ASIC

Australian Securities & Investments Commission

Review of the regulatory framework for managed investment schemes

Submission by the Australian Securities and Investments Commission

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Executive summary

1 The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to make a submission to Treasury on its consultation paper on the *Review of the regulatory framework for managed investment schemes*, released on 4 August 2023.

2 Since the commencement of the managed investment schemes framework—now contained in Ch 5C of the *Corporations Act 2001* (Corporations Act)—managed investment schemes have become a popular investment vehicle. As discussed in the consultation paper, an estimated $2.7 trillion of assets are currently held in this investment vehicle. The total value of assets held by registered schemes is about $1.8 trillion. At the end of June 2022, there were 420 responsible entities operating a total of 3,656 registered schemes.

3 However, there have been many large scheme collapses since the introduction of the framework. Examples include the schemes operated by Great Southern Managers Australia Ltd, Timbercorp Securities Limited, LM Investment Management Limited, Prime Trust and Sterling Income Trust. Previous inquiries that examined some of these collapses have recognised the devastating impacts—both financial and personal—such failures have on investors.

4 Despite a number of reviews and inquiries that have recommended changes to the regulatory framework governing managed investment schemes, some significant issues remain.

5 We believe the review presents an opportunity to strengthen the framework for managed investment schemes in some key areas, to prevent or minimise harm to retail investors. Our recommendations include:

(a) updating the definition of 'wholesale client' to ensure that investors who should be categorised as retail investors are recognised as such and benefit from the existing statutory protections for retail investors;

(b) introducing additional targeted protections for investors in retail schemes, such as tighter requirements for those schemes that can be classified and promoted as 'liquid', and additional governance requirements;

(c) enhancing the transparency of the managed fund sector through recurrent data collection powers and a notification requirement for wholesale schemes, to ensure the availability of essential information about schemes and their operators; and

(d) introducing a tailored insolvency regime for retail schemes aimed at faster and better outcomes for members.

6 We recommend that the existing registration process for retail schemes be automated, by removing the requirement for ASIC to assess the content of scheme constitutions and compliance plans. This will lower regulatory costs without impacting investor outcomes, given the limited effectiveness of the current process for assessing retail scheme documentation at the time of registration.

7 The introduction of a new power for ASIC to direct responsible entities to amend their scheme constitutions, complemented by the changes referred to in paragraph 5(c) would help improve ASIC's ongoing visibility over schemes and allow more focused intervention by ASIC where it is needed.

8 Table 1 summarises our responses in this submission to the specific questions raised in the consultation paper.

Table 1: Overview of ASIC's submission

Topic/reference	Summary of ASIC's feedback
Wholesale client thresholds: Section A (response to questions 1–4 of the consultation paper)	We recommend that the financial thresholds for the product value and individual wealth tests used to classify wholesale clients should be increased to reflect inflation. The current financial thresholds have resulted in investors who may not have financial knowledge or experience, a high net worth by today's standards or a high-risk appetite accessing wholesale-only investments. This can present significant risks of harm. We also recommend introducing a statutory mechanism to periodically increase the thresholds over time, at least in line with inflation. Increasing the financial thresholds will better ensure that investors who are in substance retail clients are recognised as such and able to access the statutory protections that then apply. We do not consider that consent requirements are an effective means of ensuring that investors fully understand the consequences of being classified as a wholesale client. However, if consent requirements are introduced, they should be applied consistently across both the individual wealth and product value tests.

Topic/reference	Summary of ASIC's feedback
Suitability of scheme investments and scheme registration: Section B (response to questions 5–7 of the consultation paper)	While we support the introduction of some restrictions on investments in principle, we consider that it would be challenging to frame an appropriate legislative restriction that does not unduly limit access to existing or future schemes that are suitable for retail investment. In the absence of restrictions, we consider our proposals such as increasing the wholesale client thresholds and changing some aspects of the liquidity regime would assist to protect and reduce the risk of harm to retail investors. We recommend an automated registration process for retail managed investment schemes, consistent with the registration process for corporate collective investment vehicles (CCIVs) as this would allow significant regulatory resources to be redeployed to our supervisory work. We do not recommend introducing additional grounds for ASIC to refuse to register schemes as this would impose a significant regulatory burden on ASIC and industry. It would also bolster the 'halo effect' of scheme registration, without effectively targeting the causes of consumer harm.
Scheme governance and the role of the responsible entity: Section C (response to questions 8–12 of the consultation paper)	We recommend that the Corporations Act be amended to give us the power to direct a responsible entity to change a scheme constitution. The power should be analogous to our power under s1223C to direct a corporate director to change the constitution of a retail CCIV. We also recommend that a qualitative standard should be introduced for auditing compliance plans, similar to the obligation for auditing financial statements. Further, we recommend that a majority of the directors on the board of the responsible entity should be external directors.
Right to replace the responsible entity: Section D (response to questions 13–16 of the consultation paper)	We recommend that the current threshold of an extraordinary resolution for members of an unlisted scheme to remove the responsible entity should be lowered at a minimum to a special resolution. We also recommend that reforms are needed to: • enable prospective responsible entities to be provided access to books and records of schemes by the current responsible entity; and • limit the liability exposure of prospective responsible entities to the scheme assets. We recommend reforms to prevent responsible entities from including provisions in the constitution or entering contractual arrangements that entrench the responsible entity and its agents in their roles or that restrict the responsible entity from exercising its powers.
Right to withdraw from a scheme: Section E (response to questions 17–19 of the consultation paper)	We recommend that the definition of 'liquid assets' should be revised to make the test of liquidity more objective, precise and transparent, rather than relying on an arbitrary time period specified in the constitution. We also recommend that schemes that become frozen (i.e. where redemptions have been suspended) should be required to notify ASIC when this occurs and prohibited from issuing new interests to investors while frozen.

<table>
<tr><th>Topic/reference</th><th>Summary of ASIC’s feedback</th></tr>
<tr><td>Winding up insolvent schemes: Section F

(response to questions 20–22 of the consultation paper)</td><td>We recommend that a tailored statutory insolvency regime for schemes would facilitate a more orderly and timely winding up of ‘insolvent’ schemes, and result in better outcomes for scheme operators, scheme members, creditors and other interested parties. This could be achieved by amending the existing provisions in Pt 5C.9 and expanding its scope.

We also recommend the introduction of a statutory limited liability for scheme members.</td></tr>
<tr><td>Commonwealth and state regulation of real property investments: Section G

(response to question 23 of the consultation paper)</td><td>We have not identified any new proposals in connection with dual-regulated schemes. We will collaboratively engage with regulators where it is apparent that multi-regulated schemes pose a risk of significant harm to investors. This engagement will be risk-based and we will consider reports of misconduct received.</td></tr>
<tr><td>Regulatory cost savings and additional ASIC powers: Section H

(response to question 24 of the consultation paper)</td><td>We recommend the following are key opportunities to modernise and streamline the regulatory framework for schemes to reduce regulatory burdens without detracting from investor outcomes:
• Automate the retail scheme registration process.
• Incorporate key legislative instruments and standard individual relief commonly provided by ASIC into the Corporations Act.

We also recommend the following increases to ASIC’s powers to improve transparency for investors, ASIC and the market:
• Enhance our data capabilities through the introduction of a legislative framework for the recurrent collection of data on registered and unregistered schemes.
• Introduce a basic notification requirement for wholesale schemes.</td></tr>
</table>

A Wholesale client thresholds

Key points

This section outlines our feedback on questions 1–4 of the consultation paper.

The financial thresholds for the product value and individual wealth tests used to classify wholesale clients are outdated. We recommend that these thresholds should be increased to account for inflation. We also recommend that a mechanism be introduced to periodically increase these thresholds over time, at least in line with inflation.

Amending the financial thresholds in this way will better ensure that investors who are in substance retail clients are recognised as such and benefit from existing statutory protections.

If consent requirements are introduced, we recommend that they should be applied consistently across both the individual wealth and product value tests.

Statutory protections for retail clients

9 There are a number of important statutory protections that apply to retail investors—for example:

(a) the design and distribution obligations (DDO) regime, which requires financial product issuers to identify a target market for their financial products and take reasonable steps to ensure that distribution of those financial products to retail clients is consistent with that target market;

(b) various obligations that AFS licensees must comply with (as responsible entities of schemes with retail investors must hold an AFS licence), including the requirement that licensees have an appropriate internal dispute resolution system to deal with complaints from retail clients, and membership with the Australian Financial Complaints Authority (AFCA);

(c) entitlements to receive financial product and service information disclosure such as a Product Disclosure Statement (PDS) or a Financial Services Guide; and

(d) a range of protections under Ch 5C of the Corporations Act that apply to registered schemes (where registration is generally required when retail clients are scheme members), including the duty for the responsible entity of a registered scheme to act in the best interests of scheme members.

10 Retail clients also benefit from significant additional protections under the Corporations Act when receiving financial advice, including:

(a) requirements on providers of personal financial product advice to retail clients to:

(i) act in the best interests of their client (s961B);

(ii) ensure their advice is appropriate (s961G);

(iii) give priority to their client's interests where there is a conflict of interest (s961J); and

(iv) in many cases, give a retail client a statement of advice (s946A); and

(b) the conflicted and other banned remuneration provisions in Divs 4–5 of Pt 7.7A of the Corporations Act, which primarily aim to align the interests of providers of advice on financial products more closely with the interests of their retail clients.

Note: The Government is currently progressing its response to the recommendations in the *Quality of advice review final report*. The reforms implemented through that process may impact a number of these obligations.

11 The protections listed above do not apply to investors classified as 'wholesale clients'.

Financial thresholds for wholesale clients

12 A financial product or service is generally considered to be provided to a retail client, unless the client is classified as a 'wholesale client'. An investor will be classified as a wholesale client if they satisfy one of the eligibility tests in s761G.

Note: In addition to the wholesale client test in s761G, s761GA provides for the 'sophisticated investor' test.

13 A number of these tests incorporate financial thresholds, including the following:

(a) The product value test in s761G(7)(a)—A person will be a wholesale client if the price of the financial product provided to them, or the value of the financial product to which a financial service relates, is $500,000 or more.

(b) The individual wealth test in s761G(7)(c)—A person will be a wholesale client if they have net assets of at least $2.5 million or gross income of at least $250,000 per year for the last two financial years.

14 The product value test and individual wealth test operate independently. An investor need only satisfy one of these tests, or one of the limbs (net assets or gross income) of the individual wealth test, to be classified as a wholesale client.

15 The dollar value of the monetary thresholds above were set in 2001. The dollar value is contained in reg 7.1.28 of the *Corporations Regulations 2001* (Corporations Regulations).

Note: The $500,000 figure for the product value test predates its introduction in 2001, having been set in 1991 as the threshold for exclusion from the prospectus requirements under the Corporations Law.

16 The wholesale client tests using these monetary thresholds appear in Ch 7 of the Corporations Act and apply to a variety of financial services and products beyond managed investment schemes. There are also equivalent definitions in Ch 6D.

17 As discussed in the consultation paper, the policy rationale for these financial thresholds is that individuals holding the requisite level of assets or income have the knowledge or experience to understand and take on additional risk, or have the means to obtain professional advice.

18 We have seen a range of scheme collapses that have resulted in significant financial loss for investors classified as 'wholesale' under the current tests. Examples include the LM Managed Performance Fund where over $400 million was invested by over 4,500 members (based locally and overseas), and the Equititrust Premium Fund where approximately $56.7 million remained owing to members when administrators were appointed.

Increasing the financial thresholds

19 The financial thresholds used in the product value and individual wealth tests for wholesale clients are outdated, having not been indexed since their introduction into the Corporations Act in 2001.

20 Given that the thresholds have not been indexed, they have become easier to satisfy, resulting in investors who may not be financially sophisticated or wealthy by today's standards accessing wholesale-only investments. In *Mayfair Wealth Partners Pty Ltd v Australian Securities and Investments Commission* [2022] FCAFC 170, the Full Federal Court held that it could not be assumed that all people who meet the product value or individual wealth test have knowledge or experience in financial products.

21 Overseas jurisdictions also use tests that employ wealth thresholds to distinguish between retail and wholesale clients. Australia's peer jurisdictions generally impose higher financial thresholds or exclude certain assets—such as the primary residence—when determining whether an individual meets the equivalent wealth tests.

22 For example, in New Zealand, an investor is classified as a wholesale client if they have net assets of NZ$5 million or more (currently equivalent to

A$4.6 million based on the Reserve Bank of Australia's published exchange rate on 22 September 2023).

23 While the net asset thresholds in the United States and the United Kingdom are lower than the financial thresholds in Australia, they both exclude assets such as the primary residence when calculating an individual's net assets. They also supplement the lower thresholds with significant restrictions on retail client access to certain investments (such as illiquid investments) and limits on scheme leverage (see paragraph 36).

24 In relation to the financial thresholds in the product value and individual wealth tests, we recommend:

(a) increasing the thresholds to account for inflation since their introduction in 2001; and

(b) introducing a legislative mechanism to facilitate periodic increases to the thresholds in future to account for inflation ensuring they keep pace with inflation.

25 Increasing the thresholds will not prevent all harm resulting from products marketed or sold to retail clients. However, it should help mitigate harms, as it will better ensure that investors who are in substance retail clients are recognised as such and benefit from the existing statutory protections for retail clients when acquiring certain financial products or obtaining financial advice.

Application to securities in Ch 6D

26 We also recommend that the equivalent financial thresholds that apply to the sophisticated investor test for securities in Ch 6D should be increased, consistent with our feedback for Ch 7 products in paragraph 24.

Application to derivatives and leveraged financial products

27 The product value test applies where the face value or notional amount of the derivative is $500,000 or more when the parties enter into the derivative: see regs 7.1.22(2)(a) and 7.1.22(3). This is problematic because a consumer need only provide a small initial margin (as little as $1,000) to enter into a leveraged derivative that has a notional value of $500,000, to be classified as a wholesale client.

28 In 2019, reg 7.1.22.AA was introduced to exclude contracts for difference from s761G(7)(a) to address this problem in relation to contracts for difference. We recommend that other leveraged financial products—including derivatives—also be excluded from s761G(7)(a).

Consent requirements

29 The consultation paper refers to the recommendation from the *Quality of advice review final report* that a written consent requirement be introduced for wholesale clients who meet the net assets or gross income thresholds of the individual wealth test. The consultation paper asks how such a requirement could be designed to ensure investors understand the consequences of being considered a wholesale client.

30 Given the inherent limitations of disclosure as a consumer protection tool, we do not consider that the imposition of a consent requirement will be an effective means of ensuring that investors fully understand the consequences of being classified as a wholesale client.

31 Report 632 *Disclosure: Why it shouldn't be the default* (REP 632)—jointly published by ASIC and the Dutch Authority for Financial Markets—explains why disclosure and warnings do not necessarily result in informed consumers, and sometimes do not correlate with good consumer outcomes. The report concludes that disclosure is necessary, but not sufficient to protect consumers and drive good consumer outcomes, as it:

(a) does not solve or reduce inherent complexity (e.g. underlying complexity in financial products and services);

(b) must compete with other attempts to capture an investor's attention and influence their decisions; and

(c) is not one size fits all, as the effects of disclosure differ from person to person and situation to situation.

32 However, if consent requirements are introduced, we recommend that they be applied consistently across both the individual wealth and product value tests.

33 As discussed in the consultation paper, the consent recommendation in the *Quality of advice review final report* largely relates to clients who are being advised. Any consent requirements introduced for the wholesale client tests would apply to both advised and non-advised clients, and for a variety of products and services.

34 Therefore, in designing the requirements, consideration should be given to the different contexts in which consent may be sought from an investor, and the unique consequences of being considered a wholesale client for different products and services. For example, an investor in a wholesale scheme would not receive the protections in Ch 5C of the Corporations Act that would apply to an investor in a registered scheme.

B Suitability of scheme investments and scheme registration

Key points

This section outlines our feedback on questions 5–7 of the consultation paper.

In principle, we support some restrictions on investments, proportionate to the risks involved. However, we consider that there are complexities in implementing such restrictions. In the absence of restrictions, we recommend changing the wholesale client thresholds and other reforms to assist consumer protection, as outlined in this submission.

We recommend automating the registration process for retail managed investment schemes given the limited effectiveness of the current review process. This will allow significant regulatory resources to be redeployed to our supervisory work.

We do not recommend introducing additional grounds for ASIC to refuse to register schemes as this would impose a significant regulatory burden on ASIC and industry. It would also bolster the 'halo effect' that registration provides, without effectively targeting the causes of consumer harm.

Restrictions on scheme products offered to retail clients

35 By international standards, the Australian regulatory regime for funds management is open and liberal. Provided an appropriately licensed entity operates the scheme and the nature, benefits and risks of the scheme are adequately disclosed, almost any type of scheme can be sold to Australian retail investors, subject to the requirements under the DDO regime.

36 In comparison, a number of overseas jurisdictions prohibit or impose additional restrictions on the offer of certain investments to retail clients—for example:

(a) In the United Kingdom, investment in real property, gold and unregulated and illiquid funds is prohibited.

(b) In the United States, a cap is placed on illiquid assets and no more than 15% of assets can be illiquid if the scheme is to be widely marketed to retail clients.

(c) In some jurisdictions, more complex strategies are restricted from general distribution to retail clients. For example, in the European Union, alternative investment funds (e.g. hedge funds) may generally only be marketed to 'professional investors'.

(d) In some jurisdictions, restrictions are imposed on scheme borrowing. For example, in the United Kingdom, leverage is capped at 10% of the assets of the scheme.

(e) In some jurisdictions, spread restrictions are imposed on investment composition. For example, in the United Kingdom, no more than 5% of the assets can consist of transferable securities or approved money-market instruments issued by any single body and no more than 20% of the assets can consist of the units of any one collective investment scheme.

Note: See FCA Handbook (UK), COLL5 (5.1.4, 5.2.11 and 5.55); Investment Company Act Rules (US), Rule 22e-4 (Liquidity risk management programs); and Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers.

37 We have seen many instances of high-risk schemes sold to investors who did not understand the risk of financial loss, and a number of these schemes have subsequently collapsed. In some cases, the responsible entity may have complied with all relevant obligations; in others, there was misconduct. However, in both cases, investors lost considerable sums. We acknowledge the very significant retail investor harms that have resulted from the collapse of some schemes.

38 In our view, a number of the significant collapses that have occurred since the introduction of the current regime—including some property and residential schemes and agribusiness schemes—involved schemes that may not have been appropriate for retail clients.

39 In principle, we support some restrictions on investments, proportionate to the risks involved. We have considered, in detail, whether to recommend restricting certain asset classes or certain types of scheme structures (such as contract-based schemes) from retail investment. However, it would be challenging to frame an appropriate legislative restriction that does not unduly limit access to existing or future schemes that are not problematic, are well-performing and are suitable for retail investment.

Note: In ASIC's experience, contract-based schemes typically involve a series of agreements between the investor and the scheme operator (or other parties) for the ongoing operation of the scheme. These schemes involve member contributions being used in a common enterprise, rather than being pooled.

40 In the absence of restrictions on investments, we consider that increasing the financial thresholds for classifying an investor as a 'wholesale client' in s761G of the Corporations Act—as addressed in Section A—would help protect and reduce the risk of harm for investors. This will ensure that only truly wholesale clients are captured by that definition and that retail clients benefit from existing statutory protections.

41 Other proposals in this submission would also assist in providing further protection for retail clients, such as changes to the liquidity regime in Ch 5C (see Section E).

Limitations of the DDO regime

42 The DDO regime in Pt 7.8A and product intervention power in Pt 7.9A of the Corporations Act are relatively new regulatory frameworks, intended to reduce consumer harms. The DDO regime is an important tool for ensuring that a product issuer identifies the target market for its product and takes reasonable steps to ensure that distribution of the product is consistent with the target market.

43 Nonetheless, we have seen instances where product issuers have failed to appropriately define the target market given the features and risks of the scheme, such as underlying assets, investment strategy and an investor's ability to exit the product. These have been outlined in Report 762 *Design and distribution obligations: Investment products* (REP 762).

44 Investors who are outside the target market can also access the product, given:

(a) the product issuer need only take 'reasonable steps' that will, or are reasonably likely to, result in a distribution being consistent with the product's target market determination (s994E(1)); and

(b) the interplay of personal advice.

Note: See the definition of 'excluded conduct' in s994A(1) and 994E(3).

Registration of schemes

Automated registration process

45 To register a managed investment scheme, the responsible entity must lodge an application with ASIC together with the scheme constitution, compliance plan and directors' statement that the constitution and the compliance plan meet particular requirements in s601EA.

46 We must register a scheme within 14 days of lodgement unless it appears that the application, scheme documents or proposed responsible entity and compliance plan audit arrangements do not meet the relevant statutory requirements: see s601EB(1). For example, the scheme constitution and compliance plan must meet certain content requirements and the proposed responsible entity must hold an AFS licence authorising it to operate the scheme.

47 We will check that the proposed responsible entity is appropriately licensed, the application and the scheme documents have been properly completed and signed, and the constitution and compliance plan appear to meet the statutory content requirements. If we identify an issue with the application and/or scheme documents, we may ask the applicant to provide an explanation and further information or to amend the scheme documents to address the issue.

48 While this process can result in minor improvements to scheme documents, a responsible entity may, after registration, unilaterally change the constitution where they reasonably consider that the change will not adversely affect members' rights: see s601GC(1)(b). The compliance plan may also be changed after registration.

49 Our experience is that the current scheme registration process is of limited effectiveness. While assessment of scheme constitutions and compliance plans can result in improvements to these documents, we have not observed a clear link between the quality of scheme documents and the governance and compliance practices of the responsible entity. Given a responsible entity may amend scheme documents at any time after registration, the requirement for ASIC to assess scheme constitutions and compliance plans does not ensure a material reduction in consumer harm.

50 Over the last 10 years, ASIC has received, on average, 230 scheme registration applications per year, with each registration often requiring several hours to complete. Given the narrow grounds on which we may refuse to register a scheme or request improvements to scheme documents as part of the application process, we rarely refuse to register a scheme.

51 Unlike the registration process for managed investment schemes, the Corporations Act provides a more automated process for registering a CCIV where basic registration requirements are met. The CCIV registration process can be largely automated because ASIC is not required to actively assess the content of the constitution and compliance plan. We also have the power to direct a retail CCIV to modify its constitution to ensure that it deals in adequate detail with relevant statutory minimum content requirements: see s1223C. The more automated registration process for CCIVs compared with the current or a more detailed assessment process for schemes could give rise to regulatory arbitrage issues.

52 We recommend removing the need for ASIC to actively consider whether the criteria in s601EB are satisfied before registering a scheme. This means an automated registration process could be adopted for schemes, removing the need to assess the content of scheme constitutions and compliance plans before registration. Removing this legal requirement to consider the content of scheme documents would allow significant regulatory resources to be redeployed to undertake activities that more effectively target investor harms.

53 This proposal complements our proposal in paragraph 63 that ASIC have a new power to direct amendments to registered scheme constitutions, similar to our power under s1223C for retail CCIVs, and our proposals in Section H that ASIC be granted additional powers to collect a base level of data on the managed investment scheme sector.

54 The new powers would facilitate ASIC taking a risk-based approach to reviewing scheme constitutions at any time after the scheme has been registered.

Grounds for refusing to register a scheme

55 Currently, there are limited grounds under the Corporations Act on which ASIC may refuse to register a managed investment scheme, as set out in paragraph 46. As discussed in the consultation paper, the registration of schemes has been misunderstood by some investors to mean that ASIC has scrutinised and/or endorsed the merits of the scheme's investment strategy (i.e. a 'halo effect').

56 The introduction of additional grounds that we must consider for registration applications could be interpreted by some investors as endorsement or approval of the scheme by ASIC. We therefore do not recommend introducing any additional grounds such as the following for ASIC to refuse to register a scheme.

Scheme type, investment strategy and suitability

57 We do not consider that scheme type, investment strategy or suitability for retail clients are appropriate grounds on which to refuse to register a scheme. These factors alone are not reliable indicators of which schemes will result in consumer harm.

58 If such grounds were introduced, applicants would need to prepare and lodge detailed information about the scheme investment strategy—including a PDS and other disclosure material—for a scheme that may not be registered. This would result in significant uncertainty, delay and cost for industry, as well as a significant resourcing burden on ASIC.

59 Furthermore, investment strategy and asset allocation can evolve over time and differ from the original strategy presented at registration.

General concerns about the responsible entity, directors and officers

60 We also do not recommend introducing grounds to refuse to register a scheme based on general concerns ASIC may have about the responsible entity and/or its officers and directors. We already assess a responsible entity's competence to carry on a financial services business, financial resources and ability to meet the obligations of an AFS licensee under s912A (such as training, compliance, insurance and dispute resolution) before granting an AFS licence. We may take steps to suspend or cancel an AFS licence in circumstances such as where the licensee has not complied with its AFS licence obligations or the 'fit and proper person test' is not satisfied: see s913BA.

61 An additional assessment of the governance and compliance practices and/or track record of a responsible entity or its responsible officers and directors as part of the scheme registration process is not practicable. In many cases, such information may not be available.

C Scheme governance and the role of the responsible entity

Key point

This section outlines our feedback on questions 8–12 of the consultation paper.

We recommend that the Corporations Act be amended to give ASIC the power to direct a responsible entity to change a scheme constitution, similar to our power under s1223C of the Corporations Act to direct a corporate director to change the constitution of a retail CCIV.

We also recommend that qualitative standards be introduced for auditing compliance plans.

Further, we recommend that a majority of the directors on the board of the responsible entity be external directors.

Governance and the scheme constitution

62 The constitution is an integral document to the governance of a registered scheme and the protection of investors in the scheme. After ASIC registers a scheme, we have limited capacity to ensure that the constitution complies, and remains compliant, with the Corporations Act. This is because, under the Corporations Act, the responsible entity may unilaterally change the constitution where the responsible entity reasonably considers that the change will not adversely affect members' rights: see s601GC(1)(b). A scheme constitution may also be changed by member approval, which requires the members to pass a special resolution: see s601GC(1)(a).

63 We recommend that the Corporations Act should be amended to give us a power to direct a responsible entity to amend the constitution of a registered scheme to satisfy minimum content requirements. This is modelled on the directions power for constitutions of retail CCIVs in s1223C. That provision provides that when the corporate director of a retail CCIV receives a direction from ASIC to change the constitution of the retail CCIV, the corporate director must comply within 14 days and must lodge the modified constitution within 14 days of the modification: see s1223C(4)–1223C(5).

64 Following are two examples where we may use a power to require a change to a scheme constitution:

(a) If, contrary to s601GA(2), a provision purports to give the responsible entity the right to be paid a fee out of scheme property where the fee is not dependent on the responsible entity's proper performance of its duties.

(b) If the constitution allows the responsible entity an unreasonably long period in which to pay accepted withdrawal requests. In this situation, the withdrawal provisions of the constitution would not satisfy the requirements under s601GA(4) that the withdrawal procedures are adequate and fair to all members.

Compliance with auditors' minimum standard

65 Under the current regime, the auditor of a scheme is required to provide an opinion on the responsible entity's compliance with the compliance plan and whether the compliance plan continues to meet the requirements in Pt 5C.4 of the Corporations Act: see s601HG.

66 We expect compliance plan auditors to comply with the Standard on Assurance Engagements ASAE 3100 *Compliance engagements* and take into account the Guidance Statement GS 013 *Special considerations in the audit of compliance plans of managed investment schemes*. However, ASAE 3100 and GS 013 do not have the force of law.

67 If a compliance plan audit is not required to satisfy a suitable legal standard, there is a risk that the audit will not be adequately performed. In turn, there is a risk that non-compliant conduct by the responsible entity will not be detected by the audit, which could have a negative impact on members of the scheme. This concern is supported by the Parliamentary Joint Committee inquiry into the collapse of Trio Capital. It found that a lack of qualitative standards for the auditor may contribute to compliance plan audits not providing the regulatory oversight expected.

Note: Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital* [report], May 2012, p 131.

68 We recommend that the Corporations Act should be amended so that a compliance plan auditor must audit a responsible entity's compliance with the compliance plan in accordance with a qualitative standard such as the relevant auditing standards. Imposing a requirement on a compliance plan auditor to comply with the auditing standards would address the current gap in the Corporations Act that does not give auditing standards the force of law. This would align the audit requirements for a scheme's compliance plan with the audit requirements for an entity's financial report under Ch 2M, which must be conducted in accordance with the auditing standards: see s307A.

Board representation

69 A responsible entity must hold an AFS licence, authorising it to operate a managed investment scheme: see s601FA. The directors (as officers) of the responsible entity are subject to the statutory duties under Pt 5C.2, including a duty to act in the best interests of scheme members. This overrides any conflicting duty under Pt 2D.1.

70 If less than half a responsible entity's directors are external directors, the responsible entity must establish a compliance committee: see s601JA(1). If more than half a responsible entity's directors are external directors, the responsible entity is not required to establish a compliance committee but can elect to do so.

71 Since the introduction of s601JA in 2001, we have observed varied effectiveness in the operation of compliance committees across the managed fund sector. We consider that, unlike the wider duties that apply to the directors and officers of the responsible entity discussed above, the roles and responsibilities of compliance committee members are not fully articulated in the Corporations Act.

72 We recommend a legislative requirement that responsible entities must have a majority of external directors for the following reasons:

(a) The requirement is consistent with the practice recommended by ASX Limited (ASX).

Note: ASX Corporate Governance Council, *Corporate governance principles and recommendations*, 4th edn, February 2019, Recommendation 2.4, p 15.

(b) The requirement would align with the position for retail CCIVs: see s1224G(1).

(c) In our view, enhanced governance should help responsible entities create better outcomes for retail investors.

73 Such a requirement would remove the option for a responsible entity to establish a compliance committee. However, a responsible entity can elect to maintain a compliance committee, even when it has a majority of external directors.

Review and surveillance work

74 In 2021, ASIC conducted a limited review of responsible entity corporate governance. We focused our review on ten of the largest responsible entities in Australia and specific business models used. The responsible entities in ASIC's review were not selected based on risk factors or specific concerns. A summary of our high level empirical findings are available in the article ASIC releases findings from review of responsible entity governance on ASIC's website.

75 The sample of responsible entities was narrow, both in number and type. As previously outlined, there are approximately 420 responsible entities, with varying structures and investment strategies. Therefore, the findings of our review may not be reflective of the governance arrangements of the regulated population as a whole.

76 It is important that responsible entities have adequate corporate governance arrangements in place. We will take a risk-based approach to our reactive surveillance and supervisory work, including corporate governance. We will make inquiries and take enforcement action on an individual or collective basis, as part of our work.

D Right to replace the responsible entity

Key points

This section outlines our feedback on questions 13–16 of the consultation paper.

We recommend that the current threshold of an extraordinary resolution for members of an unlisted scheme to remove the responsible entity should be lowered to at least a special resolution.

We also recommend that there should be reforms to:

- enable prospective responsible entities to be provided access to books and records of the scheme from the current responsible entity; and
- limit the liability exposure of prospective responsible entities to the scheme assets.

Further, we recommend the introduction of reforms to prevent responsible entities from including provisions in the constitution or entering contractual arrangements that entrench the responsible entity and its agents in their roles or that restrict the responsible entity from exercising its powers.

Voting thresholds for removing responsible entities

77 Section 601FM currently requires the passing of an extraordinary resolution for members of an unlisted scheme to change the responsible entity.

78 As discussed in the consultation paper, the resolution thresholds imposed under the Corporations Act are either ordinary, special or extraordinary. The extraordinary resolution is the most difficult to achieve, requiring at least 50% of the total votes that may be cast by all members entitled to vote (including members who are not present or vote by proxy at the meeting).

79 In our view, the requirement for an extraordinary resolution to be passed before members can replace a responsible entity of an unlisted scheme sets too high a bar. This issue was canvassed in recommendation 2 in the *Report on the review of the Managed Investments Act 1998* and section 5.4 of the 2012 report by the Corporations and Markets Advisory Committee *Managed investment schemes* (CAMAC report), with various alternatives being proposed.

80 The majority of managed investment schemes are unlisted and therefore a significant number of members would need to pass an extraordinary resolution to remove the responsible entity. This high threshold may have the adverse impact of entrenching a responsible entity that is underperforming or where members have identified red flags. Without the

support of an institutional shareholder or the rallying of a significant number of individual members, it is difficult for members to call for and pass the resolution.

Note: Based on ASX records of listed funds, listed investment trusts and stapled groups, it is estimated that 79 schemes out of approximately 3,656 registered schemes had an ASX listing as at 31 August 2023.

81 The removal of the responsible entity has been described as 'the ultimate expression of dissatisfaction by investors in a collective investment scheme'.

Note: ALRC/CASAC, *Collective investments: Other people's money* [ALRC report 65], 1993, vol 1, paragraph 11.17.

82 The extraordinary resolution required to be passed by members has been viewed as necessary due to the possible adverse consequences of changing the responsible entity: see section 5.4.2 of the CAMAC report. However, in light of the benefits of competition and current limitations on members exercising this important right, there is a clear need for a shift in perspective and reforms to make it easier for members to change the responsible entity where appropriate.

Changes to the resolution requirements

83 We recommend that the resolution required for members to remove the responsible entity of an unlisted scheme should, at a minimum, be reduced to a special resolution of members. This would be consistent with the lower bar required for members of a CCIV to replace the corporate director under s1224U of the Corporations Act.

84 We recommend that feedback be sought from consumer representatives on whether the process of calling a members' meeting imposes any roadblocks that require reform. For example, to remove the responsible entity, members initially have to request a members' meeting. This may require access to the register of members maintained by the responsible entity.

85 Based on our experiences, we also recommend the following reforms for meeting processes:

(a) The form in which the register can be provided to members under reg 2C.1.02 of the Corporations Regulations should be updated to remove the outdated reference to provision of the register on CD-ROM and to provide technology neutral methods for accessing the register.

(b) A member's right to inspect the register under s173 should include:

(i) access to the details of any email address nominated by a member; and

Note: We note the recent decision in *Lawrence v Melbourne Football Club Ltd* [2022] VSC 658 which confirmed that the right to inspect and obtain copies of the company register under the Corporations Act includes access to members' email addresses if nominated as a means of communication.

(ii) the ability for a member to receive updated information with administrative ease, given the register information may become outdated after the member receives it and when it is ultimately used to call a members' meeting.

(c) The members' meeting, once called, should only be able to be deferred for a specified period, subject to application to the court to continue the adjournment.

(d) The notice of meeting to replace a responsible entity under s252B should be accompanied by the resolutions to remove and replace the responsible entity and an explanatory memorandum to ensure that members are provided timely and sufficient information to vote on the resolutions. However, the responsible entity should be obliged to send the meeting materials and call the members' meeting, even if it considers that there is an omission in the explanatory memorandum.

(e) There should be clarification that proxy appointments should be sent to the responsible entity in accordance with s252Z(2). As the scheme constitution can currently override the general position and a number of parties may be involved in preparing the meeting materials (including the prospective replacement responsible entity), the requirements for proxy appointments may not be clear to all parties involved and disputes may arise.

Reforms to assist prospective responsible entities

86 Based on our experience, there are inherent limitations under the current regime in Pt 5C.2 for members or ASIC to identify an entity that is willing and suitable to take on the role of replacement or temporary responsible entity. Some of the difficulties in securing a replacement responsible entity were highlighted in section 15.11 of the Senate Economic References Committee's report into agribusiness managed investment schemes.

87 Entities approached to take on these roles have raised common disincentives:

(a) There is no transparency over the scheme operations before actually becoming the responsible entity. The existing responsible entity has no obligation to provide access to books and records to an entity interested in taking over the role. If asked to provide access, the existing responsible entity is often unwilling to do so or the prospective responsible entity has little confidence that any access provided will be complete and accurate.

Note: Section 601FR of the Corporations Act only specifies that a former responsible entity must give access to the books and reasonable assistance once the responsible entity has actually been changed.

(b) The incoming responsible entity will inherit the liabilities and obligations (as well as the rights) of the existing responsible entity in accordance with s601FS. The liabilities may be extensive and expose the incoming responsible entity to financial detriment and/or cause the incoming responsible entity to be non-compliant with its AFS licence obligations.

88 To improve the effectiveness of the consumer protections mechanisms under Pt 5C.2 and facilitate a pool of entities that are willing to act in the role of replacement or temporary responsible entity, we recommend the following:

(a) An existing responsible entity should be expressly required to provide reasonable assistance to an entity interested in becoming a replacement or temporary responsible entity with appropriate controls to prevent misuse of this process. For example, parties undertaking due diligence could be subject to a contractual obligation to treat any commercially sensitive information as confidential.

We anticipate that the type of assistance required will differ depending on the features of the relevant managed investment scheme. However, we expect it would at least include providing access to books and records and engagement with key personnel involved in the scheme's operation, to enable a prospective or temporary responsible entity to understand its potential rights, obligations and liabilities should it become the responsible entity of the scheme.

(b) The operation of s601FS should be limited so the incoming replacement or temporary responsible entity is only liable to the value of scheme property for any pre-existing liabilities and liabilities incurred by that entity in its capacity as the responsible entity of the scheme.

89 We also recommend imposing increased record keeping obligations on responsible entities to ensure that the books and records of the responsible entity (as a company) are clearly identifiable and segregated from the books and records of each scheme it operates. Scheme books and records can then be provided to an entity interested in becoming the responsible entity or the incoming responsible entity (as required under s601FR) within a reasonable period.

90 We have seen situations where the books and records of the responsible entity are mingled with those for the scheme and where the current responsible entity has delayed providing access to the books and records of the scheme. This can delay the incoming responsible entity's ability to update members and take required actions, which may have a detrimental impact on members.

91 A further technical issue that we recommend should be resolved is clarity that the courts have the power to appoint a temporary responsible entity under reg 5C.2.02 of the Corporations Regulations. The regulation currently provides an application can be made to the court. However, there is no express provision for the court's powers in respect of the application.

Restrictions on entrenchment of responsible entities and agents

92 Responsible entities frequently engage agents or other service providers such as investment managers, custodians, administrators and registries to assist in the operation of managed investment schemes. The responsible entity remains liable for the acts and omissions of its agents and other service providers under s601FB(2) of the Corporations Act.

93 We recommend that responsible entities, and their agents and service providers, should not be able to entrench themselves in their respective roles. Agents and service providers should also not be able to constrain responsible entities in the exercise of their powers or discharge of their duties by using provisions in scheme constitutions or other contractual arrangements. This can result in adverse consequences and/or costs for members. This behaviour can:

(a) frustrate members' statutory right to remove the responsible entity; and

(b) frustrate the ability of the responsible entity to direct, appoint and remove agents, and decide when to call and determine the agenda of members' meetings, where it is in the best interests of members.

Responsible entity entrenchment

94 We have seen a number of responsible entities include provisions in scheme constitutions that trigger a significant fee payable to the responsible entity if the responsible entity is removed from its role. This fee trigger operates to entrench the responsible entity (often referred to as a 'poison pill').

95 One example we have seen involves a scheme that collapsed, having a detrimental impact on members. The responsible entity had included in the constitution a provision that required payment of 2.5% of the gross assets of the scheme if the responsible entity was removed by members or ASIC in circumstances other than proven fraud, wilful negligence or cancellation of the AFS licence.

De facto control by investment managers

96 We have observed a number of instances where responsible entities have entered into service agreements with investment managers, entrenching the role of the investment manager or constraining the exercise of the responsible entity's powers if against the interests of the investment manager. We have seen provisions that:

(a) give the investment manager influence or control over the responsible entity's decisions on the operation of the scheme and restrict the responsible entity's power to issue directions to the investment manager;

(b) inhibit the responsible entity's power to amend scheme constitutions or PDSs without the investment manager's approval;

(c) require the responsible entity to retire at the direction of the investment manager;

(d) restrict the responsible entity's power to call members' meetings to consider replacing the investment manager and give the investment manager the power to require the responsible entity to call members' meetings to extend the investment manager's term or replace the responsible entity;

(e) allow the investment manager to stay in its role for a long or indefinite term irrespective of its investment performance; and

(f) give the investment manager the right to approve the appointment of other service providers by the responsible entity.

97 In these circumstances, non-compliance by the responsible entity would result in a breach of contract by the responsible entity and may result in a claim against the assets of the scheme.

Reforms to address entrenchment issues

98 We recommend that:

(a) section 601GA be amended to prohibit the inclusion of problematic provisions such as poison pills (as discussed in paragraph 94) in a scheme constitution;

(b) section 601FB be amended so that the appointment of an agent or other person to do anything in connection with the scheme must include a right for the responsible entity to terminate the appointment on reasonable notice without any further recourse to the responsible entity and the scheme assets (excluding fees for services already provided); and

(c) section 601FB also provide that the responsible entity cannot agree with any agent or other service provider to constrain its powers or duties in the operation of a scheme.

E Right to withdraw from a scheme

Key points

This section outlines our feedback on questions 17–19 of the consultation paper.

We recommend that the definition of 'liquid assets' should be revised to make the test of liquidity more objective, precise and transparent, rather than relying on an arbitrary time period specified in the constitution.

We also recommend that a frozen scheme be required to notify and provide certain information to ASIC and be prohibited from issuing new interests to investors while frozen.

Liquidity and the definition of 'liquid assets'

99 Under Pt 5C.6 of the Corporations Act, a managed investment scheme is liquid if 'liquid assets' account for at least 80% of the value of scheme property. The definition of 'liquid asset' includes property that the responsible entity reasonably expects 'can be realised for its market value within the period specified in the constitution for satisfying withdrawal requests while the scheme is liquid': see s601KA.

100 As discussed in the consultation paper, the 2014 CAMAC discussion paper identified problems with the liquidity regime in Ch 5C and recommended reforms. A key issue highlighted in the discussion paper was that the definition of 'liquid assets' under s601KA is imprecise and permits instability as the responsible entity can classify a scheme as liquid, depending on whether it reasonably expects that an asset can be realised within the redemption period specified in the scheme's constitution. It does not impose any objective limit on the redemption period the responsible entity can set in the constitution or the saleability of scheme assets within this period, as even a quick, distressed sale will be at 'market value'. The Financial System Inquiry Committee's final report from November 2014 endorsed the recommendations in the CAMAC discussion paper.

Note: CAMAC, *The establishment and operation of managed investment schemes* [discussion paper], March 2014, pp 128–133.

101 We have observed responsible entities classifying and promoting a scheme as liquid, even if the scheme constitution specifies a lengthy period for satisfying redemptions (e.g. 365 days or longer) and the scheme assets would not generally be considered liquid (e.g. where the assets comprise mortgages, property, infrastructure or private equity).

102 As a result, the following issues arise:

(a) The promoted liquidity of the scheme may not actually align with:

(i) members' expectations of their ability to withdraw from the scheme; or

(ii) the nature of the underlying assets (see paragraphs 114–120).

(b) The responsible entity permits members to exit on a 'first come, first served' basis, rather than ensuring members participate fairly and equally in liquidity, potentially giving rise to inequitable distribution of limited liquidity, with detrimental effects on the remaining members.

103 We consider that some responsible entities apply the definition of 'liquid assets' in a manner that is not consistent with Government's intention to:

(a) draw a clear distinction between redemption requirements for liquid and illiquid schemes under the Corporations Act; and

(b) ensure investors of illiquid schemes have fair and equal participation in withdrawal opportunities.

The issues go beyond sales practices and disclosure, as the current 'liquid assets' test essentially permits unsuitable liquidity management.

104 The harm to consumers that can arise from liquidity issues was illustrated during the global financial crisis. As discussed in the consultation paper, in November 2009, 87 schemes were frozen, having suspended withdrawals. Investors lost access to around $25 billion in funds, in some cases for seven years or longer. Complaints received by ASIC highlighted the financial distress experienced by investors not being able to redeem as expected.

105 Since 2009, there have been no significant examples in Australia of open-ended schemes facing a liquidity event of this magnitude. We note, however, that in recent months a number of unlisted property schemes have been unable to satisfy all redemption requests received and have had to scale back, extend or defer redemption payments. We also note that market conditions since 2009 have been relatively steady.

106 While our targeted review of retail schemes undertaken in 2020 during market disruptions related to COVID-19 found that these schemes had adequate liquidity frameworks (see Media Release (21-091MR) *ASIC review finds retail managed funds responded well to COVID-19 challenges in 2020* (30 April 2021)), investors were able to access Government benefits during the pandemic and interest rates were low.

107 ASIC does not currently have data on the underlying investments held by schemes, but we anticipate that a substantial minority of the unlisted scheme sector invests to some extent in illiquid assets such as direct property, mortgages and high yield fixed income. These schemes are more susceptible to liquidity issues. Liquidity events can be difficult to predict and can affect a single responsible entity or a broader subset of industry. We recommend that reforms are required to ensure fair distribution of liquidity and mitigate the impact on investors of any liquidity event.

Alignment with international regimes and standards

108 As discussed in the consultation paper, key overseas jurisdictions have imposed more prescriptive liquidity regimes for open-ended schemes or are taking steps to respond to liquidity issues. As schemes that operate in global markets have similar underlying assets to Australian schemes and similar liquidity risks can arise, we believe our regime should align more closely with those of our overseas counterparts. At the same time, it should retain flexibility for the responsible entity to manage scheme liquidity, as appropriate.

109 We recommend that the liquidity regime in Australia also needs to promote and uphold relevant international standards. In February 2018, the International Organization of Securities Commissions (IOSCO) published its final report *Recommendations for liquidity risk management for collective investment schemes* (PDF 363 KB), which sets out 17 principles-based recommendations for liquidity risk management for collective investment schemes (IOSCO liquidity recommendations).

110 In their 2022 *Thematic review on liquidity risk management recommendations* (PDF 715 KB), IOSCO reviewed participating jurisdictions' compliance with a subset of their key recommendations for liquidity risk management for collective investment schemes. IOSCO found Australia's compliance was broadly consistent, but not fully compliant. It acknowledged Australia's principles-based regime prevents it from being fully compliant with some of IOSCO's recommendations because the regime does not place direct or explicit obligations on responsible entities in relation to liquidity. Rather, Australia relies on broader regulatory requirements and guidance to ensure that responsible entities manage their liquidity risks.

111 In their July 2023 consultation report *Anti-dilution liquidity management tools*, IOSCO acknowledged that there is scope for greater use of liquidity management tools by operators of collective investment schemes to address liquidity issues and have proposed additional guidance. The consultation paper acknowledges that the scheme operator has the primary responsibility and is best placed to manage the liquidity of the collective investment scheme and requires flexibility to respond to investor demand on liquidity, including by use of liquidity management tools.

112 However, we note a driver for the proposed guidance is the need to address financial stability issues that arise from the 'first mover advantage' from open ended schemes. This issue can be more inherent in our regime, as schemes with less liquid assets can be structured as open ended, and avoid the additional consumer protections intended for illiquid schemes under Pt 5C.6 of the Corporations Act.

113 IOSCO is proposing to release a final report in late 2023 and to revisit the IOSCO liquidity recommendations as needed in 2024. We will monitor these developments.

Mismatch between member expectations and scheme liquidity

114 Under the current regime, we consider a mismatch can arise between members' expectations of their right to withdraw from the scheme and the liquidity of the scheme for the following reasons.

Inappropriate liquidity representations

115 In our experience, many responsible entities promote schemes through PDSs and marketing materials as offering open-ended and frequent (often at-call) redemptions, that can be met within a short period of time (e.g. five days or less), even though the constitution allows a much longer timeframe (ensuring the scheme is classified as 'liquid').

116 In some cases, these representations may not be consistent with the liquidity of the underlying assets of the scheme. Investors may expect schemes to be more liquid than they actually are (notwithstanding any disclaimers in the fine print of the PDS or marketing material).

117 As an example, following ASIC action, the Federal Court imposed a $750,000 penalty on the responsible entity of a scheme that invested in mortgages, cash and other assets. It made misleading representations, including that members were able to withdraw their funds within 48 hours or 90 days (as applicable) of providing a withdrawal notice. In fact, the responsible entity had up to 12 months under the scheme constitution to satisfy the redemptions while the scheme was liquid: see Media Release (21-319MR) *La Trobe Financial Asset Management to pay $750,000 penalty for false and misleading marketing* (29 November 2021).

Unsustainable withdrawal terms

118 In our experience some responsible entities offer unsustainable, unrealistic or overly optimistic redemption terms. A responsible entity that offers daily or short notice redemptions for a scheme with predominantly long-dated or illiquid assets is arguably not operating the scheme prudently. However, this conduct is permitted by Pt 5C.6.

119 These unsustainable withdrawal terms mean consumers may face lower returns from their investments. That is, if the responsible entity receives a large number of redemption requests, it is more likely that the scheme will need to sell its assets quickly at lower prices to meet the redemptions within the redemption terms (or the redemption requests will ultimately not be met given the ability for responsible entities to suspend withdrawals under the scheme constitution).

120 Our 'true to label' surveillance undertaken in 2020 identified that a small number of the 37 schemes reviewed had a significant mismatch between redemption features and the actual asset liquidity: see Media Release (20-218MR) *ASIC tells fund managers to be 'true to label'* (22 September 2020).

Changes to the test of 'liquid assets'

121 Our view is that the definition of 'liquid assets' should be revised to make the test of liquidity more objective, precise and transparent. For example, a scheme could be defined as 'liquid' if the responsible entity reasonably expects that 80% of the scheme property can be realised for book value within a short, fixed timeframe such as 10 days.

122 This will help ensure that only schemes that are truly liquid can be promoted, distributed and operated as having liquidity at-call. Schemes with less liquid assets will be required to comply with the prescribed regime for illiquid schemes to ensure fair and equal access to available liquidity.

123 The level of market disruption, investor harm and loss of confidence in the financial system that will flow from a liquidity event can be mitigated by revising the definition, as the liquidity profile of schemes (as specified in their promotional material and withdrawal terms) will more closely align with the actual liquidity of the underlying investments.

124 It will also offer competition benefits. Under the current regime, responsible entities that accurately classify a scheme as having illiquid assets and limited withdrawal rights are at a competitive disadvantage as investors are more likely to be attracted to liquid schemes.

Changes to withdrawal procedures for frozen funds

125 A responsible entity typically represents the redemption period in the PDS, consistent with the constitution. We recommend that when a scheme is 'frozen' (i.e. the responsible entity suspends those promoted redemptions), the responsible entity should be subject to the following additional obligations:

(a) *A general restriction on the issue of new interests in the scheme while redemptions are suspended*—In our view, it is not in members' best interests for a responsible entity to use new application monies to fund redemptions while the liquidity—and potentially the broader financial position—of the scheme is under pressure. We also consider it is not appropriate for new applicants to join the scheme when their expected

rights to exit may not be able to be met. Once the fund is no longer 'frozen' it can resume issuing new interests.

As an example of the harm that can occur, during the global financial crisis, a responsible entity froze redemptions, but continued to accept new applications for an extended period until it ultimately commenced winding-up. The new members were subject to an extended wind-up and restricted from accessing any of their funds.

(b) *A requirement to notify ASIC when the scheme becomes frozen and when it ceases to be frozen*—There is no current obligation under the Corporations Act for a responsible entity to inform ASIC when it becomes frozen. At the outset of COVID-19 in early 2020, we manually wrote to a selection of responsible entities and requested voluntary notification of freezing. A statutory notification requirement would assist us to more effectively monitor the freezing of schemes across the managed fund sector and would inform actions that we may take to assist responsible entities and members as appropriate.

126 If our broader recommendations for recurrent data collection in paragraphs 176–188 are not adopted, we recommend that, at a minimum, a responsible entity of a frozen fund is required to include in the notification to ASIC details of the underlying investments, number of members, status of withdrawal requests and a liquidity management plan.

Transitional arrangements and additional liquidity tools

127 We recognise that any significant reform to the 'liquid asset' definition and withdrawal procedures will require transitional arrangements. Existing responsible entities may need to amend disclosure and constitutional provisions to align with the reforms. The impact on existing members and available liquidity must also be managed. We recommend seeking industry feedback on these issues.

128 To assist responsible entities to offer liquidity opportunities to members, we recommend that the following matters where ASIC has intervened and granted relief should be moved to the primary law:

(a) *The ability for the responsible entity of an illiquid scheme to make a 12 month 'rolling withdrawal offer' to members*—This should reduce the administrative burden on responsible entities of making multiple single offers and on members having to lodge multiple applications and allow members to have periodic access to available cash. Our policy for granting this case-by-case relief is outlined in Regulatory Guide 136 *Funds management: Discretionary powers* (RG 136).

(b) *The ability for the responsible entity of a scheme that has become frozen to offer withdrawals to certain members that are suffering hardship*—This relief is currently afforded under *ASIC Corporations (Hardship Withdrawals Relief) Instrument 2020/778*.

Reporting on liquidity

129 In 2017, the Financial Stability Board set out the *Policy recommendations to address structural vulnerabilities from asset management activities*, including its first recommendation to frequently collect granular information on the liquidity profile of individual funds. Australia has not yet fully implemented that recommendation (see *Assessment of the effectiveness of the FSB's 2017 recommendations on liquidity mismatch in open-ended funds* (PDF 891 KB)) and therefore does not currently have any transparency over the ongoing liquidity profile of a scheme.

130 We recommend that ASIC should have a statutory power to collect periodic data from responsible entities on liquidity, rather than needing to rely on our statutory powers under s912C and s30 to collect data on an individual basis. The periodic data collected could include:

(a) details of the underlying investments;

(b) promoted withdrawal timeframes;

(c) rights of members to withdraw specified in the scheme constitutions;

(d) withdrawal requests received by responsible entities and those satisfied by responsible entities; and

(e) an overview of responsible entities' liquidity management arrangements.

131 This would assist us to better understand key trends, risks and issues with scheme liquidity. It would also assist us in determining if further guidance or action is required for the liquidity management of a particular sector or individual responsible entities.

132 It would also further align Australia with the IOSCO liquidity recommendations, referred to in paragraph 109, which promote:

(a) the collection of appropriate information by the regulator to monitor the liquidity regime of the scheme operator or collective investment scheme consistent with their supervisory model;

(b) scheme operators being able to demonstrate, when requested, how they periodically test contingency plans, including whether additional liquidity management tools can be activated and used in a prompt and orderly manner; and

(c) the regulator taking appropriate supervisory action where there are issues with operators' processes for liquidity assessment.

133 To date, ASIC has not been able to provide detailed data on scheme liquidity in response to surveys conducted by IOSCO—for example, the 2023 *IOSCO investment funds statistics report* (PDF 1,716 KB) noted Australia was not able to fully participate in the survey's full data collection exercise.

134 In contrast, peer regulators collect and report information on the liquidity of collective investment schemes. For example, in the United States, mutual funds are required to maintain monthly reports. These reports classify the liquidity of the fund's investments based on the number of days that the assets can be converted to cash in current market conditions (categorised as highly liquid, moderately liquid, less liquid and illiquid investments). These reports are then submitted to the US Securities and Exchange Commission (SEC) quarterly. For an example of such reports, see *Form N-Port Monthly portfolio investments report* (PDF 362 KB).

F Winding up insolvent schemes

Key points

This section outlines our feedback on questions 20–22 of the consultation paper.

The winding up provisions in Ch 5C of the Corporations Act are inadequate to address the needs of creditors, scheme members and other interested parties of an 'insolvent' scheme or a scheme with a responsible entity that is insolvent or under external administration.

We recommend that a tailored statutory insolvency regime for schemes would facilitate more orderly and timely winding up of insolvent schemes, and result in better outcomes for scheme operators, scheme members, creditors and other interested parties. This could be achieved by amending the existing provisions in Pt 5C.9 and expanding its scope.

We recommend the introduction of a statutory provision that limits the liability of scheme members.

Limitations of the current winding up regime

135 The relevant provisions for winding up a registered scheme are set out in Pt 5C.9 of the Corporations Act. They provide that a scheme may be wound up:

(a) *in accordance with the scheme constitution* at a specified time, in specified circumstances or when a specified event happens (s601NA);

(b) *by extraordinary resolution of members* directing the responsible entity to wind up the scheme (s601NB);

(c) *by notice given by the responsible entity* if it considers that the purpose of the scheme has been accomplished or cannot be accomplished (s601NC); or

(d) *by court order* directing the responsible entity to wind up the scheme if the court thinks it is just and equitable or because the court orders in favour of a creditor and against the responsible entity in its capacity as the scheme's responsible entity and this has not been satisfied (s601ND).

136 The court may make other orders about winding up, including:

(a) appointing a person other than a responsible entity to be responsible for the winding up of the scheme in accordance with its constitution (s601NF(1)); and

(b) giving directions on how the scheme should be wound up if the court thinks it is necessary to do so (s601NF(2)).

137 Unlike the insolvency regime for companies in Ch 5 of the Corporations Act or the provisions in Pt 8B.6 for CCIVs, Ch 5C does not specify statutory procedures for winding up unviable (commonly referred to as 'insolvent') or potentially insolvent schemes. There is also no statutory insolvency regime for trusts, which is how most managed investment schemes are structured. As the consultation paper discussed, various parliamentary inquiries recognised this ongoing regulatory gap, which was examined in detail in the CAMAC report.

138 We consider that there are some regulatory gaps in the current legislative regime for the treatment of insolvent schemes. Our experience is that, where the winding up of potentially insolvent schemes is performed by a responsible entity in external administration, the process tends to be lengthy, expensive and result in poor financial outcomes for scheme members, creditors and other parties interested in the winding up.

139 When a responsible entity enters into external administration, the administrator must consider whether the schemes the responsible entity operated are insolvent, and then must wind up insolvent schemes. A scheme often becomes insolvent because scheme property is insufficient to meet the scheme liabilities to creditors as they fall due.

140 Insolvency practitioners winding up insolvent schemes must navigate the statutory provisions dealing with:

(a) the insolvency of the responsible entity in Ch 5;

(b) the responsible entity's duties in Ch 5C;

(c) the constitution that governs the scheme;

(d) state-based trusts law where the scheme is structured as a trust; and

(e) the growing body of case law on the winding up of schemes.

141 The patchwork of overlapping but incomplete regimes results in complexity that necessitates frequent court applications. The cost of such applications reduces the pool of assets that can be returned to investors as a final distribution upon winding up, such as in the following examples:

(a) The winding up provisions included in scheme constitutions may not contemplate the scheme being insolvent or the insolvency of the responsible entity. Therefore, it may not be possible to wind up the scheme in accordance with its constitution. Court assistance may be required to provide direction on how the scheme is to be wound up.

(b) Without statutory provisions that confer powers on the external administrator of the responsible entity or another person to deal with scheme assets, insolvency practitioners must obtain court orders to set out their powers to deal with the scheme property and other assets of the managed investment scheme.

(c) Insolvency practitioners will usually seek court directions under s601NF(2) before taking action that could prejudice the interests of any of the above groups to manage the tension between competing interests of:

(i) creditors of the responsible entity as trustee of the scheme;

(ii) creditors of the responsible entity as trustee of other schemes it operates;

(iii) creditors of the responsible entity in its personal capacity;

(iv) the interests of scheme members;

(v) the interests of shareholders of the responsible entity; and

(vi) the insolvency practitioner's own interests in recovering costs, expenses and remuneration for the winding up of the scheme(s) and/or responsible entity.

(d) Many legal questions about the insolvency of trusts generally, and registered managed investment schemes specifically, have not yet been resolved by case law. Where such questions arise in winding up a scheme, the insolvency practitioner must seek judicial advice to resolve the question before it can take further action.

142 Further complexity, expense and delay can arise in winding up some schemes where contributions are invested in assets that are difficult to realise, or scheme property is entangled in complex arrangements with entities related to the responsible entity (which may also be insolvent or distressed).

143 We recommend that comprehensive reforms are required to improve the ability of registered liquidators and responsible entities (whether under external administration or not) to conduct an orderly and timely wind up of insolvent schemes. The existing winding up provisions in Pt 5C.9 of the Corporations Act are deficient, lack sufficient prescription and should be amended to provide more certainty and support a more efficient process for winding up insolvent schemes. We endorse the recommendation in section 7.2.6 in the CAMAC report that s601NF be amended to:

(a) widen the scope of the court's power to make directions about how a registered scheme is to be wound up, so that it can make any orders it considers appropriate; and

(b) allow the person appointed by the court to wind up the scheme under s601NF(1) to apply under s601NF(3) for court directions about how the scheme is to be wound up.

A tailored insolvency regime

144 The current winding up provisions in Ch 5C of the Corporations Act are inadequate to address the needs of scheme operators, scheme members, creditors and other interested parties of an insolvent scheme or a scheme that has a responsible entity under external administration. Scheme assets that could otherwise be made available to meet liabilities or be distributed to scheme members are consumed in the winding up process, which is unduly complex and expensive.

145 We recommend introducing a tailored insolvency regime for managed investment schemes. As detailed in the recommendation in section 7.5.3 of the CAMAC report, the Corporations Act should regulate the winding up of an insolvent scheme in a manner comparable to the regulation of the winding up of an insolvent company.

146 We recommend achieving this by amending some existing provisions in Pt 5C.9 (see paragraph 143) and expanding its scope to address some basic but fundamental aspects of winding up an insolvent registered scheme to facilitate a more orderly and timely wind up of such schemes. For example, the provisions could specify:

(a) how debts and claims proved are to be ranked and paid;

(b) a statutory order of priority;

(c) whether the external administrator of the responsible entity has the power to deal with assets and liabilities of the scheme or if it must seek court approval to do so;

(d) the duties and powers of the person appointed to wind up the scheme (if not the external administrator of the responsible entity, then a registered liquidator appointed to wind up the scheme) including, for example, the power to deal with assets and liabilities of the scheme;

(e) how the remuneration, costs and expenses of external administrator(s) are to be allocated from the assets of the scheme and across the assets of the responsible entity, and where relevant, the assets of other schemes it operates;

(f) the procedures for the external administrator to seek remuneration, costs and expenses;

(g) what kinds of transactions entered into by the responsible entity in its capacity as responsible entity of the scheme are voidable and what orders the court may make about those transactions;

(h) a requirement that the person appointed to wind up the scheme must provide ongoing reporting of their winding up activities to the members of the scheme; and

Note: Notional s601NFA—as inserted by *ASIC Corporations (Externally-Administered Bodies) Instrument 2015/251*—imposes a requirement on responsible entities or the person appointed to be responsible for winding up the scheme under s601NF(1) to make a report available to scheme members. The report must include information about the progress and status of the winding up of the scheme, financial information about receipts and payments for the scheme, the value of scheme property and any potential return to scheme members. This section applies to a responsible entity if the scheme it operates relies on the exemptions from the obligations for financial reporting (Pt 2M.3), compliance plan audit (s601HG) and final reporting (reg 5C.9.01) in the legislative instrument.

(i) a statutory definition of 'insolvent scheme'.

147 We recommend that the proposed insolvency regime applies in circumstances where the responsible entity (whether in external administration or not) has determined that a scheme it operates is no longer viable. Although a registered scheme cannot technically become insolvent because a scheme is not a separate legal entity that incurs debts in its own right, introducing a legal definition of an 'insolvent scheme' may also improve certainty for insolvency practitioners applying the regime.

148 We consider that the approach taken in creating an insolvency regime for CCIVs in Pt 8B.6 of the Corporations Act—which amends and applies some Ch 5 provisions to the sub-funds of CCIVs—would not be workable for managed investment schemes and the use of translation rules may lead to uncertainty in the interpretation and administration of the legislation. For these reasons and noting that managed investment schemes are not separate legal entities, with many structured as trusts or as a series of contracts, any insolvency regime applied to schemes would preferably be designed as a standalone tailored regime.

149 We note that the Parliamentary Joint Committee on Corporations and Financial Services recently recommended that the government amend the Corporations Act to expressly clarify the treatment of trusts with corporate trustees during insolvency. The Committee also recognised that:

(a) the treatment of trusts in insolvency has 'long been identified as an area for improvement with historical calls for reform'; and

(b) the absence of clarity around the regulation of trusts, particularly in the context of insolvency, was raised as an issue and a cause of time inefficiency, complexity and expense.

Note: Parliamentary Joint Committee on Corporations and Financial Services, *Corporate insolvency in Australia*, July 2023, pp 299, 303 and 313.

150 If the government pursues statutory reforms that deal with the treatment of trusts in insolvency, careful consideration should be given to how this would affect the winding up of insolvent schemes.

Statutory limited liability for members

151 We recommend that a statutory limited liability provision should be introduced so that:

(a) the liability of scheme members for unpaid debts is limited to any unpaid portion of the amount they agreed to contribute to the scheme; and

(b) the limited liability does not apply where the scheme member enters into agreements on their own behalf or through the responsible entity acting as their agent.

152 In our experience, the constitutions of registered schemes typically limit the liability of scheme members so that when the scheme winds up, members do not need to make further contributions beyond any capital amount still outstanding on their units or interests.

153 However, we consider that a statutory limited liability provision that applies regardless of the provisions in the scheme constitution would:

(a) provide greater clarity and uniformity in the application of limited liability to schemes; and

(b) better align the managed investment scheme regime with the regime for other investment vehicles such as companies and CCIVs by protecting members against personal liability for the debts incurred by the scheme operator, while providing certainty for scheme creditors.

G Commonwealth and state regulation of real property investments

Key points

This section outlines our feedback on question 23 of the consultation paper.

A wide variety of schemes, including some real property schemes, can be regulated by both the Corporations Act and at least one state or territory legal framework. This multiplicity of regulation can result in complexity and increased risk to investors.

We have not identified any particular proposal to address schemes that are regulated by multiple regimes and different regulators. We will take a risk-based approach to our work on dual regulated entities and adopt a joint approach with other regulators to respond to misconduct where appropriate.

Dual regulation of property arrangements

154 In some circumstances, a scheme may be subject to 'dual regulation', with the scheme itself regulated under the Corporations Act and the assets of the scheme regulated under one or more pieces of state or territory legislation. As explained in the consultation paper, property schemes can be subject to dual regulation in this way.

155 Our experience across the broad managed investment scheme sector is that it is relatively uncommon for scheme arrangements to be subject to state or territory regulation, beyond mainstream property and infrastructure investments. Some specific examples include management rights and serviced strata schemes, time-sharing schemes and the residential lease arrangements entered into by some members of the Sterling Income Trust. More generally, the sale and disposal of, and rights to, real property will be subject to state laws.

156 In some instances, property arrangements are expressly clarified under state or territory legislation to be outside of the scope of the Corporations Act. For example, an owners' corporation is declared to be an excluded matter under s8 of the *Strata Schemes Management Act 2015* (NSW) for the purposes of s5F of the Corporations Act. This provides certainty on who has regulatory oversight, particularly where it is not clear that a financial service is provided.

157 In circumstances where a property arrangement is subject to dual regulation, ASIC has considered the interaction of the state or territory legislation in developing policy and relief that applies to that sector. For example, we provide

an exemption for management rights schemes from the need to hold an AFS licence to provide general advice where the person is already licensed under state or territory laws to manage, promote or sell real property: see Regulatory Guide 140 *Strata schemes and management rights schemes* (RG 140). Where ASIC has received complaints from the state or territory regulatory body, it has liaised with the co-regulator about its related surveillance work.

158 We consider that a framework of dual (or multiple) regulation of property arrangements is generally unavoidable and appropriate. The function of regulatory oversight, resources and expertise sits best across the different regulatory bodies, with ASIC having oversight of the provision of financial services to investors.

Impact of dual regulation

159 We acknowledge that when there is dual regulation of property arrangements this can:

(a) add complexity and risk to the scheme (including, uncertainty about the rights and protections that members of the scheme hold);

(b) result in the nature of the investment and role of dual regulation not being apparent to, or understood by, investors; and

(c) increase the risk of investor harm when the dual regulatory frameworks fail to meet investor expectations.

Role of Corporations Act in the sale of schemes, risks and conduct of scheme operators

160 For certain property arrangements, we have developed tailored policy and relief that will apply to the responsible entity—for example, RG 140 and Regulatory Guide 160 *Time-sharing schemes* (RG 160).

161 For other schemes involving property arrangements, the responsible entity is subject to full compliance with the obligations under the Corporations Act (as well as any separate obligations under state or territory legislation).

162 We consider that the operation of the DDO regime may reduce the availability of high-risk schemes (including those with property arrangements) to retail investors for whom such schemes would be unsuitable, as we expect the target market of investors for complex dual regulated schemes would generally be narrow.

163 We also consider it good practice to adequately disclose the dual regulation in the scheme's PDS and any risks arising from that. This is consistent with the obligations of the product issuer to include:

(a) content about the significant risks of holding the product, the significant characteristics or features of the product and rights, terms, conditions and obligations attached to the product (s1013D); and

(b) any other information that might reasonably be expected to have a material influence on the decision of a reasonable person as a retail client to acquire the product (s1013E).

164 Where appropriate, we may use our general powers to take action against a dual regulated scheme where there is a contravention of the Corporations Act (including stop orders, licensing action and bannings). We may also use the product intervention power to temporarily intervene and ban a scheme when there is a risk of significant consumer detriment, or exercise our general enforcement powers for contravention of the Corporations Act. However, we note that a relatively high threshold must be met to establish significant consumer detriment and enliven the product intervention power.

165 Our recommended reforms relating to the wholesale client definitions outlined in Section A will also extend the consumer protections available under the Corporations Act (including the DDO regime and the product intervention power) to certain investors in high-risk property arrangements who are currently excluded from these protections as wholesale clients.

166 In some circumstances, remedies to respond to consumer harm will also sit under state or territory legislation and we will need to interact with the relevant regulatory body.

Interaction between regulatory bodies

167 Early and ongoing engagement between ASIC and the relevant state or territory regulators that share regulation of the property arrangement is essential to improve regulatory oversight.

168 Based on our experiences, we will take a risk-based approach to dealing with dual regulated structures, including when dealing with complaints received from co-regulators or about dual regulated structures. Where necessary, we will determine a joint approach for responding to misconduct. A collaborative approach is needed to ensure more timely and better outcomes for investors.

H Regulatory cost savings and additional ASIC powers

Key points

This section outlines our feedback on question 24 of the consultation paper.

We recommend the following key opportunities to modernise and streamline the regulatory framework for managed investment schemes:

- Automate the registration process for retail schemes, discussed in Section B.
- Incorporate standard relief commonly provided by ASIC into the Corporations Act.

We also recommend increasing ASIC powers to improve access to certain data for our supervisory work:

- Enhance our data capabilities through the introduction of a legislative framework for the recurrent collection of data on registered and unregistered schemes.
- Introduce a basic notification requirement for wholesale schemes, to facilitate ASIC's collection of data on the wholesale scheme sector.

169 Managed investment schemes that are offered to retail clients are predominantly regulated by Ch 5C of the Corporations Act. This chapter was first introduced into law in 1998. The regulatory framework has remained largely unchanged since its introduction.

170 We recommend the following key opportunities to modernise and streamline the framework in addition to the automated registration process discussed in Section B. These reforms would reduce regulatory burdens on industry and assist us in performing our regulatory functions more efficiently.

Incorporation of standard relief into the Corporations Act

171 The *Review of the legislative framework for corporations and financial services regulation* by the Australian Law Reform Commission (ALRC) highlighted that notional amendments to the Corporations Act are an unnecessarily complex design feature in corporations and financial services legislation. The regulatory framework for managed investment schemes includes a substantial number of notional amendments implemented through ASIC legislative instruments, some of which are significant in their effect.

Note: ALRC, *Interim report B: Financial services legislation* [ALRC report 139], September 2022, p 213.

172 We note that, since the ALRC review, the Government has consulted on moving some provisions made in ASIC legislative instruments into the primary law and regulations. We have identified the following legislative instruments as appropriate to move into primary law and regulations:

(a) The regulatory regimes for:

(i) investor directed portfolio services (IDPSs) regulated under *ASIC Corporations (Investor Directed Portfolio Services) Instrument 2023/669*;

(ii) IDPS-like schemes regulated under *ASIC Corporations (Investor Directed Portfolio Services Provided Through a Registered Managed Investment Scheme) Instrument 2023/668*); and

(iii) managed discretionary accounts regulated under *ASIC Corporations (Managed Discretionary Accounts) Instrument 2016/968*.

(b) The financial requirements for a range of financial service providers—including responsible entities, corporate directors, IDPS operators, responsible entities of IDPS-like schemes and custodians—and minimum standards for holding assets that are significant aspects of the regulatory framework for these financial services providers regulated under *ASIC Corporations (Financial Requirements for Responsible Entities, IDPS Operators and Corporate Directors of Retail CCIVs) Instrument 2023/647*, *ASIC Corporations (Financial Requirements for Custodial or Depository Service Providers) Instrument 2023/648*, Class Order [13/1409] *Holding assets: Standards for responsible entities* and Class Order [13/1410] *Holding assets: Standards for providers of custodial services*.

(c) ASIC class relief to facilitate the quotation of exchange traded funds on licensed exchanges in Class Order [CO 13/721] *Relief to facilitate quotation of exchange traded funds on the AQUA Market* and Class Order [CO 13/1200] *Periodic statements relief for AQUA quoted and listed managed investment scheme manager* regarding the provision of periodic statements to retail investors.

173 We recommend incorporating the above legislative instruments into primary law to:

(a) modernise the regulatory regime by recognising the growth and popularity of platforms and managed discretionary accounts as common investment vehicles;

(b) recognise the importance of AFS licensees that operate in the managed funds industry and hold assets meeting minimum financial requirements and standards; and

(c) provide more certainty about the continued operation of these regimes and requirements compared to legislative instruments made by ASIC, which automatically sunset after 10 years under the *Legislation Act 2003* unless action is taken to preserve them.

174 We also recommend that individual relief commonly granted under RG 136 would be suitable for inclusion in primary law. Specifically, ASIC routinely grants relief in accordance with that policy to facilitate:

(a) the stapling of interests that include an interest in a registered scheme; and

(b) a change in the responsible entity to a related body corporate without the need to hold a members' meeting.

175 Incorporating common relief provisions into the Corporations Act will improve certainty for industry and reduce the regulatory burden for the managed funds industry, which frequently relies on such relief. It will also allow ASIC to redeploy the significant resources we devote to re-making and maintaining these legislative instruments and to granting individual relief.

Recurrent collection of data

176 As outlined in paragraph 2, Australia's investment management sector is large, with around $2.7 trillion in assets held in registered and unregistered schemes. As at June 2022, there were 420 responsible entities operating 3,656 registered retail schemes and 1,791 wholesale trustees operating an unknown number of wholesale schemes: see p 17 of ASIC's *Annual report 2021–22*.

177 However, the sector is opaque. There are significant limitations in the data ASIC currently receives on the sector, which impedes our ability to identify regulatory risks and inform regulatory activities.

178 We do not currently have direct access to all critical data and information. We receive financial statements and other statutory lodgements for registered managed investment schemes. However, these alone are not sufficient for all our supervisory functions.

179 Information on unregistered (or wholesale) schemes is even more limited, as there is no formal registration or notification process for wholesale schemes, and no requirement to provide financial information about these schemes to ASIC.

180 We may collect data using our existing notice powers (such as that in s912C of the Corporations Act) on individual entities. However, exercising these statutory powers is not well-suited to the regular collection of sector-wide data, given the size of the managed investment scheme sector. Issuing notices to responsible entities and wholesale trustees individually, and reviewing and collating the responses, requires substantial regulatory resources.

181 To supplement the limited data available, we use data obtained from third-party data providers. However, information from some providers relies on data provided voluntarily by scheme operators. This data is also prone to particular biases, as certain types of schemes are more likely to opt out of reporting data. As such, it does not provide complete coverage of the retail or wholesale scheme sectors.

182 Australia's collection of managed funds data lags global best practice. It is standard practice for other regulators—including the SEC, the European Securities and Markets Authority (ESMA), the UK Financial Conduct Authority and the NZ Financial Markets Authority (FMA)—to collect data on managed funds for use by the regulator, industry and consumers. For example, the SEC and ESMA receive reports about fund liquidity, risk metrics and management, and portfolio holdings. The FMA's Smart investor website provides data on fees, performance and asset allocations and uses interactive graphics to allow consumers to compare various data.

> Note: In the United States, registered management investment companies must report census-type information to the SEC annually (Form N-CEN). Registered investment companies and exchange traded funds organised as a unit investment trust (other than money market funds) must file quarterly reports of their portfolio holdings as at the end of each month (Form N Port). In Europe, alternative investment funds have reporting requirements under Article 24 of Directive 2011/61/EU.

183 We recommend introducing a legislative framework for the recurrent collection of data on managed investment schemes, including unregistered schemes. Data should be provided to ASIC in a machine-readable form.

184 A power for recurrent data collection would allow us to collect comprehensive and detailed sector-wide data to target regulatory activities more efficiently. We could also apply data analytics more effectively to support supervision and enforcement activities.

185 ASIC could publish aggregate data and analysis, which would promote transparency and competition in the sector, leading to improved consumer outcomes. Such an approach would align with strategies of other regulators, which publish aggregate data to improve investor outcomes and industry practice.

186 In 2019, IOSCO published its expectations for data to be provided by regulators to enable IOSCO to publish annual reports on global leverage trends in the asset management industry. ASIC has not been able to provide detailed leverage data in response to surveys conducted by IOSCO.

> Note: IOSCO, *Recommendations for a framework assessing leverage in investment funds* (PDF 1,066 KB) [final report FR18/2019], December 2019.

187 As discussed in paragraph 133, these surveys also highlighted that Australia has not met IOSCO's expectations with respect to data collection by regulators for liquidity monitoring.

> Note: IOSCO, *IOSCO investment funds statistics report* (PDF 1,716 KB) [report FR01/2023], January 2023.

188 A requirement for recurrent collection of data would enable ASIC to meet IOSCO expectations about the provision of data on liquidity and leverage. It would also help us fulfill the commitment in our *Corporate plan 2024–27* to use data and technology to more quickly and accurately identify harms in our environment and to support improved decision making.

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Notification requirement for wholesale schemes

189 Wholesale schemes are not required to be registered with, or notified to, ASIC. Further, we do not collect basic information such as the name, number, and trustee of existing wholesale schemes. As a result, we have limited visibility of the wholesale scheme sector. This has significant implications for our ability to identify and monitor risks and trends in the wholesale scheme sector.

190 In 2012, the International Monetary Fund highlighted ASIC's limited information on unregistered managed investment schemes and recommended that we gain access to sufficient information on unregistered schemes to properly supervise the sector and risks to investors, market integrity and financial stability.

Note: International Monetary Fund, *IOSCO objectives and principles of securities regulation—Detailed assessment of implementation* (PDF 1,149 KB) [IMF country report no. 12/314], November 2012.

191 We recommend that a notification requirement be introduced for wholesale schemes, requiring lodgement with ASIC of base level data such as the scheme's name, trustee and investment strategy. For established schemes transitioning to the notification requirements, we would seek details of assets under management for each wholesale scheme.

192 This requirement would improve transparency for investors, ASIC and the market and enable us to better identify those products and the wholesale trustees responsible for them. It does not involve imposing additional regulatory obligations on wholesale scheme trustees, beyond the requirement to notify ASIC.

Key terms

Term	Meaning in this document
AFCA	Australian Financial Complaints Authority—the external dispute resolution scheme for which an authorisation under Pt 7.10A of the Corporations Act is in force
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
ALRC	Australian Law Reform Commission
ASIC	Australian Securities and Investments Commission
ASX	ASX Limited or the exchange market operated by ASX Limited
CAMAC	The Corporations and Markets Advisory Committee, established in 1989 under the *Australian Securities and Investments Commission Act 2001* to provide advice and recommendations to the Minister about matters relating to corporations and financial services law, administration and practice
CAMAC report	CAMAC, *Managed investment schemes* [report], July 2012
CCIV	A corporate collective investment vehicle—a company that is registered as a corporate collective investment vehicle under the Corporations Act Note: This is a definition contained in s9 of the Corporations Act.
Ch 7 (for example)	A chapter of the Corporations Act (in this example numbered 7), unless otherwise specified
consultation paper	*Review of the regulatory framework for managed investment schemes*, released on 4 August 2023
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
Corporations Regulations	*Corporations Regulations 2001*
CSLR	Compensation Scheme of Last Resort
design and distribution obligations (DDO)	The obligations contained in Pt 7.8A of the Corporations Act
ESMA	European Securities and Markets Authority
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
Financial Services Guide	A document required by s941A or 941B to be given in accordance with Div 2 of Pt 7.7 of the Corporations Act Note: This is a definition contained in s761A.

Term	Meaning in this document
FMA	Financial Markets Authority (New Zealand)
global financial crisis	The period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009
IDPS	An investor directed portfolio service as defined in *ASIC Corporations (Investor Directed Portfolio Services) Instrument 2023/669* or any instrument that amends or replaces that class order
IOSCO	International Organization of Securities Commissions
IOSCO liquidity recommendations	Seventeen principles-based recommendations for liquidity risk management for collective investment schemes published in IOSCO's final report *Recommendations for liquidity risk management for collective investment schemes* (PDF 363 KB)
managed investment scheme	Has the meaning given in s9 of the Corporations Act
PDS	A Product Disclosure Statement—a document that must be given to a retail client for the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
product intervention power	Means the power contained in Pt 7.9A of the Corporations Act and Pt 6-7A of the National Credit Act
Pt 7.7A (for example)	A part of the Corporations Act (in this example numbered 7.7A), unless otherwise specified
reg 7.1.22 (for example)	A regulation of the Corporations Regulations (in this example numbered 7.1.22), unless otherwise specified
responsible entity	A responsible entity of a registered scheme as defined in s9 of the Corporations Act
retail client	A client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of the Corporations Regulations
s761G (for example)	A section of the Corporations Act (in this example numbered s761G, unless otherwise specified)
SEC	Securities and Exchange Commission (United States)
Sterling Income Trust	The Sterling Income Trust (ARSN 158 828 105), a registered managed investment scheme established in 2012
target market determination	Has the meaning given in s994B of the Corporations Act