Governance Institute of Australia

T +61 2 9223 5744 **F** +61 2 9232 7174
E info@governanceinstitute.com.au
Level 10, 5 Hunter Street, Sydney NSW 2000
GPO Box 1594, Sydney NSW 2001
W governanceinstitute.com.au

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John Kluver
Corporate and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

By email: camac@camac.gov.au

Dear John

The establishment and operation of managed investment schemes — discussion paper

Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our members are involved in governance, corporate administration and compliance with the *Corporations Act* (the Act), including working for and with responsible entities (REs) and managed investment schemes (MISs).

We welcome the opportunity to comment upon the Corporate and Markets Advisory Committee's (CAMAC) *The establishment and operation of managed investment schemes—discussion paper* (the discussion paper), and draw on the expertise of our Members in formulating our submission.

General comments

Governance Institute notes that the current consultation provides an opportunity for CAMAC to report on the governance, risk and compliance frameworks for MISs. We recognise that the registered scheme, itself, does not have a legal identity, and that the RE becomes the entity responsible for the MIS, being a public company that holds an Australian financial services licence (AFSL). This licensing regime imposes certain obligations on REs, including that they have available adequate financial resources, and adequate risk management systems. A registered MIS must also have a scheme constitution, a compliance plan, and in certain circumstances, a compliance committee.

We note, from the outset, that we strongly support CAMAC's key principle set out throughout the discussion paper, namely the alignment of the regulatory regime for MISs with that of companies, unless there are compelling reasons for treating registered schemes differently, given that the these two types of enterprise often operate in the same markets and perform similar functions.

Indeed, we noted in our previous submission to CAMAC on MISs, that in light of the unfortunate collapses of Timbercorp and Great Southern, it was necessary for consideration to be

considered with respect to '…the need for any legislative or regulatory change[1]'. We are supportive, therefore, of the need for amendments to the legal and regulatory structure to align with the requirements for corporations under the *Corporations Act 2001* (Cth) (the Corporations Act).

We also note, however, that in some areas, alongside alignment with the Corporations Act, there is the opportunity to endorse better governance practice through more stringent requirements.

The registration of MISs

Governance Institute notes that all schemes must be registered except 'private' and 'wholesale' schemes. While Governance Institute recognises that wholesale schemes have not generally been an area of concern, we do note that there is the potential for retail schemes to be able to invest in some wholesale schemes. We believe that this provides an avenue through which a retail investor may invest in an unregulated scheme with less legal or regulatory oversight.

For example, we note that a wholesale scheme may be set up which allows for investment by retail MISs and utilises the services of a custodian. While the use of a custodian potentially offers additional oversight of the investment of the funds received, the duties and obligations of a custodian for a wholesale fund are not the same as those required of a RE and custodian of a registered retail scheme. This difference in the regulatory oversight remains a concern.

We recommend, therefore, that all wholesale MISs be registered. Wholesale MISs that do not accept investment from retail schemes may be provided with exemptions to ensure that they are not unreasonably burdened with additional requirements; however, those wholesale schemes that accept investment from retail schemes should be required to ensure that they have in place appropriate governance, transparency and accountability frameworks.

Aligning the regulation of MISs with companies

As noted above, Governance Institute supports a position that the regulation of MISs should mirror the requirements for companies, particularly where there is no good reason for a different regime to exist. We believe that this should be the base level of requirement for the regulation of MISs.

However, there are some areas where consideration should be given to having a higher level of regulation applied, where appropriate. For example, we note that retail MISs may resemble pooled schemes of retail investors regulated by the Australian Prudential Regulation Authority (APRA). We note, further, that there may be no public policy reason for having the oversight of retail investors' money being managed differently in each of these areas, when concerns about the confidence and trust about retail investment remain.

We believe it is appropriate, therefore, that an APRA-style regime be instituted for the regulation of schemes. In this regard, we recognise the high level of interrogation that APRA brings to the oversight of retail investment, through the imposition of a prudential regulatory framework which we believe to be appropriate for the regulation of money invested in schemes by retail investors.

We note that this could occur by changing where schemes are regulated, so that they sit under the auspices of APRA, or otherwise imposing on ASIC a requirement that it adopts and enforces a prudential regulatory scheme on MISs registered as retail managed investment schemes.

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[1] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Aspects of agribusiness managed investment schemes*, (September 2009) [pg vii]

We believe that there are further areas where consistency is required in relation to the regulation of MISs, and we detail these as follows:

The proposed repeal of the 100 member rule

The discussion paper notes the current position in relation to the requisitioning of scheme meetings, and notes that an RE must call a meeting of scheme members at the request of 100 members or members with at least five per cent of the votes that may be cast on a resolution.

Governance Institute noted in a recent submission on the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014 that we support the proposed repeal of the 100-member rule, as it is can be used for vexatious and frivolous purposes, requiring a company to call a general meeting of members at substantial cost to the company, when other avenues remain open for the member to raise their concerns, and it is unlikely that those who have called the meeting expect the resolutions put forward at the general meeting to carry.

We note that our support of the repeal of the 100-member rule does not extend to the repeal of the five per cent threshold for calling a general meeting of members. We also support the retention of various member rights, for example, allowing members to continue to place a resolution on the agenda of the AGM and have statements related to that resolution distributed to all members at the cost of the company.

It is important that members are provided with suitable rights and access to the company. However, we are of the view that putting corporations and their shareholders, the majority of whom are not expected to support the resolutions put forward at an general meeting, to the expense of the meeting, is a mischief that can be prevented through the repeal of the 100-member rule in s 249D of the Corporations Act.

We recommend, therefore, that the 100-member rule as relevant to REs be amended to align with the proposed changes to the Corporations Act, as and when such change is made.

Procedure for changing the scheme constitution

Governance Institute is also cognisant that under the current arrangements, the constitution of the MIS can be changed either by special resolution of the members of the scheme, or by the RE unilaterally, if the RE reasonably considers the change will not adversely affect members' rights.

Governance Institute agrees with the overarching position put forward by CAMAC in the discussion paper, that there should be no discrepancies between the regulations for schemes and companies where there is no compelling reason for treating schemes differently. In this instance, **we recommend** that the pre-condition allowing a RE to unilaterally change its constitution be repealed. We believe that there is no compelling policy reason to allow for the constitution to be amended by the RE without the consideration and special resolution of members of the registered scheme.

Related party transactions

While Governance Institute generally agrees with the current position on related party transactions, we believe that there needs to be more forthright disclosure concerning related party transactions. We note, for example, that related party transactions should be conducted objectively and at commercial arms length.

As with our comments on aligning the practice of MIS with those of corporations, we believe that this is one area in which more stringent disclosure is necessary to prevent the risks that arise in relation to related party transactions.

Meeting quorum requirements in scheme constitutions

A related point which also requires further consideration is ensuring proper and due process at meetings of members. Governance Institute notes that the terms of the provisions of the Corporations Act require only that two members be present, unless the company's constitution provides for a different quorum.

While this minimum requirement is not usually an issue for listed companies on the ASX, the same level of interest is not always present in MISs. As such, it is important to ensure that when a meeting is called, there is a reasonable turn-out to ensure that the business of the MIS is appropriately conducted.

A second related point is whether or not a sole director of the MIS should be able to call a meeting of the scheme's members. Governance Institute notes that this is currently a replaceable rule in the Corporations Act, but that consideration should be given to enshrining for MISs the right for a director to call a meeting where they believe an issue ought to be referred to a meeting of the members.

Registration of misleading names

Governance Institute recognises concerns about the way in which registered schemes are able to name themselves. In particular, we are in accord with the principle that ASIC should refuse to register names which are misleading. For example, where the naming reflects performance or proposed performance, such as providing that a return is 'guaranteed', we note that such naming is counterintuitive to the general understanding that all investment affords some element of risk. There may be many examples of this type of naming.

We are also cognisant that financial services guides and product disclosure statements are still the most appropriate avenues for providing investors with information on the risks associated with their investment, independently of the name of the organisation. Nonetheless, we also believe that this could be helped by having clearer naming laws in relation to registered schemes.

We are also aware of the regulations which make clear those names which are not permitted when registering a company, alongside passing off laws, and white labelling restrictions which also limit the ability for an entity to register a company name. For example, ASIC will refuse to register identical names.

Against this position, however, we recognise that trying to provide a single definitive position and law on the naming of MISs and arriving at a position which is not subjective will be extremely difficult. We believe that such a position might be impossible to achieve.

Instead, we note that appropriate consideration must be given to an overall framework which recognises that issues concerning misleading labelling are also captured by consumer law focused on misleading and deceptive conduct. For example, we note that ASIC already has some regulatory responsibility for false or misleading representations concerning financial products, which also dovetails with the Australian Competition and Consumer Commission's (ACCC)'s responsibility for misleading and deceptive conduct in relation to trade and commerce.

Governance Institute believes that consideration should be given to having one regulatory body charged with oversight of this area, rather than splitting this across different bodies, unless suitable cross-agency arrangement can be made. We believe that for investors, one body represents a more consistent approach and provides for a streamlined approach to protecting

investors' rights. We note that the recent National Commission of Audit report similarly put forward a recommendation that ASIC's consumer protection function be moved to the ACCC.

Improving the risk management of registered schemes

Governance Institute does not hold any particular view on which of the options put forward for improving the risk management requirements for registered schemes is appropriate. However, we do believe that risk management for MISs needs to be improved, particularly with reference to the standards required in relation to compliance for schemes.

While we recognise that the intention is to bring the risk management practices of schemes up to the same level of companies, we believe that there is merit in prescribing further the framework for schemes.

There is currently a prescriptive regime in place in relation to compliance, requiring registered schemes to have mandated compliance plans which are audited, and in some instances schemes are also required to have compliance committees. By contrast, however, risk management is identified but not detailed for schemes. As the ASIC Report 298, *Adequacy of risk management systems of responsible entities*, highlighted, there have since been identified various inadequacies in the risk management systems of schemes.

Again, Governance Institute accords with the principle that the requirements for schemes should mirror those of companies, whereby, for example, listed companies are required to report against Principle 7 of the Australian Securities Exchange (ASX) Corporate Governance Council's *Corporate Governance Principles and Recommendations* (the Principles and Recommendations) which encourage companies to establish sound systems of risk oversight and management and internal control.

However, we note that even compliance with the risk management requirements of the Principles and Recommendations, while a good starting point, is not as comprehensive as the requirements for compliance. For example, we note that the requirement for management to report to the board on matters concerning risk management does not provide for the external audit that occurs with respect to compliance plans, which explicitly require an audit of the robustness of the company's compliance plan.

By contrast, Governance Institute notes that APRA, an organisation which has an extensive and in-depth understanding of risk management, requires audited risk management plans, and generally has a more fulsome program with respect to the prudential regulation of risk. We believe, therefore, that it would be preferable to have in place a prudential regulatory framework with respect to risk management applied to schemes. We believe that there is no policy reason for retail schemes to be regulated in a manner different from how other schemes that manage the money of retail investors are managed.

To accomplish this, Governance Institute recognises that there will need to be a mechanism in place to provide for the APRA requirements to apply to schemes registered with ASIC. While we note that our preferred position is for the regulation to remain under one body, rather than be split across multiple regulators, we note that in this instance, APRA, with its expertise in risk management, is the appropriate body with respect to risk management. It may be possible to mitigate against dual regulatory burdens for MISs by incorporating only the APRA prudential standards as relevant to risk management for MISs under the ASIC regime, and we note that at some level there must be cooperation between the two regulators to ensure a coordinated approach.

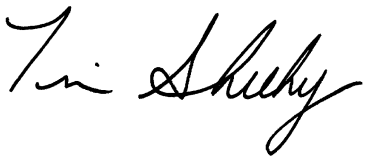
We note further that adopting the APRA prudential standards in relation to risk will allow any of the options in relation to risk management reform to be adopted with due consideration having been given to the quality and form of risk management disclosures required from schemes.

Conclusion

Governance Institute otherwise recognises the excellent work undertaken in relation to researching and developing positions on the governance, risk and compliance positions of MISs, and in particular in providing recommendations and options which promote better practice among schemes.

Governance Institute is happy to provide further comment as necessary, and looks forward to seeing the final report on the establishment and operation of MISs

Yours sincerely



Tim Sheehy
Chief Executive