A paper presented for The Continuing Professional Education Department of the College of Law on 25 February 2008

The College of Law

The Regulatory Structure of Managed Investment Schemes

Published in Sydney by the Continuing Professional Education Department of the College of Law, 2 Chandos Street, St Leonards, NSW, Australia, 2065.

ABOUT THE PRESENTERS

MATTHEW BRANSGROVE

Matthew Bransgrove holds a Bachelor of Laws and was admitted to the NSW Supreme Court in 1992. He has practised exclusively in the field of mortgage law since 1998.

He is a co-author of the 2008 LexisNexis textbook 'The Essential Guide to Mortgage Law in NSW' and the 2013 LexisNexis textbook 'The Essential Guide to Mortgage Law in Australia'.

His articles in the NSW Law Society Journal and his textbook have been cited with approval by the NSW Supreme Court. Chandra v Perpetual Trustees Victoria [2007] NSWSC 694; Perpetual Trustees Victoria v Kirkbride [2009] NSWSC 377; Bank of Western Australia v Ellis J Enterprises [2012] NSWSC 313.

He has presented the following papers for the College of Law:

1. Enforcement of Mortgages *19 June 2003*
2. Indefeasibility of Mortgage Title *17 Nov 2003*
3. Mortgage Drafting in NSW *17 Mar 2004*
4. Mortgage Priorities *15 June 2004*
5. The Rights of Mortgagors *10 Oct 2005*
6. The Rights of Mortgagees *10 Nov 2005*
7. Mortgagees Power of Sale *23 May 2006*
8. Discharge of Mortgage *28 Nov 2006*
9. Contracts Review Act Defences to Mortgages *29 May 2007*
10. Equitable Defences to Mortgages *18 July 2007*
11. Variation, Assignment & Transfer of Mortgages *12 Sept 2007*
12. Mortgagor's power to mortgage *13 Nov 2007*
13. Regulatory Structure of Managed Investments *23 Feb 2008**
14. Licensing a Responsible Entity *20 March 2008**
15. Proportionate Liability in claims against Valuers *29 Oct 2008**
16. Examinations under the Corporations Act and ASIC Act *5 March 2012*†

**Presented jointly with Kate Cooper of Bransgroves Lawyers*
† *Co-authored by Lesa Bransgrove of Bransgroves Lawyers*

KATE COOPER

Kate Cooper was admitted as a solicitor in the Supreme Court of New South Wales in December 2006. Kate Cooper joined Bransgroves Lawyers in 2006 and has been a partner since 2009.

Kate specialises in Supreme Court litigation in the fields of mortgage enforcement, professional negligence and originator/funder disputes. She has an extensive transactional practice including, origination deeds, aggregation deeds, commercial and construction lending and mortgage securitisation.

In addition to legal services, Kate performs funds management (responsible officer services) for mortgage funds operated by responsible entity clients of the firm.

She has presented the following papers for the College of Law:

1. The Regulatory Structure of Managed Investments *23 Feb 2008**
2. Licensing a Responsible Entity *20 Mar 2008**
3. Proportionate Liability in claims against Valuers *29 Oct 2008**
4. Proportionate Liability 5 years on *13 May 2010*
5. Enforcement of Mortgages *24 Nov 2010*

**Presented jointly with Matthew Bransgrove of Bransgroves Lawyers*

TABLE OF CONTENTS

Introduction

In its simplest incantation the aim of the regulation of Managed Investments is to provide supervision of promoters who purport to invest other peoples' money on their behalf. Broadly speaking this can be distinguished from equities (whereby the investor is buying a portion of the promoter's vehicle), debentures (whereby the promoter's vehicle is borrowing the money) and prudentially supervised investments (banks, insurance, superannuation).

The current regulatory framework commenced with the passage of the Managed Investment Act 1998. The Managed Investment Act did away with the old "prescribed interest provisions" of the Corporations Law which had dominated the regulation of managed investments in Australia since the middle of the last century. There have been several legislative additions to the regime the most significant being the Financial Services Reform Act 2001. The Managed Investment Act is now essentially found in Chapter 5C of the Corporations Act.

Managed investment schemes are governed by Chapters 5C and 7 of the Corporations Act, which require:

a) some managed investment schemes to be registered and to conform with certain structural and compliance requirements ('registration requirements');

b) some managed investment schemes to be operated by licensed responsible entities ('licensing requirements'); and

c) certain disclosures to be made to retail investors who invest in registered managed investment schemes ('product disclosure requirements').

There are many different forms of managed investments. These include:

1. *Cash management* – invest in the money market (government bonds, bank bills)
2. *Fixed interest and bond* – invest in bonds, cash, bank bills
3. *Shares* – Mainly in listed companies (sometimes called equity trusts)
4. *Mortgages* – both pooled trusts and as select mortgage investments (including contributory mortgages)
5. *Indirect Property* – Usually directly invest in commercial properties, shopping centres, offices towers and the like. Many property funds are also listed.
6. *Direct Real Property* – These involve syndicates of investors that purchase specified properties.
7. *Primary Production and Film Schemes* – The common factor being favourable tax treatment. Olives, coffee, wine, and avocadoes. Often the responsible entity does no own the land, but rather leases it and undertakes to grow a crop, the profits of which are then split between the investors. With film schemes the investment is usually in a single movie with the investor sharing in the box office and DVD profits.
8. *Serviced Strata Schemes* – These are considered by ASIC to be managed investments where the investors' income is of a pooled nature (relying on the

occupancy of other investors apartments), or there is some arrangement for fairly allocating tenants.

Some schemes are open ended. This involves the continuous issuing and redemption of units by investors. For example, a mortgage trust may offer 12 and 24 month terms. To ensure liquidity investors may have restrictions on, and fees charged, for early redemption. Other schemes are fixed for the period of a project, for example a film or crop. Some schemes lock investors in and do not offer redemption unless a buyer can be found for their units.

The Legal status of a Managed Investment Scheme

The Corporations Law does not preclude flexible arrangements in structuring a managed investment. This includes contractual arrangements, limited partnerships, syndicates and trusts. However section 601FC2 of the Corporations Act states:

> The responsible entity holds scheme property on trust for scheme members.

This together with the requirement imposed by s601FC(1) as a duty of the responsible entity:

> (i) ensure that scheme property is:
>
> (i) clearly identified as scheme property; and
>
> (ii) held separately from property of the responsible entity and property of any other scheme; and

And the requirement imposed by s601HA(1) that the compliance plan include arrangements for :

> (a) ensuring that all scheme property is clearly identified as scheme property and held separately from property of the responsible entity and property of any other scheme (see paragraph 601FC(1)(i)); and

Means that except in a case where the scheme has no property pursuant to s601FC(2) the responsible entity will be a trustee with fiduciary obligations arising out of the general law in addition to the obligations imposed by the Corporations Act. These include the obligation to put the interests of the investors before the responsible entity, the obligation not to make a profit (except as contractually entitled), a duty of good faith and an equitable duty of care.

In *Mirvac and Mirvac Funds* [1999] NSWSC 457 (4 May 1999) Austin J noted:

> Section 601FC(2) states that the responsible entity holds scheme property … on trust for scheme members (in this case the respective unit holders). There are therefore express trusts here and each responsible entity clearly falls within the definition of the `trustee' for the purposes of section 63. I see nothing in Chapter 5C of the Corporations Law to suggest that it is intended to exclude the Court's jurisdiction to provide judicial advice to a responsible entity under general trustee legislation. I therefore conclude that I have jurisdiction to provide appropriate advice in this case.

Trusts can be structured as a unit trust in which case the investor beneficiaries own a fraction of the entire fund. Under these arrangements the responsible entity takes a fee and the beneficiaries are entitled to the profits or loss of the fund on a pro rata basis. Other arrangements include trusts where the responsible entity is entitled to all income of the fund after an agreed annual return is paid on capital invested by each beneficiary. Some unit trusts are tradeable on the ASX.

Definition

The section 9 definition

Section 9 (which contains the dictionary of the Corporations Act) defines a *managed investment* scheme as:

(a) a scheme that has the following features:

(i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);

(ii) 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 (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);

(iii) the members do not have day to day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions); or

(b) a time sharing scheme;

but does not include the following:

(c) a partnership that has more than 20 members but does not need to be incorporated or formed under an Australian law because of regulations made for the purposes of subsection 115(2) ;

(d) a body corporate (other than a body corporate that operates as a time sharing scheme);

(e) a scheme in which all the members are bodies corporate that are related to each other and to the body corporate that promotes the scheme;

(f) a franchise

(g) a statutory fund maintained under the Life Insurance Act 1995

(h) a regulated superannuation fund, an approved deposit fund, a pooled superannuation trust, or a public sector superannuation scheme, within the meaning of the Superannuation Industry (Supervision) Act 1993

(i) a scheme operated by an Australian ADI in the ordinary course of its banking business ;

(j) the issue of debentures or convertible notes by a body corporate;

(k) a barter scheme under which each participant may obtain goods or services from another participant for consideration that is wholly or substantially in kind rather than in cash;

(l) a retirement village scheme operating within or outside Australia:

(i) under which the participants, or a majority of them, are provided, or are to be provided, with residential accommodation within a retirement village (whether or not the entitlement of a participant to be provided with accommodation derives from a proprietary interest held by the participant in the premises where the accommodation is, or is to be, provided); and

(ii) which is not a time sharing scheme;

(m) a scheme that is operated by a co-operative company registered under Part VI of the Companies (Cooperative) Act 1943 of Western Australia or under a previous law of Western Australia that corresponds to that Part;

(ma) a contribution plan;

(n) a scheme of a kind declared by the regulations not to be a managed investment scheme.

Statutory interpretation

In considering the section 9 definition of managed investments, the Courts have had recourse to the pre-Managed Investments Act authorities which considered the old "prescribed interests". This was the approach taken in *ASIC v Enterprise Solutions 2000 Pty Ltd* (2000) 35 ACSR 620 by the Queensland Court of Appeal which noted:

> Mason J, referring to a similar argument under earlier statutory provisions, said:
>
> > There are real difficulties in the suggestion that the court can read down the very comprehensive definition of "interest" by reference to the supposedly unintended consequences of a literal reading on everyday commercial transactions . . . The hazards of adopting such a course are not dispelled by the absence of a supporting context. It would be different if we could glean from the legislative provisions an overall purpose which, being limited in scope, justified a reading down of the definition: [*Australian Softwood Forests Pty Ltd v A-G (NSW); Ex rel Corporate Affairs Commission* (1981) 148 CLR 121 at 130;]

The essence of the definition (like its predecessor) is that there is a broad all embracing definition with express exclusions and the regulatory mechanism to increase the exclusions. There is little scope to avoid the capture of a scheme except by reference to the plain meaning of the words.

In *ASIC v Takaran Pty Ltd* (2002) 43 ACSR 46 at 49, Barrett J said:

> The Act makes no attempt to define 'scheme' for these purposes. It does, however, refer to the 'features' of a 'scheme' that make it a 'managed investment scheme'. Those 'features' are first, the act of contribution of money or money's worth by several persons; second, the accruing for those persons in return ('as consideration') of certain rights to benefits produced by the scheme; third, pooling of the contributions or other use of them in the common enterprise; fourth, an objective or expectation of accrual of benefits to persons for the time being holding the rights generated by the contributions; and, fifth, absence of day-to-day control of the operation of the scheme by those persons. It is clear from the characteristics that a 'scheme' must be capable of being identified within certain boundaries. Such identification is necessary to decide whether it has the characteristics which bring it within the statutory definitions.[1]

Inclusions

Scheme

In *ASIC v Takaran* (2002) 20 ACLC 1732 at 1737:

> The essence of a "scheme" is a coherent and defined purpose, in the form of a "programme" or "plan of action", coupled with a series of steps or course of conduct to effectuate the purpose and pursue the programme or plan. In some cases, the scope of the scheme will readily be gathered from some constitutive document in the nature of a blueprint setting out all relevant matters. In others, there may be no writing or such as there is may tell only part of the story, leaving the remainder to be supplied by necessary implication from all the circumstances. Profit making will almost invariably be a feature or objective of the kind of scheme with which the s. 9 definition of "managed investment scheme" is concerned, given the definition's references in several places to "benefits". Whatever is incidental and necessary to the pursuit of the profit (or "benefits") will therefore be comprehended by the scheme, including, it seems to me, steps sensible to counter risk of loss (or detriment). Every cogent plan caters for – or, at least, recognises and takes into account - contingencies of an adverse kind.
>
> It must also be emphasised that a scheme having the characteristics bringing it within the s.9 definition of "managed investment scheme" will not necessarily possess those characteristics alone. In *Royal Bank of Canada v Inland Revenue Commissioners* [1972] Ch 665, Megarry J observed, in relation to the concept of "ordinary banking business", that "a statement of the essentials of a business does not seem to me, without more, to be exhaustive of all that is ordinary in that business". A managed investment scheme, like a banking business, may involve elements beyond the core attributes that give it its essential character. Elements which lie beyond those attributes but contribute to the coherence and completeness which make a "programme" or "plan of action" must form part of that "scheme". Every programme or plan of action must be taken to include the logical incidents of and consequences of and sequels to its acknowledged components.

In *ASC v Su* (1995) 13 ACLC 770, Olsson J (with whom King CJ and Moher J agreed) held:

> It is quite unreal to suggest that there were in fact three separate schemes, simply because there were three separate trusts... The plain fact of the matter was that it was

[1] Cited with approval by Young CJ in Eq in *Crocombe v Pine Forests of Australia Pty Ltd* [2005] NSWSC 151

> brought into existence for the sole purpose of carrying into effect a single scheme for the marketing of the machines in South Australia

Contribution of money or money's worth

In *Burton & Ors v Arcus* [2006] WASCA 71 McClure JA noted (with whom Steytler J agreed)

> The word "contribute" means, in this context, to pay or supply. It is implicit in the first element in par (a) of the definition, in the context of the definition as a whole and the provisions of Ch 5C, that the people will pay or supply the money or money's worth to or as directed by the promoter or operator of the scheme.

In *Crocombe v Pine Forests of Australia Pty Ltd* [2005] NSWSC 151 Young CJ in Eq held that where the consideration was land it was caught by this definition. His Honour noted:

> The expression "money or money's worth" is a common one used in gift and death duty legislation. In a death duty case Attorney General v Sandwich (Earl) [1922] 2 KB 500 at 517, Lord Sterndale MR said:
>
>> "I am not sure what is the accurate definition of money's worth. It was an expression originally introduced to exclude marriage as a consideration, and the learned counsel for the appellant defined it as any valuable consideration not being marriage. I do not intend to decide whether this is an accurate and complete definition, but I think that at any rate money's worth includes the kind of benefits accruing to the defendant in this case from the possession of the estate and freeing it from the claims and powers of the Earl and the Admiral."

In *ASIC v Chase Capital Management Pty Ltd* (2001) 19 ACLC 476, Owen J determined that payments to agents of the promoter did not quarantine the scheme from the definition of "contribution of money or money's worth". His Honour noted at 487:

> It is clear that the investor participants ''contributed money or money's worth''. However, and this is the first point relied on by the respondents in support of their contention that these are not managed investment schemes, was the money provided ''as consideration for the acquisition of rights to benefits produced by the scheme''? Counsel for the respondents submitted that here the money was paid by investors to the various corporate entities as managers ''as a conduit'' to the ultimate investments. Chase and Leadenhall were never in a position ''to give consideration'' for anything. Rather, they were trustees or agents to invest the money as requested by the investors. I do not accept this submission. It seems to me that relevant part of the definition focuses on the acquisition of benefits from the ''scheme'', not from the manager. The ''scheme'' is the entire operation.

Rights or benefits

In *ASIC v Enterprise Solutions 2000 Pty Ltd* [2000] QCA 452 some ingenious arguments were raised to avoid this part of the definition including that there was a requirement for the rights or benefits to be of some permanence or that if the rights and benefits were merely the fruit of services provided then it was not a managed investment. In rejecting these submissions the Queensland Court of Appeal unanimously held:

> Mr Harrison QC said …the rights acquired by the "investors" — the term used in the appellants' documents — are not interests because all investors get is the provision of betting services, and because whatever rights they have are not permanent enough to be interests. … If the argument advanced for the appellants is correct, then the definition should be read as if some such expression as "having a degree of permanence" were inserted after the word "benefits".
>
> The rights which the investors acquire when they pay money in are rights to have the scheme operate in accordance with the agreements they have made and to be paid moneys due. As one would expect, the agreements require distribution of profits made: cl 6.2(c). They also require that the investor receive all moneys due within 30 days of notice of termination of the agreement; those moneys will comprise profits, if any have been made, together with unexpended moneys put in by the investor. Of course, participation may produce no benefit for an investor, but loss only: it would, however, be perverse to read the expression "to acquire rights to benefits produced" as excluding from the definition any scheme of investment which is not bound to produce benefits.
>
> It is true that, as the appellants argue, services, particularly by way of supposedly skilful betting, are provided for the contributions made; assuming such services are not in themselves benefits — a point it is unnecessary to discuss — the expected or at least hoped-for profits are benefits.

Pooling / common enterprise

In *Co-Operative Building Society Of South Australia Ltd v Australian Securities Commission* (1993) 11 ACLC 262 Jenkinson J held:

> The provisions of the Companies Act 1961 (N.S.W.) which were under Consideration in Australian Softwood Forests Pty. Ltd.& Ors v. Attorney General for N.S.W. (1981) CLC ¶ 40−734; (1980−1981) 148 C.L.R. 121 are for present purposes so nearly the same as the provisions of the Corporations Law that certain observations of Mason J. in that case may be taken to be applicable to those latter provisions. Mason J. said...:
>
> > ..There is nothing in the notion of an undertaking or scheme that requires or implies that there is joint participation in everything comprised in the plan or that there must be a share or pooling of profits or receipts... It will be enough that the two operations constituting the enterprise contribute to the overall purpose that unites them. There is then an enterprise common to both participants and, accordingly, a common enterprise.

In *ASIC v Young* (2003) 173 FLR 441, Muir J held:

> In my view, the concept of ''pooling'', for the purposes of s 9(a)(ii), imports contributions to a discernible fund the moneys in which are to be used in an identifiable way to provide are prescribed benefits to the contributors. That analysis may be a little narrow, 4 but it will suffice for present purposes.

In *ASIC v Commission v Drury Management Pty Ltd* [2004] QSC 68, Jones J held:

> The feature that contributions are to be pooled is simply one of the descriptors by which the existence of a scheme is identified. It is a question of fact whether that descriptor is made out on the evidence. One means of establishing the fact would be if the scheme's promoters declared that contributions would be pooled. Another would be if the scheme could only be given effect if the funds were pooled as was the case in *ASIC v Young*. Yet another would be if the funds were in fact pooled by the operators of the scheme, since this action alone would evidence a prior intention by the scheme managers to do so. To suggest that for s9(a)(ii) to be satisfied, there needs to be found in the mind of a contributor, knowledge of an intention to pool the contribution, is, in my view, to impose an unwarranted restriction on the ordinary meaning of the words used in the definition. The cases to which I have been referred do not suggest otherwise. The point was authoritatively determined by the Court of Appeal in *ASIC v Enterprises Solutions 2000* Pty Ltd (2000) QCA 452 where the Court said at para [13] as follows:-
>
>> "...the words "to be pooled"...to produce in para (ii) quoted above imply that the intention must be to pool the contributions and, by use of the pool, produce benefits; they do not imply that the benefits must be of such a kind as to be unobtainable without pooling. As for the words "to be", it was contended that there was no evidence that the contributors appreciate that the contributions are to be pooled. That contributions would be dealt with in that way is obvious; but in any event under the scheme pooling occurs and that is enough."

The pooling and common enterprise requirements are alternatives. This has been amply demonstrated in the field of mortgage investment schemes. Schemes which pool investors money are caught, schemes that involve one on one investments (one mortgagee / investor lending to one mortgagor) are more uncertain. ASIC has taken the view that the determination will often hinge on the extent to which the promoter's business consists of like transactions (Regulatory Guide 144).

In relation to what constitutes a common enterprise, the reality is that the definitions, while focusing on the schemes in practice address the activity of the promoter. This is clear when one considers the outcome of the definition provided by Mason J in *Australian Softwood Forests Pty Ltd v Attorney-General (NSW); Ex Rel Corporate Affairs Commission* [1981] HCA 49; (1981) 148 CLR 121:

> The argument is that in order to constitute a "common enterprise" there must be a joint participation in all the elements and activities that constitute the enterprise. I do not agree. An enterprise may be described as common if it consists of two or more closely connected operations on the footing that one part is to be carried out by A and the other by B, each deriving a separate profit from what he does, even though there is no pooling or sharing of receipts of profits. It will be enough that the two operations constituting the enterprise contribute to the overall purpose that unites them. There is then an enterprise common to both participants and, accordingly, a common enterprise.

However, in *Lawloan Mortgages Pty Ltd v Lawloan Mortgages Pty Ltd* (2003) 21 ACLC 289, Holmes J had to consider the common enterprise aspect of this limb and held that each loan in a solicitors contributory mortgage business was a separate scheme. By this jurisprudence a business involving one on one matched mortgages would not constitute a scheme;

> Within the loan scheme in this case, there were subsets of contributors who invested in individual loans. In the case of each loan, contributions were pooled in the Elliott & Harvey trust account for disbursement as a single payment to borrowers, but there was no broader pooling of funds as between the various loans. The contributions of the investors in each subset, once pooled, were used to produce benefits for its members, but were not capable of producing, and were not intended to produce any benefit for the larger set of investors in the applicant's mortgage lending scheme as a whole.
>
> It is significant that, in subparagraph (ii), the definite article precedes in each case the nouns ''people'' and ''members''. The sub– paragraph specifies the people, the members holding interests; in other words, the benefits produced by the pooling of funds in a given scheme must be capable of flowing to all, not a subset, of the members in the scheme. In the present case, the absence of the pooling of contributions, or their use ''in a common enterprise'', to produce financial benefits for the members holding interests in the applicant's general mortgage lending scheme at large, as opposed to the pooling of contributions in each individual loan for the benefit of the members of that particular loan arrangement, prevents the mortgage lending scheme as a whole from meeting the terms of subparagraph (ii) of the definition. It has not, therefore, all of the features necessary to render it a ''managed investment scheme''. The individual loan arrangements, on the other hand, do in each case amount to a scheme possessing the three prescribed features.

Day to day control

In *ASIC v Chase Capital Management Pty Ltd* (2001) 36 ASCR 778, Owen J held:

> The question is whether the *members* have day–to–day control. It is not difficult to discern the distinction that the legislature was attempting to make. Very broadly, it is between the investment activities of an individual and that of a group. By the express terms of the applications, the investors have delegated ''management'' of the investment to CCML. There is no reservation of day–to–day or any other control or functions. I am not sure that the appointment of a committee of some of the investors to monitor the investments would make much difference. The question still remains: who has the day–to–day control.

This limb of the definition is what prevents entrepreneurs or groups of entrepreneurs from having their investments caught by the definition. If for example two sailing club buddies decide to build a town house development together it would not be caught because they have the day to day control of the investment. If, however, having completed one town house successfully they decided to seek contributions from all the other members of their sailing club so they could expand their activities it would come under the definition of a managed investment scheme because the other club members would not be meeting the tradesmen on site at 7.00am and directing the concrete pour. As was made clear in *Chase Capital*, if the other club members appointed a committee to supervise the two developers it would not be enough to escape the definition.

In Regulatory Guide 144, ASIC made clear that a solicitor who documented numerous mortgage transactions would not be operating a managed investment scheme if the investors were identifying borrowers, appointing valuers and making the decision as to whether or not to lend.

In *ASIC v IP Product Management Group Pty Ltd* (2002) 42 ACSR 343, Byrne J noted:

> The existence of a right in a member to be consulted or to give directions as to the operation of the scheme does not necessarily lead to the conclusion that that member has day-to-day control over its operation. The Law contemplates, therefore, some greater involvement.

In *Burton v Arcus* (2006) 57 ACSR 468, Buss JA held:

> The members of a scheme will have "day-to-day control over the operation of the scheme" if:
>
> (a) the members as a whole participate in making the routine, ordinary, everyday business decisions relating to its management; and
>
> (b) the members as a whole are bound by the decisions which are made.
>
> Conversely, if the members as a whole do not participate in making the routine, ordinary, everyday business decisions relating to the management of the scheme or if the members as a whole are not bound by the decisions which are made, they will not have day-to-day control over its operation.
>
> The concept of "day-to-day control over the operation of the scheme", within par (a) of the definition, does not, of course, require that there be activities in relation to the scheme on each and every day or even on most days during the term of the scheme.
>
> In my opinion, the circumstance that the promoter or operator of a scheme manages the scheme (or certain aspects of it) on behalf of the members does not mean that the members by their agent, the promoter or operator, have day-to-day control in fact over the operation of the scheme. In other words, the management activities of the promoter or operator in relation to the scheme are not to be imputed to the members in determining whether the members have such day-to-day control.
>
> My construction of the third element in par (a) of the definition gives effect to the evident legislative purpose or object embodied in the definition and Ch 5C. If:
>
> (a) the third element in par (a) of the definition was concerned with the legal right to control and not control in fact; or
>
> (b) the management activities of the promoter or operator in relation to the scheme were to be imputed to the members in evaluating whether the third element was satisfied or not, with the consequence that if the promoter or operator had "day-to-day control over the operation of the scheme" then the members, by their agent, the promoter or operator, would have day-to-day control,
>
> the legislative framework for the regulation of managed investment schemes would be seriously, if not entirely, eroded.

Time shares

Section 9 (the dictionary) of Corporations Act has a separate definition of time-shares being:

time-sharing scheme means a scheme, undertaking or enterprise, whether in Australia or elsewhere:

(a) participants in which are, or may become, entitled to use, occupy or possess, for 2 or more periods during the period for which the scheme, undertaking or enterprise is to operate, property to which the scheme, undertaking or enterprise relates; and

(b) that is to operate for a period of not less than 3 years.

Regulatory Guide 160 (an amended version was issued on 14 February 2008) makes clear that although these schemes are designed to be regulated as a financial product ASIC will give exemptions to certain classes where the effect of which is that consumers will be protected. Reading between the lines it seems ASIC is aware that the regulatory imposition is way too onerous for smaller and non-offensive time-share schemes (for example a ski club owned and controlled by its members).

Exclusions

Partnerships with more than 20 members

This exclusion is provided because s115 of the Corporations Act prohibits the formation of a partnership or association with more than 20 members unless it is for non-profit purposes. Thus, to gain the benefit of this exclusion, the scheme would have to be for non-profit purposes (for example to stop the killing of whales).

Section 115(2) allows regulations to prescribe a higher number of partners than 20 members. These provide the following numbers:

Item	Kind of partnership or association	Number
1	(a) Actuaries, medical practitioners, patent attorneys, sharebrokers, stockbrokers or trademark attorneys (b) Partnerships or associations of the kind specified in subregulation (2)	50
2	Architects, pharmaceutical chemists or veterinary surgeons	100
3	Legal practitioners	400
4	Accountants	1 000

Thus, 1000 accountants in partnership would not be caught by the definition.

There is another significance of 20 members. Under section 601ED registration of a managed investment scheme is only required if there are more than 20 members. Thus schemes including partnerships with less than 20 members are not regulated.

Companies

The law in relation to managed investments fills a regulatory gap that does not include companies. Investors in private companies are protected by general law rules in relating to oppression and breach of director's duties. Public companies and listed public companies are extensively regulated by other parts of the Corporations Act.

In *ASIC v Fuelbanc Australia Ltd* [2007] FCA 960 Heerey J noted:

> The "body corporate" exception (see [25] above) does not apply. The purpose of this exception is to ensure that the ordinary engagement of a company in commercial activities does not come within the managed investment scheme regime… The legal foundation for this arrangement is not membership of the company but the contractual relationship between the company and the participant. Relevantly for present purposes, the participant becomes a member of the scheme whether or not he or she becomes a member of the company. (In any event, ASIC has been unable to discover any membership registers, minutes or other records which might prove that participants in fact became members.)

Related bodies corporate

Where the members of a scheme are companies which are related to each other and the scheme promoter there is no need for investor protection.

Franchises

Section 9 (the dictionary) of Corporations Act has a separate definition of a franchise being:

> an arrangement under which a person earns profits or income by exploiting a right, conferred by the owner of the right, to use a trade mark or design or other intellectual property or the goodwill attached to it in connection with the supply of goods or services. An arrangement is not a franchise if the person engages the owner of the right, or an associate of the owner, to exploit the right on the person's behalf.

In Enviro Systems Renewable Resources Pty Ltd v ASIC [2001] SASC 11, Martin J held:

> The definitions in the Law and the Code, and the history of regulation of passive investment schemes and franchise arrangements, support the view that the Legislature intended to exempt from the regulatory regime applicable to managed investment schemes those types of arrangements in which the risk that the business will succeed or fail is, to a significant extent, dependent on the activities of the franchisee. On the other hand, the Legislature intended that passive investment schemes in which the risk of the business succeeding or failing is wholly or very substantially dependent on the activities of the promoter, and in which business it is not intended that the investor will actively participate, should be regulated by the regime applicable to managed investment schemes.

In practice, this loophole has been seized upon by promoters attempting to avoid the managed investment definition. However, the Courts according to the above statements of principle will look at substance rather than form and where the franchisee is not involved in the day to day management of the franchise and independently operates then the scheme will not fall within this exclusion.

Life insurance funds, Superannuation funds, Banks

These are all financial products that are prudentially regulated and gain consumer protective regulation through separate avenues.

Debentures

These are separately regulated by the Corporations Act (Chapter 2L). This exclusion was considered by Barrett J in *ASIC v Karl Suleman Enterprises Pty Ltd* (2003) 21 ACLC 1, 180. In that case, His Honour held that despite the investment being styled as debentures the scheme was nonetheless a managed investment scheme.

Barter

The managed investment scheme is designed to protect investors. Although land has been considered as constituting "money's worth" presumably the legislature does not deem barter arrangements (where the outcome is not speculative) as requiring investor protections.

Retirement village schemes

These are regulated by state and territory regulation. In NSW, by the *Retirement Villages Act* (1999).

Schemes declared outside the definition

There are not currently any regulations that exclude schemes from this definition. There is however provision under section 601QA to grant exemptions from Chapter 5C (the registration requirement).

When is registration required?

The general requirement

The registration requirement is governed by Section 601ED which reads:

> CORPORATIONS ACT 2001 - SECT 601ED
> When a managed investment scheme must be registered
>
> (l) Subject to subsection (2), a managed investment scheme must be registered under section 601EB if:
>
> (a) it has more than 20 members; or
>
> (b) it was promoted by a person, or an associate of a person, who was, when the scheme was promoted, in the business of promoting managed investment schemes; or
>
> (c) a determination under subsection (3) is in force in relation to the scheme and the total number of members of all of the schemes to which the determination relates exceeds 20.
>
> (2) A managed investment scheme does not have to be registered if all the issues of interests in the scheme that have been made would not have required the giving of a Product Disclosure Statement under Division 2 of Part 7.9 if the scheme had been registered when the issues were made.
>
> (3) ASIC may, in writing, determine that a number of managed investment schemes are closely related and that each of them has to be registered at any time when the total number of members of all of the schemes

exceeds 20. ASIC must give written notice of the determination to the operator of each of the schemes.

(4) For the purpose of this section, when working out how many members a scheme has:

(a) joint holders of an interest in the scheme count as a single member; and

(b) an interest in the scheme held on trust for a beneficiary is taken to be held by the beneficiary (rather than the trustee) if:

(i) the beneficiary is presently entitled to a share of the trust estate or of the income of the trust estate; or

(ii) the beneficiary is, individually or together with other beneficiaries, in a position to control the trustee.

(5) A person must not operate in this jurisdiction a managed investment scheme that this section requires to be registered under section 601EB unless the scheme is so registered.

(6) For the purpose of subsection (5), a person is not operating a scheme merely because:

(a) they are acting as an agent or employee of another person; or

(b) they are taking steps to wind up the scheme or remedy a defect that led to the scheme being deregistered.

(7) A person who would otherwise contravene subsection (5) because an interest in a scheme is held in trust for 2 or more beneficiaries (see paragraph (4)(b)) does not contravene that subsection if they prove that they did not know, and had no reason to suspect, that the interest was held in that way.

In summary, registration is required when:

1. There is a managed investment scheme (as defined in section 9 of the Corporations Act) and

2. If the scheme:

   (a) it has 20 members or

   (b) is promoted by a person in the business of promoting managed investment schemes or

   (c) is part of a group of related schemes with more than twenty members.

   and

3. A PDS is required under part 7.9 for any issues of interest in the scheme

   and

4. ASIC has not granted an exemption under section 601QA

Schemes that are required to be registered must be registered before they are offered to investors (see Section 102A of the Corporations Act).

20 members or more

Under Section 601ED(1)(a) if the scheme has fewer than 20 members then registration is not required. The rationale for this is probably that no systemic and large scale damage can be done to less than 20 members. This also allows small property developers to go out and raise capital amongst friends and acquaintances. It would allow a would be entrepreneur to quit his job and seek start up funds from friends and relatives for his new plumbing business. These small enterprises would be unable to get off the ground if they were subject to the onerous regulatory requirements of registration. The only difficulty this exception causes is when it is abused as a loophole by professional promoters. That is effectively dealt with by subsections (1)(b) and (c).

If a small property developer or other operator raising funds under this exception chanced to acquire funds from a trust with multiple beneficiaries that took it over the 20 investors the operator would have a defence under s601ED(7) that provides so long as the operator was unaware and had no reason to suspect the operator does not breach the registration requirement.

There is a degree of overlap in this exclusion with the "common enterprise" component of the definition of *managed investment scheme* in section 9 Corporations Act and subsections (b) and (c) of section 601ED(1). To a large extent, the same issue arises. That is, will a party operating with multiple investors on multiple schemes be able to avoid either the definition of managed investment scheme or the registration requirement. There are two competing judicial approaches, the first focuses on the activities of the promoter. In *ASC v Su* (1995) 13 ACLC 770, Olsson J (with whom King CJ and Moher J agreed) held:

> It is quite unreal to suggest that there were in fact three separate schemes, simply because there were three separate trusts... The plain fact of the matter was that it was brought into existence for the sole purpose of carrying into effect a single scheme for the marketing of the machines in South Australia.

This is consistent with the judgment of Mason J in *Australian Softwood Forests Pty Ltd v Attorney-General (NSW); Ex Rel Corporate Affairs Commission* [1981] HCA 49; (1981) 148 CLR 121:

> The argument is that in order to constitute a "common enterprise" there must be a joint participation in all the elements and activities that constitute the enterprise. I do not agree. An enterprise may be described as common if it consists of two or more closely connected operations on the footing that one part is to be carried out by A and the other by B, each deriving a separate profit from what he does, even though there is no pooling or sharing of receipts of profits. It will be enough that the two operations constituting the enterprise contribute to the overall purpose that unites them. There is then an enterprise common to both participants and, accordingly, a common enterprise.

The contrasting approach was taken in *Lawloan Mortgages Pty Ltd v Lawloan Mortgages Pty Ltd* (2003) 21 ACLC 289, where Holmes J held;

> Within the loan scheme in this case, there were subsets of contributors who invested in individual loans. In the case of each loan, contributions were pooled in the Elliott & Harvey trust account for disbursement as a single payment to borrowers, but there was no broader pooling of funds as between the various loans. The contributions of the investors in each sub−set, once pooled, were used to produce benefits for its members, but were not capable of producing, and were not intended to produce any benefit for the larger set of investors in the applicant's mortgage lending scheme as a whole.
>
> It is significant that, in sub−paragraph (ii), the definite article precedes in each case the nouns ''people'' and ''members''. The sub− paragraph specifies the people, the members holding interests; in other words, the benefits produced by the pooling of funds in a given scheme must be capable of flowing to all, not a sub−set, of the members in the scheme. In the present case, the absence of the pooling of contributions, or their use ''in a common enterprise'', to produce financial benefits for the members holding interests in the applicant's general mortgage lending scheme at large, as opposed to the pooling of contributions in each individual loan for the benefit of the members of that particular loan arrangement, prevents the mortgage lending scheme as a whole from meeting the terms of sub−paragraph (ii) of the definition. It has not, therefore, all of the features necessary to render it a ''managed investment scheme''. The individual loan arrangements, on the other hand, do in each case amount to a scheme possessing the three prescribed features.

His Honour distinguished *ASIC v Knightsbridge Managed Funds Ltd* [2001] WASC 339, in which a number of mortgaged lending arrangements were characterised as a single scheme. In that case the monies to be advanced in all loans were placed into a single cash management account which attracted interest on the total funds, subsequently shared among investors pro rata.

In the business of promoting

In *ASIC v Young & Ors* [2003] QSC 029 Muir J consider the meaning of the *promoting* for the purposes of Section 601ED(1)(b) and quoted Bowen J in *Whaley Bridge Calico Printing Co v Green* (1880) 5 QBD 109:

> The term 'promoter' is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence. In every case the relief granted must depend on the establishment of such relations between the promoter and the birth, formation, and floating of the company, as render it contrary to good faith that the promoter should derive a secret profit form the promotion. A man who carries about an advertising board in one sense promotes a company, but in order to see whether relief is obtainable by the company what is to be looked to is not a word or name, but the acts and the relations of the parties.

Muir J did not think it relevant that the promoter was not engaged solely in promoting managed investment schemes:

> In these circumstances, the respondents were "in the business of promoting managed investment schemes". The fact that the JVP Schemes constituted only a small part of

> the respondents' business activities does not, in my view, prevent their being "in the business of promoting" such schemes. Obviously, a person may carry on or be involved in more than one business at any given time.

In *ASIC v Chase Capital Management Pty Ltd* (2001) 19 ACLC 476 Owen J at 486 held:

> If the schemes are looked at in this broad sense, it is clear that they are comprised of more than 20 members. If I am wrong in this conclusion, and the individual investments are separate schemes, I would hold that those who promoted the investments (and assuming for the moment that they are managed investment schemes) were involved in the business of promoting managed investment schemes. I say this because it appears from the newsletters and other publications of the Club and from the description given by Hicks in his affidavits as to the way that the Club operated that the aim was to seek out investment opportunities, offer them to members, elicit subscriptions and manage the investments on behalf of the participating members. All of this was done for profit. For the members the profit was the returns on the investment. For the manager, the profit was the administration fee. In my view, this constitutes a ''business''.

Again the emphasis is to avoid onerous impositions on those engaging in small one-off projects and protect consumer investors from systemic and large scale financial disasters.

Related schemes that exceed 20 members

Section 601ED(1)(c) provides that where ASIC has made a determination that schemes are related then for the purposes of calculating for 20 members the various schemes are considered as one. This is an anti-avoidance provision which would, for example, capture a situation where the promotion of related schemes was carried out by a husband and wife, brother and cousin to avoid the promoter provision.

In policy statement 136 ASIC notes:

> We will make a determination that schemes are closely related under s601ED(3) when it appears to us that any of the following circumstances apply.
>
> a) The schemes are promoted by different persons but the circumstances and the similar nature of the schemes indicate that the promoters are likely to be associated.
>
> b) The businesses or activities of the schemes are similar, the schemes form part of a systematic promotion and there is doubt about whether the schemes fit within s601ED(1)(a) or (b). This doubt may arise because:
>
> (i) the interests being offered relate to separate pools or common enterprises and might not all be part of one scheme; or
>
> (ii) the schemes might not have been promoted as a business because the necessary regularity may be absent.
>
> c) The schemes are:
>
> (i) so similar that the one prospectus might reasonably relate to offers of interests in the schemes; and

(ii) structured as separate schemes because it means that the offers are "excluded offers" because no more than 20 offers will be made in 12 months for each scheme.

Section 601ED(3) is an anti avoidance mechanism to prevent promoters avoiding the registration requirement by structuring their offerings as separate schemes each having less than 20 members but which in aggregate have more than 20 members. It also provides a way for us to prevent promoters from relying inappropriately on the 20 offers in 12 months exclusion by calculating the 20 offers separately for each separate but related scheme.

If no product disclosure statement required

Section 601ED(2) provides that if the scheme would otherwise be required to be registered under Section 601ED(1) but if it is not required to issue a Product Disclosure Statement under Part 7.9. A Product Disclosure Statement is not required in the following circumstances;

The small offer exception

Under section 1021E where the number of members does not exceed 20 or the operator does not raise more than $2 million in a 12 month period. This rule creates an interesting loophole in that taken literally Section 601ED(3) 601ED(3)

Issues to non-retail clients

If the offer is made to a non-retail investor there is no need to issue Product Disclosure Statement. See sections 761G (large businesses, professional investors offerings >$500,000) and 761GA (sophisticated investors).

Exemptions from the registration requirement

Section 601QA empowers ASIC to exempt by declaration Managed Investment Schemes that would otherwise be required to be registered by Section 601ED. This is done through Class orders. There are currently 25 current exemptions ranging from school enrolment deposits to ostrich farms. ASIC also issues Regulatory Guides that set out its policy on granting exceptions in certain circumstances, for example Regulatory Guide 178: Foreign collective investment schemes.

The registration process

The registration process is governed by Part 5C.1of the Corporations Act and 5C.1.01 of the regulations. Section 601EA requires that the application must include:

(a) the name, and the address of the registered office, of the proposed responsible entity which must be a public company that holds an Australian financial services licence authorising it to operate a managed investment scheme (s601FA),

(b) the name and address of a person who has consented to be the auditor of the compliance plan,

(c) a copy of the scheme's constitution (which complies with sections 601GA and 601GB),

(d) a copy of the scheme's compliance plan (which complies with section 601HA),

(e) a statement by the directors of the responsible entity to the effect that the scheme constitution and compliance plan are compliant.

5C.1.01 requires the scheme to have a unique name (not one which is identical to any existing registered scheme or any scheme for which an application is being currently considered).

ASICs approach to considering application is set out in various Regulatory Guides (previously variously known as policy statements, practice notes, guides or guidelines, information releases, frequently asked questions). These include general guides, for example:

RG 105 - Licensing: Organisational competence
RG 132 - Managed Investments: Compliance plans
RG 133 - Managed investments: Scheme property arrangements
RG 134 - Managed Investments: Constitutions
RG 166 - Licensing: Financial requirements

And industry specific guides, for example:

RG 118 - Commentary on compliance plans: Contributory mortgage schemes
RG 119 - Commentary on compliance plans: Pooled mortgage schemes
RG 144 - Mortgage investment schemes

Section 601EB obliges ASIC to register the scheme within 14 days of lodgement of the application, unless it appears to ASIC that:

(a) the application does not comply with section 601EA; or

(b) the proposed responsible entity does not meet the requirements of section 601FA; or

(c) the scheme's constitution does not meet the requirements of sections 601GA and 601GB; or

(d) the scheme's compliance plan does not meet the requirements of section 601HA; or

(e) the copy of the compliance plan lodged with the application is not signed as required by section 601HC; or

(f) arrangements are not in place that will satisfy the requirements of section 601HG in relation to audit of compliance with the plan.

The effect of registration

In *Mier & Jonsson v F N Management* [2005] QCA 408 Keane JA noted:

> Apart from registration itself, there is little to differentiate between registered and unregistered managed investment schemes. Whereas a company only comes into existence upon registration, a managed investment scheme can exist independently of registration, with registration only being necessary if the scheme meets certain other

> criteria. Registration is therefore only an incident, rather than the necessary source, of the existence of a scheme. Unlike a company, a scheme does not cease to exist if it is deregistered. The result is that a scheme remains a scheme whether or not it is registered so long as it meets the definition of "managed investment scheme" contained in s 9 of the Act. This suggests that the definition of "scheme property" for a registered scheme must serve as a guide to what should be considered to be the property of an unregistered scheme.

Failure to register

Section 601ED(5) provides:

> A person must not operate in this jurisdiction a managed investment scheme that this section requires to be registered under section 601EB unless the scheme is so registered.

The scheme will be wound up

Section 601EE provides:

> Unregistered schemes may be wound up
>
> (1) If a person operates a managed investment scheme in contravention of subsection 601ED(5), the following may apply to the Court to have the scheme wound up:
>
> (a) ASIC;
>
> (b) the person operating the scheme;
>
> (c) a member of the scheme.
>
> (2) The Court may make any orders it considers appropriate for the winding up of the scheme.

This will often also result in the operator of the unlicensed scheme being wound up particularly if the funds of the scheme have not been kept separate. In *ASIC v A.B.C. Fund Managers Ltd (No 2)* [2001] VSC 383 Warren J held:

> Ultimately, the question is asked: how is a winding up of the 22 trusts to occur without a liquidator appointed to the companies which controlled the trusts? There are no separate records for the trusts. The Court can have no confidence that they and the former trustees and managers of the trusts will cooperate in the winding up of the trusts. In my view, the public interest in winding up the defendants far outweighs any allegation of potential prejudice to third parties. In any event, the existence and interests of those parties has not been satisfactorily proved…
>
> Further, …the … defendants should be wound up under s 601EE(2) … Furthermore, by continuing to operate the schemes, the defendants would continue to breach s 601ED(5). In light of the evidence of a substantial number of intercompany transactions which are undocumented, I consider the defendants cannot deal with this issue without the appointment of a liquidator.
>
> I am satisfied that the appointment of a liquidator will give control of the assets and undertakings of the companies and their books and records to the liquidator. The powers available to a liquidator to control the assets and books and records of the companies and to obtain evidence will aid and facilitate further investigations. The

> appointment of a liquidator is in the public interest. It outweighs any prejudice to the shareholders which could arise from appointment of the liquidator. In any event, the extent of that prejudice and the objections of the owners/shareholders of the group have not been established…
>
> The round robin transactions give rise to serious concerns about the propriety of the director and secretary of the trustees and managers of the schemes, Wharton and Gillies. For this reason alone I consider it is inappropriate that they not be left to deal with investors when winding up the schemes.

Depending on the circumstances (whether there is a company structure or simply scheme property) a receiver or liquidator will be appointed. It is even possible for the Court to order the existing operators of the scheme to wind it up. In *Lawloan Mortgages Pty Ltd v Lawloan Mortgages Pty Ltd* (2003) 21 ACLC 289 which involved a solicitors mortgage scheme the Court ordered the solicitors to continue the winding up (which had been occurring under a class order relief but was then out of time) to continue under the supervision of two independent chartered accountants. Holmes J holding at para 135:

> I do not think ASIC's argument that there should be a regime of general application for winding up of such schemes involving the appointment of an independent liquidator is compelling. The better approach in my view is a flexible one with a view to the best outcome. And, while there is undoubtedly a public interest in investor protection, that may better be achieved by using the sanction in s 601ED(5) against contravention, rather than penalising the investors in these schemes by imposing on them a form of winding up which the majority do not want and which is likely to produce a less satisfactory outcome.

However the wishes of the investors is not compelling, even when there are no creditors. In *Bells Securities Pty Ltd v LPG Mourant* [2002] QSC 156. Wilson J went against the wishes of the investors (even though there no creditors to be considered). His Honour considered the relevant factors to be:

a) the conduct of the mortgage lending business including the circumstances of the four remaining loans;

b) the potential that the applicant, the operator of the scheme, may face a conflict of interests, strictly a conflict of duty and interest, in winding up its own scheme;

c) the interests and wishes of contributories;

d) the comparative costs of the applicant's proposal and those of a winding up by independent liquidators;

e) the public interest in the integrity of the system of investor protection for which the Corporations Act stands. (See *ASIC v. Chase Capital Management Pty Ltd* [2001] WASC 27; (2001) 36 ACSR 778 at 795 per Justice Owen.)

His Honour noted in reaching his conclusion on these factors:

> The expressed wishes of the contributories are a significant factor in the exercise of the discretion to do what is appropriate for the winding up of the scheme. So, too, is

> the very real possibility that the applicant's proposal would be less expensive than the appointment of independent liquidators. However, there is a significant public interest in ensuring the transparency of the winding up process and the safeguarding of the rights of the contributories. There is good reason to be concerned that the contributories may not be fully apprised of all the circumstances surrounding the making and management of the four loans in question, and that if the applicant's proposal were approved in response to their understandable concern to contain costs they might never appreciate the full extent of their rights.

The investors may avoid the contract

Section 601MB provides:

> (1) If:
>
> (a) a managed investment scheme is being operated in contravention of subsection 601ED(5) and a person (the offeror) offers an interest in the scheme for subscription, or issues an invitation to subscribe for an interest in the scheme;
>
> a contract entered into by a person (other than the offeror) to subscribe for the interest as a result of the person accepting the offer, or of the acceptance of an offer made by the person in response to the invitation, is voidable at the option of that person by notice in writing to the offeror.

This section operates only to the advantage of the investor because the subscription is only *voidable*. However the right contained in s601MB(1) is not absolute, the operator can within 21 days approach the court, under s601MB(4), for an order that a notice under s601MB(1) be set aside and the court may make that order if it is satisfied that, in all the circumstances, it is just and equitable.

The investors or ASIC may seek orders under s1325

As well as s601MB(1) and investor (or ASIC) may also seek orders under s1325 which provides the Court with a much more flexible range of remedies including the power to declare contracts void *ab initio*, damages and injunctions etc.

The investors may avoid the contract

Section 601ED5 provides:

> A person must not operate in this jurisdiction a managed investment scheme that this section requires to be registered under section 601EB unless the scheme is so registered.

Under section 1311 and schedule 3 item 163 contravention attracts 200 penalty units or imprisonment for 5 years, or both. Under s1312 for a body corporate the penalty can be 5 times greater (1000 penalty units).

Contract not illegal

The consequences that flow from illegal contracts do not apply in the case of unregistered managed investment schemes in *Karl Suleman Enterprizes Pty Ltd v Babanour* [2004] NSWCA 214 Beazley JA (with whom Spigleman CJ and Santow JA agreed) noted:

> The registration requirement for the operation of a Managed Investment scheme is for the protection of investors. The legislation does not expressly make an unregistered scheme unlawful. Rather it impugns the conduct of the entity responsible for registration by imposing a penal sanction for a contravention of the registration provisions. The members of an unregistered scheme are protected by the provisions whereby the scheme may be compulsorily wound up. There is nothing, therefore, in the scheme of the legislation whereby an implication of an illegality would arise, nor is there anything that points to a legislative intention that contracts entered into as part of an unregistered scheme are illegal.

Responsible Entities

The role of the responsible entity

The responsible entity of a registered scheme is to operate the scheme and perform the functions conferred on it by the scheme's constitution and the Corporations Act: s 601FB(1)

> Responsible entity to operate scheme
>
> (1) The responsible entity of a registered scheme is to operate the scheme and perform the functions conferred on it by the scheme's constitution and this Act.
>
> (2) The responsible entity has power to appoint an agent, or otherwise engage a person, to do anything that it is authorised to do in connection with the scheme. For the purpose of determining whether:
>
> (a) there is a liability to the members; or
>
> (b) the responsible entity has properly performed its duties for the purposes of subsection 601GA(2);
>
> the responsible entity is taken to have done (or failed to do) anything that the agent or person has done (or failed to do) because of the appointment or engagement, even if they were acting fraudulently or outside the scope of their authority or engagement.[2]

Preconditions to being a responsible entity

The responsible entity of a registered scheme must be a public company that holds an Australian financial services licence authorising it to operate a managed investment scheme: s 601FA.

> Responsible entity to be public company and hold Australian financial services licence.
>
> The responsible entity of a registered scheme must be a public company that holds an Australian financial services licence authorising it to operate a managed investment scheme.

[2] A scheme's constitution may provide for the responsible entity to be indemnified for liabilities--see subsection 601GA(2).

Duties of the responsible entity

Section 601FC sets out the duties of a responsible entity operating a register scheme. These are not comprehensive and there are additional general law duties, contractual duties (dependant on the contents of the constitution and product disclosure statements). There are also duties that arise pursuant to the holding of the Australian Financial Services Licence (ASFL). This includes the duty to maintain financial records and undertake financial reporting contained in Chapter 2M of the Corporations Act and the duty to undertake continuous disclosure (in Chapter 6CA of the Corporations Act).

CORPORATIONS ACT 2001 - SECT 601FC

Duties of responsible entity

(1) In exercising its powers and carrying out its duties, the responsible entity of a registered scheme must:

(a) act honestly; and

(b) exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position; and

(c) act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests; and

(d) treat the members who hold interests of the same class equally and members who hold interests of different classes fairly; and

(e) not make use of information acquired through being the responsible entity in order to:

(i) gain an improper advantage for itself or another person; or

(ii) cause detriment to the members of the scheme; and

(f) ensure that the scheme's constitution meets the requirements of sections 601GA and 601GB; and

(g) ensure that the scheme's compliance plan meets the requirements of section 601HA; and

(h) comply with the scheme's compliance plan; and

(i) ensure that scheme property is:

(i) clearly identified as scheme property; and

(ii) held separately from property of the responsible entity and property of any other scheme; and

(j) ensure that the scheme property is valued at regular intervals appropriate to the nature of the property; and

(k) ensure that all payments out of the scheme property are made in accordance with the scheme's constitution and this Act; and

(l) report to ASIC any breach of this Act that:

(i) relates to the scheme; and

(ii) has had, or is likely to have, a materially adverse effect on the interests of members;

as soon as practicable after it becomes aware of the breach; and

(m) carry out or comply with any other duty, not inconsistent with this Act, that is conferred on the responsible entity by the scheme's constitution.

(2) The responsible entity holds scheme property on trust for scheme members.[3]

(3) A duty of the responsible entity under subsection (1) or (2) overrides any conflicting duty an officer or employee of the responsible entity has under Part 2D.1.

(5) A responsible entity who contravenes subsection (1), and any person who is involved in a responsible entity's contravention of that subsection, contravenes this subsection.[4]

(6) A person must not intentionally or recklessly be involved in a responsible entity's contravention of subsection (1).

There are also duties to keep a register of members (section 169), notify ASIC of a change to the constitution (section 601GC), notify ASIC of a change to the compliance plan (section 601HE).

Duty to appoint auditor

Under s 601HG the responsible entity of a registered scheme must ensure that at all times an auditor is engaged to audit compliance with the scheme's compliance plan.

Duty to keep accounts

The financial reporting and financial audit requirements of Chapter 2M of the Corporations Act apply to registered schemes pursuant to s167A(1)(b).

Licensing

The requirement for a license

A combination of section 764A, 766C and section 911A of the Corporations Act requires that a responsible entity operating a registered scheme must hold a Financial Services License. The licensing requirement gives ASIC a range of powers including the ability to set conditions of the license or to refuse to issue a license to persons or classes of persons. These requirements are echoed in section 601FA (see above).

---

[3] Under subsection 601FB(2), the responsible entity may appoint an agent to hold scheme property separately from other property.

[4] Note 1: Section 79 defines involved. Note 2: Subsection (5) is a civil penalty provision (see section 1317E).

License Conditions

As part of the financial requirements of issuing a license to a responsible entity the responsible entity must maintain net tangible assets (NTA) of 0.5% of the value of the scheme or $50,000 (whichever is greater) with a maximum of $5 million.

If the responsible entity has net tangible assets of $5 million it can perform the functions of custodian itself (otherwise it must appoint a separate custodian).

The standard license conditions are set out in a template document issued by ASIC known as Pro Forma 209. Pro Forma 209 contains 44 pages and industry specific conditions are often even more lengthy. Guidance for these are contained in regulatory guides, for example:

RG 104 - Licensing: Meeting the general obligations

RG 105 - Licensing: Organisational competence

RG 166 - Licensing: Financial requirements

Duties of Licensees

Section 912A requires that financial services licensees must:

a) do all things necessary to ensure that the financial services are provided efficiently, honestly and fairly; and

b) have in place adequate arrangements for the management of conflicts of interest and

c) comply with the conditions on the licence; and

d) comply with the financial services laws; and

e) take reasonable steps to ensure that its representatives comply with the financial services laws; and

f) have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and

g) maintain the competence to provide the financial services; and

h) ensure that its representatives are adequately trained, and are competent,

i) if the financial services are provided to persons as retail clients the licensee must have a dispute resolution system

j) have adequate risk management systems which must consist of an internal dispute resolution procedure that complies with ASIC requirements, and membership of one or more external dispute resolution schemes that are approved by ASIC.

Changing the responsible entity

Retirement of the responsible entity

Under section 601FL if the responsible entity of a registered scheme wants to retire, it must call a members' meeting to explain its reason for wanting to retire and to enable the members to vote on a resolution to choose a company to be the new responsible entity. If the members do not agree on a new responsible entity the current responsible entity can apply to the court to appoint a temporary responsible entity.

Removal by member resolution

Under section 601FM if members of a registered scheme want to remove the responsible entity, they may call a members' meeting to consider and vote on a resolution that the current responsible entity be removed and a resolution choosing a new responsible entity.

Removal by ASIC

Under section 601FN either ASIC or a member of the registered scheme may apply to the Court for the appointment of a temporary responsible entity of the scheme under section 601FP if the scheme does not have a responsible entity that meets the requirements of section 601FA (a licensed responsible entity).

Appointment of a temporary responsible entity

Under section 601FP the court can appoint a temporary responsible entity which can be a liquidator (rather than another responsible entity).

Scheme Compliance plans

The need for a Compliance Plan

Under section 601EB(1)(f) and (g) a scheme cannot be registered unless it has a compliance plan. Section 601HC requires that the copy of a scheme's compliance plan that is lodged with ASIC must be signed by all the directors of the responsible entity.

Contents of the Compliance Plan

Required by the Corporations law

Section 601HA provides that the compliance plan must set out the measures the responsible entity is to apply in operating the scheme to ensure compliance with the Corporations Act and the scheme's constitution, including arrangements for:

1. ensuring that all scheme property is clearly identified as scheme property and held separately from property of the responsible entity,

2. if the scheme has a compliance committee arrangements relating to:
    a) the membership of the committee;
    b) how often meetings are to be held;
    c) the committee's reports to the responsible entity;
    d) the committee's access to the scheme's accounts

e) the committee's access to information relevant to the responsible entity's compliance with the Corporations Act;

f) ensuring that the scheme property is valued at regular intervals appropriate to the nature of the property;

g) ensuring that compliance with the plan is audited

h) ensuring records of the scheme's operations are kept

Required by ASIC

ASIC’s policy on considering compliance plan’s (as part of the licensing process) and as part of its powers under section 601HE(2) to require amendments to a compliance plan are set out in Regulatory Guide 132. In it ASIC says:

> RG 132.6 Under the Law, the compliance plan for a scheme plays a key role in the range of measures designed to protect scheme members. We believe that our approach should therefore focus the preparation of compliance plans on:
>
> (a) the characteristics of the individual scheme; and
>
> (b) the protection of scheme members.
>
> RG 132.14 We will actively assess compliance plans when we are deciding whether or not to register a scheme under s601EB(1). We will consider, in the context of the type of scheme, whether the responsible entity has designed measures which adequately address the risks of not complying with its obligations. For example, a responsible entity must continuously monitor, review and audit the outcomes of its compliance activities. We will therefore assess whether the responsible entity’s arrangements for doing this are adequate.

Preparing

In Regulatory Guide 132

> RG 132.7 We consider that the purpose of a compliance plan is to describe how a responsible entity will make sure that it is complying with the Law and the scheme constitution. We therefore consider that a compliance plan should list the key processes, systems and structures that the responsible entity will apply. For example, a compliance plan should set out the processes, systems and structures by which a responsible entity will continuously review how it is complying with its obligations under the Law and the scheme constitution.
>
> RG 132.8 Under the Law, a compliance plan must set out adequate measures that a responsible entity will apply to make sure that it complies with the Law and the scheme constitution: s601HA. This section sets a very high standard of content for compliance plans. We consider that this does not mean that every requirement of the Law or the constitution should be dealt with exhaustively or in the same level of detail. The individual characteristics of each scheme will affect what is the appropriate content of a compliance plan for that scheme.
>
> RG 132.9 In addition to the mandatory matters listed in s601HA(1) and s601HA(2), there will be many other matters which deserve serious treatment in a compliance plan. The Law is designed to ensure that the interests of investors are protected. A compliance plan should therefore reflect:

(a) the major compliance risks which investors face; and

(b) the abuses potentially associated with conducting schemes.

RG 132.10 To ensure that the interests of investors are protected, when you prepare a compliance plan you should undertake a structured and systematic process which:

(a) considers the obligations under the Law and the constitution affecting the responsible entity;

(b) identifies risks of non-compliance; and

(c) establishes measures designed to address these risks.

Compliance Committees

Generally

Under section 601JA(1) the responsible entity of a registered scheme must establish a compliance committee if less than half of the directors of the responsible entity are external directors.

The compliance committee must be set up within 14 days of the requirement arising (for example, if an external director dies or resigns). ASIC will grant extensions on that 14 day period and its policy is set out in Regulatory Guide 136.

Composition

The composition of a compliance committee is governed by s601JB which requires a scheme's compliance committee have at least 3 members, and a majority of them must be external members.

Functions

The functions of the compliance committee are set out in section 601JC these being:

1. To monitor to what extent the responsible entity complies with the scheme's compliance plan and to report on its findings to the responsible entity; and

2. To report to the responsible entity any breach of the act of the Corporations Act or the constitution of the scheme.

3. To report to ASIC if the responsible entity does not take appropriate and timely action to remedy any breach.

4. To assess at regular intervals whether the compliance plan is adequate, to report to the responsible entity on the assessment and to make recommendations to the responsible entity about any changes that it considers should be made to the plan.

Duties of the compliance committee

The duties of the compliance committee are set out in section 601JD these being:

1. act honestly

2. exercise reasonable care and diligence
3. not make improper use of information acquired through the committee
4. not make improper use of their position as a member of the committee to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme.

Custody of Scheme Property

Section 601FC(2) provides that the responsible entity holds the scheme property on trust. This is bolstered by section 601FC(1)(i) which requires the responsible entity to ensure that scheme property is clearly identified as scheme property and kept separate from the responsible entity and any other scheme. This is mirrored in 601HA(1)(a) – the contents of the compliance plan.

ASIC takes the view that to meet these requirements an external custodian will be required (despite there being no express legislative requirement) except where it has granted relief. ASIC enforces it's opinions through license conditions and its power to order amendments to compliance plans. ASIC's policy is set out in Regulatory Guide 133 *Managed investments: Scheme property arrangements.* This states:

> RG 133.5 We expect that in most cases, the standards will be met by the responsible entity appointing a third party custodian. We have not attempted to prescribe detailed requirements which custodians must meet. Instead, in RG 133.6–RG 133.13 we have set out what we consider are the minimum outcomes which a custodian must achieve, whether the custodian is the responsible entity or its agent.

Exceptions are granted where the responsible entity is able to satisfy ASIC (in accordance with Regulatory Guide 133) that it has appropriate;

1. Organisational structure (133.6-8)
2. Staffing (133.9-10)
3. Administrative resources (133.11)
4. Arrangements for holding scheme property (133.12)
5. Financial resources (133.13)

The main determinative factor in practice is financial resources. In this regard ASIC maintains that if the responsible entity has net tangible assets of $5 million it can perform the functions of custodian itself (otherwise it must appoint a separate custodian).

Scheme Constitutions

The requirement

Section 601EB(1)(e) provides that ASIC is not required to register a scheme if it does not have a constitution that complies with sections 601GA (which prescribes the content) and 601GB (which requires the constitution be legally enforceable as between the members and the responsible entity).

Form

Section 601GB requires the constitution to be legally enforceable by the members. This can be achieved either by making the constitution a trust deed or a contract between the members and the responsible entity (a management agreement).

Contents

Section 601GA sets out the bare minimum the constitution must specify. This includes:

(i) the powers of the responsible entity to make investments of, or otherwise deal with scheme property;

(ii) the method by which complaints made by members in relation to the scheme are to be dealt with;

(iii) winding up the scheme;

(iv) if the responsible entity is to be paid fees or be indemnified out of scheme property

(v) whether the responsible entity is to have any powers to borrow,

(vi) if members are to have a right to withdraw from the scheme, and the procedures for making and dealing with withdrawal requests.

The constitution of a registered scheme must be a document that is legally enforceable as between the members and the responsible entity: s 601GB.

The balance of the contents will depend on the type of scheme. Usual provisions include the pricing of units, how and when distributions are to be made, fees and expenses the responsible entity is allowed to deduct etc.

Amendment

Section 601GC governs the amendment of the constitution. The constitution of a registered scheme may be modified, or repealed and replaced with a new constitution by a special resolution of the members of the scheme. If the change will not adversely affect the members rights then the responsible entity may change the constitution without such a resolution.

Whenever an amendment is made a copy of the modified constitution must be lodged with ASIC and can only take effect upon lodgement. The members are entitled to a copy of the constitution upon payment of a prescribed fee.

Breach of constitution

A breach of the constitution is a breach of section 601FC(1)(m) of the Corporations Act. An intentional or reckless breach of the constitution can be a criminal offence under section 601FC(6). The officers of the responsible entity are personally liable to ensure the constitution is adhered to by section 601FD(1)(f). Section 601FD(4) makes reckless or intentional breach a criminal offence. The members of the scheme have civil remedies under the Act and under the general law of trustees. If the constitution is styled as a management agreement then the members will have contractual remedies.

Product Disclosure Statements

Generally

Section 764A(1)(b) provides that for the purposes of Chapter 7 of the Corporations Act an interest in a registered managed investment scheme is a financial product. This requires that an offer of an interest in a managed investment scheme be made in the form of a Product Disclosure Statement (PDS) pursuant to Part 7.9 of the Corporations Act.

When a PDS is required

Part 7.9 of the Corporations Act, Division 2 deals with product disclosure statements. Subdivision B provides for when a product disclosure statement is required. Section 1012B provides that when there is an 'issue situation' (the issue or offer) of an interest to a retail client then a product disclosure statement is required. Section 1012C provides that a PDS is required in certain circumstances when an interest in a scheme is resold.

Definition of a retail client

Under 761G(7) a client will be treated as retail unless:

1. the value of the financial product to which the financial service relates, equals or exceeds the amount specified in regulations. The amount is currently $500,000 – see regulation 7.1.19(2)

2. the financial product is provided for use in connection with a business that employs more than 20 people or if a manufacturing business more than 100 people.

3. the client meets the sophisticated investor test (section 761G(7)(c) and (ca). Briefly the person must have net assets of at least $2.5 million or a gross income for the last 2 years of at least $250,000.

4. The client meets the definition of a professional investor as defined by section 9 of the Corporations Act.

Contents of the PDS

Section 1013C – 1013K set out at length the content that must be included in a product disclosure statement. The product disclosure statement must have the title 'Product Disclosure Statement' on the cover (section 1013B(1)). Section 1013G requires that the PDS be dated.

In Regulatory Guide 144.3 ASIC has approved the use of two-part product disclosure statements. The first part containing boilerplate information about the issue and the second part containing borrower specific information which does not need to be registered in order to keep it off the public record. This is also a practical necessity as so-called 'matched mortgages' often involve multiple amendments in the days leading up to settlement (as interest rate and term are negotiated or other particulars altered).

Supplementary PDSs

Section 1014A makes provision for the issuing of a Supplementary Product Disclosure Statement to:

1. correct a misleading or deceptive statement in the PDS; or
2. correct an omission from the PDS of information it is required to contain; or
3. update, or add to, the information contained in the PDS; or
4. change a statement of a kind referred to in paragraph 1016E(1)(a) or (b).

-End of Paper-