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LAWYERS

Corporations and Markets Advisory Committee (CAMAC)

Managed Investment Schemes

Submissions

1 Introduction

We welcome CAMAC's comprehensive review of the managed investment schemes (**MIS**) industry in the discussion paper titled "Managed Investment Schemes" released by CAMAC in June 2011 (**Discussion Paper**).

We act for many participants in the financial services industry including responsible entities (**RE**) of wholesale and retail trust-based investment MIS (including outsourced trustees and REs), Australian superannuation trustees and overseas operators looking to expand in Australia. Therefore, we welcome the opportunity to comment on the issues raised in the Discussion Paper and the submissions in this paper reflect our firm's own views.

We have not made submissions on each issue raised in the Discussion Paper. Rather, we have focussed on some of the specific issues of key concern to our clients. The issues we have focussed on are:

- Reform 1: Identification and recording of the affairs of each MIS - do not support;
- Reform 2: Use of scheme property - support;
- Reform 3: Informing MIS creditors of a change of RE - support;
- Transfer of a viable MIS - changing the RE and appointment of a TRE (Chapter 4) - voting requirements to change RE should change;
- Restructuring a potentially viable MIS and Submissions on restructuring a potentially viable MIS and winding up a non-viable MIS - Elements of a VA for an MIS (Chapters 5 and 6) - suggest completely new framework;
- Other matters:
    - cross-guarantees (Chapter 7) - do not support; and
    - limited liability of MIS members (Chapter 7) - support.

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2 Preliminary observation: trust-based investment MIS vs contract-based enterprise MIS

A number of the specific issues raised in the Discussion Paper arise from the use of the "trust" as the structure within which certain types of MIS operate.

In our view:

- while the MIS structure operates appropriately and efficiently in relation to trust-based investment MISs, in our experience it can be problematic for contract-based "enterprise" MIS in insolvency scenarios;
- the application of insolvency laws to a contract-based enterprise MIS is complex and uncertain, leading to considerable cost and delay for all involved;
- the MIS structure is arguably inappropriate for contract-based enterprise schemes (e.g. agribusiness schemes); and
- contract-based enterprise MIS should be subject to a different regulatory framework from trust-based investment MIS.

In light of these views, our submissions in this paper focus on the implications of the proposed reforms on trust-based investment MISs.

3 Submissions on specific reforms

(a) Reform 1: Identification and recording of the affairs of each MIS

Section 3.4.2

Should the policy approach in Reform 1 be enacted?

Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?

If yes:

- how could counterparties ensure that their agreements are included in the register? For instance should they have a right of access to the register? Also in what circumstances, if any, should they have a means to have the register amended?
- what remedies should affected parties have for failure to include an agreement in the register and against whom?

If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.

Submission:

We do not support the policy approach in Reform 1, because the proposals are both unnecessary and unduly onerous. Our specific concerns are:

- An RE should always identify itself as the operator of an MIS in any agreement it enters into in its capacity as RE, and identify the relevant MIS (or, where an agreement relates to more than one MIS, the relevant part of the agreement that relates to each MIS) - this represents current best practice.

- An RE should, in accordance with its existing general record keeping obligations, maintain a list of agreements it enters into in its capacity as RE of a given MIS, ensuring that it keeps on top of contract management (required under section 601HA(1)(e) of the Corporations Act 2001 (Cth (**Act**)).

- The proposals will require REs to incur significant additional compliance, technology and maintenance costs (which ultimately will be passed on to the members of the scheme). Moreover, for REs of multiple schemes (e.g. outsourced REs), there will potentially be thousands of documents on the register.

- An agreements register should not be a definitive statement of all agreements entered into by an RE as operator of an MIS.

If the agreements register requirement is made mandatory, then some additional comments are:

- The contents of the agreements register will need to be carefully considered. For instance, if scheme rights and liabilities cease on replacement of an RE, then they are not subject to the statutory novation under sections 601FS and 601FT of the Act. Accordingly, it may be important to include this information in an agreements register, to avoid misleading an incoming RE. Also, if the content of an agreements register is incorrect or misleading, liability would sit with the former RE, which may not be useful if the former RE is insolvent.

- Given the effect of the statutory novation, any prudent incoming RE should conduct due diligence on the agreements to which the current RE is party, rather than blindly relying on the register. An incoming RE would be assuming liability for the accuracy of the register going forward, so it will be incumbent on a prudent incoming RE to do due diligence from this perspective as well.

- Therefore, not only is this proposal of limited use, particularly for a TRE, but it adds another potential liability where there is little time for a new RE to carry out due diligence on the register .

- If liability is to be transferred to the incoming RE or TRE, on its appointment the incoming RE or TRE will need to rectify and update the agreements register. Responsibility for this following a change of RE, and any subsequent liabilities which arise for a failure to do

so, will also be an issue for an incoming RE or TRE and an additional administrative burden. The former RE should remain liable for any deficiencies in the register and should be required to provide all reasonable assistance to an incoming RE or TRE in correcting the register.

- Any penalties should be proportionate to the extent and significance of the RE's omission(s). It would be inappropriate to expose directors and other officers to personal liability under section 601FD(1)(f) of the Act for a breach of this requirement.
- Failure to record an agreement on the register should not affect the enforceability of that agreement. Otherwise this would unfairly penalise both innocent third parties who have contracted with the RE and MIS members, by depriving them of any benefits under those agreements.
- Any penalty which affects the Australian financial services (**AFS**) licence of the offending RE may also have the unintended consequence of the RE no longer having an appropriate AFS licence to operate the relevant MIS.
- Any remedy against the former RE for failure to record an agreement or update the register would not be useful for a TRE or a new RE if the former RE is insolvent. For instance, while a statutory indemnity from the former RE in favour of the incoming RE or TRE would only provide useful protection where the former RE is solvent.

(b) **Reform 2: Use of scheme property**

Section 3.4.2

Should the policy approach in Reform 2 be enacted? Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?

We support the policy approach in Reform 2. In our view, a statutory requirement that the property of a particular MIS must only be used for the purposes of that MIS is appropriate.

However, we would suggest two exceptions:

- The first is so that REs of multiple MISs should be permitted to engage in 'block-booked transactions', in accordance with current ASIC policy. This is because:
  - Block-booked transactions are a common investment method adopted by REs and investment managers for multiple MISs with similar mandates. They involve the RE or investment manager pooling the assets of MISs to purchase tangible assets provided they are appropriately accounted for. Normally this involves entering into a particular trade on behalf of one or more of those MISs (known as the 'contract

group') and allocating parts of the trade among the MISs before, at the time of or after the trade has been entered into.

- Executing transactions in this way provides the contract group with many efficiencies and cost saving benefits.

- The second exception would be in the case of "sub-trusts", that is, where one MIS is in effect a wholly-owned sub-trust of another MIS.

Lastly, we note that the duties of an RE under s601FC act as a safeguard for the members of each MIS to ensure that the RE will act honestly, with care and diligence and in accordance with the compliance plan when dealing with the property of an MIS.

(c) **Reform 3: Informing MIS creditors of a change of RE**

Section 3.4.2

> Should the policy approach in Reform 3 be enacted?
>
> What, if any consequences should follow where an RE fails to inform a counterparty?

We agree with the proposal. This is because:

- It would be helpful for counterparties to ongoing agreements with an RE of a particular MIS to be notified of a change in the RE, and therefore a change in their counterparty to that agreement, by virtue of the operation of the statutory novation in section 601FS.

- As CAMAC has noted, this will assist counterparties to agreements with an RE to enforce their rights against the RE.

However, a failure by an RE to inform a counterparty of a change of RE should not affect the validity or enforceability of the relevant agreement.

In terms of penalties for failure to notify:

- An incoming RE should have a sufficient period of time (for example 60 days) to notify counterparties of the change in RE before any penalties are to apply.

- The incoming RE should be personally liable for any penalties for a failure to notify, which should also be proportionate to the extent of the failure to notify. For example, it would be appropriate to limit any penalty to a nominal fine in respect of each agreement.

(d) **Tort claims and statutory liability**

Section 3.7

Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from the property of the MIS in consequence of some common law or statutory breach by the RE? In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?

Submission:

We do not consider it necessary to clarify the circumstances in which an RE should or should not be able to claim under its right of indemnity. This is because:

- Despite minor differences in the decisions of the New South Wales and Victorian Courts of Appeal cited in the Discussion Paper (*Gatsios* and *Nolan*), the circumstances in which a trustee is entitled to the benefit of an indemnity from the assets of the trust fund are sufficiently clear at common law.
- Leaving aside any particular terms of the trust instrument affecting the scope of the right of indemnity, it is clear that a trustee will generally not be so entitled where it if found to have acted in breach of trust, which includes:
  - breaching the terms of the trust deed (*Youyang v Minter Ellison* (2003) 212 CLR 484, at [32]); and
  - failing to meet the required standard of care in the exercise of its powers (*Fouche v The Superannuation Fund Board* (1952) 88 CLR 609). In this regard, however, the Victorian Court of Appeal (at [53] of *Nolan*) preferred a more lenient approach to that of the NSW Court of Appeal (at [14] and [47] of *Gatsios*).
  - The position is also fairly clear under- statute: section 601GA(2)(b) of the Act states that the right of indemnity must be available only in relation to the proper performance of the RE's duties. It is reasonably clear that the RE's conduct of its duties must accord with the obligations required of it in respect of the scheme under s 601FC(1) of the Act, under the constitution and under the applicable general law of trusts, in order for the right of indemnity to apply to such conduct.
  - It is unnecessary to amend the law to provide for tort claimants to have direct rights against MIS property - it is accepted in both *Gatsios* and *Nolan* that commission of a tort does not deprive the trustee of its indemnity, at least where there is no breach of the trustee's duty of prudence in the conduct complained of. For this reason it seems unlikely

that a victim of a tort committed by a RE might be deprived of their ability to claim damages by the inability of the RE to pay the liability from the assets of the MIS.

4 Submissions on transfer of a viable MIS

(a) Dismissal of the RE by the members and retirement by the RE

Section 4.2.3

What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why?

What changes, if any should be made to the powers of the court to appoint a TRE and why?

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

What changes, if any, should be made to the current voting requirements concerning the dismissal of an RE of an unlisted MIS by the members of that MIS and why?

Submission:

The voting requirements for the removal of an RE and approval of a replacement need to be changed. In our view:

- The threshold for removal of an RE or approval of a replacement RE by members should be lowered to that of a special resolution.
- The requirement that members of an unlisted MIS pass an extraordinary resolution[1] to remove or approve the replacement of an RE, hinders the efficient operation of registered MISs and is contrary to members' interests. In particular, it is a material impediment to facilitating a change of RE, which may be in members' best interests.
- This high threshold is particularly significant for the many widely held MISs which have a large proportion of members comprising Investor Directed Portfolio Services (**IDPS**) platforms and/or IDPS-like services (including master trusts and wrap accounts). Such platforms commonly have a policy of refraining from engaging in corporate actions in the MISs they hold interests in for retail investors. As a result, many platforms will refrain from voting on resolutions to remove the RE.
- Therefore, where a large proportion of members do not vote, it can be very difficult to carry an extraordinary resolution.

[1] An extraordinary resolution requires that at least 50% of all the votes that may be cast by members entitled to vote (including members not present in person or by proxy) must be cast in favour of the resolution.

- The current requirement for an extraordinary resolution has the effect of potentially entrenching an RE. It would be preferable if the threshold for removal were to be lower, to create a better check and balance on an RE, so that it faces a more realistic prospect of being dismissed if the majority of members consider it is not the best candidate for operating the MIS.

- We think that a special resolution is the appropriate threshold, given that other issues relating to an MIS of equivalent significance to the removal or replacement of an RE, such as approving amendments to the MIS's constitution, have the same threshold.

- In the context of an RE's voluntary retirement, an even better and more flexible outcome could be to adopt an approach consistent with the MIS winding up mechanism under Chapter 5C. We propose that this would only apply where an RE wishes to retire. In these circumstances REs should be empowered under the Act to elect to retire by giving notice to members, on the condition that the outgoing RE proposes a replacement RE. Members' interests would be protected by both the election to retire and the selection of a replacement RE being subject to the outgoing RE's prevailing obligation to act in members' best interests.

- Such a regime of RE voluntary retirement by simple notice to members would:

  - solve the impasse created where passive/abstaining members prevent voting requirements from being met; and

  - benefits MIS where the incumbent RE would otherwise be entrenched, even though an alternate RE could bring efficiencies for the administration and operation of the MIS as well as better investment performance.

- We note that the voting requirement for the dismissal of an RE of a listed MIS requires only an ordinary resolution. Historically this is in accordance with ASX Listing Rule 13.3 (now deleted). We do not consider it necessary to apply the same threshold for an unlisted MIS. This is because we support the approach suggested in the *Review of the Managed Investments Act 1998* (2001) Turnbull Report, which acknowledged that the distinction between listed and unlisted schemes had been intended by parliament (in CLERP).

- Lastly, legislative reform is required to clarify the meaning of "associate" as it applies to the voting restrictions in section 253E. Section 253E prohibits an RE and its "associates" from voting their interest if they have an interest in the resolution or matter other than as member[2].

- However, there appears to be some level of confusion as to the meaning of "associate" for the purposes of the voting restrictions in

[2] Subject to the exception that, where the MIS is listed, the RE and its "associates" may vote on a resolution to remove the RE and appointment a new RE.

section 253E and, in particular, whether the appropriate test is that set out in section 12 or that contained in sections 11 and 12. For example, in the Victorian Supreme Court decision of *Great Southern Managers Australia Ltd (Receivers and Managers appointed)(in Liq)*[3] Davies J noted that section 12 clearly applies for the purpose of section 253E. However, in the more recent New South Wales Supreme Court decision in *Everest Capital Ltd (as trustee of the EBI Income Fund) v Trust Company Ltd and Others*[4] White J accepted that if section 253E is applicable, section 15 applies. We therefore encourage CAMAC to take this opportunity to seek to clarify the definition of "associate" within the context of section 253E.

What changes, if any should be made to the powers of the court to appoint a TRE and why?

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE to conduct due diligence?

We submit that, in addition to our comments in section 5 below:

- Section 601FM should be extended to provide the court with the express power to appoint a TRE under section 601FP in circumstances where MIS members have voted to remove the RE but no new RE has been appointed. While a member of an MIS or ASIC may apply to the court under regulation 5C.2.02 of the Corporations Regulations 2001 (Cth) for the appointment of a TRE, the power of the court to appoint a TRE in circumstances where MIS members have voted to remove the RE and no new RE has been appointed is uncertain.

- This is particularly significant where the Act requires that a MIS be wound up in circumstances where scheme members have passed a resolution to remove the RE but do not at the same meeting pass a resolution appointing a new RE which has consented to that appointment. For example, this situation may arise in circumstances where MIS members who are dissatisfied with the incumbent RE have voted to remove the RE and either:

    - no alternative RE is available at that time;

    - members have not formed a consensus as to who to appoint as the new RE;

    - the proposed new RE has not had sufficient time to undertake necessary due diligence enquiries to consent to that appointment; or

    - the necessary voting requirements for the appointment of a new RE have not been satisfied. The likelihood of this situation arising in relation to unlisted MISs is increased

[3] *Great Southern Managers Australia Ltd (Receivers and Managers appointed)(in Liq)* [2009] VSC 557
[4] *Everest Capital Ltd (as trustee of the EBI Income Fund) v Trust Company Ltd and Others* (2010) 77 ACSR 371

while the Act requires the high threshold of an extraordinary resolution to appoint a new RE.

- An existing RE should be required to provide a proposed new RE with access to the books and records of the MIS in circumstances where a meeting of MIS members has been convened for the purposes of either:
  - members choosing a new RE following the retirement of the existing RE; or
  - members voting to remove the RE and choose another entity to be the new RE.
- Currently, a former RE is only required to provide the books of the MIS to a new RE once the new RE has been appointed. However, by not having access to this information prior to its appointment, a proposed new RE cannot ascertain the nature and extent of the obligations and liabilities it will inherit by virtue of the statutory novation under the Act.
- This provides a significant obstacle in entities agreeing to become the new RE of a MIS, particularly where the former RE is insolvent. Allowing a potential new RE access to the books and records of the RE after a meeting of MIS members has been called will allow a new RE the opportunity to undertake the necessary due diligence enquiries prior to that meeting. This may also reduce the length of time for which a TRE may need to be appointed where, following those inquiries, the new RE is comfortable to consent to its appointment at that meeting.

(b) **Eligibility to be a TRE**

Section 4.4.1

Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reasons?

Submission:

The role of a TRE is to operate an MIS (albeit for an interim period). Accordingly, a TRE should be able to satisfy the requirements for being an RE, including being a public company and holding an AFS licence (including appropriate authorisations and capital requirements to operate the particular type of MIS).

(c) **Outstanding obligations and liabilities of the outgoing RE**

Section 4.4.2

What, if any, changes should be made to the current provisions concerning the transfer obligations and liabilities of the outgoing RE to the TRE, and for what reasons?

Submission:

The purpose of a TRE is to operate a viable MIS for an interim period until a new RE can be found, for example if the existing RE becomes insolvent or wishes to retire.

However, the effect of the statutory novation under section 601FS is that, on its appointment, a TRE assumes the pre-existing obligations and liabilities properly incurred by the former RE. This is particularly problematic where a TRE is required at short notice (e.g. in an insolvency situation) and has had little opportunity to undertake necessary due diligence enquiries prior to its appointment.

There is a clear policy rationale for the transfer of existing financial liabilities and obligations to a TRE to protect the existing interests of scheme creditors. However, the operation of section 601FS provides a compelling disincentive for an entity to accept a TRE appointment.

In our view:

- A TRE should be responsible for any liabilities that it incurs in that capacity, so that counterparties can confidently contract with the TRE. This is important to ensure the continued operation of the MIS during the interim period of the TRE's appointment.
- It is unduly burdensome for a TRE to be exposed to the pre-existing obligations and liabilities of the former RE during this interim period.
- While a TRE should be liable for the liabilities it incurs during its appointment, it should only inherit pre-existing liabilities of a MIS to the extent that the TRE can be indemnified for those liabilities out of the MIS assets.
- This would ensure that a TRE would not be personally liable for a deficiency in the MIS assets attributable to the former RE, while still allowing the TRE to enter into commercial agreements to ensure the ongoing viability of the MIS until a new RE is appointed.
- Existing creditors should be able to claim against the former RE personally in respect of any pre-existing liabilities which the former RE cannot recover from the MIS assets through its right of indemnity.
- Whilst this would disadvantage creditors in circumstances where the former RE is insolvent, it should be balanced against the significant risks faced by a TRE on assuming the pre-existing liabilities of the

former RE beyond those for which it may be indemnified for out of the MIS assets. It also needs to be considered in light of the potential for the TRE's appointment to allow a viable MIS with an insolvent RE to continue to operate for the benefit of members and creditors alike.

- As an alternative, there could be a mandatory moratorium on the enforcement by creditors and other third parties of any pre-existing liabilities, until a new RE is appointed or the MIS is placed into external administration.

- This moratorium would provide a TRE with added protection from personal liability for pre-existing liabilities incurred by the former RE. However, the disadvantage of this approach is that the solvency of the creditors of the MIS may be jeopardised if they are unable to seek payment of the MIS' debts to them during the moratorium.

(d) **Duties of the TRE**

Section 4.4.3

What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?

Submission:

In our view, a TRE and its officers and employees should be exempt from any liability where the MIS constitution and/or compliance plan is found to be defective and for any actions taken in bringing those documents into compliance with the Corporations Act.

- On its appointment a TRE must comply with a number of statutory duties including ensure that the MIS constitution and compliance plan meet the Act's requirements. Similarly, the TRE's officers must ensure that the TRE complies with these requirements. We think this is appropriate - although the purpose of appointing a TRE is to operate an MIS for an interim period, the TRE and its officers and employees should be subject to those statutory duties applicable to the TRE's actions while it is operating the MIS. For example, the TRE and its offers should be required to act honestly and in the best interests of MIS members.

- However, the obligation to ensure that the MIS constitution and compliance plan meet the requirements of the Act is particularly onerous for a TRE and its officers. This is because:

  - Any contraventions will have ordinarily arisen through the actions of a former RE.

  - Where a TRE is appointed at short notice, it can be difficult for a TRE and its officers and employees to understand the extent of

any breaches of this obligation by the former RE and the likely impact on the TRE.

5 Submissions on restructuring a potentially viable MIS and winding up a non-viable MIS - elements of a VA for an MIS

Section 5.4

Is there support in principle for the concept of a VA for an MIS? Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?

Submission:

We do not support the concept of a voluntary administration (**VA**) for an MIS. A VA is not appropriate for an MIS, for the reasons which we have set out below.

Rather, we suggest the following arrangements should be implemented in various insolvency scenarios involving MIS and REs:

No.	Scenario	Who is appointed and for whom	Rationale/comments
1	Insolvent RE + solvent scheme	Administrator appointed to RE. TRE appointed to operate scheme.	The affairs of the insolvent RE will be managed by the administrator. A TRE is appointed to replace the RE (which, by virtue of its insolvency, is not capable of operating the scheme).
2	Solvent RE + insolvent scheme	Judicial manager appointed to represent scheme members. Insolvency practitioner appointed to represent creditors. RE either remains in place or is replaced by TRE - holds MIS assets and acts on direction of judicial manager. RE may need to be relieved of certain usual RE duties, to the extent that they conflict with directions of judicial manager. No receiver is appointed to	There are numerous conflicts inherent in this scenario: between members and creditors; and between the RE as a creditor (by virtue of its right of indemnity out of the MIS assets) and other creditors and the members. Due to these conflicts, there need to be 2 independent "champions" of the members and creditors' conflicting interests. The administration process should be subject to court oversight to ensure all parties' interests are appropriately protected.

No.	Scenario	Who is appointed and for whom	Rationale/comments
		the RE.	The judicial manager appointed should be appropriately qualified and experienced to understand the nature of an MIS and the duties of an RE.
3	Insolvent RE + insolvent scheme	Administrator appointed to RE. TRE/insolvency practitioner appointed to operate scheme and represent scheme creditors - holds MIS assets and acts on direction of judicial manager. TRE may need to be relieved of certain usual RE duties, to the extent that they conflict with directions of judicial manager. Judicial manager appointed to represent scheme members.	As per 2 above. In addition: - As the RE is insolvent, it is not capable of operating the scheme, and so it should be replaced with either a TRE or an insolvency practitioner. - If an insolvency practitioner is appointed instead of a TRE, that practitioner should be appropriately qualified and experienced to operate the MIS and understand the nature of an MIS and the duties of an RE.

We do not favour a VA for an insolvent MIS for the following reasons:

- It is unclear whose interests the voluntary administrator would be expected to serve in controlling the VA of the MIS.

- While in a corporate insolvency the duty of the administrator is to look after the interests of all stakeholders, the position of creditors is regarded as paramount. It is unclear how this would work in the context of an MIS where the usual position would be that members' interests should be paramount. The issue is, therefore, who will look after the interests of members.

- The second insolvency scenario described above is particularly challenging for multi-scheme REs, especially where the RE is an outsourced RE. Currently the practice appears to be to appoint a receiver to the RE, which not only has reputational consequences but would affect all of the other MIS of which it is RE. Furthermore, the appointment of a receiver could potentially trigger cross-default provisions in other financing documents to which the RE is party in its capacity as RE of other unrelated MIS.

- There are inherent conflicts between the interests of creditors and members. While this is also the position in relation to a company, the practical position is quite different: when a company is insolvent, the administrator effectively ignores the interests of members. It is doubtful that this is what is intended to be achieved by applying a proposed VA regime to an insolvent MIS.

- Moreover, in the case of an insolvent scheme, there are further conflicts between the personal interests of the RE, which is a creditor (given its right of indemnity out of the assets of the MIS), the other creditors and members.

- It is likely that the outcome of a VA process would be, as is the case with companies, a formal or informal liquidation of assets (even if structured, as is the case with many insolvent companies, under the guise of a deed of company arrangement). This is because creditors are unlikely to be supportive of any restructuring of the scheme for the benefit of members, wanting instead to identify the swiftest way that the assets of the MIS can be liquidated so that they may be repaid their debts.

- There is a better structure than a VA for the insolvent administration of an MIS. That structure exists in the case of insolvent insurance companies (and insolvent banks) where the Insurance Act (and Banking Act) contains a procedure known as judicial management.

- Just as prudential policy considerations have led to the establishment of specific regimes for banks and insurance companies, so too the public interests involved in MIS support the existence of a separate, tailored procedure to deal with the complexities associated with their insolvency.

- The advantages of a judicial management structure tailored appropriately for MIS are:

    - A practitioner would be appointed to administer the affairs of the insolvent scheme exclusively from the perspective of the interests of members.

    - The appointed practitioner will have no conflict in his duties, having "tunnel vision" for the interests of members. If the RE is solvent, then it would itself be very interested in protecting its right of indemnity in respect of debts it has incurred on account of the scheme. In this respect, the RE is a creditor of the MIS and has a conflict of interest with the other creditors. Therefore, it is appropriate that an insolvency practitioner is appointed to look out for the interests of the MIS creditors.

    - Alternatively, if the RE is also insolvent and has had an administrator or liquidator appointed to it, that administrator or liquidator would look after the interests of the RE's creditors and a separate TRE or appropriately qualified

insolvency practitioner would be appointed to look after the interests of the MIS creditors and act as RE of the MIS.

- As is the case under the Insurance Act and Banking Act, there would be an imperative that the appointed practitioner(s) report to the court on options for the MIS within a relatively short period (which can be extended by the court, where necessary). This is important as the court has direct supervisory control over the practitioner(s), ensuring that all options for restructuring, recapitalisation or liquidation are examined and reported on expeditiously.
- The practitioner(s) would have a duty to report to the court on options, and other stakeholders, such as the RE, would have a right to be heard when that report is presented. The court could then direct either that meetings of scheme members be convened in order to implement a restructure or recapitalisation, or the court could order that the MIS be wound up.

6 Submissions on other matters

(a) Cross-guarantees

Section 7.2

In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?

Submission:

In November 2010, we assisted the Financial Services Council in providing submissions to ASIC in relation to ASIC's Consultation Paper 140 (**CP140**) on this point and other matters.

While ASIC has not officially published any outcomes of its consultation on CP140, we had understood that in relation to this point, ASIC indicated that industry commentary had caused ASIC to rethink this proposal.

We do not agree with the cross guarantee proposal in CP140. In our view that there is no need for any further form of regulation concerning the provision of cross-guarantees or indemnities by REs. This is because:

- The issues that are attempted to be dealt with by the proposal are already adequately covered by the general fiduciary duties of a trustee, and the provisions of the Act, including an RE's obligation to act in the best interests of members, the related party provisions (Part 5C.7) and the duties of directors and officers of an RE to act in the best interests of members.

- An RE should not be prevented from entering into a commercial transaction if it has have formed the view that it is acting in the best interests of the members of the scheme.

- The proposal in CP140 is too broad and will inappropriately inhibit an RE's ability to enter into normal commercial transactions. Indemnities are standard to commercial contracting, and a restriction on indemnities will require a significant review of commercial agreements entered into by REs.

(b) **Limited liability of MIS members**

Section 7.3

Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes?

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

Submission:

The question of liability of scheme members in MISs was addressed in the Companies and Securities Advisory Committee's report to the Minister for Financial Services and Regulation on Liability of Members of Managed Investment Schemes dated March 2000 (**CASAC Report**).

We support the approach taken in the CASAC Report, in particular that there should be a statutory limitation of liability for scheme members.

Current industry practice is to address the question of liability of members in an MIS in the scheme constitution. In our view:

- Introducing a statutory limitation of liability would give greater protection and certainty to both members and creditors of an MIS.

- As scheme members by definition do not have day-to-day control of the operation of the MIS, they should not be held personally liable for debts incurred by the RE.

- Any statutory regime limiting liability of MIS members should not be subject to any contrary provision in the MIS constitution. One advantage of a statutory regime is to introduce increased certainty, and this would be undermined if the position could be reversed in the scheme constitution.

In conclusion, we thank CAMAC for the opportunity to respond to the Discussion Paper and would be happy to answer any questions on our submissions.

Henry Davis York
14 October 2011

This submission has been prepared by members of the Financial Services Group and members of the Business Recovery and Insolvency group at Henry Davis York.

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