



Review of the regulatory framework for managed investment schemes

Consultation paper

August 2023

© Commonwealth of Australia 2023

This publication is available for your use under a [Creative Commons Attribution 3.0 Australia](https://creativecommons.org/licenses/by/3.0/au/legalcode) licence, with the exception of the Commonwealth Coat of Arms, the Treasury logo, photographs, images, signatures and where otherwise stated. The full licence terms are available from <http://creativecommons.org/licenses/by/3.0/au/legalcode>.



Use of Treasury material under a [Creative Commons Attribution 3.0 Australia](https://creativecommons.org/licenses/by/3.0/au/legalcode) licence requires you to attribute the work (but not in any way that suggests that the Treasury endorses you or your use of the work).

Treasury material used 'as supplied'

Provided you have not modified or transformed Treasury material in any way including, for example, by changing the Treasury text; calculating percentage changes; graphing or charting data; or deriving new statistics from published Treasury statistics – then Treasury prefers the following attribution:

Source: The Australian Government the Treasury

Derivative material

If you have modified or transformed Treasury material, or derived new material from those of the Treasury in any way, then Treasury prefers the following attribution:

Based on The Australian Government the Treasury data

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are set out on the Department of the Prime Minister and Cabinet website (see www.pmc.gov.au/honours-and-symbols/commonwealth-coat-arms).

Other uses

Enquiries regarding this licence and any other use of this document are welcome at:

Manager
Media Unit
The Treasury
Langton Crescent
Parkes ACT 2600
Email: media@treasury.gov.au

Contents

Contents	ii
Consultation Process	4
Request for feedback and comments	4
Background and context	5
Introduction	5
What is a managed investment scheme?	5
Current regulatory framework.....	6
Role of ASIC.....	7
Size of industry	8
Previous reviews and inquiries	9
Chapter 1. Wholesale client thresholds	14
1.1 Distinguishing between retail and wholesale clients	14
1.2 Protections for retail clients in schemes	14
1.3 The wholesale client classifications	15
1.4 Wholesale client consent arrangements	18
1.5 Questions for consideration	19
Chapter 2. Suitability of scheme investments	20
2.1 Scheme investments.....	20
2.2 Measures that support suitability	22
2.3 Registration of schemes.....	23
2.4 Questions for consideration	24
Chapter 3. Scheme governance and the role of the responsible entity	25
3.1 Role of the responsible entity	25
3.2 Obligations of the responsible entity	25
3.3 The scheme constitution	26
3.4 The compliance framework	27
3.5 Questions for consideration	29
Chapter 4. Right to replace the responsible entity	30
4.1 Recourse to replace the responsible entity	30
4.2 Removal of the responsible entity by members	30
4.3 Barriers to replacing the responsible entity.....	31
4.4 Questions for consideration	33
Chapter 5. Right to withdraw from a scheme	34
5.1 Scheme liquidity and withdrawals	34
5.2 The right to withdraw from a scheme	36
5.3 Scheme liquidity and member expectations.....	36
5.4 Questions for consideration	37

Chapter 6. Winding up insolvent schemes	38
6.1 Winding up provisions	38
6.2 Winding up an insolvent scheme	38
6.3 Liability of members	39
6.4 Questions for consideration	40
Chapter 7. Commonwealth and state regulation of real property investments	41
7.1 Dual jurisdictional responsibility	41
7.2 Real property and financial products.....	41
7.3 The potential impact on scheme members	42
7.4 Question for consideration	42
Chapter 8. Regulatory cost savings	43
8.1 Modernising the regulatory framework.....	43
8.2 Question for consideration	43
Appendix A: Mapping of client definitions across the Corporations Act 2001.....	44
Appendix B: List of consultation questions.....	49

Consultation Process

Request for feedback and comments

Interested stakeholders are invited to comment on the issues raised in this consultation paper.

Submissions may be lodged electronically or by post; however, electronic lodgement is preferred via email to: misreview@treasury.gov.au. For accessibility purposes, please submit responses via email in a Word, RTF, or PDF format.

Submissions may be shared with other Commonwealth agencies for the purposes of this review. All information (including name and address details) contained in submissions may be made publicly available on the Australian Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose.

If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment. Legal requirements, such as those imposed by the Freedom of Information Act 1982, may affect the confidentiality of your submission.

View Treasury's [Submission Guidelines](#) for further information.

Closing date for submissions: 29 September 2023

Email	misreview@treasury.gov.au
Mail	Director Investment Funds Unit Retirement, Advice and Investment Division The Treasury Langton Crescent PARKES ACT 2600
Enquiries	Enquiries can be initially directed to misreview@treasury.gov.au

The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Background and context

Introduction

The Government has asked the Treasury to undertake a review of the regulatory framework for managed investment schemes.

In March 2023, the Assistant Treasurer and Minister for Financial Services, the Hon Stephen Jones MP, announced the review will consider:

- the thresholds that determine whether an investor is a wholesale client;
- whether certain managed investment schemes should be marketed and sold to retail clients;
- the roles and obligations of responsible entities;
- whether 'investor rights' for people who invest in managed investment schemes are appropriate;
- liquidity requirements for managed investment schemes;
- whether an insolvency regime is required for managed investment schemes; and
- interactions between Commonwealth and State laws when regulating real estate investments by managed investment schemes.

This consultation paper seeks views from interested parties on these issues and related matters.


What is a managed investment scheme?

The Australian managed funds industry is diverse. There are multiple products, providers and investors with different objectives, financial circumstances, time horizons and risk profiles. The industry connects both retail and wholesale clients to a breadth of investment opportunities with the benefit of scale.

Managed investment schemes are a type of collective investment vehicle. The statutory definition of a managed investment scheme is a broad test that captures a wide range of products. Examples include cash management trusts, property schemes, exchange traded funds, agricultural schemes, and time-sharing schemes.

Section 9 of the *Corporations Act 2001* (Corporations Act) defines a managed investment scheme as a scheme with the following features:

- people contribute money or money's worth as a consideration to acquire rights to benefits produced by the scheme;
- any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people who hold interests in the scheme; and
- the members do not have day-to-day control over the operation of the scheme.



In practice, a managed investment scheme enables a group of investors to pool their money to produce a financial benefit or to be used in a common enterprise. Schemes are typically structured as unit trusts where an investor is assigned units proportionate to the amount of money they invest in the scheme. Financial returns to investors typically comprise distributions from the scheme – which may be reinvested in the scheme – and any increase in the capital value of their units (for example, if the unit price is higher than the price at which the investor purchased them).

Some schemes focus on a single sector such as Australian equities, international equities, property, or fixed interest assets, whereas some are multi-asset schemes that provide greater diversification. Schemes may also cross-invest in other (often unregistered) schemes to construct their portfolio and manage financial risks.

Other schemes are operated as common enterprise schemes. These schemes use member contributions in a common enterprise rather than being placed in a common pool. They are typically underpinned by a series of agreements with the scheme operator or other parties related to the ongoing operation of the scheme. This type of scheme is commonly referred to as a contract-based scheme or an enterprise scheme.

What is not a managed investment scheme

Debentures or shares issued by a body corporate, listed investment companies, certain partnerships, barter schemes, franchises, direct purchases of shares or other equities (including via brokers), and investments operated by an Australian bank in the ordinary course of business banking (e.g. term deposits), amongst other types of investment, are not classified as managed investment schemes. Additionally, superannuation products are not themselves classified as managed investment schemes, although many superannuation funds invest in managed investment schemes.

Corporate collective investment vehicles (CCIVs) are also not classified as managed investment schemes. The recently implemented CCIV regime provides an alternate type of collective investment vehicle and uses a company structure limited by shares, which is more recognisable to offshore investors and fund managers. Features of the regulatory framework for managed investment schemes were incorporated into the design of the CCIV framework.


Current regulatory framework

Managed investment schemes are regulated like other financial products and services. The regulatory framework seeks to improve investor outcomes, promote investor confidence, and maintain financial stability while supporting choice, competition, and innovation in the market.

Managed investment schemes are predominately regulated by Chapter 5C of the Corporations Act, which was first introduced into the law by the *Managed Investments Act 1998*. It replaced the previous ‘prescribed interests’ regime. The prescribed interests regime had a dual system with scheme accountability shared between the trustee and fund manager. This was replaced by a single entity directly responsible to scheme members for the scheme’s operation.

Chapter 5C of the Corporations Act is primarily concerned with schemes that are registered. It contains provisions related to effective governance practices and the accountability of registered scheme operators, referred to as responsible entities, to members who have invested in the scheme.

A managed investment scheme that is offered to retail clients must in most cases be registered with the Australian Securities and Investments Commission (ASIC). Registered schemes can also be offered to wholesale clients. However, schemes that are only offered to wholesale clients are generally not required to be registered and are often referred to as ‘unregistered schemes’ or ‘wholesale schemes’.



Registered schemes have significant compliance and governance obligations under Chapter 5C of the Corporations Act. These include the requirement to appoint a responsible entity, which must also be a public company with an Australian Financial Services (AFS) licence authorising it to operate a scheme.

The responsible entity of a scheme must comply with obligations and perform the functions set by the scheme's constitution, the compliance plan and the Corporations Act. The constitution of a registered scheme is a legally enforceable document between the responsible entity and members that sets out the rights, duties and liabilities of the responsible entity in its operation of the scheme.

Role of ASIC

As Australia's financial services regulator, ASIC is responsible for administering the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

The role of ASIC in relation to managed investment schemes is to license responsible entities, register managed investment schemes, monitor the conduct of responsible entities, take enforcement action in response to non-compliance, provide guidance to consumers and industry, and provide relief from provisions in the Corporations Act via its exemption and modification powers where necessary.¹

ASIC publishes regulatory guides to support compliance by market participants, including operators of managed investment schemes. While these guides are not legally enforceable, they provide practical guidance on how regulated entities can meet their obligations and how ASIC interprets the law and exercises its legislative powers.

Regulatory requirements are tailored by ASIC where consistent with the underlying policy intent of the law through legislative instruments (previously known as class orders). Legislative instruments are legally enforceable and are used to modify or clarify the operation of provisions or exempt a person from provisions of an Act administered by ASIC. These instruments recognise the diversity of market participants and the limited ability of the primary law contained in the Corporations Act to deal with every circumstance in a rapidly evolving sector.

ASIC adopts a risk-based and proactive approach to the surveillance of managed investment schemes and responsible entities. It conducts targeted surveillance based on breach notifications, reports from compliance plan auditors, compliance committees and any person reporting misconduct. ASIC has information gathering powers including section 912C of the Corporations Act and Part 3 of the ASIC Act, which enables ASIC to conduct surveillance checks for compliance with the law. ASIC can also check compliance with a scheme's constitution and compliance plan under section 601FF of the Corporations Act.

ASIC has a broad range of powers enabling it to respond flexibly and proportionately to alleged misconduct. This includes taking criminal, civil, and administrative action with the aim of preventing and deterring actual and future misconduct, improving standards and behaviours within industry, and reducing the risk of harm to Australian consumers and investors.²

-
- 1 ASIC (Australian Securities and Investments Commission) [Managed investment schemes](#), ASIC website, 2023, accessed July 2023.
 - 2 ASIC, [INFO 151 ASIC's approach to enforcement](#), ASIC website, 2023, accessed July 2023.

Size of industry

The total value of all assets held in managed investment schemes in Australia is approximately \$2.7 trillion which is just over half of Australia's broader \$4.4 trillion managed funds.³ The maturation of Australia's superannuation system has contributed substantially to the sector's growth with over 55 per cent of superannuation assets invested in managed funds (excluding self-managed superannuation funds).⁴

The total value of assets held by registered schemes is about \$1.8 trillion and there were 420 responsible entities operating a total of 3,656 registered schemes at the end of June 2022.⁵

It is estimated retail clients make up about 5 per cent of overall direct investment in managed funds, noting retail investors also invest indirectly through intermediary structures or have indirect exposure through their superannuation fund.⁶ Institutional or private wholesale investors, such as superannuation funds, also invest a substantial amount through registered schemes.

Over 70 per cent of responsible entities operate 5 or less registered schemes, with some concentration at the upper end with 10 responsible entities operating 46 per cent of all registered schemes (see Figure 1). Schemes that are authorised to invest in financial assets and/or derivatives make up over 85 per cent of all registered schemes, noting schemes can be multiple 'types' depending on their underlying assets (see Figure 2).

The remaining \$0.9 trillion in the sector is held by unregistered schemes which are operated by wholesale trustees.⁷ There were 1,791 wholesale trustees as at the end of June 2022.⁸ Data is not generally collected on the number of schemes operated by wholesale trustees.

3 ABS (Australian Bureau of Statistics) (2022), 'Table 9 – Investment managers, source of funds, unconsolidated assets, amounts outstanding at end of period' [data set], [Managed Funds, Australia](#), December 2022, accessed July 2023.

4 APRA (Australian Prudential Regulation Authority) (2023), 'Table 1b Financial position' [data set], [Quarterly superannuation performance statistics – September 2004 to March 2023](#), accessed July 2023. This figure accounts for superannuation funds with more than 6 members.

5 ASIC (2022) unpublished data; ASIC (2022), [Annual Report 2021–22](#), p 17, accessed July 2023.

6 Deloitte Access Economics (2021) [REP 702 Competition in funds management](#), pp 29–30, accessed July 2023.

7 ASIC (2022) unpublished data.

8 ASIC (2022), [Annual Report 2021–22](#), p 17, accessed July 2023.

Figure 1: Number of registered schemes per responsible entity (June 2022)

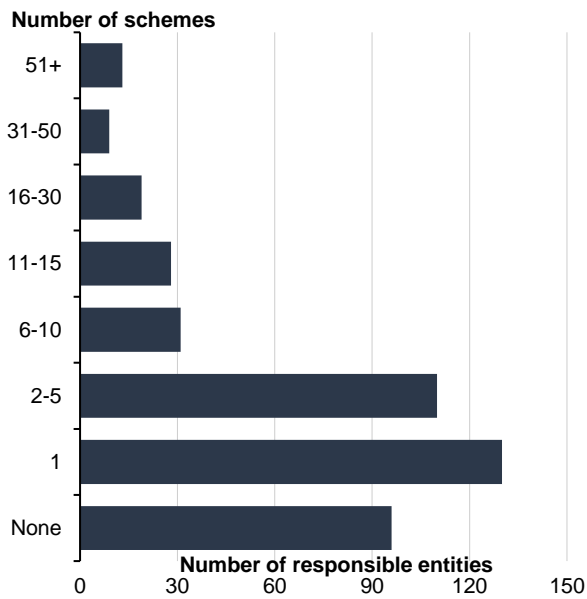


Figure 2: Type of registered schemes – by ASIC scheme types (June 2022)

Scheme type(a)	Scheme count
Financial Assets	3,149
Derivatives	1,082
Direct Real Property	361
Mortgages	134
Primary Production	58
Time Share	18
IDPS-like	10
Crypto Assets(b)	3
Commodities	0
Films	0
Other	89

(a) Schemes can have multiple types, depending on their underlying assets

(b) Most crypto schemes have been registered as financial asset or derivative schemes due to investments in intermediary products (including other schemes).

Source for Figures 1 and 2: unpublished ASIC data.

Due to the limited reporting obligations imposed on unregistered schemes (and the practice of using feeder funds and underlying funds), it is difficult to provide a comprehensive picture of the sector particularly relating to wholesale trustees and unregistered schemes.

Key data limitations regarding registered and unregistered schemes include understanding the number and type of investors in individual schemes or across certain scheme types, the actual or target asset allocation, crossholdings, liquidity of the underlying assets, fees and costs to investors, and the service providers and their profits across the sector.

Previous reviews and inquiries

A number of reviews and inquiries have raised concerns about the adequacy of the regulatory framework for managed investment schemes. The relevant findings of these reviews and inquiries have been considered in this consultation paper and are summarised below (see Box 1 and Box 2).

While successive governments have consulted on and implemented some legislative changes to enhance the regulatory framework for managed investment schemes, a full review of the regulatory framework has not occurred in recent years. This consultation paper considers these legislative changes where relevant.

Box 1. Corporations and Markets Advisory Committee (CAMAC)

CAMAC was responsible for providing expert advice to the Government about corporate, financial product and financial market matters. The committee was established in 1989 under the ASIC Act and sought to promote an effective regulatory environment by providing timely advice on policy and law design issues. The committee comprised the Chair of ASIC and part-time members appointed by the Minister. CAMAC was formally abolished in 2018 following the 2014–15 Budget decision to cease its operation.

CAMAC released a report in 2012 and a discussion paper in 2014 examining the regulatory framework for managed investment schemes.

Managed Investment Schemes: Report (CAMAC 2012)

- This report considered the effectiveness of the managed investment schemes regime, particularly relating to the difficulties that arise for responsible entities, scheme members and creditors when a scheme comes under financial stress.
- The report found the increased use of schemes as a vehicle to conduct entrepreneurial activities with enhanced investor involvement contributed to the challenges of operating a scheme or responsible entity in financial distress. It also found barriers to replacing a scheme's responsible entity.
- The report recommended developing a statutory insolvency framework for schemes and providing scheme members with statutory limited liability. It proposed that schemes be established as a separate legal entity to ensure full separation of the property and liabilities and to simplify the winding-up process. It also recommended introducing controls to prevent a responsible entity from becoming entrenched.

The establishment and operation of managed investment schemes: Discussion paper (CAMAC 2014)

- This discussion paper sought views on technical elements of the regulatory framework that applied to the establishment and ongoing operation of schemes. Its general view was that the regulatory framework for schemes should be aligned with that of companies.
- Its many considerations included the role of ASIC in the scheme registration process, the limited effectiveness of compliance plan audits based on general compliance plans, introducing a more objective definition of a liquid scheme, requiring schemes to have investment guidelines and potential investment limits, and addressing the barriers scheme members face when attempting to replace a responsible entity.
- Following the 2014–15 Budget decision, CAMAC largely focused on winding down its operations and a final report on these matters was not released.

Box 2. Previous reviews and inquiries

Several reviews and inquiries have further examined the regulatory framework for schemes.

Review of the *Managed Investments Act 1998* (Turnbull Review) (2001)

- The Turnbull Review considered the effectiveness of the then recently introduced regulatory framework for schemes which replaced the prescribed interest provisions. The review considered whether the regime provided greater investor protections and rights, and certainty for scheme operators regarding their obligations and liabilities to cater for the diversity of managed investments.
- The review recommended providing ASIC with limited powers to alter a scheme's constitution to ensure it complies with the law, as well as developing standards to inform the qualifications and experience of compliance committee members.
- The review noted the statutory definition of a liquid scheme may be used to avoid the specified non-liquid withdrawal provisions but did not recommend changes as no submissions raised concerns about the timeliness of investor redemptions.

Parliamentary Joint Committee on Corporations and Financial Services (PJC) Report on the Review of the *Managed Investments Act 1998* (2002)

- This PJC report assessed the findings of the Turnbull Review alongside global best practice, governance and compliance requirements, and potential risks to investors.
- It recommended requiring compliance plans to set out minimum standards of competency and integrity, and that ASIC should have the power to remove a member of the compliance committee when the member is not performing adequately.
- It recommended the existing obligation for a responsible entity to establish a compliance committee if a majority of its directors are not external directors. It also recommended requiring the compliance plan auditor to report to scheme members.

PJC Inquiry into aspects of agribusiness managed investment schemes (2009)

- Following the collapse of Timbercorp and Great Southern, this inquiry considered the structure of agribusiness schemes, the accuracy of disclosure information for schemes, and the level of understanding investors have of schemes.
- The inquiry raised concerns about the competing interests between investors and the responsible entity following the collapse of a registered scheme. It noted some products may be too complex for unsophisticated investors to understand even when the relevant disclosure requirements are met.
- The inquiry recommended that the Corporations Act should be amended to require ASIC to appoint a temporary responsible entity when a registered scheme becomes externally administered or a liquidator is appointed.

PJC inquiry into financial products and services in Australia (2009)

- This inquiry examined collapses such as Storm Financial and Opes Prime, with reference to several factors including the regulatory regime for financial products and services and the level of investor understanding.
- The inquiry concluded that improving the regulation of financial advice was more effective than regulators attempting to ensure that financial products are 'safe' through additional regulation. It recommended ASIC be provided with the ability to reject or cancel an AFS licence if ASIC believes the licensee will be unable to meet licensee obligations.
- The inquiry recommended that agribusiness schemes be required to demonstrate they have sufficient working capital to meet current obligations, and to ensure that these schemes do not develop ponzi-like characteristics over time by relying on new product sales to prop up existing schemes.

PJC inquiry into the collapse of Trio Capital (2012)

- This inquiry investigated the collapse of Trio Capital and focused on the cause of the collapse, the linkage between the scheme and self-managed superannuation funds, the actions of regulators, and the broader regulatory framework for schemes.
- The inquiry identified instances of poor scheme governance on behalf of Trio Capital in its role as responsible entity for multiple schemes, and a lack of understanding among investors as to the complex arrangements of the scheme.
- Amongst its recommendations was for Government to improve the oversight and operation of compliance plans and committees, as well as to enhance the disclosure of fund portfolios to help investors assess the type of financial products they are exposed to and the extent of the exposure.

Financial System Inquiry (FSI) (2014)

- The FSI examined how the financial system could be better positioned to meet Australia's evolving needs and support Australia's economic growth.
- In relation to schemes, the FSI highlighted the impact the Global Financial Crisis (GFC) had on investors who could not redeem their investments due to frozen funds. It found investors did not always understand the potential risks of financial products and highlighted limitations with Australia's disclosure-based regulatory regime.
- The inquiry supported a government-led review of CAMAC recommendations relating to schemes, prioritising areas of consumer detriment such as illiquid schemes and freezing of funds. It recommended introducing the product intervention power for ASIC (introduced in 2019). The FSI explicitly did not recommend prohibiting particular investment products for retail investors. It also recommended introducing a mechanism to facilitate the rationalisation of legacy schemes.

Senate Economics References Committee inquiry into forestry managed investment schemes (2016) (Final report: *Agribusiness managed investment schemes: Bitter harvest*) (the Bitter Harvest report)

- This inquiry focused on failed agribusinesses Timbercorp, Great Southern, Wilmott Forests and Gunn Plantation.
- The inquiry found complexities and challenges in winding up collapsed schemes. It raised concerns about the marketing of high-risk schemes to retail investors and the adequacy of existing disclosure requirements. The inquiry also found that some investors had assumed that scheme registration by ASIC indicated an endorsement of the scheme.
- The inquiry recommended Government address legislative gaps associated with managing a scheme in financial difficulties and the winding up of collapsed schemes. It supported providing ASIC with the power to intervene in the marketing of products and for the regulator to strengthen efforts to ensure retail investors understand it does not sanction schemes.

Senate Economics References Committee: Sterling Income Trust (2022)

- This inquiry examined the collapse of the Sterling Income Trust focusing on the 'novel' characteristics of the scheme, the scheme oversight by ASIC, the experience of investors, and the need for reform to prevent such losses in the future.
- The inquiry found that investors did not fully understand the operation of the Sterling Income Trust and raised concerns about complex schemes being marketed and sold to retail investors. It noted that issues relating to unviable and insolvent schemes had been raised consistently by former reviews and inquiries.
- The inquiry recommended Government undertake a review of recommendations made by relevant parliamentary and government inquiries since the GFC. It also recommended clarifying the jurisdictional overlap between Commonwealth and state regulation of schemes that include real property rights.

Chapter 1. Wholesale client thresholds

1.1 Distinguishing between retail and wholesale clients

Recipients of financial products and services are classified as a ‘retail client’ or a ‘wholesale client’ under the Corporations Act. The retail and wholesale client distinction was introduced by the *Financial Services Reform Act 2001* to assist in calibrating the regulatory framework by providing consumer protections for retail ‘mum and dad’ investors. It also allows those who are ‘better informed and better able to assess the risks involved in financial transactions’ to participate in wholesale markets under a lighter touch regulatory regime.⁹

The retail and wholesale client distinction is relevant to the regulatory framework for managed investment schemes. The governance and compliance provisions in Chapter 5C of the Corporations Act primarily relate to the operation of registered schemes and in most cases, schemes must be registered if offered to retail clients. These provisions promote effective scheme governance and better protect retail clients from undue financial risk. Fewer regulatory obligations (and protections) apply to investors of unregistered schemes. Unregistered schemes are typically offered to wholesale clients such as institutional, sophisticated, and professional investors that meet relevant tests in the Corporations Act.

This consultation paper focuses on the wholesale client definitions in Chapter 7 of the Corporations Act and their application to managed investment schemes. However, the regulatory distinction between retail and wholesale clients is applicable to a range of circumstances in the financial services sector (see Appendix A). Related considerations for other financial products and financial services may also need to be considered in this review.

1.2 Protections for retail clients in schemes

Members of registered schemes are given key protections under Chapter 5C of the Corporations Act through the promotion and regulation of effective scheme governance, and under Chapter 7 as a retail client connected to a financial product or service.

1.2.1 Chapter 5C – Managed investment schemes

Schemes that are offered to retail clients must generally be registered with ASIC and are subject to greater governance and compliance requirements than unregistered schemes. The responsible entity of a registered scheme must adhere to minimum financial requirements, execute a scheme constitution, adopt a compliance plan that must be audited annually, and establish a compliance committee when required. The responsible entity is required to provide scheme members with annual audited financial statements and, as an AFS licensee, is also subject to tailored financial resource requirements and required to hold a compliant professional indemnity insurance policy.

The responsible entity of a registered scheme is subject to important duties in Chapter 5C of the Corporations Act including acting in members’ best interests. If there is a conflict between the

⁹ Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth), paragraph 2.27.

members' interests and the entity's interests, members must be given priority. These duties are subject to civil penalty provisions where contraventions occur.

1.2.2 Chapter 7 – Financial services and markets

Important protections are provided to retail clients of financial products or financial services under Chapter 7 of the Corporations Act.

Key provisions include:

- Disclosure obligations under Part 7.7 and Part 7.9 aim to ensure transparency and provision of relevant information to clients. Part 7.9 covers general and ongoing disclosure requirements of material changes and significant events. Part 7.7 addresses disclosure obligations related to financial services provided to retail clients.
- Conduct obligations apply to the provision of financial product advice under Part 7.7A. This requires financial advisers to act in the best interests of their clients, prioritise clients' needs and provide advice that is appropriate for clients' individual circumstances.
- Design and distribution obligations under Part 7.8A require product issuers to determine an appropriate target market for their financial products and require issuers and distributors to distribute the products accordingly.
- External dispute resolution obligations under Part 7.10A establish the framework for handling complaints and disputes between financial service providers and their clients.
- Product intervention powers under Part 7.9A allow ASIC to temporarily intervene in a range of ways, including to modify or ban financial and credit products when there is a risk of significant consumer detriment.

1.3 The wholesale client classifications

A financial product or service is generally considered to be provided to a retail client unless the client is classified as a wholesale client under the Corporations Act. The same person can be considered a retail client and a wholesale client for different products and services. However, there are some exceptions in general insurance, superannuation, or retirement savings accounts where the client must always be considered a retail client.¹⁰

To be classified as a wholesale client under Chapter 7 of the Corporations Act, there are 4 objective eligibility tests under section 761G and one subjective eligibility test under section 761GA with certain financial thresholds prescribed by the *Corporations Regulations 2001*. These tests have been summarised below (see Table 1).

¹⁰ Corporations Act, s 761G(7).

Table 1. Summary of the wholesale client tests (including Corporations legislation references)

Wholesale client test	Description
Product value test s 761G(7)(a) subregulation 7.1.18(2)	Is satisfied when the price for the provision of a financial product or the value of the financial product to which the financial service is related equals or is greater than \$500,000.
Individual wealth test s 761G(7)(c) subregulation 7.1.28 (1) subregulation 7.1.28 (2) regulation 7.6.02AF	Is satisfied where the person has net assets of at least \$2.5 million or a gross income of at least \$250,000 per year in the last 2 financial years and is supported by a certificate given by a qualified accountant. ¹¹ The certificate is valid for 2 years after being issued.
Small business test s 761G(7)(b)	Is satisfied where the financial product or service is provided for use in connection with a business that is not a small business (as defined in s 761G(12)).
Professional investor test s 761G(7)(d)	Is satisfied if the client is a ‘professional investor’ as defined in section 9 of the Corporations Act. This includes where the client is an AFS licensee, body regulated by APRA, entities registered under the <i>Financial Sector (Collection of Data) Act 2001</i> , trustee of a superannuation fund with net assets of at least \$10 million, persons controlling at least \$10 million, an exempt public authority listed entities and body corporates that carry on certain investment businesses.
Sophisticated investor test s 761GA	Is satisfied when a financial product or service is not being provided in connection with a business; and an AFS licensee is satisfied on reasonable grounds that the client has previous experience in using financial services and investing in financial products that allows the client to assess the merits, value, risks and information about the product or service.

The rationale for introducing financial thresholds in the product value test and the individual wealth test assumes that individuals who have the required value in assets or income have the knowledge or experience to understand and take on additional risks or the means to acquire professional advice.¹² Other jurisdictions also use tests that prescribe wealth thresholds and measures of financial sophistication to distinguish between retail and wholesale clients (see Box 3).

11 The asset threshold in the individual wealth test includes all assets in the person’s name, including their primary residence and superannuation balance.

12 Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth), paragraphs 6.19, 6.20, 6.23 and 6.24.

Box 3. Wholesale client tests in other jurisdictions

United States

In the United States (US), accredited investor tests include the following financial and professional criteria:

- Net worth of at least US\$1 million, excluding primary residence (individually or with a spouse or partner).
- Income of at least US\$200,000 (or US\$300,000 joint income with spouse or partner) in each of the prior 2 years, with a reasonable expectation of the same income level in the current year.
- Holds in good standing one of the prescribed financial professional licenses.
- For investments in a private fund, 'knowledgeable employees' of the fund.¹³

The Securities and Exchange Commission (SEC) is required to review these tests every 4 years.¹⁴

The *Investment Company Act of 1940*, which regulates the US equivalent of managed investment schemes has a different definition called a qualified purchaser which requires US\$5 million in assets.¹⁵

United Kingdom

In the United Kingdom (UK), any investor who does not meet the professional client test is classified as a retail client. There are 2 types of professional clients:

- Per se professional clients – includes regulated financial institutions, insurance companies, collective investment schemes or the management company of a scheme, pension funds, and other institutional investors.
- Elective professional clients – includes individuals who request and receive a statement acknowledging they have been assessed by a firm as having the expertise, experience, and knowledge to be capable of making their own investment decisions and understand the risks involved. In undertaking the assessment, firms covered by the Markets in Financial Instruments Directive must be satisfied that the client satisfies additional criteria including measures of professional experience and knowledge in financial services, and size of financial investment portfolio.¹⁶

In regard to the 'financial promotion' of a financial product or service (which are communications that contain an invitation or inducement to engage in a financial product or service), there are further exemptions to the regulatory safeguards for investors based on wealth and professional experience measures.

These include certified high net worth investors who have signed a statement within the past 12 months confirming they have an annual income of at least £100,000 or have net assets of at least £250,000 (excluding their primary residence, rights under a qualifying contract of insurance, or pensions), and that they accept the risks of this classification.¹⁷

13 Code of Federal Regulations, ss 230.501 and 270.3c-5.

14 *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Public Law 111-203, s 413, 124 Stat 1376, 1577-1578.

15 *Investment Company Act of 1940*, s 2(a) (51)(A).

16 Financial Conduct Authority (FCA) (2022), *Conduct of Business Source Book (COBS)*, 3.5 Professional clients.

17 FCA (2022), *COBS*, rules 4.12B.38-40 and COBS 4 Annex 2.

Research conducted by Associate Professor Ben Phillips from the Australian National University estimated that in 2021, 16 per cent of Australian adults met the individual wealth thresholds to be classified as a wholesale client, compared to 2 per cent of Australian adults in 2002. This modelling predicted that, under the current thresholds, the percentage of Australian adults above the threshold will increase to 29 per cent by 2031 and 44 per cent by 2041.¹⁸

Given that the current thresholds have not been adjusted since they were introduced, and more Australians are eligible to be classified as a wholesale client, it is important to consider the appropriateness of these thresholds in today's environment and whether they continue to provide an adequate benchmark for determining when a client might be a wholesale client.

1.4 Wholesale client consent arrangements

1.4.1 The sophisticated investor acknowledgement

The sophisticated investor test was introduced via the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*. The rationale for the test was to provide an alternative 'subjective' test to the fixed financial thresholds used in the product value and individual wealth tests.

The sophisticated investor test was designed for clients with an appropriate level of experience or professional training who wish to be treated as wholesale investors, yet who may not meet the financial thresholds to access wholesale client status.¹⁹ The outcome was a subjective test that did not need to consider the size of a person's investment or level of individual wealth.

Section 761GA of the Corporations Act provides that an AFS licensee relying on the sophisticated investor test must be satisfied on 'reasonable grounds' that the client is able to assess the merits and value of the product, the risks associated with holding the product, the client's own information needs, and the adequacy of the information given by the AFS licensee.

The AFS licensee must provide the client with written reasons for being satisfied with these matters, and the client must also sign a written acknowledgement that they have not been given a product disclosure statement nor any other document that would normally be provided to a retail client.

This acknowledgment must note that the AFS licensee does not have any obligations to the client under Chapter 7 of the Corporations Act that they would otherwise have if the product or services was provided to a retail client.

In comparison, the product value and individual wealth tests in section 761G of the Corporations Act do not require any written acknowledgement from the client confirming the waiving of their rights as a retail client.

1.4.2 Quality of Advice Review – Recommendation 11

The Quality of Advice Review final report, released by the Government in February 2023, highlighted stakeholder concerns that the wholesale client financial thresholds were too low and identified a lack of understanding among clients as to the consequences of being considered a wholesale client. The

18 B Phillips (2021), [Sophisticated Investor Projections](#), ANU Centre for Social Research and Methods, p 8, accessed July 2023.

19 Explanatory Memorandum, Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 (Cth), paragraph 1.18.

Review noted it was undesirable and unwarranted to have a discrepancy in disclosure between sophisticated investors and other types of wholesale clients.

The Review recommended introducing written consent requirements for wholesale clients who meet the net assets or gross income thresholds of the individual wealth test. This consent should be obtained before the financial product or service is provided to the wholesale client and should be additional to the accountant's certificate that is currently required.²⁰

According to the recommendation, the written consent should outline the consequences of being treated as a wholesale client and largely relate to a client who is being advised. The suggested consent requirement includes:

- the advice provider is not required to be a relevant provider and accordingly they will not have to comply with the professional standards;
- the advice provider will not have a duty to give good advice or to act in the best interests of the client under the Corporations Act;²¹
- the advice provider is not required to give the client a product disclosure statement or financial services guide; and
- the client will not be entitled to complain about the advice under the AFS licensee's internal dispute resolution procedures or to the Australian Financial Complaints Authority.

The recommendation also proposed that the existing sophisticated investor test acknowledgement should be prospectively amended to align with the terms in this recommendation. There was no suggestion to introduce consent requirements for wholesale clients who meet the product value test.

1.5 Questions for consideration

Questions

1. Should the financial threshold for the product value test be increased? If so, increased to what value and why?
2. Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?
3. Should certain assets be excluded when determining an individual's net assets for the purposes of the individual wealth test? If so, which assets and why?
4. If consent requirements were to be introduced:
 - (a) How could these be designed to ensure investors understand the consequences of being considered a wholesale client?
 - (b) Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?

²⁰ Australian Government (2023), [Quality of Advice Review Final Report](#), Recommendation 11, Chapter 8.5, accessed July 2023.

²¹ The duty to give 'good advice' is a separate recommendation from the Quality of Advice Review and not an existing statutory obligation.

Chapter 2. Suitability of scheme investments

2.1 Scheme investments

The regulatory framework for registered schemes does not explicitly prohibit or restrict responsible entities from investing in certain asset types or using particular investment strategies. Rather, the investment and borrowing powers of a responsible entity are set out in the scheme's constitution.²² Investors rely on the expertise and compliance of the responsible entity to hold and manage those assets in accordance with the constitution and the responsible entity's statutory and fiduciary duties.

Provided the entity has the appropriate AFS licence authorisation, responsible entities may offer a wide range of investments in registered schemes to retail clients. This includes investments in real property, infrastructure, derivatives, crypto-assets, agriculture, or investments with certain features such as leveraging, short-selling or separate contracts or arrangements between members and the scheme operator in addition to the scheme constitution.

Questions have been raised about whether some investments and scheme features are too complex for retail clients. The Sterling Income Trust and its link with the Sterling New Life Lease housing product was a complex contract-based scheme that was marketed and sold to retail clients. The Senate Economics References Committee inquiry into the 2019 collapse of the scheme found that there was an expectation gap around the regulation of financial products. This was demonstrated by the misalignment between an investor's understanding of financial products and how these products were designed, disclosed and marketed to them.²³

The inquiry suggested considering the appropriateness of the regulatory settings to protect consumers from undue financial risk, due to the apparent ease with which schemes that are novel, risky, illiquid, or speculative can be registered and sold in Australia.²⁴

Other jurisdictions have incorporated conditions for certain scheme arrangements that generally ensure more diversified and liquid options are offered to retail clients (see Box 4).

22 Corporations Act, s 601GA.

23 The Senate Economic References Committee (2022), [Sterling Income Trust](#), Commonwealth of Australia, 2022, p 65, accessed July 2023.

24 The Senate Economic References Committee (2022), [Sterling Income Trust](#), Commonwealth of Australia, 2022, pp 53–54, accessed July 2023.

Box 4. Investment conditions in the other jurisdictions

United States

In the US, retail clients can generally only access registered funds operated by registered management investment companies. These funds can be open-end (where the fund issues and redeems units on an ongoing basis) or closed-end (where the fund usually issues a fixed number of units that are then traded on a public exchange) and are subject to investment restrictions.

Open-end funds cannot hold more than 15 per cent of their assets in illiquid investments and have restricted access to leverage.²⁵ Closed-end funds offered to retail clients are urged by the Securities and Exchange Commission not to hold more than 15 per cent of their assets in private funds.²⁶ These restrictions on asset holdings by investment companies generally preclude retail investors from using these vehicles to heavily invest in most private investments such as private equity or private real estate.

In addition, a US investment company must disclose at registration whether it is diversified or non-diversified.²⁷ Diversified funds are subject to concentration limits that prevent 75 per cent of their total assets value from holding more than 5 per cent of securities in any one company or more than 10 per cent of any company's outstanding voting securities.²⁸

United Kingdom

In the UK, collective investment schemes can only be promoted to retail investors if the scheme is authorised (for funds established in the UK) or recognised (for funds established outside the UK) by the Financial Conduct Authority.

Authorised funds available to retail clients must be classified as an undertakings for collective investment in transferable securities scheme (UCITS), a non-UCITS retail scheme (NURS) or a long-term asset fund (LTAF).

- UCITS are prohibited from investing directly in real property, gold, and unregulated schemes. They can only temporarily borrow up to 10 per cent of the value of their assets and invest up to 10 per cent of their assets in transferable unapproved securities.²⁹
- NURS can invest in real property, up to 10 per cent of assets in gold, and up to 20 per cent of assets in unregulated schemes (with exceptions). They can borrow up to 10 per cent of their assets and invest up to 20 per cent of assets in transferrable unapproved securities.³⁰
- LTAFs are restricted mass market investments that are largely targeted towards professional investors and facilitate investment in long-term and illiquid assets. However, retail investors are permitted partial access to LTAFs under specific conditions (such as receiving advice and meeting a suitability test) with the aim to limit investment in such restricted mass market investments to up to 10 per cent of their investable assets.³¹

25 17 Code of Federal Regulations s 270.22e-4; U.S. *Investment Company Act of 1940*, s 18(f).

26 Blass D (2020), [Speech, PLI Investment Management Institute](#), accessed July 2023.

27 U.S. *Investment Company Act of 1940*, s 8(b)(1); see Form N-1A and Form N-2.

28 U.S. *Investment Company Act of 1940*, s 5(b)(1).

29 FCA (2023), [Collective Investment Schemes](#), section 5.1.4, pp 95–96, accessed July 2023.

30 FCA (2023), [Collective Investment Schemes](#), section 5.1.4, pp 95–96, accessed July 2023.

31 FCA (2023), COBS 4 and 9.

2.2 Measures that support suitability

Despite the limited restrictions or conditions on the investments a responsible entity can make, the regulatory framework includes principles-based product governance measures that promote the responsible design and distribution of schemes to retail clients. These include recent reforms such as the design and distribution obligations and product intervention powers for ASIC.

Before the implementation of these measures, the regulatory framework generally relied on disclosure to ensure retail clients could assess the suitability of an investment. The key disclosure obligation for registered schemes is the product disclosure statement (PDS) which must be provided to a retail client before they acquire a financial product or service. Division 2 of Part 7.9 of the Corporations Act sets out the specific information a PDS must contain which includes the fees payable, risks and benefits, the complaint handling procedure, and significant characteristics of the financial product. Many responsible entities that operate simple managed investment schemes use the shorter PDS regime, which can limit the disclosure required in a PDS to prescribed items.

If the PDS for a financial product is found to be misleading or deceptive, out of date, or omits statutorily required information, ASIC has the power to issue stop orders to prevent consumer detriment.³²

2.2.1 Design and distribution obligations

Product design and distribution obligations under Part 7.8A of the Corporations Act came into force in 2021. These obligations aim to ensure retail clients obtain appropriate products by requiring issuers and distributors of financial products and services to adopt a consumer-centric approach to their design and distribution.

The obligations require the preparation and maintenance of a target market determination which describes the types of clients for whom the product is suitable based on their likely needs, objectives, and financial situation. The target market determination also establishes any conditions and restrictions on how the product can be marketed and sold to clients. Issuers and distributors must take 'reasonable steps' to ensure distribution is consistent with the product's target market. Advice licensees and financial advisers are exempt from meeting the reasonable steps obligation when providing personal financial advice.

While the regime is still relatively new, it is proving to be an effective gatekeeping mechanism for ensuring investment products are appropriately targeted towards relevant investors. As at June 2023, ASIC had issued a total of 80 interim stop orders with 44 remaining in place, preventing the distribution of certain investment products to retail clients, mainly due to deficiencies in their target market determinations.³³

³² Corporations Act, s 1020E.

³³ ASIC (2023), [23-174MR: ASIC issues 38 DDO stop orders for pet insurance products](#) [media release], 29 June 2023, accessed July 2023.

In May 2023, ASIC released Report 762 ‘Design and distribution obligation: Investments products’ which examined compliance with the design and distribution obligations by issuers of investment products. Key findings included some scheme operators defining the target market too broadly, using inappropriate risk profiles or portfolio allocation for the target market, and using inappropriate investment timeframes or withdrawal needs for the target market. As a result, ASIC issued 26 interim stop orders for breaches of target market determination requirements, of which issuers amended 18 and withdrew 7 target market determinations. The findings from the review provide product issuers with practical observations to assess their practices and address gaps informed by the report.³⁴

2.2.2 Product intervention powers

Since 2019, ASIC has had the power under Part 7.9A of the Corporations Act to make product intervention orders relating to financial products (or credit products) when it is satisfied the product has resulted in, or will likely result in, significant detriment to retail clients. This power can be exercised even when there is no suspected or actual breach of the law.

ASIC has issued guidance (Regulatory Guide 272) that outlines what it will consider when determining if intervention is required to mitigate consumer detriment. This includes poorly designed products, products that are not fit for purpose or inconsistent with the client’s needs, sales and marketing techniques that prioritise commercial interests and conceal key product features such as risks and fees (and how these fees are charged). Interventions made by ASIC must be prospective, meaning a product intervention order can only apply to products that are issued or sold after the date of the order.

As at June 2023, ASIC had used the product intervention power on 4 occasions in relation to short-term credit products, continuing credit contracts, contracts for difference, and binary options.³⁵

2.3 Registration of schemes

A scheme in most cases must be registered with ASIC if it is to be offered to retail clients.³⁶ The phrase ‘registered managed investment scheme’ may be misunderstood by investors to indicate there has been some scrutiny of the commercial viability of the scheme as part of the registration process. This was raised in both the 2016 Bitter Harvest report and 2022 Sterling Income Trust Inquiry, where some investors had assumed that ASIC’s registration of a scheme was an endorsement of the investment product itself.³⁷

For a scheme to be registered with ASIC, the proposed responsible entity must be a public company with an AFS licence, and provide a copy of the scheme constitution, compliance plan, and a statement signed by the directors of the responsible entity which declares that the scheme’s constitution and compliance plan meet the requirements in Chapter 5C of the Corporations Act.³⁸

³⁴ ASIC (2023), [REP 762: Design and distribution obligations: Investment products](#), p 3, accessed July 2023.

³⁵ See ASIC legislative instruments 2020/986, 2021/240, 2022/647 and 2022/648.

³⁶ Section 601ED of the Corporations Act determines when a scheme must be registered. This includes schemes that have at least 20 members (by itself or together with related schemes as determined by ASIC), and/or the scheme is promoted by a person (or associate), who was in the business of promoting schemes.

³⁷ The Senate Economic References Committee (2022), [Sterling Income Trust](#), Commonwealth of Australia, 2022, p 54, accessed July 2023; The Senate Economic References Committee (2016), [Agribusiness managed investment schemes: Bitter harvest](#), Commonwealth of Australia, 2016, pp 47–49, accessed July 2023.

³⁸ Corporations Act, s 601EA.

ASIC's decision to register a managed investment scheme does not include consideration of the suitability of the scheme's offering for retail clients. Rather, ASIC is under a statutory obligation to register a scheme within 14 days of receiving the application unless it appears that the application does not meet one or more of the registration requirements.³⁹

In its 2014 discussion paper, CAMAC noted that despite ASIC being required to actively consider each element specified in the legislation before registering a scheme, the regulator in practice has limited discretion to refuse to register a scheme if the specified requirements have been satisfied. This includes schemes that may be in breach of a different provision in the law, for instance, where a director of the proposed responsible entity has been disqualified from acting as a director.⁴⁰

2.4 Questions for consideration

Questions

5. Should conditions be imposed on certain scheme arrangements when offered to retail clients? If so, what conditions and why?
6. Are any changes warranted to the procedure for scheme registration? If so, what changes and why?
7. What grounds, if any, should ASIC be permitted to refuse to register a scheme?

³⁹ Corporations Act, s 601EB(1).

⁴⁰ CAMAC (2014), The establishment and operation of managed investment schemes: Discussion paper, Australian Government, p 42.

Chapter 3. Scheme governance and the role of the responsible entity

3.1 Role of the responsible entity

The responsible entity of a registered scheme operates the scheme and performs the functions conferred on it by its constitution and the Corporations Act. It has the power to appoint an agent, or otherwise engage a person to do anything that it is authorised to do in connection with the scheme.⁴¹

The Corporations Act imposes several obligations on a responsible entity to promote effective scheme governance. This includes general obligations in its capacity as an AFS licensee, as well as specific duties in its capacity as responsible entity of a registered scheme. In addition, the responsible entity as a public company is required to have at least 3 directors. As with all directors, these directors are subject to a range of director duties set out in the Corporations Act, including a duty to exercise reasonable care and diligence and a duty to act in good faith.

The 2014 CAMAC discussion paper, and the Parliamentary Joint Committee into the collapse of Trio Capital found that the governance and compliance frameworks for schemes could be improved to promote more effective scheme governance.

3.2 Obligations of the responsible entity

3.2.1 AFS licensee obligations

As an AFS licensee authorised to operate a scheme, a responsible entity has an obligation to provide services efficiently, honestly, and fairly, have arrangements for managing conflicts of interest, comply with licence conditions, and have an internal and external dispute resolution system for retail clients.⁴²

Additional obligations imposed on responsible entities as AFS licensees include:

- Requiring that responsible officers be assessed by ASIC as fit and proper persons under section 913BA of the Corporations Act (or as having good fame or character prior to February 2020).
- Requiring adequate risk management systems under subparagraph 912A(1)(h) of the Corporations Act. While the Corporations Act does not specify further details, ASIC's Regulatory Guide 259 specifies that the responsible entity should ensure its risk management systems include documented processes to identify, assess and treat risks.
- Requiring the AFS licensee to notify ASIC of reportable situations under section 912D of the Corporations Act. Reportable situations include significant breaches or likely significant breaches of the core obligations of AFS licensees.

⁴¹ Corporations Act, s 601FB.

⁴² Corporations Act, s 912A.

3.2.2 Responsible entity obligations

In addition to their AFS licensee obligations, responsible entities must comply with certain requirements to run a registered scheme. The powers, responsibilities and obligations of the responsible entity are set out in the Corporations Act and the scheme constitution.

Section 601FC of the Corporations Act sets out certain duties that, among other things, require the responsible entity to:

- act honestly in the exercise of its powers and duties;
- exercise a reasonable degree of care and diligence;
- act in the best interests of members and, if there is a conflict between the members' interests and the responsible entity's own interest, give priority to the members' interests;
- treat members equally and fairly;
- ensure the scheme's constitution and compliance plan meet statutory requirements and are adhered to; and
- ensure scheme property is clearly identified, held separately and regularly valued.

Importantly, these duties are subject to civil penalty provisions where contraventions occur.

The Corporations Act also imposes duties directly upon officers of a responsible entity under section 601FD. These include the duty to act in the best interests of members, give priority to members' interest in the event of conflict, and not make use of information acquired through being an officer to gain an improper advantage or cause detriment to the members. These duties are also subject to civil penalty provisions where contraventions occur.

The duties imposed specifically on responsible entities and the officers of the responsible entity override any general duties applicable under Part 2D.1 relating to the duties of officers and employees of companies if and where a conflict may arise.

3.3 The scheme constitution

The constitution of a registered scheme is a legally enforceable document between the responsible entity and members that sets out the rights, duties, and liabilities of the responsible entity in operating the scheme.⁴³ ASIC Regulatory Guide 134 sets out ASIC's expectations for the contents of scheme constitutions. This includes an explanation of what constitutes 'adequate provision' as required for certain matters in the Corporations Act.

The constitution must be lodged at the time of registration and can be modified following registration if a special resolution of scheme members is passed, if the responsible entity itself reasonably considers the change will not adversely affect members rights, or if relief is provided under ASIC Instrument 2019/700. The responsible entity must lodge the amended constitution with ASIC.⁴⁴

ASIC is not able to direct a responsible entity to amend a scheme's constitution after registration, whereas it does have the power to direct a retail CCIV to modify its constitution to comply with the minimum legislative content requirements.⁴⁵ This allows responsible entities to introduce changes to

43 Corporations Act, ss 601GA and 601GB.

44 Corporations Act, s 601GC.

45 Corporations Act, s 1223C.

the scheme constitution following registration that may not meet section 601GA or are contrary to other obligations under the Corporations Act.

While ASIC may elect to deregister a scheme under section 601PB of the Corporations Act if its constitution does not meet the statutory requirements, deregistration is a relatively blunt tool that can result in significant consequences for existing scheme members and assets.

3.4 The compliance framework

3.4.1 Compliance plan

Each registered scheme is required to have a compliance plan that sets out adequate measures for the responsible entity to ensure the scheme complies with its constitution and the Corporations Act.⁴⁶

ASIC Regulatory Guide 132 includes the types of things ASIC considers when assessing the appropriateness of compliance plans. This includes considering whether the compliance controls in the compliance plan are aligned with the responsible entity's values, objectives, and strategy, considering the nature, scale, and complexity of the scheme.

There is an expectation that compliance plans are tailored to the scheme, and regularly monitored and updated to maintain currency. However, the Corporations Act does not expressly require compliance plans to be tailored to the specific scheme. The Act also does not mandate content beyond the items listed in section 601HA. This may enable the submission of plans containing high-level content that addresses the minimum obligations, without detailed procedures for ensuring compliance.

A responsible entity can currently incorporate by reference the compliance plan of another registered scheme it operates under section 601HB of the Corporations Act. This can help make schemes easier to administer but may also result in the use of generic plans across several schemes.

3.4.2 Compliance plan audit

The compliance plan must be audited annually by an independent, registered company auditor or audit firm. The auditor must assess whether the responsible entity has complied with the scheme's compliance plan and whether the compliance plan continues to meet its statutory requirements. The auditor must provide a report to the responsible entity and the responsible entity must lodge its compliance plan audit report with ASIC.⁴⁷

Regulatory Guide 132 sets out ASIC's expectation that auditors follow general auditing principles to the extent they are relevant and consistent. In addition, the Auditing and Assurance Standards Board has issued Standard on Assurance Engagements ASAE 3100 *Compliance engagements* and Guidance Statement GS013 *Special considerations in the audit of compliance plans of registered managed investment schemes* which provide further guidance for auditors undertaking audits of scheme compliance plans.

Auditors of compliance plans are not required to meet any minimum qualitative standards under the Corporations Act when conducting the audit of the plan. While assurance standards are relevant to compliance plan audits, the standards do not have the force of law.

⁴⁶ Corporations Act, s 601HA.

⁴⁷ Corporations Act, s 601HG.

Both CAMAC and the Parliamentary Joint Committee Inquiry into the collapse of Trio Capital raised concerns around the effectiveness of compliance plans and their audits. They found generic compliance plans reduce the quality and effectiveness of compliance plan audits by limiting the auditor and ASIC's assessment as to whether the responsible entity has adhered to the plan. They also found that a lack of qualitative standards for the auditor may contribute to compliance plan audits not providing the regulatory oversight expected.⁴⁸

Inappropriate compliance plans and compliance auditing has the potential to impact negatively on scheme members. Issues identified in audit reports provide ASIC with important supervisory information that enables it to identify potential problem areas and calibrate its regulatory response. This information is particularly useful when paired with information from AFS licensees on reportable situations.

The inquiry into the collapse of Trio Capital recommended the Government investigate options to improve the oversight and operation of compliance plans, including the need for more detail in the plans and qualitative standards for their auditors.

3.4.3 Compliance committee

A compliance committee must be established if less than half of the directors of the responsible entity are external directors. The compliance committee is responsible for assessing whether the compliance plan is adequate, monitoring the responsible entity's compliance with the compliance plan, reporting breaches to the responsible entity and, if the responsible entity is not taking adequate action to deal with a reported breach, reporting the matter to ASIC.⁴⁹

There are no requirements in the Corporations Act regarding the qualifications and experience of the compliance committee, the governance arrangements for the committee, or the requirement to notify ASIC of committee members. Regulatory Guide 132 indicates that ASIC considers it important that compliance committee members have enough experience, qualifications, and competence to carry out their duties and functions given the important role they play as gatekeepers in monitoring the responsible entity's compliance with its obligations.

The CCIV regime adopts an alternative approach. A retail CCIV must have a majority of external directors on the board with no option of a compliance committee.⁵⁰ This means the board is directly responsible for monitoring the extent to which the corporate director adheres with the retail CCIV's compliance plan. This approach was designed to improve the standard of independent compliance management as external directors would bring a degree of 'detached supervision' to enhance the governance of the retail CCIV corporate director.⁵¹ The ASX Corporate Governance Council also recommends the board of a listed entity should have a majority of independent directors, on the basis that this maximises the likelihood that board decisions will reflect the best interests of the entity.⁵²

48 CAMAC (2014), *The establishment and operation of managed investment schemes: Discussion paper*, Australian Government, pp 69-70; Parliamentary Joint Committee on Corporations and Financial Services (2012), [Inquiry into the collapse of Trio Capital](#), Commonwealth of Australia, p 131, accessed July 2023.

49 Corporations Act, ss 601JA(1) and 601JC.

50 Corporations Act, s 1224G.

51 Explanatory Memorandum, *Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021*, paragraph 3.108.

52 ASX Corporate Governance Council (2019), [Corporate Governance Principles and Recommendations 4th Edition](#), Recommendation 2.4, p 15, accessed July 2023.

3.5 Questions for consideration

Questions

8. Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?
9. Should ASIC be able to direct a responsible entity to amend a scheme's constitution to meet the minimum content requirements, similar to the CCIV regime?
10. Are changes required to the compliance plan provisions to ensure compliance plans are more tailored to individual schemes? If so, what changes and why?
11. Should auditors be legislatively required to meet minimum qualitative standards when conducting compliance plan audits? If so, what should these standards be and why?
12. Should responsible entities be required to have a majority of external board members, similar to the CCIV regime?

Chapter 4. Right to replace the responsible entity

4.1 Recourse to replace the responsible entity

A change in the responsible entity may occur when the existing responsible entity voluntarily retires or is no longer able to continue in that role, or when members seek to have the existing responsible entity removed. Given the central role a responsible entity plays in the operation and management of a scheme, having recourse to change the responsible entity in appropriate circumstances is an important right for scheme members.

The 2012 CAMAC report and the 2016 Bitter Harvest report highlighted barriers within the existing procedures to remove and replace a responsible entity and suggested changes to the settings in the regulatory framework.⁵³

4.2 Removal of the responsible entity by members

When members wish to initiate the replacement of a responsible entity, the requirements under Part 2G.4 and section 601FM in the Corporations Act need to be satisfied. Under these provisions, the removal of a responsible entity and the appointment of a new responsible entity need to be approved by way of member resolutions. There are 3 different types of resolutions (see Box 5).

If the members vote to remove the responsible entity but do not at the same meeting choose an entity to be the new responsible entity (or the entity does not consent), a temporary responsible entity needs to be appointed or the scheme must be wound up.

Box 5. Types of resolutions

Each resolution has its own voting threshold requirements under section 9 of the Corporations Act except for an ordinary resolution which is not specifically defined in the Act.

- Ordinary resolution: passes when a simple majority of more than 50 per cent of entitled members vote in favour.
- Special resolution: passes when at least 75 per cent of entitled members vote in favour.
- Extraordinary resolution: passes when at least 50 per cent of the total votes that may be cast by entitled members (including members who are not present in person or by proxy) vote in favour.

⁵³ CAMAC (2012), *Managed Investment Schemes: Report*, Australian Government, Chapter 5; Senate Economics References Committee (2016), *Agribusiness managed investment schemes: Bitter harvest*, Commonwealth of Australia, p 245, accessed July 2023.

The responsible entity must convene a vote to remove the responsible entity on the request of members holding at least 5 per cent of the votes able to be cast, or at least 100 members entitled to vote. Members holding at least 5 per cent of the votes can also convene the meeting themselves, or a court may order the meeting to be called if it is impracticable to do so in any other way.⁵⁴

Members may also request access to the member register under section 173 of the Corporations Act in order to communicate with other members or to issue the notice of meeting to change the responsible entity.

4.3 Barriers to replacing the responsible entity

4.3.1 Voting requirements for members

The resolution type required to replace a responsible entity is different for listed and unlisted schemes.

The resolution type needed for listed schemes is not specified in the Corporations Act. In the case of *MTM Funds Management Ltd v Cavalane Holdings Pty Ltd* [2000], the New South Wales Supreme Court held that listed schemes required the passing of ordinary resolutions. In the decision, Justice Austin indicated the responsible entity should be replaced by a simple majority of members without any restrictions on who can vote.⁵⁵ This decision was subsequently implemented through ASIC Class Order 13/519 (formerly Class Order 01/1541). At the date of this paper, this class order is currently being re-made.

For unlisted schemes, section 601FM of the Corporations Act specifies the passing of extraordinary resolutions to replace the responsible entity. This extraordinary resolution requirement can be difficult to satisfy due to its high voting threshold, especially where members are passive, disengaged, or investing through an investment platform that does not facilitate voting. The requirement for an extraordinary resolution and the high voting threshold may also contribute to the entrenchment of an under-performing responsible entity.

In contrast, members of a CCIV are required to pass special resolutions to remove and replace a corporate director.⁵⁶

4.3.2 Due diligence for prospective responsible entities

An incoming responsible entity inherits all the rights, obligations, and liabilities of the existing responsible entity which is not limited to scheme assets.⁵⁷ The transfer of liabilities and obligations in a change of responsible entity protects scheme creditors who have rights of recovery against the personal assets of the responsible entity under agreements entered into as the scheme operator. This protection ensures that the rights of recovery are not compromised through a change of responsible entity.

The ability of an incoming responsible entity to undertake proper due diligence and assess the potential obligations and liabilities (for example) depends on the existing responsible entity's

54 Corporations Act, ss 252B, 252D and 252E; ASIC (2013) *ASIC Class Order [CO 13/519]*.

55 *MTM Funds Management Ltd v Cavalane Holdings Pty Ltd* [2000] NSWSC 922.

56 Corporations Act, s 1224U.

57 Corporations Act, s 601FS.

willingness to assist. This is because the legal obligation to provide ‘reasonable assistance’, including access to scheme books and records, only applies after the new responsible entity is appointed.⁵⁸

If adequate due diligence cannot be conducted, a company may be unwilling to take on the risks associated with becoming the responsible entity. For example, CAMAC noted in its 2012 report that a prospective temporary responsible entity may be ‘cautious’ about taking on an appointment if it is unable to assess the extent of personal liability and the availability of scheme property to meet that liability. The report favoured a temporary responsible entity be liable only for obligations and liabilities that it incurs in that role, with indemnity rights against scheme property.⁵⁹

4.3.3 Disincentives to replacing a responsible entity

Certain agreements between responsible entities and external parties may inhibit scheme members from seeking to replace the responsible entity in some situations. For example, where agreements are dependent on the existing responsible entity remaining in that position, there could be adverse consequences of breaking any such agreements.

In its 2012 report, CAMAC recognised that there may be good commercial reasons why external parties may seek to include provisions concerning the continuation of a particular responsible entity in that role. However, CAMAC noted that such provisions should be enforceable only if they do not unreasonably inhibit the rights of scheme members to replace the responsible entity.⁶⁰

In addition, a responsible entity’s right to be paid remuneration out of scheme property must be included in the scheme’s constitution and subject to the responsible entity’s proper performance of duties.⁶¹ There are no specific statutory restrictions on payments of fees to an existing responsible entity. This means provisions in a scheme’s constitution can require the existing responsible entity to be paid a large sum out of scheme property if it is replaced. Such arrangements can work to entrench the responsible entity and act as an impediment to members seeking to replace the responsible entity.

58 Corporations Act, s 601FR.

59 CAMAC (2012), *Managed Investment Schemes: Report*, Australian Government, pp 103–05.

60 CAMAC (2012), *Managed Investment Schemes: Report*, Australian Government, p 95.

61 Corporations Act, s 601GA.

4.4 Questions for consideration

Questions

13. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of a listed scheme? If so, what changes and why?
14. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of an unlisted scheme? If so, what changes and why?
15. In what circumstances should an existing responsible entity be required to assist a prospective responsible entity conduct due diligence? What might this assistance look like?
16. Should there be restrictions on agreements that the responsible entity enters into or clauses in scheme constitutions that disincentivise scheme members from replacing a responsible entity? If so, what restrictions may be appropriate?

Chapter 5. Right to withdraw from a scheme

5.1 Scheme liquidity and withdrawals

Where members have a right to withdraw from a registered scheme, the scheme's constitution must specify that right and include withdrawal procedures for when the scheme is liquid and non-liquid.⁶²

In the case of liquid schemes, members may withdraw according to the procedures in the scheme's constitution. For non-liquid schemes, members will only have a right to withdraw if a withdrawal offer is made in accordance with the scheme's constitution and the specific procedures in Part 5C.6 of the Corporations Act.

Considering the significance of this distinction it is important that scheme liquidity and how this informs their withdrawal rights is adequately managed and disclosed to members.

The focus on scheme liquidity was heightened for Australian investors during the GFC when 87 schemes with funds under management of approximately \$25 billion were frozen, and withdrawals suspended for an extended period.⁶³ At the same time, the regulatory framework served to preserve investors' capital where there could otherwise have been forced selling of assets to meet short-term withdrawal requests.

More recently, in anticipation of market volatility and disruption from the COVID-19 pandemic, ASIC pre-emptively wrote to responsible entities in March 2020 reminding them of their obligations and duties to members, especially in relation to managing scheme liquidity.⁶⁴ In a targeted review of 14 registered schemes in the second half of 2020, ASIC found their liquidity frameworks were generally adequate and the liquidity challenges and market disruption were well managed.⁶⁵

5.1.1 The definition of a liquid scheme

Under section 601KA of the Corporations Act, a registered scheme can be considered liquid if liquid assets account for at least 80 per cent of the value of the scheme's property. Liquid assets are prescribed as money, bank accepted bills, and marketable securities unless the responsible entity cannot reasonably expect to realise them within the period specified in the constitution for satisfying withdrawal requests. Any other scheme property can also be liquid assets if the responsible entity reasonably expects that the property can be realised for its market value within the period specified in the constitution.

This 'specified period' for realising liquid assets is not prescribed and is at the discretion of the responsible entity, subject to its overarching duties including the obligation that withdrawal provisions be fair to all members.⁶⁶ This discretion can make the determination of scheme liquidity a largely subjective process in terms of identifying assets and timeframes in which they can be realised.

62 Corporations Act, s 601GA.

63 ASIC (2016), [Information Sheet 142 Estimated frozen funds under management](#), Table 1 – Estimated frozen funds under management, accessed July 2023.

64 ASIC (2020), [ASIC letter to responsible entities of registered schemes in the current COVID-19 environment](#), [letter], 8 April 2020, accessed July 2023.

65 ASIC (2021), [21-091MR ASIC review finds retail managed funds responded well to COVID-19 challenges in 2020](#), [media release], 30 April 2021, accessed July 2023.

66 Corporations Act, ss 601FC and 601GA.

Some jurisdictions impose more prescriptive liquidity regimes for schemes (see Box 6). These regimes typically impose a cap on the level of illiquid assets that a scheme can hold and may restrict investment in illiquid schemes to wholesale clients. In addition, some jurisdictions require more prescriptive timeframes for which redemptions must be facilitated.

Box 6. Withdrawal provisions in other jurisdictions

United States

In the US, open-end funds (where the fund issues and redeems units on an ongoing basis) are required to establish liquidity risk management programs and classify the liquidity of each investment in their portfolio on at least a monthly basis.

The classification is based on the number of days in which the fund reasonably expects the investment would be convertible to cash or sold in current market conditions without significantly changing the market value of the investment. Where this exceeds 7 calendar days, the investment is considered illiquid. Open-end funds must allow investors to redeem their shares daily, which must be facilitated within 7 days.⁶⁷

In 2022, the Securities and Exchange Commission proposed additional rules for some open-end funds which included introducing minimum standards for liquidity classification analysis. It also included a requirement to maintain at least 10 per cent of net assets in highly liquid assets to help manage stressed conditions and heightened redemption levels.⁶⁸

European Union

Under the European Union's UCITS regime, UCITS must provide facilities so that units can be repurchased or redeemed at the request of fund investors. UCITS must allow redemption requests at least twice a month.⁶⁹

In addition, UCITS can only invest in transferable securities, approved money-market instruments, deposits, derivatives and forwards, and units in other collective investment schemes. Within this range of investment assets there are some detailed spread and concentration rules.⁷⁰

67 U.S. Securities and Exchange Commission (2022), [Investment Company Liquidity Risk Management Program Rules](#), accessed July 2023; U.S. *Investment Company Act of 1940*, s 22(e).

68 U.S. Securities and Exchange Commission (2022), [SEC Proposes Enhancements to Open-end Fund Liquidity Framework](#), accessed July 2023.

69 ESRB (2018), [Recommendation of the European Systemic Risk Board of 7 December 2017 on liquidity and leverage risks in investment funds \(ESRB/2017/6\)](#), p 7, accessed July 2023.

70 FCA (2023), [The Collective Investment Scheme Information Guide](#), section 2A.1.4(1-3), accessed July 2023.

5.2 The right to withdraw from a scheme

5.2.1 Liquid schemes

When a scheme is liquid, members can request to withdraw at any time according to the withdrawal procedures in the scheme's constitution. The responsible entity must redeem the member's investment within the timeframe specified in the scheme constitution. There is no statutorily prescribed redemption timeframe.

ASIC Regulatory Guide 134 sets out expectations that liquid schemes should pay members that have withdrawn within 21 days from cessation of their interest in the scheme. In circumstances such as extreme market events, if the scheme's systems and processes are durable, or if the scheme is a feeder fund, the regulatory guide allows for a payment period that exceeds 21 days.⁷¹

5.2.2 Non-liquid schemes

When a scheme is non-liquid, the responsible entity cannot allow members to withdraw from the scheme on a 'first come, first served' basis. Rather, the responsible entity has an obligation to follow the withdrawal provisions for non-liquid schemes set out in Part 5C.6 of the Corporations Act.

The provisions for non-liquid schemes require the responsible entity to make a written withdrawal offer by giving a copy of the offer to all members or to all members of a particular class. The offer must specify the period the offer will remain open, the assets that will be used to satisfy withdrawal requests, the amount of money that is expected to be available when assets are realised, and the method for dealing with withdrawals if the money available is insufficient to satisfy all requests.

The responsible entity must lodge the withdrawal offer with ASIC and satisfy all withdrawal requests within 21 days after the offer closes. No withdrawal request can be satisfied while the offer is still open.


These provisions are designed to ensure members have an equal opportunity to access whatever redemption liquidity the responsible entity determines can and should be made available from scheme assets.

5.3 Scheme liquidity and member expectations

There is a distinction between a scheme being liquid for the purposes of the Corporations Act and the general understanding of a liquid investment which implies an easy conversion to cash. Considering schemes that are marketed as 'liquid' signal an expectation that investors can obtain a timely redemption should they wish to withdraw from a scheme, it is important that investors understand their redemption rights under their scheme's rules.

Inappropriate or misunderstood liquidity representations can occur when a scheme is marketed as 'liquid' while providing for lengthy timeframes in the scheme's constitution for satisfying withdrawal requests (for example, up to 365 days or sometimes longer). This is permitted under the legislation provided the responsible entity reasonably expects that the prescribed assets can be realised for their market value in the timeframe specified in the constitution.

71 ASIC (2022), [RG 134: Funds management: Constitutions](#), p 51, accessed July 2023.



The 2014 CAMAC discussion paper described this discretionary process to determining liquid assets as imprecise, difficult to verify independently, and a possible source of instability by enabling a responsible entity to specify any realisation period in the constitution, without limit.

To address this, CAMAC suggested a more objective test of liquidity be introduced such as defining liquid assets as money, bank accepted bills and assets that can reasonably be expected to be realised for their book value within 7 business days.⁷²

5.4 Questions for consideration

Questions

17. Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?
18. Are any changes required to the procedure for withdrawal from a scheme? If so, what changes and why?
19. Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?

⁷² CAMAC (2014), The establishment and operation of managed investment schemes: Discussion Paper, Australian Government, pp.132–133.

Chapter 6. Winding up insolvent schemes

6.1 Winding up provisions

The procedures for winding up registered schemes in Part 5C.9 of the Corporations Act do not include provisions for when a scheme becomes unviable. Rather, the procedures stipulate that a responsible entity must ensure a scheme is wound up in accordance with its constitution and any orders imposed by the Court in the following situations:

- the scheme's constitution provides that the scheme is to be wound up at a specified time, in specified circumstances, or on the happening of a specified event;
- scheme members pass an extraordinary resolution directing the responsible entity to wind up the scheme;
- scheme members pass a resolution removing the responsible entity but do not, at the same meeting, pass a resolution electing a company to be the new responsible entity;
- the Court makes an order directing the responsible entity to wind up the scheme; or
- if the responsible entity considers that the purpose of the scheme has been accomplished or cannot be accomplished.

The responsible entity is generally responsible for winding up a scheme which involves collecting and liquidating assets, payment of scheme debts, and the distribution of any surplus in accordance with the scheme's constitution. If the responsible entity enters external administration, the administrator appointed may take steps to wind up the scheme. Where appropriate, the Court may appoint an independent person such as a liquidator to oversee the winding up of a scheme.

6.2 Winding up an insolvent scheme

When a responsible entity becomes insolvent, the corporate insolvency regime established under Chapter 5 of the Corporations Act is applicable as a responsible entity is a public company. There are no statutory insolvency provisions that establish when or how a registered scheme should be wound up if it becomes insolvent.

As schemes are not separate legal entities, they cannot incur their own debts and therefore cannot be considered insolvent under the Corporations Act in the same manner as companies. The courts have established that schemes may be informally referred to as insolvent when the scheme is unable to meet its liabilities and/or if the scheme's assets are no longer sufficient to indemnify the responsible entity for its liabilities.⁷³

When a scheme becomes insolvent, the responsible entity can either follow the provisions set out in the scheme's constitution or apply to the Court for directions on how to administer assets and liabilities of an insolvent scheme. ASIC has issued guidance on adequate winding up provisions, suggesting constitutions address how assets, liabilities and scheme property are dealt with.

73 *Capelli v Shepard* [2010] VSCA 2 at [93].

This includes distribution of the proceeds of winding up, the costs of winding up, and that any payments should maximise the proceeds of winding up.⁷⁴

Where a court becomes involved, it must rely on precedent, the general principles of trust law, and the facts of the scheme to determine how the scheme is wound up. Court involvement in the administration of a scheme insolvency can require additional time and significant court costs, potentially resulting in higher financial losses to investors. Registered schemes that are contract-based schemes may not be able to rely solely on the established principles of trust law to provide clarity about winding up.

In comparison, although CCIVs are a type of company, they have their own insolvency regime under Part 8B.6 of the Corporations Act. The regime includes similar external administration provisions to those afforded to companies under Chapter 5 but excludes voluntary administration and restructuring provisions.

6.2.1 Lack of statutory procedures to winding up insolvent schemes

The lack of statutory procedures to wind up an insolvent scheme was examined in the 2012 CAMAC report, and later recognised as an ongoing regulatory gap by parliamentary inquiries into collapsed schemes including the 2016 Bitter Harvest report and the 2022 Sterling Income Trust Inquiry.

The 2012 CAMAC report recommended a process comparable to the corporate insolvency regime for companies be implemented for schemes to support a more efficient winding up process.

Recommendations included granting schemes a separate legal status, introducing a voluntary administration regime, and limiting the liability of scheme members. The 2016 Bitter Harvest report recommended introducing legislative reforms to remedy shortcomings in managing a scheme in financial difficulties and winding up collapsed schemes.⁷⁵

These recommendations recognised that some schemes had developed into significant commercial enterprises over time with external financing and complex contractual arrangements. The report noted that without detailed winding up procedures in the law, there could be uncertainty about rights and obligations of impacted parties in the event a scheme became insolvent.

6.3 Liability of members

As registered schemes are not separate legal entities, they are unable to enter into agreements themselves. All agreements must be entered into with the responsible entity as the party operating the scheme under the Corporations Act. In some circumstances members may individually enter into agreements and use the responsible entity as their agent. In this case, the member is liable and accountable for any debts incurred by the responsible entity under the agreement, with creditors having recourse to the personal assets of members to satisfy their debts.

Schemes may elect to provide members with limited liability within their scheme constitutions. Where a scheme's constitution does not provide limited liability, responsible entities may have a claim against members for costs incurred while operating the scheme.

⁷⁴ ASIC (2022), [RG 134 Funds management: Constitutions](#), pp 58–60, accessed July 2023.

⁷⁵ CAMAC (2012), *Managed Investment Schemes: Report*, Australian Government, pp 16–19; Senate Economics References Committee (2016), [Agribusiness managed investment schemes: Bitter harvest](#), Commonwealth of Australia, Recommendation 20, accessed July 2023.

It was recommended in the Companies and Securities Advisory Committee 2000 and CAMAC 2012 reports that statutory limited liability, regardless of provisions to the contrary in the constitution, be provided for members of schemes to improve investor protections.⁷⁶

Under this recommendation, where a responsible entity becomes insolvent, the liability of scheme members would be limited to the unpaid portion of the amount they have contributed to the scheme. This would be comparable to the statutory limited liability provided to members of companies under section 516 of the Corporations Act. A statutory limited liability would not apply where the scheme members enter into agreements on their own behalf or through the responsible entity acting as their agent.⁷⁷

The current lack of a statutory limited liability provision for scheme members may also discourage foreign investment into Australia's managed funds. Potential foreign investors, particularly those within the Asia-Pacific region, are accustomed to investment schemes structured as corporate vehicles which generally include some form of limited liability for investors. They may be reluctant to invest through an unfamiliar structure that does not offer this protection.⁷⁸ It is important to note that the recently introduced CCIV regime does provide limited liability through an internationally recognisable corporate structure.⁷⁹

6.4 Questions for consideration

Questions

20. Are any changes required to the winding up provisions for registered schemes? If so, what changes and why?
21. Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members and creditors? Are there certain aspects of the existing company and CCIV insolvency regimes that should be adopted?
22. Should statutory limited liability be introduced to protect personal assets of scheme members in certain circumstances? If not, why not?

76 The Companies and Securities Advisory Committee is CAMAC's predecessor established in September 1989. The name was changed to CAMAC in March 2002.

77 CAMAC (2012), *Managed Investment Schemes: Report*, Australian Government, p 201.

78 Australian Financial Centre Forum (2009), [*Australia as a Financial Centre: Building on Our Strengths*](#), Commonwealth of Australia, p 62, accessed July 2023.

79 Corporations Act, s 601BN.

Chapter 7. Commonwealth and state regulation of real property investments

7.1 Dual jurisdictional responsibility

In Australia there is dual jurisdictional responsibility for financial products involving real property investments. The Commonwealth has responsibility for regulating financial products while states and territories are responsible for real property. Financial products that involve real property arrangements include management rights schemes, serviced strata schemes and contract-based schemes with land or property.

The overlap between jurisdictions overseeing these types of arrangements can create complexities due to the legal and regulatory frameworks that investors and product issuers must navigate to ensure compliance with both sets of laws.

7.2 Real property and financial products

Real property refers to interests in land, fixtures and buildings. The creation, transfer, and protection of rights to real property is typically covered by property law. These laws also include zoning and land use regulations, and the rights and responsibilities of property owners and tenants.

Australian property law is generally the responsibility of the states and territories. Each state and territory has its own legislation covering the main areas of property law, such as the *Real Property Act 1900* in New South Wales. This allows each state and territory to regulate and protect real property within its own jurisdiction, including the ability for entities to sue for damages or seek injunctions to prevent others from interfering with their own property rights.

Financial products can grant a right to real property ownership. When investors collectively invest in real property, a trust relationship is often used as the mechanism to hold and manage the property on behalf of investors. In a property trust, investors pool their money together to purchase property, and the trust is set up to hold and manage the property on behalf of the investors. Trust law plays an important role in financial products involving real property rights and in providing a framework for managing and distributing income and capital gains generated by the property. For example, income generated by the property can be distributed to the beneficiaries of the trust or reinvested into the property to improve its value. Similarly, capital gains from the sale of the property can be distributed to the beneficiaries or reinvested into the trust.

Some trusts investing in real property are registered managed investment schemes. Responsibility for the governance and management of a registered scheme is vested in the responsible entity. The responsible entity legally owns the assets but holds them for the benefit of the investors. Scheme investors share a defined entitlement and equitable interest in both the underlying capital and the schemes income of the trust.

Property rights are essential for investors who invest in real property, in that they legally enable the flow of benefits associated with the ownership of that property. While managed investment schemes are regulated at the Commonwealth level by the Corporations Act with ASIC responsible for enforcement, the property rights that legally grant property ownership to some schemes are generally regulated by state and territory agencies. This jurisdictional overlap can complicate the regulatory framework.

7.3 The potential impact on scheme members

The overlap between Commonwealth and state regulation was highlighted in the Sterling Income Trust case. As noted in the 2022 Sterling Income Trust Inquiry, the complexity of the Sterling New Life Lease arrangement resulted in 2 different regulatory bodies having jurisdiction over different aspects of the offering.⁸⁰

In this case, a long-term tenancy was linked to the performance of an investment. This created a hybrid tenant-investor product offering that was regulated concurrently by 2 separate bodies: ASIC as regulator for financial services and products (including managed investment schemes); and the Western Australian Department of Mines, Industry Regulation and Safety as the body responsible for the administration and enforcement of legislation governing real estate in Western Australia.

The interaction between Commonwealth and state and territory regulatory frameworks and the protections afforded under each framework may not have been readily understood by investors. This was highlighted in the Sterling collapse where investors had entered into a Payment Direction Deed, which ostensibly ensured an ongoing right of occupancy if the Sterling Income Trust was insufficient to meet rental payments. However, the *Residential Tenancies Act 1987* in Western Australia operated to make the deed void and of no effect.⁸¹

7.4 Question for consideration

Question

23. Do issues arise for investors because of the dual jurisdictional responsibility when regulating schemes with real property? If so, how could they be addressed?

80 Senate Economic References Committee (2022), [Sterling Income Trust](#), Commonwealth of Australia, p 65, accessed July 2023.

81 Senate Economic References Committee (2022), [Sterling Income Trust](#), Commonwealth of Australia, pp 69–70, accessed July 2023; *Hassell v Yates* [2021] WASC 389; *Soussa v Thomas* [2021] WASC 172.

Chapter 8. Regulatory cost savings

8.1 Modernising the regulatory framework

The underlying regulatory framework for managed investment schemes has remained largely unchanged since its introduction. However, as regulated entities in the broader financial services sector, scheme operators have experienced significant reform in recent years. This can cause increased compliance burden and associated costs.

Well-designed regulation is important for boosting productivity and enhancing protections for consumers. Conversely, poorly targeted or unnecessarily complex regulation can impose additional costs on entities and investors.

This consultation paper has considered several areas with potential gaps in the regulatory framework for managed investment schemes that may detract from investor outcomes. However, there are opportunities to modernise and streamline the framework to ease compliance burdens without compromising the intent of any regulation or protections. There may also be areas where the regulatory framework for managed investment schemes could be improved through closer alignment with the CCIV regime.

8.2 Question for consideration

Question

24. What opportunities are there to modernise and streamline the regulatory framework for managed investment schemes to reduce regulatory burdens without detracting from outcomes for investors?

Appendix A: Mapping of client definitions across the Corporations Act 2001

The terms ‘retail client’, ‘wholesale client’, and ‘sophisticated investor’ within the Corporations Act impact various parts of the legislation, particularly relating to the regulation of financial products and services.

Refer to Table 2 for a summary of key references in the Corporations Act to a ‘retail client’, Table 3 for a ‘wholesale client’ and Table 4 for a ‘sophisticated investor’.

Table 2. References to ‘retail client’ in the Corporations Act

Source	Description
s 9	This section provides general definitions applicable throughout the Corporations Act 2001, including definitions relevant to retail clients
s 738D	Meaning of retail client in relation to a CSF offer
s 738T	Withdrawal of applications made pursuant to a CSF offer
s 738ZA	General obligations of CSF intermediaries relating to their platforms etc
s 738ZC	Caps on investment by retail clients pursuant to CSF offers
s 738ZD	Cooling-off rights for retail clients
s 738ZE	Company making CSF offer or CSF intermediary etc. must not financially assist retail client to acquire securities
s 761A	Definitions – meaning of derivative retail client money
s 761A	Definitions – meaning of derivative retail client property
s 761A	Signpost definition – retail client
s 761E	Meaning of issued, issuer, acquire, and provide in relation to financial products
s 761G	This section sets out the definition of a retail client within the Corporations Act 2001
s 761GA	This section relates to the interaction between the definitions of wholesale and retail clients and the circumstances in which they apply
s 766A	When does a person provide a financial service?
s 766H	Meaning of provides a superannuation trustee service
s 798A	Matters to be taken into account by the Minister
s 881A	Licensed markets through which participants provide services for retail clients must generally have a compensation regime
s 881B	Additional requirements for the licence application (Australian Market Licence)
s 885C	The losses to be covered
s 910A	Definition of body corporate licensee
s 910A	Definition of relevant provider
s 911A	Need for an Australian financial service licence – this section describes when a person is required to hold an AFSL
s 912A	General obligations – this section provides the general obligations that a financial service licensee must comply with
s 912B	Compensation arrangements if financial services provided to persons as retail clients
s 912D	What are reportable situations
s 912DAB	Obligations to lodge a report – reportable situations in relation to other financial services licensees

Source	Description
s 912EB	Obligations to investigate reportable situations that may affect clients
s 920A	ASIC's power to make a banning order
s 921B	Meaning of education and training standards
s 921BA	Relevant providers to meet education and training standards
s 921BB	Additional requirements for relevant providers who provide tax (financial) advice services
s 921BC	Exemptions for certain relevant providers
s 921C	Limitations on authorisation to provide personal advice unless conditions met
s 921F	Requirements relating to provisional relevant providers
s 921K	Powers of Financial Services and Credit Panels to take action against relevant providers
s 921M	Copy of instrument to be given to affected person etc
s 921N	Variation or revocation of instruments made in relation to relevant providers
s 921S	Warnings and reprimands by ASIC
s 921T	Warnings and reprimands by Financial Services and Credit Panels
s 921Z	Financial services licensees not to continue to authorise unregistered relevant providers to provide personal advice
s 921ZA	Application for registration – relevant providers who are financial services licensees
s 921ZB	Application for registration – relevant providers who are not financial services licensees
s 921ZC	Registration of relevant providers
s 921ZE	Period of registration – relevant providers who are not financial service licensees
s 922E	Information about a relevant provider who is a financial services licensee
s 922F	Information about a relevant provider who is not a financial services licensee
s 922G	Meaning of recent advising history
s 922HA	Obligation to notify ASIC of financial services licensee's CPD year
s 922HB	Obligation to notify ASIC of non-compliance with CPD provisions
s 922HC	Requirement to retain information
s 922L	Requirement for notice to be lodged
s 922N	Obligation for relevant providers to provide information to financial services licensees
s 922P	Change in matter within 30 business days
s 922Q	Register of relevant providers
s 923C	Restriction in use of terms 'financial adviser' and 'financial planner'
s 924A	Agreements with certain unlicensed persons
s 941A	Obligation on financial services licensee to give a Financial Services Guide if financial service provided to person as a retail client
s 941B	Obligation on authorised representative to give a Financial Services Guide if financial service provided to person as a retail client
s 941F	Obligation to give updated Financial Services Guide
s 942B	Financial Services Guide given by financial services licensee – main requirement
s 942C	Financial Services Guide given by authorised representative – main requirements
Division 3, subdivisions A and C	Additional requirements for personal advice provided to a retail client
s 947B	Statement of Advice given by financial services licensee – main requirements
s 947C	Statement of Advice given by authorised representative – main requirements

Source	Description
s 949A	General advice provided to retail client – obligation to warn client that advice does not take account of client’s objectives, financial situation or needs
s 949B	Regulations may impose disclosure requirements in certain situations
s 961	Best interests obligations – Application of this Division
s 962A	Ongoing fee arrangements
s 963A	Conflicted remuneration
s 963B	Monetary benefit given in certain circumstances not conflicted remuneration
s 963C	Non-monetary benefit given in certain circumstances not conflicted remuneration
s 963L	Volume-based benefits presumed to be conflicted remuneration
s 963N	Regulations may provide for rebate of conflicted remuneration
s 964B	Asset-based fees on borrowed amounts – application
s 981D	Money related to derivatives may be used for general margining etc. purposes
s 985EA	Application of this Subdivision (special provisions relating to margin lending facilities)
s 985E	Requirements before issuing etc. margin lending facility
s 985F	Assessment of unsuitability of margin lending facility
s 985G	Reasonable inquiries etc. about the retail client
s 985H	When margin lending facility must be assessed as unsuitable (for a retail client)
s 985J	Giving the retail client the assessment
s 985K	Unsuitable margin lending facilities (to retail clients)
s 985L	Issue of margin lending facility must not be conditional on agreement to receive communications through agent
s 985M	Notification of margin calls
s 992A	Prohibition on hawking of financial products
s 994A	Design and distribution requirements relating to financial products for retail clients – definition of excluded dealing
s 994A	Design and distribution requirements relating to financial products for retail clients – definition of retail product distribution conduct
s 994B	Target market determinations for financial products
s 994C	Target market determination to be reviewed
s 994D	Prohibition on engaging in retail product distribution conduct unless target market determination made
s 994E	Reasonable steps to ensure consistency with target market determinations
s 994F	Record keeping and notification obligations
s 994G	Notice to ASIC
s 994J	Stop orders
s 1012A	Obligation to give product disclosure statement – personal advice recommending particular financial product
s 1012B	Obligation to give product disclosure statement – situations related to issue of financial products
s 1012DAA	Rights issues for which product disclosure statement is not required
s 1012DA	Product disclosure statement not required for sale amounting to indirect issue
s 1013D	Product disclosure statement content – main requirements
s 1013E	General obligation to include other information that might influence a decision to acquire
s 1013F	General limitations on extent to which information is required to be included
s 1016A	Definition of restricted issue

Source	Description
s 1017A	Obligation to give additional information on request
s 1017D	Periodic statements for retail clients for financial products that have an investment component
s 1017E	Dealing with money received for financial product before the product is issued
s 1017F	Confirming transactions
s 1017G	Certain product issues and regulated persons must meet appropriate dispute resolution requirements
s 1018A	Advertising or other promotional material for financial product must refer to product disclosure statement
s 1019A	Situations in which this Division applies (cooling-off periods)
s 1020AI	Requirement to give information statements for CGS depository interest is recommending acquisition of interest
s 1023C	Application of product intervention orders
s 1023D	ASIC may make product intervention orders
s 1023E	Significant detriment to retail clients
s 1023L	ASIC to issue public notice of product intervention orders
s 1023N	Production intervention orders may require notification
s 1023P	Enforcement of product intervention orders
s 1023Q	Civil liability
s 1023R	Additional powers of court to make orders
s 1100ZC	Making offers under this Division (Division 1A – Employee share schemes)
s 1212	Application for registration (Australian passport funds)
s 1213	Notice of intention to offer interests in a foreign passport fund
s 1222K	Retail CCIV test
s 1241J	Agreements with certain unlicensed persons
s 1241N	Prohibition on hawking securities in a CCIV
s 1317E	Declaration of contravention of a civil penalty provision
s 1527	Application of best interests obligations
s 1531B	Best interests obligation
s 1546A	Definitions – definition of existing provider
s 1546E	Application of continuing professional development standard for relevant provider
s 1546W	Obligation to notify ASIC of certain information
s 1546X	Obligation to notify ASIC of CPD year

Table 3. References to ‘wholesale client’ in the Corporations Act

Source	Description
s 761A	Signpost definition of wholesale client
s 761G	Meaning of retail client and wholesale client
s 798A	Matters to be taken into account by the Minister
s 827A	Matters to be taken into account by the Minister
s 911A	Need for an Australian financial services licence
s 923C	Restriction on use of terms ‘financial adviser’ and ‘financial planner
s 924A	Agreements with certain unlicensed persons
s 1018A	Advertising or other promotional material for financial product must refer to product disclosure statement
s 1023D	ASIC may make product intervention orders
s 1241J	Agreement with certain unlicensed persons

Table 4. References to ‘sophisticated investor’ in the Corporations Act

Source	Description
s 708*	Offers that do not need disclosure
s 734*	Restrictions on advertising and publicity
s 761A	Definitions – meaning of derivative retail client money
s 761A	Definitions – meaning of derivative retail client property
s 761GA	Meaning of retail client – sophisticated investors

*Note: The Chapter 6D definition of sophisticated investor applies to this section.

Appendix B: List of consultation questions

Chapter 1 – Wholesale client thresholds

1. Should the financial threshold for the product value test be increased? If so, increased to what value and why?
2. Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?
3. Should certain assets be excluded when determining an individual's net assets for the purposes of the individual wealth test? If so, which assets and why?
4. If consent requirements were to be introduced:
 - (a) How could these be designed to ensure investors understand the consequences of being considered a wholesale client?
 - (b) Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?

Chapter 2 – Suitability of scheme investments

5. Should conditions be imposed on certain scheme arrangements when offered to retail clients? If so, what conditions and why?
6. Are any changes warranted to the procedure for scheme registration? If so, what changes and why?
7. What grounds, if any, should ASIC be permitted to refuse to register a scheme?

Chapter 3 – Scheme governance and the role of the responsible entity

8. Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?
9. Should ASIC be able to direct a responsible entity to amend a scheme's constitution to meet the minimum content requirements, similar to the CCIV regime?
10. Are changes required to the compliance plan provisions to ensure compliance plans are more tailored to individual schemes? If so, what changes and why?
11. Should auditors be legislatively required to meet minimum qualitative standards when conducting compliance plan audits? If so, what should these standards be and why?
12. Should responsible entities be required to have a majority of external board members, similar to the CCIV regime?

Chapter 4 – Right to replace the responsible entity

13. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of a listed scheme? If so, what changes and why?
14. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of an unlisted scheme? If so, what changes and why?
15. In what circumstances should an existing responsible entity be required to assist a prospective responsible entity conduct due diligence? What might this assistance look like?
16. Should there be restrictions on agreements that the responsible entity enters into or clauses in scheme constitutions that disincentivise scheme members from replacing a responsible entity? If so, what restrictions may be appropriate?

Chapter 5 – Right to withdraw from a scheme

17. Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?
18. Are any changes required to the procedure for withdrawal from a scheme? If so, what changes and why?
19. Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?

Chapter 6 – Winding up insolvent schemes

20. Are any changes required to the winding up provisions for registered schemes? If so, what changes and why?
21. Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members and creditors? Are there certain aspects of the existing company and CCIV insolvency regimes that should be adopted?
22. Should statutory limited liability be introduced to protect personal assets of scheme members in certain circumstances? If not, why not?

Chapter 7 – Commonwealth and state regulation of real property investments

23. Do issues arise for investors because of the dual jurisdictional responsibility when regulating schemes with real property? If so, how could they be addressed?

Chapter 8 – Regulatory cost savings

24. What opportunities are there to modernise and streamline the regulatory framework for managed investment schemes to reduce regulatory burdens without detracting from outcomes for investors?