

16. Transition to the new regime

Introduction

16.1 In previous chapters the report discusses the key elements of the regulatory regime proposed for collective investment schemes. The new regime will make a number of significant changes to the regulation of collective investment schemes including

- requirements for schemes to be registered and for licensing scheme operators
- requirements for scheme operators to have appropriate measures to ensure compliance with the law and the scheme's constitution
- increased obligations on the scheme operator to disclose information to the regulator and investors
- establishment of a common, minimum set of rights for investors
- new controls on withdrawing from schemes
- standard financial controls on collective investment schemes
- increased regulation of intermediaries
- increased powers for the regulator.

The implementation of this regime will need to take account of the many prescribed interest schemes established under the existing regime. Some of these changes can and should apply from the commencement of the regime. For others, a transition period will be needed. This chapter outlines the main issues to be dealt with in such a transitional phase.

'Grandfathering' schemes not an option

16.2 Some of the groups consulted by the Review suggested that some investors invest in prescribed interest schemes, especially unit trusts, because of the presence of a trustee independent of the manager. These investors, it was argued, are entitled to expect that that structure will not change. It was suggested that existing schemes should continue to be regulated under the current prescribed interest provisions. The Review regards 'grandfathering' schemes in this way as impractical as there would be two sets of laws governing collective investment schemes. This dual legal system would have to continue for many years, given the life-span of many current prescribed interest schemes. It may create considerable confusion and uncertainty for investors, while the regulatory costs to the ASC of administering two sets of laws could be prohibitive. The Review **recommends that**, with the exceptions indicated in this chapter, all schemes wishing to continue after commencement of the collective investment provisions of the Corporations Law should be required to meet the requirements of those provisions.

Application of particular recommendations

Registration, licensing and terminating schemes

16.3 Requiring each scheme to be registered and to have a single operator that holds a scheme operators licence is a key recommendation of this report. A reasonable period will be needed for existing schemes to make the necessary arrangements to change to the new system, for the decision who will be the operator to be made and for that party to seek a licence and have the scheme registered. Consultations by the Review suggest that about two years would be required for this purpose. The Review **recommends** that existing schemes should be given a two year period in which to convert from the existing regime to the new regime. The ASC should, however, be able to extend this period if appropriate. Either the trustee or the management company of an existing prescribed interest scheme will be able to apply to be licensed as scheme operator. The Review expects, however, that in most instances the management company will apply. The Review **recommends** that the consent of the party that does not apply for the licence should have to be attached to the licence application if the application is made within 18 months after the legislation implementing the Review's recommendations comes into effect. After that time, the management company should be able to apply without the consent of the trustee. If the manager is licensed as scheme operator, the trustee should have to transfer the scheme assets to the operator or to a custodian, as the operator directs, as soon as practicable. The costs of the transfer should be met out of the scheme funds. The Review **recommends** that the law should be amended to ensure that the transfer does not create a liability either to stamp duty or to capital gains tax. Finally, until a scheme is registered and a scheme operator licensed, the rules recommended in this report for terminating and winding up a scheme should not apply. Those matters should be governed by the present law.

Disclosure rules

16.4 Most of the recommendations in relation to disclosure can and should take effect in relation to existing schemes as soon as possible after the amending legislation is enacted. The requirement to disclose a scheme's registration number is an obvious exception: this will not be possible until the scheme has been registered by the ASC under the new regime. The Review **recommends** that all disclosure requirements that do not depend on the existence of a scheme number, such as the enhanced disclosure recommendations, should apply from the commencement of the amendments to the Corporations Law recommended in this report.

Financial controls

16.5 The new regime will, in most cases, limit the capacity of a scheme operator to borrow funds on behalf of the scheme. In most cases the funds borrowed must not be more than 10% of the value of the assets in the scheme unless the scheme is registered as a 'geared' scheme. Because there is no such restriction at present (other than the 20% cap imposed on unlisted property trusts), some schemes will need to be registered as geared schemes. The Review **recommends** that schemes

should not have to comply with the recommended financial controls until they are registered under the new regime. In relation to auditing, however, including the requirement that auditors report breaches, the Review **recommends** that the requirements should apply to existing prescribed interest schemes as soon as the amending legislation commences.

Exit controls

16.6 Under the Review's recommendations, scheme operators will not be under a statutory obligation to purchase investors' interests on request. Operators will only be able to offer to repurchase investors' interests after specifying the amount they are prepared to spend. The ability of an investor to redeem his or her interests will also be matched more closely to the liquidity of the scheme. The changes the Review recommends in relation to leaving collective investment schemes are designed to minimise commercial instability. For this reason it would be desirable to introduce these changes at the earliest opportunity. The fact that they do not depend on any other aspect of the reforms means they can be introduced independently of other recommendations in this report. The Review **recommends** accordingly. Investors in many collective investment schemes, however, are not likely to notice any changes to their schemes.

Operator's obligations

16.7 The Review recommends that significant obligations be imposed on operators of collective investment schemes and their officers. They include obligations to maintain a minimum net value and to establish an informal dispute resolution mechanism and obligations similar to the statutory obligations that directors owe to companies. They have been formulated in the light of the overall impact of the recommendations on the structure and operation of schemes. The Review **recommends** that they should not be imposed in relation to a scheme until it is registered and a scheme operator licensed.

Investors' rights to information

16.8 Another set of rights recommended by the Review concerns the provision of information to investors.

- **Access to information on demand.** The Review has recommended that investors in all collective investment schemes should have access to information about the scheme on the same basis as investors in companies.¹ Investors in unit trusts and limited partnerships would, it seems, already have an equivalent right under the existing law. The Review **recommends** that this right should be available as soon as the amending legislation commences.
- **Annual and other reports.** The Review also recommends that scheme operators should provide annual reports to investors, and lodge with the ASC half yearly reports, with specific information, including:

1. See para 11.4.

- details of any purchase of interests by the scheme operator
- a change in the identity of the directors of the operator.

The Review **recommends** that these obligations should be imposed on managers of prescribed interest schemes for which there is an approved deed as soon as possible after the amending legislation is enacted.

Investors' power to dismiss or replace the operator and to amend the constitution

16.9 All investors in collective investment schemes will have a minimum set of rights. Three important rights are to dismiss the scheme operator, to replace it with another and to amend the constitution of the scheme.² Investors in unit trusts presently have a right to dismiss either the manager or the trustee. There is also a right to vote on certain amendments to the deed.³ The Review **recommends** that investors should have the same right to dismiss the trustee or manager, after commencement of the amendments but before the scheme is registered and an operator appointed, as they would have to dismiss the operator under the new regime. Their existing rights should be superseded. However, rights of either the manager or trustee to call on the other to retire should continue. The Review **recommends** that the mechanism for amending the constitution of a prescribed interest scheme should not be changed until the scheme is registered.

Oppression remedy

16.10 The Review elsewhere recommends that investors should be able to apply to the court for relief on the grounds of oppression.⁴ The Review **recommends** that this right should be available to investors in all collective investment schemes on commencement of the amending legislation. If oppression arises during the transition by a scheme to the new regime, the investors should be able to protect themselves by using this remedy.

Controls on intermediaries

16.11 The changes recommended in relation to intermediaries, apart from those relating to prescribed education standards, can and should apply as soon as the amending legislation commences. There is no reason why investors in existing schemes should not enjoy the benefits of the reforms (principally the increased disclosure to clients) at the earliest opportunity. The Review **recommends** that the controls on intermediaries recommended in the report should apply as soon as the amending legislation commences.

Regulator's powers

16.12 The recommendations in this report will, when enacted, give the ASC significantly increased powers to protect the interests of investors. There is no reason not to enable the ASC to use them as soon as possible. The Review

2. Subject to the agreement of the operator: see para 11.22.
3. Corporations Law s 1069A.
4. See para 11.33.

recommends that as soon as the amending legislation commences the ASC should be able to exercise, in relation to both trustees and managers of prescribed interest schemes, all the powers it will have, including powers to conduct audit surveillances, in respect of scheme operators.

