable MIS

4.5.1 At outset, we reiterate that speed is a critical factor in the potential workout or restructure of distressed MIS. All MIS, in particular Agri MIS, will suffer asset decay if funds are not available for or cannot be expended on maintenance of assets for an extended period.

4.5.2 In a number of the collapsed Agri MIS matters with which we have been involved we have observed viable or potentially viable MIS decay over the extended period of the administration of the RE and/or its liquidation, to such a point where the MIS are no longer viable or sufficiently viable for a restructure to be completed or winding up resisted. In addition, failure to maintain assets leads to significant breaches of covenants under contractual documents adversely affecting members' rights.[14]

4.5.3 For these reasons, any process implemented to facilitate restructuring of potentially viable MIS must attempt to address the issue of delay and decay, either by ensuring the process is efficient or other measures can be taken to maintain assets whilst the process is completed.

4.5.4 We also note the observation at page 74 in the discussion paper that:

> *...many of the issues arising from the rights of members in contract-based MISs can currently only be solved, if at all, by court applications that raise complex legal problems.*

4.5.5 It is important to acknowledge that the 'complex legal problems' raised by these contract based schemes are the result of overly complex structures of the scheme and related arrangements, as discussed at section 3.1 above.

4.5.6 We make the following response to Chapter 5 of the Discussion Paper:

5.4.7 New RE

Questions

Is there support in principle for the concept of a VA for an MIS?

We support in principle the concept of a VA for MIS.

We strongly support the application of a wider moratorium to protect members' proprietary interests from the actions of third parties. In our experience, actions such as the termination of head leases have had irreparable effects on the ability of a potentially viable scheme to be restructured and continued.[15]

The Discussion Paper observes the potential for a draft MIS deed proposed by an MIS administrator to provide for postponement or compromise of the proprietary or contractual rights of members or related third parties, and could provide for a compromise of distribution or other rights that members may have as contributors to the scheme.

We assume that such compromise would be in addition to suitable compromise of creditors' claims and that it is not envisaged that the MIS deed would provide a means for certain classes to effect a compromise of other classes' rights for their benefit in the VA.

Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?

What types of matters concerning these parties should be included in the VA of an MIS?

We submit that an MIS VA should apply to a broader range of persons connected with the MIS in order to make the VA procedure as effective as possible, and to avoid it being frustrated by actions of persons connected with the MIS but outside the scope of the VA procedure.

We consider the MIS VA should apply to:

- Creditors of the MIS[16];
- Members holding proprietary or contractual rights;

[14] For example: failure to maintain firebreaks constituted serious breaches of lease agreements.

[15] See for example *Primary RE Ltd*.

[16] We do not support Reform 4 and the right of creditors of the RE to claim directly against scheme property. The characteristics of 'creditors of the MIS' is therefore complicated. Essentially, they are creditors of the RE of the MIS in respect of whose debt the RE has a right of indemnification out of scheme property. Their role in an MIS VA would necessarily be based on claims lodged in this fashion – on the expectation of their subrogation of the RE's right to claim against the MIS. It would be necessary for the MIS administrator to assess such claims. We do not use the term MIS creditors in the manner it appears the Discussion Paper does, namely envisaging persons who transacted with the RE and who by virtue of Reform 4 have direct claims against the scheme property.

- Certain affected third parties who have an interest in the subject matter of the MIS or claims against the RE as operator of the MIS, members, or property which may be scheme property; and
- All other members.

We are concerned that if members are not included in the VA process there is a risk that their rights might be 'sidestepped', and may be altered or affected without their having any ability to influence the VA, whilst a moratorium prevented them from seeking to exercise their statutory rights or protect their rights in court.

We are concerned that such a moratorium, in circumstances where all members are not included in the VA process, could unreasonably curtail members rights and ability to influence the future of the MIS, and the VA process could be used as a means of stifling members' and facilitating changes which may be adverse to members' rights or interests.

If all members are not included in the process, we submit other means of ensuring members have direct representation in the VA process must be considered. One suggestion is establishment of a committee of members who have an oversight and representative function in the VA process.

What should be the grounds for initiating the VA of an MIS?

Grounds for initiation of an MIS VA should be based on a modified 'insolvency test' supplemented by a 'purpose test' to account for the dynamics of MIS and the capacity for issues beyond insolvency to affect viability and continuation.

We submit an appropriate insolvency based test could be based on the following:

- An MIS is or may be insolvent when scheme property is insufficient or may be insufficient to meet scheme liabilities to scheme creditors (irrespective of the solvency or otherwise of the RE).[17]

If the relevant person reasonably considers that the MIS is or may be insolvent then a VA procedure can be initiated.

In addition, the following additional alternate ground is suggested:

- Where the relevant person reasonably considers that the purpose of the MIS cannot be achieved or may not be able to be achieved, a VA process can be initiated.

Viability may be a relevant consideration in the alternate ground as would the potential for third parties to seek to enforce rights which may affect the MIS's ability to continue.

Who should be entitled to initiate the VA of an MIS?

We submit that appointment of a VA should be made by the court on the application of specified classes of persons or any other person sufficiently affected by the MIS.

We submit the following are appropriate persons to have immediate standing to apply to the court to initiate the VA of a MIS:

- The directors or a liquidator or provisional liquidator of the RE or TRE;
- Substantial creditors;
- Members holding at least 5% of votes that could be cast at a meeting of the MIS.

In addition, the court should have discretion to recognise any person's standing to apply for initiation of an MIS VA provided they can demonstrate a sufficient connection and interest in the MIS or its business.

[17] This formula is based upon discussion John Moutsopoulos and Jennifer Bell of Clayton Utz in their article *Insolvent managed investment schemes: uncertainty and conflicts* (30 May 2011) published in the *Insolvency Law Bulletin, Vol 13 No 3 (October 2010)* and accessible at http://www.claytonutz.com/publications/news/201105/30/insolvent_managed_investment_schemes_uncertainty_and_conflicts.page

If the VA of an MIS is to involve classes other than MIS creditors:

- ***in relation to any voting on a proposed MIS deed:***
  - ***how should the classes entitled to vote on the MIS deed be determined? For instance, should it be left to the administrator to determine those classes, taking into account the extent to which the deed affects their interests***

We consider that the classes should be determined by the administrator based on the extent to which their interests are affected, however, because of the potentially complex nature of the rights which may be affected and the task of assessing the level of potential affect, we submit that the administrator should be required to obtain court approval.

  - ***where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests***

We submit that classes should only be entitled to vote on the part of the MIS deed that affects their interests, however, in determining voting rights 'affects' should be given a broad and inclusive definition so as to encompass rights directly and indirectly affected.

  - ***should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it***

We do not consider that the MIS deed must be approved by all classes for aspects of the MIS deed to come into force.

To the extent that the MIS deed can be compartmentalised such that different aspects of it can be effectively implemented without all others being implemented, then we support the implementation of a MIS deed to the classes that approve it.

In simple cases, a partial implementation could effectively address the issues facing the MIS.

In more complex cases, we think it is likely that a MIS deed will be of a more complex and interconnected nature, such that implementation of certain aspects will be ineffective unless all or some other aspects are also implemented.

An MIS administrator may consider making aspects of a MIS deed explicitly interdependent, such that failure in approval of certain aspects precludes implementation of the MIS deed in any capacity.

The ability to separately implement aspects of the MIS deed could be a matter to be considered by the court in the court approval process.

- ***what should be the voting rules for any proposal that:***
  - ***the MIS be wound up, or***
  - ***the MIS administration end and the MIS continue as before?***

We have not reached a concluded view on this question.

Our preliminary submission is that a proposal to wind up the MIS should be passed by a majority of each class of participant, by value and number, or value of interests, as appropriate to the relevant class.

A similar process could be adopted for approval of a proposal to end the administration and continue the MIS. However, given this is a less drastic step than winding up and only likely to be proposed in circumstances where there is sufficient confidence in the viability of the MIS and its ability to achieve its purpose, a lower or more flexible threshold may be appropriate.

In what circumstances, if any, should an MIS deed be able to override the rights of members under the constitution of the MIS or impose new obligations on those members?

An MIS deed should only be able to override the rights of members under the constitution of the MIS or impose new obligations on those members if members are entitled to vote on the aspects of the MIS deed which affect their rights, and the members approve the changes with a level of support equal to that which would be required under the Act to effect such changes by voting on resolutions at a members' meeting.

5.5 Other matters relevant to the VA of an MIS

5.5.1 Avoiding duplicate VAs

Question

What, if any, legislative provision needs to be made to prevent duplicate VAs?

We support the suggested legislative restrictions detailed in section 5.5.1 of the Discussion Paper.

Because of the potential greater complexity of an MIS VA, it is critical that all scheme property and claims by creditors be dealt with under the MIS VA. In addition, an administrator of the RE of the MIS should be required to give all reasonable assistance to the administrator of the MIS and legislative provision made to facilitate information sharing.

5.5.2 Who can be an MIS administrator

Question

In the context of an MIS administration, should there be any change to the current requirements that only a registered liquidator can be an administrator and, if so, why?

We support appointment as an MIS administrator being limited to registered liquidators with the following additional requirement.

In recognition of the specific and specialised activities certain MIS engage in, we consider that as part of the court appointment approval process, the court must be satisfied that the proposed MIS administrator has skills and experience commensurate with the size and complexity of, and relevant to, the business of the MIS. This would provide a sufficient check on the appointment of suitably skilled liquidators to complex and specialised MIS, or the appointment of liquidators who have outlined a framework to address any potential skill deficiencies or to ensure adequate experience and skills though the engagement of specialists to operate the company (compliance with such frameworks being a condition of appointment).

5.5.3 Powers and liabilities of the MIS administrator

Questions

Should an MIS administrator have similar powers to those of the administrator of a company?

We support MIS administrators having similar powers to the administrator of a company.

For what liabilities, if any, should an MIS administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?

We submit that an MIS administrator should only be liable for contractual or other liabilities the administrator incurs while acting in the role of MIS administrator.

We support an MIS administrator having a right to indemnity out of scheme property for debts they lawfully incur while acting as MIS administrator of the MIS.

5.5.4 Remuneration of the MIS administrator

Questions

Who should determine the remuneration of an MIS administrator or an MIS deed administrator?

Through the court appointment approval process the court should approve the MIS or MIS deed administrators' remuneration.

Support, or otherwise, of that remuneration by the committee of creditors and/or committee of members would be a relevant matter for the court.

What, if any, classes of persons in addition to the MIS creditors should be involved and in what manner and for what reasons?

We wish to comment on the term 'MIS creditors' in the Discussion Paper. Its appears to refer to creditors of the RE in respect of which the RE has a right of indemnity from the scheme property, but whom, following implementation of Reform 4, would have direct claims against the MIS property, thus becoming 'MIS creditors'.

We reiterate that we do not support Reform 4.

If it is not implemented, then the process of MIS administration or liquidation will be complicated by the fact that such 'MIS creditors' will be claimants in the administration or liquidation of the RE, and strictly speaking not the MIS. However, it is desirable to have their derivative rights recognised.

We consider that provision should be made for creditors of the RE who have an expectation of an indemnity claim being made by the RE in respect of their debt to lodge proofs directly with the MIS administrator or liquidator in addition to the RE administrator or liquidator. The MIS administrator or liquidator would have to determine the recoverability of the RE from the MIS in respect of those claims, and could accept them directly for the value he considers the debt is indemnified.

Where we talk of creditors of the MIS or 'MIS creditors' we use the terms to mean persons who have lodged, or are entitled to lodge claims, and have them assessed, in this manner.

In response to the question we refer to our comments in relation to the preceding question. We consider the involvement of members (albeit indirectly given ultimate power to approve remuneration rests with the court reflects the significance of members in MIS).

What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?

We support the same priority provisions for remuneration of MIS administrators or MIS deed administrators in any winding up of the MIS as are provided for corporate administrators.

5.5.5 Court powers

Question

What powers should the court have in any VA of an MIS, and who should be entitled to apply to the court for this purpose?

We support the court being given a broad discretionary power similar to that under section 447A of the Act to make such orders as it thinks appropriate about how the MIS VA procedures operate in relation to a particular MIS.

We consider that the following parties should be able to apply to the court for the purpose of the court exercising such a power:

- The RE;
- A member of the MIS;
- A creditor of the RE or MIS;
- The MIS administrator or deed administrator;
- ASIC; or
- Any other interested person.

5.5.6 Need for an ongoing RE

In what circumstances, if any, should there be a power to appoint a TRE to operate an MIS in the context of a VA of that MIS, and who should be able to exercise any such power?

If the MIS is viable or an MIS deed has been entered into, but the incumbent RE is unwilling or unable to continue in that role, the court should have the power to appoint a TRE to the MIS for the purpose of continuing the MIS to allow a potential replacement RE to be identified and due diligence to be conducted by it.

We submit the following should be able to apply to the court for this appointment:

- The RE;
- The MIS administrator or MIS deed administrator; or

- ASIC.

4.6 Chapter 6 – Winding up a non viable MIS

4.6.1 Subsection 601GA(1) of the Act provides relevantly:

> *(1) The constitution of a registered scheme must make adequate provision for:*
>
> *….*
>
> *(d) winding up the scheme.*

4.6.2 Problems in practice with winding-up MIS are largely the result of poor compliance with this requirement and inadequate provision for winding-up being provided in the constitution of the particular MIS. Further clarity in termination provisions of constitutions, in particular early termination, would have obviated the need for termination to be agitated in the courts so frequently in recent years.

4.6.3 Obviously, this is a failure of scheme operators in establishing the schemes. It is also a regulatory failure, with ASIC registering MIS whose constitutions do not comply with the requirements of subsection 601GA(1)(d) of the Act. The implications of this regulatory failure have become apparent since the onset of the global financial crisis.

4.6.4 It also raises the question of to what extent ASIC should actively oversee and regulate MIS. The registration regime, coupled with provisions in the Act such as subsection 601GA(1), appear designed to provide ASIC with a gatekeeper function that would prevent, where an operator or issuer failed to comply with the requirements of the Act, from that product being registered and issued because of ASIC's final oversight and implicit approval role.

4.6.5 It may be argued that this is not the role ASIC should, or is able, to take. That may be the case, but this highlights the need to reconcile the Regulator's expectations and intentions with those underpinning the MIS legislation.

4.6.6 We refer to the comments at page 89 regarding section 601NA and the explicit prohibition therein regarding attempts to entrench a particular RE through winding-up provisions.

4.6.7 We discuss 'poison pills' in MIS constitutions in more detail in section 5.3 below.

4.6.8 We also note the discussion at pages 95-6 of the Discussion Paper in relation to whether the MIS of an insolvent RE needs to be wound up. We note that a substantial amount of the discussion is predicated upon the implementation of Reform 4.

4.6.9 We reiterate our opposition to implementation of Reform 4.

4.6.10 We also refer to and note the various suggestions made by Garry Bigmore QC and Neil Hannan, in their article, *Issues arising out of winding up managed investment schemes*[18], in particular their suggestion that the court be given power to:

a. appoint a receiver to a MIS to report to the court on the viability of the MIS and whether its assets should be sold; and/or

b. alter the provisions of Chapter 5C of the Act so as to allow the purpose of the MIS to be achieved taking into account the rights of the competing parties involved.

4.6.11 We see potential utility in their suggestion detailed in 1.2.11(b) where an MIS deed was unable to be approved by the various classes of parties to it.

4.6.12 Also, we refer to schedule 2 where we provide detail on the liquidation and administration of a number of REs of Agri MIS relevant to this discussion. In all of these cases, landlords (under the control of secured creditors) belonging to insolvent corporate groups, have been able to utilise the poisoning of the RE with the insolvency of the group (by means of cross guarantees in particular) to engineer a removal of the schemes from the land. This gives the landlord the ability to sell the land with clear title free from the encumbrances of the growers, who in many cases have invested significant sums of money in developing the assets being sold. A substantial number of investors borrowed to make their investments and have been saddled with the ongoing loan obligations notwithstanding the loss of their investments.

[18] Insolvency Law Bulletin (October 2010) pp 42 to 45.

4.6.13 In addition, we make the following specific response to Chapter 6 of the Discussion Paper:

6.1.4 Application to practice

Questions

Are any changes needed to:

- ***the current circumstances where an MIS can be put into liquidation with/without the need for court approval?***
- ***the provisions governing who can conduct the winding up?***

There is presently a lack of clarity and express legislative provisions to provide a satisfactory range of 'tools' to wind-up an MIS in the varied circumstances in which it can be necessary.

In improving the winding-up framework, we think a distinction should be drawn between MIS which have accomplished their purpose and those where they cannot or appear unlikely to accomplish their purpose. MIS which were insolvent or may be insolvent and/or no longer viable would fall into the second category.

We consider the current framework for initiating and winding up schemes where the purpose of the MIS has been accomplished is sufficient (s.601NC) and should remain in the control of the RE in the first instance.

However, we consider reform is required in relation to MIS whose purpose cannot be accomplished.

In recognition of the fact that something may have gone 'awry' or 'amiss' in relation to such MIS, we submit that the winding-up should be conducted by a party independent to the RE, most appropriately a registered liquidator.

Such appointment should be made by the court on the application of either a creditor, member, ASIC or any other party sufficiently interested in the MIS.

We consider that the grounds for a court ordered winding up of an MIS should mirror those found in sections 459A, 459P, 461(1) and 464 of the Act.

We note, in particular, that this would confer explicitly on the court a general discretion to order that an MIS be wound-up where it was just and equitable to do so.

We also consider that the court should be conferred a power in respect of MIS to appoint a liquidator provisionally (see subsection 473(2) of the Act re corporations). A provisional liquidator of an MIS should be given the powers contained in subsections 473(3) to 473(6) of the Act.

In this context:

- ***should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why***

We submit that the onus should remain on members of MIS to call meetings if they do not agree with the RE's proposal to wind up the scheme. We note that if the changes we outline above were adopted, RE winding ups would only occur where the purpose of the MIS had been accomplished, perhaps reducing the likelihood of members seeking to vote on the proposal.

Nonetheless, we recommend, consistent with our submissions elsewhere, that the threshold for passage of a resolution relating to the proposed winding up be reduced to a special resolution where 25% of those members eligible to vote have voted in favour of winding up the scheme.

- ***is there a need for a separate insolvency ground for winding up an MIS***

As indicated above, we consider that an amendment should be made to Part 5C.9 to include similar provisions to those in Part 5.4 Division 3 and Part 5.4A of the Act, including a ground for winding up in insolvency.

- ***if so:***
    - ***how should the insolvency of an MIS be defined***

As detailed above, a potential definition is that an MIS is insolvent when scheme property is insufficient to meet scheme liabilities to creditors of the MIS, irrespective of the solvency or otherwise of the RE.[19]

6.2 Liquidation of an MIS where the RE is solvent

Questions

Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?

As set out above, we submit that where the purpose of the MIS has been achieved, it is appropriate for the RE to wind-up the MIS.

As we noted at paragraph **Error! Reference source not found.**, problems in practice have arisen because MIS constitutions do not adequately provide a framework for winding-up the MIS.

We support implementation of a legislative framework and consider it could be based upon Part 5.5 Divs 2 and 4 bearing in mind that an RE will only be conducting the winding-up where the MIS's purpose has been accomplished.

Where there is a question over the MIS's insolvency or its ability to accomplish its purpose, we consider an independent party (such as a registered liquidator) should be appointed to wind-up the MIS.

We consider the liquidator should be given similar powers to those of Part 5.4 of the Act tailored to specifically apply to MIS.

6.4.7 Current power to initiate a separate liquidation

Questions

In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)?

In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?

We note the observations in the Discussion Paper regarding the conflict that can arise or may be perceived to have arisen for a liquidator acting as liquidator of the RE and in effect, liquidating the MIS.

We consider that this conflict is best cured by separation of the role of liquidator of the RE and liquidator of the MIS.

At present, similar conflicts when faced by liquidators (including receivers and managers) of REs inevitably necessitate application to the court for judicial directions.

We acknowledge that separate liquidators may lead to litigation between these parties, but consider it may overall reduce the instance of litigation and otherwise benefit the winding up of the MIS.

With a separation between the interests of the RE and MIS in liquidation through separate liquidations, there may be greater capacity for competing claims to be compromised given the liquidators are freed of conflicts.

We consider because of the potential for conflicts to arise or be perceived, in most instances separate liquidations should be conducted.

We note that this may lead to increased expense and certain complexities as identified on page 100 of the Discussion Paper. However, in our experience, potential or actual conflicts have greatly increased the complexity of the liquidation of REs and required repeated applications to the court for directions.

In exceptional circumstances and where the prospect of conflict is low, the court may be able to order that one liquidator act in both capacities where it is in the interests of creditors and members and the liquidations are expected to be more straightforward.

[19] See: John Moutsopoulos and Jennifer Bell, Clayton Utz, *Insolvent managed investment schemes: uncertainty and conflicts* (30 May 2011) published in the *Insolvency Law Bulletin, Vol 13 No 3 (October 2010)* and accessible at http://www.claytonutz.com/publications/news/201105/30/insolvent_managed_investment_schemes_uncertainty_and_conflicts.page

If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome? In this context:

- ***are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take responsibility for the liquidation of an MIS***

We refer to our previous submission that registered liquidators should be appointed to wind up MIS which are insolvent or where the purpose of the MIS cannot be accomplished.

6.5 Options for an MIS liquidation process

Question

Would the process for liquidating an MIS be better provided for by:

- ***an extension of the powers of the court in s 601EE to all MISs, or***
- ***a legislative procedure containing some or all of the elements discussed in Section 6.6 and for what reasons?***

We submit that the process for liquidating an MIS would be better provided for by a legislative procedure, accompanied by a right to apply to the court for directions and general court discretion to make any order it sees fit in relation to a liquidation on the application of certain parties.

We consider that the legislative framework should be derived largely from Chapter 5 Part 5.4 to Part 5.9 of the Act.

6.6.2 Procedural matters

Questions

What procedural provisions should there be for winding up an MIS and why?

We refer to our comments at paragraphs **Error! Reference source not found.** to **Error! Reference source not found.** in relation to the operation of the current legislative procedure to determine the winding up of an MIS.

We also refer to our comments above in response to the questions posed in the Discussion Paper in section 6.1.4 and 6.2.

We support the implementation of the procedural powers and obligations detailed in section 6.6.2 in particular:

- A liquidator of a MIS having the power to conduct compulsory examinations as approved by the court;
- A requirement of a liquidator to:
    - keep proper books;
    - meet certain requirements in relation to money received;
    - meet public notification requirements;
- a prohibition in similar terms to that contained in section 471A of the Act;
- court powers similar to those provided by section 483 and to make such orders as are just and to make appropriate orders concerning persons guilty of misconduct causing loss to an MIS.

In particular, should a party conducting a winding up:

- ***have information-gathering and other investigative powers comparable to those of the liquidator of a company***

We strongly support such powers being given to a registered liquidator conducting the winding up of a MIS.

- ***have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity?***

Again, we strongly support such obligations being imposed on the registered liquidator appointed to the MIS. It is of particular relevance as they will be appointed in circumstances of insolvency or where the purpose of the MIS cannot be accomplished such that there may be questions over the management of the MIS.

Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating?

Given the RE will only be responsible for winding up MIS where the purpose has been accomplished, we do not consider that it is necessary for them to have such powers.

However, in the case of an MIS whose purpose cannot be accomplished or which is insolvent, there is an inherent conflict for the RE who has presided over the MIS's failure if it were to act to wind up the MIS. For this reason, an independent and qualified party should be appointed to wind up such MIS and meet the obligations of investigation and reporting to ASIC.

6.6.3 Rights of priority creditors

Questions

Should there be a statutory order of priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?

We consider that statutory priority should be given to fees of liquidators and administrators appointed to MIS.

In respect of trust-based MIS, we consider that the application of principles of trust law are adequate to deal with matters of priority and reform to the law is not required.

In respect of contract-based MIS, we note that the position is not so clear. Contract-based MIS have different structures with different relationships. Trust law provides little assistance. At the same time, over prescription through statutory order of priority may not assist given the potential for certain structures or arrangements to fall outside the statutory regime.

It may be that the order of priority in complex situations is a matter for consideration and determination by the court.

6.6.4 Voidable transactions

Question

Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those provisions?

We have not considered the potential for voidable transaction provisions to be applied to a MIS winding up and as such, do not have any detailed submissions in relation to their content. However, we support provisions with a similar effect to those relating to corporations.

In particular, related party transactions should be subject to a strict regime of voidability, given the issues which have been observed in relation to Complex Group MIS and multi-function REs.

6.6.5 Access to books of the MIS

Question

What provisions, if any, should be included to deal with access to books of the MIS?

As we recommend that liquidators should be appointed for insolvent MIS, the same requirements of a corporate liquidator to keep books and provide access should be imposed (section 531 of the Act and regulation 5.6.02 of the Regulations).

This should be extended to explicitly provide for access by members.

6.6.6 Court power to give directions

Questions

Should there be any changes to the current provisions by which the court can give directions, and, if so, what and why?

In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?

We strongly support such a power being provided to the court.

The breadth and variety of structures, arrangements and relationships comprising and connected with MIS creates the need for dynamic response to novel or unexpected situations and consequences.

The court is best placed to respond to such circumstances through such a power.

We have seen many instances of receivers and managers, and liquidators, using court directions to obtain court sanction of actions in the context of the liquidation of REs and MIS.

An express power to direct how a MIS liquidation be conducted would simplify and promote orders as required.

We consider the following should be entitled to apply for such orders:

- The liquidator of the MIS;
- The RE or its liquidator or the TRE;
- A creditor of the MIS;
- A member of the MIS;
- ASIC;
- Any other interested person (which would include a potential new RE).

6.6.7 Position of MIS members

Questions

What provision, if any, should be made for MIS members in the winding up of their scheme?

As discussed in relation to potential MIS VA procedures, we consider that a committee of members should be appointed in a MIS liquidation to oversee the conduct of the liquidator and represent members' interests.

Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?

Recent judgements in the Federal Court analysed the duties of liquidators and receivers in relation to members of MIS. The courts have considered the legislative intent in relation to whether a receiver is considered an 'officer' for the purpose of the duties of officers of an RE in subsection 601FD(1) of the Act,[20] the potential conflict between a liquidator's duty to the court and its duty to members under subsection 601FD(1) of the Act,[21] and how a liquidator's duty to creditors is affected by subsection 601FD(1) of the Act.[22] From our conversations with ASIC, these judgments are inconsistent with ASIC's interpretation of the law and are also inconsistent with statements on their websites about the obligations of receivers.

There is considerable uncertainty arising out of the application of these cases. The duties of a liquidator in each of its potential roles (e.g. receiver, receiver & manager, administrator, liquidator etc.) should be clearly provided for in statute. If the duties of liquidators to members of MIS are restricted in the ways

[20] *Forest Enterprises Australia Limited (Administrators Appointed) (Receivers & Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed)* [2010] FCA 1274 at [22] to [43].
[21] Ibid at [42].
[22] *Timbercorp Securities Limited (in liq) v WA Chip & Pulp Co Pty Ltd* [2009] FCA 901.

suggested by the courts, it is important that there is a clearer and more accessible mechanism for members to change the RE or have a TRE appointed.

6.7 Unregistered MISs

6.7.2 Unlawful unregistered MISs that are viable

Question

Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?

In our opinion, an express provision for the appointment of a TRE to such MIS for the purpose of determining their viability and/or preparing them for registration and either return to a suitably licensed RE or into control of a new RE would be desirable to facilitate continuation of illegal schemes which but for their regulatory non-compliance, are viable.

Alternatively, an express provision for the appointment of an administrator or receiver to the illegal MIS may achieve the same result.

6.7.3 Unlawful unregistered MISs that are not viable

Questions

Should a former member of an MIS have standing to apply for the winding up of an unregistered MIS?

We support such standing being given to former members.

Should a creditor have standing to apply for the winding up of an unregistered MIS?

We support such standing being given to creditors. This would be subject to any moratorium arising through the appointment of a TRE, administrator or receiver.

4.7 Chapter 7 – Other matters

4.7.1 We make the following response to chapter 7 of the Discussion Paper:

7.1 Convening scheme meetings

Questions

Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons?

We consider, consistent with the recommendations of the Turnbull Report, which provision should be made in the Act for members to request the RE of a MIS to call a general meeting.

As identified in the Discussion Paper, such general meetings would provide an opportunity for members to 'provide a sense of cohesive ownership and provide an opportunity for members to raise matters with the RE without the need to propose a special or extraordinary resolution.'

In recognition of the varied size and nature of MIS, we do not consider that all MIS should be required to hold an annual general meeting, but members should be able to request such a meeting. The threshold for the request should be as stipulated in subsection 249D(1) of the Act. Provided the threshold is met the RE should be obliged to hold the meeting.

Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?

We refer to our comments above.

The requisitioning members should be required to state the purpose for which the meeting is called.

7.2 Cross guarantees

Question

In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?

We submit that cross-guarantees and indemnities by REs of MIS should be expressly prohibited because of the substantial risks they create for MIS with multifunction REs and Complex Group MIS. The impact of these risks has been observed in the recent high profile Agri MIS collapses.

We support the proposed amendments of the licensing requirements by ASIC.

Because of the seriousness of this issue, irrespective of whether ASIC amends the licensing requirements, we consider prohibitions in the same form should be included in Chapter 5C of the Act.

We note that this would leave little doubt as to the legality of such arrangements and would enliven recovery provisions relating to breaches of Chapter 5C for members where contraventions may have occurred. More fundamentally, because of the seriousness of the issue the prohibition should be contained in the part of the Act expressly dealing with MIS.

7.3 Limited liability of MIS members

Questions

Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes?

We submit statutory limited liability should be introduced for all MIS (where the RE is not acting as agent for the members).

We don't think that distinguishing between levels of passivity or activism is useful or necessary. Fundamentally, where the RE is not acting as agent, the member has no active involvement in the MIS and no ready ability to influence its business or management, commensurate with passivism.

***Should the limited liability principle be subject to any contrary provision in the scheme constitution*?**

We do not consider that the limited liability principle should be subject to contrary provisions in the MIS constitution. We have observed too many matters where constitutional provisions adverse to members' rights have been inserted into constitutions with tacit member approval but in circumstances of inadequate disclosure or member engagement.

For this reason and because of the serious implications for members of the principle being modified or eroded, it should not be able to be modified by the MIS constitution.

7.4 Other matters

Question

Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?

We discuss a number of additional issues facing MIS, and potential policy or legislative responses to these issues, in section 5 'Other Matters' below.

5 Other Matters

5.1 Additional issues facing MIS

5.1.1 As noted above, we have observed a number of additional issues facing MIS, in particular distressed MIS, which are either not addressed or not addressed in any detail, in the Discussion Paper.

5.1.2 The majority of these issues relate to the difficulties facing, and impediments to, members exercising their statutory rights to influence the management of the MIS. Whilst by definition a member has no 'day-to-day' control over the affairs of an MIS, the limited capacity they do have to effect change or influence management of MIS is an important right.

5.1.3 We have observed the majority of these issues in the context of our work in relation to trust based MIS, however, they are equally applicable to contract based MIS.

5.1.4 The major issues we have identified are:

a. The difficulties members face in replacing an underperforming RE of an unlisted MIS including the high threshold for removal and replacement, practical issues relating to member engagement and entrenching provisions;

b. Unresolved issues relating to the procedure of member meetings to consider resolutions for the removal and replacement of a responsible entity;

c. Mismanagement and/or misconduct by the RE, in particular relating to:

i. Conflicts of interest between the interests of schemes for a multi-function RE and between the REs interests and a particular MISs; and

ii. Related party transactions; and

d. Inadequacy of professional indemnity insurance cover.

5.2 Difficulties with replacement of an RE

5.2.1 It is an oft made observation that members of an unlisted MIS have limited rights by which they may influence its management or direction[23]. When the practical difficulties associated with the exercise of those rights are considered, the actual extent of this limitation becomes clear.

5.2.2 The primary method by which members may influence the management of their investment is under the meeting procedures provided by Part 2G.4 of the Act, and the most powerful means is the removal and replacement of the RE. In our experience, effecting a change of RE of an unlisted MIS is extremely difficult.

5.2.3 Passage of an extraordinary resolution is an extremely high threshold. A high level of passivity and investor apathy has been observed in relation to such investments and significant resources and time is required to rally support for passage of the requisite resolution. Active members are in effect hamstrung by inactive members, and an underperforming or incompetent RE can get a 'free pass' because of this.

5.2.4 We have also observed that inevitably in the lead-up to a members' meeting there will be a 'battle' between the incumbent RE and the proponents of its replacement for support. This will generally involve significant communications to investors and advisors by both parties to influence the completion of proxies.

5.2.5 We have also observed that an incumbent RE is in a particularly strong position to advocate against a proposal involving its replacement, often relying upon uncertainty or structural constraints, further complicating the process of change.

Inhibitive Funding Facilities

5.2.6 We refer to our comments in response to section 4.7 of the Discussion Paper in section 4.4 of our submission above regarding inhibitive funding facilities and similar agreements.

Collection of Proxies

5.2.7 In our experience there is a significant advantage to knowing the numbers of proxies collected and in whose favour they are made in the lead up to a meeting of members. It can inform the proponents on whether to press ahead with the meeting, and inform their communication strategy with members. It is similarly advantageous for the incumbent RE to be aware of the proxy count details.

5.2.8 A common practice we have implemented and observed involves the appointment of an intermediary to collect proxies and report to both parties on the collection on a regular basis. In some cases a registry services provider such as Computershare or Link has been appointed by the proponent of the replacement of the incumbent RE by an agreement that requires the proxy collector to act independently in completing their duties.

[23] See for example: *Lachlan REIT Limited v Garnaut & Ors* [2010] VSC 399 (6 September 2010) at [38].

5.2.9 Despite the apparent conflict between the proxy collector acting independently and its appointment by the proponent, there are significant reputational and financial risks for an intermediary should they fail to act independently and breach their obligation to do so under the relevant agreement. Despite this a number of incumbent REs have opposed such a practice.

5.2.10 Section 252Z of the Act requires that proxies must be received by the RE 48 hours prior to the members' meeting. However, the Act is silent on:

a. Who may collect them; and

b. By whom, and how, they must be delivered to the RE.

5.2.11 In a number of cases it has been argued that collection of the proxies by an intermediary prior to delivery to the RE in accordance with section 252Z presents the possibility of tampering with the proxies and is contrary to the Act.[24] The legal position remains unclear.

5.2.12 We do not consider that such assertions are correct. In respect of any resolution for removal of an incumbent RE we note that it is an extraordinary resolution and there is no advantage to be gained by an intermediary who is engaged by or has a relationship with the proponents for replacement, failing to deliver unfavourable proxies. To the extent tampering involving alteration of proxies is suggested as a possibility, we note that the delivery of the proxies to RE provides the RE with an opportunity for inspection and identification of any proxies which are questionable.

5.2.13 In respect of special and ordinary resolutions there may be an advantage to be gained by withholding unfavourable proxies. In our opinion this risk can be suitably managed by the engagement of a disinterested intermediary and contractual requirements of transparency.

5.2.14 We also note that an RE fighting for its survival is in a position of significant conflict[25]. The delivery of proxies directly to the RE does nothing to reduce the possibility of tampering by the incumbent RE, and interposition of a relatively neutral and appropriately credentialed proxy collector improves the process.

5.2.15 We consider that legislative reform to approve the practice of proxy collection by an intermediary and to clarify the presently unclear status of the law in this area is appropriate.

5.2.16 If the alternative view is taken, and the law clarified to require proxies to be delivered directly to the RE, we consider it would be appropriate to insert a requirement that the RE provide regular updates to the proponents of the proposal as to the state of the proxies and a requirement that they make available for inspection the proxies in advance of and at the meeting.

Adjournment of meetings

5.2.17 There is presently a lack of clarity surrounding the operation of provisions governing adjournment of members' meetings.

5.2.18 Section 252K of the Act requires a new notice of adjourned meeting if the meeting is adjourned by one month or more. We have been involved in disputes about the meaning of this clause in relation to the following:

a. The details of the notice to be given;

b. In the case of multiple adjournments, whether "one month or more" refers to the length of each adjournment or all adjournments;[26] and

c. Whether it requires a new meeting (i.e. new proxies must be collected) or an adjournment of the unfinished business of the same meeting.

5.2.19 Section 252U only allows unfinished business to be transacted at an adjourned meeting. We submit that this should be brought into line with the common law which permits new business to be transacted if notice is given to members. We consider this better accommodates the fluid nature of the environment involved in restructuring MIS.

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[24] See: *Bisan Ltd v Cellante* (2002) 173 FLR 310; *City Pacific Ltd v Bacon* (2009) 72 ACSR 418; *Lachlan REIT Ltd v Garnaut & Ors* [2010] VSC 399 at [27].

[25] See: *Lachlan REIT Ltd v Garnaut & Ors* [2010] VSC 399 at [27].

[26] *Re Colonial First State Trust Group* [2002] ATP 16 (23 September 2002) is the only authority on the matter. It implies the latter which we consider is unworkable and plainly wrong as it would impose a mandatory notice period of 21 days on each adjournment after a month since the meeting was originally called.

5.2.20 The law requires clarification in this respect. Such clarification and/or reform should acknowledge the difficulties members have in reaching the thresholds for replacement of a RE, and the significant period of time that can be required to organise and mobilise members, develop a replacement proposal, call the meeting and rally provision of proxies and member engagement. These issues are discussed further in the context of contract based schemes below.

Obligations of the RE with respect to meetings to consider their removal and replacement

5.2.21 Recent matters have raised concerns over the conduct of REs in relation to meetings to consider their removal and replacement.

5.2.22 As noted above, an incumbent RE in such a position is in an irreconcilable position of conflict. There is significant potential for the meeting process to be derailed through unhelpful or resistant behaviour by a RE, which undermines the integrity of the process as an exercise of members' rights.

5.2.23 By way of example, we refer to the decision of the Honourable Justice Dowsett of the Federal Court in *Wellington Capital Limited, in the matter of Premium Income Fund v Premium Income Fund Action Group* [2011] FCA 781 (***Wellington Capital Limited***).

5.2.24 The facts of this case are illustrative of the background against which members' meetings for removal of the RE are often conducted.

5.2.25 Often significant disputes arise over procedural and substantive issues related to the meeting, resulting in court proceedings. It is illustrative of the complicating effect that such disputes have on the meeting process and the capacity for them to derail the exercise of the members' rights under that process. Whilst obviously genuine procedural and substantive issues relating to the meeting must be resolved and will at times necessitate resort to the courts, in our view, an RE is obliged through the obligations under subsection 601FC of the Act (as are its directors under section 601FD of the Act) to facilitate resolution of such disputes in the most efficient manner to allow members to exercise their rights. In practice, this does not always occur. Legislative reform to make explicit an incumbent RE's responsibility to take all reasonable steps to facilitate the holding of a members' meeting, and take no action to frustrate or impede the meeting may be required.

5.2.26 By way of example, alleged uncertainty over the status of Opus Capital Limited's Australian Financial Services Licence was identified by Centuria as a significant issue for members in the Opus Capital and Income Fund No 21, and a reason why members should replace Opus with Centuria. Prior to the meeting being called Opus' AFSL had been cancelled by ASIC, the cancellation set aside by the Administrative Appeals Tribunal (**AAT**) on review initiated by Opus, and ASIC appealed the decision of the AAT to the Federal Court.

5.2.27 In the period prior to the meeting, Opus contended that this alleged uncertainty was not a significant issue and propounded its confidence that the ASIC's appeal to the Federal Court would be unsuccessful. Opus communicated with members stating it had legal advice to the effect that ASIC's appeal would fail and the AAT's decision was sound. Attached to this was a copy of a letter from a lawyer of the firm acting for Opus, which Opus attached in support of the representation made.

5.2.28 Centuria's bid subsequently failed to attract the requisite member approval and Opus remained (and remains) RE.

5.2.29 On 31 August 2011 ASIC's Federal Court appeal was successful, an outcome contrary to that advocated in the member communication discussed above.

5.2.30 This illustrates the conflict the incumbent RE finds itself in. Statements as to the confidence of the incumbent RE as to the likelihood of a particular state of affairs arising relevant to the matters to be considered by or as an adjunct to the members' meeting should be tempered by acknowledgement of the uncertainty of outcomes and the possible range of outcomes available. This is not always the case.

5.2.31 By way of further example we refer to paragraphs 15 to 21 of Dowsett J's judgment in *Wellington Capital Limited*. We note at the outset that the issues raised therein were not resolved in the proceedings before Dowsett J and remain disputed. However, they are illustrative of the issues that could arise if an RE, or its officers, take steps which may frustrate or impede the meeting process.

5.2.32 In particular, as the physical recipient of proxies prior to the meeting, the incumbent RE is in position whereby it can act to impede the process by failing to attend the meeting and prevent quorum requirements from being met.

5.2.33 A general requirement upon the RE as outlined at paragraph 5.2.24 above should also be accompanied by explicit statutory requirements that the incumbent RE attend any members' meeting and produce all proxies in its possession at the meeting to prevent issues such as those alluded to in *Wellington Capital Limited* from arising and potentially impeding the exercise of members' rights.

5.3 Entrenching provisions

5.3.1 We have observed a number of MIS constitutions containing provisions which entrench (act to significantly impede or constitute a significant disincentive in commercial and practical terms to the exercise by members of their statutory right to replace the incumbent RE[27]) through:

a. Fees payable to the outgoing RE on its removal; or

b. Restrictive quorum and/or chair election requirements for meetings to consider resolutions for the removal and replacement of the incumbent RE.

Removal Fees

5.3.2 There is a lack of clear statutory or judicial authority on the propriety and legality of fees which seek to entrench an RE of a listed or unlisted MIS.

5.3.3 As noted in the Discussion Paper, RE fees are governed by subsection 601GA(2) which provides:

> *(2) If the responsible entity is to have any rights to be paid fees out of scheme property, or to be indemnified out of scheme property for liabilities or expenses incurred in relation to the performance of its duties, those rights:*
>
> *(a) must be specified in the scheme's constitution; and*
>
> *(b) must be available only in relation to the proper performance of those duties;*
>
> *and any other agreement or arrangement has no effect to the extent that it purports to confer such a right.*

5.3.4 Arguably, a fee whose basis is removal of the RE, is not in relation to a properly performed duty of the RE and therefore not permitted to be paid out of scheme property. However, we note the unusual drafting of subsection 601GA(2) and the use of the word 'those' in subsection 601GA(2)(b). However, there is presently some uncertainty in this area.

5.3.5 Ostensibly the requirements of subsections 601FC(1) and 601FD(1) of the Act (in particular subsections 601FC(1)(c) and 601FD(1)(c) & (e)), should prevent the insertion of entrenching provisions in a MIS constitution or acts by the RE to facilitate such insertion. In turn, they should also prevent a RE from taking or paying such a fee.

5.3.6 Such a view is supported by the detailed decision of the Takeovers Panel in Re AMP Shopping Centre Trust (No 1)28 where the panel stated at [66]:

> *The Panel considers that there is a principle of "non-entrenchment" in the managed investment scheme provision of the Act and in the purposes of Ch 6 of the Act and that it should apply that principle in its consideration of this application. Its view is that the Act stands for a non-entrenchment principle is supported by the obligations imposed on a responsible entity to prefer the interests of interest holders in the managed investment scheme if the interests of those holders conflict with the responsible entity's interests. Entrenchment would appear to run directly counter to this obligation (unless it had been given informed consent from the unitholders).*

5.3.7 However, a review of secondary materials relating to the enactment of Chapter 5C of the Act does not reveal support for such a principle and there is no judicial authority on this point of which we are aware.

5.3.8 In contrast, the recent Federal Court decisions of *Australian Olive Holdings Pty Ltd v Huntley Management Ltd* (2010) 185 FCR 97 (***AOL v Huntley***) and *Saker, in the matter of Great Southern*

[27] A similar definition of entrench was used by the Takeovers Panel in *Re AMP Shopping Centre Trust (No 1)* (2003) 45 ACSR 496.

[28] (2003) 45 ACSR 496 at 508. The panel's decision in *Re AMP Shopping Centre Trust (No 1)* was upheld on review in *Re AMP Shopping Centre Trust (No 2)*.

Managers Australia Ltd (receivers and managers appointed) (in liquidation) [2010] FCA 1080 (***Re Saker***) appear to validate payments to an RE which have a disincentive effect on its replacement. We note that subsection 601GA(2)(b) was not argued in *AOL v Huntley* and was not considered relevant by the Court in *Re Saker* because of provisions in the scheme documents which had the effect that contributions made by growers lost the character of scheme property once paid into a Trust Maintenance Fund.

5.3.9 If not a case for law reform, this may instead be a regulatory failure. The constitutions of the MIS operated by the 'Great Southern Group' generally contained provisions whereby contributions from growers were paid to the RE as 'fees' and at that point lost their character as 'scheme property'. This enabled the Great Southern Group to operate in a manner that has been likened to as a 'ponzi' scheme, with funds from one scheme being used to pay for expenses in others. It is submitted that such constitutions do not comply with s601GA(2)(b) and so the MIS should not have been registered with constitutions in that form.

5.3.10 We are not aware of any guidance from ASIC on the legality or otherwise of 'poison pills' in scheme constitutions but note their comments in the Turnbull Review.

5.3.11 We have observed MIS constitutions which provide for fees in the same form as or similar to the following:

> *In the event that [the RE] is appointed … removed without its consent for any reason other than negligence or fraud, [the RE] will be entitled to receive payment of removal fee of 2% of the gross value of the Scheme (as determined in the most recent audited accounts) which fee is payable immediately prior to replacement of [the RE] as Responsible Entity of the Scheme. The fee will only be payable on removal of [the RE] as Responsible Entity of the Scheme and may not otherwise be claimed by [the RE] in any other circumstances.*

5.3.12 Arguably such a fee is contrary to subsection 601GA(2) and other provisions of the Act, however, the position is presently unclear.

5.3.13 We consider that entrenchment is contrary to the principles underpinning Chapter 5C of the Act and the exercise of rights by members to control the management of MIS. We recommend that the 'principle of non-entrenchment' discussed by the Takeovers Panel in *Re AMP Shopping Centre Trust (No 1)* should be codified with an express prohibition on fees which have or may have the effect of significantly impeding, or constitute a significant disincentive to, the exercise of members' statutory rights to remove and replace an RE of a MIS.

Quorum requirements

5.3.14 In addition to RE fees which may operate as 'poison pills' we have also observed provisions in MIS constitutions relating to quorum requirement for meetings to consider the removal and replacement of an RE, which act to impede the exercise of members' statutory rights in that respect.

5.3.15 The following is such an example of a combination of provisions which have such a potential effect:

> *10.2 Except as provided for at subclause 10.3 below, two Unit Holders present constitute a quorum for a general meeting. No business may be transacted at any meeting except the election of a chairman and the adjournment of the meeting unless the requisite quorum is present at the commencement of the business.*
>
> *10.3 The quorum for a meeting at which any resolution is proposed (whether ordinary or Extraordinary) to remove the Responsible Entity of the Scheme, is a minimum of four persons holding or representing in person, by proxy or attorney at least 51% of Units on issue in the Scheme by number.*
>
> *10.4 The quorum for a meeting at which any resolution is proposed (regardless of the type of resolution) to amend clause 10.2 or clause 10.3 is at least four persons holding or representing in person, by proxy or attorney at least 51% of the Units by number.*

5.3.16 Such provisions seek to elevate the barrier to such a meeting being convened. Whilst it will be necessary that over 50% of members vote in favour of resolutions for the removal and replacement of an RE, this is a requirement only of the passage of the resolution, not the convening of the meeting. Such restrictions on quorum requirements would prevent a meeting being convened in circumstances where less than 51% of members are represented. The reality of meeting processes in this context is that meetings will often be convened and adjourned to a later date when the substantive resolutions are considered. Restrictive quorum requirements prevent the convening of the meeting and the commencement of the meeting process in the absence of the prescribed high threshold.

5.3.17 We also note the observations made at paragraphs 5.2.21 and 5.2.33 above regarding non-facilitative conduct by an incumbent RE who is in possession of proxies.

5.3.18 The above example of a restrictive quorum requirement is taken from the constitution of the Premium Income Fund ARSN 090 687 577, the MIS subject of the discussion at paragraphs 5.2.31 and 5.2.33 above and the proceedings in *Wellington Capital Limited*.

5.3.19 This illustrates the effect restrictive quorum requirements can have in circumstances where inhibitive or non-facilitative conduct by the incumbent RE is present.

5.3.20 In our opinion, there is no reason why the constitution of a MIS should depart from the ordinary quorum requirements provided for by the Act and the law should be reformed to prohibit departures from the law to the extent that they raise the threshold for quorum requirements.

Election of chair

5.3.21 Subsection 252S(3) of the Act provides that the members present must elect a member to chair the meeting.

5.3.22 In limited cases, we have observed MIS constitutions which place restrictions on the operation of subsection 253J(2) of the Act, whereby a poll cannot be demanded on any resolution for the election of the chair.

5.3.23 In our experience, and as is generally accepted, the chair of a meeting holds a significant and powerful position. They have effective control of the conduct of the meeting and certain critical functions such as those under section 253G of the Act. In addition, the chair has the discretion to adjourn a meeting.

5.3.24 We have observed constitutional provision in the following or similar form:

> ***28.4 Chairing meetings of Unitholders (section 252S)***
>
> *...*
>
> *(c) The Unitholders present at a meeting called under sections 252C, 252D or 252E of the Law must elect a Unitholder present to chair the meeting.*
>
> ***30.8 Matters on which a poll may be demanded (section 253K)***
>
> *...*
>
> *(b) A poll cannot be demanded on any resolution concerning:*
>
> *(i) the election of the chairperson of a meeting; or*
>
> *(ii) the adjournment of a meeting.*

5.3.25 The effect of such a provision is to complicate the process of the election of the chair, such as to require a critical mass of members to attend in person. The reality is that the majority of members may have granted proxies to a particular person and given them discretion to vote on such matters. However, provisions of this nature operate to frustrate the will of the members underlying the proxyholder (who may be a single individual and therefore can only cast one vote on a show of hands despite representing hundreds if not thousands of members).

5.3.26 We can see no justification for departure from subsection 253J(3) of the Act and consider that the legislation should be reformed to eliminate the prohibition of a poll being demanded and conducted on the election of the chair.

5.4 Section 173 – access to register of members

5.4.1 Pursuant to section 173 of the Act any person can inspect and obtain copies of a register kept under chapter 2C of the Act, including the register of members of a MIS.

5.4.2 Access to the register of members is critical to pursuing the replacement of an RE of a MIS, as it allows for communication with all members in relation to the proposal by its proponents, and provision of the notice of meeting, explanatory memorandum and proxy forms to the members.

5.4.3 In practice, our clients have experienced difficulties in exercising their rights under this section. REs have delayed or resisted providing the register of members, which has had the effect of delaying or complicating proposals for their replacement.

5.4.4 In addition, there have been disputes as to what information the RE must provide.

5.4.5 The register of members must include the details specified in subsections 169(6A) and (7) of the Act. In practice, MIS member registers often contain additional data including the email addresses of the members, and often the name and email addresses of their financial advisors.

5.4.6 In our view, section 173 of the Act requires that the register of MIS members be provided in the form in which it is kept. If the register 'as kept' includes additional information to that specified in subsections 169(6A) and (7) of the Act, then it should be provided 'as is' including that additional information.

5.4.7 In practice we have seen REs resist providing the register in the form in which it is kept by excluding certain information not required by subsections 169(6A) and (7), in particular email addresses and advisor details. Both these types of information are extremely useful in communicating with members in relation to a replacement RE proposal.

5.4.8 We consider that changes to the law are required to facilitate the effective operation of section 173 and to promote members' ability to exercise their statutory rights.

5.4.9 We submit that section 173 of the Act be clarified to provide that the register should be provided in the form in which it is kept and the copy provided contain all information on the register.

5.4.10 We further submit that subsections 169(6A) and (7) be modified to include a requirement that the register record the members' email address and the name and email address of their financial advisor, if these details are known to the RE.

5.4.11 Finally, we submit that consideration should be given to requiring the RE to lodge copies of the register of members with ASIC at certain specified periods[29], so that members and other persons can obtain the register directly from ASIC and avoid difficulties which may arise in utilising section 173 of the Act. This would also allow ASIC to collect significant data in relation to the membership of MIS and changes in that membership.

5.5 Compensation arrangements

5.5.1 In our experience the regulatory regime intended to ensure there is adequate insurance cover to compensate retail investors in MIS is failing drastically.

5.5.2 In a number of matters in which we have been involved, in particular in relation to trust-based MIS, the inadequacy of professional indemnity insurance cover has effectively precluded action being taken by or on behalf of retail investors in those MIS to recover compensation for substantial losses suffered as a result of potential contraventions of chapter 7 and 5C of the Act, and general law.

5.5.3 We consider that a more prescriptive regime is required, and that ASIC should take a more active role in enforcing it.

5.5.4 This may require ASIC taking a more flexible approach to what is required to be covered under the relevant insurance cover to ensure that sufficient quantum of cover for the majority of losses that may be suffered can be obtained on reasonable commercial terms.

5.5.5 If Reform 4 proposed in chapter 3 of the Discussion Paper is to be considered, let alone implemented, then remedying the current failures of the compensation arrangements regime is critical. Implementation of Reform 4 would see the burden of pursuing an RE who acted beyond power shifted

[29] Lodgement at intervals between monthly and quarterly would be appropriate – the more frequent, the more current the information.

from creditors to members. In circumstances where the insurance cover of the RE is inadequate this would simply reallocate that loss to members without any effective mechanism for recovery.

The regulatory regime

5.5.6 Section 912B of the Act provides that:

> *(1) If a financial services licensee provides a financial service to persons as retail clients, the licensee must have arrangements for compensating those persons for loss or damage suffered because of breaches of the relevant obligations under this Chapter by the licensee or its representatives. The arrangements must meet the requirements of subsection (2).*
>
> *(2) The arrangements must:*
>
> *(a) if the regulations specify requirements that are applicable to all arrangements, or to arrangements of that kind—satisfy those requirements; or*
>
> *(b) be approved in writing by ASIC.*

5.5.7 Regulation 7.6.02AAA of the Regulations provides that:

> *(1) For paragraph 912B (2) (a) of the Act, arrangements mentioned in subsection 912B (1) of the Act are, unless the financial services licensee is an exempt licensee, subject to the requirement that the licensee hold professional indemnity insurance cover that is adequate, having regard to:*
>
> *(a) the licensee's membership of a scheme (or schemes) mentioned in paragraph 912A (2) (b) of the Act, taking account of the maximum liability that has, realistically, some potential to arise in connection with:*
>
> *(i) any particular claim against the licensee; and*
>
> *(ii) all claims in respect of which the licensee could be found to have liability; and*
>
> *(b) relevant considerations in relation to the financial services business carried on by the licensee, including:*
>
> *(i) the volume of business; and*
>
> *(ii) the number and kind of clients; and*
>
> *(iii) the kind, or kinds, of business; and*
>
> *(iv) the number of representatives of the licensee.*

5.5.8 Essentially, as a financial service provider and holder of an AFSL, an RE must hold professional indemnity insurance cover that is 'adequate' with regard to nature, scale and complexity of their business, and their other financial resources[30].

5.5.9 As stipulated in ASIC regulatory Guide 126[31] (**RG 126**):

> *…it is up to each licensee to determine what is adequate PI insurance for them to meet their obligations under s912B and obtain such PI insurance.*
>
> …
>
> *ASIC will not 'approve' a licensee's PI insurance arrangements.*

5.5.10 ASIC RG 126 provides the following guidance on the minimum requirements:

Amount of Cover	***Minimum requirement:*** *We consider that, to be adequate, a PI insurance policy must have a limit of at least $2 million for any one claim and in the aggregate for licensees with total revenue from financial services provided to retail clients of $2 million or less. For*

[30] See ASIC Regulatory Guide 126 (**RG 126**) at 126.61.
[31] RG 126 at 126.61-2.

licensees with total revenue from financial services provided to retail clients greater than $2 million, minimum cover should be approximately equal to actual or expected revenue from financial services provided to retail clients (up to a maximum limit of $20 million).

5.5.11 The onus of compliance with section 912B rests with the RE, and the adequacy of their cover, as required by regulation 7.6.02AAA(1), is a matter of the RE's subjective assessment. It is, essentially, a system of self-regulation.

Current problems and required response

5.5.12 In our experience, this 'self-regulation' is not working. We have observed REs with only the minimum of $2 million prescribed by RG 126, irrespective of the nature, scale or complexity of their business and the risks attached to it. In our opinion, in certain of these cases, that cover was grossly inadequate.

5.5.13 More problematic is the fact that this inadequacy is only being identified in circumstances where losses have been incurred and/or the RE has failed. By this time, it is too late.

5.5.14 In addition, the guidance in RG 126 regarding amount of cover is based on expected or actual revenue, not funds under management. In respect of MIS, where revenue is often a small proportion of the net assets or invested capital, this is of limited relevance where actions of the RE can place significant amounts of the net assets or invested capital at risk, and substantial losses suffered.

5.5.15 We submit that a more prescriptive approach coupled with a policy of proactive assessment by ASIC is warranted to address these issues and to identify inadequacy in advance of losses being incurred.

5.5.16 In addition, we note that commercial constraints can contribute to the cover obtained by REs. In this respect, it is important to consider whether ASIC's policy of requiring professional indemnity cover for fraud may have a counterproductive effect. Inclusion of fraud cover significantly increases premium expense and could be resulting in REs obtaining lower quantum in order to afford fraud cover. We consider this issue requires further consideration in any reform of the compensation arrangements regime.

Schedule 1 – Cases

Proceeding	Brief Description
Non-agricultural scheme related cases	
NSW Supreme Court No. 1344 of 2009	**ANZ CASH PLUS FUND – Frozen Funds** ***ING Funds Management Ltd v ANZ Nominees Ltd; ING Funds Management Ltd v Professional Associations Superannuation Ltd [2009] NSWSC 243*** Amendment to scheme constitution to freeze funds set aside as it was found that the amendment "*adversely affect[s] the rights of members of the fund*" in contravention of section 601GC of the *Corporations Act 2001* (Cth) (**Act**).
VIC Supreme Court SCI 2010 4565	**BECTON – Removal of Responsible Entity** ***Lachlan Reit Limited v Garnaut & Ors [2010] VSC 399 (6 September 2010)*** Members of managed investment schemes called a meeting to replace a financially distressed responsible entity (**RE**). The RE applied for an injunction to prevent the meetings.
Timbercorp agricultural scheme related cases	
VIC Supreme Court No. 7114 of 2009	**TIMBERCORP ALMOND & OLIVE SCHEMES – Application to wind up** ***Re Timbercorp Securities Limited (in liq) (No 2) [2009] VSC 411 (14 September 2009)*** The Timbercorp Growers Group, representative of members' interests in the various Timbercorp almond and olive managed investment schemes (**Schemes**) successfully opposed the application made by the Liquidators in the Victorian Supreme Court to wind up the Schemes.
VIC Supreme Court No. 9408 of 2009	**TIMBERCORP ALMOND SCHEMES – Directions regarding sale of assets** ***Re Timbercorp Securities Ltd (in liq) (No 3) [2009] VSC 510 (8 October 2009)*** The Supreme Court of Victoria allowed entry into the sale of almond assets on the basis that funds received from the sale would be placed into a separate account, and a separate proceeding then be commenced to decide the appropriate apportionment.
VIC Supreme Court SCI 2009 10699	**TIMBERCORP ALMONDS APPORTIONMENT – Rights Proceeding** ***BOSI Security Services Limited v Australia and New Zealand Banking Group Limited & Ors [2011] VSC 255 (15 June 2011)*** An application in the Supreme Court of Victoria made by the Liquidators of Timbercorp Securities Ltd (**TSL**) for directions regarding the apportionment of the net sale proceeds between the Growers and Secured Creditors of the sale of almond assets to Olam. Davies J found against the Growers.
VIC Appeals Court S APCI 2011 0103	**TIMBERCORP ALMONDS APPORTIONMENT - Appeal** ***IN PROGRESS - GRAHAM GOLDBERG & Ors v BOSI SECURITY SERVICES LIMITED & Ors*** This is an appeal against the decision of Davies J in the case above.
VIC Supreme Court SCI 2009 10382	**TIMBERCORP TPIF ALMONDS APPORTIONMENT** ***IN PROGRESS - Re Timbercorp Securities Limited (in liq) [2009] VSC 590 (11 December 2009)*** An application in the Supreme Court of Victoria made by the Liquidators of TSL, the RE of the almond schemes, in relation to the apportionment of the proceeds of sale from the Timbercorp almond scheme assets.
VIC Supreme Court SCI 2010 1354	**TIMBERCORP OLIVE SCHEMES – Olives Apportionment** ***IN PROGRESS – Bosi Security Services Limited 9ACN 009 413 852) (as Trustee for Australia and New Zealand Banking Group Limited (ACN 005 357 522) and BOS International (Australia) Limited (ACN 066 601 250) and Westpac Banking Corporation (ACN 007 457 141) v BB Olives Pty Ltd (in liq) (ACN 083 992 367) and ors*** An application in the Supreme Court of Victoria made by the Liquidators of TSL, the RE of the olive schemes, in relation to the apportionment of the proceeds of sale from the Timbercorp olive scheme assets.

Proceeding	Brief Description
VIC Supreme Court **SCI 2010 398**	**TIMBERCORP CITRUS SCHEMES – Citrus Apportionment** ***IN PROGRESS - Re Timbercorp Securities Limited (in liq) [2010] VSC 50 (26 February 2010)*** An application in the Supreme Court of Victoria made by the Liquidators of TSL for directions regarding the sale of the Solora citrus assets.
VIC Supreme Court **SCI 2011 888**	**TIMBERCORP CITRUS SALE - Kangara Assets** ***IN PROGRESS - Re Timbercorp Securities Limited (in liq) [2011] VSC 83 (15 March 2011)*** An application in the Supreme Court of Victoria made by the Liquidators for directions pursuant to section 511 of the Act regarding the sale of the non-Solara citrus assets.
VIC Supreme Court **SCI 2010 07029**	**TABLE GRAPES - Table Grapes Sale** ***IN PROGRESS - Re Timbercorp Securities Limited (in liq) (No 4) [2011] VSC 24 (7 February 2011)*** An application in the Supreme Court of Victoria brought by the Liquidators of TSL pursuant to section 511 of the Act regarding the sale of land and water rights relating to the Timbercorp table grape schemes.
Federal Court (VIC) **VID 497 of 2009**	**TIMBERCORP FORESTRY – Injunction and disclaiming leases** ***Timbercorp Securities Limited (in liq) v Plantation Land Limited [2009] FCA 741 (10 July 2009)*** The Federal Court of Australia ruled that the leasing obligations of Timbercorp Limited, incurred prior to the its collapse, were not expenses that the Liquidators had to pay in priority to other creditors' claims. The Liquidators, were therefore, not forced to disclaim or terminate the Timbercorp leases, which may have adversely affected Growers.
Federal Court (VIC) **VID 541 of 2009**	**TIMBERCORP FORESTRY – Extension of time** ***Timbercorp Securities Limited (in liq) v WA Chip & Pulp Co Pty Ltd [2009] FCA 901 (18 August 2009)*** An application made to the Federal Court of Australia seeking further time in which to respond to notices served under subsection 568(8)(b) of the Act.
Federal Court (VIC) **VID 595 of 2009**	**TIMBERCORP FORESTRY – Implementation of SPD** ***Commonwealth Bank of Australia v Fernandez [2010] FCA 1487*** An application by TSL (In Liquidation) for the Liquidators of TSL to seek a power of sale to enable the implementation of the sale/recapitalisation strategy.
VIC Supreme Court **No. 8870 of 2009**	**TIMBERCORP - Termination of Lease / Relief Against Forfeiture** An application in the Supreme Court of Victoria by TSL (In Liquidation) for relief from forfeiture due to the purported termination of leases by Plantation Land Limited. The matter was settled out of court.
Great Southern agricultural scheme related cases	
VIC Supreme Court **No. 8169 of 2009**	**GREAT SOUTHERN – Lien** ***Re Great Southern Managers (Australia) Limited (No 1) [2009] VSC 642 (19 August 2009)*** A proceeding concerning the indemnity granted in the earlier proceeding no. 6861 of 2009, which is supported by an equitable lien over the trees, olives, grapes or almonds and any resultant sale proceeds. The proceeding was to determine the scope of the lien supporting this indemnity.
VIC Supreme Court **SCI 2009 10266**	**GREAT SOUTHERN – Notice of Meeting** ***Re Great Southern Managers Australia Limited (rec's & m'gers app'td) (in liq) [2009] VSC 557 (4 December 2009)*** A proceeding brought by the Receivers & Managers of the RE seeking directions it was justified in putting Gunns' proposal for certain schemes to meetings of Growers.

Proceeding	Brief Description
VIC Supreme Court **SCI 2009 10745**	**GREAT SOUTHERN – Approval of Implementation** ***Re Great Southern Managers Australia Limited (recs & mgers app't) (in liq) [2009] VSC 627 (31 December 2009)*** A proceeding brought by the Receivers & Managers of the RE to seek approval of the implementation of the resolutions passed by Growers at the meetings.
VIC Supreme Court **SCI 2010 07069**	**GREAT SOUTHERN – Termination of Leases / Relief Against Forfeiture** ***Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq) & Ors [2011] VSC 242 (8 June 2011)*** A proceeding brought by Primary RE Limited (**Primary**), the replacement RE of the Great Southern Plantations 2007 scheme, against various landowning entities in the Great Southern Group and their Receivers/Receivers and Managers. Primary sought declarations that the termination of leases between the former RE, Great Southern Managers Australia Limited, and the landowning entities, was invalid and the leases remained valid and enforceable, and in the alternative relief from forfeiture of those leases. This relief was claimed to allow the scheme to continue. Justice Judd held that the terminations were valid and that Primary had no standing to seek relief from forfeiture, as this right did not novate under section 601FS of the Act. Accordingly relief from forfeiture was not granted. Primary RE Ltd elected not to appeal.
VIC Supreme Court **SCI 2011 00725**	**GREAT SOUTHERN – Removal of Caveats** ***Great Southern Property Holdings Limited v Primary RE Limited & Anor. Heard with Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq) & Ors [2011] VSC 242 (8 June 2011)*** An application by Great Southern Property Holdings Limited for the removal of caveats lodged by Primary RE Ltd to protect equitable leases it claimed by virtue of the invalid termination of the leases subject of proceeding SCI 2010 07069. This proceeding was heard with proceeding SCI 2010 07069 and judgment delivered in favour of the plaintiff.
TAS Supreme Court **TAS SC 91 OF 2011**	**GREAT SOUTHERN –** ***Great Southern Property Holdings Limited v Primary RE Limited & Anor*** A further application by Great Southern Property Holdings Limited for the removal of caveats lodged by Primary RE Ltd to protect equitable leases it claimed by virtue of the invalid termination of the leases subject of proceeding SCI 2010 07069. This proceeding was discontinued with the parties' consent following judgment in proceeding SCI 2010 07069 and Primary RE Ltd's withdrawal of the relevant caveats.
WA Supreme Court **COR 35 of 2010**	**GREAT SOUTHERN – Olives Apportionment** ***Great Southern Managers Australia Ltd (IN LIQ) in its capacity as responsible entity of various managed investment schemes v Thackray [2010] WASC 138 (15 June 2010)*** An application by Growers applied to the Supreme Court of Western Australia for apportionment of sale proceeds of scheme assets. The application was withdrawn by consent.
VIC Supreme Court **SCI 2010 6155**	**HVT SCHEMES** ***In the matter of Lowell Capital Limited*** The RE is seeking judicial approval of reconstructed plantation schemes previously run by Great Southern Limited.
Rewards agricultural scheme related cases	
WA Supreme Court **COR 104 of 2010**	**REWARDS MANAGED INVESTMENT SCHEMES** ***Rewards Land Pty Ltd (Administrators appointed) (Receivers and Managers appointed) v Martin Bruce Jones, Andrew John Sake and Darren Gordon Weaver in their capacity as joint and several administrators of Rewards Projects Ltd and others [2010] WASC 233 (2 September 2010)*** A dispute over the right of Rewards Land Pty Ltd and ARK to possession of leased properties. The Administrators submitted that if the plaintiffs retake possession of the leased lands it will be practically impossible for the administrators of Rewards Projects to propound a deed of company arrangement that will enable the schemes to continue in some form. The plaintiffs submitted that the evidence in support of that contention was insufficient.

Proceeding	Brief Description
FEA agricultural scheme related cases	
Federal Court (VIC) **VID 283 2010**	**FEA SCHEMES – Scheme Property** ***Silvia v Fea Carbon Pty Ltd (ACN 009 505 195) (Administrators Appointed) (Receivers and Managers Appointed) [2010] FCA 515 (30 April 2010)*** Clarendon Lawyers acted for the FEA Growers Group in an application by the Administrators of FEA Plantations Limited (**Administrators**) in the Federal Court of Australia for orders regarding clarification of the scope of property included in the administration.
Federal Court (VIC) **VID 349 2010**	**FEA SCHEMES – Meetings** ***Silvia, in the matter of FEA Plantations Ltd (Administrators Appointed) [2010] FCA 468 (12 May 2010)*** Clarendon Lawyers acted for the FEA Growers Group in an application by the Administrators in the Federal Court of Australia for orders extending the time to hold creditors meetings.
Federal Court (VIC) **VID 555 2010**	**FEA SCHEMES – External Leases** ***Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers & Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) [2010] FCA 1274 (18 November 2010)*** Clarendon Lawyers acted for the FEA Growers Group in resisting an application made by the Receivers of FEA Plantations Limited in the Federal Court of Australia to terminate external leases on plantation land. This application was dismissed.
Federal Court (VIC) **VID 692 2010**	**FEA SCHEMES – Internal Leases** ***Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers & Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) (No 3) [2011] FCA 624 (3 June 2011)*** Clarendon Lawyers acted for the FEA Growers Group in resisting an application made by the Receivers of FEA Plantations Ltd in the Federal Court of Australia for termination of internal leases on plantation land. The application was dismissed in part (the Receivers have appealed in VID 1179 2010).
Federal Court (VIC) **VID 1179 of 2010**	**FEA SCHEMES – Appeal** ***Norman; in the matter of Forest Enterprises Limited v FEA Plantations Limited [2011] FCAFC 99 (9 August 2011)*** Clarendon Lawyers acted for the FEA Growers Group in opposing the appeal by the Receivers of FEA Plantations Ltd in the Full Court of the Federal Court of Australia against the judgement made in VID 692 2010. Judgment is anticipated to be made in late 2011.
Willmott agricultural scheme related cases	
Federal Court (VIC) **VID 836 of 2010**	**WILLMOTT SCHEMES – Removal of Administrator** ***Commonwealth Bank of Australia v Fernandez [2010] FCA 1487*** Application by secured creditor, Commonwealth Bank of Australia, for removal of administrator A T Fernandez and appointment of Messrs I Carson and C Crosbie in his place as administrator of Willmott Forests Limited. Clarendon Lawyers acted for the Willmott Growers Group Inc (**WGG**) and appeared in support of the CBA's application. The court granted the application and removed Mr Fernandez appointing Messrs Carson and Crosbie in his place.
Federal Court (VIC) **VID 386 of 2011**	**WILLMOTT SCHEMES – Approval of Amendments to Constitutions** ***Re Willmott Forests Limited (receivers and managers appointed) (in liquidation)*** Clarendon Lawyers acted for WGG, an Intervener in the Liquidators' application in the Federal Court of Australia seeking various directions pursuant to s 511 of the Corporations Act, including that they are justified in procuring the RE of the Willmott schemes to amend scheme constitutions and disclaiming the Project Documents as being onerous. The application was granted, subject to the requirement that the Liquidators must obtain Court approval prior to exercising their rights. It is anticipated that the Liquidators will make further application to the Court towards the completion of their sale process of land on which the Willmott schemes were conducted.

Proceeding	Brief Description
<u>Supreme Court (VIC)</u> **SCI 3155 of 2011**	**<u>WILLMOTT SCHEMES – Injunction Against Voting on Constitutional Amendments</u>** ***IN PROGRESS - Willmott Forests Limited (receivers and managers appointed) (in liquidation) & Ors v Grimsey Financial Services Pty Ltd & Ors*** Willmott Forests Limited (**WFL**) in its personal capacity and its receivers and managers brought proceedings seeking permanent injunctions restraining the defendants from putting to Growers resolutions for the removal of WFL as RE of the Willmott Forests 1995-1999 Project and implementation of a proposal for restructure and continuation of the scheme. The plaintiffs claimed certain proposed amendments to the project constitution to implement the proposal would affect a fraud on the minority of Growers who cannot or will not contribute to a reconstituted scheme. Clarendon Lawyers acted for the defendants (WGG and the attorneys of the requisitioning members or persons associated with them). The application was supported by the Liquidators of WFL. After an interlocutory hearing injunctions were granted on an interlocutory basis until further order with trial of the matter to commence 14 December 2011.

Schedule 2 – Observations on failed agricultural MIS

Observations on external administration of failed agricultural MIS

1.1. Overview

1.1.1. Different methods have been adopted to manage the insolvency of agricultural MIS by insolvency practitioners acting for secured creditors of corporate groups which operate agricultural MIS.

1.2. Timbercorp Group

1.2.1. The directors of Timbercorp Limited appointed administrators to the Timbercorp Group of companies. Within that group there were various companies with different roles, ie, a finance company which made loans to investors, land owning companies which owned land upon which schemes were operated, a responsible entity (**RE**) holding an AFSL which acted as responsible entity for registered schemes and service entities which provided services to the schemes. There were also a few unregistered schemes of which the responsible entity was trustee/manager/responsible entity. The responsible entity was Timbercorp Securities Limited.

1.2.2. The creditors of the Timbercorp Group appointed the administrators as liquidators. Subsequently, the liquidators sought to wind up the schemes. Applications were made in the Federal Court of Australia for forestry schemes and in the Supreme Court of Victoria for almond and olive schemes.

1.2.3. A growers' group known as Timbercorp Growers Group intervened and opposed the application to wind up the schemes.

1.2.4. Eventually, the Court made an order that the responsible entity have power to amend the constitutions of the schemes to cancel growers' rights to enable the assets to be sold – land and improvements, in return for the right to make claims against the sale proceeds in apportionment cases.

1.2.5. In the case of forestry, the Federal Court of Australia made a similar order and the forestry assets were sold. The purchase price was apportioned in the contract of sale between land and trees, with the proceeds of the land going to the secured creditors and the proceeds of the sale of the trees going to scheme members.

1.2.6. In the case of some of the almond schemes, an apportionment case has been completed with the secured creditors being awarded an entitlement to all of the proceeds of scheme assets. That decision is currently being appealed against by the growers. There are still to be apportionment cases heard in relation to the balance of the almonds, the olive schemes and the citrus schemes.

1.2.7. The significant feature of the Timbercorp insolvency is that the liquidator of the Timbercorp land owning companies which owned the land upon which the schemes were conducted and the liquidators of the responsible entity were the same person. The secured creditors never appointed receivers over any of the entities.

1.2.8. There were head leases between the Timbercorp land owning company and the responsible entity, which, in turn, granted either licences or subleases to scheme members.

1.2.9. No steps were taken by the landowning companies to terminate the head leases or by the responsible entity to terminate the licences or the subleases. The liquidator may have refrained from taking either of these steps conscious of his obligations under subsection 601FD(1)(c) of the *Corporations Act 2001* (**Act**) to act in the best interests of scheme members and to prefer the interests of scheme members to those of any others.

1.2.10. The original intention of the Timbercorp Growers Group was to replace the RE for some or all of the schemes. The group approached ASIC and requested it to make an application to the Court for the appointment of a temporary RE. ASIC refused to undertake this course on the grounds that it might lead to the eventual winding up of the schemes.

1.2.11. A number of the schemes were viable and it would have been in the interests of the members in those schemes for the schemes to continue. Regardless of whether the schemes were viable, members who made substantial investments in the schemes, many of whom continue to have borrowings to fund those investments, have lost their investments through no fault of their own in order to maximise the recovery by the secured creditors of the land owning companies.

1.3. Great Southern

1.3.1. The Great Southern insolvency took a different route to Timbercorp with both receivers and administrators appointed. The secured creditors appointed the receivers over the RE and exercised the function of the RE. It was recognised in court that their control of the RE was based on the right of a receiver to do what is necessary or incidental to enforcing its security. In our view, this placed the receivers in a position of gross conflict in duties.

1.3.2. In preparation for the sale of the land, the secured creditors amended the appointment of the receivers to effectively retire from the RE. Within days, the receivers had issued default notices and then termination notices on the RE towards an eventual sale of the land.

1.4. Rewards Group

1.4.1. An active growers group promoted a deed of company arrangement for group entities working with the liquidators, but the secured creditors appointed receivers to all entities other than the RE and served lease termination notices.

1.4.2. The deed of company arrangement proposed to pay out the secured creditors in full, but despite this, the secured creditors rejected the arrangement and instead have undertaken their own sale process, which may or may not result in the secured creditors being paid out. The strategy of the secured creditors has been to rid the land of the interests of the growers so that they can sell free, unencumbered title to the purchasers.

1.4.3. At one stage the Rewards growers were contemplating applying to the Court for the appointment of a RE. However, the responsible entities who were approached to take on the role all raised the issue referred to in part 4.4.2 of the discussion paper, namely they were uncertain whether section 601FS of the Act would result in them being personally liable for scheme liabilities beyond the extent to which they could be indemnified from the assets of the scheme.

1.4.4. One potential replacement RE approached ASIC to exercise its discretion under part 5C.11 of the Corporations Act to make a modification order to ensure that the RE would not be personally liable, but ASIC refused to grant the modification. Had the modification order been granted, it is likely that a new RE would have been appointed and the RE would have negotiated with the secured creditors who could still realise the land subject to the rights of the tenant RE.

1.5. FEA

1.5.1. At no time have the receivers of the FEA companies asserted control over the RE. However, the receivers have claimed that monies received by the RE under the contract-based schemes are the property of the RE in its personal capacity rather than scheme property.

1.5.2. The totally inadequate documentation within the FEA group has led to so much uncertainty of the rights and liabilities of the companies of the failed group, that it has been impossible for a new RE to agree to an appointment until these uncertainties are resolved.

1.6. Willmott

1.6.1. In the Willmott insolvency, liquidators and receivers have been appointed over entities within the Willmott group of companies, included Willmott Forests Ltd (**WFL**), the RE of the Willmott Schemes. In this case, WFL also holds the legal title to a significant proportion of scheme land in its personal capacity, which it has leased directly to growers. We note that on the basis of expert evidence procured by the Willmott Group, it appears that a number of the plantations in the Willmott schemes are likely to be viable.

1.6.2. Willmott Growers Group Inc (**WGG**), an active growers group of growers in the Willmott schemes has sought to implement a proposal to replace the RE of the Willmott Forests 1995-1999 Project, which it considers viable, by seeking to convert the scheme from a non-contributory to a contributory scheme. However, the liquidators and receivers of WFL instituted separate legal actions which have to date prevented the WGG from effecting proposals to reconstitute potentially viable schemes.

1.6.3. In May 2011, the liquidators of WFL applied to the Federal Court for directions pursuant to section 511 of the Corporations Act that they are justified in procuring WFL to amend the constitutions of the managed investment schemes and disclaim the Project Documents of the schemes as onerous. In effect, the liquidators sought orders to facilitate the unencumbered sale of Willmott land in winding up the Willmott schemes, subject to preserving the growers' entitlements to sale proceeds attributable to the termination of their rights. The Court granted the liquidators' application, subject to the requirement that the liquidators must obtain leave of the Court prior to exercising its powers to disclaim Project Documents.

1.6.4. In June 2011, the receivers of WFL applied to the Supreme Court of Victoria seeking an interim and final injunction against WGG and other parties from passing resolutions that would affect WGG's proposal. The substantive matter is based on an allegation that elements of the WGG proposal constitute a fraud on a minority of scheme members who are unable or unwilling to make further contributions to the scheme. The interim injunction was granted and subsequently extended on an interlocutory basis until the matter is tried, which will be at least December 2011.

1.6.5. The liquidators commenced its sales process relating to the Willmott schemes land, starting with an Expressions of Interest campaign. It is likely that the sales process will conclude before the receivers' injunction can be lifted, which may have the effect of preventing growers of the 1995-1999 Project from implementing its (or any) proposal to continue the scheme. The conclusion of the sales process will also prevent any other groups of growers from continuing their schemes, restricting their rights to the apportionment of the proceeds to the sales process attributable to the termination of their rights.

In the matter of the Managed Investment Schemes Discussion Paper dated June 2011

SUBMISSION TO REVIEW

1. The authors of this submission have acted for Growers in litigation arising out of the Great Southern, Timbercorp, Willmot and FEA managed investment schemes and the submission contained in this document are shaped by those experiences. Mr Bigmore QC, whose views are also represented in this submission, has also acted for Growers in the Environinvest MISs.

2. The submission responds to the matters raised in the Corporations and Markets Advisory Committee's Managed Investment Schemes Discussion Paper ("the Discussion Paper"), but does not necessarily respond directly to each of the proposed reforms or questions set out in the Discussion Paper.

3. The Discussion Paper notes that "…a number of high profile managed investment schemes (MISs) and their responsible entitles (REs) has highlighted the legal difficulties that can arise where this form of investment or entrepreneurial structure suffers financial stress". It also acknowledges the "…wider need to review the MIS legislative framework under Chapter 5C of the *Corporations Act* 2001 ("CA"), to make it workable and relevant…". The authors of this submission agree with this perspective from which the Discussion Paper starts.

4. The ultimate winding up of MISs causes significant financial loss to many people. There is a risk that the legal framework is preventing viable managed investment schemes from surviving because of the financial stress of an RE. This appears to particularly be the case in respect of managed investment schemes that have "multi-function REs". The failure

of such schemes not only cost investors, but also creditors, which are denied the benefits of a viable managed investment scheme carrying on under a new RE.

5. In our view, the following should be considered in the current review of Chapter 5C of the CA:

   (a) the appointment of a receiver to a scheme in which the RE is under external insolvency administration modelled on a court appointed receiver to a trust (relevant to Part 5 of the Discussion Paper);

   (b) limiting of the operation of s 601FS so that a temporary RE is only liable for the debts that it incurs during the course of its appointment as temporary RE, possibly modelled on the liability of company administrators and liquidators (relevant to Part 4 of the Discussion Paper);

   (c) further or alternatively to (b), considering a change in ASIC policy with respect to exemptions granted under s 601QA to the operation of s 601FS;

   (d) clarification of operation of s 601FS, particularly in relation to the ability of a temporary or replacement RE to seek relief from forfeiture of a lease terminated prior to its appointment;

   (e) clarifying the duties imposed on officers of a company under s 601FD, and particularly on Receivers; and

   (f) clarifying the impact of disclaimer on leases.

The appointment of a receiver to a scheme in which the RE is under external insolvency administration modelled on a court appointed receiver to a trust

6. One source of concern for Growers in the recently collapsed schemes has been the perception of a conflict of interests between the duties that a Liquidator holds to the RE's creditors and the Liquidator's duties to

Growers in his or her capacity as an officer of the RE of the various schemes.

7. Another source of concern for Growers has been the perception that the Liquidators appointed to the various insolvent REs have considered the viability of all schemes together and have not adequately considered the solvency of each scheme separately.

8. In Mr Bigmore QC's view, this conflict can be addressed by the Court appointing a receiver to each scheme if and when the RE is made insolvent, on the basis that a MIS is a trust. This:

(a) avoids the perceived conflict of interests between duties to investors and duties to creditors;

(b) allows the receiver to determine the viability of each individual scheme; and

(c) facilitates independent evaluation of scheme viability; but

(d) provides limited protection to the receiver; and

(e) is not a perfect solution.

Limiting of the operation of s 601FS so that a temporary RE is only liable for the debts that it incurs during the course of its appointment as temporary RE.

9. In *BOSI v ANZ*, one of the main issues in determining the value of the Growers' rights was whether a replacement RE could be found.

10. In the lead-up to the first fund created by Robson J in October 2009, there were a number of factors at play:

(a) TSL's liquidators had limited funds available to maintain the various plantations, so there was pressure to find a quick resolution;

(b) the Banks were, presumably, applying pressure to the Liquidators to effect a quick sale;

(c) the Growers are a disparate group of investors with limited resources available. Co-ordinating those Growers and rallying their resources was a time-consuming process;

(d) a number of potential replacement REs expressed interest in various schemes, particularly the various olive and almond schemes;

(e) however, TSL had incurred significant liabilities to the banks in the lead-up to TSL's liquidation;

(f) the extent of those liabilities was not clear, nor was it clear (at least around June 2009) whether the replacement RE would be liable for those debts under s 601FS, a fact exploited by the Banks at trial;

(g) there was limited evidence available as to the solvency of the schemes. The Growers had produced some material suggesting that some or all of the schemes were viable. However, the Liquidators' reports suggested that the schemes were not viable (albeit that they were shown to be unreliable reports);

(h) two of the potential replacement REs applied to ASIC for an exemption from the operation of s 601FS. However, there was evidence at the trial that ASIC refused to grant that exemption, and that it would not, as a matter of policy, approve an exemption under that section;

(i) the decision in of R D Nicholson J in *Syncap Management (Rural) Australia Ltd v Lyford* (2004) 51 ACSR 223 was (and still remains) unchallenged.

11. The first issue is the operation of s 601FS with respect to temporary REs.

12. It appears from the structure of Chapter 5C that the device of temporary RE was designed (at least in part) to allow investors to temporarily appoint a replacement RE in order to salvage a viable scheme when faced with an insolvent RE (see p. 43 of the Discussion Paper).

13. However, s 601FS appears to operate with full force against a temporary RE, meaning that the temporary RE may be exposed to a claim for the debts that made the former RE insolvent. For obvious reasons, this makes a potential temporary RE wary.

14. Generally, under trust law, where a trustee lacks capacity to perform its role as trustee, the trust does not fail and a new trustee is found. The liabilities incurred remain the previous trustee's liabilities, even after it ceases to hold the office as trustee. The previous trustee has a right to be indemnified in respect of liabilities that it has properly incurred. The Discussion Paper notes at page 29 that this affords protection to beneficiaries of the trust, but goes on to suggest that it also may operate in a way that constitutes a diminution of creditor rights.

15. This may partly explain the reasoning behind s 601FS. Further it may be understandable that such a framework apply to a new RE given "the nature of many commercially based MISs" (see page 29 of the Discussion Paper). However, whilst s 601FS applies to temporary REs, there is limited or no ability for a managed investment scheme to make a fresh start when its RE finds itself in financial stress.

16. In practice, it would appear that, unlike a traditional trust, a managed investment scheme will most likely fail if its RE fails. In respect of viable managed investment schemes, this is a bad result for investors and creditors alike.

17. If s 601FS could be limited to operate only on a permanent replacement RE but not on a temporary RE, then the Growers' limited resources could be applied to underwriting a temporary RE, particularly the costs of maintaining the plantations, while it determined whether the schemes

were viable with full access to the relevant material. It could then determine, in a relatively risk-free environment, whether the schemes were viable and whether it (or any other potential replacement RE) wanted to be appointed permanently to the schemes.

18. The *Syncap* decision highlights the risks faced by a temporary RE, as the broad interpretation of 'in relation to the scheme' could make the temporary RE significantly exposed. The evidence in the *BOSI v ANZ* case suggested that the potential replacement RE was, at least in June 2009, concerned about the operation of that decision and that it presented a potential impediment to its appointment as a permanent replacement RE. Again, excluding temporary REs from the operation of s 601FS would facilitate the rapid appointment of a temporary RE.

Further or alternatively, considering a change in ASIC policy with respect to exemptions granted under s 601QA to the operation of s 601FS.

19. In the *BOSI v ANZ* case, one of the proposed replacement REs sought from ASIC but did not receive exemption under s 601QA from the operation of s 601FS. There was evidence that ASIC has a policy of not granting exemptions in those circumstances. This presents an additional barrier to the reconstruction of an otherwise viable MIS.

20. A change to this policy should be considered as an alternative to excluding temporary REs from the operation of s 601FS.

Clarification of operation of s 601FS, particularly in relation to the ability of a temporary or replacement RE to seek relief from forfeiture of a lease terminated prior to its appointment.

21. Despite the amount of litigation on s 601FS, its precise operation is not entirely clear.

22. The issue that is most significant for the reconstruction of MISs is whether the new RE has a right to seek relief against forfeiture of a terminated head lease.

23. In *Primary RE v Great Southern*, Judd J in the Victorian Supreme Court held that the right to seek relief against forfeiture under s 146 of the *Property Law Act 1958 (Vic)* was not capable of being assigned, so could not be used by a new RE to revive terminated leases. The Court did not consider the effect of s 601FS on the ability to seek relief from forfeiture under the Court's general equitable jurisdiction. It is, with respect, difficult to see how that finding is consistent with both the words and the apparent intention of s 601FS and with the decisions in *Syncap* and *Re Investa*.

24. However, if that decision is correct, Growers seeking to reconstruct an otherwise viable MIS face the following hurdles:

    (a) insolvent REs are often in significant rental arrears;

    (b) many have fallen behind in maintenance obligations under their leases, leading to allegations of wasting crops in fruit or nut schemes and fire hazards in forestry schemes, usually giving the RE's landlord the ability to terminate the lease;

    (c) the insolvency administration of the former RE often also gives the RE's landlord the ability to terminate the lease;

    (d) it takes time to:

        i. rally the Growers' resources to fund litigation;

        ii. locate a replacement RE; and

        iii. call a meeting of members;

    (e) this places an extra strain on the Growers when the collapse of the schemes already places an extraordinary strain on many of the Growers' resources;

(f) if the replacement RE cannot seek relief from forfeiture, then the Growers need to ensure that they appoint the RE before the head leases are terminated;

(g) if receivers are appointed to land owning companies (or those with leasehold estates above the RE in the chain of title), then the termination of those head leases means the receivers can sell the land unencumbered by the MISs and the Growers' rights. Charge holders usually do not face the same difficulties in rallying their resources and co-ordinating their members; and

(h) this creates a 'race' to terminate the RE's lease and extinguish the Growers' rights before a new RE can be appointed.

25. Secondly, it is not clear whether the section is intended to cause an assignment of existing rights or a form of novation, or even something different again from assignment or novation. His Honour Justice Judd in *Primary RE v Great Southern* treated the section as assigning rights. However, other decisions have described the section as novating rights. Perhaps it is unhelpful to consider the operation of s 601FS within either the operation of assignment or novation.

26. One potential area of significance is the impact on sub-leases. Most of the Growers' rights in agricultural MISs are secured by sub-leases granted by the RE. If s 601FS assigns the head lease to the new RE, then the sub-leases survive. However, novation is a concept that has arisen out of contract law and which involves the old contract being discharged and replaced by a new contract. If s 601FS is a form of novation, then (on one view) the head lease in the hands of the old RE is extinguished and a new head lease is created in the hands of the new RE. In those circumstances, it is not clear whether the Growers' sub-leases would survive the novation. We are not aware of this argument having been tested.

27. In addition, a significant amount of argument in the *Primary RE* case was devoted to the question of whether an equitable cause of action is capable

of assignment, or whether that cause is personal to the former RE. As the case unfolded, Judd J was not required to rule on that argument, so it appears that the issue remains alive.

28. One solution may be to clarify that s 601FS gives the new RE (or its creditors) a statutory cause of action under s 601FS. This avoids the need to invoke the fictions of either a novation or assignment. Instead, all that needs to be established is:

(a) a right, obligation or liability in relation to the scheme; and

(b) the appointment of a new RE.

29. This approach is consistent with Barrett J's finding in *Re Investa Properties Ltd* and Rares J's finding in *Huntley Management Limited v Timbercorp Securities Limited*, that ss 601FS and 601FT are designed to allow the new RE to '*step into the shoes*' of the old RE.

30. If you require further submissions or discussion on this topic, please contact Mr Hopper.

Clarifying the duties imposed on officers of a company under s 601FD, and particularly on Receivers.

31. In *Norman Re Forest Enterprises Australia Ltd (admin apptd) (recs and mgrs apptd) v FEA Plantations Ltd (admin apptd) (recs apptd)* (2010) 191 FCR 39, Finkelstein J rejected Mr Bigmore QC and Mr Hopper's submission that receivers appointed to the RE were officers of the RE and were subject to duties to the investors under s 601FD. This was also rejected (albeit in the swiftest of terms and in extraordinary circumstances) by the Full Court in *Norman; Re Forest Enterprises Ltd v FEA Plantation Ltd* (2011) 280 ALR 470.

32. Those decisions, with respect, do not accord with the clear words of the statute, that include receivers as officers of the RE company, who are caught by s 601FD.

33. The potential for conflict between the interests of the Growers and the interests of the appointing charge holders is obvious, particularly in circumstances where:

(a) the receivers, as officers of the RE, will have access to more information about the viablility of the schemes and the debts inherited by a replacement RE than would be easily available to either the investors or a potential replacement RE;

(b) a temporary RE risks liability for the debts that made the former RE insolvent;

(c) a replacement RE may not be able to seek relief from forfeiture;

(d) the receivers (as happened in the FEA case) may also be appointed to the landholding companies, so have the power to terminate head leases and, in so doing, extinguish the Growers' rights.

34. In our view, there is good reason to impose s 601FD duties on all officers of the RE, including receivers appointed in another capacity.

Impact of disclaimer of leases

35. Consideration should also be given to clarifying the impact of disclaimer of a head lease by liquidators appointed to the RE or another company in the chain of title above the investors and the ability of a Liquidator appointed to a RE/landlord to disclaim a lease.

36. It was argued in both *BOSI v ANZ* and in one of the applications for judicial advice in the Willmot insolvency that the liquidator of a landowning company can disclaim leases granted by that company to another entity (including investor tenants).

37. Mr Bigmore QC and Mr Hopper in *BOSI v ANZ* and Mr Bigmore QC and Mr Kennedy in the *Willmot* case argued that:

(a) a Liquidator can only disclaim the companies own property rights and cannot use the disclaimer power to extinguish other people's property rights; and

(b) if a head lease or freehold interest burdened by onerous covenants is disclaimed, the interest will escheat to the Crown (or the next highest interest). As escheat is a species of merger, interests lower in the chain of title (such as the Growers' sub-leases) will survive the disclaimer (see *NAB v NSW* (2009) 260 ALR 115 per Rares J).

38. Her Honour Justice Davies was not required to rule on this point in the *BOSI v ANZ* case. Likewise, , Dodds-Streeton J was not required to rule on this point in the *Willmott* case. While we have not seen a compelling argument to the contrary, it appears the point remains alive.

39. Also, a similar argument might also be made that the Liquidator could disclaim Growers' rights under contract-based schemes (such as the 2002 schemes in the *BOSI v ANZ* case). However, it is, in our view, also clear that the Liquidator can only disclaim the company's liabilities and not the rights of the other contracting party.

40. In our view, the legal position on the effect of a disclaimer is clear. However, the point may continue to be argued and we anticipate that it will arise in litigation over the remaining Timbercorp funds. While we do not, of course, suggest that legislation be passed that will have an effect on current litigation, we suggest legislation be considered to clarify that a liquidator cannot disclaim another person's property or contractual rights.

41. If you require further submissions on this point, please contact Mr Hopper or Mr Kennedy.

Garry Bigmore QC

Sam Hopper

Matthew Kennedy