KING&WOOD MALLESONS
金杜律师事务所

Level 61
Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000
Australia

T +61 2 9296 2000
F +61 2 9296 3999

www.kwm.com

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To The Director
Investment Funds Unit
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600
misreview@treasury.gov.au

Review of the regulatory framework for managed investment schemes – Submissions in response to consultation

1 Background and overview

We refer to the Review of the regulatory framework for managed investment schemes (**MIS**) Consultation paper (**Paper**) released on 4 August 2023 and the invitation from the Treasury to provide feedback on the issues raised in the Paper.

We particularly welcome the opportunity to make a submission because our firm has had a market-leading practice as lawyers to the investment funds industry and major institutional investors since the commencement of the *Managed Investments Act 1998* which introduced the existing MIS regime. Our practice is focused on the full range of types of registered managed investment schemes structured as unit trusts that have been deployed by financial institutions including cash funds, retail and wholesale equity and debt funds, listed and unlisted property and infrastructure funds, listed investment trusts, institutional club structures, ETFs and other exchange traded products quoted on AQUA or Cboe.

Our submission is limited to the questions to which our experience and legal expertise is most relevant, and generally does not comment on matters of general public policy which are more the realm of commercial industry participants. It covers the following matters (adopting the numbering in the Paper):

- Chapter 3: Scheme governance and the role of the responsible entity (**RE**)
- Chapter 4: Right to replace the RE – voting thresholds
- Chapter 5: Right to withdraw from the scheme – matching withdrawal terms to liquidity of assets
- Chapter 8: Regulatory cost savings – under this category we address the potential for improvements in the clarity and efficiency of the MIS regime, such as incorporating the effect

of certain ASIC Class orders into legislation, providing for limitation of investors' liability, tailoring the impact of the reportable situations regime and other technical and practical suggestions.

We also comment briefly on technical issues with the retail/wholesale client test (Chapter 1), suitability of scheme investments (Chapter 2) and winding up of schemes (Chapter 6).

2 Chapter 3: Scheme governance and the role of the responsible entity – in particular scheme constitutions

8. Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?

In relation to Chapter 5C of the Corporations Act (**Act**), no - but there could be more changes to other parts of the Act that would continue to enhance overall regulation.

The Australian Law Reform Commission report from 1993, *Collective Investments: Other People's Money,* laid out the foundational ideas on which the managed investments regime in Chapter 5C was based. One of those ideas, which is still valid today, was to consider the types of risk taken by those who participate in collective investments: investment or market risk, institution risk and compliance risk.

The regime, when it was introduced, was directed at institution risk and compliance risk and, we would argue, has been relatively effective in dealing with those issues, noting that it is not possible for regulation to entirely prevent dishonest conduct. On investment risk, the report noted that "The law governing collective investment schemes cannot – and should not – eliminate investment risk. The cost of doing so would be too great, and fund managers would be discouraged from devising innovative financial products. The law can, however, ensure that investors are given, as clearly and simply as possible, all the information they need to understand fully, and judge for themselves, the level of risk involved in the investment."

The effect of the MIS governance regime in deterring misconduct was enhanced in October 2021 by changes to breach reporting requirements. These made any breach of an RE's statutory duties a "deemed reportable situation" that must be reported to ASIC regardless of materiality. This has increased the focus of RE directors on the nature of their duties, compliance systems and reporting[1].

If there have been weaknesses in the regulation of managed investment schemes over the last two decades, it has not been in the duties imposed on the responsible entities that operate them or the compliance structures they are required to have in place, but in commissions and other incentives for intermediaries to market investments, and disclosure to investors being less effective than it could be.

The introduction of the Future of Financial Advice (**FoFA**) laws in 2013 and the Design and Distribution Obligations (**DDO**) regime in 2021 have gone a long way to addressing the issues with marketing of funds, but since then, nothing meaningful has been done to reduce the complexity

[1] There has however been an unintended consequence of this change, in that breaches of compliance plans that are immaterial must be reported to ASIC. See the reference to section 601FC(1)(h) in part 5 below. There is also some concern that the duty of licensees, including responsible entities, to provide financial services efficiently, honestly and fairly under section 912A(1)(a) of the Act has a very broad and uncertain scope, and was originally intended as part of the guardrails for licensee conduct rather than a specific prohibition punishable by civil penalty.

(and therefore increase the effectiveness) of disclosure laws. Research in the field of behavioural economics has shown that most investors do not read product disclosure statements, and that many rely on recommendations from friends or on social media.

With FoFA and DDO in place, for unlisted funds there could now be a major simplification of disclosure to fund investors, reducing it to a few pages with a brief description about how the product actually works, and a traffic light system to label products according to risk. More detailed information[2] could be on a website. The large amount of prescribed language in an 8 page "shorter" PDS for simple managed investment schemes obscures the key information on product features and risks. There is an over-emphasis on pro forma warnings and providing information which allows comparison of different products, with the result that the ability to understand and assess the particular product itself is lost.

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?

Direction powers

Section 1223C of the Act gives ASIC powers to direct the corporate director of a CCIV to modify the CCIV's constitution to ensure it complies with certain content requirements. The content requirements for a CCIV constitution are, however, narrower than those applicable to a MIS. In particular, the CCIV regime has no equivalent of section 601GA(1)(a) of the Act in relation to the issue price of scheme interests, a matter which takes up 19 pages of ASIC's Regulatory Guide on constitutions, arguably giving an emphasis on, and interpretation to, the subsection way beyond its intent.

It follows that introducing a power for ASIC to direct modification of a MIS constitution would have broader reach than the equivalent CCIV power, and this should be considered in deciding whether such a power is appropriate.

If the Government decides to introduce a directions power:

- it would need to be limited to newly established schemes, so that the rights and expectations of existing fund investors to have a MIS continue as-is are not disturbed and, importantly, should be limited to amendments required for the constitution to comply with the Corporations Act and which would not adversely affect the scheme or the rights of any member (such as the tax and stamp duty consequences that may flow from amending a trust instrument, or adverse effects under contracts including financing agreements, which typically contain a provision preventing amendment of the constitution without bank consent); and

- it should only be on the basis that the 14 day registration process for registered schemes is abolished, so that ASIC does not review the constitution before the scheme is launched, and schemes are registered in the same timeframe as CCIVs and other companies.

[2] Such as the fee disclosure tables prescribed by ASIC in Regulatory Guide 97 and Instrument 2019/1070.

Other issues with constitutions

Although not covered in Treasury's set of questions, we offer the following additional observations on scheme constitutions and the registration process:

- *Unit pricing*. We propose that section 601GA(1)(a) of the Act be amended by removing the word "adequate" from the expression "make adequate provision". This would put the regulation of MIS and CCIV on the same footing and remove the basis for the prescriptive regulation of unit pricing in Regulatory Guide 134 and the Class Order ASIC has made to implement their broad interpretation of section 601GA(1)(a). Earlier this year there was a proposal[3] to move the substance of what was then ASIC Class Order [CO 13/655][4] into legislation which was ultimately, quite rightly, abandoned. The provisions that had been proposed were inflexible and carried heavy penalties for breach. It illustrated the difficulty of hard-wiring into legislation a process that must, of its nature, be flexible. When issuing units, responsible entities are required to act in the best interests of members, and the circumstances when it is necessary to discount, round or otherwise adjust prices to produce a fair result as among existing, incoming and outgoing investors are numerous and complex. A simple requirement for the constitution to make provision for determining the price should be sufficient, because the RE must comply with the constitution, and in exercising any discretion act in the best interests of members. The additional layer of prescriptive unit pricing rules is unnecessary and creates unjustified concern when there are minor variations in prices for example due to information on expenses becoming available after the time when the price had to be calculated[5].

- *ASIC review*. We understand that ASIC applies an internal policy for review of constitutions lodged with a scheme registration application. In this way, ASIC uses the 14 day registration period and its obligation under section 601EB to consider the compliance of the documents lodged to impose requirements under its internal policy which go beyond the wording of Chapter 5C. Requisitions consistently raised during this process include a request to use the definition of "Member" in section 9 of the Act (which is incompatible with the concept of a "unit holder" in a unit trust[6]), and to require that redemption proceeds in liquid funds be paid within 21 days of redemption, neither of which has any basis in the Act.

- *Amending the constitution*. Uncertain drafting in section 601GC(1) of the Act has meant that the provision has been the subject of many cases over the years, culminating in *360 Capital RE Ltd v Watts* (2012) 36 VR 507 and the High Court's decision in *ASIC v Lewski* [2018] HCA 63. It is now clear that a scheme constitution cannot be amended without a meeting if the change is adverse to the right of members to have the scheme administered according to the existing terms of the constitution, making the opportunity to amend a constitution without a members' meeting extremely narrow. An amendment of section 601GC(1)(b) to expand its scope to have at least some efficacy[7] would be desirable. This could be achieved by making

3 *Treasury Laws Amendment (Measures for Consultation) Bill 2023: Rationalisation of ending ASIC instruments (Tranche 2)*

4 Now reissued as Instrument 2023/693.

5 The Financial Services Council has for many years published guidance on materiality tolerance in unit pricing errors (currently FSC Guidance Note 26). This is widely adopted as industry practice but does not afford the protection that clarification of the law could provide.

6 If the section 9 definition were used, "Member" would then mean anyone with an interest in the scheme. In a typical constitution, the term Member is explicitly used to mean a person *who holds a unit* – and distinguishes them from others who may have an "interest" in the scheme, such as the holder of an option or a person whose units have been redeemed and who awaits payment. Obviously such persons should not be entitled to participate in per-unit distributions, for example.

7 See the judgement of Barrett J in *Re Centro Retail Limited and Centro MSC Manger Limited* [2011] NSWSC 1175

the concept of "rights of members" narrower than the blanket right to have the scheme administered in accordance with its precise existing terms. As Barrett J pointed out in *Re Centro Retail Ltd* [2011] NSWSC 1175, there must have been a legislative intent for the section to have some scope to operate. There are valid reasons why the amendment provision is different to that for companies, where a special resolution is required for any amendment to the company constitution. First, the Act and ASIC's interpretation of it require specific content, and consequently constitutions are detailed and prescriptive, whereas company constitutions are more standardised. Secondly, most managed investment schemes are structured as trusts, and a trustee has only the powers set out in the constitution (and limited powers under trustee legislation), so it may be unable to act in certain situations without a constitution amendment. By contrast, a company has the powers of a natural person under section 124 of the Act.

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?

No. There is already a requirement for a compliance plan to set out adequate measures in relation to compliance with the particular scheme's constitution, and the relevant provisions of the Act. Given that the same legislative regime applies to all registered schemes, and that constitutions vary more according to fund type (listed, ETF, unlisted) and generally don't limit the investment mandate, there is a high degree of commonality in the requirements for checking under the compliance plan among funds operated by the same RE. The fact that a single compliance plan, with necessary modifications, can apply across a suite of products is appropriate and efficient. Requiring significant differences among plans may increase the likelihood that oversight is not carried out because it is too complex and burdensome for the available compliance resources.

We do not have any comments on question 11.

12. Should responsible entities be required to have a majority of external board members, similar to the CCIV regime?

There is anecdotal evidence that one reason for reluctance by industry participants to adopt the CCIV regime is the need for the Board of the corporate director to be at least half independent. There is also a perception in some quarters that compliance committees can sometimes perform the monitoring function better than an independent Board would be willing or able to do, because the function involves attention to detail at an operational level and independent directors may take a more high level approach to governance, particularly in large organisations. To address any concerns with the model, compliance committees could be given additional powers, for example to require a matter of concern to be added to the Board's agenda.

One alternative for alignment of the regimes would be to allow CCIVs to use the compliance committee approach.

3 Chapter 4: Right to replace the responsible entity – voting thresholds

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?

The threshold of an ordinary resolution to remove the RE of a listed MIS should remain, because it leaves listed trusts on an equal footing to listed companies for changes of directors. Where the RE has chosen to list a trust on ASX, seeking the advantages of liquidity for investors and growth through public market fundraising, it should be exposed to the same scrutiny and risk of removal of management as a listed company. Sections 601FS and 601FT of the Act support listed trust takeovers by statutory transfer of assets and contracts to a new RE following change of responsible entity.

In the original MIS legislation, there was an oversight in not giving members holding 5% of units the power to convene a meeting to pass an ordinary resolution to change the RE. This issue, which arose in *MTM Funds Management v Cavalane Holdings Pty Ltd* [2000] NSWSC 922, was solved by an ASIC Class Order (currently CO 13/519) which is due to expire this year and be reissued. Its substance should instead be incorporated into the legislation.

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?

Yes, this is an aspect in need of reform. This is clearly demonstrated by the 188 instruments of ASIC relief, amending section 601FL, that have been issued over time. This section imposes the requirement for an extraordinary resolution of members to change the RE of unlisted funds. An extraordinary resolution is defined in section 9 of the Act to require "at least 50% of the total votes that may be cast by members entitled to vote on the resolution" to be in favour. This has the effect that every unit held by a member entitled to vote that is not voted is effectively a vote against the resolution. In practice this requires a huge effort to round up members to turn out and vote. In addition to the required 'campaign' for a change of RE, there are difficulties with (i) an increasing volume of investments being held through investor directed platform structures, where the platform either cannot or will not facilitate voting; and (ii) exclusion of votes where units are held by an associate of the retiring RE, which is quite common where there are feeder funds or 'building block' funds. In the absence of ASIC relief, this can leave an RE unable to retire and be replaced, even where this would be in members' interests.

For example, when a company is exiting the business of funds management and wanting to hand over to a qualified and reputable replacement, the change is clearly in members' best interests but it can be impossible to have the vote passed because of the factors above.

The CCIV legislation addressed this point by providing for a change of corporate director upon a special resolution in all cases, both listed and unlisted (section 1224U). However, a special resolution threshold has its own difficulties. The threshold it imposes is 75% of the votes that are actually cast, no matter how small the number of units that are voted. If this threshold were introduced for the MIS, an RE that has spent the resources to establish a fund and meet investors needs through careful management and produced good returns, and so has a legitimate commercial interest in continuing to operate the fund, could be more easily removed by an activist or competitor buying 5% of the units, convening a meeting and passing a special resolution with potentially only that 5% voting, if other members don't vote (including because of the factors above). An activist or competitor, before they or their associates become RE, has no duties to members and can take over the operation of the scheme even if the change would be contrary to members' best interests.

A compromise that could facilitate appropriate changes of RE without creating this problem would be to set the voting threshold as a special resolution, but impose a condition that the meeting must have a particular quorum greater than the 5% required to requisition the meeting. This could be set at a level to ensure the vote is properly representative of members' wishes. For example, the quorum might be members present in person or by proxy holding at least 25% of units eligible to be voted. The vote would then be more properly representative of members' needs and wishes, but not set a major practical hurdle for the exercise of consumers' rights.

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?

We submit that no additional obligations should be imposed on the incumbent RE when a change is proposed. Section 601FR already requires a former RE to hand over the books and records of the fund as soon as practicable after the change, and give other reasonable assistance to the new RE to facilitate the change. If the change is agreed between the retiring and incoming RE, due diligence enquiries are facilitated. If the replacement arises in hostile circumstances, requiring the threatened RE to hand over information about its business would be unreasonable.

Whilst we recognise the importance of the RE removal right as a consumer protection mechanism where an RE is failing in their duty to manage the scheme properly, the removal right can also be used by particular members who are competitors or who are motivated purely by short term profit.

In such situations, the playing field as between an incumbent RE and those proposing a potential replacement is already very uneven. An activist or competitor, before they become RE, has no duties to members but they can acquire 5% of interests in a scheme and convene a meeting[8]. No voting restrictions apply to them (or their related bodies corporate) under section 253E of the Act, even where they or their associates have an interest in the outcome of the vote "other than as a member".

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?

No further restrictions are required. There are already various protections in the existing legislative and regulatory framework. They include:

- **Duties of RE to act in best interests of members:** REs are subject to a duty to act in the best interests of members and to give priority to members' interests over those of the RE (s601FC(1)(c)). This duty would already prevent an RE from entering into an arrangement designed to "entrench" its position at the expense of members' ability to exercise their rights to replace it once the scheme is registered.
- **No right to recover "break fees" or similar on removal:** Section 601GC(2) provides that an RE can only be paid fees out of scheme property where those are in relation to the proper performance of its duties. This provision already prevents an RE from recovering "break fees", "accelerated fees" or similar fees triggered by moves to replace it. See ASIC Regulatory Guide 135 at [134.158].
- **Related party transactions:** Once a scheme is registered, agreements with related parties are subject to the requirements of Chapter 5C.7 of the Act, which applies Chapter 2E to registered schemes (with targeted changes to reflect the registered scheme construct). Any arrangements that might have the effect of "entrenching" a responsible entity via agreements with related parties are already regulated under a well established and well understood framework.
- **The special case of listed schemes**: An additional specific restriction applies to a listed MIS under ASX Listing Rules. Management contracts, entrenching a related party of the RE as

[8] For example, see *E&P Investments Ltd as responsible entity of US Masters Residential Property Fund* [2022] NSWSC 1781

manager of a fund, are limited to 5 years unless the circumstances justify an ASX waiver to allow for a 10 year contract (see ASX Guidance Note 26). As noted above, the rules applying to listed funds are justified by the need for equivalence with listed companies. Any further restriction applicable to schemes generally would impact on this equivalence for listed schemes, and is not desirable.

If, notwithstanding the above, a restriction on "disincentives" were introduced, a high degree of care would be needed in defining the concept, so as to avoid the risk of inadvertently putting investors in registered schemes at a disadvantage or unduly restricting the types of investments that a registered scheme can make. In particular, third parties contracting with responsible entities may have legitimate commercial and regulatory reasons for negotiating provisions which are triggered by replacement of the RE (or the taking of steps to effect such a replacement). Such provisions should be expressly excluded from any concept of "disincentive". For example:

- **Financing agreements:** it is standard market practice for banks and other financiers to include provisions that would be triggered by a change of RE (or the taking of steps to make such a change) without consent. Imposing any restriction which would (or might) capture such provisions would make it difficult (if possible at all) for registered schemes to obtain financing, putting them at significant disadvantage, to the detriment of members.
- **Transfer restrictions and change in control provisions in underlying arrangements:** similarly, pre-emptive rights regimes and change in control provisions are market standard in consortium/joint-ownership arrangements, particularly in the case of long term assets such as infrastructure and real property. Other consortium/co-owner parties have a legitimate commercial interest in the identity of the person "sitting across the table" from them. If REs are unable to enter into arrangements containing such terms, that may effectively prevent registered schemes from investing in such assets, again to the detriment of investors looking to obtain exposure to such assets through registered schemes.
- **Regulatory/KYC requirements of counterparties:** many counterparties will have regulatory and internal process requirements around conducting due diligence enquiries concerning parties with whom they contract. We expect that this will only increase with the current regulatory and commercial focus around ESG (including obligations to measure/consider ESG factors at all levels of an entity's supply chain or contractual matrix). Again, given the "statutory novation" regime, such counterparties often require consent (or termination) rights in the context of a change of RE. There should be no risk that these could be seen as prohibited "disincentives".
- **Market standard change in control/transfer restrictions in concession agreements:** particularly in the case of infrastructure assets, government counterparties to concession agreements and the like would typically include change in control/transfer restrictions as standard. These assets are often highly sought after. Requiring an RE of a registered scheme to resist the standard provisions (or even to seek to negotiate for their removal, particularly in a competitive bid situation where deviation from the "standard" can count against bidders) would put registered schemes at a disadvantage, to the detriment of investors.

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4 Chapter 5: Right to withdraw from the scheme – matching withdrawal terms to liquidity of assets

17. Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?

The test for whether a managed investment scheme (**MIS** or **Fund**) is liquid in Part 5C.6 of the Act has worked well over the 25 years since it was legislated, and is not in need of any significant reform. ASIC's report of 30 April 2021 found that retail managed funds had responded well to the challenges of Covid-19 in 2020, noting that "their liquidity frameworks were generally adequate".

The key benefits of the existing approach include:

- The RE is not required to give members a right to withdraw from the Fund (sections 601KA and 601GA(4)). This has allowed a range of redemption terms that are adapted to the nature of the Fund's assets and its investment mandate. This type of flexibility has supported the enormous growth in collective investments in MIS form over the two decades.
- The mathematical nature of the liquidity test in section 601KA(4) has given REs clarity as to how to determine when a Fund ceases to meet the test. Despite some challenges in application, this test is far preferable to a qualitative or fluid concept which would make fund compliance and operations more difficult and less consistent across the industry.
- The fact that the reference point for liquidity in section 601KA(5) is the period specified in the constitution for satisfying withdrawal requests[9] has given the flexibility for MISs to be the vehicle for diversified investments in property and infrastructure for retail investors, including on investment platforms. If the legislation had not operated in a flexible way, the choice for investors would have been limited to fixed term closed end funds or listed funds, as opposed to the broad choice that has delivered returns from those sectors to large numbers of superannuation and non-super investors. An investment of this kind as a conservative proportion of an investment portfolio is a valuable supplement to investments in debt and market-traded equities.

In the early years of the MIS regime, some aspects of the working of the liquidity and redemption provisions were unclear. This was remedied by the decision of the NSW Supreme Court in *Basis Capital Funds Management v BT Portfolio Services Ltd* [2008] NSWSC 766, which settled questions as to the time when units in a scheme are redeemed, the rights of redeemed former members and the time when units are issued on application. In our experience, there is no longer material uncertainty as to the working of Part 5C.6, and any difficulties tend to stem from the drafting of constitutions for particular funds.

18. Are any changes required to the procedure for withdrawal from a scheme? If so, what changes and why?

It may be helpful to:

- build into the legislation the substance of the relief ASIC gives for withdrawals from illiquid schemes in cases of consumer hardship; and

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9 In rare cases, we have seen constitutions that do not specify a period. It should be a mandatory content requirement for scheme constitutions.

- modify section 601KB to allow withdrawals that are not perfectly pro rata among members to "mop up" tiny amounts left over after a withdrawal offer process is completed. For example, if a withdrawal offer is made and the members who participate have (say) 90% of their units redeemed, they should be able to redeem the remaining (say) 10% in full in the next round of offers, rather than be scaled back again and again on subsequent pro rata withdrawal offers to ever diminishing holdings. This creates frustration for members wishing to exit and continuing administrative work for REs on tiny sub-scale holdings. The ASX Listing Rules that allow small holdings to be sold might be a point of reference for this change. The threshold could be a percentage of units or a dollar amount.

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?

In a relatively recent case[10], the Federal Court considered a credit fund which allowed in its constitution 365 days to process redemptions but was advertised as having a 48 hour redemption facility. In the case, ASIC was successful in prosecuting a breach of disclosure laws, that is, it was misleading to create the impression that redemptions would always be processed in 2 days when the RE had the discretion to take a year. This was a problem with disclosure – communicating the facts of the fund to investors – not the design of the fund itself. In a financial crunch it may well have been the best approach not to be forced to fund redemptions by selling fund assets such as mortgages or bonds before their maturity, preserving their capital value in the best interests of members overall.

The topic of a mismatch between redemption terms and liquidity of fund assets, and specifically the need for funds to have flexible levers to deal with redemption requests in times of market dislocation, is discussed in the recent consultation papers published by IOSCO and the Financial Stability Board (FSB). The FSB has identified redemptions from open ended unlisted funds as a risk to the global financial system unless liquidity management tools and anti-dilution arrangements are in place.

The papers recommend that funds should adopt longer settlement periods and use suspensions, redemption gates, in-kind redemptions and side pockets to manage redemptions, as well as pricing redemptions to attribute to redeeming investors not only brokerage-type costs but also market effects of their redemptions.

It is striking that Australia's MIS regime is already flexible enough to accommodate these redemption management tools. As Treasury's paper notes, it is the US and EU that have restrictive rules and are apparently the cause of the FSC's concern. Adopting anything of that kind in Australia would be a backwards step, inconsistent with the international recommendations. Changing the concept so that a fund is only allowed to process withdrawals on demand if 80% of assets can be sold within (say) 30 days would result in open-ended property and infrastructure funds ceasing to be available to retail investors, which cannot be considered progress.

The only change that may be helpful would be to mandate prominent disclosure to investors of the maximum allowable period for processing withdrawals.

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[10] *ASIC v La Trobe Financial Asset Management Ltd* [2021] FCA 1417

5 Chapter 8: Regulatory cost savings

We see significant opportunities to make some tidy-up changes to the MIS legislation, and to lighten the load of paperwork for responsible entities, without materially diminishing investor protection. These include:

(a) **Moving certain long standing ASIC legislative instruments of general application (Class orders) into the Act** or the Corporations Regulations.

ASIC legislative instruments of general, as opposed to individual, application should not be used to modify the law on an indefinite basis. We submit that there should be a full legislative review process of all long-standing ASIC Class Orders that are intended to operate for the foreseeable future, to determine whether it is appropriate to incorporate them into the Act or the Corporations Regulations or if they should be repealed. We strongly support this process both from a general policy and primacy of law perspective. We note that some instruments have already been moved to legislation, apparently driven by the work of the Australian Law Reform Commission on the undue complexity of the financial services legislation, and we are keen for this to continue. In our view, doing so would reduce complexity and improve navigability of the legislative regime, as there will be one fewer source that needs to be checked to determine what the law is, and the name and number of the relevant provision will not change over time. This will be more accessible and less confusing for users of the legislation. Incorporating these Class Orders into the Act would also have efficiency benefits by obviating the need for ASIC to maintain (and users to keep abreast of) the law, as and when Class Orders approach the end of their sunset period.

Many ASIC instruments set out lengthy detailed requirements, including for maintenance of policies and record keeping, that do not necessarily bring a consumer benefit proportionate to the resources required to fulfil them. For this reason, the process of translation into legislation should also involve simplification, particularly for provisions that will be in the Act rather than Regulations. This will, of course, require public consultation for reasonable periods where there is a possibility that the new drafting will change the effect or impact of the law. We also submit that, in this process, the application of higher penalties for breach such as civil penalties should be avoided unless there a good reasons specific to a particular case.

Examples of Class Orders that could be considered for incorporation in legislation include the following:

- The Class Orders relating to custody of assets (CO 13/1409 and 13/1410) could move into more simply drafted regulations, as was done for CCIVs. The difference between the Class Orders and the CCIV Regulations largely relate to reducing paperwork. The RG 133 reforms to which these Class Orders relate have generally been protective of members' assets, but the requirements for policies and record keeping are more onerous than is justified by any perceived regulatory benefit they may provide.

- A small sample of others that might be considered for the Act or Regulations include LI 16/1054 (Top up PDS relief), Instruments 2023/668 and 669 (Investor directed portfolio services), LI 2020/1090 (DDO for ETFs) and LI 2023/647 and 648 (Licensee financial requirements).

- Some Class Orders stand out as most likely not suitable to be legislated due to being unnecessarily prescriptive, such as Instrument 2019/1070 (Disclosure of fees and costs), and the unit pricing Instrument 2023/693 (see our comments at question 9 above).

(b) **Providing for limitation of investors' liability.** A provision should be added for MIS, equivalent to section 516 of the Act which limits the liability of shareholders in companies (including CCIVs) to the price of the shares. The decision in *JW Broomhead (Vic) Pty Ltd (in liq) v JW Broomhead Pty Ltd* [1985] VR 891 supported the idea of limited liability, but the absence of High Court authority left doubt on the point until the rule in *Hardoon v Belilios* was abolished, at least in NSW, by section 101A of the *Trustee Act* 1925 (NSW). That section in New South Wales, introduced in 2019, has been helpful but as this is a Corporations Act issue it should be dealt with at Commonwealth level. Although domestic investors have largely been unconcerned about this gap in investor protection, foreign investors have sought legal opinions on the nature of the risk, and in a market downturn it could have real consequences for consumers. We endorse the recommendation of prior CAMAC reports on this, as noted in section 6.3 of the Paper.

(c) **Tailoring the impact of the reportable situations regime.** The issue is that in its current form, the Act requires reporting to ASIC of all breaches of the compliance plan of a registered managed investment scheme, regardless of materiality. A compliance plan is a process document which sets out in granular detail the process for the RE to check that all requirements in operating a scheme under the Act and the scheme's constitution are complied with. This has resulted in ASIC receiving numerous reports of breaches of a trivial nature, which may have added to ASIC's regulatory burden. For REs, it creates administrative work and often incurs legal costs without any corresponding regulatory or consumer benefit. The problem occurs because the RE's duty to comply with the compliance plan is set out in section 601FC(1)(h) of the Act, and the whole of section 601FC(1) is a civil penalty provision (see section 1317E). Section 912D(4)(b) provides that a breach of a core obligation (which includes Chapter 5C) that is a civil penalty provision is a deemed significant breach and therefore a reportable situation, unless the civil penalty provision is excluded by the Corporations Regulations. A review of all Corporations Act civil penalty provisions would be desirable, to check that it is appropriate for them to trigger automatic breach reporting.

(d) **Facilitating product rationalisation.** The Financial Services Council has been calling for some time for measures to facilitate the merging, closing down or transition of 'legacy' funds so that fund offerings can be modernised and streamlined. To the extent this can be done without any taxation or other consequences for members, it should reduce costs and complexity in the industry and generally be in the interests of consumers. Any comment on the tax changes required to achieve this is beyond the scope of this submission, but we do note that provisions to allow registered schemes a smooth transition to become CCIV sub-funds would be one path to a more efficient managed funds industry. We would be happy to provide more detail of how this could be achieved.

(e) **Other technical and practical suggestions** for improvements in the MIS Regime are set out below in the order the sections appear in Chapter 5C of the Act.

#	SECTION	ISSUE/SUGGESTION
1	601EB	Abolish the 14 day ASIC review period. This would address the concern that the review suggests ASIC has "approved" the scheme's business model (as mentioned in the Senate Committee report on Stirling Income Trust) and would reduce the resources ASIC is required to spend on this function.

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#	SECTION	ISSUE/SUGGESTION
3	601FC(1)(h)	We suggest separating out this provision into a new section or paragraph which is not a civil penalty provision, and require reasonable steps to comply, not strict compliance. Currently all breaches of a compliance plan (eg a missed report) are deemed reportable situations. See paragraph 5(c) above.
8	601HC	It does not seem logical that all RE directors have to sign the compliance plan and all changes to it, when the constitution can be executed by one director and the secretary under section 127 of the Act. Obtaining signatures from all directors can create practical difficulties. Signature by one director should be sufficient.
9	601MA(1)	A small point - the heading "Where recovery *against scheme* may be made". As the section is related to recovery against the RE personally (not out of scheme property) where it has breached its duties, the heading should reflect that.
10	601PA	There is a drafting problem with this section that means that schemes with all wholesale clients, all of whom consent, can't deregister if the fund had any retail clients at any time during its existence. This is because the section references section 601ED(2) which refers to a PDS not being required for the offers *when they were made*. This could be solved by an additional paragraph allowing deregistration if all the members are wholesale clients and they all consent to the deregistration.
11	252S(2)	Where a competitor of the incumbent RE has (or influences) 5% of units and requisitions a meeting, this section allows members present at the meeting to elect their own Chair of the meeting even if the RE is willing and able to appoint a chair of the meeting. The Chair has significant powers not only to control the conduct of the meeting but to rule on such matters as validity of votes. Members of a scheme have no duties to other members to conduct matters properly, but the incumbent RE and its directors do have statutory duties. To ensure an orderly process from the commencement of the meeting, the RE should be able to appoint the chair of a requisitioned meeting in all cases, with election of the Chair from the floor only applicable if the RE has not appointed a Chair or, with the meeting having commenced with the RE's nominated Chair in office, a vote on the chair is requested (with a certain % support) at the meeting.
14	Add	As recommended by CAMAC, liability of members should be limited to the amount they subscribe, as in section 516 of the Act for companies. See paragraph 5(b) above.

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#	SECTION	ISSUE/SUGGESTION
15	Add	As recommended by the Senate Committee, the name of current RE and the date it commenced as RE should be made public on ASIC Connect. Currently a paid search is required for this key information.

6 Chapter 1: Wholesale client thresholds

We make no comment on any change to the monetary thresholds required to be treated as a wholesale client, as this is a policy rather than a legal matter.

However, we note the following technical and drafting points for consideration by Treasury:

(a) **Grandfathering**. If the thresholds to qualify as a wholesale client are increased, transitional arrangements that do not undermine existing rights and obligations will be required. We propose that, in respect of a product (including an interest in a MIS) that has been issued to a person at a time when they qualified as a wholesale client, that person should continue be considered a wholesale client in respect of all financial services associated with the product. Alternatively, in the context of the accountant certificate category in section 761G(7)(c), it should be possible for an investor to obtain a certificate from a qualified accountant which applies the current monetary thresholds in respect of such services. In the context of MIS, we note the following:

a. **General advice**: Product issuers generally provide monthly or quarterly updates to existing investors, which may include recommendations or statements of opinion that amount to advice.

b. **MIS - other ongoing financial services**: Responsible entities of registered MISs, and trustees of unregistered MISs, provide a number of other ongoing financial services to MIS members. A responsible entity provides an ongoing responsible entity service by continuing to operate the registered MIS, and a trustee of an unregistered MIS provides an ongoing custodial or depository service by holding MIS assets that are financial products. Further, both a responsible entity and trustee provide an ongoing dealing service by acquiring and disposing of MIS assets that are financial products on behalf of MIS members. The responsible entity or trustee may hold an Australian financial services licence which is limited to servicing wholesale clients.

c. **Distribution reinvestment**: Many funds offer a distribution reinvestment plan, which allows distributions of income to be automatically reinvested in the fund, usually at a small discount to the standard unit price. This will involve an issue of units, even though money does not leave or enter the fund. Such arrangements should be permissible as a feature of the existing product, even though they involve the issue of additional units. It should remain possible to treat existing members of a MIS equally on reinvestment, in line with the duty in section 601FC(1)(d).

d. **Scheme registration**: It should be clear that the change of status of an existing investor in an unregistered scheme will not trigger a requirement for the trustee to register the scheme. Section 601ED of the Act already has this effect, but care should be taken not to undermine its operation in any changes. A change of status triggering registration would be impractical because (i) the trustee of an unregistered wholesale fund is typically not licensed to operate registered scheme (ii) the other investors may not want the scheme to be registered because terms may have to be changed and (iii) if the terms of the fund are such that redemptions are not permitted, for example if there is a fixed term, it will not be possible to remove the person from the fund to put an end to breaches of the law that may arise from a change to retail client status.

These aspects of preserving the status of an existing investors would, for practical reasons, need to last indefinitely.

It is a policy matter whether other additional or top-up investments in the same fund would be able to be made by the person. If this exemption was offered, it would be practical for the grandfathering to have an end date.

(b) **The "wealth test" and the "not for use in connection with a business" qualification**. Section 761G(7)(c) refers to financial products or services "not provided for use in connection with a business". This qualification creates compliance challenges for financial service providers, as a client's intended use of a particular financial service or financial product is often unknown. Further, the facts relevant to whether a client is carrying on a business (eg as a sole trader or trustee or a family trust) are often within the sole knowledge of the client. We suggest that the service provider should be permitted to rely on a certification by the client that the service or product will not be used in connection with a business, or the qualification should simply be removed from the wealth test.

(c) **The "price" and "value" tests** (section 761G(7)(a)). The regulations made for the purposes of these tests have some technical deficiencies. For derivatives and foreign exchange contracts, there is only a value test, but not a price test (regulations 7.1.22 and 7.1.22A). The lack of a price test casts some doubt over whether the test is available for the provision of (ie entry into or issue) of a derivative[11] or foreign exchange contract. Secondly, the product aggregation provisions are too narrow (see regulations 7.1.17B and 7.1.19(5)). The aggregation provision in regulation 7.1.19(5) only covers financial product advice and dealing by "arranging". The manager, for example, of a portfolio invested across a range of different financial products for diversification reasons would not be permitted to aggregate the value of the products in the portfolio under the value test. Such a manager would typically deal as agent for their client, which is not "arranging" (see sections 766C(1) and (2)).

(d) **Simplifying the law**. There are multiple Corporations Regulations that affect the meaning of section 761G, and these are dispersed across Parts 7.1 and 7.6 of the Regulations[12]. To the extent practicable, they should be incorporated into the drafting of the Act so the law is clear on its face, particularly as this is such an important test, applied across a wide range of products and services and a "need to know" provision for issuers, advisers and consumers. Changes to the tests to ensure they are unambiguous and specific would also be beneficial both for simplicity of compliance and because increasingly, investment is conducted on-line and without human intervention, so rules need to be capable of being systematised.

7 Chapter 2: Suitability of scheme investments

As noted in section 2 above (Question 8), FoFA and the DDO regime have already provided the regulatory framework to prohibit unsuitable marketing of excessively risky or complex products to retail clients, a practice which had created some of the difficulties with managed investment

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[11] We note that the price or value test is not intended to be applicable to derivatives that are contracts for difference – regulation 7.1.22AA.

[12] Key modifications include Regulations 7.1.11 to 7.1.28 and 7.6.02AB to 7.6.02AF, but there may well be others hidden in the detail.

schemes in the past. No further changes on this point are needed, other than the improvements in disclosure laws noted at Question 8 above.

8 Chapter 6: Winding up of schemes

As we point out at paragraph 5(d) above, clarity around the ability of an RE to wind up, merge or transition an uneconomic scheme without breaching its duties or causing unwelcome tax events for investors should be considered.

In relation to winding up on "insolvency", we make the following observations:

- We agree that there can be difficulties where there is a solvent responsible entity but the scheme ceases to be viable because the liabilities attributable to the scheme exceed its assets. However, the requirements for holding assets on trust and record keeping for commingled assets imposed by ASIC under the legislative instruments related to Regulatory Guide 133[13] should have reduced the difficulties that existed prior to 2015in tracing fund assets on a collapse.
- We can see no simple solution to problems that arise from a single RE/trustee of numerous schemes becoming insolvent, other than the Court promptly ordering a replacement or the insolvency practitioners appointed to the RE/trustee conducting an orderly winding up of the schemes in accordance with the provisions set out in the scheme constitutions.
- In certain circumstances, it may be appropriate for the receivers and managers of the scheme to be different from the insolvency practitioners appointed to the RE/trustee.[14] Currently, section 601FH of the Act does not cater for this scenario and provides that the RE's right of indemnity out of the scheme property may only be exercised by the administrators, deed administrators, liquidators or restructuring practitioners appointed to the RE, rather than the receivers and managers of the scheme. This can lead to litigation and disputes between the two sets of insolvency practitioners, resulting in the further depletion of the scheme property.[15]
- We propose that an exception be introduced so that in circumstances where a scheme's assets are insufficient to meet its liabilities, administrators, deed administrators, liquidators or restructuring practitioners can opt out from the operation of section 601FS of the Act, which provides that all liabilities of a former RE are automatically assumed by the replacement RE. The automatic operation of this section creates significant practical difficulties in finding a company willing to take on the role of the replacement RE in those circumstances.
- The omission of a voluntary administration regime from the insolvency provisions for CCIVs suggests that such an arrangement was considered unsuitable from a policy perspective.
- The suggestion in the 2012 CAMAC report that schemes should have separate legal personality has been overtaken by the CCIV regime, where a clear regime for external administration of

[13] ASIC Class Orders [CO 13/1409] and [CO 13/1410]

[14] As occurred in relation to LM Investment Management Ltd (In Liquidation) and the LM Managed Performance Fund.

[15] See eg *LM Investment Management Ltd (In Liquidation) v Whyte* [2023] QSC 132.

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sub-funds has been legislated[16]. Rather than introduce a concept for registered schemes which conflicts with the fundamental concept of a trust as not being a separate legal person, reforms to facilitate transition to a CCIV structure would be preferable.

9 Contacts

If we can provide any further detail on the matters covered by this submission, or assist Treasury in any way with its further work on the review, please contact us at the details below.

Yours faithfully

King & Wood Mallesons

Contact details

Glenda Hanson | Consultant
King & Wood Mallesons
T +61 2 9296 2377
M +61 429 150 927
F +61 2 9296 3999
E glenda.hanson@au.kwm.com

Daniel Natale | Partner
King & Wood Mallesons
T +61 2 9296 2755
M +61 408 869 681
F +61 2 9296 3999
E daniel.natale@au.kwm.com

Level 61, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000

[16] Part 8B.6 of the Corporations Act