1. Introduction

The reference

1.1 On 24 May 1991 the federal Attorney-General, Mr Michael Duffy MP, asked the Australian Law Reform Commission and the Companies and Securities Advisory Committee (the Review) to carry out a thorough review of the regulatory framework for prescribed interests and 'like collective investment schemes'. The terms of reference are set out at the front of this report. This report is a joint report of the Commission and the Advisory Committee.

Background to the reference

Prescribed interests and like collective investment schemes

1.2 The term 'collective investments' covers a wide variety of investment schemes. Most involve a number of investors handing over their money or some assets to a professional manager who manages the total fund or collection of assets to produce a return which is shared by investors. A common form of collective investment is the unit trust, but there are many others. Most are subject to regulation under the Corporations Law as 'prescribed interests'.

Collective investment schemes and the economy

1.3 Collective investment schemes are a major source of investment funds in Australia. There is an enormous variety of such schemes, from the largest commercial property and cash management trusts through to yabbie farm schemes, pine forest schemes, jojoba bean plantation schemes and racehorse syndicates. During the 1980s these schemes grew rapidly, partly as a result of deregulation in the financial sector. Investments in unit trusts alone grew from less than $2 billion in 1980 to over $38 billion in 1992. The fastest growing unit trusts were cash management trusts and, until recently, property trusts. Increasingly the funds in these schemes come from persons investing their superannuation lump sums and from superannuation schemes seeking better rates of return than those offered by banks. The amount of money invested in collective investment schemes will continue to increase now that superannuation is compulsory for most workers.

Need for investor confidence

1.4 While many investors are keenly aware of what they are doing, others do not have the experience or expertise to appreciate fully the risks associated with investing. Many investors in these schemes choose them because they enable investors to pass responsibility for the day-to-day management of their savings to someone else. These investors rely on the law, not their own expertise and ability, to provide their savings with appropriate protection. The ability of collective investment schemes to continue to accumulate the savings of Australians and channel them into investment will depend heavily on investor confidence in the regulatory regime for these schemes.

Investor confidence and decline in commercial property values

1.5 At the end of the 1980s there was a rapid and unsustainable rise in Australian asset prices, particularly for commercial property. This was accompanied by an unprecedented increase in the size of the unlisted property trust market. Between 1988 and 1990 unlisted property trust assets swelled by 62% from $5.5 billion to $8.9 billion. The collapse of the Estate Mortgage trusts in particular focused attention on the difficulties facing unlisted property trusts. Within a year asset values had fallen by almost $2 billion (or 22%) to $6.9 billion, resulting in quite spectacular capital losses by investors in these property trusts and triggering the virtual closure of all unlisted property trusts except those whose management companies were controlled by banks. The opportunity for the remaining unlisted property trusts to increase their market share was short-lived, however. The loss of confidence by investors meant that redemption requests continued to outstrip applications for new units. After the promoters of the remaining property trusts and their parent banks approached the federal Government, the federal Attorney-General and the federal Treasurer announced, on 23 July 1991, a one year freeze on redemptions from unlisted property trusts.[1] This freeze did not stop the collapse in asset prices. It merely stopped the collapse of schemes as a result of the panic withdrawal of funds. For example, in the first nine months following the imposition of the freeze on redemptions, the value of unlisted property trust assets fell a further $2.4 billion, from $6.9 billion to $4.5 billion, making a total loss since 1990 of $4.4 billion or almost half their value.

Calls for reform

1.6 The need for a comprehensive review of collective investment schemes has been acknowledged in Australia for almost 20 years. In 1974, the Senate Select Committee on Securities and Exchange (the Rae Committee) called for reform of the regulation of securities markets to enhance their capacity to mobilise investment funds.[2] In 1981 the Committee of Inquiry into the Australian Financial System (the Campbell Committee) pointed to the need for comprehensive reform, suggesting that separate legislation for collective investment schemes be considered.[3] In 1988 the Companies and Securities Law Review Committee (CSLRC) examined the regulation of prescribed interests under the then Companies Codes.[4] Finally, in 1990, the National Companies and Securities Commission (NCSC) Unit Trusts Task Force recommended a full-scale review of the regulatory framework for prescribed interests.

1. See *Corporations Law (Unlisted Property Trusts) Act 1991* (Cth).
2. Senate Select Committee on Securities and Exchange *Australian Securities Markets and their Regulation* AGPS Canberra 1974.
3. Committee of Inquiry into the Australian Financial System *Final Report* AGPS Canberra 1981, para 21.171.
4. CSLRC Report.

A thorough review required

1.7 The reviews of prescribed interest schemes undertaken to date, such as the ASC reviews of property trusts and trustee common funds and the 1990 NCSC review of unit trusts, were all conducted on the basis that the existing regulatory structure was not to be replaced. The terms of reference from the Attorney-General require the Review to consider 'whether the present legal framework for collective investment schemes provides for the most efficient and effective legal framework' for those schemes. The Review, therefore, has not taken the existing legal framework as given. It is not enough merely to try to fashion further *ad hoc* changes to add to those made after the previous reviews. Instead, the Review has taken the opportunity presented to it by the Attorney-General to conduct a thorough and fundamental review of the appropriate regulatory framework for collective investment schemes.

The Review's work

A joint report

1.8 The Attorney-General's reference was given jointly to the ALRC and the Advisory Committee. By arrangement between the two bodies, the ALRC assumed administrative responsibility for the work. Officers of both the ALRC and the Advisory Committee prepared the report.

Issues paper (IP 10)

1.9 In September 1991 the Review published a comprehensive issues paper (ALRC IP 10, 1991). That paper identified the scope of the collective investments industry and discussed the importance of the industry for both national retirement incomes policies and capital formation in Australia. It set out the issues, so far as the Review saw them then, and called for submissions. The Review received over 40 submissions in response to this paper.

Superannuation — interim report

1.10 ***Request for interim report.*** In September 1991, just before IP 10 was published, the Attorney-General wrote to the Review asking for an urgent interim report on superannuation issues. Specifically, he asked that the report

> traverse the regulation of superannuation investments products under the Corporations Law. As part of that report it would also be desirable, where appropriate, to consider the regulatory arrangements applying to comparable investment products which are not currently regulated by the Corporations Law.

This request was a result of developments in the Commonwealth's retirement incomes policy, which aims to generate long term savings by individuals to provide a capital base and thus increase their level of retirement income. Superannuation is also becoming increasingly important in the Australian economy. Total superannuation assets have quadrupled in the last decade to $139 billion and is likely to more than double again by the turn of the century. The

Review interrupted its work on the broader reference and focused on superannuation. In January 1992, the Review published a discussion paper (ALRC DP 50, 1992) setting out preliminary proposals for the regulation of superannuation. The Review received 111 submissions from a wide range of individuals and organisations.

1.11 ***Interim report (ALRC 59).*** The Review published its report, *Collective investments: superannuation* (ALRC 59, 1992), in April 1992. It covered most major issues associated with the regulation of superannuation schemes, including

- the constitutional power to regulate superannuation
- the policy implications of the changed nature of superannuation from a voluntary to a compulsory system
- standards of probity for those who administer superannuation schemes
- duties of superannuation scheme trustees
- disclosure to members and prospective members of superannuation schemes and to the regulator
- investment controls that should be imposed on superannuation schemes
- the role and powers of the regulator
- the relationship between superannuation schemes and their members, including the need for inexpensive, non-judicial resolution of disputes
- problems concerning surpluses and reserves.

Announcements by the federal Treasurer, Mr John Dawkins, in June and October 1992 indicated that the Government accepted most of the recommendations in the report. Legislation to implement many of the recommendations, the Superannuation Industry (Supervision) Bill (Cth), was introduced into the federal Parliament on 16 December 1992, but, with the dissolution of Parliament for the 1993 federal election, the Bill lapsed. Following the 1993 election the Bill was introduced to the Parliament on 27 May 1993.

Discussion paper (DP 53)

1.12 After completion of the superannuation report, the Review resumed work on the broader reference. In October 1992 it published a detailed discussion paper (ALRC DP 53, 1992) covering the remaining aspects of the reference, relating to collective investment schemes other than superannuation schemes. DP 53 discussed the policy goals of the Review and identified the fundamental issues to be addressed. A further 73 detailed submissions were received in response to DP 53.

Consultations

1.13 ***Consultants.*** Soon after the Attorney-General asked the Review to report on superannuation, the ALRC engaged Mr Paul Klumpes of the Australian National University to provide the Review with an overview of the superannuation industry, its existing regulatory framework and the inconsistencies within that

framework.[5] The ALRC also engaged Mr Ian Ramsay of the University of New South Wales to prepare a paper on trustees' duties, company directors' duties and the issues involved in the incorporation of trustees. In accordance with its usual practice, the ALRC appointed a number of honorary consultants to help the Review. They were selected from the funds management and superannuation industries, the legal profession, academia, the public service and the community. The Review acknowledges, with appreciation, their contribution. They attended several lengthy meetings to discuss the Review's proposals and gave valuable assistance in other ways. The Review wishes to express its particular appreciation for the extensive contribution made by Mr Robert Ferguson, Managing Director, Bankers' Trust Australia. Special mention should also be made of Mr Tony Hartnell, former Chairman of the Australian Securities Commission, Mr Don Blyth of the Trustee Companies Association, Mr David Davis of Permanent Trustee Company Limited, Mr Peter Hutley of the Investment Funds Association of Australia, Mr Jim Murphy of the Attorney-General's Department, Canberra, Mr John Rutherford and Ms Chloris Latham of the Australian Securities Commission, Mr George Pooley, the Insurance and Superannuation Commissioner, Mr Donald Magarey of Blake Dawson Waldron and Mr David Purchase of the Life Insurance Federation of Australia. Finally, special mention must be made of Mr Leigh Hall and Mr Jim Armitage. After their term as members of the ALRC ended, they continued to devote considerable time to completing this report.

1.14 ***Consultations.*** In November 1992 the Review held public hearings in Melbourne and Sydney on the proposals advanced in DP 53. It also conducted a number of lengthy consultations with trustee companies, funds managers, consumer and investor groups and federal, State and Territory regulators. In addition, the Review held several meetings with its honorary consultants and addressed a number of meetings and seminars to explain the proposals in DP 53.

Other reports, studies and reviews

1.15 The Review has had regard to a number of other reviews and reports dealing with the specific issues within the scope of the Review's terms of reference. While preparing its interim report on superannuation, the Review maintained close liaison with the Senate Select Committee on Superannuation chaired by Senator Nick Sherry. The Review also contributed to the Trade Practices Commission's report on life insurance agents. Finally, the Review has maintained a close working relationship with the Special Premiers' Conference Working Party on Non-Bank Financial Institutions Sub-committee on Trustee Companies, through its convenor, Dr Paul Moy, of the NSW Treasury.

5. The results of Mr Klumpes' work were published in ALRC Collective Investments Research Paper 1 *A Review of Regulatory Arrangements Applying to Superannuation Schemes in Australia*, July 1992. A member of the Advisory Committee staff, Mr Mark Blair, has also written a paper published separately by the Review: ALRC Collective Investments Research Paper 2 *Review of collective investment schemes in overseas jurisdictions*, June 1993.

Outline of this report

1.16 This report addresses the terms of reference for the Review in the following order. Chapter 2 sets out the policies and principles that collective investment regulation ought to pursue. Chapter 3 identifies what schemes are covered by the report. Chapters 4 to 7 cover various aspects of the day-to-day operation of schemes, including how they are established (chapter 4), what matters need to be disclosed to investors and how that should be done (chapter 5), what borrowing limits, audit requirements and other financial controls should be imposed (chapter 6) and how investors withdraw from schemes (chapter 7). Chapter 8 discusses the procedure for terminating a scheme. Chapters 9 and 10 identify the need for scheme operators to take effective measures to ensure that they comply with the law and the scheme constitution, which is a key factor in the recommended controls on who should be authorised to operate a collective investment scheme. Chapter 11 covers the role investors should play in protecting their interests, while chapter 12 considers whether the present requirement that each scheme have a separate trustee or representative should continue. Chapters 13 and 14 deal with the way intermediaries sell collective investment schemes and the role and powers of the regulator. Chapter 15 considers whether contraventions should be dealt with as offences and makes recommendations about the construction of offences. Finally, chapter 16 deals with the way in which the transition to the new regime should be managed.