Australian Government

Corporations and Markets Advisory Committee

Managed Investment Schemes

Report

July 2012

CAMAC considers that implementation of these proposals to assist a change of RE of a viable scheme will help to protect a scheme from the consequences of the insolvency of its RE.

Imposing prohibitions or requirements (additional to the foreshadowed ASIC capital requirements) on the ability of the RE to provide guarantees or indemnities in its personal capacity and involving its personal assets may reduce the likelihood of an RE becoming insolvent. However, there was little support in the submissions for restricting the activities that an RE undertakes in its personal capacity so as to reduce the likelihood that the RE will fail, even where (as in the case of some common enterprise schemes) scheme members have prepaid the RE for services or expenses in connection with the scheme and those prepayments form part of the personal assets of the RE (not scheme property held on trust for scheme members) and therefore are lost to scheme members if the RE fails.[593] Accordingly, CAMAC does not favour the introduction of this restriction, subject to an ongoing evaluation of ASIC's ability to manage appropriately the risk of RE failure through implementation of its financial requirements policy.

RE acting as scheme operator

CAMAC considers that an outright prohibition on an RE providing guarantees or indemnities involving scheme property may unduly inhibit an RE in operating a scheme for the benefit of scheme members. An RE that provides guarantees or indemnities using scheme property, but without some commercial or financial benefit to the scheme, could be in breach of its statutory and common law obligations as operator of the scheme.

8.4 Limited liability of scheme members

8.4.1 Current position

Inquiries conducted by the Companies and Securities Law Review Committee (1984), the ALRC and CASAC in their collective investments review (1993) and CASAC in its review of the liability of members of managed investment schemes (2000) recommended

[593] However, in Section 5.3.2 of this report CAMAC recommends controls on advance payments of remuneration to the RE.

statutory provisions to the effect that (except under arrangements whereby the RE is acting as agent for the scheme members) the members of a scheme should have limited liability for scheme debts that remain outstanding on the winding up of the scheme, in the same manner as shareholders of a company limited by shares.[594]

Further information on these reviews, and the full details of the recommendations by CASAC, are found in the CASAC 2000 report *Liability of Members of Managed Investment Schemes* (March 2000).[595]

The recommendation in the 2000 CASAC report to introduce limited liability for members of registered and ASIC-exempt schemes (but not other unregistered schemes) was based on these persons being passive investors, who, in principle, should have similar protections against personal liability, whether they invest in schemes or in limited liability companies.

However, in some agribusiness common enterprise schemes, the scheme members have sought to be characterised, for taxation and other reasons, as playing a much more active role as 'growers' carrying on their own individual businesses, and with proprietary interests in the agricultural land or its produce. This raises the question whether, or in what circumstances, they should not have the protection of limited liability.

Issues

Except where the RE is acting as the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some schemes?

If so, should distinctions be drawn between different classes of passive or active scheme members, and for what purposes?

Should the limited liability principle be subject to any contrary provision in the scheme constitution?

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[594] See also the discussion at Section 2.6.2 of the Turnbull Report.

[595] The CASAC 2000 report can be found on the CAMAC website **www.camac.gov.au** by going to *Publications*, and then to *Reports*.

8.4.2 Submissions

General principle

Respondents considered that, except where the RE is acting as the agent for scheme members, members of a scheme should have statutory limited liability.[596] Respondents noted that most scheme constitutions seek to do this, but it would be beneficial if limited liability were to be confirmed by statute.

Active and passive scheme members

One view in submissions was that no distinction should be drawn between active and passive scheme members.[597] One respondent commented, however, that limited liability may sit uneasily with some agribusiness common enterprise schemes where scheme members were described as 'growers' with direct rights to cultivate their trees, which concept underpinned the tax effectiveness of their investment.

Scheme constitution

Some respondents supported limited liability of scheme members being subject to any contrary provision in the scheme constitution, with an obligation that the product disclosure statement clearly disclose any such provision to potential investors.[598]

Other respondents opposed a scheme constitution being able to override limited liability of scheme members.[599] It was pointed out, for instance, that if appropriate disclosure of a contrary provision is not made to scheme members, they may be unaware that they do not have the benefit of limited liability. Also, members who join schemes may, contrary to their wishes, be exposed to personal liability if scheme members by special resolution subsequently approve an amendment to the scheme constitution to override limited liability.[600]

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596 Alan Jessup, ASIC, McCullough Robertson, Henry Davis York, Freehills, Property Funds Association, The Trust Company, Financial Services Council, Primary Securities Ltd, Ashurst Australia.
597 McCullough Robertson, Freehills.
598 Alan Jessup, Financial Services Council.
599 McCullough Robertson, Henry Davis York.
600 s 601GC(1)(a).

8.4.3 CAMAC position

As scheme members, by definition[601] (which applies to common enterprise schemes as well as pooled schemes), do not have day-to-day control over the operation of the scheme, they should not be personally liable for debts incurred by the RE as operator of the scheme. Their liability in the event of the insolvency of the scheme should be limited to any unpaid portion of the amount that they had agreed to contribute to the scheme.[602]

Current industry practice is to provide for limited liability of scheme members in the scheme constitution. Statutory limited liability would give greater protection to scheme members and provide greater certainty to scheme creditors.

Statutory limited liability would not apply to agreements into which 'active' scheme members (as in some common enterprise schemes) enter on their own behalf or through the RE acting as their agent. Members who are principals to agreements are personally liable according to their terms.

The principle of limited liability should not be subject to any contrary provision in the scheme constitution. The benefits of protection for individual scheme members and certainty for scheme creditors would be undermined if the position could be reversed in the scheme constitution, particularly where that occurs by subsequent amendments to that constitution.

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601 See subparagraph (a)(iii) of the definition of managed investment scheme in s 9.
602 cf s 516 for companies.

Appendix Terms of reference

The regulation of managed investment schemes

Since the passage of the *Managed Investments Act 1998*, collective investments, known as managed investment schemes, have been regulated by Chapter 5C of the *Corporations Act 2001* (the Corporations Act). The Corporations Act provides that the main features of a [scheme] are that:

- people are brought together to contribute money to get an interest in the scheme;
- money is pooled together with that of other members or used in a common enterprise; and
- members do not have day to day control over the operation of the scheme.

While the overwhelming majority of funds under management in Australian [schemes] are placed in schemes structured as unit trusts, where investors hold units in the scheme property, the [scheme] structure has also been applied in the agribusiness sector where the members (known as 'growers') operate their own individual businesses.

The recent global financial crisis highlighted the difficulties that arise for responsible entities (REs), scheme members, and creditors where a [scheme] comes under financial stress in a credit constrained environment. Those difficulties were evidenced initially through the freezing of investor redemptions in the mortgage fund sector, and then through the collapse of a number of significant participants in the agribusiness [scheme] market.

The collapse of Great Southern Limited and Timbercorp Group led the Parliamentary Joint Committee on Corporations and Financial Services (PJC) to initiate an inquiry into agribusiness managed investment schemes. Submissions to the inquiry highlighted a range of concerns relating to the regulation of agribusiness, including in relation to: the provision of narrow sales recommendations; the 'one

size fits all' licensing model; the accuracy of disclosure material available to investors, especially in relation to predicted scheme performance; the appointment of temporary REs; and better investor education. The PJC released its report, *Aspects of agribusiness managed investment schemes*, on 7 September 2009.

In that report, the PJC made three recommendations relating to agribusiness [schemes].

- Recommendation 1 related to the tax treatment of agribusinesses.

- Recommendation 2 was that the Government amend the Corporations Act to require ASIC to appoint a temporary RE when a registered [scheme] becomes externally administered or a liquidator is appointed.

- Recommendation 3 related to ASIC requirements for agribusiness [schemes] to disclose the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance.

As part of its *Financial products and services in Australia* report released on 23 November 2009, the PJC also recommended that, as part of their licence conditions, ASIC require agribusiness [scheme] licensees to demonstrate that they have sufficient working capital to meet current obligations (Recommendation 7).

While the recommendations made by the PJC were limited in scope, the PJC Inquiry highlighted the current lack of certainty with respect to the arrangements for dealing with unviable [schemes]. While the corporate insolvency provisions in the Corporations Act provide creditors and directors with certainty about their rights and obligations, the Corporations Act sets out very few specialised rules regarding the administration of insolvent trusts or trustees. Instead, the administrations of such are determined by a mix of legislation, common law and equitable principles. The lack of clarity has led liquidators to resort often to the Court in order to obtain advice about the legality of future actions.

It is therefore not clear whether the legislative arrangements contained in the Corporations Act are adequate to maintain the confident participation of retail investors in [schemes] because of

deficiencies in the way the Act deals with: resolving the consequence, for otherwise viable schemes, of the insolvency of their RE; and what is to occur when the RE is insolvent and the scheme itself has failed. Informal stakeholder consultations have also raised issues with the general operation of the [schemes] regime, which has not been reviewed since 2001.

I request that CAMAC:

- examine whether the current statutory framework is adequate for the winding up of [schemes], and agribusinesses in particular, and whether it provides the necessary guidance for liquidators, creditors, investors and growers;

- advise what legislative amendments should be made if the current legislative framework does not provide the necessary legislative tools with respect to the arrangements for dealing with non-viable [schemes];

- examine whether the current temporary RE framework enables the transfer of viable scheme businesses where the original RE is under financial stress, and if not whether it should be reformed or replaced;

- examine whether REs are unable to restructure a financially viable [scheme] and advise if the current legislative methods available to companies under the Corporations Act should be adapted to managed schemes; and

- examine other proposals to improve Chapter 5C, including in relation to: convening scheme meetings; cross-guarantees entered into by REs on behalf of other group members; and statutory limited liability.