Chapter 3 Definitions

Template for submissions

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3.1 Definition of 'managed investment scheme'

Question 3.1.1
Should arrangements where not all the members of the scheme receive a benefit under the scheme come within the definition of 'managed investment scheme' and, if so, how might the definition best be amended to extend to these arrangements?

Submission

Primary Securities is frequently asked to act as RE for very small syndicates, such as mortgage syndicates ("contributory mortgage schemes").

We have been asked to be involved in crowd sourced funding for loan syndicates where each lender is lending only a small amount of money but there may be many lenders.

Likewise, we would like to be able to form small retail property syndicates (particularly in country towns) for separate properties costing around $1m.

In each of these situations, if we have to separately register each syndicate, the costs would be prohibitive.

If we could have one registered scheme for smaller syndicates, this will save costs, for example registration, audit, compliance audit, and reporting costs, and at the same time, enable us to comply with the current registration and compliance obligations. A number of forestry schemes were organised on this basis (e.g some of the Australian Growth schemes).

Hence, we support the ability to have schemes for any purpose which contain many syndicates, all governed by the same Constitution, but in respect of which not all members have an interest in every

syndicate.

[However we recognise that the Corporations Act did not intend scheme property to be held only by some of the members. Refer for example to sections 177(4), 601FB(4), 1317H(4) and 1317HA(4). These sections, and possibly others, may have to be amended for a scheme which has many sub-schemes.]

Question 3.1.2
Are there any reasons why the definition should not be amended in this way?

Submission

No.

3.2 Definition of 'member' of a managed investment scheme

Question 3.2.1
Have any problems arisen from the breadth of the definition of 'member' of a managed investment scheme? If so, please give details, including how many schemes and investors may have been affected.

Submission

As CAMAC correctly observes (note 46), in one of the Willmott Forests cases, the Court gave consideration to whether or not the owner of land and head-leases had made contributions to the scheme. Such an extension could cause problems for an RE.

Primary has difficulty sometimes in accommodating mortgagees of interests in agricultural schemes, where we are aware that the rights have been charged to the mortgagee and we are expected to make payment of any distributions to the mortgagee rather than to the holder of the interests. The mortgagee is usually not on the register.

As CAMAC observes, persons may have options to acquire units in a scheme and not be on the register.

Question 3.2.2 Should the definition of 'member' of a scheme be made more specific, for instance, by providing that a person is a member of a registered scheme only if the person appears on the register of members?
Submission Notwithstanding our answer to 3.2.1, no changes are recommended.
Question 3.2.3 Alternatively, if the current broad definition of 'member' remains, are any amendments required to other Corporations Act provisions to deal with the administrative consequences for the RE of having this wide definition?
Submission No. The aberrations that have occurred in agricultural schemes are unlikely to be repeated.
Question 3.2.4 Are there any reasons why the current broad definition of 'member' in the Corporations Act should remain as it is or, alternatively, why it should not be changed in a particular manner?
Submission There are more important issues to attend to.

Question 3.2.5
What, if any, specific rights should be preserved for holders of options over unissued interests in a scheme if it is made clear that those option holders are not members of the scheme?

Submission

The issues mentioned by Primary Securities can be accommodated without changing the rules.

3.3 Definition of 'scheme property'

Question 3.3.1
Have any problems arisen from the current definition of 'scheme property'? If so, please give details, including how many schemes may be affected.

Submission

In agricultural schemes, the right to the trees is usually held by individual scheme members and is equivalent to those trees only on their lot. These trees are not pooled, only after harvest. The few court decisions in which an interest in trees has been held to be scheme property are a distortion of the intention of the legislation. We see this as an issue. What if a liquidator were to the rights to a particular scheme member's trees in pursuing a lien claim, this would operate unfairly to those scheme members who hold those trees.

Likewise, we have arguments with the liquidator of Willmott Forests as to whether insurance proceeds paid for by scheme members individually (rather than by the RE as a whole for the scheme) is scheme property.

Following our appointment as RE, we have had arguments with banks as to whether or not bank accounts relevant to the scheme are scheme property or should be novated to a new RE even if expressly described as trust accounts, and the bank should treat the new RE as the holder of the account. Banks tend to ignore the novation provisions and look to the previous RE for instructions in relation to any bank accounts. In one case the previous RE directed substantial payments to be made by the Custodian of the scheme to various parties (including itself) after the resolution for change of RE by scheme members had been carried but before ASIC had registered that change.

In the case of the Templegate forestry schemes, "maintenance funds" were held by the previous RE in trust for scheme members but these could not be accessed by the scheme members because they were held not to be scheme property but constituted funds set up by the RE out of its own assets to secure the performance of its own maintenance obligations. [There is an inconsistency here because money paid to the RE as fees was not regarded as a "contribution to the scheme" but a payment to the RE. Therefore when the RE acquires assets using that money, the assets do not belong to the scheme members but to the RE personally. See also the Treecorp case.]

In the case of the Willmott Forest schemes, the RE owned the land which was leased to scheme

members. Even though the land was held "in relation to the scheme", the Supreme Court of Victoria held that the land was not scheme property but the RE had rights of use in relation to the land to enable the scheme to be operated. There were possibly Constitutional law reasons for the court not holding that the land was scheme property, as novation of ownership of the land would have required express wording in sections 601FS and FT.

In the case of Willmott Forests, the former RE entered into Forestry Right Agreements in favour of a subsidiary company (because it could not contract with itself to create a registrable instrument) and had these agreements registered on the title. The Forestry Right Agreements did not expressly state that they rights were held in trust for scheme members. The liquidator disputed the right of the new RE (Primary Securities) to the benefit of these agreements.

Primary Securities has had arguments with liquidators as to whether or not documents and accounts relevant to a scheme are scheme property. And what is the status of minutes of meetings of the board of the previous RE in relation to the scheme?

Whether insurance policies held in relation to a scheme are scheme property or novate to a new RE is also a question which has caused arguments for Primary Securities. In some cases, the insurance policies were worded to terminate upon the previous holder ceasing to the RE of the scheme.

A question also arises whether or not legal privilege belongs to the previous RE or the new RE when an RE changes. Who is entitled to the files? If a firm has been acting for the previous RE as responsible entity, can it then act for the new RE to sue the previous RE? Primary Securities would argue that a novation of all rights has occurred including rights of confidentiality and privilege.

Question 3.3.2
Should the legislation be amended to provide a more comprehensive definition of 'scheme property' and, if so, should specific categories of property be added to the current definition or should that definition be replaced with a more general definition?

Submission

The scheme property and novation provisions do need review as (from the perspective of Primary Securities) they have been the cause of too many arguments.

The definition should not include fees because fees will then be held in trust for scheme members which is contradictory.

Question 3.3.3
If specific categories are added to the definition, what should those additional categories be?

Submission

Add:

- Money declared by the RE to be held for the benefit of scheme members.
- Property held by or in the name of some trustee, nominee or agent for the RE including property held on constructive trust.
- The right to access any land, or use infrastructure or rights of way or other assets of an agricultural scheme held by the RE for the term of the scheme (or the continued use of the relevant property for the scheme) where the scheme uses or needs to use those assets.
- Head-leases (or licences) to the RE when scheme members hold sub-leases (or licences).
- Documents in relation to a scheme.
- Insurance in relation to a scheme.
- Bank accounts in relation to a scheme.

Question 3.3.4
If a more general definition is preferred, what should that definition be?

Submission

Add the matters referred to in 3.3.3.

Question 3.3.5
If a more general definition is preferred:

- does it need to deal with the situation where property in relation to the scheme is held on constructive trust for the RE
- should it exclude property relating to the scheme that is property of the RE in its own right?

Submission

See the answer to Question 3.3.3.

In the case of the Compass Hotel Group Trust, the RE was in receipt of a bank guarantee from the management company of the trust. When receivers were appointed over that company for that bank, the bank refused to honour the bank guarantee, claiming that it held security over it, notwithstanding clear documentation that the bank guarantee was not the property of the scheme or the management company but an entitlement of the RE personally. Primary Securities was forced to sue the receivers and the bank.

Question 3.3.6
If specific categories are added to the definition, should the Corporations Act clarify the circumstances in which property ceases to be scheme property and, if so, how?

Submission

See the answer to Question 3.3.3.

Question 3.3.7
If a general definition is adopted, would that definition make it sufficiently clear when property ceases to be scheme property?

Submission

See the answer to Question 3.3.3.

Question 3.3.8 Are there any reasons why there should not be a broader definition of scheme property or, alternatively, why further specific categories of scheme property should not be added to the current definition?
Submission No.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.
Submission

Chapter 4 Scheme registration

Template for submissions

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4.1 Criteria for determining whether a scheme should be registered

Question 4.1.1 Should all schemes require registration? If not, what should be the criteria for exemption from registration (for instance, should the numerical test be retained in its current form or with a higher or lower numerical threshold)?
Submission The requirement that a professional promoter must register all its schemes should not apply to a professional RE because its activities are already regulated by ASIC, an RE is used to due diligence and proper disclosure and carries PI insurance for all its activities. An RE should be allowed to form any number of schemes with less than 20 members or if each member has paid $1,000 or less without having to register those schemes. The $1,000 or less exception is to facilitate crowd sourced funding. There should be a minimum amount which ASIC should not concern itself with for any investment, such as $1,000 per investment, similar to the principle at law that the law does not concern itself with trifles.

Question 4.1.2
If an exemption from registration along the lines of the professional promoter test is retained, does the test require amendment? If so, how should it be amended?

Submission

Permit a responsible entity to form any number of syndicates of 20 persons (retail or wholesale) (or an unlimited number of persons who invest $1,000 or less) without having to register the syndicate as a scheme.

The exception should be the situation in which each of the sub-schemes in fact comprise a larger scheme, such as forestry lots.

Question 4.1.3
Does special provision need to be made for wholesale-only schemes and, if so, what? For instance, should there be a separate class of registered scheme for wholesale-only schemes or, alternatively, should wholesale-only schemes be exempt from regulatory requirements and, if so, what requirements and why?

Submission

Wholesale schemes should be exempt from the regulatory requirements.

Unfortunately, these requirements are due to change on 1 July 2014 by the introduction of the requirement of custodians for wholesale schemes. This is a backward step. Why not let the promoter and investors decide whether to have a custodian or not? If there is no custodian and the institutional investors require one, then one will be appointed. Otherwise, why insist when investors are wholesale investors, presumed to be able to look after themselves.

One change which would make the process simpler is to remove the requirement to file notices in relation to the appointment of authorised representatives, if the authorised representatives are only involved with wholesale schemes or in giving general advice.

4.2 ASIC's role in scheme registration

Question 4.2.1
Should ASIC's role in relation to scheme registration be brought more closely into line with its role in relation to company registration by:

- permitting it to register schemes without requiring active consideration of the registration criteria in each case, but giving it stop order powers to prevent the operation of non-compliant schemes
- giving it the same powers to refuse registration on the basis of name or a potential breach of the law as it has in relation to companies?

Submission

Yes. Scheme registration is not as simple a procedure as you indicate.

The Discussion Paper omits to mention the requirement before registration (or transfer) of a new scheme for the holder of the AFSL to vary the AFSL of the RE (assuming the holder of the AFSL holds their licence on a scheme by scheme basis).

Primary's AFSL only grants us the right to operate schemes on a scheme by scheme basis. If you have an AFSL authorising the RE to operate 16 registered schemes and the RE wants to add a 17th, there must first be an application for variation of the AFSL.

Variation of an AFSL is a tedious, expensive and time consuming process, and quite unnecessary if the RE already has appropriate key persons or responsible officers for the new scheme. Primary Securities Ltd has applied 50 or so times to vary its AFSL. There should be no requirement to vary an AFSL if the RE has an appropriate approved responsible officer.

Relevant to the topic of registration is the fact that there is no procedure for registration of a scheme which is unregistered but which should be registered. ASIC's only power is to apply to have an unregistered scheme wound up. Suppose there is an unregistered forestry scheme comprising 200 investors who each have separate leases of the same kind with the one manager, which has been in existence for 30 years and now as the trees are to be harvested, the manager has become insolvent. There is currently no procedure to regularise such a scheme, whereas to wind the scheme up would cause complete loss to the investors.

Question 4.2.2
Should ASIC have the power to refuse to register a scheme if it considers that the scheme's name may mislead investors? If so, should ASIC also have:

- a power to refuse to amend the register in the case of a notification of change of name where it believes that the proposed name may be misleading
- a power to issue a direction to change the name of a scheme if it considers it to be misleading?

Submission

Yes.

Question 4.2.3
Should ASIC have a power to refuse to register a scheme if circumstances exist in relation to the scheme that create a potential risk that the affairs of the scheme would not be conducted 'efficiently, honestly and fairly'?

Submission

Isn't this a licensing matter? If ASIC formed the view that the RE could not operate a scheme within its competence "efficiently, honestly and fairly" it should remove the AFSL.

Question 4.2.4
Should ASIC have a power to require schemes that fall within a particular class to have specific terms in their name?

Submission

If ASIC wishes.

Question 4.2.5 Are there any other grounds on which ASIC should be permitted to refuse to register a scheme?
Submission ASIC should always retain the power not to register a scheme.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.
Submission

Chapter 5 Governance framework for schemes

Template for submissions

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5.6 Reform options

Question 5.6.1
Should the current governance framework consisting of compliance requirements (including a compliance plan, a compliance committee in certain circumstances and audit of the compliance plan) and risk management requirements be retained (Option 1) and why? What problems and/or inadequacies have been experienced with the current framework and what steps might be taken to overcome them?

Submission

The various Regulatory Guides dealing with Compliance Plans already require compliance plans to deal with risk management both at the RE level and the scheme level. As a result, Primary includes full risk management issues and steps to be taken in all its compliance plans. In other words, Primary already has in place Option 2.

Primary opposes Option 3 because it confuses the identification of risks with the monitoring of risks. An ongoing risk management committee is an extra cost that is not warranted.

Identification of risks is a complicated business, best left to the RE itself. Primary's method of identifying risks is to have regard to risks commonly identified in the same industry by other REs, but to also require the relevant responsible officer to list all risks relevant to the investment activity and to play an active part in devising the management system, all of which is incorporated into the risk management system statement and transported into the compliance plan, which is regularly reviewed. The compliance committee is quite capable of monitoring the steps to be taken in mitigation of risks as this is parallel to monitoring compliance.

Question 5.6.2
Alternatively:

- should risk management requirements be introduced specifically for schemes, to operate alongside the compliance requirements for schemes and link in with the risk management licensing obligation of the RE (Option 2) and why, or
- should the current compliance requirements be abolished, with compliance to be covered as part of a risk management regime for schemes that could link in with the risk management framework for the REs that operate them (Option 3) and why?

Submission

Yes to Option 2. See the answer to Question 5.6.1.

Given that risks are included in the compliance plan, the risk management system should be incorporated into the compliance system, not the other way round. This is Option 2.

Question 5.6.3
If Option 1 or Option 2 is adopted, should one or more of the following changes (or some other change and, if so, what) be made to the compliance plan requirements:

- remove the liability of the RE and its officers for non-material breaches of the compliance plan to encourage more detailed plans
- define 'compliance plan' in the Corporations Act so that it covers all the company's documents that deal with compliance with the law
- prescribe additional (or alternative) matters that must be included in the compliance plan?

Submission

Yes, remove any liability for non-material breaches of the compliance plan. Do not expand the definition of compliance plan. Prescribe risk management as one of the matters that must be dealt with in the compliance plan.

Question 5.6.4
If additional matters are prescribed, what should those matters be?

Submission

Steps required to mitigate risks.

Question 5.6.5
If alternative matters are prescribed, which of the matters stipulated in s 601HA should be replaced and with what?

Submission

Primary sees no reason to remove any matters stipulated.

Question 5.6.6
If a risk management regime for schemes, to operate in conjunction with the compliance regime, is introduced (Option 2) or if compliance is merged into a risk management regime for schemes (Option 3):

- what should the elements of the risk management regime be
- should the legislation itself set standards for each of these elements or, alternatively, require that the RE set standards for each element
- should the risk management regime be in writing
- should the risk management regime include specific requirements for particular types of risk and, if so, what risks should be subject to specific requirements and what should those requirements be?

Submission

It is not possible to legislate to include the matters which might be risks. There is a danger in doing so as it could focus the responsible entity on inappropriate matters. For example, the matters required to be commented on as risks in property and investment scheme financial statements often bear little relation to the actual risks of the scheme and can tend to lull investors into thinking that these are all the risks there are (e.g. currency fluctuations).

Question 5.6.7
If Option 2 or Option 3 is adopted, how should the scheme's risk management arrangements be supervised? For instance, should a risk committee or an audit committee supervise those arrangements and, if so, what governance arrangements should apply to such a committee?

Submission

Continue as currently by including such matters in the compliance plan and have them audited by the compliance committee, being what Primary Securities does now.

Question 5.6.8
If Option 2 or Option 3 is adopted, should there be a requirement for an audit of the scheme's risk management arrangements?

Submission

Yes as part of the audit of the compliance plan.

Question 5.6.9 Under any of the options, what potential is there for duplicated or inconsistent regulation where the RE: • is listed in its own right • is prudentially regulated by the Australian Prudential Regulation Authority and how might any duplication or inconsistency be avoided?
Submission Listing makes no difference to what a responsible entity should be doing. This just adds to the matters to be considered in the compliance plan.
Question 5.6.10 What transitional arrangements might be required if Option 2 or Option 3 is adopted?
Submission
Question 5.6.11 Should the oppression remedy and/or the statutory derivative action procedure be available to members of a scheme in relation to the RE of the scheme and why?
Submission Yes, if appropriate.

5.7 Investment guidelines

Question 5.7.1 Should there be an express requirement for schemes that involve the ongoing investment of members funds to have investment guidelines?
Submission There is no need for any express requirements.
Question 5.7.2 Should departure from any investment guidelines be permitted in some cases and, if so, subject to what safeguards (for instance, approval by a risk committee)?
Submission Primary Securities suggests that is not appropriate to be prescriptive as to what risks exist and how they might be mitigated. Every scheme is different and there is a very wide variety of schemes which can be conceived, from agriculture to art. Risks cannot be predicted or prescribed. By prescribing certain risks which are inappropriate to a particular type of investment, investors may be misled into thinking that these risks are significant when there are not. Let the RE do its job.
Question 5.7.3 Should the RE be required to disclose the scheme’s investment guidelines and any changes to, or departure from, those guidelines and, if so, how?
Submission There is no need for any express requirements.

Question 5.7.4
Should a committee (for instance, a risk committee or an audit committee) be given a role in relation to investment guidelines, for instance to certify that a proposed transaction is in accordance with the guidelines or to approve a transaction that departs from the guidelines, either outright or subject to conditions? If so, what governance arrangements should apply to such a committee?

Submission

Only if these are matters covered in the compliance plan.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission

Amendments to the legislation are necessary to increase the transparency of the compliance committee. Currently, if a scheme member has a point of concern regarding a scheme it is often not possible to contact the members of the compliance committee to raise this concern because many REs do not disclose who the members of the compliance committee are, there is no register of members of the compliance committee and ASIC cannot disclose who they are.

The RE should be required to put on its website or otherwise make available to any scheme member the names, addresses, phone numbers and email addresses of the members of the compliance committee.

Compliance committee members should be permitted to disclose scheme information to scheme members, and should have qualified privilege when doing so (section 601JE).

This section on governance deals only with compliance and risk management.

What about management issues and the issue of scheme viability? The main risk for members of all managed investment schemes is that the responsible entity is a poor manager, or is taking advantage of scheme members.

For example, a number of agricultural schemes continue with no prospect of viability as currently managed and scheme members continue to pay fees year after year. The issue is not necessarily that the agricultural activity is not viable, the RE may simply be overcharging for the work done or making no effort to control costs.

Suppose, for example, that a vineyard scheme annually charges its scheme members $60,000 per hectare to run the scheme when the industry average per hectare is $30,000. This is difficult to challenge when you are a scheme member. Agricultural scheme members may not wish to shut the scheme down because their leases will be terminated and hence all their rights, with the result that the

land owner picks up all the assets. Regrettably, one of the only weapons for ASIC when a scheme is in difficulties is termination. Termination of an agricultural scheme, particularly just as the trees are reaching maturity, can operate as a fraud on scheme members because they lose everything.

The scheme needs to be made viable or saved by replacing the RE with an RE which will charge arms length fees and properly monitor sub-contractors and control costs.

Chapter 6 Scheme constitution

Template for submissions

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6.1 Rights and powers requiring inclusion in the constitution if they are to exist

Question 6.1.1 What rights and powers, if any, not currently requiring specification in a scheme constitution should be required to be so specified if they are to exist (for instance, an RE's power to grant security over scheme property)?
Submission We do not see the need to be prescriptive of what must be in a Constitution.

6.2 Enforceability of the scheme constitution

Question 6.2.1
How common is it for scheme constitutions to fail to provide that they are legally enforceable by all relevant parties against all other relevant parties?

Submission

The fact that Constitutions are not executed by scheme members always gives rise to a concern that a scheme member will say it is not binding on them though Primary Securities has never encountered this argument).

It is preferable if the Corporations Act specifies that a registered Constitution is binding on scheme members.

Question 6.2.2
Are there any instances of scheme members experiencing difficulties through being unable to enforce the scheme constitution against other members?

Submission

No.

Question 6.2.3
Are there any reasons why the approach to the enforceability of scheme constitutions should not be the same for schemes as for companies?

Submission

It is not the function of a Constitution to be enforceable against other scheme members.

Managed investment schemes are not companies and members do not have limited liability.

Scheme Constitutions are like spokes to wheel. The agreement constituted by the Constitution is an agreement between each several scheme member and the RE only. They are “several ventures” as opposed to “joint ventures”.

Primary opposes the extension to render a Constitution an agreement between each member. There could be unwanted consequences in members contracting with each other. There are potentially so

many kinds of schemes that such a change could sometimes result in danger for scheme members.

Some schemes could become closer to being outsized partnerships if they constituted agreements between each scheme member.

6.3 Procedure for changing the scheme constitution

Question 6.3.1
What difficulties, if any, have been experienced as a result of the current procedure for amending scheme constitutions?

Submission

We appreciate the effect of the decision in the *360 Capital* case, and the doubt that now arises in relation to any amendments an RE might unilaterally make to a Constitution. However, the situation in the *360 Capital* case was extreme because as a result of the RE's unilateral amendment, convertible notes were to be issued at a discount of 23%, and the interests of scheme members were going to be severely adversely affected.

Primary continues to make unilateral amendments where it considers that the rights of members are not adversely affected and the fund continues to be essentially administered in accordance with the constitution of the scheme prior to the amendments.

Question 6.3.2
Is there any reason why the procedure for changing a scheme constitution should differ from that for amending a company's constitution?

Submission

A responsible entity is under a much higher duty than the board of directors of a company. This higher duty justifies permitting the RE to make amendments which will not adversely affect members' rights.

As a professional responsible entity, Primary Securities makes a lot of Constitutional amendments for administrative convenience which of course do not adversely affect members' rights or interests. Our procedure involves full consideration of the question and the receipt of a legal opinion on the matter. We do not wish this facility to be removed. It could considerably add to our costs if every amendment, no matter how innocent, required a meeting of scheme members.

We oppose removing that right.

Question 6.3.3
If the procedure for amending a scheme constitution should differ from that for amending a company's constitution, does the current procedure for schemes (in particular the ability of the RE to amend the constitution where the RE reasonably considers that the amendment would not adversely affect members' interests) need to be modified and, if so, how?

Submission

To remove the concerns that were present in the *360 Capital* case, the Corporations Act could be amended so that it provides that amendments can be made unilaterally provided the amendments do not adversely affect members' rights **or interests**.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission

A recent ASIC Regulatory Guide 134 recommended that Constitutions be rejected which do not precisely specify the fees payable to a responsible entity or for the use of its staff but refer to the RE's usual rates. A maximum amount was permitted with the RE having the right to charge less.

Primary Securities believes that it is quite inappropriate to include in a Constitution a fee which is excessive (say 5% of the gross assets of a fund, or $1,000 per hour for its staff) and say that the RE is permitted to charge less. This is meaningless to scheme members and dangerous. Primary Securities prefers to charge a fee for its staff which is published on our website and available for all to see. Scheme members can see whether or not the fee is reasonable or not. These inappropriate provisions of Regulatory Guide 134 need to be withdrawn.

Chapter 7 The responsible entity and others involved in the operation of a scheme

Template for submissions

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7.1 Duty to treat members equally

Question 7.1.1
Should the RE's obligation to treat members of the same class 'equally' be replaced with an obligation to treat those members 'fairly'?

Submission

No, except in relation to the distinction between wholesale and retail clients.

Question 7.1.2
Are there any reasons why such a change should not be made?

Submission

"Equally" is unequivocal. "Fairly" is open to abuse and could lead to all kinds of inequities between members.

There are, however, good grounds for distinctions between wholesale investors and retail investors. Wholesale investors are usually careful in conducting due diligence and ongoing monitoring, and the presence of wholesale investors in a managed investment scheme assists retail investors who are

usually more passive and have fewer resources.

Question 7.1.3
Should such a change be accompanied by any consequential amendments (for instance, disclosure to investors of relevant details about differential fee arrangements)?

Submission

Yes, disclosure.

7.2 RE's entitlement to fees and indemnities

Question 7.2.1
What issues have arisen in practice in relation to the concept of 'proper performance' of an RE's duties?

Submission

There is a question as to whether or not fees in agricultural schemes are payable "out of scheme property", as if they were paid from a trust fund. The question depends upon whether they are "contributions to the scheme", like contributions to a trust fund. There is a possibility that fees may be payable otherwise than out of scheme property by reason of a separate agreement between the RE and the scheme member (see Jessup: Managed Investment Schemes para 7.6 and *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Company Ltd* [2008] WASCA 119).

Primary Securities has always treated fees as contributions "to the scheme" but to the extent that they are, their status as such vanishes as soon as they are received. If fees are simply received as fees, then they probably do not constitute contributions "to the scheme". If they are not contributions "to the scheme" but simply fees to the RE, then section 601GA(2)(b) does not apply at all. There is a legislative gap. Such fees then do not have to be spent for the proper performance of the duties of the RE.

If section 601GA(2)(b) does apply to fees in agricultural schemes, then there is a question as to whether or not that section is merely a requirement as to what must be included in a Constitution, or is also proscriptive of how fees must be treated. Primary Securities has always regarded the section as proscriptive and has placed fees in separate fee account to be used "for the proper performance" of the

RE's duties.

This means (in Primary's view) that the fees must be applied gradually over the course of the period for which the duties are to be carried out. In other words, it is not permissible to take the fees and put them in globo into the RE's general account whereby ordinary creditors of the RE can seize them.

This has occurred in a number of windings up of forestry schemes, including one example where the scheme members made contributions to plant trees on 30 June and the responsible entity was put into receivership the next day, on 1 July. The receivers (bank) took all fees paid on 30 June but no services were carried out. In that case, tens of thousands of seedlings were never planted and died.

If fees are paid in advance, the legislation should make it clear that the fees must first be put into a fee account whereupon they are subject to an obligation to be applied as required under the statutory duty in section 601GA(2)(b). The fees are then gradually paid to the general account as the work is done.

Question 7.2.2
If clarification of the meaning of 'proper performance' is required, which of the options mentioned in Section 7.2 should be adopted? Alternatively, should some other option be adopted and, if so, what?

Submission

Options 1 and 3 are quite inappropriate. Suppose a fee is payable in advance for work to be carried out over the life of a scheme – 25 years. It would be wrong not to permit the fee to be paid for 25 years. How is 25 years of work to be carried out without accessing the fees paid for that work? There should be no link between fees and breach. Breach is a separate matter. Option 2 is the correct interpretation.

The fees should be paid if there is proper performance of the duties. The fees should be payable ONLY if there is performance. Non-performance means the fees stop being paid. Non-performance may or may not be a breach, there may be a good reason for non-performance unrelated to breach.

The provisions should be interpreted to mean that for work for which the fee is done, that work actually has to be carried out, and the fee is only earned as the work is carried out. The fee should be able to be gradually paid from the fee account to the RE's general account as the work is done, and to pay for that work, in the same way as fees paid in advance are treated under the *Arthur Murray* principle – they are not "earned" until the services are carried out. It is inappropriate to interpret section 601GA(2)(b) as limiting the RE to any fees unless and until it has carried out all duties required of it without breach.

If there has been a breach of obligations of the RE, this is something that needs to be separately considered, outside the matter of fees.

Question 7.2.3
If Option 3 or Option 4 in Section 7.2 is adopted, should any restored entitlement to fees or rights of indemnity or reimbursement extend to amounts relating to the period of the breach?

Submission

As to Option 4, we cannot see this working in practice. Is CAMAC expecting an RE to be so disinterested as to recognise a breach, calculate the appropriate loss to scheme members, reimburse them for that loss and carry on as if all was normal? This is in our view unreal. We can hardly see this operating with success.

What kinds of breach are contemplated by CAMAC? Failure to insure? Investing too much into one high risk investment? Lending without security resulting in total loss? Failing to properly explain the risks of the scheme? Failing to register an instrument on the title? Failing to plant trees during the wet season so that the trees all die? (all actual examples we have come across).

Does CAMAC contemplate that the RE is simply able to remedy a breach by some credit against its fees? Each of the breach examples given in the last paragraph would be substantial breaches significantly outweighing any fees that might be payable to the RE.

Fees are liquidated claims and damages for breach are unliquidated claims.

Suppose an RE is covered by professional indemnity for a breach. Is the RE expected to make a claim on its PI policy on behalf of investors on account of its own negligence? Surely such an act would invalidate the policy as the RE is under an obligation to act as a prudential insured and deny any claim, or require it to be properly proved.

The only solution for breaches that are significant is for the scheme members to change RE.

Perhaps there needs to be some procedure to alert scheme members when there has been a breach for which damages are payable. The scheme members can then decide whether or not to try and change the RE.

Question 7.2.4
If Option 5 in Section 7.2 is adopted, what standard for determining 'proper performance' should be specified?

Submission

Option 5 should not be adopted.

7.3 Attribution to the responsible entity of acts or omissions of persons engaged to perform the responsible entity's functions

Question 7.3.1
For what purposes, or in what circumstances, should an RE be liable for the acts and omissions of its agents?

Submission

In all cases. We see no reason for change.

Question 7.3.2
Are there any reasons why liability should not be imposed on REs for the acts and omissions of their agents in all instances?

Submission

Primary accepts that liability.

Question 7.3.3
Does the current law adequately prevent the possibility of double compensation for an act or omission by an RE's agent and, if not, how should the law be clarified?

Submission

Double compensation should not be possible as recompense by one party would be set off against any compensation awarded against another.

7.4 Disclosure of interests of directors of the responsible entity

Question 7.4.1
Should the requirements for disclosure of interests of directors of REs of listed schemes be brought into line with the disclosure requirements in this area for listed companies?

Submission

Yes, except that the disclosure should also extend to directors of a management company engaged by the RE to manage the scheme.

7.5 Related party transactions

Question 7.5.1
Do the related party provisions for schemes need to differ from those for companies and, if so, in what respects and why?

Submission

Yes. To continue to ensure that it covers agents and persons engaged by the RE to manage the scheme. This is necessary because many REs are merely AFSL lenders for the actual operator of the scheme.

Question 7.5.2
Should the RE be subject to criminal liability and/or civil penalties for breach of the related party provisions?

Submission

As currently provided.

Question 7.5.3
Where an RE has given a benefit in contravention of the related party provisions, what should be the effect on the validity of the contract or transaction?

Submission

As currently provided.

7.6 Change of responsible entity

Question 7.6.1
Should the Corporations Act allow for the possibility of a change of RE without a meeting of members:

- in the types of circumstances where ASIC has given relief
- in any other circumstances and, if so, what circumstances

and what procedural safeguards should apply?

Submission

Yes, in the following circumstances:

- Where the new RE is a member of the same corporate group as the previous RE unless within a month of being advised of the right to do so, at least 5% of scheme members require a meeting to approve the appointment (as is currently the case where ASIC sometimes gives relief)
- Where the incumbent RE has retired and appointed a replacement RE unless within a month of being advised of the right to do so, at least 5% of scheme members require a meeting to approve the appointment
- Where the incumbent RE is under external control and a new RE has been appointed by the court, unless within a month of being advised of the right to do so, at least 5% of scheme members require a meeting to approve the appointment
- Where the incumbent RE is otherwise non-compliant (insolvent, insufficient NTA or cash, no appropriate responsible officer etc), and a new RE has been appointed by the court unless within a month of being advised of the right to do so, at least 5% of scheme members require a meeting to approve the appointment
- Where the incumbent RE has a serious conflict of interest and a new RE has been appointed by the court unless within a month of being advised of the right to do so, at least 5% of

scheme members require a meeting to approve the appointment.

7.7 Scheme custodians

Question 7.7.1
Should custodians of scheme property be required to hold an Australian financial services licence?

Submission

No. Primary Securities sees no reason for any change.

Question 7.7.2
Are there any reasons why scheme custodians should not be required to be licensed?

Submission

Custodians should not be required to be licensed.

Question 7.7.3
Should the Corporations Act be amended to clarify the basis on which custodians of scheme property hold that property on behalf of the RE and, if so, how?

Submission

No.

Question 7.7.4
Should the Corporations Act be amended to allow for a custodian to operate a designated account for holding application money?

Submission

No. This would be really inconvenient when raising money. It is quite important for the RE to have a good understanding of what has been received on a day to day basis, and from whom, or from what sources.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission

Difference between managed investment schemes and companies

There is a general theme throughout the Discussion Paper that the rules for companies and managed investment schemes should be brought more into line. We have sympathy for this but there are important differences between companies and managed investment schemes.

Board members of companies most often have a substantial stake in the company. Hence, the assets of the company are in part their own assets and any loss is a loss to themselves. The board of a company is able to use the assets of the company as it wishes, and has discretion in relation to remuneration and board fees. A company is a vehicle designed for risk taking and members have limited liability. Boards of a company rarely appoint a management company to run their activities, and self-manage.

Managed investment schemes are mostly trusts and the controlling responsible entities often have no or very few units in the trust and are simply managers of the assets of the trust. The responsible entity of a managed investment scheme is only able to use the scheme assets as authorised under the Constitution and can only pay such fees as are strictly authorised. A trust is not a vehicle designed for risk taking and members do not have limited liability. The RE is merely a manager. Frequently, the RE appoints a management company to operate the scheme, so the RE is even more removed, overseeing another manager.

Replacing the RE

Strangely, when REs are simply managers of other peoples' assets, they are immune from takeover.

The current legislative regime prevents or discourages takeovers and enables poor responsible entities to stay in place, or even makes it impossible to replace them.

This has led to abuse with entrenched REs plundering the assets they manage or being lazy. Managed investment schemes are rife with examples of poor management, exploitation, negligence, conflict

and even fraud.

It is not only poor managers who need to be replaced, any responsible entity needs to be constantly under pressure to reduce their fees because of the possibility of being replaced by a lower fee RE. What of the situation where a potential new RE promises to lower fees by 0.25% per annum? It is in the public interest that the rules encourage such takeovers.

Scheme members should be able to readily and easily replace a responsible entity as all they are doing is replacing the manager of their assets. Why should a mere manager possibly with no stake in a scheme have any special privileges?

In other words, rather than bringing companies and managed investment schemes into line in relation to changing the responsible entity and takeovers, the ability to change responsible entity should be made **easier** than it is to change the board of a company.

Facilitating changes in the responsible entity

Primary Securities proposes the following changes to the current regime to make it easier for scheme members to change responsible entity of a registered scheme:

- Regulation 2C.1.03(e) currently prohibits the use of a register for the purpose of making an offer to purchase a financial product that satisfies paragraphs 1019D(1)(a) to (d) of the Corporations Act. This regulation renders every responsible entity of an unlisted scheme absolutely immune from takeover as no-one is able to obtain a copy of the register with a view to purchasing units or shares. The effect of this regulation is to leave unit holders and shareholders who are being oppressed or exploited utterly without an important remedy, namely to start to buy up units with a view to taking over the trust or company, or to replacing the RE. Primary Securities understands the historic reasons for this rule, but an absolute prohibition is going too far. There is adequate protection imposed by virtue of section 1019D on its own without completely prohibiting the use of the register for takeovers.
- When an investor register is provided to a party contemplating a takeover, invariably the register omits email addresses and telephone numbers. The RE trying to replace the incumbent RE has to mail everything, while the incumbent RE can cost effectively and quickly email and even phone investors (mostly to misinform scheme members about the proposed new RE or the virtues of the incumbent RE). The incumbent RE should be required to provide email addresses and telephone numbers (at least in relation to possible attempts to replace the incumbent RE).
- The current voting requirements for takeover of unlisted schemes are very onerous. The requirement is for an “extraordinary resolution” which is a resolution “that has been passed by at least 50% of the total votes that may be cast by members entitled to vote (including members who are not present in person or by proxy).” Primary Securities can give the example of the Templegate schemes which were pine schemes which had been in existence since 1988. In 2010, the receivers and managers of Great Southern were proposing to terminate these schemes only a year or so after Great Southern had received substantial offers for the trees following a tender process. In other words, the receivers and managers who controlled the RE simply wanted to terminate the schemes so that the banks could take the land and trees on an unencumbered basis. Primary Securities arranged for 5% of scheme members to convene a meeting to change the RE. However, getting the required number of votes to change the responsible entity to Primary Securities Ltd was very difficult as many of the investors were dead or deregistered or their addresses unknown. Nonetheless, the required vote was obtained, but only through the mammoth effort of some of the scheme members. This is an example of where investors simply had to vote or lose everything. And it was still difficult and time consuming to bring in the required proxies to reach 50% of all

interests. Several reports have recommended that these onerous rules be changed and it is time this happened. No-one is protected except the incumbent RE.

- The problem for a prospective new RE is that obligations and liabilities may have been entered into in relation to a scheme which are unexpected or unknown and a new RE could be surprised upon takeover to find those obligations exist. As takeovers are usually hostile, the incumbent RE is not going to volunteer information to a prospective RE as this may assist the prospective RE in understanding or reducing the risks of takeover. There should be a requirement that upon 5% of scheme members calling a meeting to replace an incumbent RE, the incumbent RE should be obliged to make available to the unit holders calling the meeting (for the benefit of the prospective RE) such information as the prospective RE reasonably requires.
- Any management agreements entered into by the incumbent RE should cease to be binding from the date of change of an RE, otherwise the new RE could take over to find that a subsidiary of the previous RE is still operating the scheme.
- Any agreements of benefit to the incumbent RE (for example forestry rights on the title to protect the interest of scheme members) should not terminate on change of RE (as is the case with some of the Willmott Forests agreements).
- ASIC currently requires a new RE to continue to use the previous RE's auditors to until completion of the next audit, even after takeover. Following takeover, in the interest of scheme members, the new RE should be encouraged to inquire into the conduct of the past responsible entity and its auditors (particularly after an insolvency). A new RE should be able to immediately replace the auditors should it wish to do so without having to commence proceedings in the Administrative Appeals Tribunal (as Primary Securities was once forced to do) to effect a change of auditors, after replacing another RE.
- Following takeover, a new RE should not be penalised for the failures of the previous RE. For example, when Primary Securities has taken over schemes from insolvent REs we always have to prepare and file financial statements late (in one case, 8 years of financial statements had to be prepared and filed). Each time, Primary Securities is asked to pay penalties which are sometimes (but not always) able to be passed on to the scheme. This is inappropriate. Also, we have sometimes been asked by ASIC to prepare half yearly financial statements in such circumstances, which we refuse to do when they are being lodged years later, simply because this is pointless.

Chapter 8 Meetings of scheme members

Template for submissions

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8.1 Requisitioning scheme meetings

Question 8.1.1
Should the 100 member test for requisitioning scheme meetings be retained?

Submission

Yes, because for entities with a very large number of unit holders it is often difficult to get the support of 5% for a notice of meeting.

Question 8.1.2
If so, should the method for determining who is to be included as a member be clarified:

- by specifying how members who hold interests on behalf of the same beneficial owner are to be counted
- by specifying how a member who holds an interest on behalf of several beneficial owners is to be counted
- in some other manner and, if so, how?

Submission

It is not practicable to try and count beneficial members. One of our schemes has one unit holder holding their units for 100 members under a wrap arrangement. We have no idea how many beneficial holders they are or who they are, and they would not tell us even if we wanted to know. The information is highly confidential. Hence any requirement to go beyond the registered unit holders is going to involve time and cost and will result in uncertainty.

8.2 Meeting quorum requirements in scheme constitutions

Question 8.2.1
How common is it for scheme constitutions to adopt restrictive quorum requirements?

Submission

Primary Securities has encountered this for schemes where the responsible entity wishes to entrench itself. For example, one of the Constitutions for the Australian Growth schemes required at least 5 scheme members holding at least 10% of the aggregate number of interests in the scheme as the quorum for an ordinary resolution and at least 25% of the aggregate number of interests in the scheme as the quorum for a special resolution. Primary Securities deleted this provision of the Constitution upon becoming RE.

Question 8.2.2
Should the Corporations Act be amended so that the statutory quorum requirements for scheme meetings cannot be overridden by a scheme constitution:

- in any circumstances or, alternatively
- only where the purpose of a meeting is to consider the replacement of the RE?

Submission

Primary Securities supports such an amendment. The second bullet point is too restrictive as, at least in our case, whenever we wish to replace another RE, the notice of meeting always includes proposed amendments to the Constitution and is not confined to retirement and replacement resolutions. In most cases, we would not wish to be appointed as the RE unless these amendments are carried. Hence, there is no point in confining the smaller quorum requirement for appointment of RE if in conjunction with any appointment, amendments or other resolutions are required for which a smaller quorum is not required.

8.3 The chair of a scheme meeting

Question 8.3.1
Should it be permissible for a scheme constitution to exclude the right to demand a poll on the election of a chair?

Submission

Yes. The Managing Director of Primary Securities was at one of the Australian Olives schemes meetings at which the incumbent RE brought along a large number of proxies for individual scheme members to oppose the appointment of the chair that most of the scheme members (if there had been a poll) would have wanted. This resulted in the appointment of a chair supported by the incumbent RE who refused to put any of the resolutions to change RE on the spurious basis that they were "not in the best interests of the scheme members".

At meetings, scheme members have to be alert to the possibility that the incumbent RE will stack the meeting with student proxies so that the vote for chair on a show of hands can be won by the incumbent RE, who then refuses any resolutions.

Question 8.3.2
Should it be permissible for a scheme constitution to vary the finality of a chair's decision in relation to:

- determining a challenge to a person's right to vote at the meeting
- making a conclusive declaration of the results of a vote on a show of hands?

Submission

Yes, for the same reason.

Question 8.3.3
Should chairs of meetings be required to state the reasons for some or all of their decisions at the relevant meeting and include those reasons in the minutes? If such a requirement were to apply to some decisions only, to which types of decisions should it apply?

Submission

A little late requiring reasons to be put in the minutes if the scheme members have lost control of their meeting.

Question 8.3.4
Should the Corporations Act stipulate that the chair of a meeting of scheme members has a casting vote and, in addition, if the chair is a member of the scheme, any vote that the person may have in that capacity?

Submission

No.

8.4 Voting restrictions on resolutions at members' meetings

Question 8.4.1
Should the restriction on the entitlement of an RE and its associates to vote be clarified and, if so, in what respects and in what way? In particular, should it be made clear that the takeovers test applies when determining the meaning of 'associate' for the purpose of this voting exclusion?

Submission

Yes, the restriction should continue and be made clear as proposed.

Question 8.4.2 Should the current voting exclusion be amended so that it applies regardless of whether the scheme is listed or unlisted?
Submission Yes.

8.5 Proxy voting

Question 8.5.1 In what respects should the provisions relating to proxy voting for schemes be further aligned with those relating to companies?
Submission Those provisions which do not apply to schemes should be brought into alignment.

8.6 Procedures relating to adjournment of meetings

Question 8.6.1 Should a scheme constitution be permitted to vary the current requirement for giving notice of an adjourned scheme meeting?
Submission Yes.

Question 8.6.2
Should a scheme constitution be permitted to vary the statutory rule prohibiting an adjourned scheme meeting from considering new business?

Submission

Yes. Frequently, particularly in attempts to change RE, it is necessary to introduce new resolutions.

Question 8.6.3
What details should be given in any notice of an adjourned meeting?

Submission

Sufficient to enable the scheme members to understand the proposed resolution.

Question 8.6.4
Should the rules relating to adjourned meetings for schemes be aligned with those for companies?

Submission

It is difficult to see how the rules could be aligned.

It is important for scheme members that meetings can continue to be adjourned without having to go to the cost of reconvening. In the case of a number of schemes, circumstances prevent the actual brining of the resolutions required until everyone is ready, and in the interest of the scheme members calling the meeting, the meeting has had to be adjourned again and again.

It should also be borne in mind that a scheme is not like a company. Scheme members are mostly not in a strong position when trying to achieve anything in relation to the RE in control. Incumbent REs under attack cannot be trusted to deal honestly with proxies. Scheme members should be permitted to assemble proxies and deliver them to the incumbent RE prior to the meeting.

Question 8.6.5
Should the members of a scheme have the power to direct the chair of a meeting of scheme members to adjourn the meeting?

Submission

Yes.

8.7 Other alignment issues

Question 8.7.1
Should the law applicable to scheme meetings be brought into line with that applicable to company meetings in relation to:

- the time for determining the percentage of votes held by members
- the timing and manner of a poll?

Submission

Not completely. It is important for the protection of scheme members when a responsible entity is behaving badly, that the scheme members be able to gather proxies and then take them to the incumbent responsible entity just prior to the required time for delivery of proxies.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission

There should be provision for the chair at its discretion to accept proxies after the time for delivery of proxies but prior to the vote being taken.

Chapter 9 Other matters relating to scheme members

Template for submissions

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9.1 Access to scheme registers

Question 9.1.1
Are there legal or practical difficulties in the members of a scheme obtaining access to the scheme register?

Submission

Yes. Primary Securities has experienced the following strategies on the part of recalcitrant responsible entities, unwilling to be make a register available (particularly in the face of a possible attempt to replace it):

- Refusing to acknowledge that the proposed use was not a "prescribed use", and thereby refusing to give up the register
- Providing the register only upon certain restrictive undertakings being given
- Providing the register electronically as a continuous stream of data without columns (forcing us to reformat, an expensive and time consuming exercise for a long register)
- Providing the register in an incomplete form, for example, failing to set out lot numbers in relation to an agricultural scheme
- Failing to provide all the information kept by the responsible entity in relation to the scheme members (e.g. email addresses, phone numbers and planner details) and forcing Primary Securities to communicate expensively and slowly by mail when the incumbent responsible entity conducts an aggressive and sometimes defamatory or misleading email and phone campaign to prevent takeover. To combat such dirty tactics, Primary Securities sometimes employs staff to track down email address and phone numbers using internet search engines,

an expensive and time consuming process. Primary Securities accepts that privacy legislation may prevent such information being given, but perhaps it should be given if in any proxy battle the incumbent responsible entity is itself using the information or proposes to use the information so that the combatants are on a level playing field.

Question 9.1.2
If so, should the current requirement for the RE to allow access to the register be supplemented by:

- a duty for the officers of the RE to take the degree of care and diligence that a reasonable person would take to ensure that the RE complies with the access requirement (Option 1)
- liability of the RE and its officers for damages for any loss arising from non-compliance with the access requirement (Option 2)
- a requirement for the RE to lodge a copy of the scheme's register with ASIC regularly and, if so, how often (for instance, monthly or quarterly) (Option 3)
- a combination of two or more of these measures (Option 4)
- some other measure and, if so, what?

Submission

Primary Securities does not like any of these options. We prefer ASIC having the power to direct the RE to provide the register.

Question 9.1.3
Should the right of inspection and the right to obtain copies relate to:

- anything that happens to be recorded on the scheme register, or alternatively
- only the information that the Corporations Act requires to be included on that register?

Submission

Refer to the answer to Question 9.1.1.

Telephone numbers, email addresses and planner information (including email addresses and phone numbers) should be provided if the incumbent RE proposes to use that information in response to or in anticipation of the proposed use by the person seeking the register. Or this information should be provided to any RE which asks for the register, but on the basis that the information will only be used relevant to the scheme.

Question 9.1.4
Should the Corporations Act require any additional information to be included on the register and, if so, what?

Submission

No, we do not think that email addresses, phone numbers and planner details should be available to be inspected or provided in normal circumstances.

9.3 Scheme liquidity and the procedure for withdrawal

Question 9.3.1
Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?

Submission

Question 9.3.2
Should the requirement for pro rata sharing of available funds in relation to withdrawal from a non-liquid scheme be modified and, if so, how and why?

Submission

Question 9.3.3 Should the procedure for withdrawal from a scheme be modified in any other way and, if so, how and why?
Submission
Question 9.3.4 Should ASIC be given any administrative powers in relation to withdrawal, for instance a power to stop a withdrawal offer?
Submission

9.4 Possible buy-back procedure for scheme interests

Question 9.4.1 Should there be a buy-back procedure for interests in managed investment schemes?
Submission

Question 9.4.2 If so, should it be based on that provided for companies or take some other form?
Submission
Question 9.4.3 How should any buy-back procedure for schemes relate to the withdrawal procedure for schemes (either as currently set out in Part 5C.6 or as amended (see Questions 9.3.1-9.3.4))?
Submission

9.5 Ceasing to be a scheme member

Question 9.5.1 Should the Corporations Act clarify when a withdrawing member ceases to be a member of a scheme and, if so, how?
Submission

Other comments

Please insert any other comments you may have on the matters covered in this chapter.
Submission

Chapter 12 External administration

Template for submissions

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12.1 Remuneration and expenses in the winding up of a scheme

Question 12.1.1
Should a scheme liquidator, or other person charged with the winding up of a registered scheme, be given a statutory right to claim remuneration and expenses of winding up the scheme and, if so, what form should it take?

Submission

Under the Corporations Act, liquidators are appointed in relation to companies not schemes. A liquidator of a responsible entity may assume that it is also liquidator of the scheme but this is not necessarily the case because the insolvency of the responsible entity does not necessarily mean the scheme is insolvent.

Elsewhere in these Question 12 submissions Primary Securities points out how inappropriate it is for a liquidator of a responsible entity to also be liquidator of a scheme.

There is already sufficient authority at common law for liquidators to be remunerated from scheme property for its expenses in winding up a responsible entity when the liquidator also winds up the scheme.

Question 12.1.2
Should the Corporations Act provide that the liquidator of a registered scheme (or other person charged with the winding up of the scheme) is not liable to incur any expense in relation to the winding up of the scheme unless there is sufficient available property?

Submission

Liquidators already claim this to be the case.

Primary Securities has experienced first hand many dealings with conflicted REs purporting to act in the interests of scheme members (and claiming the costs of so acting from scheme property) but in reality acting to advance the interests of ordinary creditors.

The problem is that the power is sometimes inappropriately used for the benefit of the ordinary creditors at the expense of the scheme members.

When it is in the interest of the ordinary creditors, liquidators of forestry schemes are quite prepared to incur expense on behalf of a scheme (and then claim a lien for the costs) to:

- commission an opinion to the effect that the rent the RE is obliged to pay under a head-lease is indexed when indexation had hitherto clearly been waived [Gunns 2000 and 2001] which achieved the purpose of frightening a prospective replacement responsible entity (Primary Securities) from taking on the liability.
- commission lawyers to explain the obligations of being RE, when the RE had no intention of carrying out any work on the ground [Willmott Forests].
- commission an expert's opinion in relation to the viability of the scheme which is not made available to the scheme members to enable them to satisfy a prospective RE that the scheme was viable [Willmott Forests].

See also the answer to Question 12.1.4.

Question 12.1.3
Should the court or ASIC have a power to direct a liquidator of a registered scheme (or other person charged with the winding up of the scheme) to incur an expense where a creditor is willing to indemnify that person and, if necessary, give security for the expense?

Submission

Yes.

Question 12.1.4
Should the court have a power to make such orders as it deems just with respect to the distribution of scheme property whose recovery, protection or preservation has been assisted by money contributed by particular creditors?

Submission

Yes, they already do have this power. However, from the perspective of the scheme members, the exercise of this power becomes complicated when the liquidators are conflicted.

Liquidators usually do not recognise that their paramount duty is to the scheme as required by section 601FD(2). Their usual position is that their paramount duty is to the secured and ordinary creditors. Therefore to have liquidators in control of an RE and exercising the powers of the RE without accepting corresponding duties to scheme members is dangerous. An example of what can happen is how the liquidators of Willmott Forests have treated members of the Willmott Forests schemes.

The main asset of the liquidators of Willmott Forests Ltd, PPB, was land some of which was unencumbered by any mortgage but some was encumbered.

The land was subject to very long term leases to scheme members in many registered and unregistered managed investment schemes on which all rent had been paid in advance (with some exceptions). The value of the land encumbered by these long term leases was only $2m, but without these long term leases the value was $40m. The difference between the two values was $38m. In other words, the value of the schemes was $38m and the value of the land for creditors was $2m. If the land had to be sold with the leases in place, the liquidators were at risk of not receiving sufficient proceeds to pay for their own fees, particularly as they had borrowed several million dollars without security.

What the liquidators did will demonstrate that a scheme cannot be left in the hands of the liquidators of an insolvent RE because they are unable to overcome the conflict issues.

In a very short campaign, the liquidators sought replacement managers or responsible entities for the schemes but only invited responsible entities who would take on the burden of paying for completion of the schemes over 20 years, an unrealistic objective. The liquidators did not contemplate or initiate any proposal for the continuation of the schemes as contributory schemes, in which the scheme members might begin to pay fees and rescue themselves. The campaign to find replacement REs of course failed.

The liquidators then sought approval of the court to sell the trees (which were scheme assets) with the land, on the basis that the campaign to find replacement REs had failed. This court application ignored the fact that the main asset for the scheme members was their long term leases on which rent had been prepaid, and not just the immature trees.

The liquidators (who owned the land but not the trees) then advertised the land and trees together and asked the **purchasers** to allocate the purchase price between the land and the trees. When dealing with the owner of the land (and not the trees), purchasers are hardly likely to allocate to the detriment of the land owner. The liquidators have kept confidential the purchasers' allocations.

The purchaser's allocation for the Bombala schemes overall was so extreme in favour of the land (as opposed to the trees) that the liquidators tried to adjust the allocation with what was called the "Bombala Adjustment", increasing the amount offered for the trees, and reducing the amount to be paid for the land. The receivers refused to agree to this adjustment, as a result of which no adjustment was made in relation to the secured land.

Having gone through this exercise, the liquidators then allocated the sale costs in the proportion 32% to the scheme members and 68% to the ordinary creditors and then deducted the 32% of the sale costs from the price paid for the trees, as a result of which, for most schemes, the scheme members received nothing.

When the 95-99 scheme members sought to appoint a replacement responsible entity and convert the scheme into a contributory scheme, both the receivers and the liquidators commenced proceedings against the individual scheme members who called the meetings, for an injunction to restrain the meetings. The grounds for restraining the meetings were that the conversion of the scheme into a contributory scheme constituted a fraud on the minority scheme members who did not wish to pay any more fees, as their interest would be diluted. The principle of fraud on scheme members (the *Gambotto* principle) has only ever been applied to trusts and companies and not to contractual schemes which depend on fees being paid, so the claim was spurious.

Primary Securities was eventually appointed as the new RE but the liquidators continue to own the land and are not cooperative in relation to any matter and have taken many possible points at law at cost to the scheme members. Scheme members and their association Willmott Grower Group have so far endured five court proceedings including a High Court Appeal.

When the 95-99 scheme members (through Primary Securities) recently sought to purchase the land (and additional forestry land) to remove this problem, the liquidators refused to allow inspection of the additional land or provide due diligence materials to enable the scheme members to proceed with any purchase offer.

Question 12.1.5
What, if any, other provisions might assist a liquidator or other person charged with the winding up of a registered scheme in meeting the expenses of the winding up?

Submission

A better solution is the SLE Proposal.

12.2 External supervision of a scheme winding up

Question 12.2.1
Should there be external supervision of the winding up of a managed investment scheme and, if so, in what circumstances and by whom?

Submission

12.3 Disclaimer of leases

Question 12.3.1
Should the liquidator of an RE that is a lessor of property have the power to disclaim a lease of property under which scheme members are the lessees?

Submission

The High Court has pronounced on this issue. The liquidator of an RE (or any liquidator) that is a lessor of property does have the power to disclaim the leases. This will now act to the detriment of the forestry industry and many other industries with long time scales as no-one will want to enter into long term leases for fear that the owner will become insolvent and disclaim their leases.

Question 12.3.2
If the liquidators of lessor REs continue to have the power to disclaim leases with member lessees, should those who intend to become lessee investors have the benefit of disclosure of the possible consequences of a liquidation of the RE in relation to the interests that they intend to acquire in the scheme?

Submission

Yes, the possible disclaimer of leases by an insolvent land owner is now a risk of agricultural schemes and any business where property is leased.

What disclosures are made in any disclosure document is up the relevant RE. The Corporations Act should not try to prescribe what might be disclosed.

12.4 Duties and obligations of officers of an RE in financial difficulties

Question 12.4.1
Should the definition of 'officer of a corporation' be amended to clarify whether an external administrator of the RE of a managed investment scheme is, or is not, covered by the definition?

Submission

Yes. It is understandable that receivers are not bound to the duties of officers of an insolvent responsible entity but liquidators and administrators should be, and those duties should be paramount. Scheme members need some party to represent them and protect them. When the responsible entity is insolvent, scheme members are in a poor negotiating position and not having the active protection of a responsible entity can be very detrimental to their interests as explained above.

Question 12.4.2
If it is made clear that the definition extends to external administrators of an RE:

- should it apply to all provisions affecting officers of the RE and, if not, which provisions should be excluded and why
- should it apply to all external administrators of the RE and, if not, which categories of external administrator should be excluded and why?

Submission

The definition should not apply to receivers, but should apply to all other external administrators of an RE. A better solution is needed than to clarify who are officers of the RE.

Question 12.4.3
Should the duty of officers of the RE to act in the best interests of members be modified to allow for the situation where the scheme is, or is likely to become, insolvent?

Submission

No, this will lead to the same conflicts scheme members of agricultural schemes have experienced.

12.5 Notification of appointment of receiver

Question 12.5.1
Should the public notification requirements on appointment of a receiver to property of a corporation be amended and, if so, how?

Submission

Yes. If a scheme has become insolvent, such as a trust, in most cases the responsible entity is not personally liable for any debts as the responsible entity is usually protected by a covenant that any liabilities to the creditor / bank are limited to the assets of the scheme. It is therefore inappropriate for a notice of receivership to be shown against the name of the responsible entity as it is not the responsible entity which is in receivership, or any of its personal assets, but the assets of the scheme.

In many cases, notwithstanding the "single responsible entity" system, a trust or scheme is in fact managed by another entity and the trustee merely has an oversight role. Not all liquidations are the result of poor management, the global financial crisis was such a severe storm it undid many trusts, some of which are still frozen after 6 years.

Question 12.5.2
How significant is the problem identified in Section 12.5 in practice?

Submission

The problem is significant for the following reasons:

- The law should encourage companies to serve as trustees
- It can be very damaging to a professional trustee / responsible entity if the scheme has become insolvent but the trustee is not.
- It is misleading to show the responsible entity as subject to receivership when it is only a trust

operated by the responsible entity which is in receivership.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission

What should ASIC do when an RE is non-compliant?

An RE can become non-compliant for a number of reasons including:

- The RE is insolvent, and an administrator, receiver and manager, or liquidator have been appointed;
- The RE does not have sufficient assets or cash or its 12 monthly forecast shows that there will be insufficient assets or cash at some point during the next 12 months;
- The RE has lost one of its responsible officers relevant to the scheme and not replaced that person;
- The RE does not have the required professional indemnity or fraud insurance;
- The RE is late in lodging its financial statements;
- The RE is in default of its external resolution requirements;
- The RE has breached the related party provisions.

Primary understands that the current policy of ASIC is to treat the RE as an asset which could possibly be sold for the benefit of ordinary creditors of the corporate group that includes the RE. This policy is a poor one because it prefers ordinary creditors of companies in the same group over scheme members (quite contrary to section 601FD(2)) and can leave scheme members essentially unrepresented or at the mercy of liquidators who are in a serious conflict as explained further below.

Primary Securities took over one property scheme which had been in receivership with no active responsible entity for 8 years (Ferndale Unit Trust). In all that time, the scheme members had never been represented or reported to. ASIC had even granted an exemption to the receivers from having to carry out the statutory obligations such as financial reporting.

Primary Securities was appointed by the Supreme Court on the application of some of the scheme members. Primary completed the financial statements and tax returns for the 8 previous years, collected outstanding rent and subsequently sold the main asset of the scheme and returned capital to the long suffering unit holders.

Receivers and liquidators controlling non-compliant REs are non-compliant, unqualified and inexperienced and are subject to serious conflicts of interest if they try and operate a scheme. The policy of many receivers is now not to take over RE functions (because of the problem of this conflict

of interest). They leave the task of running the RE to liquidators who often have no assets and must generate funds from scheme assets to pay their fees. This leads to serious conflict with scheme members (see the notes above in relation to Willmott Forests Ltd).

In these circumstances, the SLE proposal is an excellent solution as it enables a solvent RE to take over an insolvent scheme without personally incurring the obligations of the scheme.

There is another possible solution to the problem, which is to legislate to enable ASIC to require any non-compliant RE to write to its members to inform them that it is non-compliant, setting out the reasons why it is non-compliant, and inviting them to find a new RE.

If the RE fails to do that, then ASIC should remove its AFSL because removal of the AFSL will enable a court to more readily appoint a replacement RE under section 601FN.