11. The investor

Introduction

11.1 The rights and obligations of the parties to a collective investment scheme must be clearly defined. The Review sets out in chapter 10 the role and duties of scheme operators. This chapter deals with the rights of investors. The Review considers that investors choose collective investment schemes because they prefer not to participate in the day to day management of their investments.[1] The primary right of investors, therefore, will be to information about the scheme. The chapter deals with this first. Investors should only have a more active role where fundamental aspects of the nature or structure of the scheme are concerned. The chapter discusses these situations and makes recommendations about meetings, voting and takeovers. It also proposes dispute resolution procedures. Finally, it recommends that investors' rights be enforceable through the courts.

Investors' rights to information

Introduction

11.2 Investors' access to information will be enhanced by the Review's recommendation in chapter 5 for improved disclosure standards for collective investment schemes, particularly in relation to annual and half yearly reports.[2] This section deals with the right of access to certain documents and the right to be told about certain events or developments in the management of the scheme.

Access to documents

11.3 ***Registers and material contracts.*** Currently investors in prescribed interest schemes have rights under the Corporations Law to inspect, free of charge, at the registered office of the management company

- the register of interest holders[3]
- the material contracts referred to in the prospectus of the scheme.[4]

NCSC policy modified the right of access to the register to allow a manager to deny access if the information is to be used other than for specified purposes.[5] The Review **recommends** that the requirement to maintain a register of investors should continue. The register should indicate the extent of each investor's holding.

1. See para 3.3.
2. See para 5.27, 5.31, 5.35.
3. Corporations Law s 1070; Corporations Regulations reg 7.12.15(6)(a).
4. Corporations Law s 1029.
5. eg to call a meeting of investors: NCSC Release 138. The ASC is reviewing this policy statement: ASC Media Release 93/34.

The Review also **recommends** that investors in collective investment schemes should have access to material contracts referred to in a scheme prospectus. The ASC should, however, have power to permit a scheme operator to deny access where appropriate.

11.4 ***Other books.*** The Corporations Law s 319 permits a shareholder in a company to apply to the court for an order to inspect the company's books. Access may be granted if the court is satisfied that the member is acting in good faith and for a proper purpose. If an order is granted, only a legal practitioner or auditor may inspect the books on the shareholder's behalf. The Review **recommends** that investors in a collective investment scheme should have a similar statutory right of access to the books of the scheme.

Issue of certificate

11.5 Investors need to know when they have been allotted interests in a scheme. They also need evidence of that fact. Accordingly, the Review **recommends** that scheme operators should be required to issue certificates to purchasers of interests within two months after the allotment of those interests unless the constitution otherwise provides.[6]

Change in investment policy of scheme

11.6 ***Current law.*** Investors in a prescribed interest scheme must be informed about any change in investment policy that they would not have expected, having regard to the information contained in prospectuses issued in relation to the scheme. A change in investment policy cannot be implemented without giving investors adequate time to dispose of their interests.[7]

11.7 ***Proposal and submissions.*** DP 53 questioned the effectiveness of the law's reliance on disclosure of information in prospectuses.[8] The law does not cater for closed schemes for which there is no prospectus on issue. Nor does it assist those who invested in a scheme before the issue of a prospectus that contains information that relieves the manager of the obligation to give a separate notice of a proposed change in investment policy. It also encourages companies to make their prospectuses very general and all-encompassing. The Review proposed, therefore, that investors in collective investment schemes should

- be notified in writing of any change in the investment policy set out in the scheme's most recent annual report or half yearly report
- be allowed a reasonable period to dispose of their interest in the scheme before the change is implemented.

Submissions identified various problems with the Review's proposal. Several pointed out that requiring a reasonable period after notice to investors before implementing a change in investment policy could prevent scheme operators from

6. cf Corporations Regulations reg 7.12.15(2)(a).
7. Corporations Regulations reg 7.12.15(6)(e).
8. DP 53 para 7.12.

responding swiftly to changing market trends, possibly to the detriment of investors.[9] Other submissions argued that it would be difficult to define a 'change in investment policy': would it be a change between classes of assets (for example, from real property to shares), a change in weighting of particular classes in the investment portfolio or a change within a class of assets (for example, from industrial to resource shares)?[10] One submission suggested that only material changes should have to be notified.[11]

11.8 ***No recommendation.*** The Review accepts that requiring prior notification to investors before implementing a change of policy would be unduly restrictive. The Review elsewhere recommends that significant changes to a scheme's state of affairs should be included in the annual and half yearly reports.[12] This information would also constitute a notifiable event under continuous disclosure.[13] The Review considers that this would include material changes in investment policy.

Change of controlling interest in scheme operator

11.9 DP 53 proposed that investors should not have any right to be notified of a change in the controlling interest in a scheme operator.[14] One submission argued that investors should be notified of such a change to enable them to sell their interests if they are not satisfied with the new controllers.[15] Notification of a change in controlling interest would be consistent with full disclosure of relevant information to investors. However, it is not always easy to determine what constitutes a controlling interest.[16] The most important usual consequence of a change in control of a company is a change in composition of the board of directors. Notifying investors of all such changes may be the best way of indicating to them that a change in controlling interest in the operator may have occurred. The Review acknowledges that a requirement to report changes within a short time after they occur would involve undue expense to the scheme. It therefore **recommends** that the half yearly and annual reports of a collective investment scheme should include details of changes of directors of the scheme operator. This would be additional to the existing requirements to lodge details of changes of directors with the ASC.[17]

9. Macquarie Investment Management Limited *Submission* 24 November 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992.
10. eg T Valentine *Submission* 5 November 1992; M Starr *Submission* 12 November 1992.
11. Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992.
12. See para 5.27, 5.31.
13. See para 5.34.
14. Proposal 7.9
15. T Valentine *Submission* 5 November 1992.
16. Control under the Corporations Law is taken to be an 'entitlement' to 20% of the shares in a company. The definitions of 'entitlement' and the other concepts involved in 'entitlement' are technical and complex. In some cases they may not give an accurate view of a person's ability to control a company.
17. Corporations Law s 242, 242A.

Disclosure of substantial investors

11.10 ***CSLRC recommendation.*** In its report on prescribed interests, the Companies and Securities Law Review Committee (CSLRC) recommended that any person who intends to acquire an interest from an existing investor 'in circumstances where the acquisition could institute or increase the entitlement to interests of any company that would be eligible to be the manager of the scheme' should provide written notice to the trustee at least 14 days before the acquisition. The trustee of the scheme should then

- use reasonable efforts to find out whether the acquirer intends to bid to supplant the existing manager
- inform interest holders.[18]

One purpose of this notification would be to help investors decide whether to remain in the scheme. The CSLRC recommendations were in lieu of any other requirement for notification of interests or any extension to prescribed interest schemes of the rules governing takeovers.

11.11 ***Proposal and submissions.*** The Review considered the CSLRC recommendation cumbersome and its disclosure threshold uncertain. Instead, DP 53 proposed that

- the principles in the Corporations Law Pt 6.7 concerning substantial shareholdings should apply to all listed or 'large' collective investment schemes (meaning, for instance, schemes with more than 100 investors, or such other number as may be prescribed)
- investors having a 'major stake' in a collective investment scheme should be required to notify their interests (a 'major stake' should be an 'entitlement'[19] to 10% of the value of issued interests[20])
- those investors should also be required to notify changes of more than 5% in their entitlements
- the operator should be required to keep a register of substantial investors
- for listed collective investment schemes, copies of notices should also be served on the ASX.[21]

Several submissions considered it impractical to require disclosure of percentage investments. The principal objection was that, as the number of issued interests may change daily, it would be too onerous to require investors to constantly

18. CSLRC Report *Prescribed Interests* Sydney, 1988, para 124.
19. Entitlement is defined in the Corporations Law s 609. In broad terms, this would cover interests in a collective investment scheme in respect of which the investor and the investor's associates have the power to vote and dispose.
20. The Review considered that a 5% disclosure threshold and a 1% change of entitlement notification requirement, as required under Part 6.7, may be too burdensome (particularly for investors with relatively small holdings) as the number of interests may change constantly.
21. DP 53 para 7.19 and proposal 7.10.

recalculate their percentage investment.[22] Another objection was that passive investors may require professional advice on the intricacies of the concept of 'entitlement'.[23]

11.12 ***Recommendation.*** The Review supports the principle that the identity of substantial investors close to absolute control should be disclosed. This information may be useful to other investors in deciding whether to join, remain in or leave a scheme. The Review notes that the substantial shareholding provisions apply only to listed public companies. The Review sees merit in applying a substantial investor notification requirement to both listed and unlisted collective investment schemes. However, the system of disclosure of substantial shareholdings in the Corporations Law Pt 6.7 would need to be modified for collective investment schemes given the frequent fluctuations in the number of issued interests in some schemes.[24] This issue should be part of the general review of the application of the takeover provisions to collective investment schemes recommended by the Review.[25]The Review **recommends** that, in the interim, operators of listed collective investment schemes should have to keep a register of substantial interest holdings. The Review **recommends** that the operator of a listed collective investment scheme should include in the annual report of the scheme the total number of voting interests in the scheme as at the date of the report.[26] An investor should have to notify the operator within 14 days after receiving the annual report if, on the basis of the information in the report,

- it is entitled to 30% of the voting interests in the scheme (that is, if it and its associates have power to vote in respect of, or dispose of, 30% of the interests in the scheme)
- its voting entitlement has changed by at least 5% since it last notified the operator of its substantial holding or
- it is no longer entitled to 30% of the voting interests.

Any notification should indicate the investor's current entitlement. The scheme operator should record on the register of substantial holdings the current entitlement of a substantial investor. The register should be open to inspection by investors without charge and to any other person upon payment of an amount up

22. MLC Investments Limited *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; ANZ Funds Management *Submission* 21 December 1992.
23. M Starr *Submission* 12 November 1992.
24. Such as cash management trusts. Fluctuations in the number of shares that result from share buy-backs are dealt with in the Corporations Law s 206UB which applies to listed companies. That provision requires a company to send holders of shares in a particular class a notice of the number of issued shares in that class after the implementation of a buy-back scheme. This enables shareholders to work out their new shareholding entitlement for the purpose of giving substantial shareholding notices. A similar system for collective investment schemes would be extremely costly and would impose considerable administrative burdens given the frequent changes in the number of interests on issue compared with the much lower frequency of share buy backs.
25. See para 11.30.
26. Any interests held by the scheme operator or its associates should be deemed to be non-voting interests for the period during which they are held by the operator, except where they are held as a bare trustee and the operator or the associate does not have any discretion in determining how to vote: see para 11.26.

to a prescribed maximum.[27] This register will enable investors to determine whether the votes that a particular investor and its associates control are approaching the 50% level required to replace the scheme operator or terminate the scheme. The Review recognises that under this recommendation a register of substantial holdings may only be accurate for a brief period after the release of the annual report. Nevertheless, it considers that a yearly 'snapshot' will give investors some information about the pattern of major holdings in the scheme. Substantial investors should be able, but not obliged, to notify the operator of a change in its entitlement at any other time. The operator should enter such information on the register. The Review **recommends** that the operator of a listed collective investment scheme should have to include on a separate part of the register details of its entitlement to interests if this exceeds 30% of the total issued interests. The operator should have to amend the register within 2 business days if its entitlement has changed by 5% from the figure in the register or its entitlement falls below 30% of total issued interests.

Investors' powers

Introduction

11.13 DP 53 sought comment on what powers investors should have. This issue principally relates to the circumstances in which a scheme operator may or must call a meeting of investors (other than upon a lawful requisition by investors) to obtain their approval to a particular course of action.[28] The Review has concluded that investors should have power to approve

- the merger of the scheme with another scheme[29]
- the appointment of a replacement scheme operator where a temporary scheme operator appointed by the court recommends that the scheme continue[30]
- any action which will financially benefit a related person or entity.[31]

Investors should also have powers

- to remove the scheme operator[32]
- to terminate a collective investment scheme[33]
- to propose and approve amendments to the scheme's constitution.[34]

27. cf Corporations Law s 715.
28. DP 53 issue 7B.
29. See para 11.14.
30. See para 11.16. The appointment of temporary scheme operators is discussed at para 14.20.
31. See para 10.25.
32. See para 11.17.
33. See para 8.5, 8.6.
34. See para 11.21, 11.22.

Mergers

11.14 The proliferation of collective investment schemes following the deregulation of the finance sector in the 1980s may well continue. It is equally likely, however, that many schemes will consider merging for financial reasons or to achieve economies of scale. The merger procedure is usually a matter for each scheme's constitution. DP 53 proposed that

- mergers should require the consent of a majority of the investors of each scheme who vote on the proposal
- the notice of meeting should include an independent expert's report containing all relevant information on the proposed merger, the reasonable costs of which should be borne by the scheme.[35]

The discussion paper also raised the possibility of adapting the Corporations Law Pt 5.1 for collective investment schemes.[36] Pt 5.1 allows companies to enter into schemes of arrangement and provides for the amalgamation of companies. It authorises the court to make orders transferring assets from one company to another. Submissions generally favoured legislative provisions which would facilitate the merger of schemes.[37] However, there was no clear preference on the best way to achieve this. The Review considers it unnecessary to have both a merger procedure such as that proposed in DP 53 and a provision based on Pt 5.1. It **recommends** that, in the interests of consistency, the mergers provisions for collective investment schemes should be based on the Corporations Law Pt 5.1 as it applies to amalgamation of companies. These provisions should not deal with compulsory acquisition of minorities.[38] This matter should be considered in the context of compulsory acquisitions in takeovers of schemes.[39]

Power to approve transfer of the right to operate a scheme

11.15 A decision by a scheme operator to sell or otherwise dispose of its right to manage a scheme may have significant consequences for investors, particularly where they have been attracted to a particular scheme by the reputation of the operator. DP 53 considered, however, that to permit a change of operator only with the consent of the investors would be unworkable.[40] It proposed instead that the scheme operator should give investors advance written notice of its intention to transfer the right to manage the scheme and investors should have a reasonable

35. Proposal 7.11.
36. Issue 7F. The CSLRC Report para 129-130 recommended the enactment of such provisions to permit the amalgamation and other reconstruction of trusts. ASC Policy Statement 16 (para 20(c), 22, 32, 48A) sets out the circumstances in which the ASC will agree to the restructuring of an unlisted property trust to a redeemable listed property trust, a fully listed property trust or a fixed term property trust.
37. eg Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; IFA *Submission* 1 December 1992; National Mutual *Submission* 3 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992.
38. Corporations Law s 414.
39. The Review recommends that there should be a separate review of takeovers of collective investment schemes: see para 11.30.
40. DP 53 para 7.16.

time to redeem their interest in the scheme before the transfer.[41] Submissions supported the requirement for notification,[42] but objections were raised to providing investors with any period to dispose of their interest before the transfer. One submission said that the latter requirement would be unworkable unless the scheme were relatively liquid, the number of investors objecting was small and the redemption of their interests did not have a significant impact on the investors who elected to continue.[43] The Review has considered this issue further in the light of other recommendations permitting the appointment of a temporary scheme operator. It **recommends** that an operator should not be able to transfer its right to operate a scheme without the approval of investors unless pursuant to the court appointment of a temporary scheme operator.[44]

Power to appoint a successor to temporary scheme operator

11.16 A temporary scheme operator may recommend to the court that a scheme continue or that it be terminated.[45] The Review **recommends** that where a temporary scheme operator recommends that the scheme should continue and the court agrees, the temporary scheme operator should be obliged to, and the investors may, call a meeting of investors to appoint a replacement scheme operator. A simple majority by value of investors who vote may appoint the replacement. A company may not be proposed as a replacement scheme operator unless the ASC has certified that it is prepared to licence the company as the scheme operator if the investors appoint it to be the operator.

Power to remove the scheme operator

11.17 The ultimate expression of dissatisfaction by investors in a collective investment scheme is to remove the scheme operator. Currently the trustee or manager of a prescribed interest scheme must cease to act if the holders of the value of 50% or more of the prescribed interests resolve at a meeting that the trustee or manager should be removed.[46] DP 53 proposed that this right be retained.[47] Submissions overwhelmingly supported the Review's proposal.[48] The Review **recommends** that investors in a collective investment scheme should be

41. Proposal 7.8.
42. eg T Valentine *Submission* 5 November 1992; JP McAuley *Submission* 23 November 1992; Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; Macquarie Investment Management Limited *Submission* 24 November 1992; IFA *Submission* 1 December 1992; MLC Investments Limited *Submission* 17 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; Australian Film Commission *Submission* 7 January 1993.
43. Law Council of Australia *Submission* 16 December 1992.
44. See para 14.20.
45. For the appointment of temporary scheme operators, see 14.20. For winding up of a scheme see para 8.11.
46. Corporations Regulations reg 7.12.15(8)(d) (trustee), 7.12.15(10)(g) (management company). No procedure is laid down for substituting a trustee, nor are any rights of review or appeal specifically prescribed.
47. Proposal 7.12.
48. eg JP McAuley *Submission* 23 November 1992; IFA *Submission* 1 December 1992; MLC Investments Limited *Submission* 17 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; TCA *Submission* 17 December 1992.

able to remove the operator by the approval of the holders of more than 50% of the value of the voting interests in the scheme.[49] If the investors agree to remove the scheme operator but cannot agree on a replacement operator, the current operator should be obliged to apply to the court for a temporary scheme operator. An investor or the ASC may apply for appointment of a temporary scheme operator if the removed operator does not act.

No power to give directions to operator

11.18 ***Generally.*** Investors in prescribed interest schemes may call a meeting to give directions to the management company or trustee.[50] The manager or trustee is bound to comply with a direction unless it is inconsistent with the deed or the Corporations Law, though neither is liable for anything done pursuant to a direction.[51] DP 53 proposed that the power of investors to give directions be restricted to matters concerning the accounts of the scheme and of the operator.[52] It sought comment on whether investors should have a power to direct the operator on this or any other matter.[53] Several submissions took particular exception to the suggestion that investors should have a power to give directions in relation to accounts of the operator.[54] The Review considers that to give investors a power to direct the scheme operator as to the management of the scheme would be inconsistent with the principle that the operator (rather than the investors) is responsible for the management of the scheme. It is also arguable that an operator acting pursuant to a direction given by investors may be the agent of the investors who, in consequence, assume personal liability. The Review therefore **recommends** that scheme investors should have no power to give directions to the operator.

11.19 ***Directions on how to vote shares.*** Currently, the management company or trustee of a prescribed interest scheme must obtain the approval of investors before exercising any voting right to elect directors of a company, the shares in which are property of the scheme.[55] This obligation is intended to prevent management companies and trustees from exercising these voting rights to promote their own interests. The Review does not consider that a similar requirement should be imposed on a scheme operator. The scheme operator will be under an obligation not to exercise its powers or perform its duties in the interest of itself or anyone else if that interest is not identical to the interests of scheme investors generally.[56] This will provide adequate protection against abuse in the exercise of these voting rights.

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49. The rules in relation to voting on a resolution are discussed at para 11.26, 11.27.
50. Corporations Law s 1069(1)(m).
51. Corporations Law s 1069(13).
52. Proposal 7.5.
53. Issue 7C.
54. Macquarie Investment Management Limited *Submission* 24 November 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; MLC Life Limited *Submission* 18 December 1992.
55. Corporations Law s 1069(1)(k).
56. See para 10.8

Authorising amendments to the scheme's constitution

11.20 ***Proposal and submissions.*** Any proposal to amend a prescribed interest deed requires the approval of investors, except where the trustee reasonably believes that the modification will not adversely affect their rights.[57] The requirements for approval are that

- the holders who vote at the meeting (whether in person or by proxy) hold at least 25% of the value of prescribed interests held by persons entitled to vote
- at least 75% of those holders vote (whether in person or by proxy) in favour of the modification.[58]

DP 53 supported the same voting requirements for collective investment schemes. One submission argued, however, that the requirement for 75% approval is unrealistically high and would effectively prevent amendment of a scheme's constitution.[59] The Review does not agree. It considers that significant changes in the governing instrument of a scheme in which investors have placed their money should only be made where there is strong investor support.[60] Several submissions opposed allowing any amendments without investor approval.[61] The Review considers that there should be a simple way for minor amendments which do not adversely affect the interests of investors to be made without their approval. This would avoid the expense and delay of a meeting.

11.21 ***Recommendation — amendment proposed by the operator.*** The Review **recommends** that, where the operator proposes any amendment to a scheme's constitution, it should give investors and the ASC notice of the proposed amendment and inform them of

- details of the amendment sought
- the reasons for the proposed amendment.[62]

If the operator seeks the approval of investors for the amendment, it should call a meeting giving 21 days notice. An amendment may be approved by a vote of 75% or more of at least 25% of the value of interests in the scheme held by persons entitled to vote.[63] Where the operator considers that a proposed amendment is minor and not adverse to investors' interests, it may choose instead merely to notify the ASC and investors. The ASC and investors should have 28 days after receiving notification of the proposed amendment to require the scheme operator to

57. Corporations Law s 1069A. Most trust deeds also permit a trustee to consent to amendments made as a consequence of amendment to the law or amendments of a technical or administrative nature without reference to the general body of investors.
58. Corporations Law s 1069A(2)(c), (d).
59. County NatWest Australia Investment Management Limited *Submission* 18 December 1992.
60. The 75/25 formula permits changes to the scheme's constitution with the approval of as little as 18.75% of the value of the interests in the scheme.
61. eg H Baker *Submission* 26 November 1992.
62. Corporations Regulations reg 7.12.15(1)(g) sets out the current requirements for investors to be given notice of and information about matters to be considered at meetings.
63. The rules in relation to voting on a resolution are discussed at para 11.26, 11.27.

call a meeting of investors to consider and vote on the amendment.[64] If the ASC and investors do not require a meeting, the scheme operator may make the amendment at the expiration of the 28 day period. The non-executive directors of the scheme operator will have an important role in protecting the interests of investors by ensuring that proposed amendments to a scheme's constitution that are not minor and may be adverse to investors' interests are referred to the investors for approval.

11.22 ***Recommendation — amendment proposed by investors.*** Investors should have the right to propose amendments to the scheme's constitution and to requisition a meeting to consider them. Voting requirements for approval of amendments proposed by investors should be the same as for amendments proposed by the operator. The Review **recommends** that, in addition, a proposal put forward by investors should require the approval of the operator. The Review considers that an operator should not be required to administer provisions with which it does not agree and which were not part of the original constitution. Failure to consent may, however, be evidence of oppression.

Power to call meetings

11.23 The manager of a prescribed interest scheme must call a meeting on application by a specified number of investors.[65] DP 53 proposed that investors in collective investment schemes should have a similar requisition power.[66] This proposal was widely supported in submissions.[67] The Review **recommends** that investors in collective investment schemes should be able to call meetings for the exercise of their powers.[68] The law should provide that the scheme operator must, within 14 days after being requested by not less than 100 investors,[69] 1/10 by number of investors or the holders of 1/10 by value of interests in the scheme, convene a meeting of investors by sending written notice at least 21 days before the proposed meeting. The notice must include the matters to be considered at the meeting and details of proposed resolutions which may lawfully be put to the meeting together with a summary of information relating to those matters and resolutions. The meeting must be held not later than two months after the day on which the requisite number of investors have requisitioned the meeting.

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64. The meeting should be held within two months of the day the operator receives the requisition to call the meeting. The voting requirement for approval of the amendment should be the same as at any other meeting called by the operator to consider an amendment.
65. Corporations Law s 1069(1)(m).
66. Proposal 7.4.
67. eg T Valentine *Submission* 5 November 1992; Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; IFA *Submission* 1 December 1992; National Mutual *Submission* 3 December 1992; FPAA *Submission* 7 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; MLC Investments Limited *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; TCA *Submission* 17 December 1992.
68. The only powers that may be exercisable at a meeting called by investors are to dismiss the operator, to appoint its replacement, to approve a successor to a temporary scheme operator, to amend the scheme's constitution or to terminate the scheme.
69. Rather than 500 as proposed in DP 53: this will ensure that there is no unreasonable obstacle to effective investor action.

Meetings

Annual meetings

11.24 Unlike companies, prescribed interest schemes are not required to hold an annual general meeting. DP 53 proposed that the operator of a collective investment scheme should be required to hold a meeting of investors at least once every calendar year.[70] The Review considered that an annual meeting would provide a regular forum for addressing investors' concerns and questions and could minimise the need for investors to call meetings or, more importantly, contemplate precipitate action. Submissions overwhelmingly opposed requiring collective investment schemes to have annual meetings. Four main reasons were given:

- the expense of holding meetings annually would be disproportionately high relative to the benefit[71]
- annual general meetings of companies serve purposes (such as election of directors, presentation of accounts, declaration of dividends) that are not applicable to collective investment schemes[72]
- annual reports are as effective as annual meetings for disseminating information and less costly[73]
- investors have the ability (both under the current law and under the Review's proposals) to call a meeting if they consider it desirable or necessary.[74]

The Review is persuaded by these arguments and no longer considers that operators should be required to call annual meetings of investors.

Voting rights at meetings

11.25 ***Voting majorities.*** The Review's recommendations involve different voting majorities depending on the nature of the matter being considered by investors.

- The most significant investor powers, to remove the operator or to terminate a solvent scheme, can only be exercised by the approval of the holders of more than 50% of the value of the voting interests in the scheme. This may often be very difficult to achieve, but it is necessary to protect investors' interests by ensuring that they can only change key structural aspects of the

70. Proposal 7.3.
71. Macquarie Investment Management Limited *Submission* 24 November 1992; IFA *Submission* 1 December 1992; Australian Film Finance Corporation Pty Ltd *Submission* 8 December 1992; MLC Investments Limited *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992.
72. National Mutual *Submission* 3 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; St George Funds Manager Limited *Submission* 18 December 1992.
73. Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; MLC Investments Limited *Submission* 17 December 1992.
74. IFA *Submission* 1 December 1992; Australian Film Finance Corporation Pty Ltd *Submission* 8 December 1992; MLC Investments Limited *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992.

scheme in which they have invested where an absolute majority of them agrees.[75] A lower threshold of three quarters of investors by value voting to terminate is justifiable where a scheme is demonstrably insolvent.[76]

- The approval of the holders of more than 50% of the value of voting interests will also be required for benefits paid in respect of the retirement of scheme operators or their officers. A high threshold is justified in view of the cost to investors with no likely future benefit.[77]

- Material changes to a scheme's constitution will require the approval of at least 75% by value of investors voting, provided that those investors represent at least 25% of the value of interests in the scheme. This requires a substantial level of investor involvement without making the scheme's constitution effectively unchangeable.[78]

- Approval of a merger of collective investment schemes will require a 75% majority of investors who vote. This is the equivalent of the voting requirement for company amalgamations in the Corporations Law Pt 5.1.[79]

- The appointment of a successor to a temporary scheme operator will require a simple majority by value of investors who vote. This less onerous voting requirement will assist in the expeditious appointment of a replacement scheme operator.[80]

11.26 ***Operator and associates not to vote.*** The operator of a collective investment scheme and its associates may be investors in the scheme. Given the operator's role in management, the Review considers that to permit operators or their associates to vote as investors would involve considerable conflicts of interest.[81] The Review **recommends** that any interests held by the scheme operator or its associates should be non-voting interests except where those interests are held on bare trust and the operator or the associate does not have any discretion in determining how to vote. Non-voting interests should not be counted when determining the total number of interests in the scheme for the purpose of calculating the percentage of investors voting. Similarly, where investors are voting on a successor to a temporary scheme operator, interests held by the applicant scheme operator and its associates should be non-voting interests.

75. See para 8.5, 11.17.
76. See para 8.6.
77. See para 10.26.
78. See para 11.21, 11.22.
79. See para 11.14.
80. See para 11.16.
81. The Corporations Regulations currently exclude the voting rights of the management company and its associates in certain circumstances: reg 7.12.15(3), (6)(f), 9.

11.27 ***How votes may be exercised.*** The current law appears, in most cases, to require investors to vote in person at a meeting of investors.[82] In some cases, however, investors can vote through an appointed proxy.[83] DP 53 sought comment on whether postal votes should be allowed in relation to various matters.[84] Submissions generally favoured allowing postal votes.[85] The Review considers that investors should have the maximum opportunity to exercise voting rights in relation to their investment. The Review **recommends** that investors in a collective investment scheme should be permitted to vote on a resolution in person, by post or by proxy.

Procedure at meetings

11.28 The Review makes no detailed recommendations for the procedure that should be followed at meetings of investors. The general law lays down certain procedural guidelines for meetings:[86]

- there must be proper notices of meetings
- there must be proper time for discussion at meetings
- everyone's view must be respected before a vote on a particular matter is taken.

These guidelines are equally appropriate for meetings of collective investment scheme investors.

Rules governing substantial acquisitions in collective investment schemes

Takeovers

11.29 ***Introduction.*** Investors in a collective investment scheme may acquire interests in the scheme with the intention of taking over the scheme by removing and replacing the operator. This is analogous to the takeover of a company by the acquisition of shares. DP 53 asked whether takeover provisions based on the Corporations Law Chapter 6 should apply to collective investment schemes. An acquisition or transfer of a controlling interest in a prescribed interest scheme is not regulated by the Corporations Law Chapter 6. No formal takeover offer is therefore

82. Corporations Law s 1069(1)(k) (investor approval for exercise of voting rights); s 1074 (winding up schemes); s 1076(2)(b) (investor approval of acts or omissions of trustee or representative); Corporations Regulations reg 7.12.15(6)(g), (10) (removal of management company).
83. Corporations Law s 1069A requires the approval of holders of interests in a scheme for the amendment of approved deeds; s 1069B permits holders of interests to appoint proxies to vote on the amendment. Section 1076R permits holders of interests to appoint proxies to vote on a special variation proposal for the amendment of the entrenched provisions of a trust deed.
84. Issues 7E, 7G and 7I.
85. eg T Valentine *Submission* 5 November 1992; JP McAuley *Submission* 23 November 1992; Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; IFA *Submission* 1 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; TCA *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992.
86. These principles were discussed in *John J Starr (Real Estate) Pty Ltd v Robert R Andrew (A'Asia Pty Ltd)* (1991) 6 ACSR 63, 71-2 (Young J).

required. The trust deed of a unit trust may incorporate 'takeover', 'substantial unitholding' and 'compulsory acquisition' provisions which contractually bind unitholders. However, such provisions in deeds of public unit trusts listed on the ASX are largely unenforceable, as Listing Rule 3J(31)(a) prohibits the inclusion in a trust deed of any enforcement penalties or sanctions. The result, therefore, is that the present law does little to regulate this kind of takeover of a scheme.

11.30 ***The Review's position.*** In principle, investors in companies and collective investment schemes should have the same protection in a takeover, including equal opportunity to participate in any relevant benefits and the right to require the acquisition of their interests. However, the Corporations Law Chapter 6 could not be applied to collective investments without major modification. First, it would be necessary to have a considerably higher 'control' threshold than the 20% entitlement that applies to companies.[87] The powers of investors in collective investment schemes are far more limited than those of shareholders in a company. Unlike shareholders, the right of investors to remove the scheme operator will be by an absolute majority of all investors rather than by simple majority of investors who vote. Given this, the control threshold for collective investment schemes should probably be nearer to 50%.[88] Secondly, it may be very onerous to calculate the precise percentage of interests held by particular investors because of the frequency with which the number of issued interests in some collective investment schemes may change.[89] This also creates considerable difficulties in devising any notification provisions for substantial investors.[90] It is also necessary to consider whether these notification requirements should apply to unlisted as well as listed collective investment schemes. The Review received no submissions favouring takeover provisions for collective investments. Nevertheless, the Review is aware of takeovers of large unit trusts where investors were not treated equally. The Review considers that takeovers of collective investment schemes require further detailed consideration of issues that are beyond the scope of this report. It **recommends** that such a review be undertaken.

Compulsory acquisition

11.31 Despite its possible benefits, no submission favoured compulsory acquisition provisions for collective investment schemes. However, the Review considers that the merit of such provisions should be included in the recommended review of takeovers of collective investment schemes.

87. Corporations Law s 615.
88. Macquarie Investment Management Limited *Submission* 24 November 1992 made the point that a 20% threshold would be inapplicable since investors would not be able to influence the management of a fund at that level.
89. BT *Submission* 15 December 1992; St George Funds Manager Limited *Submission* 18 December 1992.
90. See para 11.10-11.12.

Enforcing investors' rights through the courts

Current remedies

11.32 Currently investors in prescribed interest schemes may protect their rights by seeking injunctions to require compliance with the law or to prevent a breach of the law under the Corporations Law,[91] the *Trade Practices Act 1974* (Cth)[92] or the general law. They may also take action for damages if a breach occurs.[93] If they invest in a prescribed interest scheme by accepting unlawful offers or invitations, they may avoid subscription contracts by giving notice in writing to the manager.[94] Similar remedies will be available to investors in collective investment schemes. Investors will also be able to enforce the scheme constitution at general law and seek damages for loss resulting from a breach of the constitution.

Oppression remedy

11.33 Shareholders may obtain remedies where they are affected, as a shareholder or in any other capacity, by oppressive or unfair conduct in the conduct of a company's affairs.[95] The court may make a wide range of orders, including winding up the company or regulating the future conduct of its affairs. The ASC may also apply to the court for an order. DP 53 proposed that there should be a similar oppression remedy for investors in collective investment schemes.[96] This proposal was widely supported.[97] The Review's recommendations give investors the right to bring an action directly against a scheme operator and its directors for breach of their statutory duties. The oppression remedy is wider than this. For example, a decision made in good faith and for a proper purpose may still be unfair within the meaning of the oppression remedy.[98] The Review **recommends** that the law should provide a right for investors in collective investment schemes to apply to the court for an order under a provision based on the Corporations Law s 260. The ASC should also have standing to apply to the court under this provision.

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91. s 1324(1), (2).
92. s 80.
93. Corporations Law s 1324(10); *Trade Practices Act 1974* (Cth) s 82.
94. Corporations Law s 1073, 1073A. A declaration that the purchase contract is voidable would entitle the investor to have the purchase money refunded.
95. Corporations Law s 260.
96. Proposal 7.2.
97. eg T Valentine *Submission* 5 November 1992; JP McAuley *Submission* 24 November 1992; Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; IFA *Submission* 1 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; TCA *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992.
98. *Wayde v NSW Rugby League Ltd* (1985) 10 ACLR 87, 95 per Brennan J. Another example of the width of the oppression remedy is that conduct can be unfairly prejudicial even though it is in accordance with the company's constitution: HAJ Ford & RP Austin *Principles of Corporations Law*, 6th ed, Butterworths, 1992, 632.

Representative action

11.34 In DP 53, the ALRC proposed that investors seeking damages for loss in relation to a collective investment scheme should be required to take a representative action on behalf of all investors under the *Federal Court of Australia Act 1976* (Cth) Part IVA, unless the court grants leave for an individual action, for example, where an investor suffers a loss peculiar to himself or herself.[99] The ALRC's proposal was based on the assumption that the actions of scheme operators will usually affect all investors in proportion to the interests they hold in the scheme. The ALRC took the view that a single investor should not have an unfair advantage over other investors by obtaining a judgment ahead of other investors when the funds available may be insufficient to meet all claims in full. It considered that only representative actions would ensure equity for all investors affected by the actions complained of. The Advisory Committee did not support a requirement for representative proceedings. It considered that each investor should be entitled to take legal action and recover damages individually, regardless of whether any other investor has taken action. This would give individual investors an incentive to undertake private enforcement actions. Submissions opposed the ALRC proposal. The primary concern was that, in the vast majority of cases, the rights of investors are not sufficiently homogeneous to justify such actions.[100] One submission said that the requirement would cause technical problems in relation to costs.[101] The Review accepts that investors should not be required to take representative actions against scheme operators. The representative procedure will be available to those investors who choose to use it.[102]

Rights in a dispute with the operator

Internal dispute resolution procedure

11.35 Many problems in collective investment schemes can be resolved quickly by giving investors information about the scheme. Also, it is important that investors have confidence that the operator will deal efficiently and thoroughly with their problems. DP 53 proposed a system of internal dispute resolution for

99. Proposal 7.1. The *Federal Court of Australia Act 1976* (Cth) Pt IVA, permitting representative actions, was a consequence of the ALRC's recommendations in ALRC 46 *Grouped Proceedings in the Federal Court*. Part IVA allows proceedings to be commenced on behalf of a class of persons affected by the same issue, even if they are not all identified.
100. National Mutual *Submission* 3 December 1992; AMP Society *Submission* 30 November 1992; Australian Film Finance Corporation Pty Ltd *Submission* 8 December 1992; BT *Submission* 15 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; MLC Life Limited *Submission* 18 December 1992.
101. Law Council of Australia *Submission* 16 December 1992.
102. This choice will be available if the collective investments provisions form part of the Corporations Law. Jurisdiction under the Corporations Law is conferred on the Federal Court by the *Corporations Act 1989* (Cth) Pt 9, Div 1 and its State equivalents. Any person commencing action in the Federal Court would have the option of proceeding under the *Federal Court of Australia Act 1976* (Cth) Part IVA.

investors in collective investment schemes. The proposal received wide support in submissions.[103] The Review **recommends** that scheme operators should be required to

- maintain an internal dispute resolution procedure to deal with investor enquiries and complaints
- include in each prospectus and annual report details of the scheme's internal dispute resolution procedure.

External dispute resolution procedures

11.36 Disputes that cannot be resolved by any internal procedure will arise. Currently the main way of solving such disputes is through legal action. DP 53 noted two current alternative dispute resolution procedures.

- A procedure operated by LIFA is available to the holders of investment linked life policies.[104]

- The Banking Ombudsman has jurisdiction over schemes offered by a subsidiary of a bank that is a party to the Banking Ombudsman scheme where the subsidiary has been specifically designated. To date, there has been no such designation.[105]

There are no comparable external alternative dispute resolution procedures available to investors in all collective investment schemes. DP 53 sought comment on the desirability of providing an external dispute resolution procedure.[106] Although some submissions favoured such a procedure,[107] most were either

103. eg T Valentine *Submission* 5 November 1992; JP McAuley *Submission* 23 November 1992; IFA *Submission* 1 December 1992; AMP Society *Submission* 30 November 1992; FPAA *Submission* 7 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; TCA *Submission* 17 December 1992; Financial Institutions Division, The Treasury *Submission* 24 December 1992.
104. The procedure involves an approach by the investor, in the first instance, to the life insurance company and subsequently, if the matter is unresolved, to LIFA. If this proves unsuccessful, the matter is referred to a Complaints Review Committee. The decision of this Committee is not binding on the investor but the insurance companies who are members of the scheme have agreed to adhere to a decision of the Committee. The insurance company's contract under which it participates in the scheme provides that it will not contest an adverse decision by the Committee. It is doubtful if the company's customer could enforce the Committee's decision if the company breached this undertaking, as customers are not parties to the contract.
105. This is a private scheme, based on a contract between participating banks. It is informal and the emphasis is on conciliating complaints. The Ombudsman can make an award against a bank for sums up to $100 000. The Ombudsman's determinations are binding on the bank but not on the customer.
106. Issue 7J.
107. eg IFA *Submission* 1 December 1992; FPAA *Submission* 7 December 1992.

equivocal or opposed.[108] The Review has therefore concluded that there is not at present enough evidence that an alternative dispute resolution procedure is needed for collective investment schemes.

Liability of investors

11.37 The liability of investors to creditors of a trust is governed by the general law and the terms of the trust deed. Trustees are personally liable to creditors for trust debts. The trustee may have a right to be indemnified for properly incurred expenses and liabilities out of trust assets or by the trust beneficiaries.[109] The creditors are subrogated to any rights of indemnity the trustee may have. Whether investors are liable to indemnify the trustee is determined by the trust deed in each case.[110] This is unsatisfactory for public investment vehicles. The Corporations Law, by contrast, limits the liability of shareholders.[111] DP 53 proposed a statutory provision to ensure that investors are not under any personal obligation to indemnify the scheme operator or a creditor of the scheme operator where scheme assets are insufficient to cover scheme debts.[112] This proposal was strongly supported in submissions.[113] The Review **recommends** that the law should limit the liability of investors in collective investment schemes that are trusts to the unpaid amount, if any, of their investment in the scheme.

108. eg M Starr *Submission* 12 November 1992; Macquarie Investment Management Limited *Submission* 24 November 1992; Law Council of Australia *Submission* 16 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; Mercantile Mutual Holdings Limited *Submission* 16 December 1992.
109. *JW Broomhead (Vic) Pty Ltd v JW Broomhead Pty Ltd* (1985) 3 ACLC 355.
110. *McLean v Burns Philp Trustee Co Ltd* (1985) 2 NSWLR 623.
111. s 117(5).
112. Proposal 7.14.
113. eg T Valentine *Submission* 5 November 1992; JP McAuley *Submission* 23 November 1992; Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; IFA *Submission* 1 December 1992; National Mutual *Submission* 3 December 1992; FPAA *Submission* 7 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; Mercantile Mutual Holdings Limited *Submission* 16 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; TCA *Submission* 17 December 1992; R Finlayson *Submission* 18 December 1992. One submission argued that the proposal should be accompanied by the introduction of greater protection for creditors: Arthur Robinson & Hedderwicks *Submission* 16 December 1992. The Review recommends that creditors should be entitled to assume that a scheme's constitution has been complied with: para 4.6.