

4. Establishing a collective investment scheme

Introduction

4.1 This chapter deals with a number of matters concerning the way collective investment schemes are established. It covers whether a particular legal form should be prescribed for collective investment schemes, the constitution of schemes and whether the constitution should have to be approved by the ASC before the scheme can be marketed to investors. It also covers the question whether the covenants presently prescribed by the Corporations Law should continue. Whether the operator of a collective investment scheme should have to be licensed is addressed in chapter 10.

Legal form of collective investment schemes

4.2 A prescribed interest scheme under the present law includes schemes structured as trusts, partnerships and, in some instances, investment contract schemes.¹ This recognises that the legal form of a scheme is in some ways irrelevant to the question what protection should be afforded to investors in the scheme. DP 53 sought views on whether the law should impose any constraints on the legal structures available for schemes. The majority of submissions opposed the idea of a single legal structure for collective investment schemes.² The Review sees no reason to limit artificially the legal form of collective investment schemes. The recommendations in this report will provide appropriate investor protection for all collective investment schemes governed by the Corporations Law. So long as those protections apply there is no need to prescribe the forms that collective investment schemes may take. The Review **recommends** that the Corporations Law should not prescribe a particular legal form for collective investment schemes.

A scheme's constitution

A written constitution

4.3 Under the present law, each prescribed interest scheme must have a deed that sets out the elements of the scheme and includes the covenants prescribed by the Corporations Law, or covenants to the same effect.³ It is important that collective

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1. An investment contract is 'any contract, scheme or arrangement that, in substance and irrespective of its form, involves the investment of money in or under such circumstances that the investor acquires or may acquire an interest in, or right in respect of, property, whether in [the] jurisdiction or elsewhere, that, under, or in accordance with, the terms of investment will, or may at the option of the investor, be used or employed in common with any other interest in, or right in respect of, property, whether in [the] jurisdiction or elsewhere, acquired in or under like circumstances': Corporations Law s 9.
 2. eg IFA *Submission* 1 December 1992; Australian Film Finance Corporation Pty Ltd *Submission* 8 December 1992; ISC *Submission* 16 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992.
 3. It is an offence to issue prescribed interests unless the deed is approved by the ASC: Corporations Law s 1065.

investment schemes continue to be constituted by a written document, for evidentiary purposes and to ensure that all parties are clear about the terms of the agreement. In chapter 10 the Review recommends that operators should be required to lodge a copy of the scheme's constitution with the ASC.⁴ This requirement will mean that a scheme's constitution will have to be in writing.

Covenants and contents

4.4 Prescribed covenants. The deed for a prescribed interest scheme must include the covenants prescribed by the Corporations Law, or covenants to the same effect. These covenants relate to various things the manager and trustee or representative must do and how they must act. Other recommendations in this report deal in detail with obligations and duties that the law ought to impose on operators of collective investment schemes. They cover such matters as how operators should act and the issue, buy back and redemption of interests, meetings of investors and minimum financial controls. In each case, the Review recommends that these obligations and duties be imposed directly on operators by the Corporations Law. The device of covenants between parties is an unnecessary complication. The obligations that the law imposes should be imposed, and be enforceable, directly. DP 53 proposed that necessary obligations be imposed by legislation rather than be contained in covenants.⁵ This proposal was widely supported in submissions as a more direct and expeditious method of prescribing basic obligations.⁶ The Review recommends that the approach of imposing obligations through prescribed covenants no longer be followed. The prescribed covenant provisions of the Corporations Law and regulations should be repealed. Obligations should be imposed directly, by the law itself. Appendix A shows which of the provisions of the draft legislation in Volume 2 reflect the existing covenants prescribed by the Corporations Law.

4.5 Contents of constitution. Matters covered by the Corporations Law will be dealt with as direct obligations on scheme operators. The constitution of a collective investment scheme will have to cover other matters. These would include the investment or management powers of the scheme operator, the way unit prices are to be calculated, the basis on which fees are to be charged and other aspects of the relationship between investors and the scheme operator not covered by provisions in the Corporations Law. Most of the matters left to be prescribed by scheme constitutions will be peculiar to each scheme. The provisions of the constitution should be enforceable directly.

4. As part of the licensing and registration process: see para 10.42.

5. Unless it is inappropriate to do so in respect of specific covenants, in which case they should be deleted: proposal 4.2. The Review notes that the Superannuation Industry (Supervision) Bill 1993 (Cth) has adopted from the Corporations Law the covenants system. The Review does not consider that this is advisable for the same reasons that it considers it inappropriate for collective investment schemes.

6. eg Macquarie Investment Management Limited *Submission* 24 November 1992; IFA *Submission* 1 December 1992; MLC Investments Limited *Submission* 17 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; Arthur Robinson & Hedderwicks *Submission* 16 December 1992.

Presumption of compliance with constitution

4.6 Persons who deal with companies are entitled to assume that the company's constitution has been complied with.⁷ This protects them if the company acts beyond its powers. The Review considers that persons dealing with collective investment schemes should have a similar protection.⁸ It recommends that a person dealing with the operator of a collective investment scheme should be entitled to assume that the scheme's constitution has been complied with.

Scope for standardisation and simplification of scheme constitutions

4.7 There have been suggestions over the years that deeds for prescribed interests schemes, or classes of prescribed interests schemes, ought to be standardised.⁹ While attractive in principle, the recommendations in this report make standardisation unnecessary. In any event, it is probably not possible to draft a standard constituting document without constraining schemes to an undesirable extent. The definition of collective investment schemes covers such a wide variety of schemes that a standard document would be difficult to draft and inappropriate in practice, unless it imposed a rigid structure on all schemes. The Review's recommendation to include a number of duties and procedural matters in the Corporations Law (instead of prescribing them by covenant or leaving them to individual schemes) reduces the need for a standard document.

Approval of scheme constitutions

4.8 Under the current law, deeds for prescribed interest schemes must be approved by the ASC.¹⁰ The ASC must grant approval 'unless it is of the opinion that the deed does not comply with the requirements of this Division and of the regulations'.¹¹ The main purpose of the current approval process is to ensure that the prescribed covenants are included in the deed, either expressly or by reference.¹² The Review's recommendation that the system of prescribed covenants not be continued removes the need for approval. The Review's proposal in DP 53 that constituting documents not have to be approved by the regulator was widely supported.¹³ The Review recommends that there should be no requirement for the constituting document of a collective investment scheme to be approved by the ASC.

7. Corporations Law s 164.

8. Arthur Robinson & Hedderwicks advocated including provisions to the effect of Corporations Law s 162, 164-6 for collective investment schemes: *Submission* 16 December 1992. Many of the assumptions in s 164(3) will apply to scheme operators which will be required, under the Review's recommendations, to be companies.

9. eg the CSLRC recommended that model provisions for deeds be included in the legislation: CSLRC Report, para 83.

10. Corporations Law s 1065.

11. Corporations Law s 1067(2).

12. The ASC will not rely on s 1069(7) which deems covenants to be contained in the deed if they are not expressly contained in the deed: Policy Statement 23. The deeming provisions will be relied on in relation to deeds in existence before the introduction of s 1069(1). If such a deed is amended, however, the ASC will require it to be amended so as to comply with s 1069.

13. eg Arthur Robinson & Hedderwicks *Submission* 16 December 1992; MLC Investments Limited *Submission* 17 December 1992.

Registering schemes

4.9 Individual collective investment schemes should, nevertheless, be clearly identifiable for regulatory and general information purposes. The Review recommends that each scheme should have to be registered by the ASC and given a unique registration number to enable it to be identified. It should be an offence to issue units in a scheme unless the scheme is registered. Registration should not involve an assessment by the ASC of the commercial merits of the scheme. It should be for identification purposes only. A scheme operator should be required to use the registration number of the scheme in all dealings in respect of the scheme, just as companies are now required to use their Australian Company Number in all dealings involving the company. In chapter 10 the Review recommends that the operator of a collective investment scheme should be licensed by the ASC. The application for registration of the scheme should be made at the same time as the operator applies for a licence.¹⁴

14. A company that already has a licence in respect of one scheme can apply to have its licence endorsed in respect of further schemes: see para 10.56.