ASIC
Australian Securities & Investments Commission

REPORT 347

Response to submissions on CP 188 Managed investments: Constitutions—Updates to RG 134

June 2013

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 188 *Managed investments: Constitutions—Updates to RG 134* (CP 188) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 134 *Managed investments: Constitutions* (RG 134).

Contents

A Overview/Consultation process

1 In Consultation Paper 188 *Managed investments: Constitutions—Updates to RG 134* (CP 188), we consulted on proposals to update our guidance in Regulatory Guide 134 *Managed investments: Constitutions* (RG 134). RG 134 gives guidance on the content requirements in s601GA and 601GB of the *Corporations Act 2001* (Corporations Act) for the constitution of a managed investment scheme (scheme) that is registered with ASIC and how we will assess a constitution in deciding whether or not it meets these requirements.

2 RG 134 was released in 1998 and was last updated in 2000, when the managed investments regime was in its infancy. Since then, the managed investments industry has seen significant evolution. In light of these developments, we considered it important to review and update our guidance in RG 134.

3 The proposals in CP 188 were aimed at:

(a) ensuring that responsible entities and their advisers have sufficient certainty about what we will look for in reviewing a constitution when registering a scheme; and

(b) improving the efficiency and user friendliness of the process to register a scheme.

4 This report highlights the key issues that arose out of the submissions received on CP 188 and our responses to those issues.

5 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 188. We have limited this report to the key issues.

6 For a list of the non-confidential respondents to CP 188, see the appendix. Copies of the non-confidential submissions are on the ASIC website at www.asic.gov.au/cp under CP 188.

Responses to consultation

7 We received 11 responses to CP 188 from a number of different sources, including from responsible entities, industry bodies and law firms. One of the responses was confidential. We are grateful to respondents for taking the time to send us their comments.

8 Most respondents supported the need to revisit our guidance in RG 134 to take into account industry and regulatory developments over the past 13 years. The responses were also mostly supportive of many of the proposals in CP 188, particularly our proposal to simplify our guidance on how responsible entities can satisfy the requirement that the constitution make adequate provision for the consideration that is to be paid to acquire an interest in a scheme.

9 The main issues raised by respondents related to:

- diverging views on how the updated guidance in RG 134 should be drafted (Option 1 or Option 2);
- whether responsible entities of registered schemes should amend their constitutions to comply with the updated guidance in RG 134;
- whether the existing documentation and record-keeping obligations in Class Order [CO 05/26] *Constitutional provisions about the consideration to acquire interests* relating to the calculation of the consideration should be carried over into the 'safe harbour';
- whether provisions dealing with complaints by retail clients should be consistent with the internal dispute resolution requirements for Australian financial services (AFS) licensees approved by us under s912A(2)(a)(i) of the Corporations Act;
- what requirements should apply to dealing with complaints by wholesale clients;
- whether in order to make adequate provision for winding up a scheme, the constitution must address all five of the proposed key aspects of the process of winding up;
- whether constitutional provisions dealing with winding up a scheme should require a responsible entity to arrange for an independent audit of the final accounts after winding up by a registered company auditor or audit firm;
- whether to 'specify' the right to a fee, the constitution must set out all the variables (including timing variables) that will affect the amount of the fee that will be payable to a responsible entity;
- whether any payment to a responsible entity for performing a service included in the operation of a scheme should be classified as a fee (rather than an expense);
- whether a responsible entity should be precluded from including in a constitution a right to be paid fees in advance of the proper performance of the duties to which the fees relate;
- whether a constitution can include a provision allowing for a right of indemnity out of scheme property for expenses or liabilities incurred before a responsible entity takes office as the responsible entity of a scheme;
- whether a member has a 'right to withdraw' from a scheme where the responsible entity has a discretion to accept the request or not; and
- whether a constitution should specify the maximum timeframe for payment of a withdrawal amount to a member that ceases to be a member for the interests to which the withdrawal request relates.

B Responses to submissions on CP 188

Key points

CP 188 contained proposals to update our guidance in RG 134 on the content requirements in s601GA and 601GB of the Corporations Act for constitutions of registered schemes.

This section summarises the feedback we received in response to CP 188 and explains the changes we have made to our proposals resulting from the consultation process.

Implementation of our guidance

Updating our guidance (Option 1 or Option 2)

10 In CP 188, we proposed two alternatives for how the updated guidance in RG 134 could be drafted, and sought feedback on which of the two options was preferred. We proposed to adopt one of the following options:

(a) *Option 1:* RG 134 will generally be drafted to express our views on how we believe a constitution can meet the requirements in s601GA and 601GB of the Corporations Act. We will apply these views when assessing a constitution for the purposes of registering a scheme, but will leave open the possibility that there may be other ways for the constitution to meet these requirements.

(b) *Option 2:* Except for issue and withdrawal price, RG 134 will generally be drafted to provide guidance on when we will object to a constitutional provision involving the requirements in s601GA and 601GB in assessing a constitution for the purposes of registering a scheme.

11 We received eight submissions on this proposal. There were mixed responses, with no clear preference emerging from the submissions.

12 Three respondents believed that Option 1 was preferable. This was because it afforded greater flexibility in drafting constitutions, particularly for non-traditional schemes, and better aligned with the requirements of the Corporations Act and our powers.

13 One respondent preferred Option 2 on the basis that it provides greater flexibility, which encourages innovation.

14 Four respondents supported a combination of Option 1 and Option 2, noting that it would be helpful if ASIC was transparent in not only expressing our views on how a constitution can meet the requirements in s601GA and 601GB, but also our views on why certain provisions do not meet these requirements.

ASIC's response

We have taken into account these differing views in drafting the updated guidance in RG 134 to incorporate both Option 1 and Option 2. This is consistent with the preference of the majority of respondents who provided comments on this point.

Where we consider there may be differing ways to achieve compliance, we have drafted RG 134 consistent with Option 1 (e.g. our relief under Class Order [CO 13/655] *Provisions about the amount of consideration to acquire interests and withdrawal amounts not covered by [CO 05/26]*). Where we consider that there are reasons for objecting to particular constitutional provisions, we have drafted RG 134 consistent with Option 2 (e.g. our guidance on fees and indemnities).

Application to existing registered schemes

15 In CP 188, for existing registered schemes, we proposed that we would encourage compliance with our updated guidance in RG 134 by:

(a) if the responsible entity forms the view that the amendments can be made unilaterally, the next date any other unilateral amendment of the constitution is made on or after our guidance comes into effect; or

(b) if the responsible entity forms the view that member approval is required to approve the amendments, the next date a members' meeting is held.

16 There was strong opposition and disagreement from all nine respondents who addressed this proposal. Overall, respondents did not see any significant benefit in requiring existing constitutions to be amended to reflect our updated guidance compared to the corresponding substantive costs and lengthy process involved.

17 Specifically, submissions raised concerns about the following issues:

(a) There are significant costs involved in requiring existing constitutions to be amended, including the cost of:

(i) reviewing the terms of each existing constitution to determine which clauses require amendment;

(ii) obtaining legal advice on whether the amendments can be made by the responsible entity unilaterally or whether a special resolution of members is required to approve them;

(iii) drafting supplemental deeds to give effect to the amendments;

(iv) obtaining tax and stamp duty advice on whether the amendments give rise to any revenue law implications; and

(v) convening and holding meetings of members (if such meetings are required).

Submissions also noted that these costs are likely to be borne by members.

(b) There are also costs in considering whether the amendments to the constitution require consequential amendments to be made to the compliance plan and disclosure documents, including whether significant event or continuous disclosure notices would be required.

(c) Because the costs of effecting the amendments are likely to be high, in proposing to make these amendments, responsible entities may not be able to discharge their statutory duty under s601FC(1)(c) to act in the best interests of members.

(d) Recent case law governing constitutional amendments has left a responsible entity's ability to unilaterally amend a constitution without recourse to a meeting of members subject to significant uncertainty. This may result in responsible entities taking a cautious approach and only making amendments with member approval if there is any doubt.

(e) Even if a responsible entity calls a meeting of members to effect the changes, members may still fail to approve the changes, either because the meeting fails for a lack of quorum or the members vote against the amendments. This would place a responsible entity in a difficult position, having incurred wasted expense in convening and holding a meeting without any corresponding benefit.

(f) Schemes are generally not required to hold annual general meetings and so may have no reason to call a meeting for some time. Even though we proposed that member approval occur at the next date a members' meeting is held, two respondents still raised concerns that our proposal would effectively require a meeting of members to be called solely to consider approving amendments to the constitution to reflect our updated guidance.

ASIC's response

After considering the submissions made by the various respondents about the legal, operational and cost implications, we will not require responsible entities of existing schemes to comply with our updated guidance in RG 134. Responsible entities of existing schemes can form their own view about whether or not to amend the constitution (if required) to meet our updated guidance.

If a responsible entity of an existing scheme does not amend the constitution, we will not deregister the scheme or take any action against the responsible entity or its officers for a failure to comply with our updated guidance, as long as the constitution meets the requirements of our guidance in the previous version of RG 134: see RG 134.17.

However, our no-action position does not affect the rights of other third parties to take action if the responsible entity has contravened its duty under s601FC(1)(f) to ensure that the constitution meets the requirements in s601GA and 601GB.

We have also clarified that our relief under [CO 05/26] will continue to apply to existing schemes.

Consideration to acquire

Documentation and record keeping

18 In CP 188, we proposed not to make any changes to the requirements in [CO 05/26] for documentation and record keeping when calculating the consideration to acquire an interest in a scheme. We sought feedback on what value or benefits these requirements currently provide.

19 In addition, we proposed that these documentation and record-keeping requirements should also be included in the 'safe harbour' unchanged.

20 We received four submissions in response to this proposal.

21 One respondent agreed with our proposal, noting that the current record-keeping requirements assure members that decisions affecting the value of their investment are made with proper consideration and that the requirements have had the benefit of becoming accepted practice.

22 While believing that it is good practice for responsible entities to consider (and, where appropriate, document) the exercise of discretion and keep appropriate records of these matters, one respondent submitted that these requirements should not be a condition of relief under [CO 05/26].

23 Another respondent did not have any material issues with us retaining the requirements in [CO 05/26] on documentation and record keeping, but submitted that the documents are rarely accessed by consumers.

24 The remaining respondent believed that on balance, these requirements should be removed as they add very little value (if any) and are costly for responsible entities to comply with.

ASIC's response

Taking into account the lack of opposition to this proposal and submissions that the documentation and record-keeping requirements serve a useful purpose, we have adopted the substance of our proposal.

However, we have amended the mechanism for implementing these requirements. We have modified s601FC(1) so that all responsible entities must comply with these requirements when exercising a discretion or making an adjustment affecting the amount of the:

(a) consideration to acquire an interest; or

(b) withdrawal payment or removal of liability.

See Class Order [CO 13/657] *Discretions affecting the amount of consideration to acquire interests and withdrawal amounts.*

The requirements now apply regardless of whether a responsible entity relies on our relief in [CO 13/655].

We consider that it is more appropriate to impose these requirements directly as part of a responsible entity's statutory duties, rather than indirectly as a condition of our relief in [CO 13/655].

Failure to comply with these requirements is a direct breach of a responsible entity's statutory duties under s601FC(1) with civil and criminal consequences. We consider that there are important benefits of efficiency, consistency and transparency in requiring all responsible entities to document their policies and procedures on how they calculate the consideration to acquire an interest in a scheme.

Complaints

Complaints handling procedures for retail clients

25 In CP 188, we proposed that, for the constitution to make adequate provision for dealing with complaints by retail clients, the provisions on complaints should be consistent with the requirements for internal dispute resolution (IDR) procedures for retail clients that apply to AFS licensees, as approved by ASIC under s912A(2)(a)(i).

> Note: Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165) sets out what AFS licensees must do to meet the dispute resolution requirements in s912A(2), including setting out the specific requirements for IDR procedures.

26 We suggested that a responsible entity, as an AFS licensee, could include in the constitution either:

(a) a provision stating that it will comply with ASIC-approved IDR procedures in dealing with complaints by retail clients; or

(b) provisions setting out its own complaints handling procedures for retail clients, as long as these procedures fully address all the relevant requirements in RG 165.

27 We received eight submissions in response to this proposal.

28 Five respondents agreed with our proposal that the provisions of a constitution for dealing with complaints by retail clients should be consistent with the requirements for IDR procedures for retail clients that apply to an AFS licensee.

29 However, three respondents disagreed with our proposal for the following reasons:

(a) It is problematic for certain procedures to be incorporated into the constitution. One example given was the requirement that an AFS licensee acknowledge the receipt of complaints or disputes immediately.

(b) If the dispute resolution requirements are required to be incorporated into the constitution, any failure to comply with these requirements may have the unintended consequence of being elevated to a breach of the constitution and may potentially give rise to civil and criminal consequences for the officers of the responsible entity under s601FD.

(c) As AFS licensees, responsible entities are already required to comply with the dispute resolution requirements in s912A(2), making any further requirements in scheme constitutions unnecessary.

ASIC's response

We remain of the view that responsible entities can meet the requirements in s601GA(1)(c) in part by having complaints handling procedures that meet the dispute resolution requirements for retail clients in s912A(2).

Given that s601GA(2) and 912A(2) focus on procedures for dealing with complaints or disputes and that responsible entities are also AFS licensees, we consider that it will be more efficient for responsible entities if we align our expectations for dealing with complaints by retail clients under the constitution with those for retail clients of AFS licensees. This means responsible entities can have one set of complaints handling procedures for retail clients.

We have clarified that a responsible entity can comply with s601GA(1)(c) *in part* by choosing to:

(a) include a provision to the effect that, as an AFS licensee, it will comply with the dispute resolution requirements in s912A(2) for retail clients; or

(b) if it decides not to include such a provision, include its own complaints handling provisions for retail clients, as long as they are consistent with RG 165.

We have taken into account the submissions on the difficulties of incorporating certain procedures into the constitution. However, we note that current industry practice is to include in the constitution provisions that meet the requirements of RG 165 (including that complaints are acknowledged immediately).

We consider that a responsible entity could minimise any difficulties by including a provision to the effect that, as an AFS licensee, it will comply with the dispute resolution requirements in s912A(2) for retail clients as set out in RG 165 (rather than specifying in detail its own complaints handling provisions).

We acknowledge that failing to comply with such a provision could give rise to a breach of the constitution and have civil and criminal consequences for officers. However, we note that a responsible entity can choose not to include such a provision if it and its officers are concerned about such consequences.

Complaints handling procedures for wholesale clients

30 In CP 188, we proposed that a responsible entity may devise and include in the constitution its own complaints handling procedures for wholesale clients.

31 We received eight submissions in response to this proposal.

32 One respondent submitted that dispute resolution should not apply to wholesale clients, as they are capable of protecting themselves.

33 Another two respondents considered that the complaints handling procedures for schemes with both retail and wholesale clients should be the same as the procedures for schemes with retail clients only.

34 In response to our feedback question, the remaining five respondents all expressed the view that it is not appropriate for complaints handling procedures between retail and wholesale clients to be the same.

ASIC's response

To the extent that a scheme is open to wholesale clients, we remain of the view that the constitution must address complaints handling procedures for these clients.

While we acknowledge that wholesale clients may be better able to protect themselves and may have informal arrangements with a responsible entity to resolve disputes, we think that this may not be sufficient for a responsible entity to meet the requirements in s601GA(1)(c). As 'member' is defined in s9 as a person who holds an interest in the scheme, we consider that this means that the constitution should contain provisions that deal with complaints by wholesale clients as well as retail clients.

Taking into account all of the submissions, we also remain of the view that responsible entities should have the flexibility to devise and include their own complaints handling procedures for wholesale clients. This means that a responsible entity may, if it chooses, apply the same procedures to wholesale clients and retail clients.

However, as wholesale clients may be better placed to raise complaints with the responsible entity and have these resolved, we consider that it is unlikely that wholesale clients need the same level of protection afforded to retail clients under s912A(1)(g). As such, we believe a responsible entity should be able to devise and include in the constitution complaints handling procedures for wholesale clients that differ from those for retail clients.

Winding up a managed investment scheme

Key aspects of winding up a scheme

35 In CP 188, we proposed that, to make adequate provision for winding up a scheme, the constitution must address the following key aspects of the process of winding up:

(a) the identification of the assets of the scheme;

(b) the distribution of the net proceeds of realisation of the scheme;

(c) the identification of how the parties responsible for or involved in winding up the scheme will be paid and in what priority;

(d) any power to require members to continue making payments during the process of winding up the scheme or any ability to accept such payments from members to maximise the net proceeds of realisation; and

(e) how the process of winding up the scheme will occur if the responsible entity and/or the scheme is insolvent.

36 We received eight submissions in response to this proposal.

37 While two respondents agreed with most of the key aspects, the majority of respondents were of the view that our proposed guidance was overly prescriptive. Three respondents went further, noting that it was unnecessary to include such detailed winding up procedures in constitutions given the existing statutory duties of responsible entities and fiduciary duties for trustees under general law.

38 Most respondents were in favour of winding up provisions being flexible to accommodate unforeseen circumstances and avoid the inefficiencies and costs for members that would arise in accommodating a situation that fell outside the prescriptive constitutional provisions (i.e. the cost of amending constitutional procedures by way of a meeting of members, or a court application for directions).

39 Our proposal that the constitution should deal with how the process of winding up the scheme will occur if the responsible entity and/or the scheme is insolvent was of particular concern for five respondents. Specifically, these respondents made the following submissions:

(a) This proposal should be pursued through statutory reform of the Corporations Act, rather than through updated ASIC guidance.

(b) There is little logic in setting out in the constitution how the scheme is wound up if the responsible entity becomes insolvent given that the insolvency of responsible entities (being public companies) is already governed by Ch 5 of the Corporations Act.

(c) It would be difficult when establishing a scheme to accurately determine and so draft provisions on winding up if the responsible entity and/or scheme were to become insolvent in the future.

(d) Requiring such provisions in the constitution is unlikely to reduce the number of court orders being sought in distressed scheme situations.

ASIC's response

Having taken into account all of the submissions, we consider that the constitution should address the following key aspects of winding up:

(a) how assets, liabilities and scheme property will be dealt with;

(b) the distribution of the proceeds of winding up;

(c) the costs of winding up; and

(d) any payments to maximise proceeds of winding up.

We note that the majority of respondents agreed that these aspects were key aspects of winding up a scheme.

We acknowledge respondents' preference for winding up procedures to be as flexible as possible. We consider that there is sufficient flexibility in our guidance for responsible entities and their advisers to draft provisions that suit their needs, and the needs of the scheme, while addressing each of these key aspects of winding up.

We have not required that the constitution address the scenario if the responsible entity and/or scheme become insolvent. However, we have clarified that a responsible entity should consider whether to include such provisions.

For unitised schemes, we recognise that the established principles of trust law give some assistance in a winding up, so there may be less of a need for such provisions to be included in the constitution. However, contract-based schemes cannot rely on the established principles of trust law to provide assistance in winding up. We encourage responsible entities of these types of schemes to consider adding provisions in the constitution to deal with winding up the scheme if the responsible entity and/or scheme become insolvent.

Independent audit or review

40 In CP 188, we proposed to reiterate the existing requirement that the constitution should provide for an independent audit of the final accounts after winding up the scheme to be conducted by a registered company auditor or audit firm.

41 We received six submissions in response to this proposal.

42 Two respondents agreed with this proposal.

43 However, three respondents expressed the view that mandating an independent audit in all circumstances was not a requirement of the Corporations Act. Depending on the complexity of the particular scheme being wound up, these respondents further argued that an audit may constitute an excessive and unnecessary cost ultimately paid for by members of the scheme, and that instead, a responsible entity's statutory duties should be sufficient in guiding it to determine whether an audit or a review is required.

44 Another respondent submitted that there should not be a requirement for an independent audit unless an equivalent obligation is imposed for the winding up of a company.

ASIC's response

We remain of the view that the constitution should include a provision for an independent audit of the final accounts after winding up the scheme to be conducted by a registered company auditor or audit firm.

We acknowledge that there may be costs associated with conducting an independent audit. However, we consider that, on winding up a scheme, it is an appropriate safeguard for the

accounts to be independently audited to determine the level of compliance with the Corporations Act.

We consider that the issue of an independent audit on the winding up of a scheme need not be determined based on whether an equivalent obligation is imposed on the winding up of a company.

Payment of fees, liabilities or expenses

Variables affecting the amount of the fee payable

45 In CP 188, we proposed that to 'specify' the right to a fee, the constitution must set out all the variables (including the timing variables and any index benchmark) that will affect the amount of the fee that will be payable to a responsible entity.

46 We received six submissions in response to this proposal.

47 Five respondents either supported our proposal or had no objection to it, with two respondents stating that to the extent there are multiple levels of variables in any fee, there should be no limitation on how many of these variables should be set out in the constitution.

48 One respondent expressly disagreed with this proposal, arguing that it is only necessary for the right to be paid a fee (and not the quantum) to be specified in the constitution.

ASIC's response

We remain of the view that to 'specify' the right to a fee, the constitution must set out all the variables that will affect the amount of the fee that will be payable to a responsible entity.

We took into account the submission that only the right to be paid a fee must be specified. However, we consider that such a view could allow the legislative requirements in s601GC on amending a constitution that are designed to protect members to be circumvented.

Payment for performing a service

49 In CP 188, we proposed that any payment to a responsible entity for performing a service included in operating the scheme must be categorised in the constitution as a fee, rather than as an expense.

50 We received six submissions in response to this proposal.

51 Two respondents did not object to the proposal.

52 However, four respondents disagreed with our proposal. Specifically, respondents raised concerns that:

(a) providing guidance on what may be called a fee and what may be called an expense is beyond ASIC's regulatory remit;

(b) the enhanced fees disclosure regime in Sch 10 of the Corporations Regulations 2001 (Corporations Regulations) already addresses the regulatory issue of disclosing fees and expenses;

(c) a responsible entity has duties under s601FC that provide adequate protection; and

(d) it should be open to a responsible entity to indemnify itself, rather than charge a fee, for certain services provided to a scheme.

ASIC's response

Taking into account the submissions we received, we remain of the view that any payment to a responsible entity for performing a service included in operating the scheme should be categorised in the constitution as a fee, rather than as an expense.

We note that there is authority for the proposition that a responsible entity (in its capacity as responsible entity) cannot contract with itself (in its personal capacity): see *Macarthur Cook Fund Management Limited v Zhaofeng Funds Limited* [2012] NSWSC 911 at paragraph 117. We consider that this authority may affect the ability of the responsible entity to characterise a service performed by it for operating the scheme as an expense.

We acknowledge that the responsible entity's duties under s601FC provide some protection against unfair fee practices. However, we consider that these duties do not prevent responsible entities from avoiding setting out all of the variables that will affect the amount of the fee that will be payable to them by characterising something as an indemnity.

We considered the submissions on the enhanced fee disclosure regime in Sch 10 of the Corporations Regulations. However, we consider that the requirement in s601GA(2) is separate from disclosure of fees and expenses.

Payment of fees in advance

53 In CP 188, we proposed that the constitution must not allow for a right of payment of fees in advance of the responsible entity's proper performance of its duties to which the fees relate.

54 We received four submissions in response to this proposal.

55 Three respondents either agreed with the proposal or did not object to it.

56 One respondent did not agree with the proposal because:

(a) payment of the fee in advance could help the responsible entity meet its own expenses;

(b) the responsible entity's duties in relation to proper performance provide adequate protection for members; and

(c) as with any management or other arrangement, it is open for parties to determine which fees are paid in advance and which fees are paid in arrears. To support this view, the respondent cited a management fee as typically being used by the responsible entity to pay its own expenses, which are otherwise not recoverable from the scheme.

ASIC's response

We remain of the view that the constitution must not allow for a right of payment of fees in advance of the responsible entity's proper performance of its duties to which the fees relate.

We have taken into account submissions about the responsible entity's duties providing adequate protection. However, we consider that a responsible entity may still face difficulties in recouping fees that have already been paid if it is later determined that it did not properly perform its duties. These difficulties could be exacerbated if the responsible entity is paying itself fees in advance to meet its own expenses.

We acknowledge that some flexibility is desirable for responsible entities in having a right to payment of fees and indemnities that meets their needs. However, we consider that payment of a fee in advance is incompatible with the right only being available for proper performance. This is because the responsible entity can only form a view about the proper performance after the event.

We consider that minimising any difficulties in recouping fees already paid in advance where it is later determined that the responsible entity did not properly perform its duties outweighs the desirability for flexibility in this case.

We note that the majority of respondents either agreed or did not object to our view.

Expenses or liabilities incurred before taking office

57 In CP 188, we proposed that a constitution must not allow for a right of indemnity out of scheme property for expenses or liabilities incurred before a responsible entity takes office as the responsible entity of a scheme.

58 We received six submissions addressing this proposal, with mixed responses.

59 Three respondents broadly agreed with this proposal, while three other respondents disagreed on the basis that:

(a) s601GA(2) does not prohibit indemnification out of scheme property for expenses or liabilities incurred before the responsible entity takes office and there is no clear reason why such an indemnity should be prohibited; and

(b) it is appropriate for a responsible entity to be reimbursed for pre-scheme establishment or registration costs (such as legal costs and tax advice),

as they are incurred in the proper performance of its duties, disclosed to members and ultimately for members' benefit.

ASIC's response

After considering the submissions made by various respondents about the construction of s601GA(2) and the reasons for our proposal, we will not prohibit a right of indemnity out of scheme property for expenses or liabilities incurred before a responsible entity takes office.

Withdrawal rights of members

Members' right to withdraw

60 In CP 188, we proposed to take the view that a 'right to withdraw' from a scheme is any right of a member to cease to hold an interest in the scheme at the request of the member (even if the responsible entity has a discretion about whether to accept the request before the right applies).

61 We received five submissions in response to this proposal.

62 While two respondents agreed with our proposal, three respondents did not agree that a member has a right to withdraw where the responsible entity has a discretion about whether to accept the request. These respondents submitted that a right to withdraw in these circumstances is only a right to request.

ASIC's response

Taking into account the submissions we received, we have clarified what we believe constitutes a 'right to withdraw'. We consider that provisions allowing a member (at their request) to cease to be a member for the interests that are the subject of a withdrawal request *can* confer a 'right to withdraw', even if the responsible entity has a discretion about whether to accept it.

We acknowledge that when the request is made, there may be no 'right to withdraw', but that a 'right to withdraw' will generally arise on the exercise of the discretion to allow withdrawal, or at a later point in time before the withdrawal is effected.

We note that our view is consistent with the views of the three respondents who indicated that it is only on acceptance of a member's withdrawal request that the 'right to withdraw' exists.

Maximum timeframe for payment of a withdrawal amount

63 In CP 188, we proposed that, for the constitution to have adequate procedures for making and dealing with withdrawal requests, it should address four key areas, including when a member ceases to be a member for

the interests that are the subject of the withdrawal request. We also sought feedback from industry on what is a reasonable timeframe for members to be paid a withdrawal amount and whether we should give guidance on what we consider is a reasonable maximum timeframe for payment.

64 We received six submissions that addressed this proposal and feedback question.

65 None of the respondents put forward a specific maximum timeframe for payment that they considered as being reasonable.

66 Five respondents said that it was unnecessary for us to prescribe a maximum timeframe. Reasons given by these respondents for this view were that:

(a) what is a reasonable maximum timeframe will depend on the type of scheme in question, its asset classes and the circumstances of the proposed withdrawal (e.g. current market conditions) so prescribing a timeframe for all schemes is likely to be unworkable; and

(b) in any event, responsible entities are subject to statutory and fiduciary duties and would need to consider these when determining an appropriate timeframe for payment.

67 However, one respondent acknowledged that it might be useful for members to know what we view as a reasonable maximum timeframe.

ASIC's response

We consider that responsible entities should be able to determine the timeframe for payment of a withdrawal amount to a former member, and include a provision in the constitution specifying a maximum timeframe for payment.

We agree that what is a reasonable timeframe will depend on the type of scheme, the assets held and other factors. For this reason, we have not prescribed a particular timeframe for all schemes. However, we note that for a non-liquid scheme, there is a requirement in s601KD for withdrawal requests to be satisfied within 21 days. We may ask a responsible entity or its advisers to explain why a timeframe is fair if it exceeds 21 days.

We consider that former members may have an expectation to receive payment within a reasonable timeframe of withdrawing. We also consider that former members should not lose their right to benefit from any increases in the value of scheme property by waiting an indeterminate or overly long period of time.

We agree that responsible entities are subject to duties which they would need to consider when determining an appropriate timeframe for payment.

Appendix: List of non-confidential respondents

- Allens
- AMP Capital Investors Limited
- Australian Timeshare and Holiday Ownership Council
- Clarke, Dr Tamsin
- Financial Ombudsman Service
- Financial Services Council
- Henry Davis York
- Law Council of Australia
- McCullough Robertson
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