Law Council OF AUSTRALIA

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The Treasury
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By email: misreview@treasury.gov.au

Dear Mr Moore

Review of the regulatory framework for managed investment schemes

The Law Council of Australia welcomes the opportunity to make a submission to Treasury in response to the consultation paper issued on 4 August 2023 (the **Consultation Paper**) relating to the review of the regulatory framework for managed investment schemes (**MIS**) which was first announced by the Assistant Treasurer and Minister for Financial Services in March 2023 (the **Review**).

This submission has been prepared by members of the following Committees:

(a) from the Business Law Section:
  (i) the Financial Services Committee;
  (ii) the Corporations Committee; and
  (iii) the Insolvency and Restructuring Committee; and

(b) from the Legal Practice Section—the Superannuation Committee,

collectively, the **Committees**.

The Consultation Paper seeks feedback on a number of different aspects of MIS regulation. In this submission the Committees have focused on legal aspects of MIS regulation in which members of the Committees have expertise and wish to comment. Other stakeholders may be more suitably placed to comment on other matters canvassed in the Consultation Paper.

Some representatives of the Committees have also had the opportunity to engage in more informal consultation with Treasury at roundtable discussions. The Committees thank Treasury for this, and appreciate the opportunity to have an open dialogue and help shape the development of potential law reforms in a constructive and collaborative manner.

Set out below are the questions posed in the Consultation Paper, and the Committees' responses.

Chapter 1—Wholesale client thresholds

In addition to responding to the specific questions canvassed in the Consultation Paper, the Committees wish to make the following comments.

Should this issue be considered separately from the Review?

The Committees note that the definition of "wholesale client" impacts whether a particular MIS will need to be registered with the Australian Securities and Investments Commission (**ASIC**) and whether the responsible entity will be required to prepare a Product Disclosure Statement (**PDS**) to offer interests in the MIS.

However, the definition has broader ramifications, because it also impacts issuers of other kinds of financial products and the duties and disclosure obligations associated with the provision of financial product advice. Further, there are corresponding disclosure exemptions from the obligation to provide a prospectus under subsection 708(8) of the *Corporations Act 2001* (Cth). The Consultation Paper is silent as to whether any corresponding changes to the subsection 708(8) provisions are contemplated.

The Committees therefore query whether this issue should be the subject of a standalone consultation process so that all potentially impacted stakeholders are given the opportunity to effectively participate in the policy development process.

Are the tests in place appropriate?

Before considering the relevant monetary thresholds for the product value and individual wealth tests, the Committees submit that it may be worthwhile to consider whether these are appropriate tests in the first place, bearing in mind that the amount of funds a person has for investment will not necessarily be a reliable indication of their levels of education, knowledge, sophistication or financial literacy (as in some cases these factors may have had little bearing on how the person came to have the relevant quantum of funds available to invest).

Retail client vs consumer concept

On a related point, the Committees note that the *Australian Securities and Investments Commission Act 2001* (Cth) provides protection for "consumers", which is a different concept to "retail clients" under the Corporations Act. The current disconnect between the two parts of the legislative regime produces regulatory complexity.

Further complexity should be avoided

The Committees submit that it would be undesirable to introduce reforms that produce additional regulatory complexity. Ideally, the Committees would prefer to see a reduction in the current level of complexity.

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

The current financial threshold for the product value test is $500,000, and has been for over 20 years.

The Committees note that, when an investor is classified as a wholesale client in respect of a product, none of the consumer protection measures of scheme registration, PDSs, advertising rules or (importantly) the design and distribution obligations of the Corporations Act apply to their investment.

Some practitioner members of the Committees are aware of anecdotal evidence that:

(a) investments available only to wholesale clients may be widely perceived as giving access to superior assets and lower fees, which can potentially motivate investors to seek to be classified as wholesale clients; and
(b) some product issuers prefer not to characterise investors as wholesale based solely on the amount invested, particularly where the product issuer has limited knowledge and familiarity with the investor's personal financial circumstances.

The Committees note that $500,000 (or an increased threshold amount) could represent a significant proportion of the funds that some investors have available to invest, particularly if they do not meet the professional investor test or the wealth test. The Committees note that, if an investor allocates a significant portion of their available funds to a single financial product, their investment portfolio risk could be very concentrated, and the adverse impact on the investor could therefore be significant if the product does not perform well.
A significant increase above $500,000 could potentially exacerbate this risk.

Further, as the Committees have noted above, the amount of funds an investor has to invest is not necessarily an accurate reflection of their level of financial sophistication.

Therefore, the Committees consider that there could be merit in removing the product value test for particular products that are considered to be higher risk. This has already been done in relation to foreign exchange contracts in regulation 7.1.22A of the *Corporations Regulations 2001* (Cth).[1]

If the product value test is to be retained, then the Committees submit that appropriate ongoing indexation measures should be put in place. For simplicity, if indexation were adopted, the Committees suggest that the product value threshold could be increased in $100,000 increments (e.g., where the threshold starts at $500,000 then, once CPI has increased by 20%, the threshold moves to $600,000).

[1] If this approach is taken, consideration may need to be given to the position of special purpose entities in investment structures that rely on this test, which are in substance professional investors but not able to technically qualify as professional investors, for example a 50-50 joint venture between institutional investors where neither of those investors controls the joint venture vehicle, and where the initial investment is less than the threshold to meet the professional investor definition (currently $10 million).

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?

The Committees do not wish to propose specific net assets and/or gross income threshold amounts, as this is not strictly a legal issue.

Indexation

However, the Committees acknowledge that the proportion of the Australian population who meet the 'wholesale client' definition has increased significantly as a result of there being no indexation of the individual wealth test, coupled with increases in the value of real estate assets. Assuming that the wealth test will continue, then the Committees consider that, for future purposes, an uplift in the thresholds and ongoing indexation of the relevant net assets and gross income amounts would be appropriate.

The Committees recognise that indexation of the dollar amounts could introduce complexity and uncertainty if adjustments were frequently made to align with changes in the national Consumer Price Index published by the Australian Bureau of Statistics (**CPI)**. There could also be frequent inadvertent non-compliance. For instance, if accountant's certificate templates used by financial advice firms are not updated to reflect the new threshold amounts (due to insufficient attention to detail or awareness of regulatory change—which is not infrequently a cause of breaches), an investor might be above the previous threshold but below the new adjusted threshold at a particular point in time. If an accountant's certificate is prepared using an outdated template, then an investor might be incorrectly characterised as wholesale and therefore not afforded the intended regulatory protection.

For simplicity, if indexation were adopted, the Committees suggest that:

(a) the gross income threshold should be increased in $50,000 increments (e.g., where the threshold starts at $250,000 then, once CPI has increased by 20 per cent, the threshold moves to $300,000); and
(b) the net assets threshold should be increased in $500,000 increments (e.g., where the threshold starts at $2.5 million then, once CPI has increased by 20 per cent, the threshold would move to $3 million).

For ease of implementation and to limit any compliance burdens (e.g., to allow time for the accountant's certificate templates to be updated), the Committees recommend that any changes to thresholds be introduced:

(a) on not less than 12 months' notice; and
(b) to take effect at the beginning of a financial year (1 July).

Issues with sophisticated investor test

The Committees consider that the following matters should be considered in determining whether the sophisticated investor test in section 761GA of the Corporations Act should continue in operation.

First, the Committees note that, if the thresholds for meeting existing wholesale client tests are increased, product issuers may be more likely to be tempted to avail themselves of the sophisticated investor test in section 761GA of the Corporations Act. Section 761GA imposes the obligation on the licensee that provides the relevant financial service to certify that the investor (their client) has sufficient investing experience. The Committees consider that this creates an inherent conflict because, for example, it is in the interests of a product issuer to certify an investor so that the product issuer can accept that investor's funds into their product and increase their assets under management. This issue is relevant to other kinds of financial products as well as MIS.

Secondly, some practitioner members of the Committees understand that, anecdotally, some product issuers are reluctant to rely on the sophisticated investor test because of the perceived compliance risk associated with the subjectivity of the assessment criteria.

Transitional considerations

The Committees also note that, if net assets and gross income thresholds are increased, careful consideration will need to be afforded to the investors who may currently qualify as wholesale clients, but may no longer qualify if the relevant thresholds are increased.

The Committees submit that transitional provisions should be introduced with a view to minimising disruption and disturbance to existing arrangements and investments, so that investors who met the wholesale client test at the time they acquired a product may continue to make additional investments in the product and receive correspondence and reporting (which may include reports containing financial product advice) from product issuers and other intermediaries.

The Committees also note that some financial service providers who are only authorised to provide financial services to wholesale clients may need to vary their Australian financial services licence (**AFSL**) in order to continue to provide financial services to those of their existing clients who may no longer fall within any of the wholesale client definition categories.

Some practitioner members of the Committees have observed that:

(a) historically, when ASIC has a larger volume of AFSL applications or AFSL variation applications due to a sector-specific legislative development which must be dealt with by a prescribed date, ASIC has taken a significantly longer period to process the business-as-usual AFSL applications and AFSL variation applications which are unconnected with that legislative development; and

(b) this produces uncertainty for the affected applicants, which makes it difficult for them to manage their business operations while they wait for ASIC to grant an AFSL authorisation before they can commence a new business activity.

The Committees therefore submit that ASIC should be allocated adequate resources to process in a streamlined manner AFSL variation applications which are made as a result of changes to the wholesale client definition.

Complexity

The Committees note that there is complexity and some confusion within the current provisions, which are used to determine whether an investor is a wholesale or retail client for a particular purpose, including:

(a) the need to refer to provisions in both Parts 7.1 and 7.6 of the Corporations Regulations to correctly apply some of the tests set out in section 761G of the Corporations Act;

(b) the use of the expression “not for use in connection with a business” in paragraph 761G(7)(c), because the client’s intention with regard to use of the product and/or whether they operate a small business are variable and may be subjective, and these are not matters a financial service provider can be reasonably expected to know; and

(c) uncertainty about the treatment of investors which are trustees of self-managed superannuation funds seeking to invest in financial products which are not self-managed superannuation funds (which is discussed in ASIC Media Release 14–191).

If the provisions setting out the wholesale client tests were to be amended, the Committees would also welcome amendments to reduce the current complexity and confusion outlined above.

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?

As this is strictly a matter of policy, the Committees do not seek to comment on which kinds of assets ought to be included or excluded.

The Committees note, however, that as a practical matter, if certain kinds of assets are excluded from the test, then investors' status might oscillate between wholesale client and retail client based upon their acquisitions and disposals of those types of assets.

For example, if residential property which was the investor's principal place of residence was excluded from the wealth test, an investor might be a retail client, but then they could become a wholesale client under the wealth test temporarily if they were sell that property and live in rented premises for a period of time before purchasing another property as their principal place of residence (and potentially becoming a retail client again).

4. If consent requirements were to be introduced:
(a) how could these be designed to ensure investors understand the consequence of being considered a wholesale client?
(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?

The Committees consider that the process for obtaining client consent would be more meaningful in the context of a one-on-one relationship between a financial adviser and their client than, by contrast, a product issuer obtaining the consent as part of a standard form online application form process where that product issuer has no pre-existing relationship or direct contact with the investor.

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?

The Committees consider that the product design and distribution regime in Part 7.8A of the Corporations Act is an effective gatekeeping mechanism for ensuring investment products (including MIS) are appropriately targeted towards relevant investors, and that it is more suitably placed to achieve this objective than Chapter 5C of the Corporations Act.

The Committees also note that ASIC has developed tailored disclosure guidance (which can include disclosure principles and benchmarks) for the issuers of MIS that hold certain types of assets (for example, unlisted property funds, infrastructure entities and hedge funds) which is intended to assist retail client investors in making an informed investment decision with a strong awareness of potential investment risks.

If suitability/investment restrictions for retail MIS were to be introduced into the regulatory framework, then the Committees submit that the relevant restrictions should only apply to MIS which are registered after the commencement of the relevant provisions, so that those MIS which were compliant with the law at the time they were registered can continue to operate without needing to make potentially significant divestments of assets over a short period of time (which may not be consistent with the best interests of scheme members).

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

Currently, constitutions of all MIS seeking registration must be lodged with ASIC, and ASIC must decide whether to register the MIS within 14 days. The experience of some practitioner members of the Committees is that at times ASIC:

(a) heavily scrutinises the drafting of provisions of the constitution;
(b) spends time and energy debating matters which might be considered insubstantial;
(c) provides inconsistent feedback (for example, taking issue with a provision in a constitution in circumstances where other constitutions for numerous existing registered MIS contain identical provisions); and
(d) may only raise concerns close to the end of the 14-day period, which may not allow sufficient time for responsible entities to have a meaningful debate with ASIC (and responsible entities may therefore agree to amendments they don't consider to be fair or reasonable just to ensure the MIS is registered, and that they have not expended the ASIC registration fees for nothing).

The Committees note that the existing scheme registration process does not provide ASIC with meaningful insight into the proposed business model of the MIS that is the subject of the registration application, which means it is not particularly useful in assisting ASIC to "weed out" MIS products which may be represent greater regulatory risk.

Some practitioner members of the Committees have observed that at times ASIC appears to use its compulsory notice powers in order to gather business and market information from industry participants, including the operators of MIS. The Committees consider that it may be more beneficial for ASIC to be provided with some base level information about an MIS at the time of registration, and that such information could be useful to ASIC in determining how closely it may wish to monitor that MIS and/or its responsible entity.

However, the Committees acknowledge that ASIC is not equipped, and nor should ASIC be expected, to vet MIS business models or predict with any accuracy whether any particular investment strategy will ultimately be successful. It is important that investors understand this limitation.

7. On what grounds, if any, should ASIC be permitted to refuse to register a scheme?

The grounds on which ASIC may currently refuse to register an MIS are set out in subsection 601EB(1) of the Corporations Act.

Where ASIC is permitted to refuse registration, the Committees consider that, conceptually, the grounds on which ASIC is able to refuse registration should be linked to consumer protection concerns.

The Committees note that, under the current regime, ASIC is given limited information about the MIS and its proposed activities. The Committees therefore consider that if ASIC were to be permitted to refuse to register an MIS on other grounds, ASIC would need to first obtain information relevant to assessing whether those grounds were made out as part of the registration application process.

However, the Committees also note that:
(a) ASIC does not review the constitutions of companies before registering them; and
(b) ASIC cannot reasonably be expected to prevent the failure of an MIS or its responsible entity.

Chapter 3—Scheme governance and the role of the responsible entity

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

The Committees do not consider that any changes to the provisions of Chapter 5C of the Corporations Act are necessary to enhance scheme governance and compliance. Overall, the Committees consider that existing provisions work relatively well, bearing in mind that it will never be possible for regulation to:
(a) prevent or deter all instances of misconduct; or
(b) remove all risks associated with the making of any particular investment.

The Committees note that a responsible entity of an MIS must hold an AFSL. The Committees consider that the current breach reporting regime for AFSL holders, which commenced operation in October 2021 and has considerably broadened the scope of “reportable situations” which must be reported to ASIC, has helped to sharpen the focus of directors of responsible entities on scheme governance and compliance related matters.

However, the Committees query whether other parts of the regulatory regime within the Corporations Act ought to be revisited, in particular the disclosure regime. The Committees query whether the current content obligations for a PDS are sufficiently effective in making prospective investors aware of how the product works and what the most significant risks associated with the product are. The Committees consider that this may be due to the prescriptive and complex nature of the disclosure regime, which can lead to a disproportionate focus on form rather than substance.

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?

The Committees note that, under section 1223C of the Corporations Act, ASIC has the power to direct the corporate director of a corporate collective investment vehicle (**CCIV**) to modify the CCIV’s constitution to ensure that certain content requirements are sufficiently addressed. As far as the Committees are aware, ASIC has yet to exercise this power. This does not come as a surprise, as the CCIV regime was only recently introduced and to date the number of CCIVs which have been registered is relatively small.

The Committees consider it important to note that the content requirements for a CCIV constitution are not entirely consistent with the content requirements for an MIS constitution, and there are matters which an MIS constitution is required to address that do not apply to a CCIV constitution. Consequently, a requirement to change an MIS constitution could carry broader implications than a requirement to change a CCIV constitution.

The Committees also note that forced amendments to constitutional provisions could have an impact on the members of an MIS as well as the responsible entity in circumstances where the MIS may have been in operation for a significant length of time. The Committees consider that the constitutional change process would need to be carefully managed and potentially responsible entities might need ASIC relief if, in making the amendment required by ASIC, they engage in conduct which could constitute a technical breach of another obligation (for example, their statutory duties in section 601FC of the Corporations Act). The Committees also note that making a change to the constitution of a registered MIS could have tax law implications, could trigger stamp duty liability (in the event that the amendments caused a resettlement of a trust) and, if the responsible entity has borrowed funds, require financier consent under the terms of loan arrangements.

The Committees consider that, if any such power were to be given to ASIC:

(a) the process for registering an MIS should be the same as for a CCIV or a company (i.e., ASIC should not continue to have the power to refuse to register the MIS);
(b) consideration should be given whether to limit ASIC's power to provisions which relate to those MIS constitution content requirements which have a CCIV constitution content requirement equivalent; and
(c) it should only apply to an MIS which was registered with ASIC after the provision containing the new power was introduced. The Committees submit that existing MIS which have been formed without any expectation of forced constitutional change should be allowed to continue to operate without the threat of potential disruption to their operations.

While it is not strictly within the scope of the Consultation Paper, the Committees note that some practitioner members of the Committees have also expressed some practical concerns about the following MIS constitution content requirements in their current form:

(a) the obligation in paragraph 601GA(1)(a) of the Corporations Act for the constitution to make "adequate" provision for the consideration to acquire an interest in the scheme—for which there is no corresponding CCIV constitution content requirement; and

(b) the obligation under subsection 601GC(1) of the Corporations Act to obtain members' approval of amendments to the constitution via a special resolution unless the responsible entity reasonably considers that the amendment will not adversely affect members' rights. For example, responsible entities do not, as companies do, automatically have all the powers of a natural person, and this may mean a proposed action by the responsible entity which is in the best interests of scheme members cannot be undertaken without first seeking members' approval to amend the constitution (which requires the expenditure of time and members' funds).

Treasury may wish to explore these matters in further detail as part of the Review.

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?

The Committees note that subsection 601HA(1) of the Corporations Act already requires compliance plans to set out "adequate measures" that the responsible entity is to apply in operating the particular MIS to ensure compliance with the Corporations Act and the constitution.

Some practitioner members of the Committees have:
(a) noted that it is important for responsible entities who operate multiple registered MIS to seek to minimise non-substantive differences between compliance plans because uniform compliance arrangements are generally less complex to administer (and hence, inadvertent breaches of compliance plans may be less likely to occur); and

(b) expressed concern that changes to the law that required greater particularity could make the optimal functioning of compliance processes more challenging for responsible entities without necessarily improving consumer protection outcomes.

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?

The Committees do not express a view.

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

The Committees consider that, if greater parity between MIS and CCIV regulation is the legislative objective, then a requirement for at least half (as opposed to a majority) of the directors of the responsible entity to be independent would achieve this objective.

However, if the concern is more that compliance committees are not effective as they perhaps could be, then the Committees submit that it may be appropriate to revisit the ability of the compliance committee to influence the affairs of the MIS with a view to improving the compliance committee's effectiveness.

The Review may also wish to consider whether there ought to be any minimum competency and/or capability requirements for the board of directors of the responsible entity and/or compliance committee.

Chapter 4—Right to replace the responsible entity

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?

The Committees consider that it is appropriate for members of a listed MIS to be able to replace the responsible entity by ordinary resolution. This puts the approval threshold for a change of responsible entity of a listed MIS on an equal footing with the approval threshold for changing directors of a listed company, such as in a takeover. The Committees note that, where there is a stapled group consisting of a listed company and a listed MIS, a takeover proposal might be accompanied by a proposed change of responsible entity, and therefore the Committees consider that it makes sense for the voting threshold for the approving the change of responsible entity and approving the takeover to be the same.

The Committees note that ASIC Class Order [CO 13/519] *Changing the responsible entity* modifies section 601FM of the Corporations Act to allow 5% of members to request that the responsible entity convene a meeting to consider an ordinary resolution to change the responsible entity. The class order sunsetted on 1 October 2023 and has been replaced with ASIC Corporations (Changing the Responsible Entity) Instrument / 2023/681.

The Committees would prefer to see a permanent legislative change to section 601FM of the Corporations Act to this effect. The Committees consider that this would be consistent with the Treasury program of rationalising ASIC instruments as part of the ongoing stewardship of Treasury portfolio laws.

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?

The Committees consider that this is an area which is ripe for legislative reform, noting that ASIC has exercised its power to grant relief from section 601FL of the Corporations Act on more than 180 separate occasions.

Some practitioner members of the Committees have noted that the requirement for a change of responsible entity of an unlisted MIS to be approved by an extraordinary resolution of members represents a very significant hurdle, because:

- (a) members may not necessarily be proactive about voting their interests, and it is difficult to overcome investor apathy to increase voting participation; and
- (b) there can be circumstances where:
  - (i) some members may be associates of the responsible entity, which is seeking to retire, and may therefore be prevented from voting the interests they hold as a consequence of the operation of section 253E of the Corporations Act; and/or
  - (ii) a significant portion of the interests in the MIS may be custodially held, including in an investor-directed portfolio service arrangement. The legal entity which is the member recorded on the register may not necessarily be in a position to vote the interests it holds on behalf of the beneficial owners of those interests (for example, where it has not been able to obtain voting instructions).

The Committees note that the corresponding approval threshold to replace the corporate director of a CCIV is a special resolution (i.e., at least 75 per cent of votes cast by entitled members must be in favour). The CCIV regime was only introduced recently, and the Committees are not aware of any proposed change of corporate director to date.

Some practitioner members of the Committees have noted that, under the current CCIV regime, if there is low voting participation in meetings, shareholders who hold a relatively small proportion of the shares on issue could be in a position to change the corporate director, even where it may not necessarily be in the best interests of shareholders as a whole.

The Committees consider that the appropriate voting threshold to change the responsible entity of an unlisted MIS might fall somewhere in between the current requirement for an extraordinary resolution and the current threshold for a CCIV—one option being imposing a higher than usual quorum (i.e., the percentage of members who must vote) coupled with a special resolution threshold.

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?

The Committees note that:

- (a) the existing responsible entity, for so long as it holds that office, has statutory duties, including a duty to act in the best interests of members; and
- (b) if the change of responsible entity was to proceed, section 601FR of the Corporations Act, in its current form, would require the outgoing responsible entity to:
  - (i) as soon as practicable, give the incoming responsible entity any books in its possession or control which the Corporations Act requires to be kept in relation to the MIS; and
  - (ii) give the incoming responsible entity other “reasonable assistance” to facilitate the transition.

Practitioner members of the Committees who have experience with change of responsible entity processes have not raised any major difficulties with the operation of the existing legislative framework outlined above.

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?

The Committees consider that the following provisions within the existing regulatory framework are operating effectively:

(a) the statutory duties of a responsible entity under section 601FC of the Corporations Act, in particular the duty to act in the best interests of scheme members;

(b) section 601GC(2) of the Corporations Act, which has the effect that:

  (i) the responsible entity may only receive payment or indemnification out of scheme property if the constitution expressly permits it;

  (ii) any such payment or indemnification is only available in relation to the proper performance of the responsible entity's duties; and

  (iii) any other agreement or arrangement which purports to confer such a right on the responsible entity has no effect;

(c) the related party transaction regime under Chapter 2E of the Corporations Act (which is modified in its applicable to a registered MIS by Part 5C.7 of the Corporations Act); and

(d) for a registered MIS which is listed on the Australian Securities Exchange (**ASX**), requirements imposed under the Listing Rules (as set out in ASX Guidance Note 26) which generally will not allow a management contract with a term of five years without certain approvals.

The Committees also note that the imposition of restrictions may conflict with provisions of other agreements which the responsible entity has signed with third parties such as lenders, joint venture parties and governments.

Chapter 5—Right to withdraw from a scheme

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

The Committees note that the concept of "liquid" in the context of Part 5C.6 of the Corporations Act does not necessarily correspond with the more commonly understood meaning of "liquid". Two different MISs with very different timeframes for meeting withdrawal requests could both technically be "liquid" under the current Corporations Act test. The Committees therefore submit that it may be helpful to alter the terminology in Part 5C.6 and avoid the use of the term "liquid" to prevent potential confusion.

The Committees consider that the most important consideration is the inter-relationship between the timeframe in which the responsible entity represents that withdrawal requests can be met, on the one hand, and the timeframe within which the responsible entity reasonably expects to realise the assets of the MIS, on the other. Difficulties can arise when the latter timeframe is significantly longer than the former timeframe.

The Committees submit that any mismatch between member expectations and the actual withdrawal period timeframe is more likely to be caused by inappropriate marketing and distribution behaviour and/or poor-quality disclosure from the responsible entity and/or other intermediaries than the legislative requirements of Part 5C.6 of the Corporations Act.

The Committees note that:

(a) ASIC most recently reviewed the liquidity frameworks for a sample of registered MIS following the onset of the COVID-19 pandemic in 2020 and found that overall they were generally adequate;[2] and

(b) the product design and distribution obligations in Part 7.8A of the Corporations Act should serve to prevent an MIS from being marketed to investors who may require access to their funds within a shorter timeframe than the responsible entity could reasonably expect to realise the assets. See further the response to question 19 below.

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

The Committees note that ASIC has granted some relief to facilitate withdrawals from an MIS by members who are experiencing financial hardship. The Committees consider that this relief is uncontroversial, and that provisions which facilitate hardship withdrawals ought to be incorporated into the Corporations Act rather than separate ASIC legislative instruments.

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?

The Committees submit that the expectations of members will vary from one MIS to another, and that this will depend upon how the MIS has been marketed to prospective members, what the PDS says about withdrawals and how much attention members have paid to the PDS.

The Committees consider that the existing legislative framework covering disclosure requirements and prohibitions on misleading or deceptive conduct are intended to deter responsible entities and other intermediaries from making unsubstantiated claims about the ability of members to withdraw from an MIS. Further, the product design and distribution obligations in Part 7.8A of the Corporations Act require investors' liquidity needs to be taken into account in determining the target market for a financial product. Following the introduction of Part 7.8A of the Corporations Act, the Committees consider that it is considerably more difficult for a responsible entity to market an MIS to investors if those investors may need to withdraw their funds in a timeframe that is shorter than the time which the responsible entity estimates that it will take to process withdrawal requests. This is because investors who wish to have access to their funds in a shorter timeframe would fall outside of the target market for the product.

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?

The Committees are of the view that it would be beneficial if the legislative framework provided greater clarity as to the responsible entity's ability to wind up, merge or transition an unviable registered MIS without such action:

(a) resulting in a breach of its statutory and/or fiduciary duties; or

(b) causing a tax outcome which is adverse for members and/or the responsible entity.

[2] ASIC Media Release 21-191 ASIC review finds retail managed funds responded well to COVID-19 challenges in 2020

The Committees note that the Australian Law Reform Commission's General Insolvency Inquiry Report No 45 (1988) recommended that there be a legislative regime for the winding up of trusts. 35 years later, no such regime has been enacted. The Law Council's Business Law Section has made submissions on this issue to Treasury (in late 2021)[3] and also as part of the recent Parliamentary Joint Committee on Corporations and Financial Services Inquiry (**PJC**) into Corporate Insolvency in Australia.[4] The recent report by the PJC following its inquiry also recommends amendment of the Corporations Act to put in place a regime for the treatment of trusts with insolvent trustees.[5]

The Business Law Section's position is that there should be a regime enacted to deal with the insolvency of trusts generally. The Committees note that:

(a) not all trusts are registered MIS; and
(b) not all registered MIS use a trust structure.

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?

The Committees consider that there should be an insolvency regime for all trusts (which would cover a registered MIS which was structured as a trust), as this would avoid unnecessary costs associated with making court applications and the uncertainty of the current regulatory environment.

Whilst some alignment between a trust's insolvency regime and the company and CCIV insolvency regimes may be appropriate, the Committees consider that it would not be appropriate to treat trusts (including registered MIS which are structured as trusts) as separate economic entities, at least for insolvency purposes.[6]

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

Some practitioner members of the Committees have observed that foreign investors have sought legal opinions as to the potential liability of members. The Committees consider that, in order to resolve any residual doubt or uncertainty, it would be appropriate for the Corporations Act to include a provision to the effect that the liability of scheme members is limited to the amount which they have paid for their interests.

[3] Clarifying the treatment of trusts under insolvency law - 15 October 2021 – Law Council of Australia Business Law Section submission in response to Treasury consultation. See also Inquiry into Corporate Insolvency – Response to Questions on Notice – 14 February 2023, at [79]-[83].

[4] Corporate Insolvency in Australia – 1 December 2022 – Law Council of Australia Business Law Section submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Insolvency in Australia, at [100]-[103].

[5] Parliamentary Joint Committee on Corporations and Financial Services, Corporate insolvency in Australia, July 2023. https://parlinfo.aph.gov.au/parlInfo/download/committees/reportjnt/RB000055/toc_pdf/CorporateinsolvencyinAustralia.pdf.

[6] Clarifying the treatment of trusts under insolvency law, above n3, at [58]-[69].

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?

The Committees are not aware of any specific issues for investors.

The Committees consider that the Sterling MIS structure was very unusual and complex.

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?

Some practitioner members of the Committees who have relevant experience in advising responsible entities believe the efficiency of the operation of the current legislative regime for MIS could be improved by addressing the issues outlined below.

Reporting of compliance plan breaches

The effect of paragraphs 912D(4)(b) and 601FC(1)(h) of the Corporations Act is that any breach of a compliance plan, irrespective of its level of materiality, gives rise to a "reportable situation", which the responsible entity must notify to ASIC. This is the case because subsection 601FC(1) is a civil penalty provision (and therefore a breach of any limb of subsection 601FC(1) is automatically reportable). Consequently, ASIC must be notified of breaches of the compliance plan which are inconsequential, and the Committees consider that this is not a productive use of the finite resources of the responsible entity or ASIC. Possible ways to address this issue include:

(a) providing that paragraph 601FC(1)(h) is not a civil penalty provision; or
(b) amending the Corporations Regulations to prescribe section 601FC(1)(h) as one of the civil penalty provisions which will not automatically give rise to a "reportable situation" if it is breached.

Registration process

The Committees query whether the current 14-day period for ASIC to review the constitution and the compliance plan achieves any meaningful consumer protection benefit, as the review tends to be largely technical in nature. Options Treasury may wish to consider include:

(a) aligning the MIS registration process with the more straightforward registration process used for companies (including CCIVs); or
(b) alternatively, expanding the grounds on which ASIC may refuse to register a scheme so that ASIC can better pursue the interests of consumer protection in conducting the scheme registration process.

Deregistration

The Committees submit that section 601PA of the Corporations Act should be modified to allow a registered MIS to be deregistered if, at the relevant time, all members are wholesale clients and those members unanimously consent to deregistration, on the basis that wholesale client members do not need the same level of consumer protection as retail client members.

PDS exemption in section 1012E of the Corporations Act

The effect of section 1012E of the Corporations Act is that interests in an MIS may be issued without a PDS if no more than 20 personal offers resulting in no more than $2 million in funds raised from investors who are retail clients are made in any 12-month period. The Committees query whether section 1012E is achieving a suitable consumer protection outcome for retail clients in these circumstances.

Signature requirements for compliance plans and constitutions

The Committees consider that the inconsistency between the following signature requirements should be resolved:

(a) under section 601HC, the compliance plan, and any changes thereto, must be signed by all directors of the responsible entity; and
(b) under section 127 of the Corporations Act, any two directors or one director and one company secretary may execute the constitution on behalf of the responsible entity.

As it can be difficult at times to obtain signatures from all of the directors, the Committees submit that the bespoke requirement of section 601HC should be abolished.

Rationalisation of ASIC legislative instruments

The Committees note that there are some features of the current legislative framework located in ASIC legislative instruments which modify the operation of the Corporations Act. The Committees would welcome a review of the ASIC legislative instruments relating to registered MISs to consider whether or not the relevant modifications should remain part of the legislative framework. Where it has been determined that an ASIC legislative instrument should remain part of the legislative framework then, where it is practicable, ideally the Corporations Act itself (or the Corporations Regulations) should be amended, and the corresponding ASIC legislative instrument then revoked, to streamline the regime by improving navigability and reducing unnecessary complexity.

Broader issues

More broadly, the Committees notes that the current legislative regime presents a number of obstacles which make it difficult to rationalise legacy products and to convert an MIS structure to a CCIV structure. Ideally the Committees would like to see continued progress in this direction.

Prohibition on secret commissions under State laws

Divisions 2 and 3 of Part 5C.2 of the Corporations Act recognise the fact that, from time to time, it will be appropriate for there to be a change of responsible entity of a registered MIS.

It is common (but not uniform) for registered MIS to use a trust structure, and for the responsible entity to be the trustee of that trust. Under various State-based regimes prohibiting 'secret commissions',[7] a change of trustee of a trust cannot occur (in the ordinary course because of the giving and receiving of contractual indemnities or other benefits) without the consent of the Court (or of all trust beneficiaries), even where the change

[7] Section 249E of the *Crimes Act 1900* (NSW) (as it stood up until 19 September 2023), section 180 of the *Crimes Act 1958* (Vic), section 535 of the *Criminal Code Act Compilation Act 1913* (WA) and section 442F of Schedule 1 to the *Criminal Code Act 1899* (Qld).

involves no corruption within the ordinary meaning of the term.[8] In many cases, seeking the consent of all scheme members of a registered MIS with respect to a change of responsible entity is not practicable. And, in those cases, the Committees respectfully submit that there is no legitimate policy rationale for requiring a responsible entity to bear the time and cost burden associated with applying for the Court's consent, provided the proposed change of trustee (and responsible entity) does not involve corruption.

The Law Council's Legal Practice Section and other bodies made submissions to that effect late last year and earlier this year, with the assistance of the Law Society of New South Wales, to the New South Wales (**NSW**) Government. The NSW Government accepted those submissions, with the ultimate result that the *Crimes Amendment (Corrupt Benefits for Trustees) Act 2023* (NSW) commenced on 20 September 2023. Under that Act, the prohibition does not apply unless the situation involves corruption.

However, the issue remains in other jurisdictions, notably Victoria, Western Australia and Queensland. The Committees respectfully submit that the Review provides an opportunity to fix the issue in other jurisdictions. That could be done by the Review recommending that other jurisdictions follow NSW's lead. Alternatively, the Review could consider recommending that Part 5C.2 of the Corporations Act be amended to say that the relevant provisions of State legislation do not apply to the extent that a change of responsible entity does not involve corruption.[9]

Other

The Committees would welcome the opportunity to continue to be involved in the Review and hopes to further engage with Treasury in further stages of the process.

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[8] In relation to section 249E of the *Crimes Act 1900* (NSW) (as it stood up until 19 September 2023), see *MLC Investments Ltd* [2022] NSWSC 1541 (***MLC***). In relation to section 180 of the *Crimes Act 1958* (Vic), see *Diversa Trustees Limited in its capacity as Trustee for the Future Super Fund* [2023] VSC 279 (while this case concerned the retirement and appointment of the trustee of a superannuation fund, the analysis in the case followed the analysis in *MLC* and would apply equally in relation to a change of responsible entity).

[9] Section 109 of the Commonwealth Constitution would then ensure that the desired result is achieved.

If you have any questions, please do not hesitate to contact the chairs of the relevant Committees about the parts of this submission as set out in the table below:

Section / Committee	**Chair**	**Relevant parts of this submission**
Business Law Section		
Financial Services Committee	Pip Bell pbell@pmclegal-australia.com	All
Corporations Committee	Robert Sultan robert.sultan@nortonrosefulbright.com	All
Insolvency and Restructuring Committee	Chris Pearce chris.pearce@blackwall.legal	Chapter 6 (Questions 20 and 21)
Legal Practice Section		
Superannuation Committee	Natalie Cambrell ncambrell@khq.com.au	Chapter 8

Yours sincerely

James Popple
Chief Executive Officer