Other law reform proposals

5.1 Introduction

Submissions to the Review contained a number of proposals for changes to the managed investment provisions in Chapter 5C and related parts of the Corporations Act. Many of these have been discussed in earlier chapters.

The remainder comprise proposals for relatively minor or technical legislative amendments, or deal with issues that do not fit neatly within the subject matters covered by earlier chapters. These have been divided into two groups in this chapter.

Where the issues appear clear-cut and non-controversial, the relevant proposals are supported and discussed in section 5.2.

Where the issues are multi-faceted, and are likely to have far-reaching implications or raise conflicting views across the managed investment industry, the proposals are discussed in section 5.3. It would have been premature to form a conclusive view on these issues, within the time available for this Review. Many of these issues require substantial research and/or may pose practical difficulties in implementation. These need to be more fully explored to determine whether legislative intervention would be appropriate and, if so, how the desired aims could be most effectively achieved.

Therefore, for these more far-reaching proposals for law reform further consultation is recommended. This consultation should involve the Treasury, ASIC, the managed investment industry, and investors and their representatives, with a view to assessing their merit before any legislative intervention. Thought would also have to be given to the practicalities of implementing proposals that are considered worthwhile.

The proposals in sections 5.2 and 5.3 are grouped according to their subject matter and, unless otherwise indicated, were put forward by ASIC. Each proposal is followed by as brief an explanation of the issues as the subject matter allows. Legislative references are to the Corporations Act.

5.2 Law reform proposals supported

The following proposals for law reform are supported.

5.2.1 The Compliance Committee

- Amend subsection 601JB(3) to insert 'and paragraph 4(a)' after '(2)(a)'; and
- Amend subsection 601JB(4) to insert 'or a related body corporate' after 'responsible entity'.

The effect of these amendments will be to incorporate into the legislation relief which has been granted by ASIC, such that a person is not taken to be substantially involved in business dealings, or in a professional capacity with a RE, merely because they are an external director of a related body corporate, or a member of a compliance committee of a registered scheme operated by a related body corporate. Without this relief, such persons would be disqualified from being an external member of a compliance committee.

- Extend section 601JE to apply to former compliance committee members.

Section 601JE provides compliance committee members with qualified privilege in respect of statements concerning the operation of a scheme made to the RE or ASIC. However, the provision does not apply once a compliance committee member resigns or is replaced. This may lead to reluctance on the part of former compliance committee members to provide information to the RE, or more particularly to ASIC, for fear of attracting liability. This is an undesirable outcome, and the extension of the protection is warranted.

5.2.2 Directors of responsible entities — disclosure of interests

- Amend section 205G to require disclosure by the directors of a RE of a listed scheme equivalent to disclosure required of directors of a listed company.

Section 205G requires directors of a listed company to notify the relevant securities exchange of their interests in securities of the company or related bodies corporate, and of contracts that confer rights to interests in managed investment schemes made available by the company or related bodies

corporate. However, if a managed investment scheme is listed, but the RE is not, then the directors of the RE are not subject to disclosure requirements.

The predecessor of section 205G contained a requirement for disclosure in situations where the scheme was listed but not the RE.[1] It appears that this requirement was inadvertently omitted when the section was amended.[2] Although it is understood that the Listing Rules of the Australian Stock Exchange are being amended to rectify this omission, it is felt the obligation is important enough to warrant specific inclusion in the legislation.

5.2.3 Definition of managed investment scheme

- Amend the definition of *managed investment scheme*[3] to exclude class actions and costs paid for legal proceedings.

Under the rules of the Federal and other Courts, participants in a class action may make payments to solicitors acting in the matter, so that they can be party to any favourable judgement. ASIC has received requests for relief from the operation of the managed investment provisions in Chapter 5C for such arrangements. While it is arguable whether class action arrangements fall within the definition of *managed investment scheme*, it is suggested the matter be put beyond doubt. Matters relating to the conduct and funding of class actions are more appropriately dealt with under the Rules of Court.

5.2.4 Definition of scheme property

- Amend the definition of *scheme property*[4] to clarify when property ceases to be scheme property.

This proposal is supported in the interests of providing greater certainty. ASIC has suggested that property should cease to be scheme property when it is paid to scheme members, or to the RE as a fee or indemnity under subsection 601GA(2), or where it is no longer held by the RE or its agents or appointees under section 601FB, unless a constructive trust arises. Situations in which a constructive trust is taken to arise may require some specification.

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1 Former subsection 235(1A).
2 By the *Corporate Law Economic Reform Program Act 1999*.
3 Section 9.
4 Section 9.

5.2.5 Restrictions on the size of partnerships and associations

- Amend section 115 so that it does not apply to registered managed investment schemes.

Section 115 provides that a partnership or association with more than 20 members must incorporate, subject to a limited exception. It is considered that this requirement is inappropriate where the partnership or association is a registered managed investment scheme, as the regulation of such schemes is an acceptable substitute for the regulation that would apply if the partnership or association was incorporated.

5.2.6 Annual returns

- Amend section 349 to impose a requirement that the value of scheme property be disclosed in the annual return, and to remove the requirement to identify the top 20 interest holders, and the amount of their interest, so far as it relates to members of investor-directed portfolio service (IDPS)-like schemes (as defined in ASIC PS 148) or, alternatively, give ASIC discretion to determine an approved form for the annual return.

Section 349 sets out the content requirements for a managed investment scheme's annual return. There is currently no requirement for the return to disclose the value of scheme property. This information would assist ASIC in keeping track of the total vale of assets managed in registered schemes, and its disclosure in the annual return will not place a burden on REs, who should be monitoring the value of scheme property for their own purposes.

The requirement to reveal the identity of the top 20 interest holders and the value of their interests is similar to the requirement applying to the top 20 shareholders in a company.[5] While this requirement has benefits in terms of transparency, ASIC feels that it unnecessarily intrudes upon the privacy of interest holders in IDPS-like schemes. IDPS-like schemes acquire and hold investments and involve arrangements for the custody of assets and consolidated reporting. They include most products marketed as master funds

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5 Section 348.

or wrap accounts. An important feature of IDPS-like schemes is that the investor makes all the investment decisions.

The Corporations Act contains provisions which provide power for ASIC (including at the request of a scheme member) or the RE to request information about the interests of members of a managed investment scheme.[6] It is not considered that the requirement to identify the top 20 interest holders of IDPS-like schemes in the annual return provides any additional benefits which outweigh the intrusion upon the privacy of those interest holders.

IFSA's submission supported removal of the requirement to disclose the top 20 interest holders of managed investment schemes in the annual return, particularly noting its undesirable effects for members of IDPS-like schemes.

As an alternative to amending the content of the annual return, ASIC has suggested that it be given discretion to determine the content (that is, discretion to determine an approved form for the annual return). Although no submissions have raised proposals for changes to the annual return other than those mentioned above, giving ASIC a discretion may provide greater flexibility to deal with any changes that may become necessary in the future.

5.2.7 Scheme constitution — calculation of issue price

- Amend paragraph 601GA(1)(a) to resolve the uncertainty regarding its ambit (namely, that it is wide enough to support ASIC's policy requirement for 'an independently verifiable price').

Paragraph 601GA(1)(a) requires the constitution of a registered scheme to make 'adequate provision for the consideration that is to be paid to acquire an interest in the scheme'. An argument has been advanced[7] that ASIC's policy requirement for 'an independently verifiable price'[8] exceeds the ambit of paragraph 601GA(1)(a).

It would be desirable to resolve the apparent uncertainty regarding the ambit of paragraph 601GA(1)(a) by legislative amendment, particularly in view of its

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6 Part 6C.2 (sections 672A to 672F).
7 Freehills.
8 Refer to ASIC PS 134, paragraph 134.19.

importance to investor protection. (It is intended that the amendment will not affect the operation of the relevant ASIC Policy Statement or Class Orders.[9])

5.2.8 Regulations — modification and incorporation into the Corporations Act.

- Incorporate the following regulations into Chapter 5C, with the modifications mentioned:

  – Regulation 5C.2.02 provides that ASIC, or a member of a registered scheme, may apply to the Court for the appointment of a temporary RE if ASIC or the member believes it is necessary to protect scheme property or the interests of members. This regulation does not require modification, but the provision is important enough to warrant its inclusion in Chapter 5C itself.

  – Regulation 5C.4.01 permits a compliance plan, or a modified compliance plan, lodged with ASIC under section 601HC or subsection 601HE(3), to be signed by an agent of the directors of the RE, so long as the authority to do so, or a copy of the authority verified by a director of the RE, is attached to the compliance plan or modification. It should be made clear in Chapter 5C itself that agents may sign a compliance plan or modification of the plan in the circumstances mentioned.

  – Regulation 5C.4.02 requires agents of the RE, and officers of those agents, to assist auditors of the compliance plan, for example, by allowing the auditor access to any books or information relating to the scheme held by the agent. This requirement to assist auditors should be extended to other persons engaged by the RE under section 601FB.[10]

  – Regulation 5C.5.01 requires REs, their officers, agents and officers of agents to assist the compliance committee, for example, by allowing

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9 ASIC PS 134 deals with the constitutions of managed investment schemes. Paragraph PS 134.19 sets out ASIC's policy requirements under paragraph 601GA(1)(a). Relief from these requirements is provided in Class Order 98/52. A summary of the instances when Class Order 98/52 will apply is in paragraph PS 134.20.

10 Subsection 601FB(2) gives the RE power to appoint an agent, *or otherwise engage a person*, to do anything that the RE is authorised to do in connection with the scheme.

the committee access to books or information relating to the scheme. This requirement to assist the committee should be extended to other persons engaged by the RE under section 601FB.

- Regulation 5C.11.06 provides that, in determining the RE's liability to scheme members under subsection 601FB(2) for an act or omission of an agent, any amount recovered by way of indemnity from the agent under subsection 601FB(4) is to be disregarded. This regulation does not require modification, but it should appear in section 601FB itself.

- Regulation 5C.11.05A should be deleted as its contents have already been incorporated into subsection 601ED(2).[11]

The suggested modifications to the regulations are minor but warranted. It is felt that their placement in the legislation itself will give them greater prominence and is more in keeping with the subject matter involved.

Recommendation 17

The following amendments should be made to the Corporations Act and Regulations:

- Amend subsection 601JB(3) to insert 'and paragraph 4(a)' after '(2)(a)';
- Amend subsection 601JB(4) to insert 'or a related body corporate' after 'responsible entity';
- Extend section 601JE to apply to former compliance committee members;
- Amend section 205G to require disclosure by the directors of a RE of a listed scheme equivalent to disclosure required of directors of a listed company;
- Amend the definition of *managed investment scheme* to exclude class actions and costs paid for legal proceedings;
- Amend the definition of *scheme property* to clarify when property ceases to be scheme property;

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11 An amendment to subsection 601ED(2) was contained in the *Treasury Legislation Amendment (Application of Criminal Code) Act (No.1) 2001*.

- Amend section 115 so that it does not apply to registered managed investment schemes;

- Amend section 349 to impose a requirement that the value of scheme property be disclosed in the annual return, and to remove the requirement to identify the top 20 interest holders, and the total number of interests they hold, so far as it relates to members of IDPS-like schemes or, alternatively provide ASIC with discretion to determine an approved form for the annual return;

- Amend paragraph 601A(1)(a) to resolve the uncertainty regarding its ambit (namely, that it is wide enough to support ASIC's policy requirement for an independently verifiable price); and

- Incorporate regulations 5C.2.02, 5C.4.01, 5C.4.02, 5C.5.01 and 5C.11.06 (with certain modifications) into Chapter 5C, and repeal regulation 5C.11.05A.

5.3 Law reform proposals requiring further consideration

The following law reform proposals involve issues which deserve further consideration and consultation.

5.3.1 The responsible entity

- It should be made clear that only the RE may operate a scheme (including promoting, offering interests in, or inviting contributions to a scheme, as well as all ongoing activities and winding up) and no other person may take any part in the operation of the scheme except as an agent of, or as a person engaged by, the RE.

Arguably section 601FB already makes this clear, but ASIC is concerned that allowing other parties to contract directly with members is inconsistent with the RE concept, and the issue should be put beyond doubt.

- Subsection 601FC(2) should be amended to clarify that the RE holds scheme property on trust for members, and any agents appointed by the RE, or sub-agents, hold scheme property on trust for the RE.

Subsection 601FC(2) provides that the RE 'holds property on trust for scheme members'.

There is a concern that subsection 601FC(2) does not clearly create an *obligation* for the RE to hold scheme property on trust for members and that it fails to make clear that it is the RE, rather than members, for whom agents or sub-agents would hold scheme property.

Subsection 601FC(3)[12] refers to the 'duty' under subsection 601FC(2) so it could be argued that an obligation has, in fact, been created by the legislation.

However, the exact nature and ambit of the obligation is unclear.

It has been argued that the provision 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.[13]

It is agreed that the provision could be drafted more clearly to spell out the legal relationships involved in the holding of scheme property whether by the RE or by an agent or sub-agent. 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.

- Paragraph 601FC(1)(d) should be amended to require that members must be treated equally in relation to interests they have that confer substantially the same right to benefits produced by the scheme and the same obligations, and all members must be treated fairly. Essentially this would define a 'class' of members, such that class differentiation must be based on the rights attached to an interest, rather than purely on a member's characteristics. Other references to 'class' in Chapter 5C should be consequentially amended.

This proposal needs to be considered in conjunction with Recommendation 15 in Chapter 4 that the equality test in paragraph 601FC(1)(d) should be changed to a fairness test, in so far as it relates to differential fee arrangements.

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12 Subsection 601FC(3) provides that a duty of a RE under subsection (1) or (2) overrides any conflicting duty an officer of employee of the RE has under Part 2D.1.

13 Freehills.

5.3.2 Definition of *managed investment scheme*

- Amend the definition of *managed investment scheme* to clarify whether redundancy funds come within the definition.

Redundancy funds involve an arrangement under which employers make contributions to a scheme (including under an award or agreement) the primary objective of which is to fund redundancy entitlements and other incidental benefits for employees. There is some uncertainty whether these schemes come within the definition of *managed investment scheme*.

Provided the arrangements are genuinely used to fund employees' redundancy entitlements, it is considered that they should not be regarded as managed investment schemes. However, it is understood that there are a number of variations in arrangements, including some which allow employees to also contribute moneys to the scheme, and others which allow for benefits to be paid other than on redundancy. The question becomes — at what point do such arrangements take on the character of a managed investment scheme?

Consideration needs to be given to whether an exclusion for redundancy funds from the definition of *managed investment scheme* should be drawn narrowly, such that the 'sole' purpose must be to fund redundancy benefits, and that only employers may contribute, or whether it would be sufficient if the funding of redundancy benefits was the 'primary' or 'dominant' purpose, but not necessarily the only purpose.

- Amend the definition of *managed investment scheme* to include bodies corporate that carry on an investment business, other than merely incidentally to another business.

Investment companies are currently required to be licensed securities dealers under the Corporations Act. However, when companies offer securities in investment businesses (except as interests in managed investment schemes), they are not subject to the requirements (including the provisions relating to investor protection) of Chapter 5C. It is submitted by ASIC that this provides a regulatory distortion. ASIC argues that companies carrying on investment businesses (except when incidental to their other activities) should not be excluded from the coverage of the definition of *managed investment scheme*.

However, because it is unclear how many businesses would be affected by a change along the lines suggested, comments should be sought on this proposal.

- Amend the definition of *managed investment scheme* by adding at the end of paragraph (e) words to the effect that — 'and no members:

  – hold an interest on trust except where the only beneficiaries are such bodies corporate: or

  – have acquired their interest as an acquirer under a custodial arrangement as defined in section 1012IA.'[14]

Paragraph (e) of the definition of *managed investment scheme* provides that the definition does not include 'a scheme in which all the members are bodies corporate that are related to each other and to the body corporate that promotes the scheme'. ASIC has argued that the intention of this exclusion is undermined if some person unrelated to the scheme promoter indirectly acquires an interest in the scheme. For example, a member of a registered scheme may acquire an indirect interest in a scheme that is excluded by paragraph (e) of the definition where the RE of the registered scheme invests some of that scheme's funds in the excluded scheme.

Subsection 601FC(4) provides that the RE of a registered managed investment scheme may only invest property in another managed investment scheme if it is also registered. This is designed to ensure that the protection afforded to investors under Chapter 5C can not effectively be avoided by a RE of a registered scheme investing in an unregistered scheme. However, where a scheme falls outside the definition of *managed investment scheme* because it is specifically excluded by paragraph (e), the protection afforded by subsection 601FC(4) does not apply.

Having said this, it needs to be acknowledged that some submissions argued that subsection 601FC(4) is unnecessarily restrictive. Not only was it suggested that the subsection does little to enhance investor protection, it results in wholesale managed investment schemes having to register in order that they

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14 Section 1012IA will be inserted into the Corporations Act by the FSRA. It will commence on 11 March 2002, and deals with arrangements under which a person can instruct another person to acquire a financial product.

can accept money from retail schemes, which is considered inappropriate. Those submissions have either suggested that further exceptions from the subsection be provided,[15] or that it be repealed altogether.[16] ASIC is adamant that subsection 601FC(4) is an essential anti-avoidance provision, the absence of which would substantially lessen investor protection. It is also noted that a similar provision applied under the former prescribed interest arrangements.[17]

5.3.3 Definition of *scheme property*

- Amend the definition of *scheme property* to specifically include an interest in the land necessary for the operation of a primary production scheme, for the duration of the scheme.

There is a concern that investors in primary production schemes, who do not usually have a proprietary interest in the land on which the scheme is operated, may be vulnerable to the land being taken by others with a legal right to do so, such as liquidators, mortgagees and transferees of the land owner. ASIC has sought to address this issue by way of a licence condition on REs of agricultural schemes. However, objections have been received from the industry, which ASIC is currently considering. A number of complex issues are involved, including taxation and stamp duty matters, which need to be worked through before deciding on the nature of any amendment.

- Amend the definition of *scheme property* to expressly include property to which a time sharing scheme relates.

It is suggested by ASIC that the definition of *scheme property* is based on paragraph (a) of the definition of *managed investment scheme*, and is not adequately adapted to the definition of *time sharing scheme*.[18]

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15 Some exceptions are already provided in ASIC Class Order 98/55.
16 Constellation Capital Management Limited, Freehills and Minter Ellison.
17 Former Corporations Regulation 7.12.15 prescribed certain covenants that were taken to be included in approved deeds of prescribed interest schemes. One of these covenants provided that money available for investment under the approved deed could only be invested in other prescribed interests if there was also an approved deed in respect of those interests.
18 Section 9.

5.3.4 Termination of auditor appointment on winding up of scheme

- Section 331AD should be repealed.

Section 331AD provides that the auditor of a managed investment scheme ceases to hold office where the scheme is to be wound up, or where the members vote to remove the RE, but do not at the same meeting appoint a new RE. In respect of the termination of the auditor's appointment on a wind-up, the section is similar to that applying to the winding up of a company.[19] However, unlike a company wind-up, which is generally under the control of an official liquidator, the wind-up of a managed investment scheme is conducted by the RE.

In view of this, it is argued that it is inappropriate to terminate the appointment of the scheme auditor when a wind-up commences. Rather, the appointment should continue until the wind-up is completed, and consideration should be given to including a specific requirement in the legislation that the winding up process be audited. Consideration also needs to be given to whether arrangements for the termination of the audit appointment are still required in non-winding up situations, such as current paragraph 331AD(d), where the members remove the RE, but do not appoint a replacement.

5.3.5 Related party transactions

- The provisions in Part 5C.7 should be amended so that the restrictions are more appropriate for the types of investment arrangements used by managed investment schemes.

- Section 601LD should be amended to provide that Chapter 2E applies as if section 211 (as well as the other sections mentioned) were omitted.

Part 5C.7 applies the related party transaction provisions for public companies in Chapter 2E, with certain modifications and omissions, to transactions in managed investment schemes.

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19 Section 330.

The purpose of the provisions is to protect members' interests by requiring their prior approval of certain transactions involving scheme property. The transactions involve the giving or the receipt of a financial benefit by the RE or a related party,[20] out of scheme property or that could endanger members' interests.

Not all transactions involving payments out of scheme property need member approval. In Chapter 2E, member approval is not required for the following:

- section 213: the giving of a financial benefit of a maximum of $2,000 (or greater amount as prescribed by the regulations) to the director of a public company or the director's spouse;

- section 214: the giving of a financial benefit by a body corporate to a closely-held subsidiary of the body or by a closely-held subsidiary of a body corporate to the body or an entity it controls; and

- section 224: voting by a related party of the public company or an associate of such a related party on a proposed resolution which would permit the giving of a financial benefit to the related party.

Section 601LD provides that Chapter 2E applies as if sections 213, 214 and 224 were omitted. The effect of this provision is that, contrary to the situation in Chapter 2E, prior approval of members of a registered scheme is required before the giving of the benefits referred to in these sections.

ASIC has suggested that section 211 should be included as an additional 'omission' in section 601LD. This would mean that member approval would be needed before a financial benefit of the type referred to in section 211 could be given.

Section 211 refers to a financial benefit, comprising reasonable remuneration or payment of expenses incurred or to be incurred, given to an officer or employee of a public company or a related party.[21]

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20 Namely, an entity that the RE controls or an agent of the RE.

21 Section 211, in the context of Part 5C.7 of Chapter 5C, would apply to a financial benefit given to an officer or employee of the RE, an entity controlled by the RE or an agent of the RE.

In proposing this amendment, ASIC has commented that it is difficult to see when it would be reasonable to provide a benefit out of scheme property in the circumstances to which section 211 applies.

The Law Council of Australia has expressed concerns with the whole of Part 5C.7. It has argued that the drafting of Part 5C.7 by reference to Chapter 2E has resulted in legally uncertain provisions which are not appropriate for application to managed investment schemes. Additionally, the provisions impact adversely on member protection.

The Law Council has proposed that Chapter 5C.7 be amended so that the RE of a registered scheme will only be able to confer a financial benefit on itself or a related party in certain limited circumstances.[22]

The points raised in both ASIC's and the Law Council's submissions are considered to warrant further examination.

5.3.6 Continuous disclosure

- Section 1001B should be amended:
  - so that it does not apply to unlisted managed investment schemes which do not have a redemption or withdrawal facility; and
  - to apply to other managed investment schemes having scheme property with a value over a certain specified amount.

Section 1001B imposes continuous disclosure obligations on unlisted disclosing entities in relation to information that is not generally available, that a reasonable person would expect to have a material effect on the price or value of ED securities of the entity if the information were generally available. If such information is not required to be included in a supplementary or a replacement disclosure document, the disclosing entity must lodge a document containing the information with ASIC.

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22 These are that: the benefit must be conferred on arm's length terms; the benefit must be expressly permitted by the scheme's constitution and has been disclosed to members prior to being given; the benefit must be conferred on the RE or a related party in its capacity as a member of the scheme and on terms applicable to members generally; or the entity receiving the benefit is also owned by the members of the scheme (for example, stapled securities).

There are several types of ED securities. The ED securities which would include unquoted interests in a managed investment scheme are defined in section 111AF.[23] Section 1001B would most commonly apply to unlisted managed investment schemes.

ASIC has commented that references to price or value in section 1001B are inappropriate for unlisted schemes with no redemption facility. It has suggested exempting such schemes from the operation of the section and either relying on continuous disclosure or ongoing disclosure provisions. ASIC favours reliance on the ongoing disclosure obligations in section 1017B which will be introduced into the Corporations Act by the FSRA. However, section 1017B as it is currently drafted does not apply to managed investment schemes.

As for continuing disclosure obligations for other managed investment schemes under section 1001B, ASIC does not believe that the reference to member numbers in the definition of ED securities to which section 1001B refers, is appropriate. It has proposed an amendment so that the section will apply to schemes on the basis of the value of scheme property rather than member numbers. However, this could lead to the result that schemes with high member numbers but low individual investment rates would not attract the disclosure provisions whereas a scheme having few members but high individual investment rates would attract the disclosure provisions.

5.3.7 Aggregation of voting interests and substantial shareholdings

- The substantial shareholding provisions of the Corporations Act should be modified in their application to REs of multiple schemes and associated REs.

Both IFSA and the Commonwealth Bank Group have suggested the application of these provisions causes significant problems due to the shareholdings in associated entities being aggregated for the purposes of determining substantial shareholdings. They have argued for some relief from these requirements for REs. ASIC is aware of this issue and has recently

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23 Under section 111AF, ED securities are securities in relation to which a disclosure document has been lodged with ASIC under Chapter 6D, or securities issued pursuant to the disclosure document which have been held by 100 or more persons since the securities were issued.

released a discussion paper calling for submissions on whether relief is warranted and, if so, the form it should take.[24]

5.3.8 Scheme amalgamations and reconstructions

- Introduce arrangements to facilitate the amalgamation or reconstruction of registered schemes.

The Law Council of Australia has suggested that the lack of a clear statutory procedure for scheme amalgamations and reconstructions leads to uncertainty, as it may leave such arrangements open to legal challenge. The Law Council submission noted that the Financial System Inquiry nominated industry structure as a contributing factor to the cost of funds management in Australia, and argued that a clear statutory procedure for amalgamations and reconstructions may assist the industry in alleviating structural problems which add to costs.

Two models were put forward by the Law Council — one based on existing requirements applying to companies under Part 5.1 of the Corporations Act, and the other based on the successor fund transfer provisions of the SIS Act. Of these two, the Law Council favours the first model, which requires member consent. It is felt that member involvement in any reconstruction or amalgamation process would be important, and it is agreed that of the two models suggested, the first should be given further consideration.

5.3.9 Deregistration

- Amend subsection 601PA(2) to provide for voluntary deregistration in certain cases following a special rather than a unanimous resolution of a scheme's members.

Voluntary deregistration is permitted under subsection 601PA(2) if a scheme is not a managed investment scheme, has 20 or fewer members or is not required to be registered by paragraph 601ED(1)(b) or (c). In the two latter instances, all the members must agree to deregistration.

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24 ASIC discussion paper, *Investment funds: takeover and substantial holding relief*, released 23 November 2001.

It has been argued[25] that a special resolution of members should be sufficient to allow for voluntary deregistration where a scheme (the original scheme) has been subdivided into a number of smaller schemes which are registered. The reasoning behind this is that, under the current provisions, the original scheme's constitution would require amendment as a result of the scheme's subdivision, and a special resolution only would be required to effect this.[26]

Following its amendment, the constitution of the original scheme would presumably no longer meet the requirements of sections 601GA and 601GB. ASIC would then have a discretion under paragraph 601PA(1)(b) to deregister the original scheme.

By amending subsection 601PA(2) so that a scheme may apply for voluntary deregistration upon the passing of a special resolution, it is argued that the more involved process leading to ASIC's deregistration would be short-circuited.

5.3.10 Forfeiture of partly paid units

- ASIC policy and Class Order 98/52 should be amended to remove the forfeited interest provisions.

Paragraph 601GA(1)(a) requires the constitution of a registered scheme to make adequate provision for the consideration that is to be paid to acquire an interest in the scheme.

ASIC Class Order 98/52 provides relief from certain policy requirements in PS 134 dealing specifically with paragraph 601GA(1)(a). Among other things, subparagraph (vi)A of the Class Order enables the RE of a registered listed scheme to decide the re-sale price for interests in the scheme which have been forfeited to the RE due to a failure to pay a call. The Class Order refers to the interests as having been forfeited to the RE on trust for the members and goes on to provide that the sale of these interests must comply (with the appropriate exceptions and modifications to terminology) with section 254Q of the Corporations Act.

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25 Minter Ellison.
26 Paragraph 601GC(1)(a).

It has been argued that ASIC does not have the power under paragraph 601GA(1)(a) to formulate policy regarding the sale price of forfeited interests.[27]

The main thrust of the argument is that forfeited interests do not become the property of the RE to hold on trust for scheme members. Rather, the RE merely obtains a power of sale in relation to those interests so that their re-sale is a secondary sale involving the transfer of the interests from one member to another. The sale price applicable to such a transaction would be determined by the market at time of sale.

Consequently, if ASIC is to formulate policy regarding the sale price of forfeited interests, it would also need a statutory basis under which it can formulate policy concerning transfers from member to member and secondary sales. Paragraph 601GA(1)(a) does not provide this statutory basis.

ASIC has indicated that forfeiture of members' interests may be necessary for the effective management of a scheme.[28] However, it is concerned that the mechanism applicable to the forfeiture of these interests raises issues[29] that warrant further investigation.

ASIC has proposed that legislative reform would be desirable to establish an appropriate framework within which forfeiture of members' interests could be more appropriately regulated. Such reform might involve refinements to paragraphs 601FG(a)[30] and 601GA(1)(a).

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27 Freehills.
28 ASIC's supplementary submission dated 31 October 2001.
29 These issues include: disclosure obligations of the RE; ownership of the interest; the procedure applicable to the sale and distribution of the proceeds of the forfeited interests; and the general obligations of the RE at time of sale.
30 Paragraph 601FG(a) sets out the consideration for which the RE of a scheme may acquire and hold an interest in that scheme.