

## Funds Management & Financial Services Alert

### New proposals set to re-shape funds management industry

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The Federal Government's chief advisory body on corporations law, the Corporations and Markets Advisory Committee (**CAMAC**), has recently published its much anticipated report on the operation of managed investment schemes in Australia.

#### Wide-sweeping reforms

The report contains a number of significant proposals, which, if adopted by the Federal Government, will radically transform the law relating to managed investment schemes.

Whilst the genesis of the report was the collapse of a number of agribusiness managed investment schemes following the global financial crisis (**GFC**), the terms of reference given to CAMAC extended its investigations to the operation of the managed investment scheme regime generally.

#### Key proposals

CAMAC's main proposals are as follows:

- **(Ban on common enterprise schemes)**—Most of the agribusiness schemes which collapsed during the GFC

were contractual-based schemes or 'common enterprise' schemes.

In a 'common enterprise' scheme, investors enter into a series of agreements with the responsible entity (**RE**) which relate to the ongoing operation of the scheme. For example, in agribusiness schemes structured as common enterprise schemes, investors would often enter into grower agreements to engage the RE or external parties to perform certain cultivation and management activities. Under the proposal, the creation of new common enterprise schemes would be banned.

'Pooled schemes' would be permitted to continue to operate. 'Pooled schemes' are managed investment schemes which involve the pooling of contributions by scheme members which then become scheme property. In these types of schemes, the investors play no active role in the affairs of the scheme. This expression would cover most trust-based schemes.

- **(Separate Legal Entity (SLE) proposal)**—CAMAC has recommended that a new legal structure for managed investment schemes be adopted.

Under this proposal, each scheme would be a separate legal entity, distinct from the RE or the members of the scheme. This is a fundamental change to the current law under which the scheme is not a separate legal entity and there is a trustee which holds scheme property on trust for the scheme members or which appoints a custodian to do so. Under the SLE

proposal, the scheme would hold legal title to all scheme property and would be the principal in all agreements entered into by the RE as operator of the scheme.

The reason this proposal has been made is to:

- ensure the full separation of the property, affairs and liabilities of a scheme from those of its RE;
- provide counterparties to agreements with direct rights against scheme property;
- assist in the process of changing an RE of a fund as the incoming RE would not be subject to personal obligations and liabilities for agreements entered into by a former RE; and
- simplify the external administration process for 'insolvent' schemes.

CAMAC recommends that if the SLE proposal is adopted, that all existing schemes be required to convert to this new legal structure.

- **(one RE per scheme)**—If the SLE proposal is not adopted, then CAMAC recommends that each RE only be permitted to operate one scheme. This recommendation has been made because of the difficulties in disentangling the dealings of insolvent REs from their schemes.
- **(no poison pills)**—CAMAC has recommended that provisions in a scheme's constitution or in other agreements which have the effect of entrenching the incumbent RE should only be enforceable if they do not unreasonably inhibit the right of scheme members to replace the RE.
- **(voting requirements to remove the RE)**—CAMAC has recommended that the current voting threshold to remove an RE, that is, 50% of those members eligible to vote (whether or not cast), is reduced to a simple majority of votes actually cast (in person or by proxy) provided that the total of the votes cast (both for and against) constitutes at least 25% of the total votes of eligible scheme members.
- **(appointment of temporary REs)**—CAMAC has made a series of recommendations about making the process of appointing a temporary RE less restrictive, including granting the courts much wider powers to appoint a person as a temporary RE.
- **(defining an insolvent scheme)**—As part of its suggested reforms around insolvency of schemes,

CAMAC has recommended that a statutory definition of what is an 'insolvent' scheme be included in the *Corporations Act 2001* (Cth) (**Act**). Under the current law, a scheme cannot technically be 'insolvent'.

CAMAC says that an insolvent scheme is one where the scheme's property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable.

- **(introduction of a VA procedure for schemes)**—A scheme, not being a company, cannot currently be placed in voluntary administration. There is simply no provision for it under the Act. CAMAC supports the introduction of a voluntary administration procedure for schemes.
- **(reduced voting requirements for winding up)**—CAMAC has recommended that scheme members be able to approve the winding up of a scheme by 75% of the votes cast on the resolution, provided the votes in favour of the winding up constitute at least 25% of the total votes of scheme members. Currently, the legislation provides that a resolution to wind up a scheme requires the approval of 50% of the scheme's members entitled to vote (whether or not cast).
- **(statutory limited liability for scheme members)**—CAMAC has recommended that new legislation be introduced such that in the event of insolvency, scheme members should only be liable for the unpaid portion of the amount they have agreed to contribute to the scheme. Whilst CAMAC recognises that this limitation is generally contained in scheme constitutions, it believes adding a statutory limitation will give greater protection to scheme members and more certainty for scheme creditors.

## An improved system

If the proposals are adopted, particularly the requirements that all existing schemes convert under the Separate Legal Entity proposal, then we will experience the same radical transformation we experienced when the *Managed Investments Act 1998* did away with the 'prescribed interest' regime and introduced the single responsible entity regime that exists today. It will also be an acknowledgement in some respects that our existing laws do not adequately deal with the widespread use of trusts as commercial vehicles.

However, while the changes might be transformational, they are also going to provide greater certainty for

investors, scheme operators, creditors to schemes and those contracting with schemes. It will be an improved system overall.

CAMAC has stated that it intends to conduct further public consultation on proposals to further improve the operation of managed investment schemes. We will keep you informed of any further developments in this regard.

Written by:

**Chris Mee**  
Special Counsel

For further information, please contact:

**Chris Mee**  
Special Counsel  
+61 7 3338 7589  
cmee@thomsonslawyers.com.au

**Loretta Reynolds**  
Partner  
+61 8 8236 1406  
lreynolds@thomsonslawyers.com.au

**Eugene Fung**  
Partner  
+61 7 3338 7524  
efung@thomsonslawyers.com.au

**Michael George**  
Special Counsel  
+61 2 9020 5793  
mgeorge@thomsonslawyers.com.au

[www.thomsonslawyers.com.au](http://www.thomsonslawyers.com.au)