

1997

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

MANAGED INVESTMENTS BILL 1997

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Honourable Peter Costello MP)

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1**Outline**

1.1 This Bill represents the Government's response to the recommendations made by the Australian Law Reform Commission and the Companies and Securities Advisory Committee ('the Review') in Report No 65, entitled *Collective Investments: Other People's Money*, and the Final Report of the Financial System Inquiry (in particular, recommendation 89).

1.2 The Review carried out a thorough examination of the regulatory framework for prescribed interests and like collective investment schemes. That framework is currently two tier: the funds/assets of a scheme are vested in a trustee and the scheme is managed on a day-to-day basis by a management company.

1.3 The Review was critical of the perceived confusion of responsibility between the management company and the trustee for the conduct of a scheme's operations, and concluded that no re-working of the current system could overcome its inherent problems of divided powers and responsibilities, and the attendant legal complexity and uncertainty. The fundamental recommendation of the Review was that there be a single scheme operator in relation to each scheme.

1.4 Similarly, Recommendation 89 of the Financial System Inquiry proposed that the structure of managed investment schemes be brought into line with that applying to superannuation funds since 1 July 1994, by introducing a requirement for a single responsible entity.

1.5 The Bill proposes amendments to the Corporations Law for a new regime for the regulation of managed investment schemes, implementing many of the Review's recommendations. The new regime will be set out in Chapter 5C of the Corporations Law.

2

Regulation impact statement

Problem identification and regulatory objective

2.1 The Review concluded that the existing dual responsibility structure for prescribed interests has led to confusion about what protection is afforded to investors, and may be misleading as it does not emphasise that the management company has responsibility, not only for the management of the commercial aspects of a scheme, but also for ensuring its activities comply with the Law.

2.2 Hence, the primary problem of the current arrangements is that they give rise to a market failure in information flows. The current arrangements create confusion, for both investors and those involved in the management of these schemes, about who is ultimately responsible for the scheme's operation. Related problems are as follows —

- (a) The divided responsibility inherent in the current structure reduces the accountability of both trustee and management company to investors and allows a shuffling of blame when something goes wrong;
- (b) The two tier structure for managed investments regulated under the Corporations Law is inconsistent with the single responsible entity concept, which has been the basis for regulating managed investments under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) since 1994.

Identification of alternatives

2.3 The Review identified two options —

- (a) maintain, but update and clarify, the current two tier structure, or
- (b) move to a single responsible entity structure.

2.4 As noted above, the option favoured by the Review was to move to a single responsible entity structure.

2.5 Another option is *enhanced information strategies* for investors in managed investment schemes, to give them a better knowledge of the legal obligations of trustees

and management companies. However, the Review found that all involved in the industry — whether as investors, managers or trustees — were confused as to who was responsible for the various elements of a scheme's operation. While better information may lead to investors who are better informed about the risks involved in investing in particular schemes, a system-wide deficiency in the nature of the laws regulating the whole industry requires reform of those laws.

Administrative simplicity, economy and flexibility

2.6 Adoption of the legislative proposals will result in —

- (a) a simplified structure for the managed investments industry;
- (b) clarification of the responsibilities of the operators of managed investment schemes, to be known as responsible entities;
- (c) the introduction of measures to improve corporate governance in relation to responsible entities; and
- (d) appropriate powers for the ASC as the regulator.

2.7 Scheme operators are currently required to hold a securities dealers or advisers licence issued by the ASC. The new regulatory arrangements proposed for the managed investments industry will also require a responsible entity to hold a dealers licence, thus ensuring no substantial change in the cost of meeting the ASC's entry requirements. In addition, most schemes will need to be registered by the ASC. Registration requirements will focus on the mechanisms proposed by the responsible entity to ensure compliance with the requirements of the Law and the scheme's constitution. The registration process will replace the current deed and trustee approval process of the ASC.

2.8 The new regulatory measures will introduce a threshold test into the Law which will exclude from regulation under proposed Chapter 5C managed investment arrangements involving no more than 20 persons and which have not been promoted by a person in the business of promoting such schemes. This will ensure that small groups of ordinary investors involved in a business enterprise will not need to comply with the proposed new managed investment provisions. While there is a danger that any exemption may be exploited to avoid the proposed new regulatory arrangements, and hence threaten investors' interests, there are good reasons (namely, simplicity and efficiency) for exempting essentially private activities from the proposed requirements. In particular, the compliance burden on small schemes would be disproportionate to the likely benefits of regulation, and the smaller number of investors in these schemes means that it is more likely that they will be better informed than is the case with large schemes.

2.9 As is currently the case, the ASC will have the power to make specific exemption orders and class orders in relation to a scheme or class of schemes.

Consultation

2.10 The Review conducted wide ranging industry consultations over a period of two years. Further consultations were undertaken by officials with industry representatives, industry participants and advisers, following receipt of the final recommendations of the Review in August 1993. Subsequently, an exposure draft Bill was released in December 1995 for 3 months public consultation. The Government has since consulted widely in respect of the proposed reforms and both the Treasurer and the Parliamentary Secretary to the Treasurer have consulted widely and held a number of meetings with interested parties.

Review

2.11 The new arrangements will be reviewed by the ASC and the Treasury at the end of the proposed 2 year transition period. In light of the transition costs that will be incurred in implementation of the new regime, it is not anticipated that the regulation of managed investments will be subjected to further substantial revision at that time. Rather, it is expected that the review will assess the effectiveness of the administrative arrangements and regulatory requirements of the new regime, and allow the resource implications of the new regime for the ASC to be quantified. In addition, the new regime, like the rest of the Law, will be the subject of regular review by the ASC and the Treasury as part of their on-going consultation on corporations and securities issues.

3**Financial impact statement**

3.1 Transition costs will be incurred in moving to the new regulatory arrangements. These costs cannot be easily quantified as there are a number of contributing factors, eg the size of the scheme; the size, classes and location of scheme property; the nature of the compliance arrangements the new responsible entity decides to put in place for the scheme; and whether the responsible entity retains the existing trustee to hold the scheme property, decides to hold the scheme property itself or transfers it to another entity to hold.

3.2 Schemes that choose to engage a separate custodian to hold scheme property will incur the cost of those arrangements. Nevertheless, the fees associated with custodial work are typically lower than the costs associated with trustee supervision. With the industry estimated to have a size of approximately \$85 billion, and based on a “typical” trustee fee of 0.08% of funds, the current two tier structure is estimated to give rise to trustees’ fees of approximately \$68 million per annum. In contrast, if all schemes were to retain a custodian to hold scheme property (which, while not required, provides one basis for assessing cost differences), the estimated cost of those custodian arrangements would be almost \$21.25 million per annum (based on a “typical” trustee fee for custodian services of 0.025% of funds).

3.3 Not all the costs associated with the present two tier structure will be saved, as there will be other costs associated with the discharge by the responsible entity of its duties under the new arrangements. However, the proposed new regulatory arrangements will result in other benefits and efficiencies. The single responsible entity structure will resolve —

- the existing uncertainty which, from time to time, arises as to responsibility for the operation of a managed investment scheme;
- the operating costs to schemes of separate management and supervision structures; and
- the associated costs of trustees and management companies “second guessing” each other.

3.4 The resolution of these issues will lead to greater market efficiency and investor confidence. In addition, the single responsible entity concept will provide scope for the more efficient structuring of schemes, allowing improvements in the allocation of resources between schemes.

3.5 In general, the anticipated cost to schemes of meeting procedural requirements of the ASC (such as licensing of the responsible entity, registration of a scheme etc) are expected to be no greater than the cost of current analogous requirements.

3.6 The ASC may need additional resources, at least in the transition period for the new arrangements. These resource needs will be determined in consultation with the Department of Finance, and will be taken up in the 1998/99 Budget context. The ASC's longer-term resource needs will be examined as part of the review proposed in the evaluation strategy outlined in paragraph 2.11 above and taken up with the Minister for Finance in light of the review outcome.

4**Abbreviations**

The following abbreviations are used in this explanatory memorandum.

ASC	-	Australian Securities Commission
ASC Act	-	<i>Australian Securities Commission Act 1989</i>
ISC	-	Insurance and Superannuation Commission
Law	-	Corporations Law
Regulations	-	Corporations Regulations
SIS Act	-	<i>Superannuation Industry (Supervision) Act 1993</i>

5

Summary of key amendments proposed by the Bill

5.1 The key features of the new regulatory arrangements proposed by the Bill are —

- The concept of a *prescribed interest scheme* will be replaced with that of a *managed investment scheme*.
- Each managed investment scheme is to be operated by a single responsible entity.
 - The responsible entity will be completely liable to scheme members for all aspects of the scheme’s operation.
 - The responsible entity will not be prevented from engaging another person or body to do anything in connection with the operation of a scheme. However, the responsible entity will remain liable to the scheme members for any losses that arise from the activities of that person or body. It would be up to the responsible entity to seek to recover any losses it incurs from that person or body.
- The responsible entity must be licensed by the ASC. In deciding whether or not to issue a licence, the ASC will take account of the applicant’s good fame and character, expertise and ability (including financial capacity) to perform duties associated with being a responsible entity. The ASC will consider financial capacity as an aspect of an applicant’s ability to run a scheme competently.
- Most schemes must be registered by the ASC. In particular, registration will be required for schemes with more than 20 members, or which have been promoted by a person in the business of promoting such schemes.
- As part of the registration process, the responsible entity must submit a compliance plan to the ASC.
 - The plan must set out the measures that the responsible entity will take to ensure that the scheme’s operations comply with the Corporations Law and the scheme’s constitution.
 - The compliance plan must also set out the custodial arrangements to be put in place for scheme property. The responsible entity will not be able to intermingle the property of a scheme with its own assets or those of another scheme, but must ensure scheme property is held on trust for scheme

members and separately from its own assets. The responsible entity may choose to engage a custodian to hold the scheme property. However, as noted above, the responsible entity will remain liable to the scheme members for any losses that arise from the activities of the custodian.

- The compliance plan must also provide details of the arrangements the responsible entity will put in place to ensure that it is able to monitor the extent to which it complies with the compliance plan, the Corporations Law and the scheme’s constitution in operating the scheme, and to assess the need for any changes to the compliance plan.
- If at least half of the directors of the responsible entity are not external directors, the responsible entity will be required to establish a compliance committee with a majority of external members.
- The measures and arrangements of the compliance plan are to be audited annually.
- The responsible entity will be required to hold a securities dealers licence which will authorise it to operate a managed investment scheme.
- The existing statutory buy-back requirement will be repealed and replaced by withdrawal provisions for liquid and non-liquid schemes. Withdrawal arrangements from both liquid and non-liquid schemes will more closely be tied to the liquidity of the underlying assets of the scheme.
- The current prescribed interest provisions in Divisions 5 and 5A of Part 7.12 of the Corporations Law will be repealed. There will be a transition period of 2 years, during which existing prescribed interest schemes may be re-organised to satisfy the new requirements.
 - The ASC will have the power to extend that 2 year period in cases where a particular scheme is to be wound up and the ASC considers that it would be unreasonable to require the scheme to be re-organised before being wound up.
- The ASC’s powers in relation to the regulation of managed investment schemes will be clearly set out. The ASC’s powers will be clarified, and will include a power to accept enforceable undertakings from a responsible entity on anything concerning a registered scheme.

5.2 The fundraising activities of managed investment schemes will continue to be regulated under the prospectus requirements of the Law.

5.3 The possible extension of the takeover provisions of the Law to managed investment schemes is being examined in the Corporate Law Economic Reform Program.

5.4 Provisions relating to meetings, financial statements and audit, and annual returns of managed investment schemes will be introduced separately in the Company Law Review Bill.

6

Formal clauses

Clause 1 - Short title

6.1 Upon enactment, the Bill will be known as the *Managed Investments Act 1997*.

Clause 2 - Commencement

6.2 The Bill, once enacted, will commence immediately after the provisions relating to meetings, financial statements and audit, and annual returns of managed investment schemes in Schedules 1, 2, 3 and 4 of the *Company Law Review Act 1997* commence.

Clause 3 - Schedules

6.3 The Law and the ASC Act are to be amended or repealed as set out in the Schedules to the Bill. Schedule 1 inserts proposed Chapter 5C, regulating managed investment schemes, and proposed Division 12 of Part 11.2, providing transitional provisions for the new arrangements, into the Law. Schedule 2 makes further amendments to the Law, the ASC Act and the *Pooled Development Funds Act 1992* consequential on the new arrangements.

7

Proposed Part 5C.1 - Registration of managed investment schemes

When a managed investment scheme must be registered

7.1 A definition of ‘managed investment scheme’ will be inserted in section 9 of the Law (**Schedule 2, item 16 of the Bill**). Any investment scheme or arrangement satisfying this definition may be registered with the ASC.

7.2 A scheme must be registered, subject to certain exemptions, if the scheme has more than 20 members or has been promoted by a person who is in the business of promoting such schemes, or is an associate of the promoter. Schemes exempt from registration include schemes involving only excluded issues of securities (**proposed subsections 601ED(1) and (2)**). Subsection 66(2) of the Law will be amended to extend the categories of excluded issues and offers in relation to managed investment schemes (**Schedule 2, items 37 to 42**).

7.3 The operation of unregistered managed investment schemes which are required to be registered will be prohibited (**proposed subsection 601ED(5)**). The penalty for unlawfully operating an unregistered scheme will be a penalty of \$20,000 or imprisonment for 5 years or both.

7.4 Unregistered managed investment schemes which are not required to be registered will not have to comply with the requirements of the proposed new managed investments chapter (proposed Chapter 5C). A prospectus will not be required for such unregistered schemes (**Schedule 2, items 38 and 41**), while the exclusion from the prospectus requirements for limited offers, invitations or issues of securities will be extended to registered schemes (**Schedule 2, items 37 and 40**).

7.5 Whether registered or not, all interests in managed investment schemes are securities and as such are subject to the operation of section 995 and other parts of the Law dealing with securities (**Schedule 2, items 46 to 52**).

20 person threshold

7.6 Where a number of managed investment schemes are closely related, the ASC may determine that each of the schemes is required to be registered where the total number of

members of all the related schemes exceeds 20 (**proposed subsection 601ED(3)**). An example of an arrangement involving three trusts, where the Court found there to be but one scheme, was in the decision of the Supreme Court of South Australia in *Australian Securities Commission v. Su* 17 ACSR 94.

7.7 For the purposes of determining whether the 20 member threshold is satisfied, the holders of a joint interest in a scheme are to be counted as one member. However, where an interest is held by a trustee for beneficiaries who are presently entitled to a share of income of the trust estate or who individually, or together with other beneficiaries, are in a position to control the trustee, those beneficiaries are individually counted as members of the scheme rather than the trustee (**proposed subsection 601ED(4)**).

7.8 Proposed section 601ED will not apply to trusts arising in the course of the administration of the deceased estate of a member of a managed investment scheme. Persons who will benefit from the administration of a deceased estate only have an equitable right to have the estate administered properly and do not have any beneficial interest in the assets being administered.

7.9 Persons acting as the agent or employee of another person, or who are taking steps to wind up a scheme or remedy a defect that resulted in the schemes deregistration, will be taken not to be operating a scheme (**proposed subsection 601ED(6)**).

Applying for registration

7.10 An application must be lodged with the ASC in order to register a managed investment scheme (**proposed subsection 601EA(1)**).

7.11 The registration application must be accompanied by a copy of the scheme's constitution, a copy of the scheme's compliance plan, and a statement signed by the responsible entity's directors attesting to the compliance of those documents with proposed sections 601GA, 601GB and 601HA (**proposed subsection 601EA(4)**). The application must include details identifying the proposed:

- responsible entity of the scheme; and
- auditor of the scheme compliance plan (**proposed subsection 601EA(2)**).

7.12 The named auditor must have consented to be the auditor of the scheme prior to lodgement of the application (**proposed paragraph 601EA(2)(b) and subsection 601EA(3)**). The auditor's consent is to be retained by the responsible entity (**proposed subsection 601EA(3)**).

Registration

7.13 The ASC must register a scheme within 14 days (or 28 days where the application is lodged within the first 2 years of the operation of the new arrangements) (**proposed subsection 601EB(1)**) unless it appears that:

- the application does not comply with the requirements of proposed section 601EA for the lodging of the application

- the responsible entity is not a public company that holds a dealers licence authorising it to operate a managed investment, thus not satisfying proposed section 601FA
- the scheme's constitution does not meet the requirements of proposed sections 601GA or 601GB
- the scheme's compliance plan does not meet the requirements of proposed sections 601HA, or the copy lodged with the application has not been signed as required by proposed section 601HC
- arrangements are not in place to satisfy proposed section 601HG in relation to auditing the compliance of the responsible entity with the compliance plan.

7.14 On registration, the ASC will allocate a scheme identification number (an Australian Registered Scheme Number or ARSN) which must appear on all documents in relation to the scheme that are lodged with the ASC (**proposed subsection 601EB(2) and proposed section 601EC**).

7.15 Any change of the record of registration must be notified by the responsible entity to the ASC (**see proposed subsections 601FL(2), 601FM(2), 601FP(4), 601FQ(4), and section 601HI**). Modifications the compliance plan must be lodged with the ASC within 14 days (**proposed subsection 601HE(3)**).

7.16 The record of registration will be accessible to the public by searching the ASC's ASCOT database.

8

Proposed Part 5C.2 - The responsible entity

Proposed Division 1 - Responsibilities and powers

8.1 The responsible entity of a scheme must be a public company that holds a dealers licence authorising it to operate a managed investment scheme (**proposed section 601FA and Schedule 2, item 120**).

8.2 The ASC will administer the licensing of a responsible entity under the current provisions of Part 7.3 of the Law. For instance:

- an application for a licence will be required to be made in accordance with section 782 and, when granting a licence, the ASC must consider matters specified in section 784 such as the applicant's good fame and character, expertise and ability to perform duties associated with being a responsible entity. The ASC will also consider financial capacity as an aspect of an applicant's ability to run a scheme competently;
- the ASC may impose conditions and restrictions on the licence in accordance with section 786;
- a responsible entity will be required to notify the ASC of a breach of a condition of the licence in accordance with section 787;
- in accordance with section 788, a responsible entity must provide the ASC with written information about its operation of a scheme as it directs (**Schedule 2, item 121**); and
- the ASC will be able to revoke a responsible entity's licence without a hearing in limited circumstances, revoke a responsible entity's licence with a hearing in a broader range of circumstances, and suspend a responsible entity's licence (Division 5 of Part 7.3 and **Schedule 2, items 122 to 125**).

8.3 Proposed section 825A will give the ASC power to revoke a responsible entity's licence if it is satisfied that the members of the scheme have suffered or are likely to suffer loss or damage, because of a contravention of the Law (**Schedule 2, item 122**). Where the ASC takes this action, it would also take steps for a temporary responsible entity to be appointed to the scheme (**proposed section 601FN**). Where a responsible

entity is operating a number of schemes, the provision is sufficiently flexible to allow the ASC to amend the licence in relation to, for instance, one scheme only.

Responsible entity to operate scheme

8.4 The responsible entity is to perform the functions conferred on it by the scheme's constitution and the Law.

8.5 The responsible entity will not be precluded from engaging an agent, or otherwise engaging a person, to do anything that it is authorised to do in connection with the scheme. By way of example, the responsible entity may engage a custodian to hold the scheme property. Nevertheless, the responsible entity will be liable to the members for any losses that an agent causes to the scheme even though the agent acted fraudulently or outside the scope of their actual or apparent authority (**proposed section 601FB**).

8.6 The effect of this provision is to provide that the responsible entity is liable to members for any act or omission in relation to the affairs of the scheme. This places the onus upon the responsible entity to make good to scheme members any losses suffered by a scheme as a result of the conduct of persons engaged by the responsible entity in relation to the scheme. The responsible entity may in turn seek to recover its costs from the other persons.

8.7 Proposed section 601FB will, where the scheme is structured as a trust, override inconsistent provisions of State/Territory trustee legislation. It should be noted that section 6 of the *Corporations ([name of State]) Act*, which preserves the operation of earlier State/Northern Territory laws, only applies where there is no direct inconsistency with the Law. If there is any inconsistency (express or implied), the Law will override the earlier legislation. In the present case, the Law is intended to "cover the field" and so override inconsistent provisions of State/Territory trustee legislation operating in that "field".

Duties of responsible entity

8.8 The responsible entity of a managed investment scheme will be subject to extensive statutory duties (**proposed section 601FC**). The duties will reflect both the fundamental duties of a fiduciary, as well as certain of the duties currently imposed on the management company and trustee under the covenant provisions of Division 5 of Part 7.12 of the Law. These include the duties: to act honestly (**proposed paragraph 601FC(1)(a)**); to exercise the appropriate degree of skill, care and diligence (**proposed paragraph 601FC(1)(b)**); to act in the best interests of the members (**proposed paragraph 601FC(1)(c)**); to treat members of the same class equally and all members fairly (**proposed paragraph 601FC(1)(d)**); and to not make improper use of scheme information (**proposed paragraph 601FC(1)(e)**).

8.9 A number of the statutory duties reflect the special nature of the relationship between the responsible entity and the members of a scheme. The responsible entity must ensure that the scheme's constitution meets the requirements of proposed sections 601GA and 601GB (**proposed paragraph 601FC(1)(f)**). It must also ensure that all payments out of scheme property are made in accordance with the scheme's constitution

and the Law (**proposed paragraph 601FC(1)(k)**), including the payment of fees out of scheme property for the operation of the scheme.

8.10 The responsible entity will also be under a duty to ensure that scheme property is clearly identified as such and is held separately from both the responsible entity's own assets as well as from property of any other scheme (**proposed paragraph 601FC(1)(i)**). These duties are designed to ensure that scheme assets are not applied, either unintentionally or fraudulently, to the responsible entity's own purposes rather than those of the scheme. In the event of the failure of the responsible entity, the fact that scheme assets are identifiable as such and kept separate from the responsible entity's own assets will help to ensure that those assets are not applied to meet outstanding debts of the responsible entity, but are returned to the investors in the scheme. The value of scheme property is to be adequately monitored by the responsible entity (**proposed paragraph 601FC(1)(j)**). The responsible entity must ensure the scheme's compliance plan meets the requirements of proposed section 601HA (**proposed paragraph 601FC(1)(g)**) and must comply with the scheme's compliance plan (**proposed paragraph 601FC(1)(h)**).

8.11 The responsible entity will be under a duty to report to the ASC any breach of the Law that relates to the scheme and that has had, or is likely to have, a materially adverse affect on the interests of members (**proposed paragraph 601FC(1)(l)**). Additionally, the responsible entity will be under a duty to carry out any other duty conferred on it by the scheme's constitution, so long as that duty is not inconsistent with the Law (**proposed paragraph 601FC(1)(m)**). A breach of a duty placed upon the responsible entity by the scheme's constitution will be a breach of a statutory duty.

8.12 The statutory duties imposed by proposed subsection 601FC(1) upon the responsible entity will be civil penalty provisions (Part 9.4B of the Law). The civil penalty provisions will also apply to a number of the duties of officers of responsible entities and are discussed below.

8.13 The responsible entity will also be under a duty to hold scheme property on trust for scheme members (**proposed subsection 601FC(2)**). The responsible entity may, however, choose to engage a custodian to hold the scheme property. Even in that event, the responsible entity will remain liable to the scheme members for any losses that arise from the activities of the custodian.

8.14 The duties imposed on the responsible entity by proposed subsection 601FC(1) and (2) will override any conflicting duty an officer or employee of the responsible entity has under section 232 of the Law (**proposed subsection 601FC(3)**).

8.15 The responsible entity of registered managed investment schemes will only be able to invest in other managed investment schemes if those schemes are also registered (**proposed subsection 601FC(4)**).

8.16 Members of the scheme will given standing against the responsible entity for breaches of the above duties (**proposed section 601MA**).

Duties of officers of responsible entity

8.17 The term ‘officer’ in relation to the responsible entity of a registered scheme will be defined in section 9 to mean a person who is a director, secretary or executive officer of the company that is the responsible entity (**Schedule 2, item 21**).

8.18 The duties of officers of a responsible entity will reflect, in part, the duties owed by the responsible entity. These include the duties: to act honestly; to exercise the appropriate degree of skill, care and diligence; to act in the best interests of the members; and to not make improper use of their position or scheme information to gain an advantage for themselves or other persons, or to cause a detriment to scheme members (**proposed paragraphs 601FD(1)(a) to (e)**).

8.19 A further duty to be imposed upon officers of the responsible entity will be to take all reasonable steps to ensure that the responsible entity complies with the Law, the scheme’s constitution, any conditions imposed on its dealers licence and the scheme’s compliance plan (**proposed paragraph 601FD(1)(f)**). These duties will also be subject to the civil penalty provisions of the Law.

8.20 The duties imposed by proposed subsection 601FD(1) will override any conflicting duty an officer of the responsible entity has under section 232 of the Law (**proposed subsection 601FD(2)**).

Duties of employees of responsible entity

8.21 The Law will provide that an employee of the responsible entity of a registered scheme must not make improper use of their position or of scheme information to gain an advantage for themselves or other persons, or to cause a detriment to scheme members (**proposed subsection 601FE(1)**). These duties will also be subject to the civil penalty provisions of the Law.

8.22 The duties imposed by proposed subsection 601FE(1) will override any conflicting duty an employee of the responsible entity has under section 232 of the Law (**proposed subsection 601FE(2)**).

Surveillance checks by ASC

8.23 The responsible entity and its officers must take all reasonable steps to assist the ASC in its surveillance of managed investment schemes under **proposed section 601FF**.

8.24 The ASC may check compliance by responsible entities with the scheme’s constitution and compliance plan and the Law. The ASC can exercise its ASC Law powers for this purpose but proposed section 601FF does not impliedly limit the purposes for which the ASC may exercise its powers under the ASC Law. The ASC can also check without exercising ASC Law powers such as by merely requesting information. For example, the ASC may conduct checks by issuing a questionnaire to responsible entities generally or of a particular kind to assess whether the compliance plan is adequate and the responsible entity is otherwise complying. The ASC may also conduct occasional checks in relation to particular schemes.

Acquisition of interest in scheme by responsible entity

8.25 A responsible entity may only acquire an interest in a scheme under its control for the same consideration that would apply if it were any other person acquiring the interest and on terms that do not disadvantage other members (**proposed section 601FG**). The holding of interests in the scheme by the responsible entity will be subject to the restriction on voting those interests in proposed section 253E which appears in the Company Law Review Bill. Proposed section 601FG will also be a civil penalty provision.

Liquidator of the responsible entity entitled to exercise indemnity rights

8.26 If the responsible entity of a registered scheme is under external administration, a provision in the scheme's constitution, or another instrument, which would seek to deny any right of indemnity the company may have from scheme property, is void against the liquidator or administrator of the company (**proposed paragraph 601FH(a)**). Only the liquidator or administrator of the responsible entity can exercise that right of indemnity (**proposed paragraph 601FH(b)**).

Proposed Division 2 - Changing the responsible entity

8.27 Any purported change of a scheme's responsible entity will be ineffective until the ASC's record of scheme registration is changed (**proposed subsection 601FJ(1)**) and the change is in accordance with proposed Division 2 of Part 5C.2 (**proposed subsection 601FJ(2)**). The replacement responsible entity must meet the requirements of proposed section 601FA (**proposed section 601FK**).

Retirement of responsible entity

8.28 A responsible entity that wishes to retire will be required to call a meeting of the members to enable the members to vote on an extraordinary resolution to choose another company to be the responsible entity of the scheme (**proposed subsection 601FL(1)**).

8.29 The requirements for meetings of members of managed investment schemes will be set out in Part 2G.4 of Chapter 2G of the Company Law Review Bill. The term 'extraordinary resolution' is proposed to be inserted in section 9 of the Law by that Bill. Such a resolution must be passed by at least 50% of the total value of votes that may be cast by members (whether present or not) on the resolution.

8.30 If the members choose a new responsible entity at the meeting, the retiring responsible entity must as soon as practicable (and in any event within 2 business days), by written notice, request the ASC to remove its name from the scheme's record of registration and have the new responsible entity's name entered in its place. If the retiring responsible entity does not lodge the notice, the incoming responsible entity may do so (**proposed subsection 601FL(2)**). The notice cannot be lodged unless the

incoming responsible entity has consented (in writing) to becoming the new responsible entity (**proposed subsection 601FL(4)**).

8.31 If the members fail to choose a new responsible entity, the current responsible entity may apply to the court for a temporary responsible entity to be appointed (**proposed subsection 601FL(3)**).

Removal of responsible entity by members

8.32 Members who hold at least 5% of the value of the votes that may be cast on a resolution at a meeting, or who total 200 in number, may call a meeting in accordance with Division 1 of Part 2G.4 of the Law, to be inserted by the Company Law Review Bill, to change the responsible entity. In order to change the responsible entity, members will have to pass an extraordinary resolution to firstly remove the current entity and then another resolution to choose a new responsible entity (**proposed subsection 601FM(1)**).

8.33 The ASC must be notified as soon as practicable (and in any event within 2 business days) of the results of any proposed changes, and the ASC scheme register must be amended to give effect to the changes (**proposed subsection 601FM(2)**). Notice cannot be lodged unless the incoming responsible entity has consented (in writing) to becoming the new responsible entity (**proposed subsection 601FM(3)**).

Temporary responsible entity

8.34 The ASC or a member of a scheme may apply to the Court for the appointment of a temporary responsible entity where a scheme does not have a responsible entity (**proposed section 601FN**). The Court may appoint a temporary responsible entity where it is satisfied that such an appointment is in the best interests of the members of the scheme (**proposed subsection 601FP(1)**). It may also make any other orders that it considers necessary (**proposed subsection 601FP(2)**).

8.35 The temporary responsible entity will be required to take steps either to ensure that a new responsible entity is appointed by the members or, if this fails to occur, to apply to the Court to have the scheme wound up. A members' meeting must be called within 3 months of the appointment of the temporary responsible entity, and further meetings may be called within that time or such other time as the Court permits. The temporary responsible entity may apply to the Court to have the scheme wound up where no company satisfying the requirements of proposed section 601FA is chosen to be appointed as the scheme's responsible entity. The ASC or the members may also apply to the Court to have the scheme wound up if a new responsible entity is not appointed (**proposed section 601FQ**).

Proposed Division 3 - Consequences of change of responsible entity

8.36 On a change of responsible entity, the former responsible entity must give the new responsible entity any books in relation to the scheme which are required under the

Law, and to give reasonable assistance to facilitate the change of responsible entity (**proposed section 601FR**).

8.37 Where a new responsible entity is appointed, it will assume all the rights, obligations and liabilities that were vested in the former responsible entity, other than any right to indemnification held by the former entity or any liability for which the former entity would not have been indemnified out of scheme property (**proposed section 601FS**). The purpose of the section is to ensure that the former entity has the right to be reimbursed for expenses properly outlaid, or liabilities properly incurred, on behalf of the scheme.

8.38 In keeping with the principle that the new responsible entity will assume the role of the former responsible entity, any document to which the former responsible entity was a party is to be read as if the new responsible entity was the party to that document where the document is capable of having effect after the change (**proposed section 601FT**).

9**Proposed Part 5C.3 - The constitution**

9.1 Unlike the existing prescribed interest provisions of Division 5 of Part 7.12 of the Law, the legal form of a scheme's constitution will not be prescribed. However, whatever the form of the constitution, it must be legally binding as between the responsible entity and the members of the scheme (**proposed section 601GB**).

9.2 The constitution will be required to make adequate provision for a limited number of matters (**proposed section 601GA**). A scheme's constitution will be able to include any other matters that are not inconsistent with the statutory requirements. The statutory requirements of a constitution include provision for:

- the consideration to be paid to acquire an interest in the scheme. This would cover the basis for determining the consideration
- the investment powers of the responsible entity in relation to the scheme property
- the procedures for handling complaints made by members in relation to the scheme
- the winding up of the scheme (**proposed subsection 601GA(1)**).

9.3 If the responsible entity is to have rights to be paid fees or indemnified out of scheme property, or power to borrow or raise money for the purpose of the scheme, those rights and that power must be specified in the scheme constitution. The right of payment or indemnification will only be exercisable in relation to the proper performance of the duties of the responsible entity (**proposed subsection 601GA(2)**).

9.4 Where members have rights to withdraw from the scheme, the constitution must address the method for exercising those rights and for calculating the withdrawal value of the members' interests. These provisions must be consistent with the requirements of proposed Part 5C.6 (**proposed subsection 601GA(4)**). Proposed Part 5C.6 regulates the ability of a responsible entity to offer withdrawal rights to members on the basis of the liquidity of the scheme (**proposed section 601KA**).

9.5 Whether the provisions in the constitution which deal with these matters will be 'adequate' will depend on the nature of the scheme. The ASC must not register a scheme if the constitution does not comply with proposed Part 5C.3 (**proposed**

paragraph 601EB(1)(e) and it may deregister a scheme if it appears that the constitution does not comply with this Part (**proposed paragraph 601PB(1)(b)**).

Changing the constitution

9.6. A scheme's constitution may only be amended, modified or replaced with an approval by special resolution passed at a meeting of members (**proposed paragraph 601GC(1)(a)**) unless the responsible entity considers the change will not adversely affect members' rights. In the latter case, the amendment may be made by the responsible entity (**proposed paragraph 601GC(1)(b)**). Should a responsible entity amend the constitution in accordance with proposed paragraph 601GC(1)(b) in a way which in fact does adversely affect members rights, the affected members will have standing against the responsible entity under **proposed section 601MA**.

9.7. The voting requirements of a special resolution and the requirements for calling a meeting of members will be contained in the Company Law Review Bill. The term 'special resolution' is proposed to be inserted in section 9 of the Law by that Bill. Such a resolution must be passed by at least 75% of votes cast by members entitled to vote on the resolution.

9.8. A copy of an amendment to the constitution, or of a replacement constitution, must be lodged with the ASC, and the modification, or repeal and replacement, only takes effect upon lodgment (**proposed subsection 601GC(2)**). If the ASC so directs, the responsible entity will also be required to lodge a consolidated copy of the constitution with the ASC (**proposed subsection 601GC(3)**). The responsible entity must also provide a copy of the constitution to a member within 7 days of the member requesting a copy, upon payment of any fee up to a prescribed amount (**proposed subsection 601GC(4)**).

10**Proposed Part 5C.4 - The compliance plan**

10.1 A scheme's compliance plan is a document that will set out the measures that the responsible entity will apply in operating the scheme to ensure compliance with the Law and the scheme's constitution. The compliance plan will set out the various checks and balances to be in place to ensure that the scheme is operated in accordance with the requirements of the scheme's constitution and the requirements of the Law.

10.2 The responsible entity has a duty to ensure that the compliance plan meets the requirements of proposed section 601HA (**proposed paragraph 601FC(1)(g)**) and to comply with the compliance plan (**proposed paragraph 601FC(1)(h)**). The ASC will be assessing whether the compliance plan meets the requirements of proposed Part 5C.4 when considering a registration application. The ASC may give guidance on what compliance measures it will regard as adequate. For example, the ASC may issue a policy statement as to the circumstances in which the ASC will regard arrangements for holding scheme property as complying with proposed section 601 HA, including where it considers that it is necessary for the scheme property to be held by a person other than the responsible entity. The ASC will be able to deregister a scheme if it appears that the compliance plan no longer complies with the requirements of proposed Part 5C.4 (**proposed paragraph 601PB(1)(c)**).

Contents of the compliance plan

10.3 **Proposed section 601HA** sets out the minimum contents requirements of a compliance plan. The compliance plan will be required to contain:

- arrangements for ensuring scheme property is clearly identified as such and held separately from the responsible entity's assets and the property of any other scheme (**proposed paragraph 601HA(a)**)
- arrangements for the proper operation of the compliance committee if the scheme is required to have one (**proposed Part 5C.5**). The compliance plan must detail arrangements for:
 - the membership of the committee (proposed section 601JB sets out requirements for the membership of the committee) (**proposed subparagraph 601HA(b)(i)**)
 - how often the committee meets (**proposed subparagraph 601HA(b)(ii)**)

- the ability of the committee to report and make recommendations to the directors of the responsible entity (**proposed subparagraph 601HA(b)(iii)**)
- access of the committee to accounting records of the scheme, to scheme auditors and to information relevant to compliance matters (**proposed subparagraphs 601HA(b)(iv) and (v)**)
- arrangements for the valuation of scheme property (**proposed paragraph 601HA(c)**). The responsible entity will be under a duty to ensure that scheme property is valued at regular intervals having regard to the nature of the property (**proposed paragraph 601FC(1)(j)**).
- arrangements for auditing the compliance plan (**proposed paragraph 601HA(d)**). The auditor of the compliance plan must conduct an annual audit of the plan (**proposed section 601HG**). Any change of the auditor of the compliance plan must be notified to the ASC (**proposed section 601HH**)
- arrangements for keeping adequate records of the scheme's operations (**proposed paragraph 601HA(e)**). This may include arrangements for ensuring the safety and integrity of records of the scheme's property and of members' entitlements
- any other matters prescribed by the Corporations Regulations (**proposed paragraph 601HA(f)**).

10.4 The ASC may direct the responsible entity to give it information about measures contained in the plan (**proposed section 601HD**). Such a direction may include, for example, a request for details of computer systems and information storage procedures, manuals which demonstrate internal accounting systems procedures, or evidence of custodial arrangements. The ASC may also give a direction to provide information about the current or expected operation of the scheme in relation to which the measures would operate.

10.5 A compliance plan may incorporate by reference details of another compliance plan where the respective schemes have a common responsible entity (**proposed section 601HB**). The ASC may require the lodgement of a consolidated or full text compliance plan (**proposed section 601HF**). The compliance plan must be signed by the directors of the responsible entity (**proposed section 601HC**).

Changing the compliance plan

10.6 The Bill contains a number of provisions aimed at ensuring that the compliance plan is current at all times. For example:

- the ASC will be able to direct a responsible entity to amend the compliance plan (**proposed subsection 601HE(2)**)
- the responsible entity must lodge with the ASC a copy of any amendment to the compliance plan or a replacement compliance plan within 14 days of the amendment or replacement (**proposed subsection 601HE(3)**)
- the responsible entity must engage an auditor to conduct an annual audit of the compliance plan (**proposed subsection 601HG(1)**). The auditor's report

must state whether, in the auditor's opinion, the responsible entity has complied with the scheme's compliance plan and the plan continues to meet the requirements of the Law (**proposed paragraph 601HG(3)(c)**).

10.7 The auditor of the compliance plan must be a registered company auditor (**proposed subsection 601HG(1)**) and must not be an associate of the responsible entity; an agent holding scheme property on the responsible entity's behalf; or the auditor of the responsible entity (**proposed subsection 601HG(2)**). The auditor of the compliance plan is to have access to books of the scheme and assistance from the officers of the responsible entity (**proposed subsections 601HG(5) and (6)**).

10.8 The auditor's report of the compliance plan must be lodged with the ASC, together with the scheme's financial statements and reports (**proposed subsection 601HG(7)**). For registered schemes, this will be 3 months after the financial year (see sections 292 and 319(3)(a) as inserted by the Company Law Review Bill).

10.9 Where the auditor has reasonable grounds to suspect a contravention of the Law, and believes that the contravention will not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the responsible entity, the auditor must notify the ASC (**proposed subsection 601HG(4)**). The auditor will have qualified privilege in respect of such notifications as well as statements made in the audit report (**proposed subsection 601HG(8)**).

10.10 The responsible entity will be able to engage the auditor to carry out additional audits to those required by proposed section 601HG (**proposed subsection 601HG(9)**).

Removal and resignation of auditors

10.11 **Proposed subsection 601HH(1)** provides for removal of the auditor by the responsible entity. The responsible entity *must* remove the auditor if the auditor ceases to be eligible to act under subsection 601HG(2); and *may* remove the auditor at any time with the ASC's consent.

10.12 The auditor of the compliance plan may resign by written notice to the responsible entity with the ASC's consent (**proposed subsection 601HH(2)**). The auditor is protected from the use of a statement concerning the reasons for the resignation in civil or criminal proceedings (except for proceedings relating to section 1308 of the Law) (**proposed subsection 601HH(4)**). These protections are based on section 329 of the current Law.

10.13 The date at which the auditor's resignation takes effect depends on the circumstances of the resignation and is either the day of the notice of resignation, the day the ASC consents to resignation, or the day fixed by the ASC for resignation (**proposed subsection 601HH(5)**).

10.14 The record of the scheme's registration maintained by the ASC is to be altered to reflect the change of auditor (**proposed section 601HI**).

11

Proposed Part 5C.5 - The compliance committee

When is a compliance committee required?

11.1 Where at least half of the total number of directors of the responsible entity are 'external' directors, it will not be necessary for the responsible entity to establish a compliance committee for the operation of a registered scheme (**proposed subsection 601JA(1)**). The criteria for qualifying as an external director are set below (**proposed subsection 601JA(2)**).

11.2 The responsible entity will otherwise be required to establish and maintain a compliance committee for each scheme that the responsible entity operates. Generally, a responsible entity will know if it has to establish a compliance committee before registration of a scheme. However, where there is a change in the directors of the responsible entity and, as a result, the responsible entity is required under the Law to establish a compliance committee, it must do so within 14 days of the change or such longer period as the ASC allows (**proposed subsections 601JA(3) and (4)**).

External directors

11.3 To be an external director, a director must not:

- be, or have been in the previous two years, an employee of the responsible entity, or a related body corporate
- be, or have been in the previous two years, an executive officer of a related body corporate
- be, or have been in the previous two years, substantially involved in business dealings or in a professional relationship with the responsible entity or a related body corporate
- be, or have been in the previous two years, a member of a partnership that is substantially involved in business dealings or a professional relationship with the responsible entity or a related body corporate
- have any material interest in the responsible entity or a related body corporate or be an immediate family member of such a person.

11.4 A ‘related body corporate’ is defined by section 50 of the Law and would, for example, include a holding company of the responsible entity or a subsidiary of the responsible entity.

11.5 As a transitional measure, a person who was an officer or employee of the management company or trustee of a prescribed interest scheme regulated under Division 5 of Part 7.12 of the Law will not be taken to have been substantially involved in business dealings, or in a professional capacity, with the responsible entity where the management company or the trustee has not become the responsible entity (**proposed section 1464**).

Membership of the compliance committee

11.6 A compliance committee must consist of at least 3 members and a majority of the members must be persons who otherwise satisfy the requirements of an external director (**proposed section 601JB**). A director of a related body corporate, who is not also a director of the responsible entity, will qualify as an external member of the compliance committee of a scheme if they would have qualified as an external director of the responsible entity (**proposed subsection 601JB(3)**). An external director of the responsible entity can be an external member of the compliance committee of one or more of the schemes operated by the responsible entity (**proposed paragraph 601JB(4)(a)**). Similarly, an external member of a compliance committee can be an external member of other compliance committees for schemes operated by the responsible entity (**proposed paragraph 601JB(4)(b)**).

Functions of compliance committee

11.7 The compliance committee must monitor the operation of the scheme and the adequacy of the compliance plan and report on its findings to the responsible entity (**proposed paragraphs 601JC(a) and (d)**). Even where a responsible entity is not required to have a compliance committee, directors of the responsible entity would need to monitor the operation of the scheme and the adequacy of the compliance plan in order to satisfy their duty (**proposed paragraph 601FD(1)(f)**).

11.8 Where any non-compliance with the Law, or non-compliance with the provisions of a scheme’s constitution that are required to be included in that constitution by section 601GA, is detected, the compliance committee is required to report to the responsible entity (**proposed paragraph 601JC(b)**). Where the compliance committee forms the view that the responsible entity has not taken and does not propose to take action to remedy the defect, it should make a report to the ASC (**proposed paragraph 601JC(c)**). It should be noted that the responsible entity is under a duty to report to the ASC any breach of the Law with a material adverse effect on members’ interests that relates to the scheme as soon as practicable after it becomes aware of the breach (**proposed paragraph 601FC(1)(l)**).

Duties of members

11.9 A member of the compliance committee will have the following statutory duties (**proposed subsection 601JD(1)**):

- to act honestly when performing their functions as a member of the committee
- to perform their functions as a member of the committee with the degree of care and diligence that a reasonable person in the member's position would exercise
- not to make use of their position as a member of the committee, or information acquired by virtue of their position as a member of the committee, to gain an improper advantage personally or for another person, or to cause detriment to the members of the scheme.

11.10 To a certain extent, these duties mirror the duties imposed on officers of the responsible entity. Similarly, a breach of any of the above duties will be subject to the civil penalty provisions (Part 9.4B of the Law).

11.11 A member of the compliance committee must also take all reasonable steps to assist the ASC in carrying out a surveillance check under proposed subsection 601FF(1) (**proposed subsection 601JD(2)**). Members of the committee will have qualified privilege in relation to a statement made to the responsible entity or the ASC on behalf of the committee (**proposed section 601JE**).

When can responsible entity indemnify compliance committee members?

11.12 Subject to exceptions, a responsible entity or a related body corporate will be prohibited from indemnifying, or paying insurance premiums for, a member of the compliance committee in respect of liability incurred as a member of the committee (**proposed sections 601JF and 601JG**). The prohibitions are based on sections 241 and 241A of the Law, and similar exclusions are provided in relation to liability for cost and expenses incurred in defending legal proceedings.

Proceedings of compliance committee

11.13 Subject to the requirements of the compliance plan (**proposed paragraph 601HA(b)**), the regulation of proceedings at a compliance committee meeting will be determined by the committee itself (**proposed subsection 601JH(1)**). Meetings may be held by using any available technology where agreed to by members of the committee (**proposed subsection 601JH(3)**).

11.14 The Law will require that:

- the committee must keep minutes of its meetings (**proposed paragraph 601JH(2)(a)**)
- the committee must keep records of its reports and recommendations (**proposed paragraph 601JH(2)(b)**)

- if a committee member has a pecuniary interest in a matter being considered or to be considered, the member must disclose the interest to the committee where their interest may conflict with the proper performance of their duties (**proposed section 601JJ**).

12

Proposed Part 5C.6 - Members' rights to withdraw from a scheme

12.1 A member's right to withdraw will be set out in the scheme's constitution (**proposed subsection 601GA(4)**). The Law will regulate the procedure for withdrawals only in so far as it creates a distinction between liquid and non-liquid schemes.

Schemes which are liquid

12.2 Withdrawal from a liquid scheme may be offered at any time (**proposed subsection 601KA(1)**). The withdrawal must be made pursuant to the provisions in the scheme's constitution (**proposed paragraph 601KA(3)(a)**) and must be fair to all members (**proposed paragraph 601FC(1)(d)**).

12.3 A scheme will be a liquid scheme if 80 % of the scheme's property consists of liquid assets (**proposed subsection 601KA(4)**). Liquid assets will be defined (**proposed subsection 601KA(5)**) to be:

- money on account or on deposit with a bank, building society or other financial institution
- bank accepted bills
- marketable securities. Marketable securities include debentures, stocks, shares, bonds, or share options of a Government, a body corporate, an association or society (section 9 of the Law)
- property of a prescribed kind.

12.4 The assets must also be able to be realised within the period specified in the constitution for satisfying withdrawal requests (**proposed subsection 601KA(5)**).

12.5 Any other property will also be a liquid asset if the responsible entity reasonably expects the property can be realised for its market value within the withdrawal period (**proposed subsection 601KA(6)**).

Non-liquid schemes

12.6 A scheme which is not liquid may offer members the opportunity to withdraw from the scheme on a periodic basis consistent with the requirements of **proposed sections 601KB to 601KE**. The withdrawal must also be pursuant to the provisions in the scheme's constitution and be fair to all members (**proposed subsection 601KA(2) and proposed paragraph 601KA(3)(b)**).

12.7 Before making a withdrawal offer, the responsible entity must identify the liquid assets of the scheme which are available to meet any withdrawal requests which result from the offer (**proposed subsection 601KB(1)**). To make a withdrawal offer, the responsible entity must either follow the procedure for giving notice to members set out in the scheme constitution, or give a copy of the offer, in writing, to all members of the scheme or to all members of a class of members of the scheme (**proposed subsection 601KB(2)**). A copy of the withdrawal offer must also be given to the ASC (**proposed subsection 601KB(5)**).

12.8 The withdrawal offer must specify:

- the period during which the withdrawal offer will remain open (this period must be at least 21 days);
- the assets that will be used to satisfy withdrawal requests;
- the value of liquid assets identified for withdrawal; and
- the method by which withdrawal requests will be met if those liquid assets are not sufficient to meet all withdrawal requests (**proposed subsection 601KB(3)**).

12.9 A responsible entity of a scheme which is not liquid can only have one withdrawal offer open at any time for a particular class of members (**proposed section 601KC**).

12.10 The responsible entity cannot satisfy any of the withdrawal requests until the withdrawal offer period has closed. When a withdrawal offer closes, the responsible entity must satisfy withdrawal requests made in response to the offer within 21 days. If the value of withdrawal requests exceed the amount identified as being available for withdrawal, the requests must be met on a pro rata basis in accordance with the formula set out in **proposed section 601KD**.

12.11 The responsible entity *may* cancel a withdrawal offer before it closes if the notice contains a material error; or *must* cancel if it is in the best interests of members to do so (for example, where the value of liquid assets available for withdrawal has unexpectedly declined or where the liquid assets available for withdrawal have ceased to be liquid assets) (**proposed subsection 601KE(1)**).

12.12 The responsible entity must notify the members and the ASC of the cancellation of the withdrawal offer (**proposed subsections 601KE(2) and (3)**).

13

Proposed Part 5C.7 - Related party transactions

13.1 A modified version of the related party transaction provisions in Part 3.2A will be applied to registered managed investment schemes.

13.2 The related party transaction provisions were included in the Law by the *Corporate Law Reform Act 1992*. The provisions were included to protect shareholders of public companies against the possibility that the value of their investment would be eroded by a party related to the company arranging for the company to enter into a transaction which gives a benefit to the related party. The provisions only prevent transactions with related parties with the potential to adversely affect shareholders' interests, not full value commercial transactions.

13.3 Part 3.2A will be applied, with some modifications, to registered managed investment schemes to prohibit a responsible entity from providing a financial benefit to a related party that could diminish or endanger scheme property (**proposed sections 601LA and 601LB**). The basic prohibition in section 243H will apply to responsible entities, subject to the exceptions in Divisions 4 and 5 of Part 3.2A (**proposed section 601LC**).

13.4 The exceptions in sections 243L and 243M, and the provision in section 243ZF of the Law will not apply in relation to managed investment schemes. In relation to sections 243L and 243M, scheme members would not benefit from a responsible entity providing advances from scheme property to directors of the responsible entity, or from the responsible entity transferring scheme property to a closely held subsidiary. Section 243ZF will not apply because section 253E of Division 4 of Part 2G.4 of the Company Law Review Bill provides that a responsible entity and its associates are not allowed to vote at a members' meeting if they have an interest in the resolution or matter other than as a member (**proposed section 601LD**).

13.5 Section 243ZB will be applied as if references to subsection 243ZF(1) were to section 253E (**proposed section 601LE**).

14

Proposed Part 5C.8 - Effect of contraventions (civil liability and voidable contracts)

Civil liability of responsible entity to members

14.1 Scheme members will be provided with a statutory right of action against the responsible entity for loss or damage suffered as a result of a contravention of a provision of proposed Chapter 5C (**proposed section 601MA**). The action must be begun within 6 years of the cause of action arising and will not affect any liability of the responsible entity or another person under the Law or any other law.

14.2 The right to bring a statutory action will not extend to actions against other persons involved in the operation of the scheme (such as directors, compliance committee members or any entity engaged by the responsible entity to have custody of scheme property). A member's right to bring an action against these persons will depend on the general law and will not be set out in the Law. This will preserve the concept of a single responsible entity responsible to members for the operation of a scheme.

Voidable contracts where subscription offers and invitations contravene this Law

14.3 The Law currently provides that where an offer of, or an invitation to subscribe for, a prescribed interest is made in contravention of the Law, a contract entered into by an investor as a result of the offer or invitation is voidable at the option of the investor (section 1073(2)). The investor must give written notice to the management company and the management company can apply to the Court within 21 days for an order declaring the notice to be ineffective and affirming the contract where the breach is immaterial (section 1073A).

14.4 Section 1073(2) was introduced into the Law to overcome the decision in *Hurst v West Corp Ltd* (1988) 12 NSWLR 394. That case was based on the Companies Code, which required an offer of (prescribed) interests to be made pursuant to a prospectus and only where an approved deed was in force. The New South Wales Supreme Court held that an offer of interests made in contravention of the Code was unenforceable on the basis of illegality.

14.5 **Proposed section 601MB** will make contracts entered into voidable where an interest is offered in a scheme which is operated in contravention of **proposed subsection 601ED(5)** or in contravention of Part 7.12 of the Law. In effect, **proposed section 601MB** will reproduce subsections 1073(2) to (4) and section 1073A.

15**Proposed Part 5C.9 - Winding up**

15.1 A scheme's constitution will be able to provide for the winding up of a scheme at a specified time or on the happening of a specified event. An attempt by a responsible entity to entrench itself as the responsible entity of a scheme, by providing in the constitution that the scheme be wound up if a particular company ceases to be the responsible entity, is to be of no effect (**proposed section 601NA**).

15.2 Members of a scheme can call a members' meeting under Division 1 of Part 2.G4 (to be inserted by the Company Law Review Bill) to consider and vote on an extraordinary resolution directing the responsible entity to wind up the scheme (**proposed section 601NB**). An extraordinary resolution is a resolution that is passed by at least 50% of the total value of the votes that may be cast by members (whether present or not) on the resolution (see item 169 of Schedule 2 of the Company Law Review Bill).

15.3 Where a scheme's purpose has been accomplished or cannot be accomplished, a responsible entity can take the steps set out in **proposed section 601NC** to wind up the scheme. **Proposed subsection 601NC(2)** requires that a notice be provided to members and to the ASC explaining the proposal to wind up the scheme. The notice must inform members of both their rights to call a meeting under Division 1 of Part 2G.4 and that, if no meeting is called within 28 days of the notice being provided, the responsible entity may then wind up the scheme.

Winding up ordered by the Court

15.4 The responsible entity, a director of the responsible entity, a member of the scheme or the ASC will be able to apply to the Court to have a scheme wound up on the basis that it is just and equitable to do so. A creditor will also be able to make an application for a scheme to be wound up but only on the grounds that a court order against the responsible entity in relation to the scheme has been unsatisfied (**proposed section 601st**).

Responsibility for the winding up / Other orders about winding up

15.5 The responsible entity is to wind up the scheme in accordance with the scheme's constitution and any orders made by the Court if:

- a time, circumstances or event specified in the scheme's constitution as requiring the winding up of the scheme has occurred
- the members have passed an extraordinary resolution directing the responsible entity to wind up the scheme
- the court has directed that the scheme be wound up
- the responsible entity has been removed by members and no new responsible entity appointed (**proposed section 601NE**).

15.6 The Court may, on application of the responsible entity, a director of the responsible entity, a member of the scheme or the ASC, appoint a person to wind up the scheme. The Court may make other such orders as it sees fit (**proposed section 601NF**).

15.7 Any unclaimed money or property remaining on the completion of the winding up of the scheme must be paid or transferred to the ASC to be dealt with under Part 9.7 of the Law (**proposed section 601NG**).

16**Proposed Part 5C.10 - Deregistration****Voluntary deregistration**

16.1 The responsible entity may apply for deregistration if:

- the number of members of the scheme falls below the 20 member registration threshold (**proposed section 601ED**) and all members of the scheme consent to the deregistration
- the scheme was registered, although not required to be registered, and all members of the scheme consent to the deregistration
- the scheme ceases to be a managed investment scheme as defined (**proposed section 601PA**).

16.2 The consent of all members is considered necessary because, on deregistration, most of the requirements of Chapter 5C will cease to apply to the scheme. Some members may only have agreed to join the scheme because of these requirements.

Deregistration by the ASC

16.3 The ASC may deregister a scheme if:

- the scheme's responsible entity, constitution or compliance plan no longer satisfy the requirements of Chapter 5C, or if the scheme's property is not identified as such and held separately from the responsible entity's assets. This will give the ASC the power to deregister a scheme which is not being operated in accordance with the Chapter (**proposed paragraphs 601PB(1)(a) to (d)**). If a responsible entity continues to operate a scheme after deregistration, it will be in breach of **proposed subsection 601ED(5)** and liable for a penalty of \$20,000 or imprisonment for 5 years or both penalty and imprisonment
- the scheme is at least 6 months late lodging its annual return with the ASC and has not lodged any documents for at least 18 months and the ASC has no reason to believe that the scheme is being operated (**proposed paragraph 601PB(1)(e)**)

- the scheme has been wound up (**proposed paragraph 601PB(1)(f)**).

16.4 Where the ASC proposes to deregister a scheme, it will be required to give notice of the proposal to the responsible entity of the scheme, to any person who is winding up the scheme, on the ASC national database, and in the Commonwealth of Australia *Gazette* (**proposed subsection 601PB(2)**). A deregistration notice under any of the grounds in proposed paragraphs 601PB(1)(a) to (d) must include a time period after which the ASC proposes to deregister the scheme.

16.5 The time at which the ASC may deregister the scheme varies. Under any of the grounds in proposed paragraphs 601PB(1)(a) to (d), the ASC may deregister the scheme at any time from the end of the notice period. Under the grounds set out in proposed paragraphs 601PB(1)(e) and (f), the ASC may deregister the scheme when 2 months have passed since the *Gazette* notice.

16.6 The most important consequence of deregistration will be that the scheme will no longer be a registered scheme. The operation of unregistered scheme which is required to be registered will be offence under **proposed subsection 601ED(5)**. Since the majority of the provisions of proposed Chapter 5C only apply to a registered scheme, the scheme will not need to comply with those provisions after deregistration.

16.7 Deregistration will not affect any underlying legal relationships between persons involved in the operation of the scheme and scheme members.

Reinstatement

16.8 The ASC may reinstate the registration of a scheme if satisfied that it should not have been deregistered or the defect which resulted in the deregistration of the scheme has been remedied (**proposed subsection 601PC(1)**).

16.9 A person aggrieved by the deregistration or a person winding up the scheme will be able to apply to the Court for an order that the ASC reinstate the registration of the scheme (**proposed subsection 601PC(2)**). The Court will be able to make any ancillary orders which it considers just for putting the scheme and any other person in the same position, as far as possible, as if the scheme had not been deregistered (**proposed subsection 601PC(3)**).

16.10 The ASC will be required to give notice of any reinstatement in the Commonwealth of Australia *Gazette* and to any applicant for the reinstatement (**proposed subsection 601PC(4)**).

17

Proposed Part 5C.11 - Exemptions and modifications

17.1 The ASC will be able to make specific exemption and modification orders and class orders in relation to proposed Chapter 5C and Division 12 of Part 11.2 (**proposed section 601QA**). For example, this will allow the ASC to declare that the Chapter applies to a person as if it included a requirement that scheme property be held by a person other than the responsible entity.

17.2 The operation of Chapter 5C and any other provisions of the Law relating to managed investment schemes or classes of managed investment schemes may be modified by regulation (**proposed section 601QB**).

18

Proposed Division 12 of Part 11.2 of the Corporations Law - Changes resulting from the *Managed Investments Act 1997*

Commencement of Part 5C

18.1 All managed investment schemes that commence operation after the commencement of Chapter 5C will be required to be registered pursuant to the Chapter.

18.2 Existing prescribed interest schemes to which Division 5 of Part 7.12 of the old Law applied, or which enjoyed an exemption from the operation of the old Law by subparagraph 7.12.04(c)(ii) of the Corporations Regulations, will have a period of 2 years to become registered as a managed investment scheme under Chapter 5C. Until an existing prescribed interest scheme is registered under Chapter 5C, the Law relating to prescribed interests will continue to apply to it (**proposed sections 1452 and 1454**).

18.3 The ASC will be able to extend the 2 year period in relation to an individual prescribed interest scheme where the scheme is to be wound up within a fixed period and the ASC considers it would be otherwise unreasonable for the scheme to be registered under Chapter 5C (**proposed subsection 1454(2)**). This may apply to fixed term schemes which are not issuing any further interests.

18.4 Chapter 5C will also apply to prescribed interest schemes that have an approved deed under the old Law as if the exclusion from the requirement for registration of schemes with less than 20 members did not apply, unless all members agree (**proposed section 1453**).

Conversion to a single responsible entity

18.5 An existing trustee or representative may retire from office by giving a notice of retirement to the management company and the ASC. Similarly, an existing management company may retire by giving a notice of retirement to the trustee or representative and the ASC. Where both parties give a retirement notice at the same time, the notice of the management company is ineffective (**proposed section 1455**).

18.6 A retirement notice can only be given within the first year after the commencement of Chapter 5C. This will ensure that the party receiving the notice will have sufficient time to register the prescribed interest scheme under Chapter 5C within the 2 year period set by the Bill. A retirement notice, once given, cannot be revoked.

18.7 Where the trustee or representative or the management company receives a retirement notice, it must decide (**proposed section 1456**) either to:

- undertake to register the prescribed interest scheme under Chapter 5C and become the responsible entity of the scheme; or
- retire from office. If it decides to retire it must convene a meeting of unit holders to choose a proposed responsible entity which will register the prescribed interest scheme under the new regime. The meeting may also determine to wind up the scheme. The ASC must be notified of the outcome of the meeting.

18.8 Any notice to retire is ineffective until the scheme is registered under Part 5C. This will ensure that the existing trustee or representative and the management company continue to manage the scheme until a responsible entity is in place to operate the scheme and the scheme is registered under the Part 5C.

18.9 A body receiving a notice must make a decision within 2 months and must notify the ASC of its decision.

18.10 Importantly, a body that is proposing to become the responsible entity must still satisfy the requirement of being a public company with a dealers license authorising it to operate a managed investment scheme (**proposed section 601FA and Schedule 2, item 120**). While the body may already have a dealers license, it will not have been endorsed to allow the operation of a managed investment scheme. As such, all bodies that are proposing to convert to or otherwise become a responsible entity will need to seek the appropriate dealers license endorsement from the ASC. This is despite the provisions equating various of the terms of the old and new regimes (**proposed section 1465**).

Consequences of converting to comply with Chapter 5C

18.11 A number of powers designed to facilitate the conversion of a scheme to a scheme complying with Chapter 5C will be given to a body which is proposing to register the prescribed interest scheme and become its responsible entity. These will include the power to:

- lodge a registration application
- do all things necessary for the purpose of the registration application. For example, this would include arrangements to have a compliance plan prepared and to constitute a compliance committee if one is required; and
- modify the scheme's deed so that it will meet the requirements of Chapter 5C for a constitution of a managed investment scheme. The body must lodge a copy of the modifications with the ASC. The body does not have to call a meeting of prescribed interest holders to ratify the modifications unless requested to do so by the ASC (**proposed section 1460**).

18.12 When the scheme is registered, the Bill will facilitate the transfer of rights, obligations and liabilities from the former trustee or representative and management company to the new responsible entity (**proposed section 1462**).

Schemes which do not convert

18.13 The Bill does not explicitly address what happens to a prescribed interest scheme which fails to convert to Chapter 5C within the 2 year period allowed by the Bill. An existing prescribed interest scheme which does not register as a managed investment scheme under Chapter 5C will be operating in contravention of Chapter 5C. The ASC will be able to take the necessary action to prosecute the scheme operators.

19

Consequential amendments

Amendment of the Corporations Law

Definitions relevant to managed investment schemes

19.1 The section 9 dictionary of the Law is to be amended to include a number of definitions of terms which are relevant to the new arrangements for the regulation of managed investment schemes, and to remove those terms that were only used for the prescribed interest regime. New terms include ‘managed investment scheme’, ‘ARSN’, ‘franchise’, ‘interest in a managed investment scheme,’ ‘registered scheme’, ‘responsible entity’ and ‘scheme property’. Terms being removed include ‘buy-back arrangements’, ‘buy-back covenants’, ‘management company’, ‘participation interest’, ‘prescribed interest’ and ‘public corporation’ (**proposed Schedule 2, items 3, 4, 5, 13, 14, 16, 17, 22, 23, 25, 26, 27 and 28**).

19.2 Additionally, several section 9 definitions are to be amended to reflect the requirements of Chapter 5C. These include ‘constitution’, ‘member’ and ‘officer’, ‘subscriber’ and ‘undertaking’ (**proposed Schedule 2, items 8, 19, 21, 30 and 31**). Other section 9 definitions require amendment to refer to ‘interests in a managed investment scheme’, replacing the previous ‘prescribed interests’. Such definitions include ‘class’, ‘excluded security’, ‘issue’ and ‘marketable security’ (**proposed Schedule 2, items 7, 10, 15 and 18**).

Managed Investment Schemes

19.3 The central definition of the Chapter 5C regime is that of ‘**managed investment scheme**’.

19.4 Managed investment schemes are currently regulated under the ‘prescribed interest’ provisions of the Law. The complex and seemingly all embracing definition of ‘prescribed interest’ has been widely criticised because of its lack of precision.

19.5 The definition of a ‘managed investment scheme’, to be inserted in section 9 (**proposed Schedule 2, item 16**), will provide greater certainty and guidance as to what

Consequential provisions

investment arrangements are to be regulated under the Law. The definition sets out the key elements of a managed investment scheme for the purposes of the Law.

19.6 The essential features of a scheme are that:

- (a) persons contribute money or money's worth to acquire interests in the scheme – incorporating a purposive element in the definition
- (b) any of the contributions are pooled or used in a common enterprise to produce financial or other benefits to members; and
- (c) the members do not have day to day control over the operation of the scheme although they may be consulted.

19.7 Notably, the term 'used in a common enterprise' may include arrangements described as enterprise or agricultural schemes. The concept of a 'common enterprise' has been judicially considered on a number occasions and continues to be relevant for the purposes of this definition. Since 'any of the contributions' are to be pooled, arrangements, such as those known as managed discretionary accounts or member discretionary master funds where part of the contributions made by a member to a scheme may not be pooled, will nonetheless fall within the definition.

19.8 An option to subscribe for an interest in a managed investment scheme will be an interest in a managed investment scheme because it is a contingent right to the benefits of the scheme.

19.9 The definition of managed investment scheme expressly includes time sharing schemes as defined in section 9 of the Law.

Statutory exclusions

19.10 Existing exclusions from the prescribed interest arrangements are either specifically excluded or do not come within the terms of the definition of **managed investment scheme**.

19.11 Schemes and arrangements specifically excluded from the definition are: statutory funds under the *Life Insurance Act 1995*; certain funds regulated under the *Superannuation Industry (Supervision) Act 1993*; schemes involving the issue of debentures or convertible notes by a body corporate; schemes operated by Australian banks in the ordinary course of banking business; bodies corporate; partnerships with more than 20 persons; exempt Western Australian schemes; retirement village schemes; franchises; barter schemes; and schemes or arrangements in which all the members are bodies corporate that are related to each other and to the body corporate that promotes the scheme or arrangement.

19.12 There is also provision for the regulations to declare that certain kinds of schemes or arrangements are not managed investment schemes for the purposes of the Law.

Other changes to the Corporations Law

19.13 The change in terminology from ‘prescribed interest’ to ‘interests in a managed investment scheme’ affects other areas of the Law, including some of the further definition sections, without having a substantive change on those areas. Definition sections of the Law that will continue to apply to interests in managed investment schemes after Chapter 5C commences include the definitions of ‘affairs of a body corporate’, ‘excluded issues, offers and invitations’, ‘offers and invitations to the public’, and ‘securities’ (**proposed Schedule 2, items 33-35, 37-42, 44 and 46-52**).

19.14 Importantly, the definition of ‘security’ in section 92 will include all interests in a managed investment scheme. This definition will apply to interests in both registered and unregistered managed investment schemes, in order to ensure the application of the provisions relating to misconduct in relation to securities.

19.15 Other provisions of the Law that will continue to apply to interests in managed investment schemes after Chapter 5C commences include the provisions relating to disclosing entities under Part 1.2A, the provisions relating to registers, and the ability of a responsible entity of a managed investment scheme to seek a special stock market license under s770A (**proposed Schedule 2, items 53-56, 57-93 and 105-117**).

19.16 Accompanying the commencement of proposed Chapter 5C will be a new Division 1A of Part 3.7, governing the appointment and removal of auditors of registered managed investment schemes (**proposed Schedule 2, items 102 and 103**).

19.17 A responsible entity must hold a dealers license authorising it to operate a managed investment scheme (**proposed section 601FA**). Provision is made for the issue of a dealers license authorising a public company to operate a managed investment scheme or schemes of a particular kind (**proposed Schedule 2, item 120**). The ASC may vary or revoke an authorisation under subsection 109ZB(5) without a hearing. As with all dealers licenses, a license authorising a public company to operate a managed investment scheme is subject to the provisions of Part 7.3 of the Law. In particular, this includes the imposition of conditions upon the licensee. Under subsection 786(1), this includes both prescribed conditions as well as any conditions or restrictions the ASC may impose at any time. The holder of a licence is required, under section 788, to provide the ASC with such written information in relation to the managed investment scheme operated by the licence holder as the ASC directs (**proposed Schedule 2, item 121**). It should also be noted that current dealers license holders will not automatically be permitted to operate managed investment schemes. License holders proposing to become a responsible entity will need to apply to the ASC for the additional license endorsement.

19.18 Various provisions of Part 7.11 (Conduct in relation to securities) will be amended to ensure their application to managed investment scheme operators. These include the provisions on continuous disclosure (**proposed Schedule 2, items 127-130**), insider trading (**proposed Schedule 2, items 131-133**) and prospectuses and unlawful market activity (**proposed Schedule 2, items 134 and 135**).

19.19 **Proposed Schedule 2, item 122** inserts in the Law an additional power enabling the ASC to revoke the dealers license of a responsible entity without a hearing in certain circumstances. While no formal hearing is required before the license can be revoked,

the ASC is still bound by the obligations of natural justice and other administrative law principles before a revocation could be validly made.

19.20 The civil penalty provisions of Part 9.4B will be altered to accommodate the new civil penalty provisions in **proposed sections 601FC(1), 601FD(1), 601FE(1), 601FG, and 601JD(1) (proposed Schedule 2, items 149-171)**. Some changes will occur in the manner in which any compensation under the civil penalty provisions is paid. Where the contravening party is the responsible entity itself, the compensation payment is to form part of the scheme property. In any other case, the responsible entity will accept the compensation in trust for the scheme members.

Amendment of the Australian Securities Commission Act 1989

19.21 The ASC will be empowered to examine the operations of responsible entities to ensure compliance with the scheme's constitution, compliance plan and the Law (**proposed section 601FF**). Part 3 of the ASC Act is to be amended so that the investigation and information gathering powers of the ASC are expressly applied to managed investment schemes.

19.22 The general power of the ASC to investigate a suspected breach of the Law concerning the management of the affairs of a body corporate or involving fraud or dishonesty which relates to a body corporate, securities or futures contracts is to apply in relation to a managed investment scheme (**proposed Schedule 2, items 174 and 175**).

19.23 The ASC may inspect books required to be kept under a national scheme law in the exercise of its powers or functions under the law or to ensure compliance with the law or in the course of an investigation (sections 28 and 29 of the ASC Act). This will automatically apply in relation to the proposed ASC power to check a responsible entity's compliance with a registered scheme's constitution, compliance plan and the Law. The inspection of books which relate to the affairs of a body corporate (section 30 of the ASC Act) is to be extended to require the responsible entity (or 'eligible person' in relation to the responsible entity - see definition in section 5 of the ASC Act) in relation to a managed investment scheme to produce to the ASC specified books on written request (**proposed Schedule 2, item 177**).

19.24 Section 33 of the ASC Act, which allows the ASC to require the production of books in a person's possession and which relate to the affairs of a body corporate, is also to be extended to the affairs of a registered managed investment scheme (**proposed Schedule 2, item 178**).

19.25 **Proposed Schedule 2, item 179** will insert section 39A into Division 3 of Part 3 of the ASC Act. Section 39A will enable the ASC to give any book in its possession that relates to a registered scheme to a person. The ASC may impose conditions on the provision of books. A breach of the conditions, or the use of the materials for another purpose is an offence. This power will, for example, allow the ASC to give information to a person where that person is contemplating legal proceedings in relation to a registered scheme.

Enforceable Undertakings

19.26 **Proposed Schedule 2, item 180** will insert PART 3A – ENFORCEABLE UNDERTAKINGS IN RELATION TO REGISTERED SCHEMES into the ASC Act. Part 3A will enable the ASC to accept enforceable undertakings from a responsible entity in relation to any matter concerning a registered scheme.

19.27 The provision is modelled on section 87B of the *Trade Practices Act 1974* which enables the Australian Competition and Consumer Commission to enter into enforceable undertakings. The ASC Act currently contains a similar provision in section 201A, which enables the Corporations and Securities Panel to enter into enforceable undertakings.

19.28 Where a responsible entity breaches a term of an undertaking, the ASC may apply to the Court for an order:

- directing the responsible entity to comply with that term of the undertaking
- directing the responsible entity to pay to the custodian any financial benefit that the person has obtained as a result of the breach
- directing the responsible entity to compensate any other person who has suffered loss or damage as a result of the breach; or
- for any order the Court thinks appropriate.

Record of undertakings

19.29 The ASC must keep a record of undertakings. To the extent that an undertaking is confidential, access by persons other than the responsible entity may be withheld. Confidential information may include information that is commercial in confidence, personal details of an individual, or information the disclosure of which would be against the public interest.

Amendment of the Pooled Development Funds Act 1992

19.30 Section 30 of the *Pooled Development Funds Act 1992* refers to prescribed interests under the Law. **Proposed Schedule 2, item 181** makes the necessary alteration to an interest in a managed investment scheme.