Executive summary

On 6 August 2001, the then Minister for Financial Services & Regulation, the Hon. Joe Hockey MP, announced the Terms of Reference for a review of the *Managed Investments Act 1998* (MIA).

The MIA commenced on 1 July 1998. Section 3 of the MIA required a review to be conducted as soon as possible following the third anniversary of the MIA's commencement, with a written report to be tabled in each House of the Parliament within six months of the anniversary date.

The purpose of the Review is to examine the effectiveness of the regulatory arrangements for the managed investment industry put in place by the MIA.

Submissions to the Review were invited from the public, and a website was established to facilitate an open and transparent review process. All submissions (other than those that were to remain confidential at the authors' request) were placed on the website, to allow interested parties to consider the views put forward by others.

Altogether, 31 submissions were received from industry participants and their representatives, professional advisers, investors' and consumers' representatives, and members of the public. A submission was also received from the industry regulator, the Australian Securities and Investments Commission (ASIC). A list of the submissions is in the Appendix to this report.

Overview

When conducting the Review, consideration was given to the fact that, up until relatively recently, the financial sector had been growing particularly strongly, and as a result, the industry had not faced significant stresses or pressures for large-scale rationalisation. Furthermore, given the two-year transitional period for the MIA, a large part of the industry had not operated under the new arrangements until well into 2000.

Notwithstanding this, several proposals emerged as warranting changes to the MIA and related provisions of the *Corporations Act 2001*, and these are contained within the report's recommendations.

A number of submissions identified perceived shortcomings with the legislation that raised more complex issues or were likely to have significant ramifications. With regard to these proposals, definitive conclusions have not been reached. In these circumstances, it is proposed that the issues be examined more fully, with further consultation by Treasury with ASIC, the industry, and investors and their representatives.

Structure of the report

The report consists of five chapters.

Chapter 1: Background to the MIA and this Review.

The opening chapter gives a brief history of the events leading to the development and introduction of the MIA, along with some comments on ASIC's role as the regulator of managed investment schemes, and a snapshot showing the diversity and structure of the industry.

Chapter 2: Investor protection

This chapter looks at issues dealing with those aspects of the MIA which are intended to protect investors' interests from inappropriate or poor management practices of scheme operators and the risk of fraud or dishonesty.

The chapter examines submissions concerning the licensing requirements of REs and whether, for example, the net tangible asset (NTA) levels required under the MIA and ASIC policy serve a practical investor-protection function. Connected with this is the debate over the role of independent custodians — whether their use should be mandatory and what their obligations should be generally and to scheme members in particular.

The chapter also looks at matters surrounding the removal of the RE including whether extraordinary or special resolutions should be required, and whether difficulties in finding suitably qualified and willing replacements can be overcome. A number of other issues are considered. These relate to the question of scheme members' liability in the event of a scheme's winding up and the rights of scheme members — their voting rights, voting power and whether schemes should be required to hold Annual General Meetings.

Chapter 3: Compliance

Compliance is an area that attracted considerable comment, ranging from praise for the compliance 'culture' that the MIA had engendered in the managed investment industry, to claims that the MIA's compliance arrangements were totally inadequate. Given the short time in which the MIA has applied across the whole industry, it has not been possible to state categorically whether compliance has been strengthened or weakened with the advent of the MIA, although there are encouraging signs that the profile of compliance has been raised.

Nevertheless, there are areas where ASIC has identified weaknesses in the compliance performance of a number of responsible entities (REs), including their monitoring of contracts with service providers, and the degree to which senior management of REs are committed to the compliance process. These matters will need to be carefully watched in the coming years.

Recommendations for improvements to existing compliance arrangements have been made, including:

- the development of standards relating to the qualifications and experience of compliance committee members;
- requiring the RE to notify ASIC and scheme members about changes to compliance committee membership;
- providing ASIC with power to remove a compliance committee member in certain circumstances; and
- a clearer application of compliance functions to the board of the RE, where the RE relies on its board to conduct compliance monitoring, rather than establishing a compliance committee.

Chapter 4: Costs

Claims made prior to the introduction of the MIA regarding the likely increase or decrease in costs that would result, have proved extremely difficult to verify. Although surveys and statistical analyses are helpful in monitoring the level of costs, they can not give a definitive picture as to whether movements in costs are attributable to the introduction of the MIA, or due to extraneous factors.

An important point made in this chapter is that the level of costs cannot be considered in isolation, but must be viewed in conjunction with the quality of compliance and investor protection that are achieved.

Recommendations aimed at delivering modest cost savings are made, including some relaxation of the requirement to treat scheme members equally, such that there will be increased scope for REs to offer differential fee structures to members.

Chapter 5: Other law reform proposals

This chapter deals with proposals for law reform of a minor and/or technical nature, and those that do not fit easily into the categories discussed in previous chapters. It contains recommendations for legislative amendment on a number of matters, generally involving issues that are clear-cut and uncontroversial.

The chapter also covers several proposals which have been recommended for further consultation. These include proposals to:

- amend the definition of *managed investment scheme* to clarify the position of redundancy funds and to expand the definition in certain respects, for example, to apply to bodies corporate that carry on investment businesses;
- amend the definition of *scheme property* to facilitate its application to primary production schemes;
- revise the application of provisions relating to continuous disclosure and related-party transactions to ensure they are appropriate for managed investment schemes; and
- revise the framework within which forfeiture of members' interests are regulated.