Review of the Regulatory framework for Managed Investments Schemes

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Background

The Managed Investments Act was introduced in 1998 and implemented in 2000 to solve issues associated with the confusion of the roles of the Trustee and the Investment Manager in managing unit trusts.

The single Responsible Entity (“RE”) regime was supposed to solve this problem but all that happened is Managers became their own RE, no costs savings were created, and investors where not protected as structural independence was not evident in the new structure.

So, over the last 23 years we have seen complex products sold to retail investors and disconnects between liquidity of the financial products and their assets. In this submission we will be proposing a new way to segment the market and assist in answering the specific questions.

Proposed Model

The current model tries to protect investors based on the definition of the skill of the investor (ie retail vs Professional Investor) and where the product is being distributed to (Design and Distribution Obligations (DDO) and Target Market Determination (TDD)). This approach has created significant red tape and puts the onus on the RE and allowed the investor to not take responsibility for their decisions and it does not assist most investors who need advice.

We believe products should be split into Simple (short form offer documents (PDS/IM)) and Complex (long form PDS/IM) where, note simple wholesale products can still fall into the short form regime:

Simple products = A managed investments scheme with no more than 5% of individual asset class and 25% in total in the asset classes of: shorting, derivatives (excluding FX hedging only), agricultural, property, illiquid, private equity, fund of funds and gearing.

Complex products = All products that are not Simple products.

Coupled with this approach, any licenced Trustee or RE can issue listed or unlisted Simple products with Capital based on a formula and capped at $5m (RG166) coupled with Professional Indemnity insurance via a formula of a min of $2.5m capped at 15m. However, to be a product issue of a Complex product you would need the following:

a) Regulatory capital of $15m capped (RG166), cross ref international standards
b) PI insurance min of $15m
c) Key Responsible Managers for key oversight roles including Compliance, Investment oversight, Distribution oversight and Risk oversight - i.e. an Office of the RE, separate to the other operations of the business.
d) An majority independent Board of the RE/Trustee on the same basis as the recent CCIV model which is consistent with international models, and
e) Investors defined as a Professional Investors and Investors who invest via an accredited Financial Advisor who has qualified to advise on complex product.

If this model in incorporated the following associated changes are required:

- RE, Trustees proposing to issue a Complex product will need to upgrade their licence, so that it specifically authorises the issue of Complex products.
- RE's issuing Complex products should be independent from the investment manager.
- DDO and TMD requirements can be removed.
- PDS and IMs will need to reflect the Simple short form, and the Complex long form, content requirements.
- An Office of the RE and Designated Roles, with suitably qualified and experienced officers will need to be included in regulations, cross ref UK and Europe.

Chapter 1 – Wholesale client thresholds

1. Should the financial threshold for the product value test be increased? If so, increased to what value and why?

No change is required in value if the model is changes to reflect the complex vs simple option, as this should ensure all investors are appropriately protected.

Another option is to increase the amount to $1m which is being used in the industry as a factor when financial planners are deciding what clients to take on if they want to offer complex / sophisticated products.

2. Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?

See the answer to Q1

3. Should certain assets be excluded when determining an individual's net assets for the purposes of the individual wealth test? If so, which assets and why?

Again, please review the answer to Q1, and further, the value of the family home should be excluded when you are considering the net investable position of the investor.

4. If consent requirements were to be introduced:

(a) How could these be designed to ensure investors understand the consequences of being considered a wholesale client?

We believe the system is wrong and places too much reliance on the "Product Issuer" vs the investor and the Investors' financial planner. Investors should be taking responsibility for their financial decisions and if they don't understand then they should not invest and hence wear

the consequence. If the product is defined as Simple then there should be no issues with anyone investing in this product, if Complex, then they need to pass the test or use advice and take the consequences if the investment fails etc.

(b) Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?

If the investor is required to elect, nominate as a wholesale client/sophisticated investor at least every 2 years, then ASIC and the Law should allow them the benefits and consequences of this election. They should have to confirm they understand that they cannot complain to "retail" complaints authorities and the like.

Chapter 2 – Suitability of scheme investments

5. Should conditions be imposed on certain scheme arrangements when offered to retail clients? If so, what conditions and why?

Please see the concept of Simple vs Complex, based on this no retail investors would be investing in Complex products unless they elect to be wholesale/sophisticated, or they have a planner authorised to advise retail investors into Complex products.

6. Are any changes warranted to the procedure for scheme registration? If so, what changes and why?

If the RE's licence changes then the registration of products should speed up, another option is that any Complex products that want to be registered should have a longer registration process to reflect the difference in risk. Note, unregistered complex products should fall within the current CCIV unregistered process.

7. What grounds, if any, should ASIC be permitted to refuse to register a scheme? Chapter 3 – Scheme governance and the role of the responsible entity

ASIC should have the ability to refuse registration if they believe the product is miss categorised as Simple vs Complex.

8. Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?

We believe the RE's need to have an Office of the RE with dedicated qualified and experienced resources, cross reference UK and European models where roles are dedicated for oversight of the compliance, risk, investments, service providers and distribution.

9. Should ASIC be able to direct a responsible entity to amend a scheme's constitution to meet the minimum content requirements, similar to the CCIV regime?

Yes, the regulator should be able to require outcomes to ensure system stability.

10. Are changes required to the compliance plan provisions to ensure compliance plans are more tailored to individual schemes? If so, what changes and why?

Yes, no changes to Simple funds compliance approach, but Complex or unregistered products need to be included in the compliance plan approach. Why are unregistered excluded from a compliance plan approach?

11. Should auditors be legislatively required to meet minimum qualitative standards when conducting compliance plan audits? If so, what should these standards be and why?

No change required in Audit standards re compliance plans suggested.

12. Should responsible entities be required to have a majority of external board members, similar to the CCIV regime?

Yes, why are registered schemes and CCIV's any different? Further there should be an Office of the RE especially when there is an internal RE's and it this situation they should have a majority independent board members and no compliance committee is then required.

13. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of a listed scheme? If so, what changes and why?

We believe the unitholder meeting requirement has failed as investors and IDPS platforms in particular have no compulsion to vote, thus getting sufficient numbers to change an RE is often not achieved and a barrier to change. Further, RE changes should be based on a commercial relationship vs a restrictive unitholder meeting requirement for changes, as is the case in the UK and changes can be announced to investors and if sufficient, say 10% of investors, reject the change then a unitholder meeting must be called ie make it the exception vs the rule.

14. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of an unlisted scheme? If so, what changes and why?

Regarding unlisted funds, as stated above the relationship should be more commercial ie with a term and the ability to change with notice. Also as stated above if 10% or more unitholder object then a unitholder meeting should be called to resolve the issue.

15. In what circumstances should an existing responsible entity be required to assist a prospective responsible entity conduct due diligence? What might this assistance look like?

We believe that there should be an obligation for the retiring RE to provide all due diligence material reasonably required by the proposed new RE.

16. Should there be restrictions on agreements that the responsible entity enters into or clauses in scheme constitutions that disincentivise scheme members from replacing a responsible entity? If so, what restrictions may be appropriate?

No restriction suggested. However, such agreements or clauses should be clearly disclosed to investors.

17. Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?

See the Simple vs Complex discussion above.

18. Are any changes required to the procedure for withdrawal from a scheme? If so, what changes and why?

No, notice is the key to withdrawals.

19. Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?

See the Simple vs Complex discussion above.

Chapter 6 – Winding up insolvent schemes

20. Are any changes required to the winding up provisions for registered schemes? If so, what changes and why?

No changes required to the winding up

21. Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members and creditors? Are there certain aspects of the existing company and CCIV insolvency regimes that should be adopted?

We believe we need the same or similar provisions as those relating to the appointment of a receiver/administrator for a corporation to protect the RE/ Trustee that undertakes a similar role in relation to a scheme.

22. Should statutory limited liability be introduced to protect personal assets of scheme members in certain circumstances? If not, why not?

No. No need for a change.

Chapter 7 – Commonwealth and state regulation of real property investments

23. Do issues arise for investors because of the dual jurisdictional responsibility when regulating schemes with real property? If so, how could they be addressed?

Yes, the different rules create more work for Lawyers which cannot be good for any industry.

Chapter 8 – Regulatory cost savings

24. What opportunities are there to modernise and streamline the regulatory framework for managed investment schemes to reduce regulatory burdens without detracting from outcomes for investors

See Simple vs Complex discussion above.