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Director
Investment Funds Unit
Retirement, Advice, and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: misreview@treasury.gov.au

Consultation Paper: Review of the regulatory framework for managed investment schemes August 2023

Paul Dortkamp and Margaret Sullivan welcome the opportunity to provide feedback on the questions posed in the above consultation paper. We are active members of the Independent Compliance Committee Member Forum (ICCMF).

The ICCMF provides independent members of Responsible Entity Compliance Committees with the means to develop and enhance the knowledge and skills needed to carry out their responsibilities. The ICCMF was established in 1999 and has been operating continuously since then providing a series of informal meetings covering topics relating to compliance plans, compliance frameworks and regulatory and licensing matters relating to managed investment schemes.

Our responses are provided to the questions that are most relevant to independent members of compliance committees. We sought input from other participants at a session held in late August, but the opinions expressed here are our own.

Consultation Questions

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?*

We do not believe that there is any need to increase the financial threshold for the product value.

- 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?*

While there may be merit to increase the net assets and/or gross income in the individual wealth test, this is likely to result in many existing wholesale clients no longer meeting the thresholds when the accountant certificate is required to be renewed.

This may force wholesale fund manager to exit the clients that no longer meet the thresholds, which may have a detrimental impact on these members investments. This is especially problematic if the fund is closed and/or illiquid.

This change may trigger the need for the wholesale licensee to vary their licence to include retail clients or to apply for a Responsible Entity licence. The additional costs relating to disclosure, training, dispute resolution, Professional Indemnity and general compliance requirements may make this unattractive.

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?*

Excluding certain assets when assessing the net assets for the purposes of the individual wealth test may result in wholesale clients no longer meeting the threshold on renewal of the accountant certificate. See our response to question 2.

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?*

Where the wholesale client has an adviser and is receiving financial product advice, the suggested consent requirements in the Quality of Advice review are likely to be adequate. However, if the wholesale client is a direct client of a wholesale fund and does not have an adviser, they may not understand what the consequences are of not being a retail client. The consent would need to cover, in simple language, the protections that they are opting out of including dispute resolution, more detailed explanations of risks and suitability of the product to meet their needs.

- 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 introduced, the consent requirements should apply all wholesale client tests but not to the professional investor category in Section 9 of the Corporations Act, as these clients are typically institutional clients, rather than high net worth clients.

- c. *If not, why not?*

We do not have a response to this question.

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?*

Conditions should not be imposed on certain scheme arrangements when offered to retail clients. This is because the current Design and Distribution Obligations for products marketed to retail clients should highlight the suitability of the product to the investor. These regimes provide additional protection for retail clients.

In addition, ASIC has powers to issue stop orders where it considers the Product Disclosure Statement and/or the Target Market Determination to be defective.

ASIC as a conduct and disclosure regulatory is not in a position to make judgement calls in relation to the investment case for the scheme.

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

Consideration should be given to removing the need to lodge a compliance plan when registering a scheme. When the lodgement of compliance plan for managed investment schemes were introduced, the compliance arrangements and frameworks for managed investments was very immature. Twenty-five years later, fund managers and Responsible Entities have more robust compliance arrangements in place.

Complex superannuation funds from Registered Superannuation Entities are not required to lodge a compliance plan for superannuation funds. Responsible Entities are required to have in place an adequate compliance framework and arrangements. To meet the licence conditions and audits, the Responsible Entity needs to have documented the compliance arrangements for a scheme. This would typically comprise of a compliance plan. There is little or any benefit gained from having this plan registered with ASIC.

As a breach of a compliance plan is deemed a reportable situation, compliance teams can become caught up in reporting minor and immaterial technical breaches rather than being able to focus on key areas of compliance management. As a result, it is likely the wording of these plans will become more general.

While consideration should be given to removing the need to lodge a compliance plan when registering a scheme, compliance plans should be required to be developed, used, and audited.

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

There are no grounds for ASIC to refuse to register a scheme. It is not ASIC's role to assess whether a scheme and investment outcome is likely to be a successful investment.

Chapter 2 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 current RG 132 sets out the best practice as well as good practice guidance for boards of REs. This seems to be adequate.

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?*

We have no view on this matter.

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?*

See response to question 6 above.

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?*

We believe that having registered company auditors conducting compliance plan audits, provides a higher threshold and that the generally used quantitative standards are adequate. Imposing legislative standards would add an unnecessary layer to the conduct of the audits.

There is also a view from others in the industry that there should not be compliance plan audits. Rather, the compliance arrangements for the Responsible Entity should be subject to audit review in the same way as Registerable Superannuation Entities are reviewed.

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

The CCIV is a new regime with very few CCIV entities operating. We don't believe that there is a sufficient track record for the benefits of these arrangements to decide whether to apply the regime to Responsible Entities.

Some Responsible Entities already have a majority of external board members. However, many small responsible entities do not have a majority of external board members and would prefer to remain in control of their operations.

The external compliance committee model provides the board with expert oversight of the fund compliance. Many existing members of committees may not wish to take on the additional obligations of directors' duties which cover a much wider range of tasks.

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?*

We have no view on this matter.

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 fact that most unitholders are held on platforms, makes it difficult to transition Responsible Entities. The Responsible Entity may be seeking to exit the business, and, as the platforms typically do not vote the holdings, this makes achieving the existing minimums difficult to achieve, even when there is considerable benefit.

The absolute number makes it nearly impossible to change a Responsible Entity and may entrench less capable managers.

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 have no view on this matter.

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?*

We believe that scheme members should be able to remove and replace their Responsible Entity and that there should not be disincentives for doing this. However, there should not be undue incentive for entrepreneurial Responsible Entities to agitate for change when they stand to gain a material benefit and the costs are borne by the existing members. We have seen this occur with ASX Listed Investment Companies.

Chapter 5 Right to withdraw from a scheme

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

We have no view on this matter.

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

We have no view on this matter.

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?*

We have no view on this matter.

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?*

We have no view on this matter.

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 have no view on this matter.

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

We have no view on this matter.

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?

We have no view on this matter.

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?

Removing the need for the registration of compliance plans would be one way to modernise the regulatory framework.

Paul Dortkamp
Rivergum Investors
pdortkamp@rivergum.com

Margaret Sullivan
Raeside Consulting
margaret@raesideconsulting.com.au