5. Disclosure

Introduction

5.1 This chapter makes a number of recommendations to enhance the disclosure practices of operators of collective investment schemes. The recommendations cover disclosure to prospective investors, advertising by operators of collective investment schemes, continuing disclosure to existing investors and disclosure to the ASC and hence the market generally.

The importance of disclosure

Separation of ownership from control

5.2 The separation of ownership and control that characterises many commercial enterprises, including collective investment schemes, makes it important that investors be kept informed regularly by management about the enterprise's financial position and performance. Collective investment schemes are typically characterised by a more significant separation of ownership and control than trading corporations. Investors in collective investment schemes may therefore have an even greater need for information than many company shareholders. Appropriate and timely information can alert both existing and potential investors to significant developments in the performance of the scheme and, possibly, to inefficiency or misconduct on the part of the scheme operator. Information concerning a scheme's activities can also help individuals make decisions about whether an investment in a particular scheme is advantageous in light of the rest of his or her personal asset holdings.

The role of mandatory disclosure requirements

5.3 Some commentators have questioned the value of mandatory disclosure rules, suggesting that market forces will ensure the best disclosure practices.[1] Others consider that mandatory disclosure is necessary to overcome 'market failure' associated with the private production of securities information. The Review has concluded that, without legal intervention to enforce adequate and timely disclosure, insufficient securities information is produced. Mandatory disclosure rules help to

- reduce information inequality between different classes of investors by ensuring that operators give investors all the information that they have that is relevant to assessing the proposed investment
- increase the accountability of scheme operators to investors
- reduce the duplication of search and research costs by investors[2]

1. eg GJ Stigler 'Public Regulation of the Securities Markets' (1964) 37 *Journal of Business* 117; GJ Benston 'The Value of the SEC's Accounting Disclosure Requirements' (1969) 44 *Accounting Review* 515.
2. Some duplication may be desirable if it helps to ensure the accuracy of securities information.

- increase the accuracy of securities prices and thereby improve the efficiency with which the capital market allocates financial resources among competing investment opportunities.

Mandatory disclosure rules can also reduce significantly the contracting costs incurred by scheme participants. This happens in three ways. First, the legislation provides investors and managers of all schemes with common disclosure rules. This reduces the costs associated with developing rules for new schemes. Secondly, uniform disclosure practices can reduce the uncertainty that investors face in assessing the risks and benefits of different schemes.[3] Finally, the regulator can help ensure that disclosure requirements are complied with. The Review accepts the argument that mandatory disclosure rules are essential on efficiency and equity grounds. The purpose of legal disclosure rules should be to require the scheme operator to disclose to investors and prospective investors all information in the possession of the operator that is relevant to assessing the risks and benefits of investing in the scheme — that is, to reduce the information gap between the operator and the investors.

The importance of comprehensive, comprehensible and consistent requirements

5.4 In ALRC 59 the Review stressed the importance of ensuring that comprehensive, comprehensible and consistent disclosure requirements were imposed on the superannuation industry.[4] These three criteria are equally applicable to information supplied to investors in collective investment schemes even though, unlike superannuation, investment in collective investment schemes is not compulsory. While the variety of existing collective investment schemes makes it harder to design meaningful and consistent disclosure requirements, it is important that different schemes be comparable because they perform essentially the same function.

Advertising collective investment schemes

Misleading advertising prohibited

5.5 ***Advertising by prospectus.*** DP 53 suggested that it is important to regulate advertising to help ensure that offerors of collective investment schemes do not mislead prospective investors and that information provided is truthful and realistic. Misleading or deceptive conduct in respect of prescribed interest schemes is prohibited by the Corporations Law[5] and, in some cases, by the *Trade Practices Act 1974* (Cth).[6] A false or misleading material statement in, or a material omission from, a prospectus is specifically prohibited by the Corporations Law.[7] Under the Review's proposals, operators of all collective investment schemes will be subject to these provisions of the Corporations Law and provisions of the *Trade Practices Act*

3. JN Gordon 'The Mandatory Structure of Corporate Law' (1989) 89 *Columbia Law Review* 1549.
4. ALRC 59 para 10.7.
5. s 995.
6. The *Trade Practices Act 1974* (Cth) prohibits a corporation, in trade or commerce, from engaging in conduct that is false or deceptive (s 52) or unconscionable (s 51AA, 51AB).
7. s 996.

1974 (Cth). The ASC has the power to issue stop orders in relation to a prospectus. DP 53 suggested that the regulator of collective investment schemes should also have such a power.[8] The Review maintains this view.

5.6 ***Other advertising.*** A prospectus is not the only source of information about a collective investment scheme. Other types of advertising may be used. Pre-prospectus advertising in relation to all kinds of securities is subject to specific controls.[9] Currently, the ASC does not have the power to ban advertisements for prescribed interests. The Review noted in DP 53 that the Life Insurance Commissioner may object to any form of proposal or policy if of the opinion that it is likely to mislead.[10] DP 53 proposed that the ASC should have power to stop the issue or continued use of any form of advertising it considers likely to mislead. It proposed that the law should provide the ASC with a power, similar to that of the Life Insurance Commissioner under the *Life Insurance Act 1945* (Cth) s 77, to require production to the ASC of any advertising matter used, or proposed to be used, by or on behalf of the operator of a collective investment scheme.[11] In addition, it suggested that the law should provide the ASC with power to stop the use, or further use, of the matter as advertising if it is of the opinion that it is likely to mislead or deceive. The proposal received widespread support among respondents.[12] One submission suggested that the ASC should be given standing to make an application (*ex parte* if necessary) for an injunction in relation to advertising material to prevent a breach of the Corporations Law s 995.[13] The ASC already has this power in respect of any contravention of the Corporations Law.[14]

5.7 ***Recommendation.*** The prohibition on misleading and deceptive conduct in relation to collective investment schemes imposed by the Corporations Law s 995 should continue. The Review **recommends** that it should specifically extend to all forms of advertising or disclosure material including writing, films and other media. In conjunction with the ASC's other powers, including its stop order powers,[15] which should not be affected, it would be an effective and direct means of addressing the problem of misleading and deceptive advertising.

Advertisements to identify scheme operator

5.8 Under the Review's recommendations, there will be a single operator for each collective investment scheme. Investors must be aware of the operator's identity. In the case of superannuation, it was considered necessary to require the name of the operator to be prominently displayed on the cover of the member booklet or other offer document. This was seen to be particularly important if a hired investment manager is more widely known than the operator. DP 53

8. Proposal 11.18.
9. Corporations Law s 1025. See also ASC Policy Statement 54.
10. *Life Insurance Act 1945* (Cth) s 77.
11. Proposal 6.3.
12. eg Credit Union Services Corporation *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992.
13. Arthur Robinson & Hedderwicks *Submission* 16 December 1992.
14. Corporations Law s 1324.
15. Under the Corporations Law s 1033.

proposed that the law governing collective investment schemes should require prominent display of the name of the scheme operator and that contravention should be an offence.[16] The proposal was widely supported by respondents.[17] The Review therefore **recommends** that the law should provide that the front cover or front page of a prospectus of a collective investment scheme must to display prominently the name of the scheme operator and the registration number of the scheme. It should also provide that advertisements must display the same information.

Initial disclosure by the scheme operator: the prospectus[18]

The need for a prospectus

5.9 The Corporations Law includes an absolute prohibition on offering securities without a prospectus that has been lodged with, and, in certain cases, registered by, the ASC unless the offer is specifically exempted.[19]

The content of prospectuses

5.10 ***Corporations Law requirements.*** Before the commencement of the Corporations Law, the content of prospectuses was evaluated against a detailed checklist of mandatory requirements.[20] There are now, by contrast, few detailed prescriptions.[21] The Corporations Law imposes a general, non-prescriptive obligation to include all information that investors and their professional advisers would reasonably require, and reasonably expect to find, in the prospectus for the purpose of making an informed assessment of

(a) the assets and liabilities, financial position, profits and losses and prospects of the arrangement, common enterprise, financial or business undertaking, investment contract or scheme; and
(b) the rights attaching to the securities; and
(c) the merits of participating in that arrangement, common enterprise, financial or business undertaking, investment contract or scheme and the extent of the risks involved in the participation.[22]

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16. Proposal 6.4.
17. Credit Union Services Corporation *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992.
18. There is presently some uncertainty about the role of trustees in the preparation of prospectuses for prescribed interest schemes. In particular, there is doubt whether trustees 'authorise or cause the issue of' prospectuses for prescribed interest schemes for the purposes of the Corporations Law s 1006. If the Review's recommendation that collective investment schemes need only have a single operator is adopted, this issue will not arise.
19. Corporations Law s 1018. Lodgement involves making the document publicly available whereas 'registration suggests a greater degree of regulatory involvement': Securities Information Review Committee *Interim Report* August 1988, 14.
20. Companies Act 1981 and Codes, s 98.
21. They include requirements such as that the prospectus be dated, that the interests of directors and experts be set out and that there be a statement that the prospectus has been lodged with the ASC on a specified date and that the ASC takes no responsibility as to its contents: Corporations Law s 1021.
22. Corporations Law s 1022(1); Corporations Regulations reg 7.12.12.

This obligation places the onus on prospectus issuers to determine what should be included in prospectuses. In doing this regard may be had to the nature of the securities and the kinds of persons likely to buy the securities.[23] For example, if the offer is to existing shareholders of a company regard may be had to any relevant information previously given to them.

5.11 ***Recommendation.*** The question of a general disclosure requirement was considered by the Companies and Securities Advisory Committee in its *Prospectus Law Reform Report*.[24] That report recommended that s 1022 continue. DP 53 suggested that the advantages of the general disclosure requirement[25] outweigh any disadvantages,[26] and proposed that the requirement should continue to apply to prospectuses of collective investment schemes. There was widespread support for retaining s 1022 for collective investment schemes.[27] Submissions indicated that the requirement under s 1022 is now widely understood and prospectus preparers are becoming more comfortable with its application. The Corporations Law s 1022 should continue to apply to collective investment schemes. The Review **recommends,** however, that it should be modified to require prospectus issuers to provide information relevant to the nature of, in addition to the extent of, the risks of participating in the scheme.[28]

Prescribed contents of prospectuses

5.12 ***Proposal.*** While DP 53 did not favour the use of a purely prescriptive approach to the contents of prospectuses, it did suggest that, to provide adequate protection to investors and to enable them to make better comparisons between collective investment schemes, certain information should be required specifically. DP 53 proposed that, in addition to the general disclosure requirement under s 1022, prospectuses should have to set out

23. Corporations Law s 1022(3).
24. Companies and Securities Advisory Committee *Prospectus Law Reform Report* Sydney, 1992.
25. The Advisory Committee report noted these as
    - it is more likely to promote an allocatively efficient capital market
    - it assists in ensuring relevance to investors of information disclosed
    - it reduces the likelihood of important information being omitted
    - it focuses prospectus preparers on the information needs of investors
    - it enables information providers to react to changes in investors' information needs as market conditions change: para 106-7.
26. Noted in the Advisory Committee report as
    - inconsistency and incomparability of reports
    - cost and time involved in prospectus preparation and
    - problems of interpreting the requirement through litigation.
27. Macquarie Investment Management Ltd *Submission* 24 November 1992; IFA *Submission* 1 December 1992; Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992.
28. Currently reg 7.12.12 refers only to the extent of risks involved in scheme participation.

- if investments other than those listed in the prospectus are authorised by the deed or are able to be invested in by the scheme operator — that fact
- if a prospectus suggests that there is a link between the issuer and another institution — full details of that relationship[29]
- the investment performance of the scheme over the previous five years (or over the life of the scheme, if it had not been in existence for five years)
- the amount and nature of any fees and charges the scheme operator proposes to charge against investors' funds.[30]

In suggesting that these matters should have to be disclosed in a prospectus, the Review was in no way advocating a return to the detailed disclosure requirements and vetting practices associated with the various Companies Codes. Nor was it suggesting that adherence to these requirements would absolve the operator of a collective investment scheme from its responsibilities under the general disclosure regime. The Review called for comment on whether any additional matters should be prescribed.

5.13 ***Submissions.*** The majority of submissions that commented on the proposal supported some prescribed contents for prospectuses.[31] Nevertheless, some opposed prescribing the contents of prospectuses.[32] Their main concern was the risk of reverting to a 'check-list' approach, such as existed before the Corporations Law.[33] On the question what matters should have to be disclosed, it was suggested that it may be impractical to require the disclosure of the amount of fees and charges proposed to be levied by the operator.[34] The amount of fees may, for instance, be based upon asset size at a future time. Other matters suggested as ones that should be disclosed included

- the manager's name and address, qualifications and experience
- key features of the collective investment scheme
- an independent expert's report on financial information.[35]

5.14 ***Recommendation.*** While a return to lengthy and detailed check-lists would be highly undesirable, the Review has concluded that the law should prescribe specific matters that all prospectuses issued in relation to collective investment schemes should set out. It **recommends** that the following matters should have to be included in each prospectus:

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29. The Martin Committee in its review of the banking industry recommended that there be prominent disclosure in prospectuses that subsidiaries are in no way guaranteed by the parent bank: Martin Report recommendation 37, para 14.39.
30. Proposal 6.2.
31. eg National Mutual *Submission* 3 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992; Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992.
32. Macquarie Investment Management Ltd *Submission* 24 November 1992; IFA *Submission* 1 December 1992; MLC Investments Ltd *Submission* 17 December 1992.
33. One submission suggested that an industry code should be set up to determine what information should be disclosed for specific schemes. The industry body could inform the regulator if it believed there was a breach of its code. The regulator could then issue a stop order on the offending prospectus: Macquarie Investment Management Ltd *Submission* 24 November 1992.
34. National Mutual *Submission* 3 December 1992.
35. ASCPA & ICAA *Submission* 15 February 1993.

- all the kinds of investments authorised by the scheme's constitution
- how the operator's fees and charges are to be worked out
- if the prospectus suggests that another entity will or may assume a liability in relation to the scheme, for example, by way of guarantee — the circumstances in which the liability will arise
- the scheme's management expense ratio over the previous five years (or for the years the scheme has been in existence if it is less than five years old), that is, the ratio of total fees and expenses to the value of the assets in the scheme[36]
- details of the scheme's internal dispute resolution procedures.

The s 1022 requirement should still apply.

Should prospectuses have to be lodged?

5.15 ***Present law.*** Prospectuses must be lodged with the ASC.[37] There are two main exceptions:

- offers of securities already issued and listed on the ASX before the commencement of the Corporations Law[38]
- excluded offers, invitations and issues.[39]

One of the principal exemptions for shares and debentures (known as the limited offers exception) is where

- the securities are issued or allotted to a person as a result of the acceptance of
  - — an offer made personally to that person or
  - — an offer made by that person pursuant to an invitation issued personally to that person and
- either
  - — no other securities of the same class are issued or allotted at the same time, or have been issued or allotted in the preceding 12 months, to any other person or
  - — that person, and any other person or persons to whom securities of the same class are issued or allotted at the same time or have been issued or allotted in the preceding 12 months, do not together exceed 20 in number.[40]

A similar exemption exists for offers or invitations of shares or debentures made or issued personally to a person.[41]

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36. The proposal in DP 53 that the investment performance of the scheme over the previous five years be disclosed has been abandoned as such information could, in some circumstances, give a misleading picture of the future prospects of the scheme.
37. Corporations Law s 1018.
38. Corporations Law s 1018(2).
39. Corporations Law s 1017.
40. Corporations Law s 66(2)(d). In determining whether this exemption is applicable, the relative investment expertise and the wealth of the offerees or invitees is irrelevant.
41. Corporations Law s 66(3)(d).

5.16 ***Applying exemptions to collective investment schemes.*** The Corporations Bill tabled in federal Parliament in May 1988 provided for both prescribed interest schemes and share capital companies to be exempted from the requirement to lodge a prospectus in cases constituting 'limited offers'. However, following the report of the Edwards Committee,[42] the exemption was not extended to prescribed interest schemes. In principle, there appear to be no greater opportunities for abuse of the limited offer provisions by prescribed interest schemes than by share capital companies. The rationale put forward by the Edwards Committee for not excluding such offers is unclear. If investors in small share issues do not need the information provided in a prospectus, there is no reason why investors in small collective investment schemes need the information provided in a prospectus. Perhaps individuals who invest directly in shares are more financially sophisticated than investors in other collective investment schemes and therefore are assumed to require less information to enable them to make sound investment decisions. DP 53 sought comments on whether an exemption from the prospectus requirements should be available for limited offers of interests in a collective investment scheme.[43]

5.17 ***Submissions.*** Submissions generally supported the view that a limited offers exemption should be available for collective investment schemes.[44] One submission argued that

> [t]he preparation and lodgement of a prospectus is an expensive process which would make many smaller offers uncommercial. Where a prospectus is not strictly necessary, the legislation should provide relief from that expensive obligation.[45]

Another stated, however, that:

> We cannot envisage a situation where an exemption to lodge a prospectus ought to occur for limited offers of collective investment schemes. The purpose of collective investment schemes is, by nature, 'collective' and generally available. Accordingly, an exemption should not be available under any circumstances.[46]

5.18 ***Recommendation.*** The Review **recommends** that an automatic exemption from the prospectus requirements should not be available for limited offers of collective investment schemes. Such an exemption may be the subject of abuse by unscrupulous promoters offering many small schemes. Under the new regime the ASC will have a general power to exempt a scheme operator from a requirement of the law if it is satisfied that the extent of any loss in investor protection resulting from the exemption would not be significant. This discretionary power, together with the existing prospectus exemptions, is sufficient.[47]

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42. Joint Select Committee on Corporations Legislation *Report* AGPS Canberra 1989.
43. Issue 6B.
44. eg Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992 (for offers of up to 15 people).
45. Arthur Robinson & Hedderwicks *Submission* 16 December 1992.
46. Hall Chadwick *Submission* 21 December 1992.
47. 'Small schemes', ie, those that cannot have more than $100 000 in subscriptions, will be totally exempt from the collective investment provisions of the Corporations Law: see para 3.29.

Should prospectuses have to be registered?

5.19 Most prospectuses have to be registered by the ASC.[48] If a prospectus is 'registrable', the ASC must register it within 14 days of lodgement unless it appears to the ASC that the prospectus does not comply with the requirements of the Corporations Law or the ASC is of the opinion that the prospectus contains a false or misleading statement or that there is a material omission from the prospectus.[49] A recent report by the ASC recommended the abolition of existing prospectus registration procedures on the grounds that

- the require considerable resources
- the present 14 day registration period is not long enough to conduct an extensive examination of prospectuses, yet naive investors may believe that such an examination has been undertaken
- the registration period can provide timing problems for prospectus issuers, particularly in the case of international offerings.[50]

The Review doubts that the present registration process provides significant additional investor protection. Vetting of prospectuses by the ASC after they have been lodged, and the use of the ACS's stop order power, would provide more protection. DP 53 sought comment on whether collective investment scheme prospectuses should have to be registered by the regulator.[51] The vast majority of submissions suggested that registration requirements be abolished.[52] The Review **recommends** that collective investment scheme prospectuses should not have to be registered. Lodgement with the ASC will suffice.

Maximum life of prospectuses

5.20 ***Introduction.*** Generally, a prospectus has a life of six months from its date of issue.[53] While the maximum life of certain prospectuses may be extended, a supplementary prospectus must be issued in the event of a significant change.[54]

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48. Unless an offer relates to a class of shares or debentures already listed on the ASX or is an offer or issue to existing shareholders of a company, to an 'exempt recipient' or to the employees of a listed corporation: Corporations Law s 1017A(3), (4). One result of these exemptions is that unit trusts listed on the ASX must register their prospectuses whereas companies listed on the ASX need only lodge theirs. Also, offers of unlisted prescribed interests to existing holders under the same approved deed must be registered whereas offers of unlisted shares to existing holders do not have to be.
49. Corporations Law s 1020A; Corporations Regulations reg 7.12.08.
50. ASC *Prospectus Law Reform* August 1992, para 23.
51. Issue 6C.
52. Macquarie Investment Management Ltd *Submission* 24 November 1992; IFA *Submission* 1 December 1992; National Mutual *Submission* 3 December 1992; Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992. An exception was County NatWest Australia Investment Management Limited *Submission* 18 December 1992.
53. Corporations Law s 1040. Certain prescribed interest schemes (cash management trusts and mortgage trusts) can offer interests under a 12 month prospectus, provided the ASC is satisfied that the information in the prospectus is unlikely to change over the life of the prospectus (demonstrated, for example, by past stability) and there is adequate monitoring of the issuer by an appropriate industry body during the life of a prospectus: ASC Policy Statement 18 para 45. This was also the policy of the NCSC: NCSC Policy Statement 158.
54. Corporations Law s 1024.

While DP 53 was being written, both the federal Government and the ASC were reviewing the policy on extended life prospectuses. DP 53 sought comments on what the maximum life of a collective investment scheme prospectus should be.[55] There was considerable support for a maximum time period of one year.[56] It was argued that keeping a six month life for prospectuses is costly for investors without adding materially to investor protection. Several respondents claimed that the requirement under the Corporations Law for a supplementary prospectus to be issued whenever there is a significant change affecting any matter contained in the prospectus, or significant new matters which would affect the prospectus reduces the need for a six month maximum life.[57]

5.21 ***Recommendation.*** As part of an enhanced disclosure regime, the Corporate Law Reform Bill (No 2) 1992 [1993] (Cth) proposes to extend to 12 months the life of a prospectus relating to the securities of an entity that has

- been a 'disclosing entity' for 12 months or
- on two occasions in the previous 15 months lodged primary prospectuses with the ASC under the Corporations Law s 1018.

The following entities (among others) are disclosing entities under the Bill and consequently are to be subject to the enhanced disclosure requirements:

- entities and prescribed interest schemes listed on the ASX or other specified markets
- entities and prescribed interest schemes that raise funds in circumstances where a prospectus must be lodged with the ASC
- entities and prescribed interest schemes which offer securities other than debentures as consideration for an acquisition under a takeover scheme
- other prescribed interest schemes designated by regulation.[58]

The Review supports the principles underlying the proposals in the Bill subject to one modification. It considers that the life of prospectuses should be 13 months, rather than 12. A 12 month limit would require the prospectus issuer to have a new prospectus issued slightly before the expiration of the 12 month period, to ensure there is always a current prospectus. The issue dates for prospectuses will, as a result, become slightly earlier each year.The Review **recommends**, therefore, that the Corporate Law Reform (No 2) Bill 1992 [1993] (Cth) should provide for 13 month prospectuses. The Review recognises, however, that the life of prospectuses should

55. Issue 6A.
56. eg Macquarie Investment Management Ltd *Submission* 24 November 1992; IFA *Submission* 1 December 1992; National Mutual *Submission* 3 December 1992; Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; TCA *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992. Those in support of keeping the six month life span for collective investment prospectuses included ASCPA & ICAA *Submission* 15 February 1993.
57. BT *Submission* 15 December 1992; MLC Investments Limited *Submission* 17 December 1992; Lend Lease Property Funds Management *Submission* 18 December 1992; TCA *Submission* 17 December 1992.
58. Corporations Law proposed new Pt 1.2 Div 3A.

be the same for all disclosing entities. Accordingly, it considers that, whether or not this recommendation is adopted, whatever prospectus life is provided for when this aspect of the Bill is enacted should apply to collective investment schemes.[59]

Periodic and continuing disclosure by the scheme operator

Annual reports of collective investment schemes

5.22 ***The need for a report.*** The requirement for a company to report annually to shareholders on its activities has long been accepted as fundamental to ensuring the accountability of directors for their management. The law generally does not yet require such a report to the investors in a collective investment scheme.[60] Only a 'statement of accounts' and a copy of the auditor's report on those accounts must be furnished.[61] However, like shareholders, investors in collective investment schemes have entrusted others with the management of their investment and they bear the investment risk.

5.23 ***Recent moves by the ASC.*** Disclosure requirements have been under scrutiny following the unlisted property trust crisis in mid 1991. A recent amendment to the regulations governing property trusts includes a requirement that their accounts include

> all the applicable information that would be required to be shown in the accounts of the trust by the Corporations Law if the trust were a company to which the Law applied.[62]

The ASC also recommended that the Corporations Law Pt 3.6, which covers accounts and reports by directors, should apply to all prescribed interest schemes that are required to have an approved deed under Corporations Law s 1066.[63] The approved deed test is designed to catch only 'public schemes'. The ASC suggested that there are two main benefits in this proposal:

- it will ensure that such accounts are of acceptable quality
- the accounts of the prescribed interest schemes can be used to compare the financial position of one scheme with another and with companies.

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59. The Review recommends elsewhere in this report that all collective investment schemes should be subject to the enhanced disclosure regime proposed in the Corporate Law Reform (No 2) Bill: see para 5.35.
60. Except in the case of property trusts, where the management company must report to the trustee not later than two months after the end of the financial year and give the report to the interest holders with the statement of accounts: Corporations Regulations reg 7.12.15(7)(a). Reg 7.12.15(7)(b) sets out the things that a management company must include in such a report.
61. Corporations Law s 1069(1)(f). The section also provides that the trustee or representative must send investors a statement that describes the buy-back arrangements in effect and expresses whether, in its opinion, those arrangements are adequate.
62. Corporations Regulations reg 7.12.15 (5)(p)(x).
63. ASC *Enhanced Statutory Disclosure System: A Response to the Companies and Securities Advisory Committee Report* February 1992, para 166. The ASC also recommended a requirement for accounts of unit trusts to be compiled on the basis of approved (applicable) accounting standards: submission by the ASC to the Inquiry into Corporate Practices and the Rights of Shareholders by the House of Representative Standing Committee on Legal and Constitutional Affairs, December 1990, 98.

The effect of this proposal, in broad terms, would be that the operator of each collective investment scheme would have to supply to each investor in the scheme an audited profit and loss statement and balance sheet. The financial statements would be required to comply with approved accounting standards and other prescribed standards[64] and to provide a true and fair view of the scheme's profit and loss and state of affairs.[65] In addition, the operator would be required to prepare the equivalent of a directors' report and statement, for inclusion in the annual report.

5.24 ***DP 53 proposal and submissions.*** DP 53 proposed that operators of collective investment schemes should be required to provide to investors, with the accounts of the scheme, an annual report on the activities of the scheme in accordance with Pt 3.6 of the Corporations Law.[66] It acknowledged that an examination of the cost and benefits of complying with specific accounting standards (such as the capitalisation of financial leases and the calculation of distributable income) may be necessary in respect of collective investment schemes. It added that this matter could be referred to the Australian Accounting Research Foundation.[67] There was wide support for the proposal.[68] One submission suggested that investors in a collective investment scheme should be able to elect not to receive annual reports automatically.[69] Another suggested that the operator should be under an obligation to distribute copies only to investors who request them.[70]

5.25 ***Recommendation.*** The Review **recommends** that each scheme operator should be required to give investors in those schemes for which it is responsible an annual audited report on scheme activities. In accordance with the Corporations Law Pt 3.6 this should occur automatically rather than upon the request of single investors. The general provision for the ASC to grant exemptions will apply to the reporting requirements.[71]

Additional prescriptions

5.26 ***Proposal.*** DP 53 proposed that the following information should have to be included in the annual report of a collective investment scheme:

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64. Such as the Corporations Regulations Schedule 5.
65. There is evidence of considerable diversity in current reporting practices of unit trusts: see, eg, Price Waterhouse *Unit Trusts in Australia: A Survey of Accounting Policies* August 1991; B Howieson 'Beyond Redemption: How Property Trusts Do Their Sums' 1992 (May) *Australian Accounting Review* 21.
66. Proposal 6.5.
67. The Australian Accounting Research Foundation is currently considering differential reporting requirements for various organisational forms, but it is understood that this analysis does not extend to prescribed interest schemes.
68. eg Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992.
69. National Mutual *Submission* 3 December 1992.
70. MLC Investments Limited *Submission* 17 December 1992.
71. See para 3.30.

- the percentage change in the value of units during the last reporting period
- the unit price at the beginning and end of the reporting period
- as an indication of the volatility of the investment, the highest, lowest, mean and median values of units during the last reporting period
- the size and nature of each investment that constitutes more than 5% of the funds of the scheme
- the investment policy of the scheme and its performance against that policy.

It was suggested that annual reports should also include details of any notices lodged with the ASC as part of a continuous disclosure regime.[72] There was general support for the proposal among respondents,[73] although one submission maintained that scheme operators should not be compelled to supply the information items proposed, merely encouraged to do so.

> It is considered that until more prescriptive disclosures are introduced for companies, requiring additional disclosures for collective investment schemes is premature.[74]

Other respondents considered the third point, relating to the volatility of investments, inappropriate and potentially misleading to investors.

5.27 ***Recommendation.*** The Review agrees with the majority of submissions and accepts the argument on the issue of the volatility of investments. It **recommends** that annual reports of all collective investment schemes should have to include

- the unit price at the start and end of the reporting period, and the percentage change in price between the start and end of the period
- if the scheme is unlisted, an explanation of how the price of interests in the scheme is calculated
- the highest and lowest values of units during the last reporting period
- the size and nature of each investment that constitutes more than 5% of the funds of the scheme
- the investment policy of the scheme and its performance against that policy
- any significant changes to the scheme's state of affairs, including any material change in investment policy, in the reporting period
- details of any notices lodged with the ASC as part of the proposed enhanced disclosure regime
- the scheme's management expense ratio over the previous five years (or for the years the scheme has been in existence if it is less than five years old), that is, the ratio of total fees and expenses to the value of the assets in the scheme
- details of any purchase by the operator of either existing or new interests in the scheme[75]

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72. Proposal 6.6.
73. Macquarie Investment Management Ltd *Submission* 24 November 1992 (supports only the first 3 elements of the original proposal).
74. ASCPA & ICAA *Submission* 15 February 1993.
75. This information should also be disclosed in half yearly reports.

- the procedure by which investors may apply for redemption of their interests, whether there is any obligation on the scheme operator to make redemption offers, and if so, the nature of that obligation[76]
- in relation to redemption opportunities provided to investors in the previous 2 years, how many opportunities were provided and, where redemption requests were not met in full, what proportion of the application was met[77]
- details of the scheme's internal dispute resolution procedures
- details of any change of directors of the scheme operator[78]
- the relevant assumptions and discount rates used in valuations of the assets of the scheme, and the other instructions given to valuers[79]
- a copy of the certificate prepared by an external auditor stating that, in the auditor's opinion, the operator is giving effect to the compliance measures imposed by the Commission as a condition of the operator's licence[80]
- the total number of voting interests in the scheme as at the date of the report.[81]

Accounts of scheme operators

5.28 It was suggested in consultations before DP 53 was published that the operator of a collective investment scheme should have to distribute a copy of its own accounts to investors in the scheme. The Review considered that such a requirement would impose unwarranted costs on operators. It proposed that the operator of a collective investment scheme should be required to lodge a set of its accounts with the ASC each year and to make the most recent published accounts available, upon request, to individual investors in the collective investment scheme or schemes it operates.[82] There was widespread support in submissions for the proposal.[83] The Review **recommends** that scheme operators should be required to make their annual audited accounts available, upon request, to investors in schemes for which they are responsible. Operators should be entitled to charge a reasonable fee to investors who request a copy of the accounts.[84]

Interim reports of collective investment schemes

5.29 ***Proposal by the Advisory Committee.*** There is no general requirement under the Corporations Law for companies or trusts to lodge or prepare interim financial statements. As part of its review of the disclosure practices of companies

76. See para 7.21.
77. In ch 7 the Review makes recommendations about the circumstances, and way, in which a scheme operator may offer to redeem scheme interests: see para 7.21.
78. See para 11.9.
79. See para 6.15.
80. See para 6.17.
81. See para 11.12.
82. DP 53 proposal 6.7. As scheme operators will, under the Review's recommendations, have to be incorporated (see para 10.2) they will, unless exempted, have to lodge accounts with the ASC.
83. Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992; ASCPA & ICAA *Submission* 15 February 1993.
84. ASCPA & ICAA *Submission* 15 February 1993 argued that the accounts should be available without charge.

and prescribed interest schemes, the Advisory Committee recommended that all prescribed interest schemes with total assets in excess of $10m should lodge half yearly reports with the ASC within 75 days after their fiscal half year end.[85] The Committee proposed that such reports should contain at least a profit and loss statement, a balance sheet and a qualitative assessment by directors of half yearly results. The ASC endorsed the proposal for half yearly reports.[86] Furthermore, it agreed with the Advisory Committee that half yearly reports should only have to be lodged, not distributed to investors. However, the ASC maintained that the requirement should be limited to prescribed interest schemes that are required to have an approved deed.[87] It has been estimated that the adoption of either the $10m or the 'approved deed' test would directly affect approximately 2500 prescribed interest schemes.[88]

5.30 ***DP 53 proposal and submissions.*** The Review strongly supports requirements for comprehensive and timely disclosure. The reports by the Advisory Committee and the ASC demonstrate the need for half yearly reports by operators of collective investment schemes. DP 53 proposed that the operator of a collective investment scheme should be required to produce a half yearly report on the financial position and performance of each collective investment scheme for which it is responsible within, say, 75 days after the end of the fiscal half year.[89] It suggested that these reports should be placed on the ASC's public database to allow investors ready access to them and, as with annual reports, that they include certain prescribed information.[90] There was considerable support for the proposal.[91] Some submissions suggested modifications. One suggested that half-yearly reports should only have to be prepared following a request by investors.[92] Another suggested that investors should only receive a report on fund performance each six months, rather than a complete set of fund accounts.[93]

5.31 ***Recommendation.*** It was noted in DP 53 that the federal Government intended to introduce a half-yearly reporting requirement for certain prescribed interest schemes. The Review supports the principles underlying measures contained in the Corporate Law Reform Bill (No 2) 1992 [1993] (Cth) concerning interim reports. It **recommends** that they be adopted for collective investment schemes. This will include any significant changes in a scheme's state of affairs.[94] The Review also **recommends** that half yearly reports should include details of any change of directors of the scheme operator,[95] any purchase of new or existing interests in the scheme by the scheme operator and details about redemption or

85. Advisory Committee *Report on an Enhanced Statutory Disclosure System* Sydney 1991.
86. ASC *Enhanced Statutory Disclosure System: A Response to the Companies and Securities Advisory Committee Report* Sydney, 1992.
87. id para 86.
88. id Appendix 2.
89. Proposal 6.8.
90. Such as that set out in DP 53 proposal 6.2.
91. eg TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992; ASCPA & ICAA *Submission* 15 February 1993.
92. National Mutual *Submission* 3 December 1992.
93. Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992.
94. Corporate Law Reform Bill (No 2) 1992 [1993] (Cth) s 304(3B).
95. See para 11.9.

buy back opportunities and any use of the pro-rata mechanism in the previous six months. Half yearly reports should be lodged with the ASC but need not be circulated to members.

5.32 ***Accounting standards for half yearly reports.*** DP 53 sought comment on which accounting standards should be imposed on half yearly reports of collective investment schemes.[96] Few comments were received on this matter. It would require expert study. The Review **recommends** that the Australian Accounting Standards Board should examine

- which accounting standards should apply to half yearly reports of collective investment schemes
- whether an accounting standard should be developed for collective investment schemes and the nature of any such standard.

Continuing disclosure by scheme operators

5.33 ***No general obligation.*** At present there is no general statutory obligation on companies or prescribed interest schemes to disclose material matters in a timely fashion. However, where a prospectus has been lodged and the issue is still 'open', the person who lodged the prospectus must, when a 'significant' change or new matter occurs, lodge a supplementary prospectus containing particulars of the change or new matter.[97] Furthermore, companies and trusts listed on the ASX are required to make timely disclosures of material matters to the ASX.[98]

5.34 ***Recent initiatives.*** The Corporate Law Reform Bill (No 2) 1992 [1993] (Cth) sets out continuous disclosure obligations in a proposed new Pt 7.12A of the Corporations Law. These obligations are intended to apply to certain types of prescribed interest schemes.[99] Under the proposed law, management companies will be required to notify the ASC as soon as practicable, and in any event within three days, of a 'notifiable event'. A notifiable event is defined as an event or change in circumstances about which investors and their professional advisers would reasonably require information for the purpose of making an informed assessment of

- the assets and liabilities, financial position, profits and losses, and prospects of the disclosing entity
- the rights attaching to the securities in relation to the disclosing entity
- the merits of participating in the undertaking and the extent of risk involved in the participation.

It is proposed that the disclosure requirements be subject to a confidentiality exception so that information which would be likely to result in unreasonable prejudice to the disclosing entity need not be disclosed. This exception, however, would lapse where the information ceased to be likely to result in unreasonable

96. Issue 6F.
97. Corporations Law s 1024.
98. ASX listing rule 3A(1).
99. See the definition of disclosing entity in para 5.21.

prejudice. Once this occurred, the disclosing entity would have to notify the ASC as soon as practicable or, in any event, within three business days. A management company knowingly or recklessly contravening the disclosure requirements would be guilty of a criminal offence. Civil liability would arise where an investor suffered loss as a result of a disclosing company's failure to comply with the disclosure requirements. The investor could recover the loss suffered from the disclosing entity or from any person involved in the contravention, whether or not those persons were convicted of an offence. It would be a defence to a civil action if

- the disclosing entity was not aware of the information and
- no compliance system which the disclosing entity could reasonably be expected to have could reasonably be expected to have resulted in the information being disclosed.

5.35 ***Recommendation.*** The measures outlined above largely implement recommendations made by the Advisory Committee in its *Report on an Enhanced Statutory Disclosure System* (1991). DP 53 supported the principles in the Advisory Committee report, provisionally proposing that operators of collective investment schemes be required to notify the ASC on a continuing basis of any material change (as defined by the Advisory Committee) within, say, 24 hours after the occurrence of the change.[100] There was strong support for continuous disclosure principles to be applied to collective investment schemes,[101] although one submission suggested that such an obligation should only be applied at this stage to listed entities.[102] The Review has concluded that continuous disclosure should apply to unlisted as well as listed schemes. The information about unlisted schemes disclosed by operators can be assessed by investment advisers who can disseminate the information, and their assessment of its implications for investors, through investment magazines, newsletters and in other ways. Furthermore, an investment in an unlisted collective investment scheme may be only one part of an investor's investment portfolio. It is important that he or she has as much up to date information as possible about all of his or her investments. Requiring unlisted as well as listed collective investment schemes to be subject to enhanced disclosure will help ensure this. Enhanced disclosure will help to enable investors to decide, on the basis of up-to-date information, whether to remain in a scheme or withdraw from it. The Review considers that the measures proposed in the Corporate Law Reform Bill (No 2) 1992 [1993] (Cth) for continuous disclosure by companies should also apply to listed and unlisted collective investment schemes and **recommends** accordingly.

Plain language

5.36 The Review recommended in ALRC 59 that the law should require all documents issued to members or prospective members by the trustee of a superannuation scheme to be written in clear and simple language.[103] Failure to

100. Proposal 6.9.
101. eg Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992.
102. ASCPA & ICAA *Submission* 15 February 1993.
103. ALRC 59 recommendation 10.3.

comply was not to be an offence but the regulator would be able to give a written direction to the trustee not to issue a particular document, or to take reasonable steps to recall it from circulation, on the grounds that it is not written in clear and simple language. DP 53 proposed that all disclosure obligations of collective investment schemes be subject to a similar 'plain language' requirement.[104] There was general agreement in submissions that collective investment schemes and their operators should use plain language in giving information to investors.[105] There were concerns, however, that a statutory requirement to that effect would be difficult to police. It was also suggested that existing remedies for misleading statements may be enough.[106] The Review accepts that such a requirement would be, in effect, unenforceable. It also agrees that, if a lack of plain language makes a statement misleading or deceptive, remedies are already available. The Review encourages scheme operators to ensure that all disclosure to investors and prospective investors is in plain language. The Corporations Law, however, should not impose a requirement to this effect.

104. Proposal 6.10.
105. eg Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; TCA *Submission* 17 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992.
106. Arthur Robinson & Hedderwicks *Submission* 16 December 1992.