3. What is a collective investment scheme?

Introduction

3.1 The terms of reference require the Review to examine the regulatory framework for prescribed interests and like collective investment schemes. 'Prescribed interest' and 'collective investment scheme' are both artificial concepts. All schemes that raise funds from investors and invest the funds could be called collective investment schemes in the broadest sense of the term. This chapter considers which of them should be a 'collective investment scheme' for the purposes of the Corporations Law. It considers each of these kinds of scheme in turn to see if any of them should be excluded from regulation as a collective investment scheme under the Corporations Law. It concludes with a brief outline of the regime proposed by the Review for the regulation of collective investment schemes under the Corporations Law. For ease of understanding, throughout the remainder of this report (unless otherwise indicated) the term 'collective investment schemes' means those schemes that have been defined in this chapter to be 'collective investment schemes' for the purposes of the Corporations Law.

Current regulation of investment vehicles

3.2 The current regulation of investment vehicles is a mixture of functional and institutional regulation. As a consequence of ad hoc decisions taken in the past there are some anomalies in the regulatory framework. The question how new investment vehicles should be regulated and by whom can still be difficult to resolve.[1]

Investor preferences and regulation of fundraising

3.3 Investors are not all the same. There is a spectrum of different types of investors. At one end are investors who want certainty that their funds will be returned to them at the expiry of the investment period or on demand. They rely on an explicit or implied government guarantee or extensive prudential supervision[2] of their chosen fundraising vehicle to ensure that they are able to recover their investment. They are prepared to accept a more modest return on their investment as a trade off for this security. At the opposite end of the spectrum are those investors who do not want a government regulator controlling on their behalf the activities of the fund raising vehicle in which they have invested. For this type of investor regulation protects their right to become involved in the decisions of the fund raising scheme in which they have invested and ensures that they can enforce

1. Until recently, for example, Pooled Superannuation Trusts (PSTs) were regarded by the ASC as prescribed interest schemes under the Corporations Law and by the ISC as a type of superannuation scheme and therefore subject to OSSA. Investment linked life insurance policies are other products that are regarded by some as prescribed interests and by others as life insurance policies and, therefore, outside the scope of the Corporations Law.
2. Prudential supervision is discussed in para 2.9.

their rights if necessary. Some of these investors will take a very active part in the management of their investment. Others will not take up the option available to them. Investors who chose these kinds of schemes are prepared to forego prudential supervision of their investment in return for the opportunity to exercise control over their investment. The regulation of fund raising vehicles needs to recognise this spectrum of investor preferences. Collective investment schemes may be characterised as falling between the two extremes of close prudential supervision and investor self regulation. They appeal to investors who accept that their investment is not guaranteed or prudentially supervised and therefore entails investment risk. At the same time these investors do not seek to become involved in the day to day management of their investment, preferring these decisions to be taken by others subject to some controls. They do not, however, seek a regulatory regime designed only to provide a framework in which they alone regulate their own affairs. The Review has sought in this report to consider existing fund raising vehicles on a consistent basis using this spectrum as a framework to identify which ones should be included or excluded from the definition of collective investment schemes. There are inevitably some anomalies.

Schemes the subject of this report

Prescribed interest schemes

3.4 The Corporations Law defines a prescribed interest as

- a participation interest, that is, an interest
  - in any profit, asset or realisation of any financial or business undertaking or scheme
  - in any common enterprise in relation to which the holder of the right or interest is led to expect profits, rent or interest from the efforts of the promoter of the enterprise, or a third party
  - in an investment contract
- a right to participate in a time-sharing scheme.[3]

This definition is very broad. Most kinds of fund raising schemes that should be covered by the definition of the term 'collective investment scheme' are included. However, it is too broad. Some fund raising schemes and other arrangements are therefore specifically excluded: rights or interests in a trust not established by a 'promoter' or a private trust where the deed provides for not more than 15 beneficiaries,[4] franchises,[5] retirement village schemes,[6] certain joint ventures,[7] time

3. Corporations Law s 9.
4. Corporations Regulations reg 7.12.04(c)(i), 7.12.04(c)(iii). The ambit of these exemptions is unclear and possibly wider than intended. There may also be a possibility of circumvention by creation of rights or interests under a trust without the use of a trust deed: I Ramsay 'Flaws in the prescribed interest provisions of the Corporations Law' (1991) *Butterworths Corporation Law Bulletin*, 425.
5. Corporations Regulations reg 7.1.02.
6. Corporations Regulations reg 7.12.04(a).
7. Corporations Regulations reg 7.12.04(b).

sharing schemes[8] and various partnership agreements[9] and interests in, or arising out of, life insurance policies.[10] These exclusions have been made on an ad hoc basis.

Prescribed interests to be the basis of the definition

3.5 DP 53 expressed concern at some apparent anomalies arising from the current definition of 'prescribed interest' and considered whether an alternative definition could be developed which did not require the exclusion of so many different types of scheme.[11] It suggested that the definition should focus on schemes that provide investors with a funds management function. Suggested identifying features included

- pooling of resources by investors
- an absence of day to day control of the management of the scheme by investors
- investors having the right to redeem their investments.[12]

It proposed that managed funds should not be able to seek exemption from the requirements imposed by the Corporations Law, which would be designed with such schemes in mind.[13] While some submissions supported this approach,[14] others expressed concern that the proposal did not provide enough flexibility for 'managed funds'.[15] The Review now accepts that it is not possible to replace the existing definition of 'prescribed interest' with a more precise definition of 'collective investment scheme' which applies to fund raising schemes other than those which are prudentially supervised or schemes in which the investors themselves are primarily responsible for the conduct of their scheme. The Review therefore **recommends** that the existing definition of prescribed interests in the Corporations Law should be the basis of the definition of 'collective investment schemes' to which the regulatory regime recommended in this report will apply. The Review also **recommends** that the expression 'prescribed interests', which is a less than helpful expression except to the cognoscenti, be abandoned in favour of 'collective investment schemes'.

8. NCSC Release 117; ASC Media Release 92/149.
9. See *ASC v Woods and Johnson Developments Pty Ltd* (1991) 6 ACSR 191 and ASC Media Release 92/76.
10. Corporations Law s 9.
11. DP 53 para 3.17-3.21.
12. DP 53 para 3.37-3.40. The Review acknowledged that not all collective investment schemes provide a funds management function, particularly 'enterprise' schemes such as yabbie or ostrich farms and recreational or 'lifestyle' schemes.
13. Proposal 3.3.
14. Credit Union Services Corporation (Australia) Limited *Submission* 27 November 1992; Commonwealth Attorney General's Department *Submission* 21 December 1992.
15. IFA *Submission* 1 December 1992; Law Council of Australia *Submission* 16 December 1992.

Specific inclusions

3.6 ***Trustee company common funds.*** These funds are assumed to fall within the definition of prescribed interests under the Corporations Law. However, if the money contributed to a common fund is a private client contribution, that is, money derived from deceased estates or private trusts administered by the trustee company or otherwise held or received by the trustee company on the basis that it has total discretion whether to invest in a common fund, the assumption is that no "issue, offer or invitation" is involved and, consequently, that the regulatory regime for prescribed interests does not apply. Common funds that receive money otherwise than as a private client contribution, so that a registered prospectus is required, have been granted relief from complying with certain of the prescribed interest provisions of the Corporations Law, such as the requirement for a separate trustee and some of the prescribed covenants.[16] DP 53 suggested that trustee company common funds, unless they receive money solely in the form of private client contributions, should not be exempt from the provisions of the Corporations Law simply because they are managed by statutory trustee companies. It also proposed that private client contributions should be placed in separate common funds from those in which contributions from other sources are placed.[17] Submissions from statutory trustee companies supported a continued exclusion[18] but other submissions agreed with the proposal.[19] The Review has concluded that the arguments for excluding all trustee company common funds from the regulation that applies to collective investment schemes are unpersuasive. It agrees, however, that funds with only private client contributions should not be regulated by the collective investment provisions of the Corporations Law.[20] A distinction should be drawn between common funds that contain only private client contributions and other common funds. The Review **recommends** that common funds that contain any money that is not a private client contribution should be regulated by the collective investment provisions of the Corporations Law. They should not be granted exemptions from those provisions merely because they are operated by a trustee company. Under the Review's recommendation, common funds that are regulated by the collective investment provisions of the Corporations Law will be able to receive private client contributions.

3.7 ***Limited partnerships.*** The law governing limited partnerships makes no provision for their prudential supervision. Limited partners are, however, precluded from significant involvement in the management of the affairs of the partnership. Their position is, therefore, similar to investors in other collective investment schemes. Limited partnerships have proved a popular vehicle for financing infrastructure projects such as power stations. The Corporations Regulations make limited partnerships that have, or are intended to have, more than 15 partners or that are promoted by a person who is not a partner in the

16. ASC Policy Statement 32.
17. Proposal 14.1.
18. eg TCA *Submission* 17 December 1992; cf Permanent Trustee Company *Submission* 12 November 1992.
19. eg IFA *Submission* 1 December 1992; Law Council of Australia *Submission* 16 December 1992.
20. Just as those funds are now not regulated by the prescribed interest provisions of the Corporations Law because no issue, offer or invitation is involved.

partnership or by an associate of a person whose ordinary business includes the promotion of similar schemes prescribed interests.[21] The Review considers that those limited partnerships should be regulated as collective investment schemes because the limited partners in a limited partnership are not able to regulate their affairs themselves and limited partnerships are not otherwise prudentially supervised. The Review **recommends** accordingly.

Arrangements not involving investment excluded

Employment schemes

3.8 There are some schemes which are currently regulated as prescribed interest schemes but which should not be because they are not true investment arrangements. For the sake of certainty, they should be specifically excluded from the regime recommended by the Review. Employee benefit schemes seek to provide to employees benefits in the nature of salary. The consideration or subscription for obtaining an interest in these schemes is not money or some other asset; it is providing services as an employee. The Review **recommends** that the collective investment provisions of the Corporations Law should not apply to schemes of this kind.

Retirement villages

3.9 A retirement village scheme is likewise not an investment. Its purpose is to provide long-term accommodation on a freehold basis for retirees. However, it was not clear that they were not caught by the definition of prescribed interests in the Corporations Law. To clarify that they should not be included they have been specifically excluded from the application of the prescribed interest provisions of the Corporations Law. The Review **recommends** that the present exemption in the Corporations Law for such schemes should continue. The collective investment provisions of the Corporations Law should not apply to them.

Government guaranteed investment schemes excluded

3.10 Government bonds are issued either directly by governments or through statutory authorities. The repayment of money invested in government bonds is ultimately guaranteed by the relevant federal, State or Territory government. The risk that the government will not pay investors the amount owed when it falls due is minimal. Because of the government guarantee, investors in these bonds do not need to protect their interests by taking action themselves. Accordingly, the law does not provide for their direct involvement in decisions affecting their investment. The Review **recommends** that bonds issued by the Commonwealth or a State or Territory government, or statutory authorities or corporations owned by them, should be excluded from the definition of 'collective investment scheme' in the Corporations Law.

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21. Corporations Regulations reg 1.13A.

Schemes operated by prudentially supervised institutions excluded

Banks

3.11 Banks are prudentially supervised by the Reserve Bank of Australia (RBA) under the *Banking Act 1959* (Cth).[22] Many investors mistakenly believe that the repayment of deposits with banks is guaranteed by the Commonwealth. The Commonwealth, under the *Banking Act*, requires the RBA only to protect the interests of depositors, not to guarantee deposits with banks.[23] The RBA is not legally obliged to provide a 'lender of last resort' facility to any bank. The RBA seeks to ensure that banks will be able to repay investors by imposing prudential controls on banks.[24] As a last resort, the RBA has the power to take over the operations of a bank.[25] Given the high level of protection provided to those who invest through bank deposits as a result of the extensive prudential supervision of banks, the Review **recommends** that deposits with Australian banks that are regarded by the RBA as part of a bank's banking business should be excluded from the definition of 'collective investment scheme' in the Corporations Law.

Building societies and credit unions

3.12 Until recently the level of prudential supervision of building societies and credit unions varied from jurisdiction to jurisdiction. A co-operative framework for the prudential supervision of building societies and credit unions was established in 1992.[26] The Australian Financial Institutions Commission (AFIC) is now responsible for establishing the standards of prudential supervision for building societies and credit unions throughout Australia, similar to those imposed on banks by the RBA. Compliance with these standards will be monitored in each State and Territory by an industry funded supervisory body. The position of these financial institutions is now similar to that of banks. They should be excluded from the definition of 'collective investment scheme' in the Corporations Law for the same reason. The Review **recommends** that deposits with building societies or credit unions regulated under the uniform Financial Institutions Codes should be excluded from the definition of 'collective investment scheme' in the Corporations Law.[27]

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22. The RBA recently entered into formal arrangements with those State governments still operating State Banks to permit the RBA to supervise these banks. The Commonwealth has no separate constitutional power over State banks.
23. *Banking Act 1959* (Cth) s 12.
24. For details of the capital adequacy rules for banks see RBA Prudential Statement C1, August 1988, 22.
25. *Banking Act 1959* (Cth) s 14(2).
26. 'Template' legislation establishing AFIC was passed in Queensland and adopted in the other States and Territories.
27. The draft Bill in Volume 2 of this report refers to building societies and credit unions as 'locally regulated financial institutions'.

Life insurance companies

3.13 ***Investment linked policies.*** Traditional life insurance policies require the life insurance company to bear a mortality risk.[28] Life insurance companies have therefore been subject to quite stringent prudential supervision to ensure they have the financial capacity to meet the obligations that may arise from these policies. Life insurance companies have, however, for some time offered insurance contracts that are 'investment linked' (that is, the value of an investor's interest changes in line with changes in the value of the underlying portfolio of assets). They have regarded this class of contract as falling within the exemption from the prescribed interest provisions of the Corporations Law for 'any interest in, or arising out of, a policy of life insurance'[29] on the basis that the policies may contain some death cover. The Review is not convinced that this is correct in law. Such schemes typically involve the allocation of a number of units, each representing an equal share in the investment portfolio, to an investor's account. The kind of assets included in an investor's portfolio (such as shares, fixed interest securities or property) can often be selected by the investor, in the same way that investors in unit trusts can satisfy their investment preferences by choosing a unit trust that invests in the assets or asset classes that match their preferred investments. It appears to the Review that these investment contracts perform the same role as other collective investment schemes.

3.14 ***General approach.*** In principle, therefore, investment linked policies should be regulated in the same way as collective investment schemes. DP 53 suggested that this should be achieved by specifically including these policies in the definition of collective investment schemes.[30] Submissions, particularly from life insurers and from the ISC, opposed this suggestion.[31] After consultation with the life insurance industry and the ISC, the Review accepts that, with appropriate modifications relating to disclosure and marketing, the protection afforded investors by the existing law governing life insurance companies could be made appropriate, given the nature of the contract between investor and the life insurance company. If these modifications were made, there would be insufficient justification for the difficulty and cost of transferring responsibility for the regulation of these schemes from the ISC to the ASC, thus subjecting life insurance companies to supervision by two regulators.

3.15 ***Recommendation.*** Unlike the Corporations Law, the *Life Insurance Act 1945* (Cth) presently contains no general requirements for disclosure to the potential policy holder. Insurers voluntarily disclose a number of similar matters as a matter of practice and the ISC has issued circulars which set out an agreed industry position on the appropriate level and kind of disclosure. However, compliance with the circulars is not mandatory and the legal consequences of incorrect or misleading

28. ie the insurance company runs the risk with each holder of this type of policy that their policy will have to be paid out before the insurance company makes a profit from the policy.
29. Corporations Law s 9.
30. Proposal 12.2.
31. National Mutual Life Association *Submission* 3 December 1992; AMP Society *Submission* 30 November 1992; Mercantile Mutual Holdings Limited *Submission*; ISC *Submission* 16 December 1992; MLC Life Limited *Submission* 18 December 1992; LIFA *Submission* 18 December 1992.

disclosure differ from the consequences under the Corporations Law of incorrect or misleading disclosure.[32] The Review has concluded that it is important that the disclosure regime for investment based products of life companies be similar to the regulation of collective investment schemes under the Corporations Law. It considers that the LIA should be amended to impose on life insurers and their agents the same requirements as to the level and kind of disclosure as are imposed on offerors of interests in collective investment schemes under the Corporations Law. It **recommends** that, if the LIA is not amended in this way within 18 months of the release of this report, investment linked policies should be regulated under the collective investment provisions of the Corporations Law. If the LIA is amended as recommended, all products offered by life insurance companies should be excluded from the collective investments regime proposed in this report.

Friendly societies

3.16 In many ways friendly societies are similar to life insurance companies. Traditionally, friendly societies were groups of workers who made small, regular contributions to a common fund which could be used to fund sickness payments, funeral benefits, invalid pensions and the like. They were first formed in Australia in the 1830s. The 'social service' payments provided by friendly societies have largely been replaced by government funded welfare. Friendly societies now offer members funeral benefits, 'top up' sickness insurance, disability insurance, health insurance and retirement products based on managed funds. Although essentially insurance companies, friendly societies are not regulated by the ISC. They are currently subject to the Corporations Law when they offer prescribed interests to investors, except in some situations, for example, when the offers are made within the State in which the society is established. Currently, they are also subject to legislation in each State and Territory.[33] The Review has been told that proposals for the regulation of disclosure about and marketing of investment products by friendly societies being developed by the Special Premiers' Conference Working Party will follow closely the requirements in the Corporations Law in respect of disclosure and the marketing of securities. The Review therefore **recommends** that all products offered by friendly societies should be exempted from the application of the collective investment provisions of the Corporations Law. This recommendation, like the recommendation in respect of investment linked life insurance policies, is conditional on the disclosure and marketing laws being similar for friendly societies' investment products as for collective investment schemes and on them being implemented in a reasonable period.

Superannuation schemes

3.17 Superannuation schemes are also subject to significant prudential supervision.[34] In its report *Collective investments: superannuation* (ALRC 59, 1992), the Review dealt exhaustively with superannuation schemes, approved deposit funds (ADFs), deferred annuities (DAs) and pooled superannuation trusts (PSTs). That

32. Currently, the TPA does not apply to all disclosures, or to lack of disclosure, by life insurers.
33. eg *Friendly Societies Act 1989* (NSW).
34. However, members of accumulation schemes bear the investment risk arising from the scheme's investment activity.

report made detailed recommendations about the prudential and other controls that ought to be imposed on schemes of this kind. The federal Government announced on 21 October 1992 that it had accepted most of the recommendations in the report, and the Superannuation Industry (Supervision) Bill 1993 (Cth) was introduced on 27 May 1993. The Review **recommends** that superannuation funds, ADFs, DAs and PSTs regulated under the Superannuation Industry (Supervision) Bill 1993 (Cth), when enacted, should not be subject to the collective investments regime recommended in this report. The special features associated with superannuation, including the facts that it is now virtually compulsory and that many schemes will have to have employee representatives involved in the supervision of schemes, make it appropriate that superannuation be regulated separately from other collective investment schemes.

Schemes that provide for investor participation excluded

Introduction

3.18 There are many schemes which are not otherwise subject to significant prudential supervision that are subject to regulation which aims only to provide investors with the opportunity to protect their own interests by becoming involved in the decisions concerning their investment. These schemes include

- joint venture schemes
- intra group schemes
- franchises
- partnerships (other than limited partnerships)
- direct investment in corporations through shares or debentures
- professional investor schemes
- small schemes.

To regulate them under the collective investment provisions of the Corporations Law would be contrary to the preferences of investors who have chosen to invest in those fund raising schemes because they allow a greater degree of investor participation than is provided for investors in collective investment schemes. Some of these schemes are, and should remain, subject to other provisions of the Corporations Law relating to securities generally.

Joint venture schemes

3.19 A key characteristic of joint ventures appears to be that the joint venturers often contribute specific assets or expertise, rather than merely capital. This kind of scheme has a degree of investor involvement that makes the application of the Corporations Law collective scheme provisions inappropriate. The joint venturers' rights would be restricted by these provisions to a degree that would make the schemes unworkable. The Review **recommends** that joint venture arrangements should not be regulated by the collective investment provisions of the Corporations Law. To guard against abuse of this exemption the Review **recommends** that the exclusion should only apply to arrangements that the ASC declares to be joint ventures.

Intra group schemes

3.20 Some schemes are designed simply to facilitate the operation of a group of companies as between themselves. Given the essentially private nature of such an arrangement and the fact that the 'investors' will all be within the same corporate group, the Review **recommends** that schemes where the only 'investors' are bodies corporate related to each other should not be regulated by the collective investment provisions of the Corporations Law.

Franchises

3.21 Franchise arrangements usually involve the purchaser obtaining the right to use a particular name and the franchise owner providing back up support and ensuring standardisation of marketing. Franchises involve a degree of investor involvement in the day to day management of the investment. This makes the application of the collective investment provisions of the Corporations Law inappropriate. The Review **recommends** that franchise arrangements should not be regulated by those provisions.

Partnerships

3.22 A partnership clearly involves a collective investment by the partners in the partnership. Partnership law assumes that the partners will themselves determine what level of involvement they will have. The law should not interfere with this arrangement. The Review therefore **recommends** that the existing exclusion of partnerships from the scope of the 'prescribed interest' provisions be maintained. Partnerships should not be regulated under the collective investment provisions of the Corporations Law. The existing exclusion does not cover certain limited partnerships or partnerships promoted by or on behalf of a person who promotes similar partnerships or schemes. This exception to the exclusion should continue.[35]

Fundraising by corporations

3.23 ***Shares.*** Equity capital (shares) is an important source of capital for corporations. The Corporations Law provides for a comprehensive regulatory framework for shares which provides shareholders with the opportunity to exercise a greater level of involvement in the activities of the corporation than is available to investors in collective investment schemes under the Review's recommendations. DP 53 proposed that the regulation of shares be excluded from the definition of collective investment scheme. The Review affirms that view and **recommends** that shares not be regulated by the collective investment provisions of the Corporations Law.

3.24 ***Debentures and notes.*** Another important source of finance for corporations is borrowings from the public. These borrowings frequently take the form of debentures or notes. The repayment by the corporation of these debts is also very often secured against particular assets of the corporation. They are not, however, a

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35. Corporations Law s 9; Corporations Regulations reg 1.13A. Limited partnerships are dealt with in para 3.7.

collective investment in the corporation by the lenders. The use of this form of fund raising scheme by corporations is comprehensively regulated by the general provisions of the Corporations Law which provide the regulatory framework in which any dispute as to the rights of the parties set out in their own agreements between themselves will be resolved. DP 53 proposed that all debentures and notes be excluded from the definition of collective investment schemes. The Review affirms that view. It **recommends** that debentures and notes should not be regulated by the collective investment provisions of the Corporations Law.

3.25 ***Investment companies.*** The ASC urged the Review to examine the regulation of investment companies under the Corporations Law Pt 4.4.[36] It indicated that the present regulatory provisions have been found to be unworkable. In 1986, the NCSC decided as a matter of policy not to declare a company to be an investment company under Pt 4.4 because it considered the provisions inappropriate. There is, therefore, no special regulatory regime in effect for investment companies. Specific regulatory issues raised by the ASC include

- conflicts of interest where a sponsor related investment manager is employed
- inconsistencies between the regulation of investment companies and the regulation of similar investment schemes.

Investment companies, because of their corporate form and because of the extent of the regulation imposed on them under the Corporations Law, pose particular problems. The Review has not addressed those problems in this report. They should be the subject of a separate report. The Review **recommends** that the matter be referred to it.

Professional investors

3.26 ***DP 53 proposal and submissions.*** DP 53 questioned whether collective investment schemes offered to so-called 'institutional' or professional investors should be covered by the Corporations Law regulation of collective investment schemes. It proposed that such schemes should be subject to those provisions unless an exemption is obtained from the regulator.[37] Several submissions proposed an automatic exemption for collective investment schemes whose investors are all 'professional'.[38] They argued that an investor with a significant sum to invest has enough incentive to take an active interest in the scheme. The Review agrees.

3.27 ***'Professional investor' defined.*** The Corporation Law currently defines as an excluded offer any scheme in which each investor has contributed at least $500 000.[39] The Review accepts that investors who place $500 000 in a single investment have sufficient commercial incentive to take a high level of interest in what happens to their investment. This high level of interest and, in many cases, involvement, makes it inappropriate to regulate such schemes as collective

36. ASC *Submission* 23 December 1992.
37. DP 53 para 3.25.
38. BT *Submission* 15 December 1992; MLC Life Limited *Submission* 18 December 1992.
39. Corporations Law s 66.

investment schemes under the Corporations Law. It would unduly restrict their opportunities for involvement by investors in such schemes The amount required to be invested by each investor before a scheme can gain this exemption from the collective investment provisions of the Corporations Law should be able to be increased by regulation to avoid inflation removing some investors from the coverage of the law.

3.28 ***Recommendation.*** The Review **recommends** that schemes the minimum initial subscription for which is at least $500 000 should not be regulated by the collective investment provisions of the Corporations Law. It should be made clear, however, that interests in such schemes will continue to be securities for the purposes of the Corporations Law and so subject to the general prohibitions in the Corporations Law against misleading or deceptive conduct in relation to securities.[40]

Small schemes

3.29 Collective investments include schemes that are small in size and open only to a small group of people. An example is a group of friends who regularly pool money for lottery tickets or Lotto.[41] The protective measures recommended in this report for collective investment schemes are not appropriate for arrangements of this kind. The Review therefore **recommends** that schemes that are structured so that they cannot accept from their investors more than $100 000 in total should not be regulated by the collective investment provisions of the Corporations Law.[42]

Exclusion by regulation

3.30 In view of the broad range of fund raising schemes covered by the Review's definition of 'collective investment scheme', it is possible that not all aspects of the law regulating collective investment schemes will be appropriate for all schemes. The Review recognises that it will be important to be able to modify the application of the law where appropriate. In particular cases this could go as far as excluding a scheme or a class of schemes from the application of the collective investment provisions of the Corporations Law. The Corporations Law already excludes from the coverage of the prescribed interest provisions of the law a variety of issues, offers and invitations to invest, either generally or from particular provisions.[43] It also allows the ASC to exempt persons or a particular class of persons, either generally or otherwise, from compliance with the provisions of a number of divisions of the Corporations Law.[44] The kinds of collective investment schemes which should be excluded may well change over time as new types of fund raising vehicles develop. Rather than attempt to anticipate this, it seems more appropriate to provide, as the Corporations Law does now, for individual schemes and classes of collective investment schemes to be excluded, either wholly or in part, from the new regime. The Review **recommends** that s 1084 should continue. The ASC

40. eg Corporations Law s 995.
41. But note that racehorse syndicates are in an entirely different position.
42. The figure of $100 000 should be able to be altered by regulation.
43. Corporations Law s 66.
44. s 1084.

should be able to modify, including by exclusion, the application of the collective investment provisions of the Corporations Law to schemes or classes of schemes. The Review has considered whether such a wide power is an inappropriate delegation of legislative power. It considers that, in light of the broad definition of collective investment schemes,[45] and the fact that many of the provisions of the regulatory regime will be inappropriate or unnecessary for some schemes, the power to grant exemptions represents an appropriate balance between parliamentary supremacy and the practical application of the law. It is important to ensure that, where the Parliament delegates any power, it is kept informed of the exercise of that power. The Review **recommends** that the ASC should report annually to the Parliament on the number and kind of exemptions it granted during the year.

An outline of the proposed regime

3.31 The rest of this report sets out the detail of the Review's recommendations for collective investment schemes that ought to be regulated under the Corporations Law. Those recommendations will result in collective investment schemes being established by the operator of the scheme applying to the ASC for registration of the scheme as a collective investment scheme and for the issue to it of a scheme operators licence, authorising it to accept subscriptions and otherwise carry on the business of the scheme. While the registration of the scheme as a collective investment scheme is a formal matter, principally to enable people to identify the scheme, the scheme operators licence application is designed to allow the ASC to assess whether the operator

- has compliance measures that are reasonably likely to ensure that it complies with the scheme constitution and the Corporations Law
- meets a minimum capital.

Neither the licence nor the registration is intended to assess the commercial viability of the scheme or the professional expertise of the operator. Specific controls are imposed on the way in which the scheme operator will deal with the funds subscribed. Extensive provision is made for reporting to investors and to the ASC. The present buy back obligation is to be abolished, to be replaced by rules ensuring that buy backs by the operator and redemptions of interests out of scheme assets do not prejudicially affect the viability of the scheme or the interests of other investors. In the light of all the proposed reforms, it can be left to scheme operators and their perceptions of investors' wishes to decide whether to involve a second party, such as a statutory trustee company, in the running of the scheme.

45. Which is necessary to ensure that the regulatory regime encompasses all the schemes it should.