

Improving the efficacy and efficiency of the legal and regulatory framework for
protection of retail investors investing in collective investment schemes CIS

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STATEMENT OF ORIGINALITY

This is to certify that to the best of my knowledge, the content of this thesis is my own work. This thesis has not been submitted for any degree or other purposes.

I certify that the intellectual content of this thesis is the product of my own work and that all the assistance received in preparing this thesis and sources have been acknowledged.

I certify that no content produced by generative AI tools has been used in the preparation of this thesis.

Alan Jessup

ABSTRACT

The history of collective investment schemes ('CIS') in Australia is replete with examples of failures of the legal and regulatory regime to the detriment of retail investors. Billions of dollars have been lost by retail investors and little has been done to reform this particular framework since the major reform to the laws governing CIS were made in 1998, now known as the managed investment scheme (MIS). This is despite numerous inquiries and Governmental reports containing recommendations for changes in that framework. The lack of action following these inquiries and reports is surprising given

- the toxic effect on retail investor confidence caused by such losses,¹
- the importance of the retail investor to the MIS industry,² and
- the importance of the MIS industry to the Australian economy with funds under management (in part due to compulsory superannuation for employees) exceeding Australia's GDP.³

An initial analysis of the primary and secondary materials referred to in Chapter 1 of this thesis regarding the history of failures with the legal and regulatory framework of the CIS designed to protect the retail investor was undertaken.⁴ This analysis provided a wealth of data⁵ to assist understanding 'the why' or 'the how' of this and suggest relationships between factors.⁶ By asking the questions 'What is going on here?' and 'What is this a case of?',⁷ further analysis identified patterns and themes

¹ Australian Securities and Investments Commission, *Compensation for retail investors: the social impact of monetary loss* (Report No. 240, May 2011), 13-14.

² Brian G Cartwright, 'The future of securities regulation' (2007) 21(11) *Insights: The Corporate & Securities Law Advisor* 24.

³ Deloitte Access Economics *Competition in the Funds Management* (ASIC Report 702, September 2021), 44.

⁴ See Chapter 1 hereof.

⁵ Lisa Webley, 'Qualitative Approaches to Empirical Legal Research' in Oxford Handbook of Empirical Legal Research Edition in Peter Cane and Herbert M. Kritzer (ed) *'Qualitative Approaches to Empirical Legal Research'* (Oxford University Press) 10.

⁶ Lisa Webley, 'Stumbling Blocks in Empirical Legal Research Case Study Research' (2016) *Law and Method* 1, 9.

⁷ Haridimos Tsoukas, 'Craving for generality and small-N studies: a Wittgensteinian approach towards the epistemology of the particular in organization and management studies' in David Buchanan and Alan Bryman (ed), *The SAGE Handbook of Organizational Research Methods* (SAGE 2009); Charles Ragin 'Introduction: Cases of 'What is a case?' in Charles Ragin &

in those areas of the existing MIS framework that have been found wanting and failed to protect retail investors. These areas of the existing MIS legal and regulatory framework are:

- (a) the duties of officers of the responsible entity ('RE'),⁸
- (b) compliance arrangements of the RE including the role of the compliance committee,⁹
- (c) related party transactions,¹⁰
- (d) solvent schemes with insolvent REs,¹¹
- (e) disclosure rules.¹²

From an analysis of this data, the following research questions were generated regarding each of the five above identified areas of failure. These research questions have guided conclusions on what reforms or changes need to be made to the 'law as it is' to rectify the identified problems, namely what the law 'ought to be'.

1. Research Question 1

How do each of these aspects of the legal and regulatory framework of the MIS fail to protect the retail investor?

2. Research Question 2

How can these failures be remedied?

Howard Saul Becker (ed), *'What is a case? Exploring the foundations of social inquiry'* (Cambridge University Press, 1992) 1, 6.

⁸ *Corporations Act 2001* (Cth), s 601FD.

⁹ Ibid, Part 5C.4 and 5C.5

¹⁰ Ibid, 5C.7.

¹¹ Ibid, Part 5C.9.

¹² Ibid. Part 7.9.

3. Research Question 3

On the balance of probabilities,¹³ will the proposed reforms to address these failures cause REs to abandon the retail market thereby reducing retail investor investment choice?

However to be clear, this thesis is **not** considering failures that are purely investment risk matters because this is not the purpose of the current legal and regulatory framework. As noted by the ALRC Report 65,

The law governing collective investment schemes cannot - and should not - try to eliminate the investment risks facing investors. If the law attempted this, it would fail. Investors would be deluded into thinking they could not lose their money. Many of the innovative financial products marketed to investors through collective investment schemes would no longer be viable. Investors would have no choices and no ability to accept greater risks for the opportunity of obtaining greater returns.¹⁴

Rather, this thesis examines the failures that have occurred under the current framework, where the framework was inadequate for the protection of the retail investor from losses caused by factors other than normal investment risks. This is exemplified by a number of the case studies in Chapters 3 to 7 below and some of the reports regarding MIS referred to in the thesis.¹⁵ The ALRC Report 65 is an

¹³ The expression 'balance of probabilities' as used throughout this thesis is the civil standard of proof which involves a weighing up of the facts in issue and any competing arguments to determine whether there is a tilting of the balance in favour of the proposition advanced by the author in this thesis in answer to Research Question 3.

¹⁴ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65, 1993) ('ALRC Report 65'), [2.6].

¹⁵ Malcolm Turnbull *Review of the Managed Investments Act 1998* (Report, 3 December 2001) ('Turnbull Review'); Parliamentary Joint Committee on Corporations and Financial Services *Report on the Review of the Managed Investments Act 1998* (Report, December 2002) ('Turnbull Review Report'); Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (Final Report, September 2009) ('Agribusiness Report'); Corporations and Markets Advisory Committee *Managed Investment Schemes* (Report, July 2012) ('CAMAC Report'); Parliamentary Joint Committee on Corporations and Financial Services *'Inquiry into the collapse of Trio Capital May 2012'* (Report 2012; Senate Economics Reference Committee *Agribusiness managed investment schemes Bitter harvest* (Report, 2016); ('Bitter Harvest'); Senate Economics Reference Committee *Sterling Income Trust* (Report, 2022) ('SIT Report'); The Treasury *Review of the regulatory framework for managed investment schemes* (Consultation Paper, August 2023) ('Treasury Review').

example of distinguishing between normal investment loss and loss due to failure of a regulatory framework to provide investor protection.¹⁶

Through the application of the three research methodologies described in Chapter 2, answers to these research questions were derived for each area of the existing legal and regulatory framework of the MIS. Through this process, conclusions were reached as to how the ‘law as it is’ can be reformed to strengthen the efficacy and efficiency¹⁷ of the MIS legal and regulatory framework to protect the retail investor, i.e. what the ‘law ought to be.’ A further analysis of these proposed reforms to the law leads to the conclusion that, on the balance of probabilities,¹⁸ such reforms are not onerous and therefore should not cause REs to abandon the retail market.

The results of this research contribute to the knowledge and understanding of the flaws in the current legal and regulatory framework and how the proposed reforms flowing from an analysis of that current framework should improve the protection of retail clients who invest in CIS without over-regulating the industry.

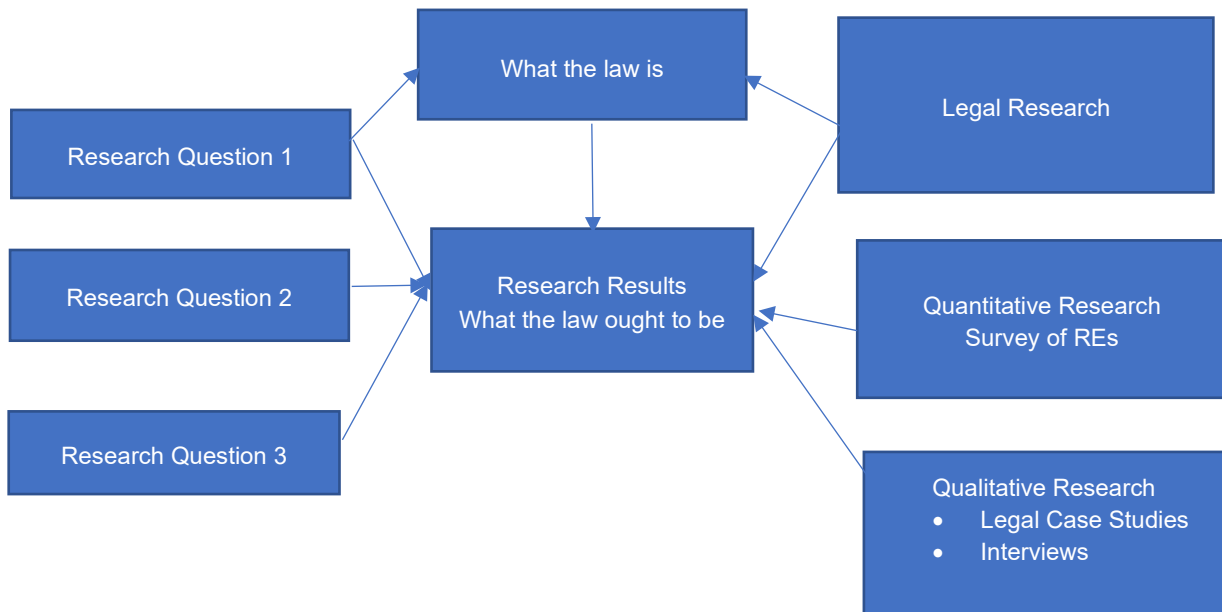
[Note: This thesis uses the citation guidelines set out in the Australian Guide to Legal Citation (4th Edition)].

¹⁶ ALRC Report (n 14), [2.6]-[2.13].

¹⁷ In the context of this thesis, ‘efficacy and efficiency’ or ‘efficacious and efficient’ means that the proposed reforms have the ability to achieve the desired regulatory results and may be implemented in a manner in which the costs of doing so is balanced by the benefit those reforms deliver to the retail client: Victoria E. Aitken ‘An exposition of legislative quality and its relevance for effective development’ (2013) (2:1) *ProLaw Student Journal* 1, 6-7 and 33.

¹⁸ (n 13).

Diagrammatic Representation of Research Approach of this Thesis



ETHICS DECLARATION

The research associated with this thesis received ethics approval from the University of Sydney Research Ethics Committee Application Number 2022/299.

DISCLOSURE OF PUBLISHED BOOK

Although I am the author of the book '*Managed Investment Schemes*' Federation Press, 2012, this thesis is my own research work into the topic and is distinct from the book. The book was directed at non-lawyers working in the MIS industry as well as lawyers. The book was also written in 2011. Therefore, this thesis is a more in-depth approach to the regulation of MIS than the book. The book is a textbook, not a research project.

The book has also been cited in other publications as set out below. Some of these publications are referred to in this thesis.

- *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (Receivers and Managers Appointed) (in liquidation)* [2014] VSC 516.
- *Re Quintis (Australia) Pty Ltd (Receivers And Managers Appointed) (Administrators Appointed) [No 3]* [2025] WASC 248.
- Lagnesh Kumar, 'Hedge fund regulation in Australia: mitigating fraud risk in an environment of mandated disclosure' (PhD thesis, University of Wollongong, 2013).
- Nuncio D'Angelo '*Commercial Trusts*' (LexisNexis Butterworths Australia 2014).
- Nuncio D'Angelo, Submission to NSW Law Reform Commission '*Review of laws relating to beneficiaries of trusts*' (29 June 2017).
- David G Millhouse, 'Systemic and cyclical failure in Australian financial services and financial products sectors: have weaknesses in law contributed to these failures?' (PhD Thesis, Bond University, 2018).
- David G Millhouse 'Empirical analysis supports the Hayne long run reform thesis' (2019) 13(2-3) *Law and Financial Markets Review* 162
- David Millhouse 'Directors and Officers - Strategic Leadership or Bondage?' (2020) *Enterprise Governance eJournal* 1.

- David Millhouse 'Litigation Financing - Untangling the Gordian Knot - The Future of Law Reform' (2022) 34:3 *Bond Law Review* 15.
- Michael Bacina, Submission No. 72 to Senate Select Committee *Australia as a Technology and Financial Centre* (28 July 2021).
- Alan Jessup, Submission to Treasury 'Review of the regulatory framework for managed investment schemes' (27 September 2023).
- Alan Jessup, 'Treasury Review of the Regulatory Framework for Managed Investment Schemes – Reforming Compliance Arrangements' (2024) 40 *Company & Securities Law Journal* 293.
- Stewart J Maiden 'Insolvent Investments' (Lexis Butterworths Australia 2015).
- 'Ford and Lee: The Law of Trusts' (Thomson Reuters 2024).

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Lastly, thanks to Catherine Welch, whose inspirational teaching in Advanced Qualitative Research encouraged me to succeed with this project.

AUTHORSHIP ATTRIBUTION STATEMENT

A shortened version of Chapter 4 of this thesis is published as 'Treasury Review of the Regulatory Framework for Managed Investment Schemes – Reforming Compliance Arrangements' (2024) 40 *Companies & Securities Law Journal* 293.

I am the sole author.

Alan Jessup

Date: 26/08/2024

As supervisor for the candidature upon which this thesis is based, I can confirm that the authorship attribution statements above are correct.

Gail Pearson

Date: 22/09/2025

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TABLE OF ABBREVIATIONS – GLOSSARY OF TERMS

Acronym	Expression
ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ACPA	Compliance Professionals of Australia
ADI	Approved Deposit-Taking Institution
AFCA	Australian Financial Complaints Authority
AFR	Australian Financial Review
AFSL	Australian financial services licence
AI	Artificial Intelligence
AICD	Australian Institute of Company Directors
ALRC	Australian Law Reform Commission
AML-CTF	Anti-Money Laundering/Counter Terrorism Financing
APCHL	Australian Property Custodian Holdings Limited
APRA	Australian Prudential Regulation Authority
ARFP	Asian Region Funds Passport
ARPGF	ARP Growth Fund
ASC	Australian Securities Commission
ASF	Astarra Strategic Fund ARSN 115 962 368
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i> (Cth)
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
BVI	British Virgin Islands
BGS	Bridge Global Securities Pty Ltd ACN 133 256 603

Acronym	Expression
BPM	Balanced Property Management
BPTC	Burns Philp Trustee Company Limited
CAC	Corporate Affairs Commission
CAMAC	Corporations and Markets Advisory Committee (formerly CASAC)
CAP	Consumer Advisory Panel
CASAC	Corporations and Securities Advisory Committee (later known as CAMAC)
CC	Compliance Committee
CCIV	Corporate Collective Investment Vehicles
CEO	Chief Executive Officer
CEU	Court enforceable undertaking
CESR	Committee of European Securities Regulators
CFO	Chief Financial Officer
CFSIL	Colonial First State Investment Limited ACN 002 348 352
CIS	Collective Investment Scheme
CLR	Commonwealth Law Reports
COO	Chief Operations Officer
CP	Compliance Plan
CPA	Compliance Plan Auditor
CPD	Continuing Professional Development
CPG	Centro Property Group
CPL	City Pacific Limited ACN 079 453 955
CPT	Centro Property Trust ARSN 090 931 123
CRT	Centro Retail Trust ARSN 104 931 928
CSLR	Compensation Scheme of Last Resort

Acronym	Expression
CSR	Corporate Social Responsibility
DDO	Design and Distribution Obligations
EDR	External Dispute Resolution
ESG	Environmental Sustainability Governance
EU	European Union
ETF	Exchange Traded Fund
FBA	Food and Beverage Australia Ltd ACN 008 197 206
FCA	Federal Court of Australia
FCAFC	Full Court of the Federal Court of Australia
FFM	Fund Facts Document'
FOFA	Future of Financial Advice
FOIA	<i>Freedom of Information Act 1982 (Cth)</i>
FOS	Financial Ombudsman Service
FPA	Financial Planning Association
FPAS	Financial Products and Services
FSA	Financial Services Authority (UK)
FSRA	<i>Financial Services Reform Act 2001 (Cth)</i>
FUM	Funds under Management
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GSG	Great Southern Group
GSMAL	Great Southern Plantations Managers Australia Ltd
HCA	High Court of Australia
HML	Huntley Management Limited ACN 089 240 513

Acronym	Expression
HRC	Hayne Royal Commission
IAS	International Accounting Standards
IAS 24	International Accounting Standard IAS 24 - Related Party Disclosures.
ICAC	Independent Commission Against Corruption
ICCMF	Independent Compliance Committee Member Forum
IOSCO	International Organisation of Securities Commissions
ISO	International Standards Organisation
ITAA 36	<i>Income Tax Assessment Act 1936</i> (Cth)
ITAA 97	<i>Income Tax Assessment Act 1997</i> (Cth)
KIS	Key Information Statement
LCA	Law Council of Australia
LLP	Limited Liability Partnership
MD	Managing Director
MFSIM	MFS Investment Management Ltd
MIA	<i>Managed Investment Act 1998</i> (Cth)
MIS	Managed Investment Scheme
NBFE	Non-Bank Financial Entity
NSWSC	Supreme Court of New South Wales
NSWSCA	Supreme Court of New South Wales – Court of Appeal
NTA	Net Tangible Assets
NZ	New Zealand
OECD	Organisation for Economic Cooperation & Development
PDS	Product Disclosure Statement
PFMF	Pacific First Mortgage Fund

Acronym	Expression
PHS	Product Highlights Sheet
PIP	Product Intervention Power
PJC	Parliamentary Joint Committee on Corporations and Financial Services
PTA	Permanent Trustee Australia Ltd
QCA	Supreme Court of Queensland – Court of Appeal
QSC	Supreme Court of Queensland
RBA	Reserve Bank of Australia
RE	Responsible Entity
RIS-FSDR	Regulation Impact Statement on Financial Services Disclosure Reform
RM	Responsible Manager
RO	Responsible Officer (¹⁹)
RPT	Related Party Transaction
RSE	Regulated Superannuation Entity
SASC	Supreme Court of South Australia
SASCA	Supreme Court of South Australia – Court of Appeal
SEC	Securities and Exchange Commission (USA)
SERC	Senate Economics Reference Committee
SMIS	Simple Managed Investment Scheme
SIT	Sterling Income Trust
SLRC	Statute Law Revision Committee (Vic)
SMIS	Simple Managed Investment Scheme
SMSF	Self-Managed Superannuation Fund
SVP	SV Partners

¹⁹ subsequently became known as responsible manager.

Acronym	Expression
TAA	<i>Taxation Administration Act 1953 (Cth)</i>
TCAG	Timbercorp Growers' Almond Committee Inc.
TEA	Trustees, Executors and Agency Co. Ltd
TGG	Timbercorp Growers' Group
TMD	Target Market Determination
TRE	Temporary Responsible Entity
UCITS	Undertakings for Collective Investment in Transferable Securities
TSL	Timbercorp Securities Limited
UK	United Kingdom
USA	United States of America
VSC	Supreme Court of Victoria
VSCA	Supreme Court of Victoria - Court of Appeal
WASC	Supreme Court of Western Australia
WASCA	Supreme Court of Western Australia - Court of Appeal
WFL	Willmott Forests Limited

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CHAPTER 1: THE COLLECTIVE INVESTMENT SCHEME (CIS) IN AUSTRALIA

'Managing other people's money is a responsibility not to be taken lightly.'¹

I. INTRODUCTION

Following a joint inquiry by the Australian Law Reform Commission ('ALRC') and Corporations and Securities Advisory Committee ('CASAC') into CIS and the issue of their joint report in 1993,² the *Managed Investments Act 1998* (Cth) ('MIA') was enacted, commencing on 1 July 1998. The MIA introduced a radical and controversial change to the legal and regulatory framework for CIS (renamed the 'managed investment scheme') ('MIS'). The former dual responsibility structure of a trustee and manager was replaced with a single responsible entity ('RE') structure.

Despite the purpose of the MIA being to 'improve corporate governance',³ there have been numerous failures of MIS since 1998 for reasons other than for normal investment risk.⁴ These failures caused billions of dollars of losses to be suffered by retail investors.⁵ This phenomenon has continued up to the present day with a number of MIS failures in 2024 and 2025.⁶

¹ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65, 1993) ('ALRC Report 65'), [9.17].

² Ibid.

³ Explanatory Memorandum to the Managed Investments Bill 1997 ('EM-MIA'), [2.6(c)].

⁴ This thesis is **not** concerned with losses by retail investors in MIS that flow from normal investment risk. The regulatory framework has not been fashioned to prevent losses that flow from normal investment risk: ALRC Report 65 (n 1), [2.6].

⁵ Chronology Table 1.3, page 341; Failed Schemes, Tables 6.1 and 6.2 page 384; Pamela Hanrahan 'Revisiting Responsible Entity Directors' Liability to Scheme Members' (2016) 34 *Companies & Securities Law Journal* 321, 325; Ruth Williams 'Don't blame us for corporate failures: ASIC chief' *Sydney Morning Herald* (10 August 2009); David Bryant 'The danger of managed investment schemes' (Speech, Agribusiness Association of Australia) *Money Management* (15 June 2010); Australian Securities and Investments Commission 'Responsible entities: Financial requirements' (Regulatory Impact Statement, November 2011), 6 (footnote 9).

⁶ Tony Boyd 'Lessons from \$1.2b funds collapses' *Financial Review*, (22 June 2025); Andrew Hobbs 'A decade of pain ahead for victims of \$1.2b super disaster' *Financial Review*, (6 August 2025); *Australian Securities and Investments Commission v Australian Fiduciaries Limited* [2025] FCA 1099.

The following tables illustrate this phenomenon.

Failed Agribusiness Schemes⁷

Date	Name	Amount Raised (\$million)	No of MIS	No of Investors
April 2010	FEA Plantations	426 ⁸	17	13,000
May 2010	Great Southern	2,000	43	43,000
September 2012	Gunns	600	16	49,000
February 2008	Palandri	155	5	3,200
May 2010	Rewards Group	250	43	8,400
April 2009	Timbercorp	1,100	34	18,000
September 2010	Wilmott Forests	400	14	8,000

Estimated Scheme Losses for Other MIS

Date	Responsible Entity	Scheme(s)	Investor Losses (\$m)
2008	MFS Investment Management Ltd	Premium Income Fund	143.5 ⁹
2008	Primary Yield Agricultural Investments Ltd (formerly Environinvest)	Various agribusiness schemes	70 ¹⁰
2008/2009	Allco and Babcock & Brown	Several Listed Funds	4,400 ¹¹

⁷ Kevin Davis and Henry Herkes 'Agribusiness MIS Failures: Policy lessons from the Quintis failure' (2019) 31(7) *Company & Securities Law Journal* 1, 3, said to be sourced from <https://www.ato.gov.au/uploadedFiles/Content/ATP/downloads/GEN_ATP_21849_TAS.xls> (viewed 1 June 2018), scheme websites and media reports.

⁸ Senate Economics Reference Committee 'Agribusiness managed investment schemes - Bitter harvest March 2016' (Report, 2016), [2.39]

⁹ Australian Securities and Investments Commission 'MFS executives found to have dishonestly breached duties' (Media Release 16-158MR, Australian Securities and Investments Commission, 23 May 2016).

¹⁰ Mike Taylor 'Investors out of pocket as MIS is place in liquidation' *Money Management* (14 November 2008).

¹¹ Tony D'Aloisio 'Regulatory issues arising from the financial crisis for ASIC and for market participants' (Speech, Securities & Derivatives Industry Association 12th Annual Conference, 29 May 2009), 4-5

Date	Responsible Entity	Scheme(s)	Investor Losses (\$m)
2009	Great Southern Projects	43 Schemes	4,000 ¹²
2009	Trio Capital Ltd	Astarra Strategic Fund and ARP Growth Fund	176 ¹³
2009	City Pacific Ltd ¹⁴	Pacific First Mortgage Fund	514 ¹⁵
2010	Prime Trust	Prime Retirement and Aged Care Property Trust	550 ¹⁶
2013	LM Investment Management Ltd	LM First Mortgage Income Fund	394.39 ¹⁷
2019	Theta Asset Management Ltd	Sterling Income Trust	16.71 ¹⁸
2024	Keystone Asset Management Ltd	Shield Master Fund	Estimated between 270 and 255 ¹⁹
2024	Falcon Capital Ltd	First Guardian Fund	446 ²⁰

¹² 'Managed investment schemes face uncertain future' *ABC Premium News* (Sydney 19 May 2009).

¹³ Parliamentary Joint Committee on Corporations and Financial Services 'Inquiry into the collapse of Trio Capital May 2012' (Report 2012), ('Trio Report')[9.1].

¹⁴ City Pacific Ltd was removed as responsible entity of the Pacific First Mortgage Fund and replaced by Trilogy Funds Management Ltd on 25 June 2009: *Trilogy Funds Management Limited v Sullivan* [2013] FCA 185, [6].

¹⁵ Mike Taylor 'Unit holders in the Pacific First Mortgage Fund have received a rude shock, with a confirmation from Balmain Trilogy Group that the gross assets of the fund have been written down to the tune of \$448.9 million for the year to 30 June' *Money Management Newsletter* (19 November 2009).

¹⁶ Australian Securities and Investments Commission 'High Court decision on Prime Trust directors' (Media Release 18-366MR, 4 December 2018); Kevin Davis 'Financial Institution Failures: An Australian Perspective' in Kevin Davis 'Bank and Financial Institution Management in Australia' (e-book www.kevindavis.com.au, February 2023), 6.

¹⁷ Affidavit of David Whyte of 9 April 2024 filed in proceedings *Bruce v LM Investment Management Limited No. 3383 of 2013* paragraph [145] indicates a total distribution to unitholders will be 19.86 cents in the dollar and the financial statements for the 6 months ended 31 December 2023 of the LMMIF shows 492,125,624 units on issue; LM Investment Management operated 7 registered MIS in total which together, including the LMMIF, 12,000 investors lost most of the \$800m invested: Davis (n 10), 6.

¹⁸ *Australian Securities and Investments Commission v Theta Asset Management Limited* [2020] FCA 1894, [296]-[297]

¹⁹ Laura Dew 'How much could investors recover from Shield Master Fund?' *Money Management* (6 December 2024).

²⁰ Hanan Dervisevic 'First Guardian investors may lose their super. Should you be worried about yours?' *ABC News* (11 July 2021).

Date	Responsible Entity	Scheme(s)	Investor Losses (\$m)
2024	ISG Financial Services Limited	ISG Private Access Fund, ISG Real Estate Equity Fund	145 ²¹
2025	Australian Fiduciaries Limited	Global Diversified Alpha Fund, Global Multi-Strategy Fund Global All Seasons Fund.	TBD ²²

There have also been numerous inquiries into the legal and regulatory framework for MIS.²³ Reports from these inquiries were issued in 2001, 2002, 2009, 2012, 2016 and 2022 with a report for the most recent inquiry in 2023 as of 16 September 2025 was awaiting issue.²⁴ The recommendations have largely been ignored.

In August 2023, the latest investigation into MIS commenced with Treasury issuing a consultation paper into the regulatory framework for MIS.²⁵ Treasury was to report on its findings by early 2024, but has not done so as of 16 September 2025.

Although the recommendations of the Hayne Royal Commission ('Hayne'), which issued a final report in 2019,²⁶ were largely accepted by the Federal Government, this was in juxtaposition to the weak reaction to the recommendations of earlier

²¹ Australian Securities and Investments Commission 'Supreme Court orders ISG Financial to wind up its registered managed investment schemes' (Media Release 24-200MR, 3 October 2024).

²² Australian Securities and Investments Commission 'ASIC takes steps to appoint receivers to Australian Fiduciaries Ltd as investigation continues' (Media Release 25-104 16 June 2025).

²³ Malcolm Turnbull *Review of the Managed Investments Act 1998* (Report, 3 December 2001) ('Turnbull Review'); Parliamentary Joint Committee on Corporations and Financial Services *Report on the Review of the Managed Investments Act 1998* (Report, December 2002) ('Turnbull Review Report'); Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (Final Report, September 2009) ('Agribusiness Report'); Corporations and Markets Advisory Committee *Managed Investment Schemes* (Report, July 2012) ('CAMAC Report'); Trio Report (n 13); Senate Economics Reference Committee *Agribusiness managed investment schemes Bitter harvest* (Report, 2016); ('Bitter Harvest'); Senate Economics Reference Committee *Sterling Income Trust* (Report, 2022) ('SIT Report'); The Treasury *Review of the regulatory framework for managed investment schemes* (Consultation Paper, August 2023) ('Treasury Review').

²⁴ Ibid.

²⁵ Treasury Review (n 23).

²⁶ Kenneth M Hayne *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, 1 February 2019) ('Hayne').

inquiries into the legal and regulatory framework of the MIS. However, Hayne mainly impacted the financial services provided by the REs rather than the MIS legal and regulatory framework specifically.

The purpose of the 2023 Treasury review into the regulatory framework for MIS, referred to above, was to ensure that the MIS framework 'remains fit-for-purpose and effectively protects investors from unnecessary financial risk'.²⁷ This purpose aligns with the purpose of this research project and the topic of this thesis.

In 2022, the Senate Economics Reference Committee ('SERC') aptly described and captured the above phenomenon which is the background and motivation for this research project as follows:

The long history of failed management investment schemes in Australia and the associated destruction of consumer wealth demonstrates that this problem goes beyond what occurred with the Sterling Income Trust (SIT) and Sterling Group of companies. Clearly, there is a broader systemic issue related to the regulation of financial products to retail investors in Australia...Many recommendations arising from previous inquiries on similar issues have yet to be implemented and high-risk managed investment schemes continue to be ruthlessly marketed and then suddenly fail, taking retail investors financial hopes and dreams with them.²⁸

The main purpose of the MIS is for investors to pool their savings to invest in various kinds of assets not available to them as individuals, and where the rates of return are higher than bank deposits. Depending on the type of MIS, pooling can also mitigate investment risk. There may also be tax advantages for the investor.²⁹ This emphasises the need to ensure that the retail investor is protected from harm.³⁰

In designing any reforms to the law to protect the retail investor from harm, care needs to be taken that the reforms do not constitute over-regulation. Over-regulation may also cause resentment by the RE, leading to non-cooperation and creating the

²⁷ Stephen Jones 'Managed investment schemes regulatory framework review consultation now open' (The Treasury, Media Release, 3 August 2023).

²⁸ SIT Report (n 23), [4.100].

²⁹ Ibid, 315-400.

³⁰ Australian Securities and Investments Commission, *Compensation for retail investors: the social impact of monetary loss* (Report No. 240, May 2011), 13-14 (Note: report prepared by Susan Bell Research and commissioned by ASIC Consumer Advisory Panel).

vicious cycle represented in Figure 1.2, page 339.³¹ This, in turn, may result in REs withdrawing their products from the retail market. Ultimately, this could lead to shrinkage of the financial products market available to retail clients, leading to lower investment returns. In other words, the legal and regulatory framework should not only operate to protect retail investors from suffering significant loss from events that are not normal investment risk while at the same time enabling investment opportunity for those retail investors.

The Hon. Michael Kirby said that the ‘law can facilitate economic development and not simply coerce, regulate and control’.³² The ideal state of affairs is therefore one where:

- (a) the legal and regulatory framework of the MIS is sufficiently robust to engender confidence in the retail investor investing in MIS through risk reduction, and
- (b) is not over-regulated, which would discourage MIS operators offering MIS products to the retail investor because of increased compliance costs.

In other words, ‘effective regulation should be efficient’.³³ This ideal approach should protect retail investors without avoid restricting retail investor choice.

Unfortunately, much of the reform to the law regulating financial products (including MIS) over the past 24 years has led to a growing complexity of the law. This growing complexity has been subject to significant and pointed criticism.

Justice Rares described the *Corporations Act 2001* (Cth) (‘Corporations Act’) as ‘a blight on our community’. His Honour considered that the current approach to legislative drafting of the Commonwealth Government had ‘attributes of a pandemic expanding the now virtual statute book exponentially so that a proper grasp of what it

³¹ Marina Nehme, Submission to Senate Economics Reference Committee, *ASIC Investigation and Enforcement* (27 October 2022).

³² Michael Kirby, ‘The company director: past, present, and future’ (Speech, Australian Institute of Company Directors, Tasmanian Division, 31 August 1998).

³³ Shyam S. Bhati, ‘An analysis of the financial services regulations of Australia’ (2008) 4(2) *International Review of Business Research Papers* 13, 22.

seeks to regulate is beyond understanding'.³⁴ Further, His Honour commented that '[l]egislative overcomplexity is the antithesis of providing access to justice'.³⁵ Earlier, His Honour also 'famously' described the financial services provisions in the Corporations Act (which apply to MIS) as 'legislative porridge' or 'legislative morass'.³⁶

These same provisions have also been described by other judges as 'tortuous'³⁷ and 'exceptionally complex'.³⁸ Justice Austin expressed the view that the 'very mention of the Financial Services Reform Act 2001 will produce moans of despair'. His Honour also claimed that every significant amendment to the corporations law since 1998 had added to its complexity and created obfuscation.³⁹ The ALRC also described the legislation governing Australia's financial services industry as 'unnecessarily complex.' The ALRC said reform was required to the legislative framework so that it was 'more adaptive, efficient, and navigable'.⁴⁰ Godwin, Brand and Langford note that 'the greater the complexity of legislation and the rules that it embodies, the less clear it is likely to become and the greater the challenges for achieving compliance'.⁴¹ Complexity in the law, therefore, disadvantages the retail investor, leading to reduced protection and investment choice.

This problem is not new. As long ago as 1593, the jurist and philosopher Francis Bacon railed against complexity in the law. He said the role of the law should be to

³⁴ Transcript of Proceedings (Ceremonial sitting of the Full Court to farewell the Honourable Justice Rares, Rares J 14 November 2023), 16- 17; see also Sarah Derrington 'The 22nd WA Lee Equity Lecture: 18 November 2021, Banco Court, Supreme Court of Queensland' (2023) 42(1) *University of Queensland Law Journal* 131

³⁵ Ibid; also see Justice Steven Rares 'Competition, fairness and the courts (FCA) [2014] *FedJSchol*10, [98]-[99].

³⁶ *Wingecarribee Shire Council v Lehman Bros Australia Ltd (In Liq)* [2012] FCA 1028, [948]; cited in support in *Gloucester Shire Council v Fitch Ratings, Inc (No 2)* [2017] FCA 248, [48] (Wigney J); *Australian Securities and Investments Commission v Davidof* [2017] FCA 658, [4], (Lee J); *Davis v Wilson* [2025] FCA 108, [1556] (Shariff J).

³⁷ *Australian Securities and Investments Commission v Westpac Banking Corporation* [2019] FCA 2147, [12].

³⁸ *Australian Securities and Investments Commission v Commonwealth Bank of Australia* (2023) 299 FCR 604, [265].

³⁹ Robert P. Austin, 'Opening Commentary on Mergers and Acquisition' (Speech, University of New South Wales Faculty of Law Centre for Continuing Legal Education, 24 October 2007), 5-6.

⁴⁰ Australian Law Reform Commission *Confronting Complexity: Reforming Corporations and Financial Services Legislation* (Final Report No. 141, November 2023), [1.1]-[1.3].

⁴¹ Andrew Godwin, Vivienne Brand and Rosemary Teele Langford, 'Legislative Design: Clarifying the Legislative Porridge' (2021) 38(5) *Company & Securities Law Journal* 280, 281.

‘guard the rights of the people, not to feed the lawyers. The laws should be read by all, known to all. Put them into shape, inform them with philosophy, reduce them in bulk, give them into every man's hand’.⁴² Bacon also considered that the law should be ‘shorn of contradiction and confusion, remodelled and reduced to a ‘sound and manageable body’.⁴³ This principle will be applied when answering the research questions referred to in this thesis so that proposed reforms do not cause complexity in the law.

Frieberg makes the point that ‘governments must ensure that regulation does not give rise to excessive or unnecessary burdens’ although he acknowledges that working out what constitutes “excessive’ or ‘unnecessary’ is complex.⁴⁴

There are a number of regulatory theories.

A. *Smart Regulation*

Haines, Sutton and Platania-Phung suggest that regulation should be problem-solving focused, i.e., ‘smart regulation’ rather than ‘regulatory proliferation’.⁴⁵ Unfortunately, there is evidence that heavy regulation is prevalent following disasters.⁴⁶ For example, following Hayne,⁴⁷ five amending statutes and nine amending regulations were enacted.⁴⁸ This is despite Hayne concluding that ‘[l]obbying for prescription, detail and tailoring has been a significant contributor to the current state of the law’.⁴⁹

B. *Principles-based Regulation*

Another theory of regulation is ‘principles-based regulation’. This relies on ‘high level, broadly stated rules or principles’ by which regulatees must conduct business rather

⁴² Frances Bacon, Speech (26 February 1593) in William Hepworth Dixon ‘*Personal history of Lord Bacon: From unpublished papers*’ ed John Murray (1861), 34.

⁴³ Catherine Drinker Bowen ‘*Francis Bacon: The Temper of a Man*’ (Fordham University Press, 1993), 147.

⁴⁴ Arie Freiberg ‘*Regulation in Australia*’ 2nd edition The Federation Press 2025, 201.

⁴⁵ Fiona Haines, Adam Sutton and Chris Platania-Phung, ‘It’s all about risk, isn’t it? Science, politics, public opinion and regulatory reform’ (2007/8) *10 Flinders Journal of Law Reform* 415.

⁴⁶ Ibid.

⁴⁷ Hayne (n 26).

⁴⁸ See Table 1.2 (Regulation Cycle – Development of Resentment by Regulatee towards the Regulator) page 340.

⁴⁹ Hayne (n 26), 495.

than 'detailed prescriptive rules'.⁵⁰ However, caution in this regard is needed because, as concluded by MacNeil, 'a principles-based approach does not work with individuals who have no principles'.⁵¹

C. *Responsive Regulation*

A further theory is 'responsive regulation theory'.⁵² Responsive regulation has been described as a 'leading approach to describing and prescribing how regulatory enforcement action best promotes compliance'.⁵³ This theory has contributed to corporate law in Australia, the civil penalty regime being an example.⁵⁴

The basic concept is that regulation will be more likely to be effective if it is responsive to the regulatory environment and the activities of the regulatee.⁵⁵ Kolieb, who develops this theory further, argues that 'rule compliance' is an 'impoverished view of regulation'.⁵⁶ If regulation is appropriately conceived, then it is not limited to compliance mechanisms or enforcement of rules but also includes methods and mechanisms to encourage regulatees to go beyond compliance with legal rules in order to satisfy the goals of the regulation.⁵⁷ Therefore, while rule compliance may be an end goal, it is not an endpoint but rather a waypoint to improve the behaviour of the regulatee.⁵⁸ It should be possible to prevent bad behaviour through incentivising

⁵⁰ Julia Black, 'Principles Based Regulation: Risks, Challenges and Opportunities' (2007) *London School of Economics and Political Science* 2 cited in Hayne (n 26), 494.

⁵¹ Iain MacNeil, 'The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis' (2010) 11 *European Business Organisation Review* 483, 524.

⁵² Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

⁵³ Nielsen, Vibeke Lehmann and Christine Parker, 'Testing responsive regulation in regulatory enforcement' (2009) 3 *Regulation & Governance* 376.

⁵⁴ Senate Economics Reference Committee *Performance of the Australian Securities and Investments Commission* (Final Report, 2014), [4.10]; see discussion at pp 73 to 78 hereof.

⁵⁵ Jasper Hedges et al 'The Policy and Practice of Enforcement of Directors' Duties by Statutory Agencies in Australia: An Empirical Analysis' (2017) 40(3) *Melbourne University Law Review* 905, 928.

⁵⁶ Jonathan Kolieb, 'When to Punish, When to Persuade and When to Reward: Strengthening Responsive Regulation with the Regulatory Diamond' (2015) 41(1) *Monash University Law Review* 136, 137.

⁵⁷ Ibid, citing Jonathan C Borck and Cary Coglianese 'Beyond Compliance: Explaining Business Participation in Voluntary Environmental Programs' in Christine Parker and Vabeke Lehmann Nielsen (ed), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2011), 139.

⁵⁸ Ibid 138.

good behaviour by REs as an alternative to strict or heavy regulation, i.e. positive rather than negative reinforcement.⁵⁹

D. Outcome-based Regulation

A more recent approach is a concentrated focus on one aspect of principles-based regulation, namely, outcome-based regulation.⁶⁰ This focuses on the outcomes sought rather than the process. Consumer protection law is moving in this direction.⁶¹ The current design and disclosure obligations ('DDO'), is an example.⁶² However, there is a risk that this approach will lead to strict liability. This may deter product issuers from offering interests in the MIS they operate, available to retail investors.

E. Conclusion

Whatever the model, regulation needs to work if the retail investor is to be protected against improper behaviour by intermediaries. On the one hand, regulation should not be so inadequate that it does not protect the retail investor or is so heavily regulated that suitable retail investor financial products are withdrawn from the market for retail investors. As Buttigieg, Consiglio and Sapiano state:

good financial regulation and supervision occurs, always and anywhere, where those responsible fulfil this role professionally with the primary aim of achieving the common good. If the financial regulatory/supervisor is constantly guided by the high level principle that the vulnerable in society should never be allowed to suffer the consequences which may result from regulatory capture or market malpractice, then financial regulation and supervision will be really working for the greater good and the interest of society in general.⁶³

⁵⁹ Charlotte Lambert, Frederick Choi and Eshwar Chandrasekharan "'Positive reinforcement helps breed positive behavior": Moderator Perspectives on Encouraging Desirable Behavior' (2024) 11(8) *Proceedings of the ACM on human-computer interaction* CSCW2 1.

⁶⁰ Black (n 50), 5.

⁶¹ Australian Law Reform Commission *Interim Report C Financial Services Legislation* (Report No. 140, June 2023), [3.125]-[3.131]; ALRC Report No. 141 (n 40), [9.47]-[9.51].

⁶² Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018, [1.7]; Corporations Act, Part 7.8A; Chapter 7 commencing at 205.

⁶³ Christopher P. Buttigieg, John A. Consiglio and Gerd Sapiano 'A Critical Analysis of the Rationale for Financial Regulation Part II: Objectives of Financial Regulation' (2020) *European Company and Financial Law Review* 437, 477.

II. WHAT IS A COLLECTIVE INVESTMENT SCHEME ('CIS')?

There is no clear definition of 'CIS'. Blair observed that 'CISs' have eluded any generally accepted definition'.⁶⁴ Each jurisdiction that regulates CIS (or MIS) has its own definition for the purposes of its regulatory regime.⁶⁵

In Australia, the term 'collective investment scheme' has, from 24 May 1991, been used to describe the subject matter of a reference by the Commonwealth Attorney-General under the *Law Reform Commission Act 1973* (Cth)⁶⁶ and the *Australian Securities Commission Act 1989* (Cth)⁶⁷ for a joint inquiry by the ALRC and the then Corporations and Securities Advisory Committee ('CASAC'),⁶⁸ concerning schemes which involved the issue of 'prescribed interests' as then defined.⁶⁹ A recommendation arising from this reference was that the then existing definition of 'prescribed interest' be abandoned in favour of a definition of 'collective investment scheme'.⁷⁰ However, the ALRC Report 65 did not define the term but recommended that four specific types of schemes be classified as CIS.⁷¹ This recommendation was not adopted by the Government. Rather, a new concept of MIS was introduced. Section 9 of the Corporations Act defines 'MIS' as:

- (a) a scheme that has the following features:
 - (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme

⁶⁴ Mark Blair, 'Collective investment schemes overseas' (1993) 66 *Australian Law Reform Commission Reform Journal*, 11.

⁶⁵ Australia: Corporations Act, s 9, definition of 'managed investment schemes'; New Zealand: *Financial Markets Conduct Act 2013*, s 9, definition of 'managed investment schemes'; UK: *Financial Services and Markets Act 2000*, s 235(1); Singapore: *Securities and Futures Act*, definition in s 3; India: *Securities and Exchange Board of India Act 1992*, s 11AA; Hong Kong: *Securities and Futures Ordinance*, definition in Schedule 1.

⁶⁶ Precursor to *Australian Law Reform Commission Act 1996*.

⁶⁷ Precursor to *Australian Securities and Investments Commission Act 2001* (Cth).

⁶⁸ *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11, [8]; (although a differently constituted Full Court of the Federal Court in *LCM Funding Pty Ltd v Stanwell Corporation Limited* (2022) 292 FCR 169 held that the decision by the majority in *Brookfield* was 'plainly wrong', the court did not overrule the decision on this particular point).

⁶⁹ ALRC Report 65 (n 1), Terms of Reference, xv.

⁷⁰ *Ibid*, [3.5], [19].

⁷¹ *Ibid*, [2.3].

(whether the rights are actual, prospective or contingent and whether they are enforceable or not);⁷²

- (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);⁷³
- (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions);⁷⁴ or

(b) a time-sharing scheme.⁷⁵

Various other things are expressly excluded from this definition, including body corporates, certain partnerships, franchises, debentures, convertible notes, regulated superannuation funds, barter schemes and retirement villages.⁷⁶

A MIS is not an entity. It is a 'scheme'⁷⁷ and a 'statutory construct'.⁷⁸ The MIS, 'unlike a company, need not involve the existence of a legal identity separate from that of its members. ... a "scheme" might also take the form of, among other things, a trust'.⁷⁹

The MIS largely exists for income tax purposes due to its 'look-through' nature. Where the MIS is a trust, an important principle applies that makes the MIS an attractive construct through which to invest. This principle is that the character of the receipt in the hands of the trustee has the same character in the hands of the

⁷² 'first limb' of the definition: *Brookfield* (n 68), [223].

⁷³ 'second limb' of the definition: *Brookfield* (n 68), [263].

⁷⁴ 'third limb' of the definition: *Burton v Arcus* [2006] WASCA 71, [79]-[83].

⁷⁵ This thesis does not consider time share schemes.

⁷⁶ The exclusions illustrate the width of the definition: *Australian Softwood Forests Pty Ltd v Attorney-General (NSW); Ex Rel Corporate Affairs Commission* (1981) 148 CLR 121, 130.

⁷⁷ *Ibid*, 140.

⁷⁸ *Australian Securities and Investments Commission v Takaran* [2002] NSWSC 834, [36].

⁷⁹ *Mier & Jonsson v FN Management* [2005] QCA 408, [20].

beneficiary.⁸⁰ This is important where the trust has net capital gains or franked dividends, the tax benefits of which may be flowed through to the investors.⁸¹

A majority of the Full Court of the Federal Court held that, in determining whether a scheme constitutes a MIS, regard is not to be had to extraneous material which suggested that the definition was only intended to apply to a narrow range of investment schemes, but rather a more textual or literal approach must be taken.⁸² This approach required 'addressing the sub-paragraphs of the definition separately and in accordance with their terms'.⁸³

However, a differently constituted Full Court of the Federal Court reconsidered this decision.⁸⁴ The court held that the decision of the majority in *Brookfield* that a litigation funding scheme ('LFS') was a MIS was 'plainly wrong'.⁸⁵ Contrary to the approach of the majority in *Brookfield*, which Lee J described as 'artificial',⁸⁶ the meaning of MIS must be construed, not only with regard to its text, but also with its context and purpose.⁸⁷ If the context and purpose of the definition are not considered, the result will be attempting to place a 'square peg into a round hole'.⁸⁸ The purpose of the MIS is to be found in its text and its context by reading the statute as a whole.⁸⁹ When this is done, the definition of MIS is limited to a 'scheme in which people invest money (or money's worth) in a common venture with the expectation of profit that will result from the efforts of others'.⁹⁰ The provisions were intended to 'govern collective investments where financial contributions are gathered from investors and are pooled or used in a common enterprise'.⁹¹ In this context, pooling has a purposive element which is to produce 'financial benefits for the members ...

⁸⁰ *Charles v Federal Commissioner of Taxation* (1954) 90 CLR 598, 603; this principle is embodied in the taxation provisions that apply to attribution managed investment trusts ('AMIT') in Division 276 of the *Income Tax Assessment Act 1997* (Cth).

⁸¹ *Income Tax Assessment Act 1997* (Cth), Subdivision 115-C and Subdivision 207-B.

⁸² *Brookfield* (n 72), [24] citing *Ford's Principles of Corporations Law* (LexisNexis Butterworths, subscription service, service 34: 8/2002), [22.470].

⁸³ *Ibid*, [35].

⁸⁴ *LCM Funding Pty Ltd v Stanwell Corporation Limited* (2022) 292 FCR 169.

⁸⁵ *Ibid*, [2], [6], and [96].

⁸⁶ *Ibid*, [9].

⁸⁷ *Ibid*, [7] and [100].

⁸⁸ *Ibid*, [7].

⁸⁹ *Ibid*, [102].

⁹⁰ *Ibid*, [106].

⁹¹ *Ibid*, [107].

where they have acquired rights to those benefits'.⁹² Lee J said that it was wrong to break down the component parts of the definition and then explain the relationship of the form, function and relationship of each part to each other part without considering the context and purpose. Once the context and purpose are considered, the difficulties of making the features of an LFS fit within the various parts of the definition of MIS fall away.⁹³ Further, in determining whether a product is a MIS, it is appropriate to consider potential difficulties in applying the regulatory regime to that product.⁹⁴

The MIS is a default position. If the investment is not a share or debenture, then it is likely to be an interest in an MIS.⁹⁵ The width of the definition is exemplified by the large number of exceptions to the definition.⁹⁶ The only limitation, by reason of the context and purpose of the provisions, is that the scheme must be an 'investment scheme'.⁹⁷

III. IMPORTANCE OF THE CIS INDUSTRY

If the regulation of CIS was to lead to the end or significant reduction of participation by the retail investor in financial markets, would it really matter?

In Australia, during the height of the global financial crisis ('GFC'), there was a mass exodus of retail investors from national financial markets.⁹⁸ This contributed significantly to the greater price and volume volatility that was experienced in the financial markets in late 2008.⁹⁹ One research study concluded that after the GFC, the 'mass exodus of retail investors and their investment dollars has negative implications not only for capital formation and investor protection, but also for market

⁹² Ibid [18]; followed in *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* (2025) 308 FCR 552, [74].

⁹³ *LCM* (n 84), [8].

⁹⁴ Ibid [163]-[166]; *Spicer Thoroughbreds Pty Ltd v Stewart* [2023] NSWCA 82, [66]; *Web3*, (n 92), [78].

⁹⁵ *Brookfield* (n 68), [24].

⁹⁶ Corporations Act, s 9 definition.

⁹⁷ *LCM* (n 84)

⁹⁸ Dimity Kingsford Smith, 'Regulating Investment Risk: Individuals and the Global Financial Crisis' (2009) 32(2) *UNSW Law Journal*, 515.

⁹⁹ Ibid.

efficiency'.¹⁰⁰ This is because 'contrary to perceived wisdom, retail trading may increase share price accuracy and market efficiency'.¹⁰¹ Therefore, the retail investor is important to the general economy.

Recent surveys indicate that retail flight has halted, with the percentage of retail clients investing in financial markets trending upwards.¹⁰² Further, these surveys found that exchange-traded funds ('ETFs'), a type of MIS, are becoming increasingly important as a method of investment diversification. One of these surveys concluded that ETFs have an important role in providing an accessible, low-cost option for those with relatively little capital and limited financial product selection experience.¹⁰³ The International Organisation of Securities Commissions ('IOSCO') has also observed that greater participation by retail investors in wealth creation through capital markets is a positive development for overall economic progress.¹⁰⁴

Therefore, if investment through MIS were to contract, either because of lack of confidence flowing from retail investor losses, or over-regulation, restricting retail investor choice the probabilities are that this would have a significant economic impact. Excluding foreign borrowings, in Australia, households, rather than institutional investors, are the main source of money for Australia's investment, including superannuation. Neither government nor businesses generate enough savings or new capital for investment.¹⁰⁵ The bulk of this investment from Australian households is provided through the pooled investment of funds in the form of an MIS (superannuation and non-superannuation). This is illustrated by the following statistics:

¹⁰⁰ Alicia J. Davis, 'Market Efficiency and the Problem of Retail Flight' (2014), 20(1), *Stanford Journal of Law, Business, and Finance*, 36.

¹⁰¹ Ibid.

¹⁰² 'ASX Australian Investor Study 2020' (ASX Operations Pty Limited, 2020); Australian Securities and Investments Commission, *Retail investor research* (Report No. 735, August 2022).

¹⁰³ ASX (n 102), 50.

¹⁰⁴ International Organisation of Securities Commissions *Retail Market Conduct Task Force Consultation Report* (Report, March 2022), 5.

¹⁰⁵ ALRC Report 65, (n 1), [2.18].

- in 2022, the value of assets held in MIS in Australia was approximately \$2.7 trillion, with \$1.8 trillion invested in registered MIS,¹⁰⁶ whereas in 1992, FUM was only \$38 billion,¹⁰⁷
- at the end of 2020, total FUM was 122% of GDP,¹⁰⁸
- Australia has the world's fifth-largest pool of managed funds in the world¹⁰⁹

As observed by the Board of Taxation, 'Australia's managed funds industry is an important and dynamic part of Australia's economy and one of the largest in the world'.¹¹⁰

Although superannuation policy in Australia creates a large proportion of this pool of capital because:

- the contributions by the employer for superannuation is compulsory for all employees (as defined),¹¹¹ and,
- the contributions as investment thereof are preserved until the employee retires after reaching his or her prescribed preservation age,¹¹²

the size of the retail MIS in the Australian economy is still significant. For example, for the December 2003 quarter, the total unconsolidated assets of public offer (retail) trusts was \$485.4 billion which was 10.22% of the total managed funds industry which had funds under management ('FUM') of \$4,751.5 billion.¹¹³

¹⁰⁶ Treasury Consultation Paper (n 25), 8.

¹⁰⁷ ALRC Report 65, (n 1), [1.3].

¹⁰⁸ Deloitte Access Economics, *Competition in funds management* (ASIC Report No. 702, 24 September 2021), [2.6.1].

¹⁰⁹ Australian Trade and Investment Commission 'Benchmark Report 2023', 11.

¹¹⁰ Board of Taxation *Review of the Tax Arrangements Applying to Managed Investment Trusts* (Discussion Paper, October 2008), [vi].

¹¹¹ *Superannuation Guarantee (Administration) Act 1992* (Cth), Part 3.

¹¹² ITAA 97, Division 280.

¹¹³ Australian Bureau of Statistics ('ABS'), *Managed Funds, Australia* (December 2023) <[Managed Funds, Australia, December 2023 | Australian Bureau of Statistics](#)>

Therefore, there would be a significant impact on the Australian economy if retail investment contracted either through loss of confidence by the retail investor from losses suffered or over-regulation leading to fewer retail investor investment choices.

The MIS in Australia is already subject to significant levels of regulation designed to protect the retail investor. The effects of any regulation on the retail investor, therefore, require careful consideration. Governments need to avoid over-complicating the law through 'knee-jerk' reactions. Any regulation designed to avoid retail investors suffering significant investment loss needs to be implemented without unnecessarily restricting investment choice.

IV. HISTORY OF THE CIS AND ITS REGULATION IN AUSTRALIA

Santayana warned that '[t]hose who cannot remember the past are condemned to repeat it'.¹¹⁴ Therefore, understanding the historical development of the CIS is essential for deducing the reasons for past failures in the legal and regulatory framework that have caused financial losses to retail investors. This will then guide hypothesised or proposed reforms to rectify these failures. As will be seen below, the reasons for the failures of CIS have many of the same features as CIS, both before and after the enactment of the MIA.

The similar failures that have occurred within the governance framework of CIS, both before and after MIA, suggest a continuing structural weakness that past reforms have not rectified. These examples of failures, both pre-MIA and post-MIA governance structures, are therefore important and relevant in proposing reforms to address these issues. Where the same failures continue through each period of regulation of CIS, whether pre-MIA or post-MIA, such failures will guide theory as to what reforms should be made to the current law and regulation of the CIS to address those failures.

The legal and regulatory framework should aim to encourage an environment in which investors may engage in informed risk-taking. Although the Australian

¹¹⁴ George Santayana, *The Life of Reason the Phases of Human Progress* (MIT Press, 2013).

Government acknowledges that balancing a free market system with investor protection is a challenge,¹¹⁵ this does not mean that this cannot be achieved.

There were three periods of regulation of CIS. The regulatory regime of the CIS for each of these three periods is analysed in terms of the form of CIS and the shortcomings of the governance structure of the regulatory regime for each of these three periods. The shortcomings reveal weaknesses in the form of CIS in each of these three periods. The actions of those responsible for managing 'other people's money' have been tantamount to 'putting the fox in charge of the henhouse'. Some examples of areas of the legal and regulatory framework of CIS that have been repeated through each period of regulation are:

- CIS promoters treating 'other people's money' as their 'own money',
- Non-adherence by CIS trustees and REs to their duties and obligations to the members of the CIS,
- Poor governance by gatekeepers,
- CIS operators entering into related party transactions ('RPTs') without member approval,
- Insolvency of CIS operators,
- Complex or inadequate product disclosure.

Therefore, in developing proposals to reform the law, these areas of the law and regulation of CIS/MIS must be considered and addressed.

¹¹⁵ The Treasury, *Fit for the future: A capability review of the Australian Securities and Investments Commission* (Report, December 2015).

A. *First Period of Regulation of CIS (1955 to 1961/2)*

The first CIS in Australia was in the form of a unit trust called 'Australian Fixed Trusts' ('AFT'), founded in 1936.¹¹⁶ Prior to 1955, the CIS was not regulated.

1. *The regulatory provisions*

In 1955, the State of Victoria commenced regulating 'interests'.¹¹⁷ The definition of 'interest' was a wide one. It was 'so wide that it [was] fruitless to attempt to describe in language other than that of the definition itself the schemes or class of schemes that fall within it'.¹¹⁸ These provisions therefore regulated unit trusts that were the main form of 'interest' at that time.

2. *Governance structure*

The governance structure for 'interests' involved a dual responsibility/supervisory model similar to that of many other jurisdictions that regulate CIS/MIS.¹¹⁹ This consisted of:

- (a) a public company, known as the management company, which was the issuer and the manager of the interests,¹²⁰ and
- (b) an independent trustee approved by the Attorney-General that performed an oversight role.¹²¹

The legal and regulatory framework required:

- (a) an approved deed containing prescribed covenants by the management company to be lodged with the Registrar General and an approved trustee or representative,¹²² and

¹¹⁶ Bernard T Mees, Monica S Wehner and Pamela F Hanrahan, 'Fifty Years of Managed Funds in Australia Preliminary Research Report' *Centre for Corporate Law and Securities Regulation* (2005), 9.

¹¹⁷ *Companies Act 1955* (Vic).

¹¹⁸ *Wade v A Home Away Pty Ltd* [1981] VR 475, 477.

¹¹⁹ e.g., NZ, UK, EU & Singapore.

¹²⁰ *Companies Act 1955* (Vic), s 10(2).

¹²¹ *Ibid*, s 10(4) and (5).

¹²² *Ibid*, s 10(4).

(b) a prospectus.¹²³

Theoretically, this dual responsibility governance structure should have assisted and contributed to the protection of retail investors because the actions of the manager of the CIS were supervised by a trustee. A trustee, by virtue of its office, has very important duties and obligations which are designed to protect the beneficiaries.¹²⁴ However, as will be seen below, this dual responsibility governance structure failed the retail investor in the first two periods of regulation and continued into the current single RE regime.

3. *Problems with the regulatory regime*

In 1960, cracks began to appear in the regulation of 'interests'. The CIS provisions of the *Companies Act 1958* (Vic) were referred to the Statute Law Revision Committee ('SLRC') for review.¹²⁵ While the SLRC considered that unit trust schemes had been

¹²³ Ibid, s 10(3).

¹²⁴ (i) exercise the same care as an ordinary, prudent business person would exercise in conducting the trust business as if it were his/her own:

Speight v Gaunt (1883) 9 App Cas 1; *In Re Whiteley*; *Whiteley v Learoyd* (1886) 33 Ch D 347, 355; *Riddle v Riddle* (1952) 85 CLR 202, 232 (Kitto J); *Fouche v Superannuation Fund Board* (1952) 88 CLR 609, 637; *Elder's Trustee & Executor Co Ltd v Higgins* (1963) 113 CLR 426, 449; *Australian Securities Commission v AS Nominees Limited* (1995) 62 FCR 504, [42]-[43]; *Wallace Funds Management Pty Ltd v Wallace Absolute Return Ltd* [2009] NSWSC 190, [45]; *Coral Vista Pty Ltd v Halkeas*; *Halkeas v Coral Vista Pty Ltd* [2010] QSC 449, [24]-[25]; *Re Macquarie Investment Management Limited* [2016] NSWSC 1184, [15], [42]-[43]; *Re Estate of Vaughan*; *Dunn v Dunn-Vaughan* [2024] VSC 7, [445];

(ii) act in the best interests of the investors as a whole:

Cowan v Scargill [1985] Ch 270, 289; *Manglicmot v Commonwealth Bank Officers Superannuation Corporation* [2010] NSWSC 363, [20]; *Accurate Financial Consultants Pty Ltd v Koko Black Pty Ltd* [2007] VSC 40, [117]; *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342, [465]; *Frigger v Trenfield (No 3)* [2023] FCAFC 49, [243];

(iii) no conflict rule:

Aberdeen Railway Co v Blaikie Bros [1843] All ER 249; *Birtchnell v Equity Trustees Executors & Agency Co Ltd* (1929) 42 CLR 384; *Everest Capital Limited as Trustee of the EBI Income Fund v Trust Company Limited* [2010] NSWSC 231, [100]; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 103; *Gray v Hart* [2012] NSWSC 1435, [323]; *Wright v Lemon* [2024] WASCA 19, [434]; *Berejiklian v Independent Commission Against Corruption* [2024] NSWCA 177, [169].

¹²⁵ Statute Law Revision Committee (Vic) *Report upon certain aspects of section 63 of the Companies Act 1958 which concerns unit trust schemes and other matters related thereto* [1960] VicSLRC 10 ('SLRC Report').

particularly useful to the small investor by enabling the small investor to invest in one fund, providing access to participation in the profits of several enterprises, there were problems. The problems examined by the SLRC included two issues that continue to plague the MIS industry today. This is despite the reforms that were legislated following the ALRC Report 65.¹²⁶

(a) *Complexity in Financial Product Disclosure*

The SLRC considered that the booklets or brochures given to proposed investors contained a large amount of statutory information. In many cases, this was beyond the understanding of inexperienced investors.¹²⁷ This was the case even with the assistance of advice of company advisory officers.¹²⁸ The SLRC therefore recommended that, in addition to this information, investors should be given a separate statement that contained the following limited information:

- (i) the actual amount of money which was to be deducted from the investment for management fees,
- (ii) the rights of the investor to sell or transfer his or her units,
- (iii) the fact that the investor understands that his or her return of capital is governed by whether he or she sells on a rising or falling market or within a limited time.¹²⁹

This information is included in today's product disclosure statement ('PDS').¹³⁰ Due to the sheer size of the mandated disclosures,¹³¹ the PDS is more likely to 'obfuscate' than 'illuminate'.¹³² As will be seen in Chapter 7, the PDS is unlikely to be read by investors because the complexity disincentivises their participation in the

¹²⁶ *Managed Investments Act 1998* (Cth) ('MIA').

¹²⁷ SLRC Report, (n 125), 9.

¹²⁸ *Ibid.*

¹²⁹ *Ibid.*

¹³⁰ Corporations Act, s 1013D inserted by the *Financial Services Reform Act 2001* (Cth) (FSRA) commencing on 11 March 2002 with a 2 year transition period replacing the prospectus with the PDS for financial products disclosure other than securities.

¹³¹ See Chapter 7 commencing at 205.

¹³² Justin O'Brien, 'The Future of Financial Regulation: Enhancing integrity through design' (2010) 32(1) *Sydney Law Review* 63, 79.

disclosure process. Disclosure has little utility if the retail investor does not engage because of the complexity.

The continuing problem with disclosure documents is revealed by my analysis of submissions by investors to the ‘Bitter Harvest’ Inquiry in 2016.¹³³ Although only two of the complainants admitted not reading the PDS, a fair reading of the other complaints indicates that it is unlikely that those investors read or relied upon the PDS. Rather, these investors relied solely on the ‘financial product advice’ they were given by financial advisors. The case law also indicates that investors in these types of schemes probably did not read, let alone rely upon, the disclosure documents.¹³⁴

The PDS is now likely to be of interest only to ASIC and lawyers, who, like the marabou stork, pick through the corpse of the failed MIS. It may well be that ‘the benefits of mandated disclosure are small’.¹³⁵ This means that disclosure is not the panacea for protecting retail investors. This problem may well be non-resolvable. As one cynic has observed, ‘[t]he “crisis” of opaque disclosure will lead to more work and continued employment) for the securities bar and SEC staff - that is, for those who are in large part responsible for the obfuscatory legalese in disclosure documents in the first place’.¹³⁶ With the advent of the design and distribution obligations (‘DDO’) superimposed on the disclosure regime in 2019,¹³⁷ the necessity of this disclosure regime in its current form must be questioned.¹³⁸

¹³³ Table 1.1 (My Analysis of submissions to Senate Economics Reference Committee ‘Agribusiness managed investment schemes Bitter Harvest’ (Report, March 2016)), page 340.

¹³⁴ *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (Receivers and Managers Appointed) (in liquidation)* [2014] VSC 516, [3588]-[3797]; *Woodcroft-Brown v Timbercorp Securities Limited (in liq)* [2011] VSC 427, [612]-[613], [652] appeal dismissed in *Woodcroft-Brown v Timbercorp Securities Ltd* [2013] VSCA 284, [228]-[237]; *Food and Beverage Australia Limited v Nash* [2020] SASC 92, [390]; *Tomasetti v Brailey* [2011] NSWSC 1446.

¹³⁵ Omri Ben-Shahar, and Carl E. Schneider, *More Than You Wanted to Know: The Failure of Mandated Disclosure* (Princeton, N.J, Princeton University Press, 2014).

¹³⁶ James A Fanto, ‘We’re all capitalists now: The Importance, Nature, Provision and Regulation of Investor Education’ (1998) 49(1) *Case Western Reserve Law Review*, 165.

¹³⁷ *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth).

¹³⁸ See Chapter 7 commencing at page 205.

(b) *Insolvency of CIS Operator*

The SLRC considered that it was essential that there be a procedure for winding up the trust or appointing a new manager where the management company has gone into liquidation or ceased to carry on business.¹³⁹ It was therefore recommended that court approval of the trustee's decision to appoint a new manager should be obtained. In relation to the removal of the manager by unit holders, this power should only be by way of special resolution of unit holders.¹⁴⁰ The effect of insolvency of the RE under the current regulatory regime remains a live issue.¹⁴¹ This issue is considered further in Chapter 6 at page 175.

4. *What does this reveal about the legal and regulatory framework for protection of retail investors investing in CIS and the areas in which improvements can be made that are both efficacious and efficient*¹⁴² (i.e., 'What is going on here?' and 'What is this a case of?').¹⁴³

Despite the recommendations of the SLRC, these two issues of complex disclosure documents and the consequences of insolvency of the scheme manager arose in later inquiries. This included inquiries held post-MIA and post-*Financial Services Reform Act 2001* (Cth) ('FSRA').¹⁴⁴ As will be seen in the following chapters, the passing of the MIA and FSRA, which contained reforms to the legal and regulatory framework of the CIS following the ALRC Report 65,¹⁴⁵ have not rectified these identified problems with the CIS governance structure. Retail investors have

¹³⁹ SLRC Report (n 125), [34].

¹⁴⁰ Ibid, [34]-[35].

¹⁴¹ CAMAC Report, (n 23); Agribusiness Report (n 23), [3.99]-[3.121]; See Chapter 6 commencing at 175.

¹⁴² In the context of this thesis 'efficacious and efficient' means that the proposed reforms have the ability to achieve the desired regulatory results and may be implemented in a manner in which the costs of doing so is balanced by the benefit those reforms deliver to the retail client: Victoria E. Aitken 'An exposition of legislative quality and its relevance for effective development' (2013) (2:1) *ProLaw Student Journal* 1, 6-7 and 33.

¹⁴³ Haridimos Tsoukas, 'Craving for generality and small-N studies: a Wittgensteinian approach towards the epistemology of the particular in organization and management studies' in David Buchanan and Alan Bryman (ed), *The SAGE Handbook of Organizational Research Methods* (SAGE 2009); Charles Ragin, 'Introduction: Cases of 'What is a case?' in Charles Ragin & H. Becker (ed), *What is a case? Exploring the foundations of social inquiry* (Cambridge University Press, 2009).

¹⁴⁴ CAMAC Report (n 23); Agribusiness Report (n 5); Trio Report (n 5); Hayne (n 26); SIT Report (n 5); David Murray, *Financial System Inquiry* (Final Report, November, 2014).

¹⁴⁵ ALRC Report 65, (n 1).

continued to suffer losses because of the bad behaviour of MIS intermediaries.¹⁴⁶ Governments and regulators appear to be missing the point on these issues.¹⁴⁷

Therefore, any proposed reforms to the law governing the legal and regulatory framework of the CIS need to be designed to address these repeated failures.

B. *Second Period of Regulation of CIS (1961/2-1998)*

1. *The Regulatory Provisions*

In 1961, or 1962 in some jurisdictions, 'interests' became subject to regulation through uniform company legislation in each State and Territory. This legislation regulated interests other than shares and debentures. 'Interests' was again widely defined.¹⁴⁸ In subsequent legislation, 'interests' became known as a 'prescribed interests'¹⁴⁹ and later as 'participation interests'.¹⁵⁰ These definitions were substantially the same.

The High Court held that the term 'interest' had a 'very wide meaning'.¹⁵¹ This was illustrated by the types of things that were excluded from the definition, e.g., shares and debentures.¹⁵² Therefore, the definition was not to be read down.¹⁵³ This decision is important because it assists in defining precisely what is being protected.

Further, the courts, in determining whether something was an 'interest', 'prescribed interest' or 'participating interest', looked to the substance, rather than the form, of what was offered or issued although it was accepted that the documentary form was a guide to determining the substance.¹⁵⁴

Essentially, there were two forms of financial products to be regulated, one being securities (i.e., shares and debentures) and the other being 'interests'. The latter was

¹⁴⁶ SIT Report (n 5).

¹⁴⁷ David Millhouse, Submission to Senate Economic Review Committee, *Inquiry into ASIC Investigation and Enforcement* (27 October 2022).

¹⁴⁸ *Uniform Companies Act 1961-2* ('UCA'), s 76 definition of 'interest'.

¹⁴⁹ *Companies Act 1981* (Cth), s 5 definition of 'prescribed interest'.

¹⁵⁰ *Corporations Law* (Cth), s 9 definition of 'participating interest'.

¹⁵¹ *Australian Softwood* (n 76), 130 (Mason J) and 137, (Murphy J).

¹⁵² *Ibid.*

¹⁵³ *Ibid.*, 130 (Mason J).

¹⁵⁴ *Corporate Affairs Commission v M G Securities A/Asia Ltd* (1975) 1 ACLR 157, 158 approved in *Amadio Pty Ltd v Russell Fraser Henderson* [1998] FCA 823.

any form of financial product that was not a security. The reason that this is important is that it allowed for the regulation of various types of financial products that did not exist at the time of the original legislation. This is illustrated by the MIS of today, which is regarded as the fallback position for the regulation of a financial product if that product is not a security.¹⁵⁵ For example, certain types of crypto assets, which did not exist at the time of the enactment of the MIA may be regulated as an interest in a MIS.¹⁵⁶

2. Governance Structure

The governance structure for ‘interests’ remained a dual responsibility/supervisory model similar to the former Victorian model. This dual structure proved to be a major weakness in the governance structure. In part, the reason was the lack of clarity of each of the dual roles.¹⁵⁷

An approved deed was required to be lodged by the management company with the Registrar.¹⁵⁸ This deed had to include prescribed covenants by both the management company and the trustee.¹⁵⁹

The management company was subject to a prescribed covenant to use its best endeavours to carry on and conduct its business in a proper and efficient manner and to ensure that any undertaking, scheme or enterprise to which the deed relates is carried on and conducted in a proper and efficient manner.¹⁶⁰

The role of the trustee was a central feature of the prescribed interest scheme. The trustee’s role was supposed to be a fundamental protection for investors.¹⁶¹ The role was described as being a ‘safeguard’¹⁶² or ‘watchdog’.¹⁶³ The trustee was subject to

¹⁵⁵ *Australian Securities and Investments Commission v Emu Brewery Mezzanine Ltd* [2004] WASC 241, [75]-[107].

¹⁵⁶ Australian Securities and Investments Commission (Information Sheet 225, October 2021); ASIC *Updates to INFO 225: Digital Assets: Financial Products and Services* (Consultation Paper No. 381, 4 December 2024).

¹⁵⁷ Russell Agnew, ‘Collective investments: other people’s money’ (1993) 66 *Australian Law Reform Commission Reform Journal* 7.

¹⁵⁸ *UCA*, ss 77 and 78; *Companies Act 1981* (Cth) and *Corporations Law* (Cth), s 1065.

¹⁵⁹ *UCA*, s 80; *Companies Act 1981* (Cth), s 168; *Corporations Law* (Cth), s 1069.

¹⁶⁰ *Companies Act 1981* (Cth), s 168(1)(a); *Corporations Law*, s 1069(1)(a).

¹⁶¹ *Gardiner v Agricultural & Rural Finance Pty Ltd* [2007] NSWCA 235, [27].

¹⁶² *Parkes Management Ltd v Perpetual Trustee Co Ltd* (1977) 3 ACLR 303, 310 cited in *Ibid*.

¹⁶³ *Global Funds Management (NSW) v Rooney* (1994) 36 NSWLR 122, 133.

a prescribed covenant to 'exercise all due diligence and vigilance in carrying out its functions and duties and in watching the rights and interests of the holders of the interests to which the deed relates'.¹⁶⁴ This covenant reflected the duty imposed on a trustee at general law to exercise the degree of care and diligence that a reasonable person would exercise if they were in the trustee's position.¹⁶⁵

However, while the contradistinction between the role of the management company and the trustee was fine in theory, in practice, the management company had a degree of influence or control over the trustee.¹⁶⁶ Essentially the manager also supervised the trustee.¹⁶⁷ Therefore, it was never clear who was responsible for the scheme.¹⁶⁸

A statement in writing, which was deemed to be a prospectus, was also required if there was an issue or offer to the public for subscription or purchase invitations to the public to subscribe for or purchase any interest.¹⁶⁹

3. *Problems with the regulatory regime*

There were a number of CIS that failed during the second period of regulation of CIS. These included:

- (a) The Dividend Fund, which was a mutual fund in the form of an unlimited company, collapsed in 1971.¹⁷⁰ It was described as a scandal 'unique in the history of Australian company scandals' which was 'more bitter and unhappy for the innocent investors' than all of the scandals put together.¹⁷¹ Investors

¹⁶⁴ UCA (NSW), s 80(1)(b)(i); *Companies Act 1981* (Cth), s 168(1)(c)(i); *Corporations Law* (Cth), s 1069(1)(e)(i).

¹⁶⁵ Cases regarding this duty at (n 124).

¹⁶⁶ *Clarke* (n 134), [309] citing *Parkes* (n 162).

¹⁶⁷ *Ibid* citing *Parkes* (n 162).

¹⁶⁸ ALRC Report 65 (n 1), 8, Summary Section.

¹⁶⁹ UCA, s 82.

¹⁷⁰ Trevor Sykes, 'Our Pierpont correspondent takes one last stand with the best of his anti-heroes' *Australian Financial Review* (January 2017); Commonwealth, *Parliamentary Debates*, House of Representatives, 29 May 1973, 2753, (Tony Staley); Select Committee on Securities and Exchange *Australian securities markets and their regulation* (Report, 1974) ('Rae Committee Report'), Chapter 12; Bernard T Mees and Ian Ramsay, 'Corporate Regulators in Australia (1961-2000): From Companies' Registrars to the Australian Securities and Investments Commission' (2008) *The Centre for Corporate Law and Securities Regulation*, 18-19; Mees (n 116), 19.

¹⁷¹ Tony Staley (n 170).

not only lost their investments but also their life savings.¹⁷² Improper RPTs were rampant.

- (b) Twelve CIS operated by Balanced Property Management ('BPM') failed in 1983.¹⁷³ Most of the \$71 million in investor funds was irrecoverable when the CISs were wound up. The schemes were described as being 'an imposing financial edifice....constructed on foundations of deceit and incompetence'.¹⁷⁴ Proper disclosure was avoided due to reliance on a loophole in the company legislation created by a NSW court decision.¹⁷⁵ Improper RPTs also occurred.
- (c) Trustees, Executors and Agency Co. Ltd ('TEA') collapsed in 1983 with debts of circa \$170 million.¹⁷⁶ This trustee company had been in business since 1878. Therefore, through the Board as the guiding mind of the company, they should have been apprised of their trustee duties. The directors failed to exercise an adequate degree of care, skill (consistent with their knowledge and experience) and diligence in the performance of their duties.¹⁷⁷ There was also a failure of the 'gatekeeper' role of the auditor.¹⁷⁸
- (d) The Aust-Wide property trusts ran into financial difficulties in 1990.¹⁷⁹ Approximately 23,000 investors lost \$145 million in two of its property trusts.¹⁸⁰ The regulator at the time, Australian Securities Commission ('ASC'), launched proceedings against Permanent Trustee Australia Ltd ('PTA'), the

¹⁷² Ibid.

¹⁷³ Mees (n 116), 51.

¹⁷⁴ George Palmer KC '*Inspector of the Special Investigation into the Balanced Property Trusts*' (Report, 1986); Mees (n 170), 19-20; P Quiddington 'Property Trusts to be reformed Victim of dangers he foresaw' *The Canberra Times* (November 29, 1985).

¹⁷⁵ *Corporate Affairs Commission v. David Jones Finance Ltd* (1975) 2 NSWLR 710.

¹⁷⁶ AS Sievers 'Farewell to the sleeping director - The modern judicial and Legislative Approach to Directors' Duties of Care, Skill and Diligence' (1993) 21(2) *Australian Business Law Review* 111, 115.

¹⁷⁷ Ibid, 116.

¹⁷⁸ Roman Tomasic 'Auditors and the Reporting of Illegality and Financial Fraud' (1992) 20(3) *Australian Business Law Review* 198, 216.

¹⁷⁹ John Arbouw, 'Rounding up the corporate cowboys. -Interview with Australian Securities Commission chairman Alan Cameron' (1997) 13(1) *Company Director* 6, 8; It appears that 100% of the money invested was eventually returned to investors: Turnbull Review Report (n 23), [9.10]; For 2 of the trusts, \$100 million was recovered from the trustee in settlement of a claim made by the then Australian Securities Commission (ASC): Mark Lawson 'Aust-Wide payout a win for ASC small-guy policy' *Australian Financial Review* (2 June 1997); Mees (n 116), 32.

¹⁸⁰ Mark Lawson 'ASC opens \$120m Aust-Wide suit' *Financial Review* (29 October 1996).

trustee or former trustee of these trusts, seeking \$210 million.¹⁸¹ The proceedings were settled with PTA contributing \$26.6 million to a pool of funds used to repay the investors in the trusts.

The Federal Government was also forced to intervene to prevent distressed sales of property assets by authorising suspension of redemptions by investors in all mortgage and property CIS.¹⁸²

Although there were significant losses suffered by investors in the above examples, it was the collapse of Estate Mortgage in 1990 that ultimately led to the abandonment of the dual governance structure in favour of a single responsible entity.¹⁸³ The Estate Mortgage collapse caused a significant loss of investment capital by the investors which in 1994 was estimated at \$663 million.¹⁸⁴ The size of this loss was far more severe for the retail investor than all of the previous failures. It was so large that it was impossible for Canberra politicians to ignore.¹⁸⁵

In the early 1970s and 1980s, Estate Mortgage managed a number of CIS, which were mortgage trusts. It had \$1.2 billion of FUM with 60,000 individual unit holders.¹⁸⁶ It was the management company in the dual governance structure. It heavily advertised high returns allegedly available from their product. Investors were seduced by the 'higher return, low risk claims' when, in fact, the trusts, at that time, were exposed to an increasing number of speculative property deals.¹⁸⁷ This was not disclosed to investors.

The collapse also led to the ultimate demise of the trustee company, Burns Philp Trustee Company Limited ('BPTC'), on which the blame for the collapse was

¹⁸¹ Ibid.

¹⁸² Mees (n 116), 5 and 32; Pamela Hanrahan and Ian Ramsay 'Regulation of mutual funds in Australia' in William A. Birdthistle and John Morley (ed), *Research Handbook on the Regulation of Mutual Funds* (Edward Elgar Publishing Limited, 2018), 421-422.

¹⁸³ ALRC Report 65 (n 1), [1.5].

¹⁸⁴ John Kavanagh 'Meridian Investors Ponder the Options' *Business Review Weekly* (24 February 1994).

¹⁸⁵ Mees (n 116), 32.

¹⁸⁶ Ibid.

¹⁸⁷ Ibid, 44.

primarily attributed.¹⁸⁸ BPTC was a significant player in the funds management industry with \$7 billion worth of FUM of the total \$128 billion under management by the trustee industry.¹⁸⁹ Although a replacement trustee sought compensation for breaches of trust from BPTC and its publicly listed holding company, the compensation was a small fraction of the investors' losses.¹⁹⁰ The collapse revealed deficiencies in the dual governance structure with trustees and managers in dispute with each other over liability for fund failures.¹⁹¹

Estate Mortgage was described as 'an accident waiting to happen'.¹⁹² It lent against overvalued property developments, with the interest in many instances being capitalised. This was not an issue as long as it was attracting new money, but once there was a run on the fund for redemptions, there was no money to pay out the investors, causing the whole business to collapse. Eventually, Estate Mortgage had to freeze its funds. The remaining investors were left with an interest in a fund which held mortgages over holes in the ground, which could not be sold for anything approaching loan value. This should not have occurred if BPTC had carried out its duties and obligations as trustee of the Estate Mortgage funds.

There were false representations in advertisements that the trusts were low risk because the trust invested only in mortgages over prime income-producing real estate up to two-thirds of the valuation, whereas its loans were secured over development properties, often for 100% of the construction and land costs.¹⁹³ This would not have occurred if the management company had conducted the business of the funds that it managed in a proper and efficient manner or if the trustee had exercised all due diligence and vigilance in carrying out its functions and duties. Two

¹⁸⁸ Emiliya Mychasuk 'Estate Woes Cause Burn Philp Trustee Liquidation' *Sydney Morning Herald* Sydney (Thursday October 18, 1990); Michael Fitzpatrick and John Wakim, 'Don't spend it all at once' 1999) 31 *Journal of the Australian Plaintiff Lawyers Association* 10.

¹⁸⁹ Ibid.

¹⁹⁰ Australian Securities and Investments Commission 'Report of Investigation: Burns Philp and Co Ltd' (Report No. 2, December 1998), [5.12].

¹⁹¹ Turnbull Review Report (n 23), [2.3]; Charles Zhen Qu, 'Australia's Managed Investment Schemes: The Nature of Relationships among Scheme Participants' (2004) 12(1) *Asia Pacific Law Review* 69.

¹⁹² 'Spanner in the works' *Sydney Morning Herald* (26 September 2012).

¹⁹³ Roman Tomasic, Stephen Bottomley and Rob McQueen, 'Corporations Law in Australia' (2nd ed. Federation Press 2002), 618.

of the directors of the management company were given custodial sentences for breach of their duties.

The ALRC Report 65 said that the collapse of the Estate Mortgage trusts focused attention on the difficulties faced by unlisted property trusts. The collapse in asset value by almost \$2 billion resulted in spectacular losses by investors. The loss of confidence by investors from this tragedy resulted in redemptions outweighing new investments. Although there was a freeze imposed on redemptions for 12 months, this did not stop the rot. Nine months after the imposition of this freeze on redemptions, property asset prices fell a further \$2.4 billion.¹⁹⁴

4. *What does this reveal about the legal and regulatory framework for protection of retail investors investing in CIS and the areas in which improvements can be made that are both efficacious and efficient (i.e., 'What is going on here?' and 'What is this a case of?').*¹⁹⁵

These financial scandals revealed a weakness in the dual responsibility and supervisory regulatory governance model for CIS that was designed to protect retail investors. The trustee generally did little more than collect a fee. Observance of the trustee's basic obligation to exercise all due diligence and vigilance in carrying out its functions and duties and in watching the rights and interests of the holders of the interests should have meant that the problems which arose in the CIS referred to above would not have occurred.¹⁹⁶

The ALRC Report 65 said the fee structure for trustees was not sufficient for them to carry out their function properly.¹⁹⁷ However, prudent trustees should have ensured that their fee structure was sufficiently high for them to carry out their duties and not give in to pressure from the managers to reduce their fees to uneconomic levels if they were to do their job properly. The ALRC Report 65 said that while this structure should, in theory, protect investors, as a matter of practice, such protection was illusory.¹⁹⁸ While noting the statutory obligation on trustees to exercise all due

¹⁹⁴ ALRC Report 65 (n 1), [1.5].

¹⁹⁵ Tsoukas (n 143) and Ragin (n 143).

¹⁹⁶ *Companies Act 1981* (Cth), s 168(1)(c)(i); *Corporations Law* (Cth), s 1069(1)(e)(i).

¹⁹⁷ ALRC Report 65 (n 1), [12.5].

¹⁹⁸ *Ibid*, [12.3].

diligence and vigilance in carrying out their functions and duties and in protecting the rights and interests of the holders of the prescribed interests to which the approved deed relates,¹⁹⁹ the ALRC Report 65 considered that the security and commercial benefit of this obligation to retail investors was unclear. It also noted that many trustees were equivocal on what powers or responsibilities this obligation imposed on them.²⁰⁰

This is hard to believe. The words of the prescribed covenant were clear. What did the trustees not understand by the duty reflected by the covenant to exercise the degree of care and diligence that a reasonable person would exercise if they were in the trustee's position?

Professional trustees, such as TEA, PTA and BPTC, should also have been aware of their duties to:

- (i) exercise the care that a prudent business person would exercise in conducting the trust business as if it were his or her own,²⁰¹
- (ii) act in the best interests of the investors as a whole,²⁰²
- (iii) not enter into a transaction in which their personal interest or duty conflicts with the interests of, or the duty the trustee owes to, the beneficiaries of the trust without informed consent.²⁰³

The ALRC Report 65 considered that the dual responsibility and supervisory governance structure had led to confusion about what protection was afforded to investors.²⁰⁴ Although the report acknowledged that some submissions had argued that the governance structure should be improved and refined rather than replaced, the report concluded that this would 'not overcome the inherent problems of divided

¹⁹⁹ *Companies Act 1981* (Cth), s 168(1)(c)(i); *Corporations Law* (Cth), s 1069(1)(e)(i).

²⁰⁰ ALRC Report 65 (n 1), [12.4].

²⁰¹ see cases at (n 124).

²⁰² *Ibid.*

²⁰³ *Ibid.*

²⁰⁴ ALRC Report 65 (n 1), [12.4]

powers and responsibilities’ or the ‘inevitable legal complexity and uncertainty’ that was thereby created.²⁰⁵

C. Third Period of Regulation of CIS (1998 to date)

1. Regulatory Provisions

The ALRC Report 65 considered that a fresh approach was required for the regulation of CIS. In its view, the ‘very fact of split responsibility’ was the problem. The report therefore recommended that there be a single scheme operator who was responsible for the operation of the scheme.²⁰⁶ The report also considered that the operator and its directors were in a fiduciary relationship with investors so there should be a minimum common set of duties imposed by law.²⁰⁷ Following this report, the regulation of CIS was substantially changed through the MIA with the licensing and disclosure issues raised in the report being subsequently tightened through the FSRA.

Unusually, in world terms,²⁰⁸ Australia has a single entity that is responsible for the operation of the scheme namely the RE.²⁰⁹ There is no division of responsibility between a trustee and manager. The RE fulfils both functions. The ALRC Report 65 considered that this fresh approach to the regulation of CIS was required to support the policies and principles underlying the regulation of CIS.²¹⁰ The ALRC Report 65 said that the presence of the dual structure trustee supervisory model gave a false impression to consumers that the usual trust principles would apply to the trustees, whereas, according to the ALRC Report 65, trustees of prescribed interests did not bear ultimate responsibility as they would under a traditional trustee role.²¹¹

This new approach imposed clear and non-delegable legal obligations on the scheme operator and its officers. Each of the operators and their officers was subject to criminal and civil liability for breach. The focus was on the requirement to comply

²⁰⁵ Ibid, [12.7].

²⁰⁶ Ibid, [12.8].

²⁰⁷ Ibid, [10.4].

²⁰⁸ Hanrahan (n 182), 420.

²⁰⁹ Corporations Act, s 610FB(1).

²¹⁰ ALRC Report 65 (n 1), [12.8].

²¹¹ Ibid, [12.7] (although it is not clear how the ALRC/CASAC arrived at this conclusion given the role of the trustee as described in section (IV)(B)(2) above, page 25).

with the law and the constitution for the scheme.²¹² The ALRC Report 65 considered that the operation of CIS did not require an additional entity to the operator of the scheme.²¹³

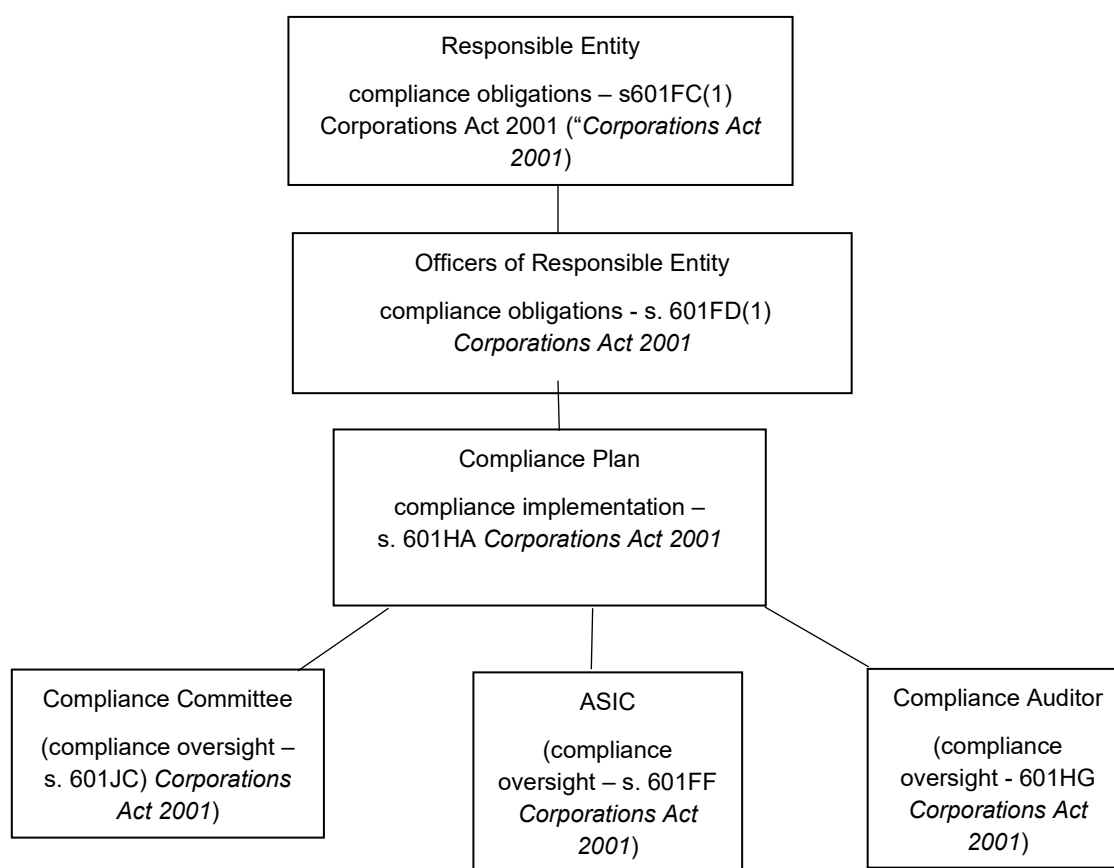
2. *Governance Structure*

The MIA introduced radical change to the legal and regulatory framework for CIS in Australia. Australia moved from a dual responsibility/supervisory model to a multi-layered model of governance which is illustrated by the following figure:

²¹² Ibid, [12.9].

²¹³ Ibid, [12.12].

Figure 1.1 - MIS Governance Structure²¹⁴



This model is built on compliance requirements and a series of ‘gatekeepers’.²¹⁵ The ‘gatekeepers’ in this framework are considered by ASIC to include the RE,²¹⁶ the

²¹⁴ Figure 1.1 (MIS Governance Structure), page 340.

²¹⁵ Trio Report (n 23), [9.17].

²¹⁶ Parliamentary Joint Committee on Corporations and Financial Services *Statutory Oversight of the Australian Securities and Investments Commission: the role of gatekeepers in Australia’s financial services system* (Report 3, July 2013), [1.5], [1.14], [2.95]; also see *Re Banksia Securities Limited (Rec & Mgr Apptd) (in liq) (No 2)* [2018] VSC 47, [3] regarding the duties of a trustee for debenture holders described by the court as the statutory apex of the regulatory structure designed to protect the interests of debenture-holders which is analogous to the role of the RE with registered MIS.

directors of the RE,²¹⁷ the compliance committee ('CC'),²¹⁸ and the compliance plan auditor ('CPA').²¹⁹

The courts have often used the term 'gatekeeper' in various circumstances without defining that term. However in a case involving the collapse of Banksia Securities Limited ('Banksia'), a non-bank property lender, which owed approximately \$663 million to approximately 15,622 debenture holders, including retirees, the court ruled that 'gatekeepers' are those persons 'charged with duties to safeguard the interests of others' in this case being the debenture holders who had invested in the debentures issued by Banksia.²²⁰ The court also considered the collapse of Banksia was the result of 'spectacular "gatekeeper" failure'.²²¹

This definition supports ASIC's view that each of the following participants in the multi-layered model of governance are 'gatekeepers' because each of them are persons who are 'charged with duties to safeguard the interests of others' (i.e., the members of the MIS):

- (a) the RE who is subject to general fiduciary duties,²²² and statutory fiduciary-type duties,²²³ including complying with the scheme's compliance plan ('CP'),²²⁴

²¹⁷ John Price 'Monitoring the activities of companies in Australia' (Speech, Asia-Pacific Resources Conference 2014, 18 November 2014); Greg Medcraft 'What ASIC expects of directors' (Speech, AICD, 24 June 2014); Trio Report (n 23), [4.47].

²¹⁸ Trio Report (n 23), [1.43]; Australian Securities and Investments Commission, *Funds management: Compliance and oversight* (Regulatory Guide RG 132, 23 June 2025), [RG132.189].

²¹⁹ Trio Report (n 23), [4.47].

²²⁰ *Banksia* (n 216), [3].

²²¹ Ibid, citing John C Coffee, *Gatekeepers: The Professions and Corporate Governance* (Oxford University Press, 2006).

²²² *Re Australian Style Investments Pty Ltd* [2009] VSC 128, [67]; *Australian Securities and Investments Commission v A.B.C. Fund Managers Ltd (No 2)* [2001] VSC 383, [124]; *Stacks Managed Investments Ltd* [2005] NSWSC 753; *Australian Securities and Investments Commission v West* [2008] SASC 111, [217].

²²³ Corporations Act, s 601FC(1); EM-MIA (n 3), [8.8]; *Mercedes Holdings Pty Limited v Waters (No 2)* [2010] FCA 472, [16].

²²⁴ Corporations Act, s 601FC(1)(h).

- (b) the officers of the RE who are also subject to statutory fiduciary-type duties,²²⁵ including taking all steps that a reasonable person would take, if they were in the officer's position, to ensure that the RE complies with:
- (1) the Corporations Act,
 - (2) any conditions imposed on the RE's AFSL,
 - (3) the scheme's constitution and
 - (4) the scheme's CP,²²⁶
- (c) the CC of at least three persons, the majority of whom must be external members, each of whom has fiduciary-like statutory duties,²²⁷ (although a CC is not required if not less than half of the directors of the Board are external directors),²²⁸ whose function is to monitor compliance by the RE with the scheme's CP
- (d) The CPA,²²⁹ who is required to audit the RE's compliance with the CP and provide to the RE a report as to whether the RE has complied with the scheme's CP and the plan remains compliant with Part 5C.4 of the Corporations Act.²³⁰

Despite the presence of a series of 'gatekeepers' in the governance model of MIS, ASIC nevertheless considers that this does not abrogate it from its responsibilities as an oversight body.²³¹ ASIC has the power from time to time to check whether the RE of a registered MIS is complying with the MIS's constitution, CP and the Corporations Act.²³²

²²⁵ Corporations Act, 601FD(1).

²²⁶ Ibid, s 601FD(1)(f).

²²⁷ Ibid, s 601JD; *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497, [61].

²²⁸ Corporations Act, s 601JA.

²²⁹ Ibid, s 601HG.

²³⁰ Ibid, s 601HG(3)(b)(i).

²³¹ Ibid, [4.48].

²³² Corporations Act, s 601FF.

In conjunction with the change to the regulatory regime for MIS introduced by the MIA, the FSRA introduced a new system of licensing which applies to the RE of registered schemes. Prior to the FSRA, the RE was only required to hold a securities dealer's licence, which had limited requirements.²³³ The FSRA operates in tandem with the MIA to regulate the RE as the key 'gatekeeper' of the current MIS regulatory regime. The RE is now required to hold an Australian financial services licence ('AFSL') covering the provision of the financial services that the RE requires to carry on that financial services business.²³⁴ The AFSL must also authorise the RE to operate the particular scheme or type of scheme of which it is the RE.²³⁵

The obligations imposed on the RE as the holder of an AFSL require it to have adequate resources, including financial resources, to enable the RE to provide the financial services covered by the AFSL and to carry out supervisory arrangements (unless regulated by the Australian Prudential Regulatory Authority ('APRA')).²³⁶ The RE, as a holder of an AFSL, is also required to comply with the conditions on its licence.²³⁷ ASIC has included prudential requirements in the conditions of the AFSL applicable to a RE.²³⁸

Despite this new regulatory regime for MIS, the multi-layered model of corporate governance of MIS including a series of "gatekeepers" has not always worked in practice.²³⁹ In 2017, 19 years after the MIA was enacted, ASIC reported that its surveillance of REs revealed four out of every five fund managers failed some aspect of compliance.²⁴⁰

²³³ Ibid, s 601FA (prior to its amendment by the FSRA).

²³⁴ Ibid, s 911A.

²³⁵ Ibid, s 601FA; *Sandalwood Properties Ltd (Subject to a Deed of Company Arrangement) v Huntley Management Ltd* [2018] FCA 1502, [58].

²³⁶ Ibid, s 912A(1)(d).

²³⁷ Ibid, s 912A(1)(b).

²³⁸ conditions 12 – 22 of ASIC Pro forma 209.

²³⁹ Jennifer Payne, 'The Role of Gatekeepers' in N Maloney, E Ferren and J Payne (ed) 'Oxford Handbook of Financial Regulation' (Oxford University Press, 2014), 8.

²⁴⁰ James Frost, 'Four out of five fundies not compliant', *The Australian Financial Review* (Melbourne 14 June 2017).

3. *Problems with the Regulatory Regime*

Despite the introduction of the MIA with its new model of corporate governance, the failures that occurred under the previous CIS regulatory regimes have continued under the current legal and regulatory framework for the protection of retail investors (see tables at pages 2 to 4 above).²⁴¹ Also a number of post-MIA mortgage funds that have failed bear similar characteristics to what occurred with Estate Mortgage under the former dual governance regime.²⁴²

The MIA was intended to rectify the failures that occurred with the former legal and regulatory framework for the CIS. The Government considered that the MIA provisions would result in 'greater market efficiency and investor confidence'.²⁴³ The subsequent failures that have occurred under the current framework, as exemplified by a number of the case studies in Chapters 3 to 7 below, indicate that, save where the failures were caused purely by investment risk, the amendments to the law were inadequate to protect the retail investor. Retail investors are still suffering significant losses despite the earlier comprehensive examination of the framework for CIS undertaken by the ALRC and CASAC.²⁴⁴ This is illustrated by the following tables:

4. *What does this reveal about the legal and regulatory framework for protection of retail investors investing in CIS and the areas in which improvements can be made that are both efficacious and efficient (i.e., 'What is going on here?' and 'What is this a case of?').*²⁴⁵

One of the key issues that arose under the former prescribed interest schemes was that the wrong people were given control of 'other people's money', i.e., 'the fox was in charge of the hen house'. The new model of corporate governance including the 'gatekeepers' has not prevented a repeat of this problem. This is despite the legal and regulatory framework for protection of retail investors imposing on the RE and its

²⁴¹ See references at (n 5).

²⁴² Pacific First Mortgage Fund and Premium Income Fund case studies at 67 and 70.

²⁴³ EM-MIA (n 3), [3.4].

²⁴⁴ ALRC Report 65 (n 1).

²⁴⁵ (n 143).

officers, fiduciary-type duties owed directly to the members. This was supposed to prevent the occurrence of this problem.

An analysis of the above financial scandals points to the need to build into the legal and regulatory framework of the CIS a robust system of governance. In this respect, the Organisation for Economic Co-operation and Development ('OECD') states that owing to the CIS sector's

critical role as an investment instrument for smaller savers and to their widespread applicability in providing for their future needs for retirement income, it is imperative to have systems that adequately protect the interests of small investors. Additionally, the equitable treatment of various categories of investors is a key objective in constructing a sound system of governance for CIS.²⁴⁶

It has also been observed that:

[w]eak and ineffective governance of systemically important financial institutions (SIFIs) has been widely cited as an important contributory factor in the massive failure of financial sector decision making that led to the global financial crisis..... Management teams, boards of directors, regulators and supervisors, and shareholders all failed, in their respective roles, to prudently govern and oversee.²⁴⁷

V. RESEARCH QUESTIONS

Despite these problems, there is no need to abandon the current framework entirely. There are reforms that can be made to the legal and regulatory framework for the protection of retail investors investing in CIS that are both efficacious and efficient to reduce the risk of these failures continuing to occur. This is the subject of the research undertaken for this thesis. It is possible to prevent retail investors suffering significant losses with appropriate reforms, i.e., moving from what 'the law is' to what the 'law ought to be'. It requires a willingness of governments and regulators to

²⁴⁶ Organisation of Economic Cooperation and Development '*Governance of Collective Investment schemes*' (White Paper, 2005), 139.

²⁴⁷ '*Toward Effective Governance of Financial Institutions*', The Group of Thirty Working Group on Corporate Governance, 5.

address the real issues that have resulted in this phenomenon, which is a 'Never Ending Story' or 'Groundhog Day'²⁴⁸.

An initial analysis of the primary and secondary material provided significant data²⁴⁹ to assist in the understanding of 'the why' or 'the how' something is the way that it is, or suggests relationships between certain things.²⁵⁰ Through undertaking an initial analysis of this material and asking the questions 'What is going on here?' and 'What is this a case of?' when analysing that material,²⁵¹ the following areas were identified for further investigation as to what the 'law ought to be' where the 'law as it is' has been found wanting and failed to protect retail investors:

- (a) the duties of officers of the responsible entity ('RE'),²⁵²
- (b) compliance arrangements of the RE,²⁵³
- (c) related party transactions ('RPTs'),²⁵⁴
- (d) solvent schemes with insolvent REs,²⁵⁵
- (e) investor disclosure rules.²⁵⁶

Through the application of reasoning logic to the analysis of this data, the following research questions were generated with respect to each of these identified areas.

1. *Research Question 1*

How do each of these aspects of the legal and regulatory framework of the MIS fail to protect the retail investor?

²⁴⁸ Film titles.

²⁴⁹ Lisa Webley, 'Qualitative Approaches to Empirical Legal Research' in Peter Cane and Herbert M. Kritzer (ed), *Oxford Handbook of Empirical Legal Research Edition: Chapter 1 'Qualitative Approaches to Empirical Legal Research'* (Oxford University Press) 10.

²⁵⁰ Lisa Webley, 'Stumbling Blocks in Empirical Legal Research Case Study Research' (2016) *Law and Method* 1.

²⁵¹ Tsoukas (n 143).

²⁵² See Chapter 3 commencing at 54.

²⁵³ See Chapter 4 commencing at 103.

²⁵⁴ See Chapter 5 commencing at 153.

²⁵⁵ See Chapter 6 commencing at 175.

²⁵⁶ See Chapter 7 commencing at 205.

2. *Research Question 2*

How can these failures be remedied?

3. *Research Question 3*

On the balance of probabilities, will the proposed reforms to address these failures cause REs to abandon the retail market thereby restricting investment choice by retail clients.²⁵⁷

(‘Research Questions’)

To make it clear, in answering these Research Questions, this thesis is **not** considering failures that are purely investment risk matters because this is not the purpose of the current legal and regulatory framework. As noted by the ALRC Report 65,

The law governing collective investment schemes cannot - and should not - try to eliminate the investment risks facing investors. If the law attempted this, it would fail. Investors would be deluded into thinking they could not lose their money. Many of the innovative financial products marketed to investors through collective investment schemes would no longer be viable. Investors would have no choices and no ability to accept greater risks for the opportunity of obtaining greater returns.²⁵⁸

Rather, this thesis examines the failures that have occurred under the current framework, where the framework was inadequate for the protection of the retail investor from losses caused by factors other than normal investment risks. This is exemplified by a number of the case studies in Chapters 3 to 7 below and some of the reports regarding MIS referred to earlier in this thesis.²⁵⁹ The ALRC Report 65 is an example of distinguishing between normal investment loss and loss due to failure of a regulatory framework to provide investor protection.²⁶⁰

²⁵⁷ The expression ‘balance of probabilities’ as used throughout this thesis is the civil standard of proof which involves a weighing up of the facts in issue and any competing arguments to determine whether there is a tilting of the balance in favour of the proposition advanced by the author in this thesis in answer to Research Question 3.

²⁵⁸ ALRC Report 65 (n 1), [2.6].

²⁵⁹ Reports, (n 23).

²⁶⁰ Ibid, [2.6]-[2.13].

These Research Questions guided conclusions on what reforms need to be made to the existing legal and regulatory framework to rectify the identified problems namely what the law 'ought to be'. It is argued that these reforms should strengthen the efficacy and efficiency of that framework in protecting the retail investor.

In the next Chapter, the methodological and philosophical approaches designed to answer these Research Questions is described. This is illustrated by Figure 2.1 at page 346. This approach has assisted in identifying the reasons for failure of the 'law as it is' in each of the identified areas, thereby providing guidance as to what the 'law ought to be' if we are to stop the repeated significant losses by retail investors from bad intermediary behaviour.

CHAPTER 2: RESEARCH METHODOLOGY

Research methods are a means of moving from what may be known that is not known to that which is known.

I. INTRODUCTION

In answering the Research Questions, a mixed methodology was used. This comprised a combination of legal, quantitative and qualitative research methods. The application of these methodologies was undertaken to take advantage of the strengths of each of these alternative methodologies.¹ The aim was to push 'through settled legal questions to address questions that are complex and unresolved in the legal system'.² The use of these three methods was also intended to assist in triangulation.³ Figure 2.1 at page 346 diagrammatically illustrates this approach.

However, it was important to be constantly aware that there is more to research than following strict methodology. As noted by Ketokivi and Mantere, 'reasoning from data is an essentially cognitive process that involves much more than just the data'.⁴ Moving from process to 'thinking outside the square' can result in a new theory. After all, we are human beings created to use our intelligence and imagination.

Advances in science often arise from challenging existing theory, e.g., Einstein's challenge to Newton. There may be more to observe about the world than is suggested by current theories. What may be thought of as being unknowable may in fact be knowable. As Gabriel says, 'creative imagination' should be the gold standard in research.⁵ Through research, we are taken on the exciting journey of discovery.

¹ Margaret McKerchar, 'Philosophical paradigms, inquiry strategies and knowledge claims: applying the principles of research design and conduct to taxation' (2008) 6(1) *eJournal of Tax Research* 5, 20; Pat Bazeley and Lynn Kemp, 'Mosaics, Triangles, and DNA: Metaphors for Integrated Analysis in Mixed Methods Research' (2012) 6(1) *Journal of Mixed Methods Research* 55, 56.

² Theunis Roux 'Judging the Quality of Legal Research: A Qualified Response to the Demand for Greater Methodological Rigour' (2014) 24 *Legal Education Review* 173, 187.

³ Mary Yoko Brannen and Mark F Peterson 'Merging without alienating: interventions promoting cross-cultural organizational integration and their limitations' (2009) 40 *Journal International Business Studies* 468.

⁴ Mikko Ketokivi and Saku Mantere 'What warrants our claims? A methodological evaluation of argument structure' (2021) 67(6) *Journal of Operations Management* 755, 755.

⁵ Yiannis Gabriel 'Reflexivity and beyond – a plea for imagination in qualitative research methodology', (2015) 10(4) *Qualitative Research in Organizations and Management* 332.

II. PARADIGMATIC APPROACH TO THE RESEARCH

The research design for a research project is underpinned by the philosophical paradigm of the researcher. Therefore, before providing a justification for the three research methodologies used to answer the Research Questions, it is important to understand the paradigmatic approach that was adopted.

Kuhn defines a paradigm as the prevailing combination of theory, standards and methods of investigation and confirmation that are accepted by a scientific community.⁶ Applying Kuhn's definition to the law, there are two main paradigms.⁷ The first is legal positivism, which is the dominant theory of law.⁸ This theory 'underpins both law and law reform'.⁹ The second is interpretivism.¹⁰ There is a continuum between these two main paradigms, allowing for some flexibility.¹¹ However, other paradigms have arisen over time. These include critical theory,¹² critical realism,¹³ pragmatism,¹⁴ legal constructivism¹⁵ and moral impact theory.¹⁶ This is illustrated by Figure 2.2 at page 346.

⁶ Thomas S Kuhn '*The Structure of Scientific Revolutions*' (3rd ed. University of Chicago Press 1996), 10-11.

⁷ McKerchar (n 1), 6.

⁸ Brian Z Tamanaha, 'The Contemporary Relevance of Legal Positivism' (2007) 32 *Australian Journal of Legal Philosophy* 1; Mehmet Ruhi Demiray 'Natural Law Theory, Legal Positivism, and the Normativity of Law' (2015) 20(8) *The European Legacy Toward New Paradigms* 807, 813.

⁹ Ron Levy, Molly O'Brien, Simon Rice, Pauline Ridge and Margaret Thornton '*New Directions for Law in Australia Essays in Contemporary Law Reform*' (ANU Press 2017), 2; The main proponents were Jeremy Bentham and John Austin during the 18th and 19th centuries and H.L.A. Hart in the second half of the 20th century.

¹⁰ Ronald Dworkin was the main protagonist of interpretivism rejecting the legal positivist world view and in particular the views of H.L.A. Hart. Dworkin argues legality is ultimately determined not by social facts alone, but also by moral facts.

¹¹ McKerchar (n 1), 7.

¹² Ben Agger 'Critical theory, post-structuralism, postmodernism' (1991) 17 *Annual Review Social* 10, 107.

¹³ McKerchar (n 1), 8.

¹⁴ Ibid.

¹⁵ Merry-Jo D. Levers, 'Philosophical Paradigms, Grounded Theory, and Perspectives on Emergence' (2013) *Sage Open* 1.

¹⁶ Mark Greenberg, 'The Moral Impact Theory, the Dependence View and Natural Law' in George Duke and Robert P George (ed), '*The Cambridge Companion to Natural Law Jurisprudence*' (Cambridge University Press 2017), 275.

Although quantitative research may be seen to be positivist and qualitative research, as interpretivist, neither research method is exclusive to any one paradigm.¹⁷ Mixed methods may be used.¹⁸ One should not conflate the paradigm with the research method. Research methodologies are systematic ways of knowing whereas a research paradigm is a set of fundamental assumptions, beliefs and values that enable the researcher to decide what is genuine scientific knowledge.¹⁹ There is no reason why a combination of quantitative and qualitative methodologies cannot be used in legal research. If the methodology assists in answering a research question to deal with the identified phenomenon, there is no reason for its exclusion. This approach will avoid 'social boxes'.²⁰

A researcher with a legal positivist view of the world is likely to take a doctrinal law approach to research because the latter is underpinned by the former.²¹ While the traditional view of legal positivism is that there is a distinction between what the 'law is' as established by some legal authority and recognised socially, and the 'merits of that law', contrary to popular belief, being a legal positivist does not mean that either law reform or the morality of the law is an anathema. Law reform flows from the legal positivist approach to the law. This is because legal positivism distinguishes what the 'law is' from what the 'law ought to be'. Understanding what the 'law is' leads to identification of where it has failed and therefore what the 'law ought to be'. The legal positivist maintains the position that you cannot identify failures in the law without having a full understanding of what the 'law is'.

By taking a legal positivist position, the legal researcher is able to critique the existing law and propose or 'hypothesise' reforms to that existing law. The legal positivist approach leads to justice through the recognition of what the law 'ought to be', having

¹⁷ Ibid; Lisa Webley, 'Qualitative Approaches to Empirical Legal Research' in Peter Cane and Herbert M. Kritzer (ed), *'Oxford Handbook of Empirical Legal Research'* (Oxford University Press), 4.

¹⁸ McKerchar (n 1).

¹⁹ Jessica Heineman-Pieper, Katherine B. Tyson, Martha Heineman-Pieper 'Doing Good Science Without Sacrificing Good Values: Why the Heuristic Paradigm is the Best Choice for Social Work' (2002) 83(1) *Families in Society: the Journal of Contemporary Human Services* 15, 7.

²⁰ Alvesson, Mats and Jorgen Sandberg 'Re-Imagining the Research Process Conventional and Alternative Metaphors' (Sage Publications, 2021), 67.

²¹ Amrit Kharel 'Doctrinal Legal Research' (February 26, 2018). Available at <SSRN: <https://ssrn.com/abstract=3130525> or <http://dx.doi.org/10.2139/ssrn.3130525>>, 5.

regard to what the 'law is'. Doctrinal legal research, which is underpinned by the legal positivist worldview, has the purpose of improving substantive law, leading to the ultimate goal of the law, which is justice.²² Separating what the 'law is' from what it 'ought to be' is an 'act of theory construction' enabling 'alternative concepts of law which are future oriented'.²³

Legal positivism underpins this research project because it assisted in arriving at conclusions on how the current law can be reformed. This approach combined with the research methodologies was able to provide answers to the Research Questions taking one from what the 'law is' to what the 'law ought to be' leading to justice for the retail investor.

III. PHILOSOPHICAL REASONING

Philosophical reasoning and argument are important aspects of the law. Reasoning may be deductive, inductive or abductive or a combination of some or all of these. Forms of philosophical reasoning in legal research are not restricted. All three methods or a combination thereof may be used to provide solutions to failings with the 'law as it is', leading to findings of what the 'law ought to be'. It has been recognised by the High Court that in judicial reasoning, there is both an inductive and deductive element.²⁴ Inductive logic (normally associated with interpretivism) and deductive logic (normally associated with positivism) occur in judicial reasoning and have been recognised as part of the methodology of change.²⁵ Abductive reasoning also occurs in judicial reasoning, even if it is not recognised as such. Abductive reasoning has been described as a 'form of bottom-up reasoning employed when not all facts are completely known'.²⁶

The research undertaken in this project therefore was not restricted by differences in philosophical reasoning approaches. As the courts have found, any or all of these approaches or a combination thereof may be used to produce a just result.

²² Kharel (n 21), 7.

²³ Margaret Davies 'Legal theory and law reform: Some mainstream and critical approaches' (2003) 28(4) *Alternative Law Journal* 168, 17.

²⁴ *Skelton v Collins* (1966) 115 CLR 94, 134 (Windeyer J).

²⁵ *Dietrich v The Queen* (1992) 177 CLR 292, 322 (Mason CJ and McHugh J).

²⁶ *Bristow v the Queen* [2020] SASFC 91, [137].

IV. LEGAL RESEARCH METHODOLOGY

There have been many attempts at defining what is legal research.²⁷ The following is an apt description:

The messy work product of the judges and legislators requires a good deal of tidying up, of synthesis, analysis, restatement, and critique. These are intellectually demanding tasks, requiring vast knowledge and the ability (not only brains and knowledge and judgment, but also *Sitzfleisch*)²⁸ to organize dispersed, fragmentary, prolix, and rebarbative material.²⁹

Legal research encompasses three aspects: doctrinal legal research, reform-oriented research and theoretical legal research.³⁰ All three methods are closely aligned and intertwined, operating in tandem to take the researcher from what the 'law is' to what the 'law ought to be'.

Doctrinal legal research is aimed at 'the systematisation and critique of a defined body of positive law' to 'persuade other legal professionals of the researcher's understanding of the state of the law and the seriousness of any deficiencies identified'.³¹ The focus of legal doctrinal research is always on what the particular body of the law is and 'how it ought to be understood and how it may be improved'.³² The principal purpose of doctrinal legal research is to 'provide explicit normative comment (how things should be)' in order to formulate 'needed proposals for

²⁷ Dan Jerker B. Svantesson, 'The Hypocritical Hype about Hypothesis' (2014) 39(4) *Alternative Law Journal* (Gaunt) 259, 260.

²⁸ "*Sitzfleisch*" is a German word that conveys the concept of having the means and the ability to sit still for long periods of time required to be truly productive and with the stamina to work through a difficult situation seeing a project through to the end.

²⁹ Richard Posner, 'In Memoriam: Bernard D. Meltzer (1914-2007)' (2007) 74(2) *University of Chicago Law Review* 435, 437; Mathias M Siems 'Legal Originality' (2008) *Oxford Journal of Legal Studies* 147, 153; Jeffrey C Dobbins 'The Oregon Law Commissioner: Bridging the Gaps between Islands of the Legal Profession' (2007) 44(2) *Willamette Law Review* 161; Svantesson (n 27), 260; Terry Hutchinson and Nigel Duncan 'Defining and describing what we do: Doctrinal legal research' (2012) 17(1) *Deakin Law Review* 83, 107.

³⁰ Terry Hutchinson 'Developing Legal Research Skills: Expanding the Paradigm' (2008) 32(3) *Melbourne University Law Review* 1065, 1068 citing Dennis Pearce, Enid Campbell and Don Harding "Australian Law Schools: A discipline assessment for the Commonwealth Tertiary Education Commission" (AGPS, 1987).

³¹ Roux (n 2), 178.

³² Ibid, 179.

improvement'.³³ In fact, 'most doctrinal scholars go beyond mere construction of legal doctrine. They also evaluate the law and give recommendations for reform'.³⁴

Reform-oriented research is research that 'intensively evaluates the adequacy of existing rules and recommends changes to any rules found wanting'.³⁵ McKerchar says that such research is 'designed to accomplish change in the law'.³⁶ Hutchinson argues such research will also suggest ways in which the law can be amended or how philosophy, processes or administration of the law can be improved.³⁷ As Davies puts it 'law reform is about changing doctrinal law so that it better suits the social conditions of the times'.³⁸

Theoretical research methodology 'is that which fosters a more complete understanding of the conceptual bases of legal principles'.³⁹

Further, Argyrou argues that legal research includes non-doctrinal legal research, which embodies law reform. This involves the legal scholar raising problems that affect the law, such as indicating flaws in the effectiveness and implementation of underlying policy, and then suggesting changes to the law.⁴⁰

In undertaking legal research, the two most important questions that can be asked are 'What is going on here?' and 'What is this a case of?'⁴¹ In answering these questions, one can work backwards to identify gaps and defects in the way the 'law

³³ Andria Naude Fourie 'Expounding the Place of Legal Doctrinal Methods in Legal-Interdisciplinary Research Experiences with Studying the Practice of Independent Accountability Mechanisms at Multilateral Development Banks' (2015) 8(3) *Erasmus Law Review* 95 citing J Vranken 'Exciting Times for Legal Scholarship', (2012) 2 *Recht en Methode in Onderzoek en Onderwijs* 42, 43.

³⁴ Sanne Taekema and Wibren van der Burg 'Legal Philosophy as an Enrichment of Doctrinal Research Part I: Introducing Three Philosophical Methods' (2020) *Law and Method* 1.

³⁵ Hutchinson and Duncan (n 29).

³⁶ McKerchar (n 1).

³⁷ Terry Hutchinson, 'The Doctrinal Method: Incorporating Interdisciplinary Methods in Reforming the Law' (2015) 3 *Erasmus Law Review*.

³⁸ Margaret Davies 'Keynote: Reforming Law – The Role of Theory' in Ron Levy et al (ed), 'New Directions for Law in Australia Essays in Contemporary Law Reform' (ANU Press, 2017).

³⁹ McKerchar (n 1).

⁴⁰ Aikaterini Argyrou, 'Making the Case for Case Studies in Empirical Legal Research' (2017) 13(2) *Utrecht Law Review* 95, 97.

⁴¹ Haridimos Tsoukas, 'Craving for generality and small-N studies: a Wittgensteinian approach towards the epistemology of the particular in organization and management studies' in David Buchanan and Alan Bryman (ed), 'The SAGE Handbook of Organizational Research Methods' (SAGE 2009).

is' and to put forward explanatory hypotheses or reforms as to what the 'law ought to be' to deal with those gaps and defects. This may be a working idea as to what the outcome of the research may be.⁴² This library-based analysis of the law generates theory for change. There are also similarities between this approach and the 'bricoleur' description of qualitative research.⁴³

There are aspects of legal research that embody both quantitative and qualitative methods of research.⁴⁴ Lawyers engage in a form of qualitative research, using documents as source material on a regular basis when using the case-based method of establishing the law through analysis of precedent.⁴⁵ Law has also been described as 'intuitive, qualitative and argument-based' with law reform being 'based upon argument and an implicit normative foundation'.⁴⁶ Ultimately, the purpose of legal research is 'to initiate some change in society through the legal system, to enhance justice, and improve society overall'.⁴⁷

Therefore, in this research project, the first task was to analyse the history of the failures of the legal and regulatory framework of the CIS using existing data.⁴⁸ From this initial historical analysis, the Research Questions were generated.⁴⁹ The Research Questions, in turn, are answered through an analysis of the 'law as it is', leading to propositions of what the 'law ought to be' to address the identified failures. This generated propositions or hypotheses for reform of the existing legal and regulatory framework that would better protect the retail client without constituting complex regulation.⁵⁰

⁴² Terry Hutchinson 'Researching and Writing in Law' (Thomson Reuters (Professional) Australia Pty Ltd 2018), 206.

⁴³ Norman K Denzin and Yvonna S Lincoln, 'The Discipline and Practice of Qualitative Research' in Norman K Denzin and Yvonna S Lincoln (ed) *The Sage Handbook of Qualitative Research* (Thousand Oaks, CA: Sage), 5.

⁴⁴ Hutchinson and Duncan (n 29), 116.

⁴⁵ Webley (n 17).

⁴⁶ Susan Bartie 'Review Essay: The Social Sciences in Australia and the Experience of Law' (2012) 34(2) *Sydney Law Review* 371, 381.

⁴⁷ Robert J Landry II, 'Empirical Scientific Research and Legal Studies Research a Missing Link' (2016) 33(1) *Journal of Legal Studies Education* 165, 170.

⁴⁸ This included obtaining relevant documents under the *Freedom of Information Act 1982* (Cth) discussed in Chapter 4 below

⁴⁹ See Chapter 1 above.

⁵⁰ See Chapters 3 to 7 below.

The purpose of this research project was to arrive at conclusions for reform to the existing legal and regulatory framework of the CIS to address those features of the existing framework which have failed to protect the retail client, namely, what the 'law ought to be'.

V. QUANTITATIVE RESEARCH METHODOLOGY

The quantitative research methodology component of this research project was to conduct a survey of industry participants ('Survey').⁵¹ The results are set out in the Survey Results commencing at page 405 as well as being interleaved where appropriate throughout this thesis.

In conjunction with the legal research methodologies and the qualitative research used in this research project, quantitative research was undertaken in the form of a survey. The population selected for the survey was persons who are engaged in the operation of registered MIS known as responsible entities (REs). There were 68 REs approached to participate.⁵² While this number is low, 10 of the 68 REs represented 38.8% (\$588 billion) of assets under management in registered MIS, managing between them a total of 35.2% (1,273) registered MIS.⁵³ Also at the end of June 2022, according to ASIC, there are only 420 responsible entities operating a total of 3,545 registered schemes.⁵⁴

The survey was completely confidential. The data was collected using REDCap.⁵⁵ The participants obtained access through a URL issued by REDCap and ticked boxes to questions set out in the survey document.

The questions were designed to be both descriptive and experimental. The descriptive aspect was to ascertain how the current legal and regulatory framework of MIS for the protection of retail investors was working. The experimental aspect provided data on what the participants considered would be the probable effect if

⁵¹ Note: References made to a 'Survey' in the following chapters are references to this Survey.

⁵² This information is not available on a public data base and is based on ASX, Google and LinkedIn searches and personal knowledge.

⁵³ Australian Securities and Investments Commission '*Governance of responsible entities*' (Report, January 2022), 1.

⁵⁴ Australian Securities and Investments Commission 'ASIC issues Equity Trustees infringement notices for misleading investment statements' (Media Release 25-105MR, 19 June 2025).

⁵⁵ REDCap 12.5.8 © Vanderbilt University.

certain proposed changes were made to the legal and regulatory framework of the MIS that were designed to protect the retail investor.

The survey was primarily designed to empirically test the conclusions reached from the legal research methodology described above as to what the 'law ought to be'. A number of the questions were also designed to answer the third research question, namely whether the proposed changes as to what the 'law ought to be' ascertained from the legal research would cause the REs to exit the retail market.

These Survey results are interleaved in Chapters 3 to 7 inclusive hereof where applicable.

VI. QUALITATIVE RESEARCH METHODOLOGY

Although qualitative research may mean different things to different researchers, there is a common theme. The data collected in the research is what is observed such as words, pictures and other artifacts whether aural, visual to textual. The phenomenon being studied is what is experienced and given meaning by the individuals or groups being studied.

One method of qualitative research that is particularly apt for legal research is the small-N case study. The small-N case study, by its very nature, provides depth to the analysis of a research problem.⁵⁶ The small-N case study can be focused with 'a depth of detail and granularity that other methods are lacking'.⁵⁷ Siggelkow argues that a 'single case can be a very powerful example'.⁵⁸ Ragin similarly argues that 'one of the primary virtues case study method is the depth of analysis that it offers'.⁵⁹ It may identify exactly what the phenomenon of interest is a case of.⁶⁰ The small-N

⁵⁶ Julien Etienne 'Case studies in administrative law: the example of self-reporting rules in the regulation of business activities' in Willem van Boom, Pieter Desmet, Peter Mascini (ed), *'Empirical legal research in action: reflections on methods and their applications'* (Edward Elgar Publishing, 2018) 174,179; Nicolaj Siggelkow 'Persuasion with Case Studies' (2007) 50(1) *The Academy of Management Journal* 20; Charles Ragin, 'Introduction: Cases of "What is a case?"' in Charles Ragin & Howard Becker (ed), *'What is a case? Exploring the foundations of social inquiry'* (New York: Cambridge University Press 1992) 6, 348.

⁵⁷ Etienne (n 56),179.

⁵⁸ Nicolaj Siggelkow, 'Persuasion with Case Studies' (2007) 50(1) *The Academy of Management Journal* 20.

⁵⁹ Ragin (n 56), 348.

⁶⁰ Ibid.

case study may also assist in tracing the causes of a phenomenon, both in theoretical and applied settings.⁶¹

While small-N studies are criticised as failing to generalise because the small sample means the results are not representative, Tsoukas argues that this is a statistical view of life, not appropriate for case studies.⁶² He further argues that, with small-N case studies, the particular refines the general.⁶³ One moves from craving for the general, where the particular is subsumed in the general, to craving for greater elucidation.⁶⁴ From the epistemology of the particular, one can find family resemblances rather than overarching features.⁶⁵ This aids the understanding of the existing phenomenon. Because life is experienced by concrete individuals in concrete cases, even the most general of concepts take their particular shape in particular settings.⁶⁶ In the law, the craving for generality instead of the particular can lead to jurisprudential error.⁶⁷

The small-N case study is exemplified by the legal case study.⁶⁸ This was extensively used in answering the Research Questions in the following Chapters. Court decisions will often reveal ‘unusually extensive and in-depth perspectives on law, on the actions of various stakeholders, and on the societal context in which these operate’.⁶⁹ Through applying content analysis to the legal case studies, themes and concepts were revealed to operate in particular factual circumstances.⁷⁰

Further, the legal case studies used in this research project provided examples of where the ‘law as it is’ failed to protect the retail investor. If the norm is that the ‘law as it is’ will protect the consumer, then the examples of where the ‘law as it is’ has

⁶¹ Paul F. Steinberg, ‘Causal Assessment in Small-N Policy Studies’ (2007) 35(2) *The Policy Studies Journal* 181, 185.

⁶² Tsoukas (n 41), 289.

⁶³ Ibid.

⁶⁴ Ibid.

⁶⁵ Ibid, 298.

⁶⁶ Ibid, 299.

⁶⁷ John Glover, ‘Wittgenstein and the Existence of Fiduciary Relationships: Notes Towards a New Methodology’ (1995) 18(2) *UNSW Law Journal* 443, 451

⁶⁸ Cases were identified from searches undertaken at www.austlii.edu.au.

⁶⁹ Katerina Linos and Melissa Carlson, ‘Qualitative Methods for Law Review Writing’ (2017) 84 *The University of Chicago Law Review* 213, 214.

⁷⁰ Kylie Burns, ‘The Australian High Court and Social Facts: A Content Analysis Study’ (2012) 40(3) *Federal Law Review* 317, 323-324.

failed to protect the consumer deviate from the norm and therefore are ‘deviant’ cases.⁷¹

Deviant cases have been found to perform well in discovering causal pathways that are either not known or not completely understood with respect to a phenomenon.⁷² Therefore, an analysis of deviant cases led to an understanding of ‘the why’ and ‘the how’ the various aspects of the legal and regulatory framework for the protection of retail investors in MIS have failed. Through the study of these ‘real-world’ or ‘real-life’ cases, not only did the answer to the first Research Question emerge, but patterns and common themes were identified supporting the hypothesised reforms, taking one from the ‘law as it is’ to ‘the law as it ought to be’.

In addition, to provide more in-depth answers than was the case with the Survey and to bring to light any other issues which the other methodologies might not reveal, interviews were also conducted of the managing directors of two REs who had been involved in the operation of CIS from the 1990s and 1980s respectively and who survived the crashes in the MIS industry following the GFC.⁷³ Details are in Interview Transcript commencing at page 461.

⁷¹ Argyrou (n 40), 103.

⁷² Jason Seawright, ‘The Case for Selecting Cases That Are Deviant or Extreme on the Independent Variable’ (2016) 45(3) *Sociological Methods & Research* 493, 506.

⁷³ See Interview Transcript, page 461; Note: References made to the ‘Interview’ in the following Chapters are references to this interview.

CHAPTER 3: DUTIES OF OFFICERS OF THE RESPONSIBLE ENTITY ('RE') TO SCHEME MEMBERS

'A human action is morally good, not because it is done
from immediate inclination – still less because it is done
from self-interest – but because it is done for the sake of
duty'¹

I. INTRODUCTION

The examples of failures of collective investment schemes ('CIS') referred to in Chapter 1 suggests that there may be a problem with some of the persons involved in the management and operation of these CIS. It may be the case that the wrong people have been in control of the operation of the CIS to the detriment of the retail investor, i.e., 'the fox has been put in charge of the hen house'. In Kantian terms, these persons appear to have acted in self-interest rather than for the sake of duty.² This is concerning for financial markets generally because, as Wallis notes, '[f]inancial markets cannot work well unless participants act with integrity'.³

By way of recap, from an analysis of this history in Chapter 1, three research questions were generated regarding a number of areas of the regulatory framework for the managed investment scheme ('MIS') designed to protect retail investors, which have proved to be problematic. One identified area for further research was the duties of officers of the RE.⁴ In this Chapter, an analysis of this area of regulation of the MIS was undertaken using the methodological and philosophical approaches to research referred to in Chapter 2 to ascertain the answers to the three Research Questions in sections II, III and IV of this Chapter. These answers identified reforms that can be made to the regulatory and legal framework to protect retail investors without over-regulation. However, before proceeding further, it needs to be understood how the duties of officers currently operate within this framework.

¹ Immanuel Kant '*The Moral Law Groundwork of the Metaphysic of Morals*' Translated by HJ Paton (Routledge 2005), 10.

² Ibid.

³ Stan Wallis *Australian Financial System Inquiry* (Final Report, March 1997) ('Wallis'), 235.

⁴ *Corporations Act 2001* (Cth) ('Corporations Act'), s 601FD(1).

A. *Statutory duties of officers of a RE within the MIS legal and regulatory framework*

Officers of a company, including a RE, owe duties to the company and not to the shareholders.⁵ A key reform to the regulation of CIS instituted by the *Managed Investments Act 1998* (Cth) ('MIA'), was the imposition of two sets of statutory duties firstly on the RE and secondly on the officers of the RE.⁶ These respective duties are owed directly to the scheme members.⁷ Some of these duties are common to both the RE and the officers to which see the following Table 3.1.

Table 3.1 –Duties in Common of the RE and its Officers to the members of the MIS

Duties	RE	Officer of RE
act honestly	601FC(1)(a)	601FD(1)(a)
exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's/officer's position	601FC(1)(b)	601FD(1)(b)
act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests	601FC(1)(c)	601FD(1)(c)
not make use of information acquired through being the responsible entity/officer of the responsible entity in order to: (i) gain an improper advantage for itself/the officer or another person; or (ii) cause detriment to the members of the scheme	601FC(1)(e)	601FD(1)(d)
comply with the scheme's compliance plan	601FC(1)(h)	601FD(1)(f)(iv)

⁵ See Table 3.1 (Ayres and Braithwaite Regulatory Pyramid), page 351.

⁶ Corporations Act, ss 601FC(1) and 601FD(1).

⁷ Ibid.

Although some of the statutory duties of the RE to scheme members and the duties of a trustee company to beneficiaries in general law have similarities, the statutory duties are more extensive. There is a clear distinction between:

- the statutory duties of an officer of a company that is a RE to the scheme members, and
- the statutory and general law duties of an officer of a company to the company, including if the company is a RE,⁸ or a trustee.⁹

The duties to scheme members are therefore operatively unique.¹⁰ Further, the duties of the officers of the RE to the scheme members impose on those officers a higher degree of care and diligence than if they were officers of a company that is not an RE.¹¹ These duties are more demanding.¹² The imposition of these duties, therefore, makes officers of the RE important ‘gatekeeper’s’ in the MIS legal and regulatory framework.¹³ They are ‘charged with duties to safeguard the interests of others.’¹⁴ The theory of the ‘gatekeeper’ model, as it applies to officers of the RE, is that the reputational and litigation risk involved should cause those officers not to violate the law.¹⁵ As discussed later in this Chapter, the failure of officers to adhere to these duties can have a profound effect on retail investors.¹⁶

The duties of the officers of the RE to scheme members complement the RE’s duties to those members ‘by imposing duties on the persons who control the RE’s activities in the administration of a managed investment scheme and its dealings with scheme

⁸ See the comparison Table 3.2 (Duties of Officers of RE to the company under Part 2D.1, at general law and to the members under 601FD(1)), page 352.

⁹ Pamela Hanrahan and Ian Ramsay, ‘*Regulation of mutual funds in Australia*’ in William A Birdthistle and John Morley (ed), ‘*Research Handbook on the Regulation of Mutual Funds*’ (Elgaronline, 26 October 2018), 425.

¹⁰ Pamela Hanrahan, ‘Revisiting Responsible Entity Directors’ Liability to Scheme Members’ (2016) 34 *Company & Securities Law Journal* 321, 322.

¹¹ *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452, [212].

¹² *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342, [524].

¹³ Section IV.C.3 of Chapter 1 herein, page 33; Figure 1.1 (MIS Gatekeeper Model), page 340.

¹⁴ *Re Banksia Securities Limited (Rec & Mgr Apptd) (in liq) (No 2)* [2018] VSC 47, [3].

¹⁵ John C Coffee (jr), ‘*Gatekeepers: The Professions and Corporate Governance*’ (Oxford University Press, 2006), 5.

¹⁶ *Australian Securities and Investments Commission v Healey* (2011) FCR 291 (liability), [14].

assets'.¹⁷ The RE can only act through human beings.¹⁸ The officers are the guiding minds of the RE.¹⁹ Although the RE is a 'gatekeeper' in the current regulatory framework of the MIS, because the RE is a corporation and therefore a 'fictional person', the RE's role as the pinnacle of the 'gatekeeper' model²⁰ is dependent upon the acts and omissions of its officers.²¹ Where there is misconduct by the officers of a RE, that misconduct may be attributed to the RE.²²

B. *Fiduciary nature of statutory duties of officers of RE to scheme members*

Although the duties of the officers of the RE to scheme members were intended, in part, to reflect the duties owed by the RE to those members,²³ such duties were also intended to reflect the fundamental duties of a fiduciary and duties that were imposed on the management company and the trustee under the former regulatory regime.²⁴ These statutory duties are essentially fiduciary in nature.²⁵

It is well accepted that a key feature of fiduciary duties is that they are prophylactic in the sense that they tend to prevent the disease of temptation in the fiduciary.

Therefore, the standard expected of the fiduciary is strict.²⁶

Allsop J, writing extra-curially, said:

I venture to suggest that many of the commercial problems of corporate and financial regulation exposed in the recent Royal Commission would be made more ruthlessly

¹⁷ *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (Receivers and Managers Appointed) (in liquidation)* [2014] VSC 516, [1949].

¹⁸ *Black v Smallwood* (1966) 117 CLR 52, 61 (Windeyer J).

¹⁹ *R Consulting & Drafting Pty Limited v Cummings* [2016] FCAFC 20, [187].

²⁰ Corporations Act, s 601FB.

²¹ Andrew F Tuch, 'Multiple Gatekeepers' (2010), 96(7), *Virginia Law Review* 1583, 1608.

²² *Australian Securities and Investments Commission v Managed Investments Ltd (No 9)* [2016] QSC 109, [478], [610]-[613].

²³ Explanatory Memorandum to the Managed Investments Bill 1997 ('EM MIB'), [8.18].

²⁴ *Ibid*, [8.8].

²⁵ *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Company Ltd* [2005] WASC 189, [33]; approved in *Australian Property Custodian (No. 3)* (n 12), [524] noting that Pamela Hanrahan in 'Managed Investments Law' (Centre for Corporate Law and Securities Regulations - The University of Melbourne and CCH Australia, 1998), 102 called the duties in s 601FD(1)(a) to (e) 'fiduciary-type' obligations.

²⁶ *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298, 407-409 cited with approval in *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Company Ltd* [2005] WASC 189, [36] in the context of the duties of an officer of a RE under Corporations Act, s 601FD; *Zibara v Ultra Management (Sports) Pty Ltd* (2021) 283 FCR 4, [282]; *Pilmer v The Duke Group Ltd (in liq)* (2001) 207 CLR 165; *Blythe v Northwood* [2005] NSWCA 221, [184].

manageable by a full understanding and a daily application of the fiduciary principle, rather than by ever more detailed regulation which has as its (false) working assumption the ability exhaustively to define good faith, fiduciary responsibility, and behaviour in good commercial conscience.²⁷

Millhouse also makes the point that:

The Damoclean Sword over improper conduct is to be provided by fiduciary obligation in the investment chain enforced by effective regulation and much greater levels of financial literacy²⁸... Fiduciary standards mitigate malfeasance by reducing the power imbalance resulting from asymmetries of knowledge and comprehension. They align interests²⁹... Fiduciary obligation is the mirror of community expectation of trust in those that advise them or manage their funds.³⁰

Therefore, an officer of a RE, armed with this knowledge, should instinctively adhere to those standards when handling 'other people's money', i.e., act out of duty with no exception for inclination.³¹ To do so is 'fundamental to a safe and smooth-running society'.³²

Notwithstanding the imposition of these duties on officers of a RE as part of the reforms effected by the MIA, losses have been suffered by retail investors where there have been breaches of these duties.³³ Reported decisions where officers of a RE have been found to have breached one or more of the duties to the members illustrate that such breaches of these duties can prove devastating for retail investors.³⁴ Retail

²⁷ James Allsop, 'The intersection of companies and trusts' 43(3) *Melbourne University Law Review* 1128.

²⁸ David G Millhouse, 'Empirical analysis supports Hayne long run reform thesis' (2019) 13(2-3) *Law and Financial Markets Review* 162, 164.

²⁹ Ibid, 166.

³⁰ Ibid, 180.

³¹ Kant (n 1).

³² Elizabeth Mary Grierson 'Trust and fiduciary relationships in education: What happens when trust is breached?' (2018) 50:2 *Educational Philosophy and Theory* 203, 105.

³³ Table 6.2 (Estimated Scheme Losses), page 384.

³⁴ *Australian Securities and Investments Commission v Heydon Park Ltd* [2005] FCA 1583; *Australian Securities and Investments Commission v Beekink* [2006] FCA 388 (on appeal *Australian Securities and Investments Commission v Beekink* [2007] FCAFC 7 where penalties increased); *Healey No. 1* (n 16) (liability) & *Australian Securities and Investments Commission v Healey (No 2)* (2011) 196 FCR 430 (penalties); *Hickie and Australian Securities and Investments Commission* [2013] AATA 853; *Australian Property Custodian (No.3)* (n 12); *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed)* [2014] FCA

investors have often, through misconduct of fiduciaries, suffered substantial losses³⁵ with the consequential loss of consumer confidence.³⁶ Despite these failures, theoretically, the statutory duties imposed on the officers of the RE³⁷ are one of the strengths of the legal and regulatory framework for MIS.³⁸ This is because those duties are owed directly to the members.³⁹

The ALRC Report 65 considered that imposing duties on officers of the RE owed to the scheme members would lead to those officers paying close attention to the interests of the members in the scheme.⁴⁰ Not only would the officers of the RE be required to prefer the RE's interests to their own, but they would also be required to prefer the members' interests to their own.⁴¹ The officer's duties to the members were to be paramount.⁴²

The nature and extent of the statutory duties to members is informed by the RE:

1308 (penalties) (High Court on appeal: *Australian Securities and Investments Commission v Lewski*; *Australian Securities and Investments Commission v Wooldridge*; *Australian Securities and Investments Commission v Butler*; *Australian Securities and Investments Commission v Jaques*; *Australian Securities and Investments Commission v Clarke* (2018) 266 CLR 173); *Agricultural Land Management Ltd v Jackson* [No 2] [2014] WASC 102; *Trilogy* (n 11)(appeal dismissed in *Sullivan v Trilogy Funds Management Limited* (2017) 255 FCR 503); *Australian Securities and Investments Commission v Managed Investments Ltd* (No. 9) [2016] QSC 109 (contravention declarations), *Australian Securities and Investments Commission v Managed Investments Ltd* (No 10) [2017] QSC 96 (penalties); *King v Australian Securities and Investments Commission* [2018] QCA 352 (on appeal *King v Australian Securities and Investments Commission* [2019] QCA 121; on further appeal *Australian Securities and Investments Commission v King* (2020) 270 CLR 1); *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497; *Australian Securities and Investments Commission v Project Management (Aust) Pty Ltd* [2019] FCA 47; *Australian Securities and Investments Commission v Theta Asset Management Limited* [2020] FCA 1894; *Australian Securities and Investments Commission v Daly (Liability Hearing)* [2023] FCA 290; *Australian Securities and Investments Commission v Daly (Penalty Hearing)* [2024] FCA 3 (appeal dismissed in *Daly v Australian Securities and Investments Commission* [2024] FCAFC 125); *J&J Richards Super Pty Ltd ATF The J&J Richards Superannuation Fund v Nielsen* [2024] FCA 1472.

³⁵ Table 6.2 (Estimated Scheme Losses), page 384.

³⁶ Australian Securities and Investments Commission *Compensation for retail investors: the social impact of monetary loss* (Report No. 240, May 2011), 8.

³⁷ Corporations Act, s 601FD(1).

³⁸ Participant 2 in the Interview also held this view: Interview Transcript, page 468.

³⁹ Corporations Act, s 601FD(1).

⁴⁰ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65,1993) ('ALRC Report'), [10.16].

⁴¹ *Ibid.*

⁴² *Ibid.*

- being a public company,⁴³
- holding an Australian financial services licence ('AFSL'),⁴⁴ and
- holding scheme property on trust for the scheme members.⁴⁵

The scope of the duties of the officers of the RE to the members 'must be considered in light of the vulnerabilities inherent in the position of the members as beneficiaries of a trust and (as will often be the case) the fact that the RE holds itself out to the public and is paid as a professional trustee'.⁴⁶ Because the duties imposed on officers of a RE are fiduciary in nature, a strict standard is applied.⁴⁷

II. RESEARCH QUESTION 1: HOW HAVE THE DUTIES OF THE RE'S OFFICERS TO THE SCHEME MEMBERS FAILED TO PROTECT THE RETAIL INVESTOR?

Despite the significant penalties for breaches of duties by officers of the RE,⁴⁸ the case law illustrates that there is often a gap between what is required of an officer of a RE by law and what that officer does or omits to do. The severe consequences of breaching those duties have not acted as a deterrent. This is despite research indicating that there is a strong view held by governance professionals that harsher penalties are the solution to corporate misconduct.⁴⁹

The usual response by governments to bad behaviour is to increase penalties. It is an easy political 'fix' for bad behaviour complaints. The 'tyranny of politics'. You look like you are doing something when you are not. There is little evidence that harsher

⁴³ Corporations Act, s 601FA.

⁴⁴ Ibid, s 601FA.

⁴⁵ Ibid, s 601FC(2).

⁴⁶ *Australian Property Custodian (No. 3)* (n 12), [526].

⁴⁷ *Alpha* (n 25), [36].

⁴⁸ Corporations Act, s 1325 (generally) and s 601FD(3) with 1317E(1) (specifically).

⁴⁹ George Gilligan et al 'Penalties Regimes to Counter Corporate and Financial Wrongdoing in Australia - Views of Governance Professionals' (2017) 11 *Law and Financial Markets Review* 4.

penalties have a deterrence effect.⁵⁰ This is a flawed approach.⁵¹ Research indicates that it is not the severity of the punishment but rather the certainty of apprehension that is the more effective deterrent.⁵² It is also one thing to have a heavy maximum penalty and another thing for such a penalty to be imposed.⁵³ Maximum penalties for criminal offences are confined to the very worst possible case.⁵⁴ It would be rare for any case to fit within this category. The conclusion from research undertaken into enforcement of directors' duties, casts doubt on the deterrence value of penalties given monetary penalties were only 12.5% of the maximum available and 46.43% of custodial sentences were suspended.⁵⁵

Because the officers are a significant 'gatekeeper' in the regulation of the MIS, the reputational and litigation risk should override the temptation to act in breach of those duties.⁵⁶ The whole purpose behind the imposition of these duties is that they are intended to prevent the disease of wrongful behaviour in the first place.⁵⁷ However, when one analyses the circumstances where courts have found officers of the RE breached their duties, in many instances, there was a lack of knowledge or understanding by those officers of the importance of those duties in the MIS regulatory framework. It seems to be a case of 'they did because they could'.⁵⁸

⁵⁰ Mirko Bagaric and Theo Alexander, 'A Rational Approach to Sentencing White-Collar Offenders in Australia' (2014) 34(2) *Adelaide Law Review* 317, 348; Isak Ladegaard 'We know where you are, what you are doing and We will catch you – Testing Deterrence Theory in Digital Drug Markets' (2018) 58 *British Journal of Criminology* 414, 428.

⁵¹ Mirko Bagaric, Jean Du Plessis and Jaclyn Silver, 'Halting the Senseless Civil War against White-Collar Offenders: The Conduct Undermined the Integrity of the Markets and Other Fallacies' (2016) (4) *Michigan State Law Review* 1019, 1023.

⁵² Daniel S. Nagin 'Deterrence in the Twenty-First Century' (2013) 42(1) *Crime and Justice* (Chicago, Ill.), 199, 201-202.

⁵³ This is distinct from the civil penalty regime that has no concept of proportionality, the purpose being to promote the public interest in compliance with the law by way of deterrence of further contraventions rather than punishing contraventions: *Australian Building and Construction Commissioner v Pattinson* (2022) 274 CLR 450, 457; However given the potential size of the civil penalties that may be imposed, the courts may need to focus on whether these penalties are oppressive: Ian Ramsay and Miranda Webster 'The Origins, Evolution and Merits of the Civil Penalty Regimes Enforced by ASIC' (2024) 40 *Company & Securities Law Journal* 261.

⁵⁴ *Markarian v The Queen* (2006) 228 CLR 357, 372 applied in *Australian Property Custodian* (2014) (n 34), [106].

⁵⁵ Jasper Hedges et al 'The Policy and Practice of Enforcement of Directors' Duties in Australia: An Empirical Analysis' (2017) 40 *Melbourne University Law Review* 905, 966.

⁵⁶ Coffee (n 15).

⁵⁷ *Alpha* (n 25), [33]-[36].

⁵⁸ Kenneth M Hayne, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, 1 February 2019 (1)), 2 ('Hayne').

If the officers, who were found to be in breach of their duties, had a basic understanding of the law and the professional and ethical responsibility involved in decision-making as officers of a RE and, in particular, with respect to the handling of 'other people's money', this should have caused those officers to adhere to the law. The members and, in particular, retail clients are to be given primacy in the decision-making over the REs and the officers' own interests. This is why the officer's duties to the scheme members have absolute priority over their duties to the RE as a company.⁵⁹

Officers should act in accordance with Kant's categorical imperative, i.e. they should act only according to that maxim by which you can at the same time will that it should become a universal law.⁶⁰ This should result in the officers acting out of duty rather than self-interest.⁶¹ As will be seen later in this chapter, good character can be learnt.⁶²

The following case studies are examples of cases where the 'law as it is' regarding the duties of officers of the RE to scheme members has failed to protect retail investors. Because these cases are deviant (i.e., counter to the norm), they have proved useful in determining what the 'law ought to be' in answering Research Question 2.⁶³

F. Case Study 1 – *Centro Properties Limited ('CPL')*,

Although this is a case where the behaviour of the officers may not have been the cause of the losses suffered by retail investors, expressing 'current liabilities' as 'non-current liabilities' meant that investors could have made investment decisions without being fully informed of the true financial status of CPL. This case is therefore an important case on the duties of the officers of the RE to the members of a MIS.

⁵⁹ Corporations Act, s 601FD(2).

⁶⁰ Kant (n 1).

⁶¹ Ibid.

⁶² Alasdair MacIntyre 'After virtue: A Study in Moral Theory' (3rd ed)(University of Notre Dame Press, 2007), 154; Tom E. Culham, Richard J. Major and Neha Shivhare 'Virtue ethics and moral foundation theory applied to business ethics education' (2024) 9 *International Journal of Ethics Education* 139.

⁶³ Jason Seawright 'The Case for Selecting Cases That Are Deviant or Extreme on the Independent Variable' (2016) 45(3) *Sociological Methods & Research* 493, 506.

During the GFC, the Centro Property Group ('CPG') suffered extreme liquidity problems and came close to collapse in December 2007.⁶⁴ A member of CPG, CPL, was a RE that operated two MIS, the Centro Property Trust ('CPT') and the Centro Retail Trust ('CRT'). CPT and CRT were required to have a financial report and a directors' report prepared each financial year.⁶⁵ This financial report required the inclusion of certain declarations by the directors, including whether, in the directors' opinion, the financial statement and notes complied with the Corporations Act and the accounting standards and whether they were true and fair.⁶⁶ Because CPL was listed, the declarations could only be made after the person performing the functions of CEO or CFO had given a declaration in writing that, in that person's opinion, the financial records of the registered scheme had been properly maintained, the financial statements and notes complied with the accounting standards and the financial statements and notes gave a true and fair view.⁶⁷

For the financial year ended 30 June 2007, the consolidated financial reports did not comply with the relevant accounting standards and did not give a true and fair view of the financial position of the various members of the CPG, including CPT and CRT.⁶⁸ This was because around AUS\$2 billion of debt was wrongly classified as non-current liabilities, and there was a failure to disclose guarantees of short-term liabilities amounting to approximately US\$1.75 billion that were provided after the balance date.⁶⁹ The management representation letter from the CEO and CFO, which purported to be a declaration under section 295A of the Corporations Act, also did not satisfy the statutory requirements.⁷⁰ Despite this, the directors approved the financial statements, and two of the directors made the required declarations.

⁶⁴ Jennifer G Hill, 'Centro and the Monitoring Board Legal Duties versus Aspirational Ideals in Corporate Governance' (2012) 35(1) *UNSW Law Journal* 341, 343 citing Tim Leung, and Jon Webster, 'Directors' Duties, Financial Literacy and Financial Reporting After Centro' (2012) 30 *Company & Securities Law Journal* 100.

⁶⁵ Corporations Act, s 292(1).

⁶⁶ *Ibid*, ss 295(4), 296 and 297.

⁶⁷ *Ibid*, s 295A.

⁶⁸ *Healey* (n 16), [9], [574].

⁶⁹ *Ibid*, [9]

⁷⁰ *Ibid*, [510].

At the time, this case was widely described as a ‘landmark decision’.⁷¹ The business world was ‘shocked into the brutal reality’ of the importance of the role of an officer of a company, particularly one that is a RE of a registered MIS.⁷² There was no suggestion that each director did not honestly carry out his responsibilities as a director.⁷³ However, what occurred was not a ‘mere technical oversight’.⁷⁴ The requirement to prepare a financial report for each financial year⁷⁵ that met certain requirements⁷⁶ and provide that financial report to the members⁷⁷ was ‘one of the fundamental reasons why the directors are required to approve them and ensure that they present a true and fair view’.⁷⁸ In other words, the officers are a very important ‘gatekeeper’ in the legal and regulatory framework of the MIS.

There is an expectation that each director will apply an inquiring mind to those matters that come before the board for decision.⁷⁹ The court emphasised that:

[e]ach director armed with the information available to him was expected to focus on matters brought before him and to seriously consider such matters and take appropriate action. This task [approving the financial statements] demands critical and detailed attention, and not just ‘going through the motions’ or sole reliance on others, no matter how competent or trustworthy they may appear to be.⁸⁰

Although ASIC does not require that directors must know everything about the company, ASIC expects that the directors will ‘know of a very significant matter to the company’s business – its current liabilities – at a crucial time: when the economy was experiencing a credit crunch’.⁸¹ There is a considerable difference between non-

⁷¹ Hill (n 64), 100; Australian Securities and Investments Commission ‘*Decision in Centro Civil Penalty Case*’ (Media Release, 11-125MR, 27 June 2011); Leonie Wood, ‘Centro Loses Landmark Decision: Courts’, *Sydney Morning Herald* (28 June 2011), 1; Pia Akerman, ‘Landmark Centro Case Could Trigger Director Exodus – Buck Stops with the Board: Judge’, *The Australian* (Canberra 28 June 2011), 21.

⁷² Samantha Bowers and Jason Murphy, ‘Centro case makes directors sit up’ *Australian Financial Review* (29 July 2011).

⁷³ *Healey* (n 16), [8].

⁷⁴ *Ibid*, [10].

⁷⁵ Corporations Act, s 292(1).

⁷⁶ *Ibid*, ss 296, 297, 298, 299 and 299A.

⁷⁷ *Ibid* s 314(1).

⁷⁸ *Healey* (n 16), [10].

⁷⁹ Belinda Gibson and Diane Brown, ‘ASIC’s Expectations of Directors’ (2012) 35(1), *UNSW Law Journal* 254, 259.

⁸⁰ *Healey* (n 16), [174].

⁸¹ Gibson and Brown (n 79).

current liabilities and current liabilities. The latter meant that CPG would be in serious financial trouble if it were unable to meet those liabilities when called upon to do so.

The case highlights the dangers of officers of a RE not turning their mind to the importance of their duties to scheme members. Leaving aside the light penalties imposed, the case is a sobering reminder to directors of a RE that they must focus their minds on 'material matters known to them or material matters that should be known to them'.⁸² Although not all information provided by management to the officers is required to be verified, the officers must not blindly accept such information.⁸³ All officers of REs should now be under no illusion as to their duties to members. They must apply an inquiring mind to the material and draw their own conclusions.

The officers of the RE including the CEO, CFO and the non-executive directors breached their duties to scheme members by failing to exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position and to take all steps that a reasonable person would take, if they were in the officer's position, to ensure that the RE complied with the Corporations Act.⁸⁴ This was notwithstanding that the management representation letter purported to include the required declaration of compliance of the financial reports with the requirements of the Corporations Act (although, as a matter of construction, the management representation did not comply). The court said that, prior to participating in the resolutions, the directors should have:

(a) properly read, understood and given sufficient attention to the content of the financial statements, and,

(b) considered or properly considered the content of the financial statements,

regarding the classification of liabilities as either current or non-current and the guarantees given post balance date.

Further, the directors should have:

⁸² *Healey* (n 16), [13].

⁸³ *Ibid*, [222]; *Australian Prudential Regulation Authority v Kelaher* [2019] FCA 1521, [41].

⁸⁴ Corporations Act, s 601FD(1)(b) and (f)(i).

- (a) raised, or made an enquiry with management, the Audit and Risk Management Committee and other members of the Board, the apparent failure to properly classify liabilities, current or non-current and the failure to disclose the guarantees given post balance date,
- (b) caused the apparent failures with respect to the financial statements to be corrected, and,
- (c) taken reasonable steps to ensure they had sufficient knowledge of the requirements of the law to read, understand and give sufficient attention to the management representation letter provided to the directors and requested that the directors be given a declaration which accorded with those requirements.⁸⁵

The directors should not have relied solely on management and external advisors. They were required to read and understand the financial statements.⁸⁶ If they had done so, the errors would have been discovered earlier.⁸⁷ It mattered not that CPG had an audit committee or that a major accounting firm was engaged to audit the accounts.⁸⁸

This case illustrates that a person should not act as an officer of a RE unless they have a full knowledge and understanding of the duties to which they are subject by reason of their office. As explained earlier in this Chapter, their duties are wider than those of a director of a company that is not an RE. Their duties are not just owed to the company but also to scheme members. Officers of a RE must have their focus on the members of the MIS. This is why these duties are a strength of the current regime.

This case reveals that the legal and regulatory framework of the MIS concerning the duties of officers of the RE failed to protect the retail investor. There were two reasons for this:

- (a) the officers' lack of knowledge of the law and the accounting standards governing the financial information that was required to be prepared for MIS,

⁸⁵ *Healey No. 1* (n 16), [583].

⁸⁶ *Ibid*, [175] & [582].

⁸⁷ *Ibid*, [582].

⁸⁸ *Ibid*, [239]-[240].

leading to a lack of diligence in exercising their powers within the bounds of their statutory duties, and,

- (b) non-critical acceptance of the information provided to them by senior management, evidencing a lack of knowledge on their part.

Honesty in the discharge of their duties was not sufficient.

B. Case Study 2 – Pacific First Mortgage Fund ('PFMF')

City Pacific Limited ('CPL') was the RE for the PFMF. PFMF had a portfolio of development and construction loans secured by registered mortgages over properties located in Qld, Vic and NSW. There were in excess of 10,000 unitholders. In 2008, redemptions by unitholders were suspended.

On 25 June 2009, CPL was removed and replaced as RE of the PFMF.⁸⁹ In the final year before the RE was replaced, the PFMF had impairment losses exceeding \$514 million. This reduced the unit price of the PFMF by 52% from \$1.00 to \$0.48. On the appointment of a new RE, over 86% of the mortgage portfolio was in maturity and interest default. Prudent mortgage investment should not reduce the unit price below \$1.00 because the loan-to-value ratio should be sufficient to recover the principal. The replacement RE brought proceedings against the officers of the former RE for breach of their statutory duties to the members.⁹⁰

CPL lent monies to a developer ('AGA') to enable AGA to purchase parcels of agricultural land for subdivision and development. The loan facility was secured by mortgages over the land.⁹¹ Extensions or increases to the loan facility and several drawdowns and advances were made. The first change to the facility involved a 'provisional' increase of the facility limit pending the occurrence of certain events. The documentation created for this increase to the facility falsely represented that the increase was approved on a date earlier than it was.⁹² Similarly the documentation for the second increase to the facility was also found by the court to have been

⁸⁹ *Trilogy*, (n 11), [6].

⁹⁰ *Trilogy*, (n 11) (appeal dismissed: *Sullivan v Trilogy Funds Management Limited* (2017) 255 FCR 503, [13]).

⁹¹ *Trilogy*, (n 11), [2]-[4].

⁹² *Ibid*, [5]-[8].

backdated.⁹³ These two increases to the facility limit were also based on what the court said were 'questionable valuations'.⁹⁴ The facility limit was further drawn down and eventually was approximately \$10 million overdrawn.⁹⁵

The directors' approval to increase the facility limit was contrary to the RE's mandated compliance policies and procedures, which required the increase to be first approved by the RE's Credit Committee. The facility limit was also increased in circumstances where the increase was not supported by an appropriate valuation of the land, which was held as security. Further advances were also made in excess of the limit approved by the Credit Committee. The directors covered up their conduct in increasing the facility limit without Credit Committee approval by backdating the loan proposal and the letter of offer. This backdating was intended to give the appearance that the facility was approved by the Credit Committee.⁹⁶

An officer who knew and understood what his or her duties were to the scheme members would have known that they needed to focus on adhering to those duties in their decision-making. However, the priority of their thinking in this case was on the borrower who had been given the loan facility and on themselves through the 'cover-up'. If they had focused on their duties as an officer of a RE to ensure compliance with the constitution and compliance plan of the PFMF, the officers would have immediately recognised what they were doing was wrong. This was because what they chose to do compared with what they were required to do was incompatible.

The directors were held to have breached their duties to exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position and failed to take appropriate steps to ensure compliance with the constitution and compliance plan of the PFMF.⁹⁷ Two of the directors were subject to compensation orders of significant amounts.⁹⁸ This was despite the directors not personally benefiting from their actions. However, this is not to the point. The directors failed to 'exercise appropriate care and diligence to ensure compliance with the

⁹³ Ibid, [8].

⁹⁴ Ibid, [9].

⁹⁵ Ibid, [10].

⁹⁶ Ibid

⁹⁷ Corporations Act, s 601FD(1)(b) and (f)(iii) and (iv).

⁹⁸ *Trilogy*, (n 11), [929].

scheme's mandated policies and procedures',⁹⁹ putting them in breach of their statutory duties. As a result of their conduct, the scheme members suffered loss when the borrower, to whom the facility was provided without Credit Committee approval, went into external administration and could not repay the facility.

C. *Case Study 3 – Prime Retirement and Aged Care Property Trust ('Prime Trust')*

Australian Property Custodian Holdings Limited ('APCHL') was the RE of the Prime Trust. Prime Trust owned retirement villages. The investment strategy was to provide monthly income distributions to unit holders as well as the maintenance and accrual of capital gains to the assets of the Trust.¹⁰⁰ Prime Trust was listed on the ASX in 2007.¹⁰¹ In 2010, Prime Trust collapsed with 10,000 'mum and dad investors' losing \$550m.¹⁰²

When the directors considered the plan to list Prime Trust, they proposed introducing new fees, including a listing fee, to be paid to the RE out of scheme property. They obtained legal advice on whether they could do this. However, this advice merely referred to the two methods of amending the constitution. The lawyers did not advise which of those methods was the appropriate one to amend the constitution to include these fees. Therefore, the advice could not be relied upon by the directors to amend the constitution without member approval.

Nevertheless, the directors resolved to amend the constitution to permit various fees to be paid out of scheme property. The RE thereby became entitled in its own right to, and was paid, a listing fee of \$33 million out of the scheme property, when the units in the Prime Trust were subsequently listed on the ASX in August 2007. The directors purportedly passed these resolutions pursuant to s 601GC(b) of the Corporations Act. This section permits a RE to amend the constitution if the RE reasonably considers that the change will not adversely affect members' rights. Otherwise, a special resolution of the members is required.

⁹⁹ Ibid, [1].

¹⁰⁰ *AIG Australia Ltd v Jaques* (2014) 44 VR 780, [15].

¹⁰¹ *Australian Property Custodian* (n 12), [54].

¹⁰² Australian Securities and Investments Commission 'High Court decision on Prime Trust directors' (Media Release 18-366MR, 4 December 2018).

The High Court held that the purpose of the amendment provisions was to protect the members.¹⁰³ Accordingly, although there was a power for the RE to amend, this power was intended to be confined to ‘circumstances that, considered reasonably, will not adversely affect the members’ rights unless the members so resolve’.¹⁰⁴ The protective purpose of the provisions, therefore, required a broad construction to be given to the notion of members’ rights.¹⁰⁵ Having regard to this protective purpose, the directors failed to reasonably consider that the amendments would not adversely affect members’ rights.¹⁰⁶ If the directors had known and understood their duties to members, they would have concluded that their actions were wrong. The primary judge said that the contraventions by one of the directors revealed ‘a plain lack of understanding of his duty to act in the best interests of the members, including to prioritise the Members’ interests in the event of a conflict of interest’.¹⁰⁷

D. Case Study 4 – Premium Income Fund (‘PIF’)

MFS Investment Management Ltd (‘MFSIM’) was the RE of the PIF.¹⁰⁸ MFSIM made a payment of \$147.5 million out of the scheme property of the PIF. This payment was alleged by ASIC to have been paid to related parties of MFSIM rather than for the benefit of the members of the PIF.¹⁰⁹ ASIC also alleged that the directors created false documents purportedly showing that these payments were for the benefit of the members of the PIF when they clearly were not.¹¹⁰ This was done in haste in an attempt to hide from the auditors and the bank, from whom MFSIM had borrowed funds, the previous misappropriations.¹¹¹ The documents were also backdated.¹¹²

The court said that the directors had used the PIF as a ‘slush fund’.¹¹³ The MIS was operated in the interests of the MFS Group of which MFSIM was a member rather

¹⁰³ *Lewski* (n 34), [52].

¹⁰⁴ *Ibid.*

¹⁰⁵ *Ibid.*

¹⁰⁶ *Australian Property Custodian* (n 12), [665]-[667] (at first instance) and *Lewski* (n 34), [32] on appeal to the High Court (Note: The decision of the Full Court of the Federal Court was overturned by the High Court).

¹⁰⁷ *Australian Property Custodian* (2014) (n 12), [381].

¹⁰⁸ *Managed Investments Ltd (No 9)* (n 22), [1]-[3].

¹⁰⁹ *Ibid.*, [4].

¹¹⁰ *Ibid.*, [5], [735].

¹¹¹ *Ibid.*

¹¹² *Ibid.*, [5], [449].

¹¹³ *Ibid.*, [972].

than in the interests of the investors. The court described the position as a 'sorry tale of the misuse of other people's money by those who should have known better'.¹¹⁴ This statement was a brief caption of the problem. Clearly, the directors were not fit and proper persons to be officers of a RE. They were treating 'other people's money' as their own.

The directors were found to have breached their duties to members of the PIF.¹¹⁵ This included their failure to act honestly,¹¹⁶ to act in the best interests of the members,¹¹⁷ not to make improper use of their position as an officer of the RE¹¹⁸ and to take all reasonable steps that a person in their position should take to secure compliance by the RE with the constitution and the Corporations Act.¹¹⁹

E. *Conclusions from Case Studies*

These cases illustrate that the legal and regulatory framework of the MIS failed to protect the retail investor because the officers acted in breach of their duties. They lacked the knowledge and understanding of what was expected of them in managing 'other people's money'. If they had the necessary knowledge and understanding expected of an officer of a RE, then the probabilities are that this would have caused them not to act in breach of their duties in this way, i.e., they would not have made such poor choices. This lack of knowledge and understanding of their duties meant that they were the wrong people to be in charge of managing 'other people's money', i.e., 'the fox was put in charge of the hen house'. In Kantian, terms they acted in self-interest rather than for the sake of duty.¹²⁰

¹¹⁴ Ibid, [1619]

¹¹⁵ *Managed Investments (No. 10)*, (n 34).

¹¹⁶ Corporations Act, s 601FD(1)(a).

¹¹⁷ Ibid, s 601FD(1)(c).

¹¹⁸ Ibid, s 601FD(1)(e).

¹¹⁹ Ibid, s 601FD(1)(f)(i) and (iii).

¹²⁰ Kant (n 1).

III. RESEARCH QUESTION 2 - HOW CAN THESE FAILURES BE REMEDIED? (I.E., WHAT THE 'LAW OUGHT TO BE)

A. Introduction

In answering Research Question 1, flaws have been identified in the effectiveness of the legal and regulatory framework with respect to the duties of officers in protecting retail clients. These flaws led to a consideration of what the 'law ought to be', generating propositions for reform that should eliminate these flaws and better protect the retail client.

The above case studies illustrate that the officers of a RE do not always comply with their duties. This is not so much a failure of the law but a failure of the regulated individuals to adhere to their duties to scheme members. The weakness in this regulatory regime is that it assumes officers of a RE will have a normative motivation or commitment to conform to the law.¹²¹ The case law illustrates that this normative approach is not sufficient to ensure compliance.

Further, based on deterrence theory, the penalties, the reputational damage and the liability for compensation should be sufficient to prevent bad behaviour by officers of the RE as key 'gatekeeper's' in the MIS structure.¹²² However, the substantial penalties have not acted as a deterrent to bad behaviour.¹²³ Flowing from the incompetent, unethical or illegal behaviour by directors are the substantial losses suffered by retail investors.¹²⁴

While the statutory duties of the officers of the RE to the members theoretically should protect the retail investor, as the above case studies illustrate, in practice, this is not always the case. For example, recently, retail investors, including retirees, not only lost their investment, but also their homes, which they had expected to live in rent-free for the rest of their lives.¹²⁵

¹²¹ Christine Parker, and Vibeke Lehmann Nielsen 'What do Australian Businesses Really Think of the ACCC and does it matter?' (2007) 35(2) *Federal Law Review* 187, 192-193.

¹²² Ibid, 192; ASIC also regulates on the basis of deterrence theory: Gilligan (n 49), 4.

¹²³ Hedges (n 55).

¹²⁴ Table 6.2 (Estimated Scheme Losses), page 384.

¹²⁵ *Theta* (n 34).

B. Compliance through Incentivisation – Role of Professionalisation and Education in causing compliance by RE officers with their duties to MIS members

The conclusion to be drawn from the above case studies is that greater emphasis needs to be placed on arriving at solutions that should cause officers of a RE to naturally adhere to the legislative standards of behaviour required of them, i.e., act for the sake of duty.¹²⁶ The remedies should be simple but practical, 'rather than by ever more detailed regulation which has as its (false) working assumption the ability exhaustively to define good faith, fiduciary responsibility, and behaviour in good commercial conscience'.¹²⁷

Character virtues may be learnt.¹²⁸ Therefore, through education and training, officers of the RE should be able to learn to act in accordance with Kant's categorical imperative, i.e., the officers will adhere to the legislative standards of behaviour despite any natural desires to the contrary.¹²⁹ Relevant educational pre-requisites for appointment would therefore be an essential element. In turn, this should lead to the retail client having trust and confidence in those who manage their money.¹³⁰

1. Current Regulatory Model

The current regulatory enforcement system is based on responsive regulation theory.¹³¹ The basic concept of this theory is that regulation will be more likely to be effective if it is responsive to the regulatory environment and the activities of the

¹²⁶ Kant (n 1).

¹²⁷ Allsop (n 27).

¹²⁸ Macintyre (n 62); Culham (n 62).

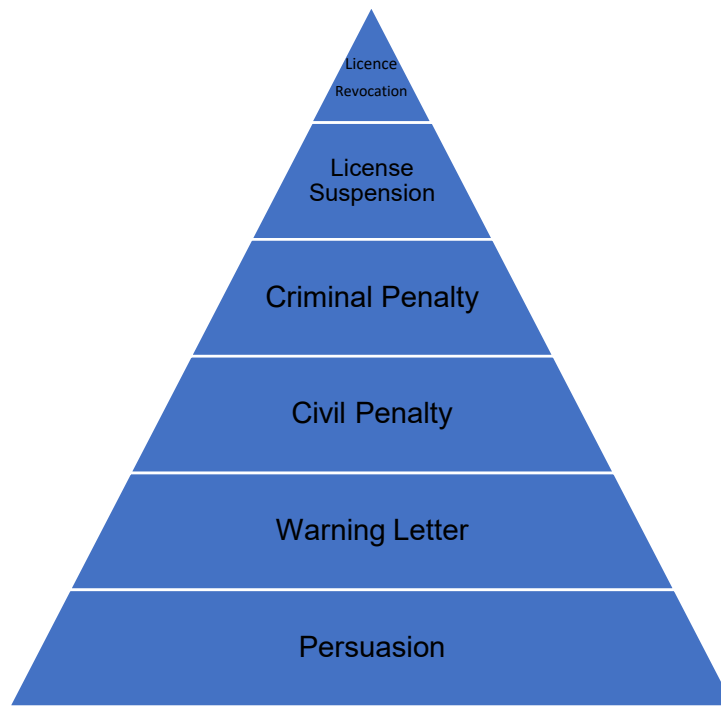
¹²⁹ Kant (n 1), 97.

¹³⁰ David G Millhouse, 'Corporate Governance in Non-Bank Financial Entities' (Reed International Books Australia Pty Ltd trading as LexisNexis, 2019), 18.

¹³¹ Ian Ayres and John Braithwaite, 'Responsive Regulation: Transcending the Deregulation Debate' (Oxford University Press, 1992); Hedges (n 55), 928; Parker (n 121), 195-196; ¹³¹ Nielsen, Vibeke Lehmann and Christine Parker, 'Testing responsive regulation in regulatory enforcement' (2009) 3 *Regulation & Governance* 376.

regulatee.¹³² It should not have an approach that is solely deterrent or solely cooperative.¹³³ Ayres and Braithwaite use a pyramidal model of enforcement.

Figure 3.1 - Ayres and Braithwaite Regulatory Pyramid¹³⁴



This model has both prescriptive and predictive content.¹³⁵ The prescriptive content is the vertical aspect of the pyramid. The level of sanctions commences at minimal levels at the base of the pyramid and increases in severity as they move vertically, with the most severe sanctions at the tip.¹³⁶ The predictive content is the horizontal aspect of the pyramid.¹³⁷ If the regulator follows the prescriptive aspect of the pyramid, the theory predicts that there will be an inverse correlation between the severity of the sanction or strategy and the frequency with which the sanction or strategy is applied,

¹³² Senate Economic References Committee *Performance of the Australian Securities and Investments Commission* (Final Report, 2014), [4.10]; Hedges (n 55), 929 citing Ayres and Braithwaite, (n 131).

¹³³ Vibeke Lehmann Nielsen and Christine Parker 'Testing responsive regulation in regulatory enforcement' (2009) 3 *Regulation & Governance* 376.

¹³⁴ Hedges (n 55), 931; Also see Figure 3.1 (Ayres and Braithwaite Regulatory Pyramid), page 351

¹³⁵ Hedges (n 55), 929-930.

¹³⁶ Ibid, 930.

¹³⁷ Ibid.

i.e., there will be more sanctions at minimal levels than the sanctions at the higher end of severity.¹³⁸

The problem with this model is that it is based on rational choice theory. This theory assumes that, because humans are rational, they will weigh up what they will gain if they break the law against what it will cost them if they are subject to sanctions for breaking the law.¹³⁹ There is no indication in any of the cases where officers have breached their duties that any consideration of this kind was made by the directors. For example, in *Healey*, the RE and its officers simply did not apply an ‘inquiring mind’ to their decision-making.¹⁴⁰ What happens if officers are, in fact, irrational actors? How does this regulatory model account for ‘the worrying capacity of human agents’ moral reflectiveness to concoct specious rationalisations’ to justify their immoral acts in order to exclude themselves from the supreme principle of morality?¹⁴¹ This phenomenon is exemplified by the case of convicted banker Kareem Serageldin, who justified his crime by asserting that it was in the interests of his employer to do so because of the financial turmoil at the time.¹⁴²

The model is also based on negative factors (i.e., punishment). No thought is given to whether, through positive action, directors can be incentivised to make appropriate choices. Kolieb has recognised this, arguing that ‘rule compliance’ is an ‘impoverished view of regulation’.¹⁴³ If regulation is appropriately conceived, then regulation is not limited to compliance mechanisms or enforcement of rules. Regulation must also include methods and mechanisms to encourage regulatees to go beyond compliance with legal rules to satisfy the goals of the regulation.¹⁴⁴ Therefore, while rule

¹³⁸ Ibid.

¹³⁹ Ibid.

¹⁴⁰ Gibson (n 79).

¹⁴¹ Hugh Breakey, ‘Building Ethics Regimes: Capabilities, Obstacles and Supports for Professional Ethical Decision-Making’ (2017) 40(1) *UNSW Law Journal* 322, 332 citing Immanuel Kant, ‘*The Moral Law: Kant’s Groundwork of the Metaphysic of Morals*’ (H J Paton trans, Hutchinson’s University Library, 1948).

¹⁴² Joe McGrath ‘Self-deception as a technique of neutralisation: an analysis of the subjective account of a white-collar criminal’ (2021) 75 *Crime, Law and Social Change* 415.

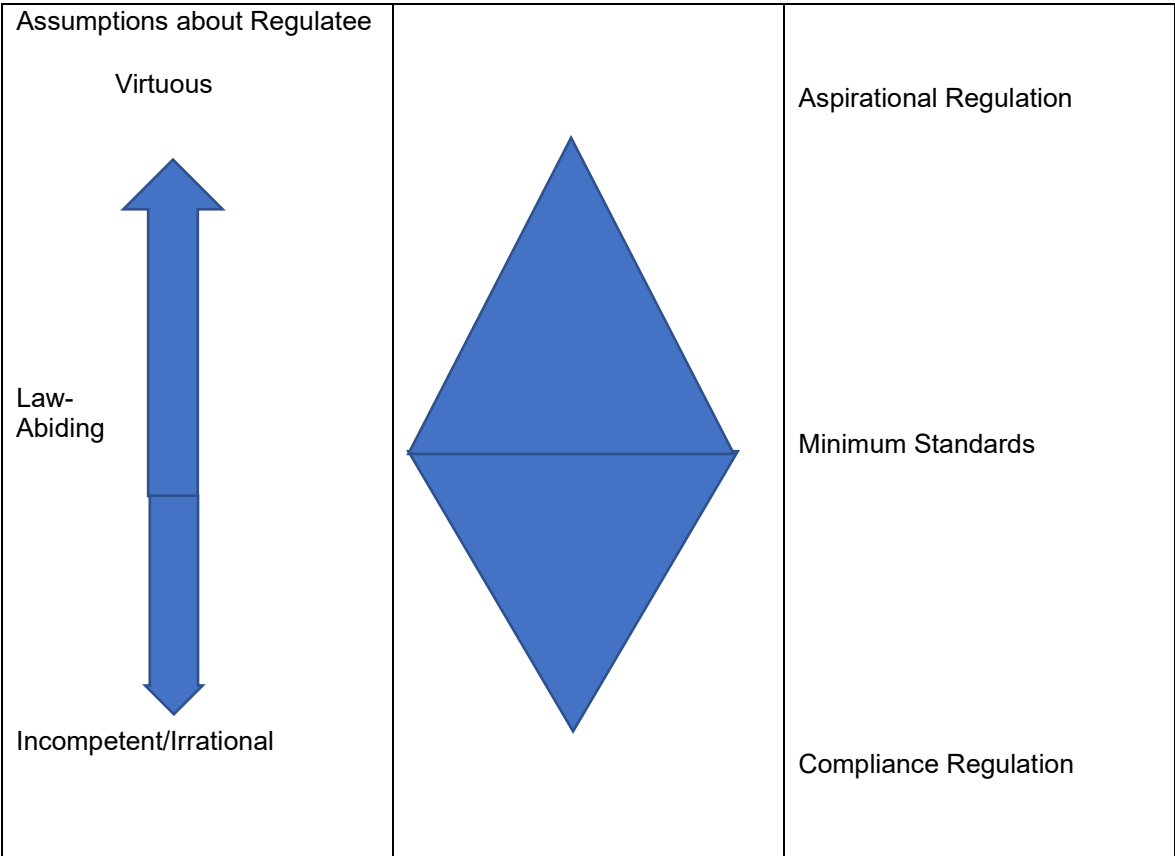
¹⁴³ Jonathan Kolieb, ‘When to Punish, When to Persuade and When to Reward: Strengthening Responsive Regulation with the Regulatory Diamond’ (2015), 41(1), *Monash University Law Review* 136, 137.

¹⁴⁴ Ibid citing Jonathan C Borck and Cary Coglianese, ‘Beyond Compliance: Explaining Business Participation in Voluntary Environmental Programs’ in Christine Parker and Viebeke Lehmann Nielsen (ed), ‘*Explaining Compliance: Business Responses to Regulation*’ (Edward Elgar, 2011), 139.

compliance may be an end goal, compliance with legal standards is not an endpoint but rather a waypoint to improve the behaviour of the regulatee.¹⁴⁵

Kolieb proposes an alternative diamond model.¹⁴⁶

Figure 3.2: The Kolieb Regulatory Diamond



The mid-line of the diamond represents the minimum standards of behaviour with the mechanisms to enforce those standards in the bottom half of the diamond and the mechanisms to encourage and incentivise adherence to higher aspirational behavioural goals which is the top half of the diamond.¹⁴⁷ The wide mid-sections represent mechanisms that are based on education and dialogue.¹⁴⁸ As you move downwards to the point where the regulation becomes more onerous, but upwards to

¹⁴⁵ Kolieb (n 143), 138.
¹⁴⁶ Ibid, 150; Figure 3.2 (The Kolieb Regulatory Diamond), page 348.
¹⁴⁷ Ibid, 151.
¹⁴⁸ Ibid, 152.

the point where the regulation becomes more rewarding.¹⁴⁹ The points represent the few who either ignore the legal standards or those who well exceed those standards, embracing exemplary conduct.¹⁵⁰ Through this regulatory diamond, one can see the role of law and its limitations.¹⁵¹ Incentivising good behaviour by the officers of REs is particularly important when the history of unacceptable behaviour by MIS industry participants causing significant losses to retail investors is considered.¹⁵²

Despite these models of responsive regulation, a difficulty with the model is accounting for the irrational behaviour that remains. Jones reviewed scholarly literature, which shows that the approach to risk by many corporate managers is dysfunctional. This then leads them to engage in self-destructive conduct.¹⁵³ In other words, not all human beings act rationally as assumed by rational choice theory.¹⁵⁴ This is an explanation for the deviant behaviour exhibited in the above case studies. Jones refers to studies which showed that, among other things, corporate managers had a higher rate of certain personality disorder traits than psychiatric patients and the criminally insane. In support of the results of these studies, Participant 1 in the Interview also considered that, in many cases, the offending officers had a psychological or personality disorder and may be sociopathic.¹⁵⁵

Jones argues that, although the number is small, it is not so insignificant that the problem can be ignored. This is because such affected corporate managers have the potential to cause significant damage.¹⁵⁶ This is particularly so when one considers the loss of 'other people's money' invested in the MIS described earlier in this thesis. Further, the various studies she reviewed indicated that many corporate executives may be more prone to reckless risk-taking than would be predicted by rational actor theory.¹⁵⁷ Jones therefore argues that corporate governance which is based on

¹⁴⁹ Ibid.

¹⁵⁰ Ibid.

¹⁵¹ Ibid.

¹⁵² See examples Table 6.2 (Estimated Scheme Losses), page 384.

¹⁵³ Renee M Jones, 'The Irrational Actor in the CEO Suite: Implications for Corporate Governance' (2017) 41(3) *Delaware Journal of Corporate Law* 713, 762.

¹⁵⁴ Hedges (n 55).

¹⁵⁵ Interview Transcript, page 467.

¹⁵⁶ Jones (n 153), 721.

¹⁵⁷ Ibid, 740.

rational actor theory needs to be rethought. Corporate governance policies that promote risk-taking and self-serving behaviour need to be avoided.¹⁵⁸

Confidence can be quickly eroded by expectation gaps between what the retail investor perceives to be the role of a 'gatekeeper' in the operation of MIS or the protections within the system and what is actually the case.¹⁵⁹ It is therefore important to ensure that only a person of good character is appointed as an officer of the RE. How can this be achieved?

2. *Professionalising the position of officers of the RE*

Dang and Mescher argue that the law alone cannot prevent breaches of the law.¹⁶⁰ So much is clear from the above case studies. However, good behaviours by officers of the RE could be achieved by professionalising their position.¹⁶¹

At present, no educational or experience are required to be an officer of a RE. Any adult, who can 'tick the boxes' to be a 'fit and proper person' can be an officer of a RE.¹⁶² The role is not particularly prestigious. This is so, even though the RE may be handling hundreds of millions of dollars of 'other people's money'. Elevating the role of a director of a RE to a professional status by increasing the entry level requirements, through imposition of educational and experience pre-requisites to appointment, should incentivise persons with good character to take on the role of an officer of the RE. Therefore, the behaviour of officers of the RE will be more likely to be in the direction of the aspirational point of Kolieb's regulatory diamond.

Consistent with the incentivisation regulatory diamond model of Kolieb and based on the philosophy of Aristotle, Mescher and Howieson, argue that professionalisation of the role of a company director should motivate directors to comply with the law. This should lead to the community having a higher regard for their position as a

¹⁵⁸ Ibid, 750.

¹⁵⁹ Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into the collapse of Trio Capital Report* (Report, May 2012) ('Trio Report'), [7.27]-[7.35].

¹⁶⁰ Nguyet Minh Dang and Barbara Mescher 'Directors and the Ethics Components of their Duties' (2010) 7(7) *Macquarie Journal of Business Law* 1, 6, 9.

¹⁶¹ Joe McGrath and Ciaran Walker 'Regulating ethics in financial services: Engaging industry to achieve regulatory objectives' (2023) 17, *Regulation & Governance* 791, 793 and 798.

¹⁶² Corporations Act, ss 913B(1)(c), 913BA(1)(b), 915C(1)(b).

professional. As part of that professionalisation of the role of director, they also argue that directors should be required to do whatever is necessary to carry out their duties to a high professional standard. This includes meeting minimum educational standards in meeting fit and proper person requirements.¹⁶³ This is particularly important where the person is an officer of a RE which has specific issues not relevant to companies generally, namely their duties to scheme members. Additionally, they argue that such educational standards should also include applied ethics.¹⁶⁴ This should create an ethical mindset leading to ‘law-abidingness for its own sake’.¹⁶⁵

3. *Application of Fit and Proper Person test*

An appropriate application of the fit and proper person test could also be applied to professionalise the role of the officer of an RE. The RE is required to be a public company that holds an AFSL that authorises it to operate a named scheme or particular kinds of scheme.¹⁶⁶ This gives ASIC substantial power and control over who should be authorised to operate a MIS.¹⁶⁷

Following the Hayne Royal Commission (‘Hayne’),¹⁶⁸ the Corporations Act was amended to require that officers of a corporate licensee (which includes a RE) pass a ‘fit and proper person’ test prior to the grant of, or variation to, the AFSL of the RE and thereafter on an ongoing basis.¹⁶⁹ The fit and proper person test was imposed on officers of corporate licensees because the fitness and propriety of a person occupying the position of an officer of a corporate licensee is relevant to ASIC’s decision-making power whether to issue an AFSL.¹⁷⁰ Therefore, by proper and stringent application of this test, ASIC can determine whether the proposed operator of a scheme and its officers are sufficiently trustworthy to operate the proposed

¹⁶³ Barbara Mescher and Bryan Howieson, ‘Beyond compliance: promoting ethical conduct by directors and corporations’ (2005) 1(1) *Corporate Governance Law Review* 93, 100-101.

¹⁶⁴ Ibid.

¹⁶⁵ Kant (n 1), 14.

¹⁶⁶ Corporations Act, ss 601FA; *Australian Olives Limited v Stout* [2007] FCA 1958; *Sandalwood Properties Ltd (Subject to a Deed of Company Arrangement) v Huntley Management Ltd* [2018] FCA 1502.

¹⁶⁷ Corporations Act, Part 7.6.

¹⁶⁸ Hayne (n 58).

¹⁶⁹ Corporations Act, ss 913B(1)(c), 913BA(1)(b), 914B(2) and 915C(1)(b).

¹⁷⁰ Explanatory Memorandum to the Financial Sector Reform (Hayne Royal Commission Response - Stronger Regulators (2019 Measures)) Bill 2019, [4.14].

registered scheme, i.e., ASIC can ensure that the ‘fox is not put in charge of the hen house’.

Although the ‘fit and proper person’ test is largely prescriptive, there is a general requirement that ASIC can take into account ‘any other matter which ASIC considers relevant’.¹⁷¹ This test is not subject to any implied limitation to matters that may be considered by ASIC which are not specifically excluded.¹⁷² The only matter that ASIC must not take into consideration is spent convictions referred to in Part VIIC of the *Crimes Act 1914* (Cth) (‘Crimes Act’).¹⁷³ The purpose of the licensing scheme is to ensure that the relevant activities conducted under the licence are ‘performed by persons who are fit and proper to perform them, in order that the exposure and vulnerability of consumers is lessened’.¹⁷⁴ Despite the exclusion of the spent convictions in Part VIIC of the Crimes Act from consideration, the expression ‘any other matter which ASIC considers relevant’ is still a powerful requirement that, if applied appropriately by ASIC, would strengthen the protection of retail investors in MIS from harm.

The fit and proper person test has increasingly been used in other areas of life. For example, a person involved in the management of a higher education provider is required to demonstrate that they are a ‘fit and proper person’.¹⁷⁵ Various professionals are also required to satisfy this test, e.g., liquidators of corporations,¹⁷⁶ solicitors,¹⁷⁷ migration agents,¹⁷⁸ persons involved in education and care services for children,¹⁷⁹ tax agents,¹⁸⁰ and persons engaging in credit activities.¹⁸¹

The High Court in *Hughes and Vale Pty Ltd v New South Wales (No. 2)*,¹⁸² considered the meaning of ‘fit and proper person’, which, although in another context, is equally

¹⁷¹ Corporations Act, s 913BB(2)(k).

¹⁷² *Frugtniet v Australian Securities and Investments Commission* [2016] FCA 995; *Frugtniet v Australian Securities and Investments Commission* (2017) 255 FCR 96.

¹⁷³ *Frugtniet v Australian Securities and Investments Commission* (2019) 266 CLR 250.

¹⁷⁴ *Frugtniet* (Full Court)(n 172), [35].

¹⁷⁵ *Tertiary Education Quality and Standards Agency Act 2011* (Cth), s 7A.

¹⁷⁶ Corporations Act, Schedule 2, s 20-20(4)(h).

¹⁷⁷ *Legal Profession Uniform Law NSW*, ss 17 & 45.

¹⁷⁸ *Migration Agents Regulations 1998* (Cth), reg 9N(2).

¹⁷⁹ *Children (Education and Care Services National Law Application) Act 2010* (NSW), s 8(b).

¹⁸⁰ *Tax Agent Services Act 2009* (Cth), s 20-5.

¹⁸¹ *National Consumer Credit Protection Act 2009* (Cth), s 80.

¹⁸² *Hughes and Vale Pty Ltd v New South Wales (No. 2)* (1955) 93 CLR 127.

applicable here. Their Honours Dixon CJ and McTiernan, and Webb JJ, in a joint judgment, held that:

The expression 'fit and proper' is of course familiar enough as traditional words when used with reference to offices and perhaps vocation. But their very purpose is to give the widest scope for judgment and indeed for rejection. 'Fit' (or 'idoneus') with respect to an office is said to involve three things, honesty, knowledge and ability: honesty to execute it truly, without malice affection or partiality; knowledge to know what he ought duly to do; and ability as well in estate in body, that he may intend and execute his office, when need is, diligently, and not for impotency or poverty neglect it.¹⁸³

Satisfying the requirement to be a 'fit and proper person', therefore, should be more than a box-ticking exercise by ASIC. The attributes of the person must comprise not only 'honesty' but also 'knowledge and ability'.

Therefore, professional qualifications should be, but presently are not, an attribute in satisfying the 'fit and proper person' test. ASIC, through a proper application of the 'fit and proper person' test, could ensure that officers of a RE meet minimum standards of education, experience and character. This would increase the probabilities that such officers should act legally and ethically and not breach their statutory duties.¹⁸⁴

4. *The role of ethics in assisting compliance with the law*

Hanrahan defines ethical behaviour as 'people acting in accordance with the rules or standards for right conduct or practice in the context.'¹⁸⁵ Hanrahan argues that ethical behaviour by regulated entities and their operators is necessary if regulation is to achieve the goals of the regulator which for ASIC is market integrity and consumer protection.¹⁸⁶ Hanrahan also points out that legal rules cannot cover the whole field of conduct because the legal rules have gaps.¹⁸⁷ Hanrahan argues that an important function of the regulatory system is to invite operators of the MIS to fill the gaps by

¹⁸³ Ibid, [9].

¹⁸⁴ MacIntyre (n 62), 154.

¹⁸⁵ Pamela F Hanrahan 'Regulation, Ethics and Collective Investments' in MacNeil, Iain G, & O'Brien, Justin. (Eds.) *The Future of Financial Regulation* (Bloomsbury Publishing Plc, 2010) 331, 334.

¹⁸⁶ Ibid, 333.

¹⁸⁷ Ibid.

reference to a particular ethical model.¹⁸⁸ Without ethical behaviour by the officers of a MIS, these gaps will not be filled thereby inviting repeated failures of MIS as described in Chapter 1 through improper behaviour by officers slipping through the gaps.

From an ethical stand point, Kantian philosophy would hold that as long as an officer of the RE as a moral being holds to the categorical imperative, i.e. they act only according to that maxim by which you can at the same time will that it should become a universal law,¹⁸⁹ the officer will act out of duty rather than self-interest.¹⁹⁰ Such behaviour should then cover the gaps in the regulation of the MIS.

This role of ethics in regulating conduct does not rely upon disclosure, transparency or information asymmetry. Rather ethical behaviour may in a particular context require the ethical or moral person to disclose, be transparent or address information asymmetry even if that is contrary to self-interest.

If a person is to be a fit and proper person to manage 'other people's money', there should not only be strict adherence to the law but also ethical conduct. This is because the relationship of the RE with the investor involves trust and confidence. Something may be legal, but is it morally or ethically right when the retail investor is in a position of disadvantage to the manager of their money and relying upon their decision-making?

The case studies illustrate that the law, of itself, is not sufficient to prevent improper behaviour by officers. Something more is required. If officers were instinctively able, through education and training, to make good ethical or moral choices, this would lead to compliance with the law. They would instinctively act for the sake of duty rather than self-interest.¹⁹¹ Such conduct will fill the gaps in the law rather than rely upon the gaps to benefit themselves.

Ethics is important in the context of officers of a RE dealing with other people's money. It has been suggested that a 'good way to prevent fraud from occurring in the

¹⁸⁸ Ibid 339.

¹⁸⁹ Kant (n 1).

¹⁹⁰ Ibid.

¹⁹¹ Ibid.

first place is to have a strong and ethical tone at the top'.¹⁹² Further, it has been observed that 'If you aren't deliberately and systematically embedding ethical considerations into your organisational strategy and decision-making, you're playing a dangerous game of chicken'.¹⁹³

Business ethics has been described as 'individual behaviour that is subject to or judged according to generally accepted moral norms of behaviour'.¹⁹⁴ Ethics encompasses 'the social norms and expectations that guide judgment in a particular setting'.¹⁹⁵ Unethical behaviour is therefore conduct that is unacceptable to the mores of the community.¹⁹⁶ As noted by Longstaff:

[e]thics both informs the law and goes beyond its limits. For the most part, law sets boundaries for what may or must be done. Ethics concerns what should be done – even if not required or prohibited by law. Directors will often seek legal advice about what can be done. Whether or not to approach or cross the limits of the legal 'envelope' of possibilities is an ethical question. The fact that something can be done does not mean that it should be done.¹⁹⁷

The application of ethical principles in business should enable a participant (such as an officer of a RE) to discover what, in particular circumstances, is the moral foundation of a particular law. This should encourage participants to apply the spirit of the law in those circumstances.¹⁹⁸ As concluded by Mescher, ethics assists compliance with the law.¹⁹⁹

¹⁹² Megan Connell, 'The Fall of Enron and the Creation of the Sarbanes-Oxley Act of 2002' (2017) *HON499 projects* 19, 5; Bahram Soltani 'The anatomy of corporate fraud: A comparative analysis of high profile American and European corporate scandals' (2014) 120(2) *Journal of Business Ethics* 251.

¹⁹³ Annamarie Rooding 'Why ethical considerations are crucial to legal compliance' *Lawyers Weekly* 17 May 2022.

¹⁹⁴ Linda K Trevino, Gary R Weaver and Scott J Reynolds, 'Behavioral ethics in organizations: A review.' (2006) 23(6) *Journal of Management*, 32, 952.

¹⁹⁵ John A Pearce II 'Using Social Identity Theory to Predict Managers' Emphases on Ethical and Legal Values in Judging Business Issues' (2013) 112 *Journal of Business Ethics* 497, 499.

¹⁹⁶ Thomas M Jones, 'Ethical decision-making by individuals in organisations: An issue-contingent model' (1991) 16(2) *Academy of Management Review* 366.

¹⁹⁷ Simon Longstaff. Forward in '*Ethics in the Boardroom - A decision-making guide for directors*' (Australian Institute of Company Directors, October 2019).

¹⁹⁸ Barbara Mescher 'Business Ethics and the Law of Contract' (2009) 8(2) *Journal of Law and Financial Management* 8, 9.

¹⁹⁹ Ibid.

Dang and Mescher argue that it is essential for legal compliance and good corporate governance that officers understand the ethical component of their legal responsibilities.²⁰⁰ They further argue that ethics is not optional. If officers believe that the law is merely rules without regard to ethics, this may cause them to act in accordance with that with which they can get away rather than in accordance with standards of moral responsibility.²⁰¹ On the other hand, if the officers believe that the law is more than just rules but involves moral imperatives in accordance with societal norms these rules should be internalised thereby resulting in greater compliance.²⁰²

In Kantian philosophical terms, there will be things that officers of a RE will recognise are required of them (e.g., their duties to scheme members) irrespective of what they really desire to do. So, for example, although the officer may want to buy an asset of the MIS at a discount because of the financial reward, the officer will not do this because the officer recognises that they ought rather to comply with the law (the ‘Categorical Imperative’ of Kant) because they are dealing with ‘other people’s money’.

Aristotle argues that being virtuous is a state that arises not so much from reason but is acquired through effort and practice over time similar to the acquisition of other skills.²⁰³ A circular process of habituation takes place whereby a person becomes just by doing just actions and by being just will do just actions (which is continuously repeated in a circular motion).²⁰⁴ MacIntyre similarly argues that:

- ‘intellectual virtues are acquired through teaching’, and
- ‘the virtues of character [are acquired] from habitual exercise’.²⁰⁵

²⁰⁰ Dang and Mescher, (n 160).

²⁰¹ Ibid, 5 citing S Stoljar, ‘*Moral and Legal Reasoning*’. (MacMillan Press, London, 1980), 139.

²⁰² Kim Peterson and Andrea Diss-Torrance ‘Motivation for compliance with environmental regulations related to forest health’ (2012) 112 *Journal of Environmental Management* 104, 106.

²⁰³ Mark Dimmock and Andrew Fisher ‘Ethics for A-Level’ (Open Book Publishers, 2017), 54.

²⁰⁴ Agnes Callard, ‘The Virtuous Spiral: Aristotle’s Theory of Habituation’ in Manuel Vargas (ed). and John M. Doris (ed), ‘*The Oxford Handbook of Moral Psychology*’ (Oxford University Press, 14 April 2022), [3.4]; Figure 3.3 (The Habituation Circle), page 349.

²⁰⁵ MacIntyre, (n 62); Alejo José G. Sison and Dulce M. Redín ‘If MacIntyre ran a business school... how practical wisdom can be developed in management education’ (2022) *Business Ethics* 274.

Consistent with the proposition that characters of virtue may be learnt, Moosmayer, Rocchi and Ferrero have developed a learning framework, based on the philosophy of MacIntyre, for character building that they describe as 'virtue as competence'. Their suggested framework develops whole-person competence both behaviourally and personally.²⁰⁶ They also suggest that this could be embedded in business school pedagogy.²⁰⁷

Education and training, therefore, are important components in preventing bad behaviour by officers of the RE in the handling of 'other people's money'. Through such education and training, officers of a RE should develop skills that enable them to act intuitively in a virtuous manner.²⁰⁸

Officers of a RE should therefore be required to have a knowledge of not only the law governing the operation of MIS but also ethics and how this assists compliance with the law and the moral imperatives underlying the law.²⁰⁹ This should also strengthen corporate governance.²¹⁰ Experience in ethical decision-making should develop good habits.²¹¹ Further, a board is a micro-community of people all of whom will have developed virtuous and ethical behaviours through education and training. This should cultivate and positively reinforce good behaviours by each director.²¹²

Dang and Mescher have a similar view. They argue that directors in their reflection process in decision-making should consider the core values of trustworthiness, respect, responsibility, fairness, caring and citizenship.²¹³ This, in turn, should aid character development of the officers, including moral virtues of loyalty, integrity, discipline and generosity.²¹⁴ Education should therefore aid moral development by

²⁰⁶ Dirk C Moosmayer, Marta Rocchi and Ignacio Ferrero 'Virtue as Competence: A Conceptual Integration of Competence Thinking with MacIntyrean Virtue Ethics' (2025) *British Journal of Management* 1; see diagram at Figure 3.4 (The virtue as competence learning framework), page 350.

²⁰⁷ Ibid, 13.

²⁰⁸ Culham (n 62).

²⁰⁹ Dang and Mescher, (n 160), 6.

²¹⁰ Ibid.

²¹¹ Ibid, 7 and 9.

²¹² Aaron Bruhna and Anthony Asher 'The primacy of ethics in the provision of financial advice' (2021) 61 *Accounting & Finance* 3305, 3323, citing MacIntyre (n 62).

²¹³ Ibid citing M Schwartz, 'Universal Moral Values for Corporate Codes of Ethics' (2005) 59(27) *Journal of Business Ethics* 30.

²¹⁴ Ibid.

‘explaining ethics, establishing values and applying ethical principles to some of the typical ethical problems in the commercial sphere’.²¹⁵ Officers of a RE need to be proactive in interpreting the ethical component of their duties. In turn, this should lead to decision-making that is done with integrity and meets community expectations.²¹⁶ Over time, by engaging in virtuous activity, moral virtue should be developed²¹⁷ and lead to instinctive adherence to the law.

Breakey also argues that ethics training should encourage law compliance. Firstly, ethics training can raise the sensitivity of the person to the considerations that arise in a particular circumstance.²¹⁸ Secondly, ethics training can improve a person’s reasoning process. It does this by illustrating in the person’s professional context how broad moral principles can give rise to specific duties. By doing so, the training should lead to the person being able to manage his or her way through conflicting ethical obligations.²¹⁹ Breakey further argues that professional virtues can be built up in individuals through university education.²²⁰ There is no reason why this cannot take place in any educational environment.

Based on social role theory, Hoyt, Price and Poatsy suggest that in positions of leadership, people’s ethical decision-making is partly driven by their understanding of the requirements of their leadership role. Their research indicates that leaders may be inclined to engage in unethical behaviours because of the social role expectations of goal attainment, which serve the group that they lead. They conclude that this expectation has the potential to contribute to ethical failures. The leadership role can be associated with an increased valuing of the group’s goals. This can result in the leader engaging in ethically questionable behaviour in the service of these goals.²²¹ In essence, according to social role theory, if the directors of a company see their leadership role as to increase the profits of the company above all else, because this

²¹⁵ Ibid.

²¹⁶ Ibid.

²¹⁷ Callard, (n 204) [3.3]-[3.4]; Figure 3.3 (The Habituation Circle), page 349.

²¹⁸ Breakey (n 141), 342.

²¹⁹ Ibid.

²²⁰ Ibid, 347.

²²¹ Crystal L Hoyt, Terry L Price and Laura Poatsy ‘The social role theory of unethical leadership’ (2013) 24(5) *The Leadership Quarterly* 712.

satisfies the social role expectations of goal attainment, which serves the company that they lead, there is a very real risk of unethical behaviour by the directors.

An example is revealed in a case study undertaken by Keneley of the downfall of AMP based on the evidence given at Hayne. AMP lost its moral compass, retreating from an organisation that prided itself on honesty and integrity to one of greed, being a 'profit-at-all-costs' mentality.²²² The social role expectations of goal attainment, which served AMP, were therefore anything that was required to boost profits. This led to the leadership thinking that this was the role they were to serve. As a result, unethical and illegal behaviour that was known to be prevalent was condoned by the leadership because it was in accordance with the social role expectations of AMP as a group. The conduct satisfied the group's goal. This developed into a 'lack of corporate will' to do anything about the bad behaviour.²²³ However, the leadership should have risen above this and acted as the captain driving the ship, not the ship guiding the captain. The 'gatekeeper' role did not work despite the reputational and litigation risk involved.

If the social role expectations of goal attainment, which serve the group that the directors lead, is compliance with the law and acting with honesty and integrity above all things, rather than profits at all costs, then according to social role theory, this should lead to officers of the RE adhering to their statutory duties to scheme members. This is because it meets the social role expectations of goal attainment, which serve the group, namely compliance with the law, honesty and integrity, rather than seeking profit above all other things.

The law regards corporate culture as important. Whether or not there is a 'culture of compliance' is a matter to which the courts may have regard when considering the imposition of penalties and other orders on corporations.²²⁴ In criminal matters, it is

²²² Monica J Keneley 'The shifting corporate culture in the financial services industry: Explaining the emergence of the 'culture of greed' in an Australian Financial Services Company', (2023) 65(4) *Business History* 583, 587.

²²³ *Australian Securities and Investments Commission v AMP Financial Planning Pty Ltd (No 2)* [2020] FCA 69, [178].

²²⁴ *Australian Securities and Investments Commission v Westpac Banking Corporation* [2019] FCA 2147, [258]; *AMP* (n 223), [160]; *Australian Securities and Investments Commission v MLC Nominees Pty Ltd* [2020] FCA 1306, [224]; *Australian Securities and Investments Commission v Firstmac Limited (Penalty Hearing)* [2025] FCA 12; [74].

also a factor in ascertaining attribution of fault to a body corporate.²²⁵ Although, as noted by Lee J, a ‘culture of compliance’ is an amorphous concept, nevertheless, whatever its meaning, ‘it must transcend simply putting in place expensive “systems” or it must be more than persons, whose titles include terms such as “governance” and “compliance”, declaiming platitudes’.²²⁶ Such a culture is more than box ticking and more than ‘robotic risk-averse managers and staff’.²²⁷ A ‘culture of compliance’ should predispose members of the company, including its leadership, to comply with the law and regulatory codes.²²⁸ In line with social role theory, the social goal attainment expectations of the RE should be to comply with law and regulatory codes. This should in turn drive leadership to behaviour that is in accordance with the law and in particular their statutory duties.

ASIC also considers corporate governance important.²²⁹ ASIC says that public companies should ‘adopt sound corporate governance practices that support market integrity and good investor outcomes’.²³⁰ There is also some research indicating that the level of corporate governance has a significant positive correlation with investor confidence.²³¹

How then can a ‘culture of compliance’ be developed within the organisational structure of the RE to ensure that its officers comply with their statutory duties, thereby avoiding harming the retail investor?

Social learning theory proposes that any form of behaviour can be learnt through a modelling process. The theory is that new patterns of behaviour may be learnt by watching others, which impacts previously learned behaviour by strengthening or weakening inhibitions. This is largely determined through observation of the rewards or punishments that accompany the behaviour. However, disinhibitory effects may

²²⁵ *Criminal Code Act 1995*, Schedule Part 12.3(1), (2)(c) & (d).

²²⁶ *AMP* (n 223), [2].

²²⁷ Robert French, ‘The culture of compliance - a judicial perspective’ (FCA) [2003] *FedJSchol* 16.

²²⁸ *Ibid.*

²²⁹ Greg Medcraft ‘*What ASIC expects of directors*’ (Speech, AICD, 24 June 2014).

²³⁰ John Price, ‘*What good looks like*’ (Speech, ASIC Governance Institute of Australia – Essential Legal and Regulatory Update, 6 April 2017), 6.

²³¹ Xiaolu Li, Jieji Lai and Jian Tang, ‘Study of the Influence of Corporate Governance Level on Investors’ Confidence’ (2016) 12(5) *Canadian Social Science* 8.

occur from observation of bad behaviour occurring without any adverse consequences.²³²

Ethical conduct in the workplace can also be positively influenced through ethics training.²³³ Weber argues that stimulating managers to become more 'other-oriented' in making business decisions with moral consequences can be achieved through the design of ethics training programmes.²³⁴ Brown, Trevino and Harrison consider that it is possible to train leaders to model behaviours that support ethical culture within an organisation that is in the best interest of that organisation.²³⁵ Brown and Chikeleze propose an ethical leadership development program that is circular, pursuant to which ethical leaders and leadership create an ethical culture within an organisation, which in turn demands and grows ethical leaders and leadership, which becomes self-sustaining.²³⁶ This is consistent with the habituation cycle of Aristotle referred to above.

The education and training of officers of a RE in ethics matters. Research undertaken by Kowaleski, Sutherland and Vetter considered nearly 1.2 million investment advisers and financial representatives working at US broker-dealers between 2007 and 2017. A comparison was made between those who qualified prior to 2010 and those who qualified from 2010 onwards, when there was a shift of the rules and ethics section to the technical material section. The rules and ethics section covered allowable forms of compensation, disclosure requirements and prohibitions of unethical business practices, while the technical section covered such topics as capital market theory, investment vehicle characteristics, ratios and financial reporting. Prior to the change in 2010, rules and ethics questions received an 80% weight. After the change, the questions were weighted only 50%. They discovered those passing the older exam

²³² Albert Bandura, *'Analysis of Modelling Processes'* (New York, NY: Routledge ed 1, 2021), 5-6.

²³³ OC Ferrell, John Fraedrich and Linda Ferrell *'Business Ethics: Ethical Decision-making and Cases'* (Houghton Mifflin Company, Boston, 2002), 444.

²³⁴ John A Weber, 'Business Ethics Training: Insights from Learning Theory' (2007) 70(1) *Journal of Business Ethics* 61.

²³⁵ Michael E Brown, Linda K Trevino and David A Harrison, 'Ethical leadership: A social learning perspective for construct development and testing' (2005) 97(2) *Organizational Behavior and Human Decision Process* 117.

²³⁶ Shannon Brown and Michael Chikeleze, 'A New Conceptual Model: Integrating Ethical Leadership into the Assess, Challenge and Support (ACS) Model of Leader Development' (2020) 19(4) *Journal of Leadership Education* 147.

were one-fourth less likely to be guilty of misconduct, including obvious offences such as fraud, theft or deception.²³⁷ The conclusion they reached was that the exam altered individuals' perception of acceptable conduct, not just their awareness of specific rules.²³⁸ This research indicates that ethics training may reduce the likelihood of an officer of an RE breaching their duties, finding that those advisers with greater rules and ethics training were 25% less likely to commit misconduct.²³⁹

The conclusion from this analysis is that, through education and training, the officers of a RE should not only develop intellectual virtues but also moral virtues, enabling them to adhere to the 'do no harm' philosophy in carrying out their duties and obligations.²⁴⁰ Officers should instinctively consider the harm that may be done to MIS members if they engage in unlawful and unethical behaviour. The officers will likely not 'make arbitrary decisions to use other people's wealth for their own interests'.²⁴¹ Rather, they will prefer the interests of members over their own interests.²⁴² In Kantian terms, investors will be treated as an end and not a means to an end.²⁴³

C. *Reforms flowing from the above analysis*

The conclusion from the case studies, the literature and the above analysis is that if the following reforms are made to the existing legal and regulatory framework of the MIS regarding the 'gatekeeper' role of the officer of the RE concerning their duties, this should strengthen the efficacy and efficiency of that framework. This should result in retail investors being better protected. This is because the officers of the RE who are appointed will have full knowledge of the law and ethical rules that apply to them as officers of the RE. In turn, this will enable and empower their decision-making to be fully informed and focused. Further, the changes to the law should ensure that the officer of the RE will be a type of person who takes their 'gatekeeper' role seriously

²³⁷ Zachary T Kowaleski, Andrew G Sutherland and Felix W Vetter, 'Can Ethics be Taught? Evidence from Securities Exams and Investment Adviser Misconduct' (2020) 138(1) *Journal of Financial Economics* 159.

²³⁸ Ibid.

²³⁹ Ibid.

²⁴⁰ Shan Turnbull, 'Causes and solutions for misconduct in the financial services industry' (2019) 13(2-3) *Law and Financial Markets Review* 99.

²⁴¹ Soltani (n 192), 270.

²⁴² ALRC Report 65 (n 40), [10.16]; Corporations Act, s 601FD(1)(c).

²⁴³ Kant (n 1), 27

without being unduly influenced by other factors such as greed and inappropriate remuneration incentives. Officers will be persons of good character rather than dysfunctional or sociopathic. No longer will the ‘fox be in charge of the hen house’. The natural response will be to act in the best interests of members.

1. *First Reform*

The first reform flowing from the case law, literature and the above analysis is to lift the entry level for a person to qualify to hold the position of an officer of a RE. No person should hold that position unless they hold industry-specific educational and experience prerequisites appropriate to the role of an officer of a RE. The educational qualifications should include studies in the legal and regulatory framework of the MIS (including the statutory duties of the RE and its officers), the principles of corporate governance, virtue ethics and professional responsibility of officers of a RE (which could be undertaken as a short Certificate IV course if not included in their existing educational qualifications).

The professionalisation of the financial services industry following Hayne,²⁴⁴ illustrates how this reform can work to the advantage of the retail investor. In March 2022, Treasury published an Issues Paper for comment.²⁴⁵ In that paper, Treasury noted that the professional standards reforms for financial advisors had created a higher bar and potential barrier for new entrants.²⁴⁶ In its submission to Treasury, the Joint Associations Working Group (‘JAWG’)²⁴⁷ argued that the recognition of professionalism was important for the enhancement of the reputation and health of the financial advice profession.²⁴⁸ JAWG further argued that this would increase consumer confidence and trust in the profession. JAWG noted that this professionalism was underpinned by, amongst other things, education standards and continuous CPD obligations.²⁴⁹ According to the JAWG, this professionalisation of the financial advice

²⁴⁴ (n 58).

²⁴⁵ The Treasury *Quality of Advice Review* (Paper, March 2022) (‘QAR’), 6.

²⁴⁶ Ibid.

²⁴⁷ JAWG comprised representatives of 12 key financial services industry and financial advice professional associations that represented more than 90% of advisers on the Financial Advisers Register and the majority of financial services firms.

²⁴⁸ Joint Associations Working Group, Submission to The Treasury, *Quality of Advice Review—Issues Paper*.

²⁴⁹ Ibid.

industry meant that the then-current regulatory regime was outdated and therefore a more principles-based approach was required that promoted sound professional judgement guided by professional standards.²⁵⁰

Similarly, the Financial Services Committee of the Business Law Section and the Superannuation Committee of the Legal Practice Section of the Law Council of Australia ('LCA') in their joint submission to Treasury recognised there had been a lifting in standards of the financial advice industry through the requirement for degree qualifications, passing compulsory examinations and compliance with a code of ethics.²⁵¹ In these circumstances, LCA submitted that this meant that participants in the industry were capable of exercising a degree of independent professional judgement.²⁵² Therefore, given the industry had evolved, LCA submitted that the obligations imposed should be more principles-based and less box-ticking.²⁵³

This reform to the existing legal and regulatory framework of the MIS regarding the officers of the RE as a 'gatekeeper' should result in officers of the RE adhering to their duties to scheme members. The result of the proposed reform is that the officers should adhere to their statutory duties to members as a matter of habit, i.e., act for the sake of duty, not self-interest, thereby strengthening the efficacy and efficiency of this aspect of the legal and regulatory framework for the MIS in protecting retail investors.

Firstly, the reform would incentivise the right type of person to accept such a position, which, as seen above, is important for an organisation that manages 'other people's money'. This is because the professionalisation of the position would cause the position to be highly regarded both by the officer and society. This reform is also consistent with the Kolieb diamond regulatory model referred to above. These entry-level requirements for a person to hold the position as an officer of a RE have worked for the financial advice industry, so logically it follows that this should also occur with the officers of a RE.

²⁵⁰ Ibid.

²⁵¹ Law Council of Australia, Submission to The Treasury, *Quality of Advice Review—Issues Paper* (10 June 2022).

²⁵² Ibid.

²⁵³ Ibid.

Secondly, this reform should remove from the industry people with poor personality traits. At the present time, someone with a good idea can set up a RE and be an officer with no qualifications or experience. The only requirement is for the officer to be a 'fit and proper person'. As currently administered by ASIC, the 'fit and proper person' test does not require an officer of the RE to hold any qualifications or experience. This reform should make it more difficult for the wrong sort of person to be appointed as an officer of the RE and therefore should reduce the likelihood of the 'fox being put in charge of the hen house'. This is exemplified by the entry-level requirements for the financial advice industry, which has reduced the numbers in that industry from 28,561 in January 2019 to 17,492 in February 2022.²⁵⁴ This has resulted in the removal from the industry of persons who should not be giving financial product advice. The same should apply to this reform regarding officers of the RE.

Thirdly, ethical judgment requires the person to first identify that there is an ethical implication to their decision-making.²⁵⁵ Without the ability to make that identification through a lack of training in ethical issues, the officer will be unable to formulate an appropriate response. Therefore, ethical training should assist the officer of the RE to make correct legal and ethical choices. This reform would be consistent with the current 'gatekeeper' model of the MIS because the reputational risk will be higher for officers of the RE than currently is the case.

Fourthly, this reform should improve the business environment within which the appointed officers work. By improving the 'tone at the top', the application of social learning theory means that this should improve the legal and ethical performance of the whole organisation.²⁵⁶

Fifthly, this reform should make it less likely for officers to breach their statutory duties to MIS members because the officers of the RE will have full knowledge of the law and should therefore have internalised their ethical obligations to others, developing good character.

²⁵⁴ QAR (n 245), 7.

²⁵⁵ Pearce (n 195), 499.

²⁵⁶ Connell (n 192); Hayne (n 58), 335; Keneley (n 222), 600-601 citing Soltani (n 192).

Survey Results

This results of the survey regarding this reform to the law was mixed. On the one hand overall, the respondents were positive regarding the effect of educational qualifications on making the position more professional agreeing that:

- (a) if there was a requirement for officers of the RE to hold industry-specific qualifications, including studies in corporate governance and ethics:
 - (i) 51.9% of respondents agreed that this would make the position of officer of an RE more professional, and,
 - (ii) 7.4% of respondents agreed it would make the position more attractive,while only
 - (iii) 18.5% of respondents agreed this would make the position less attractive, and
 - (iv) 22.2% of respondents agreed it would make no difference,²⁵⁷

but on the other hand regarding the effect of educational qualifications on compliance culture the respondents were less positive and evenly divided agreeing that:

- (b) if there was a requirement for directors of the RE to hold industry-specific qualifications, including studies in corporate governance and ethics:
 - (i) 40.7 % of respondents agreed that this would improve the compliance culture of the organisation,
 - (ii) 33.3 % of respondents agreed that this would enhance the protection of retail investors,

²⁵⁷ Survey Results, Q10, page 412.

Survey Results

(iii) 22.2% of respondents agreed that it would make it less likely that there would be breaches of duties by the officers of the RE,²⁵⁸

although,

(iv) 40.7% of respondents agreed that it would make no difference.

However, despite the mixed result above, significantly,

(a) 80.8% of respondents agreed that their organisation carried out independent vetting of directors as to their suitability to act as a director,²⁵⁹

(b) 92.6% of respondents agreed that their organisation required directors to hold minimal professional standards (e.g., education and experience) as a condition of appointment,²⁶⁰

(c) 74.1% of respondents agreed that their organisation required directors to have experience in the operation of registered schemes as a condition of appointment,²⁶¹

(d) 74.1% of respondents agreed that their organisation required directors to undertake annual CPD,²⁶²

(e) 96.3 % of respondents agreed that their organisation already had guidelines to ensure that their directors were fit and proper persons,²⁶³

²⁵⁸ Ibid Q11, page 411.

²⁵⁹ Ibid Q5, Page 407.

²⁶⁰ Ibid Q7 408.

²⁶¹ Ibid Q8, 409.

²⁶² Ibid Q9, 410.

²⁶³ Ibid Q6, 407.

The Second Participant in the Interview was strongly in favour of officers being educationally qualified for the position and being more than just RG 146 compliant. He said he was qualified in law, tax and financial services and undertook annual CPD.²⁶⁴

2. Second Reform

Linked to the first reform, the second reform flowing from the above analysis is that every officer of a RE should be required to undertake compulsory annual continuing professional development ('CPD') in MIS law, corporate governance, virtue ethics and professional responsibility of officers of a RE. This would be consistent with the professional status of the position resulting from the first reform and ensure that officers are kept up to date with the legal requirements and remind them of the ethical issues involved in their decision-making. This requirement is regarded as important with numerous professions such as financial advisers,²⁶⁵ lawyers,²⁶⁶ tax agents²⁶⁷ and registered health practitioners.²⁶⁸

This proposed reform to the law is supported by the following Survey results.

Survey Results
74.1% of respondents agreed that the directors of their organisation were required to undertake annual CPD. ²⁶⁹

Both of these reforms could be instituted by ASIC as part of its administrative functions as the regulator of registered schemes and licensing. ASIC, through a more rigorous application of the existing 'fit and proper person' test as discussed above, could require an officer of a RE to meet the above professional standards, including annual CPD. There is no reason why the fit and proper person test cannot be applied in this manner because this test is directed at ensuring the proposed officers are fit

²⁶⁴ Interview Transcript, page 471.

²⁶⁵ Corporations Act, s 921D.

²⁶⁶ *Legal Profession Uniform Continuing Professional Development (Solicitors) Rules 2015* (NSW).

²⁶⁷ *Tax Agent Services Act 2009*, s 20.5.

²⁶⁸ *Health Practitioner Regulation National Law 2009* (NSW)

²⁶⁹ Survey Results, Q9, page 411

and proper persons to perform their duties, ‘in order that the exposure and vulnerability of consumers is lessened’.²⁷⁰ Alternatively or in addition thereto, ASIC could make it a condition of the RE’s licence that the RE’s officers must meet the requirements referred to in the first reform and continue to meet the second reform on an ongoing basis.²⁷¹

Licensees already have a general obligation to maintain the competence to provide the financial services covered by their licence.²⁷² Further, they have a duty to act ‘efficiently, honestly and fairly’.²⁷³ This connotes a requirement of competence.²⁷⁴ Administering the fit and proper person test in the above manner would also be consistent with, and is justified by, these existing obligations imposed on a RE as a licensee. If ASIC has reason to believe that the licensee is not complying with its general obligations, ASIC has the power to take administrative action, which could include suspending or cancelling the RE’s licence, or imposing additional licence conditions.²⁷⁵ While this general competence provision is currently applied by ASIC to responsible managers (‘RMs’),²⁷⁶ there is no reason why it cannot be similarly applied to officers of the RE.

Further, it has also been held that the general obligation of a licensee to act ‘efficiently, honestly and fairly’ requires that the licensee must have sound ethical values and judgement when dealing with clients (e.g., the scheme members).²⁷⁷

Further, the word ‘honestly’ in that general obligation includes being ‘ethically

²⁷⁰ *Frugtniet* (FCA) (n 172), [45].

²⁷¹ Corporations Act, s 914A.

²⁷² *Ibid*, s 912A(1)(e).

²⁷³ *Ibid*, s 912A(1)(a).

²⁷⁴ *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* [2012] FCA 414, [69] citing *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661, 672; followed in *Australian Securities and Investments Commission v Cassimatis* (No 8) [2016] FCA 1023, [674]; *Australian Securities and Investments Commission v Westpac Banking Corporation (No 2)* [2018] FCA 751, [2347], *Australian Securities and Investments Commission v AGM Markets Pty Ltd (in liquidation) (No 3)* [2020] FCA 208, [507]-[510]; *Australian Securities and Investments Commission v MLC Nominees Pty Ltd* [2020] FCA 1306, [69]-[70]; *Australian Securities and Investments Commission v MobiSuper Pty Ltd* [2021] FCA 855, [38]; *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2023] FCA 1150, [52]; *Australian Securities and Investments Commission v Macquarie Bank Limited* [2024] FCA 416, [46].

²⁷⁵ Corporations Act, s 915C(1).

²⁷⁶ *Australian Securities and Investments Commission AFS licensing: Organisational competence* (Regulatory Guide 105, 27 July 2020), [RG 105.1]-[RG105.18].

²⁷⁷ Cases at (n 274).

sound'.²⁷⁸ Therefore, requiring officers of an RE to undertake the ethical training suggested above should ensure that REs comply with this general obligation currently imposed on them as a licensee.

These proposed reforms would also be consistent with reforms made following Hayne,²⁷⁹ to raise the education, training and ethical standards of financial advisers who give personal advice.²⁸⁰ Given the important role of the officer of a RE as a 'gatekeeper' in the MIS model, which is a part of the Australian financial services industry, there is no reason why the officer should not have similar obligations imposed on that officer as apply to financial advisers. The administrative requirements to ensure that an officer of a RE is a 'fit and proper person' to hold that position both initially and on an ongoing basis are straightforward and only require minor adjustments to the existing regime.

Officers of a RE need to be vigilant, aware of their obligations, fully informed and ethical in all decisions they make.²⁸¹ Therefore, the requirement for a person to be appointed as an officer of a RE to undertake compulsory training in MIS law, corporate governance, ethics and professional responsibility of officers of a RE and for all officers of a RE to undertake ongoing CPD would be an important but simple change to boost retail investor confidence in the management of their investments and reduce the types of failures referred to in section II above.

The introduction of this educational requirement is consistent with the increasing focus on the importance of corporate governance regarding listed entities. For example, before a MIS may be listed on the ASX, it must provide a statement disclosing on a 'if not, why not' basis the extent to which it will follow, at the date of its admission to the official list, the recommendations set by the ASX Corporate Governance Council.²⁸²

Once listed, the MIS must include in its annual report a corporate governance statement (or provide the URL of the page on its website where the corporate

²⁷⁸ *Camelot* (n 274), [69]-[70].

²⁷⁹ (n 58).

²⁸⁰ *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth).

²⁸¹ Lisa Barnes, 'The Albatross Around the Neck of Company Directors: A Journey Through Case Law, Legislation and Corporate Governance' (2013) 12(2) *Journal of Law and Financial Management* 2, 9.

²⁸² Condition 16 of ASX Listing Rule 1.1.

governance statement is located) that discloses the extent to which the company or MIS has followed the recommendations set by the ASX Corporate Governance Council during the reporting period and if the MIS has not followed a recommendation for any part of the reporting period, its corporate governance statement must separately identify that recommendation and the period during which it was not followed and state its reasons for not following the recommendation and what (if any) alternative governance practices it adopted in lieu of the recommendation during that period.²⁸³

IV. RESEARCH QUESTION 3 - ON THE BALANCE OF PROBABILITIES,
WILL THE PROPOSED REFORMS TO ADDRESS THESE FAILURES
CAUSE REs TO ABANDON THE RETAIL MARKET THEREBY
RESTRICTING INVESTMENT CHOICE BY RETAIL CLIENTS

The above reforms to professionalise the position of the officer of the RE are designed to address the failures which have occurred regarding the statutory duties of officers to MIS members, and should not, on the balance of probabilities, cause REs to abandon the retail market. The reforms will only require REs to adjust their recruitment program for the appointment of officers to attract the right candidates to the position. The ongoing CPD is not expensive. Other professions do not have to spend more than \$2,000-\$3,000 per annum to attend such sessions. The expenses are also tax-deductible.²⁸⁴ Further, the professionalisation of the position of the officer of the RE will also be a 'value-add' for the RE. This is because the officers the RE engages will have full knowledge of the legal and regulatory framework of the MIS, designed to protect the retail investor, and who are ethical in their decision-making. This should result in the cost-benefit ratio of the reforms favouring the benefit over its cost.

Firstly, the reforms should reduce the risk of the RE and its officers being in breach of their duties regarding the MIS, which they operate. This is because the officers will be armed with the body of knowledge necessary to ensure that any proposed action by the RE complies with the legal and regulatory framework for MIS and acts accordingly. In addition, the officers of the RE should instinctively act in an ethical fashion for the

²⁸³ ASX Listing Rule 4.10.3.

²⁸⁴ *Income Tax Assessment Act 1997*, s 8-1(1).

benefit of the retail investors because of the internalisation of the principles of law and ethics obtained through their educational and ethics training. The consequent reduction of risk to the RE in its operation of MIS should reduce the prospects of the RE having to defend any regulatory response or class action by retail investors for the loss and damage suffered by them. The costs of such actions will be avoided. In turn, this will avoid reputational damage, the cost of which can be fatal to any business, as evidenced by the fall from grace of AMP.²⁸⁵ This reduction in risk should also result in a reduction of claims and premiums for professional indemnity insurance.

Secondly, the reduction in risks created by the professionalisation of the officer's position should induce confidence in the retail investor.²⁸⁶ This should lead to the funds operated by the RE being more attractive to retail investors, thereby increasing the investment from such investors in those funds. The professionalisation of the financial advice industry through the imposition of minimum training and ethical standards was considered by the Government to be necessary to improve consumer outcomes and increase public confidence.²⁸⁷ Similarly, the professionalisation of the position of officer of the RE should also improve consumer outcomes and therefore increase public confidence. This should, in turn, lead to the attraction of more investment in the MIS.

Thirdly, operating a retail fund based on principles of good corporate governance may also have a major positive impact on the performance of the fund.²⁸⁸ Therefore, this should act as an incentive for REs to support the proposed reforms because it should also drive fund performance, thereby increasing the value of the fund and attracting more investors.

Although it may be preferable to legislate the proposed reforms along similar lines to Subdivision A of Division 8A of Part 7.6 of the Corporations Act, the proposed reforms can be implemented under the present provisions of the Corporations Act. This can be effected by ASIC making adjustments to how it administers the 'fit and proper person'

²⁸⁵ Keneley (n 222).

²⁸⁶ Millhouse (n 130).

²⁸⁷ Explanatory Memorandum to the Corporations Amendment (Professional Standards Financial Advisers) Bill 2016, [1.14].

²⁸⁸ K Smimou, 'Corporate culture, ethical stimulus, and managerial momentum: Theory and evidence' (2020) 29(2) *Business Ethics*, 360 [2.2.3].

test to include education and training standards. Arguably, an officer who does not have the appropriate education and training standards necessary to carry out their role as an officer of the RE is not a fit and proper person to hold that position.²⁸⁹ Currently, officers of a RE can be the subject of a banning order by ASIC if ASIC has reason to believe that the person is not adequately trained, or is not competent, to perform one or more functions as an officer of a RE.²⁹⁰

The satisfaction of the fit and proper person test in the manner suggested in the above reforms is also consistent with the RE's general obligation as a licensee to ensure that the financial services covered by its licence (which includes the operation of the MIS) are provided efficiently honestly and fairly as well as maintaining the competence to provide those services.²⁹¹ REs and their officers should already be familiar with their existing duties. Therefore, the application of this existing requirement in the manner proposed should not significantly add to the cost of the operation of the retail MIS.

If legislation were required, then the Government could simply bring officers of the RE within the regime that applies to financial advisers who give personal advice, subject to adjustment for the nature of the MIS.²⁹² It would not be new. There are precedents in legislation for a variety of professions which has not proven to be a hindrance to the entry level of those professions. Although there has been a decline in the number of financial advisers following the introduction of the training and ethics standards, this could simply be because those who have left the industry were not competent to provide personal advice.

It follows from this analysis that the benefits the RE will obtain from the implementation of the proposed reforms outweigh the costs. Therefore, on the balance of probabilities, the proposed reforms should not lead to REs abandoning the retail market.

²⁸⁹ Explanatory Memorandum to the Financial Sector Reform (Hayne Royal Commission Response - Stronger Regulators (2019 Measures)) Bill 2019, [4.14].

²⁹⁰ Corporations Act, s 920A(1)(da)(ii).

²⁹¹ Ibid, s 912A(1)(a) and (e).

²⁹² Ibid, Division 8A of Part 7.6.

Survey Results

This conclusion is supported by the results of the Survey with:

- 84.6% of respondents agreeing that their organisation would not reduce the availability of its products to retail investors if officers were required to hold industry-specific qualifications, including in MIS law and ethics.²⁹³
- 96.2% of respondents agreed that their organisation would not reduce the availability of its products to retail investors if officers were required to undertake annual CPD.²⁹⁴

²⁹³ Survey Results, Q70, page 450.

²⁹⁴ Ibid, Q73, page 451.

CHAPTER 4: COMPLIANCE PLAN, COMPLIANCE COMMITTEE AND COMPLIANCE PLAN AUDITOR AS 'GATEKEEPER'¹

'One can remain in technical compliance with the law but in breach of its moral framing'²

I. INTRODUCTION

As described in Chapters 1 and 3 above, the current legal and regulatory framework for collective investment schemes ('CIS') in Australia is built on compliance requirements and a series of 'gatekeepers'.³ Gatekeepers have been defined as persons who are 'charged with duties to safeguard the interests of others'.⁴ Consistent with this definition, the 'gatekeepers' in this governance framework are considered by ASIC to include the RE,⁵ the directors of the RE,⁶ the compliance committee ('CC'),⁷ and the compliance plan auditor ('CPA').⁸

'Gatekeepers' have an important role in the governance structure of the managed investment scheme ('MIS') for the protection of the retail client. Where 'gatekeepers' fail, there is a high probability of retail clients suffering loss. This is illustrated by the case studies in Chapters 1 and 3.

¹ Note: A shortened version of this chapter was published in 2024 as: Alan Jessup 'Treasury Review of the Regulatory framework for Managed Investment Schemes – Reforming Compliance Arrangements' (2024) 40 *Company & Securities Law Journal* 293.

² Justin O'Brien "'Because They Could": trust, integrity, and purpose in the regulation of corporate governance in the aftermath of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' (2019) 13:2-3 *Law and Financial Markets Review* 141, 143.

³ Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital* (Report, May 2012) ('Trio Report'), [9.17].

⁴ *Re Banksia Securities Limited (Rec & Mgr Apptd) (in liq) (No 2)* [2018] VSC 47, [3].

⁵ Parliamentary Joint Committee on Corporations and Financial Services *Statutory Oversight of the Australian Securities and Investments Commission: the role of gatekeepers in Australia's financial services system* (Report 3, July 2013), [1.5], [1.14], [2.95]; also see *Banksia* (n 4), [3] regarding the duties of a trustee for debenture holders described by the court as the statutory apex of the regulatory structure designed to protect the interests of debenture-holders which is analogous to the role of the RE with registered MIS.

⁶ John Price 'Monitoring the activities of companies in Australia' (Speech, Asia-Pacific Resources Conference 2014, 18 November 2014); Greg Medcraft 'What ASIC expects of directors' (Speech, AICD, 24 June 2014); Trio Report (n 3), [4.47].

⁷ Trio Report (n 3), [1.43]; Australian Securities and Investments Commission, *Funds management: Compliance and oversight* (Regulatory Guide RG 132, 23 June 2025), [RG132.189].

⁸ Trio Report (n 3), [4.47].

Although the RE is singularly responsible for the operation of the MIS,⁹ the combined operation of the compliance plan ('CP'),¹⁰ the CC¹¹ and the CPA are an important part of the governance arrangements for the MIS.¹² The CP and the CC in particular, are designed to address institutional risk.¹³ In addition, the CC and the CPA are 'gatekeepers'.¹⁴

Although a CC is not required if the board has an equal number of external directors, arguably, those external directors have an equivalent role to the CC. This arises from the form and context of the CC provisions in Chapter 5C.5 of the *Corporations Act 2001* (Cth) (Corporations Act).¹⁵ The purpose of having external directors was to bring a level of detached supervision to enhance corporate governance and significantly reduce compliance risk.¹⁶ The Survey results indicate that for the sample 90% of respondents, whose organisation did not have a CC, agreed that the external directors of the Board in their organisation took an active role in engaging with compliance issues.¹⁷

This supports the intended purpose of the provision and reflects the Australian Securities and Investments Commission's ('ASIC') view that external directors should be 'particularly vigilant and actively engaged with compliance issues', notwithstanding

⁹ *Corporations Act 2001* (Cth) ('Corporations Act'), s 601FB.

¹⁰ Ibid, Part 5C.4. This document, although of itself being inert, nevertheless acts as a gatekeeper because of its active role in ensuring compliance by the RE with the Corporations Act and the scheme's constitution. ASIC considers that it plays a 'fundamental role in the regulatory framework designed to protect retail investors' Australian Securities and Investments Commission, 'ASIC uncovers widespread compliance plan deficiencies in the managed investment industry' (Media Release 25-090MR, 2 June 2025; Australian Securities and Investments Commission, *Funds Management: Compliance and oversight* (Regulatory Guide 132, 23 June 2022, [132.17]).

¹¹ Corporations Act, Part 5C.5; NB: A compliance committee is not required if the RE has an equal number of external directors: Corporations Act, s 601JA: However, compliance committees still appear to be the favoured option. ASIC, in a review of 10 large REs having between them 38.8% (\$588 billion) of assets under management in registered MIS and 35.2% of all registered schemes on 30 June 2021 (1,273 registered schemes), found that 60% had a compliance committee: Australian Securities and Investments Commission 'Governance of responsible entities' (Presentation, January 2022) 1, 21.

¹² Corporations Act, s 601HG; the compliance plan auditor ('CPA') is an external and not an internal auditor.

¹³ *Woodcroft-Brown v Timbercorp Securities Limited (in liq)* [2011] VSC 427, [266].

¹⁴ *Banksia* (n 4), [3]; Trio Report (n 3), [1.43] and [4.47].; RG 132 (n 7).

¹⁵ Explanatory Memorandum to the Managed Investment Bill 1997 (EM MIB), [11.1] – [11.4].

¹⁶ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65,1993) ('ALRC Report'), [9.10].

¹⁷ Survey Results, Q30, page 425.

that this is not expressly legislated.¹⁸ Although research results are mixed on the effect of external directors on corporate governance, where an external director devotes sufficient time to effectively discharge his/her duties, this appears to have a positive effect on corporate governance.¹⁹

The CP is ‘fundamentally important to the proper operation of the statutory scheme and the protection the statutory scheme is intended to afford to members of managed investment schemes’.²⁰ This is because the CP documents the measures the RE is to apply in operating the scheme to ensure compliance with the Corporations Act and the scheme's constitution.²¹ The importance of the CP in the legal and regulatory framework of the MIS is emphasised by the officers of the RE having a duty to take all steps that a reasonable person would take, if they were in the officer's position, to ensure that the RE complies with the CP.²² The importance of the CP is exemplified by the following Survey results.

Survey Results
85.2% of respondents agreed that the CP has an important role in the protection of retail investors who invested in their organisation's schemes. ²³

The CC, if required, is responsible for compliance oversight.²⁴ It acts as an intermediary between the operational compliance unit within the RE and the board of directors regarding compliance monitoring, assessment, and reporting.²⁵ The Survey results also emphasise the importance of the CC.

¹⁸ Australian Securities and Investments Commission, *Funds management: Compliance and oversight* (Regulatory Guide 132, June 2022), [RG 132.29].

¹⁹ Ronald W. Masulis and Emma Jincheng Zhang ‘How valuable are independent directors? Evidence from external distractions’ (2019) *Journal of Financial Economics* 226; Pamela Brandes et al ‘Time is of the Essence!: Retired Independent Directors’ Contributions to Board Effectiveness’ (2022) *Journal of Business Ethics* 767.

²⁰ *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452, [283].

²¹ Corporations Act, s 601HA(1).

²² *Ibid*, s 601FD(1)(f)(iv).

²³ Survey Results, Q42, page 434

²⁴ EM MIB (n 15), [11.7]-[11.8].

²⁵ Trio Report (n 3), 28; RG 132 (n 18), [RG132.177].

Survey Results
92.6% of respondents considered that the CC has an important role in protecting retail investors. ²⁶

The legislative duties that are imposed on the CC members are indicative of the importance of the CC in the regulatory regime.²⁷ These duties were intended to mirror the duties imposed on officers of the RE,²⁸ being ‘director analogous duties’.²⁹ It is not clear whether these duties are owed to the scheme members.³⁰ While there is a view that the duties are owed to the RE,³¹ logic and the form and context of the provisions dictate that the duties are owed to the scheme members.

The ALRC Report 65,³² while acknowledging that the law governing CIS cannot prevent all instances of non-compliance and dishonesty, concluded that the law can establish rules that should reduce the risk of non-compliance to an acceptably low level. It said that a focus on compliance is of particular importance for the regulatory framework of the CIS because of the limited power of investors and the risk that operators may not act in the best interest of investors.³³

II. RESEARCH QUESTION 1 - HOW DOES THE COMBINED OPERATION OF THE COMPLIANCE PLAN, COMPLIANCE COMMITTEE (OR EXTERNAL DIRECTORS) AND COMPLIANCE PLAN AUDITOR FAIL TO PROTECT THE RETAIL INVESTOR?

Hanrahan and Ramsay said, somewhat cynically, ‘[a]rguably, the emphasis placed on formal internal processes for compliance has been more successful in creating an

²⁶ Survey Results, Q25, page 420.

²⁷ Corporations Act, s 601JD.

²⁸ EM MIB (n 15), [1.10]; For a comparison of the duties see Table 4.1 (ASF Flow of Monies), page 362.

²⁹ *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497, [221].

³⁰ *Sovereign MF Limited v Compliance and Risk Services Pty Ltd* [2013] VSC 213, [37].

³¹ Grant Moodie and Ian Ramsay, ‘Managed Investment Schemes: An Industry Report’ *Centre for Corporate Law and Securities Regulation, University of Melbourne* 2003, 79.

³² ALRC Report 65 (n 16), [2.8].

³³ *Ibid*; while this may be an over-optimistic view of the ALRC Report 65, it may be achievable with accompanying changes in enforcement policy and resources.

industry rather than a culture of compliance'.³⁴ There is some truth to this statement, evidenced by the failings that have occurred with respect to the combined operation of the CP, the CC and CPA as a gatekeeper in the regulatory framework for the protection of retail investors.

The following case studies are examples of where the application of the 'law as it is', governing the combined operation of the CP, CC and the CPA, failed to protect retail investors. Because these cases are deviant, i.e., contrary to the norm, they reveal causal pathways to understanding this phenomenon, thereby allowing one to deduce what the 'law ought to be' in answering Research Question 2.³⁵

A. Case Study 1 – Trio Capital Limited ('Trio')

The first example where the combined operation of the CP, the CC and the CPA failed to protect the retail investor was the collapse of Trio in 2009. Trio was the registrable superannuation entity ('RSE') for four superannuation funds and the responsible entity ('RE') for 28 MIS. The collapse resulted in investors losing approximately \$176,000,000.³⁶ The scandal was described as the largest superannuation fraud in history.³⁷ The losses were incurred through investments made in two MIS operated by Trio. These were the Astarra Strategic Fund ('ASF') and the ARP Growth Fund ('ARPGF'). Australian Prudential Regulatory Authority ('APRA') regulated superannuation funds and self-managed superannuation fund ('SMSF') trustees invested in ASF. Therefore, both APRA and ASIC had a regulatory interest in ASF.

ASF was marketed and sold as a product designed to produce absolute returns using typical hedge fund strategies designed to achieve a positive return despite any fluctuations in capital markets.³⁸ ASF invested in entities registered in offshore jurisdictions through complex arrangements. ASF transferred all its funds to these offshore entities. The money was then used to acquire shares at an inflated price in small companies. These offshore funds falsified valuations and reported fictitious

³⁴ Pamela Hanrahan and Ian Ramsay 'Regulation of mutual funds in Australia' in William A. Birdthistle and John Morley (ed), *Research Handbook on the Regulation of Mutual Funds* (Edward Elgar Publishing, 2021), 414, 434.

³⁵ See Chapter 2 above.

³⁶ Trio Report (n 3), xvii.

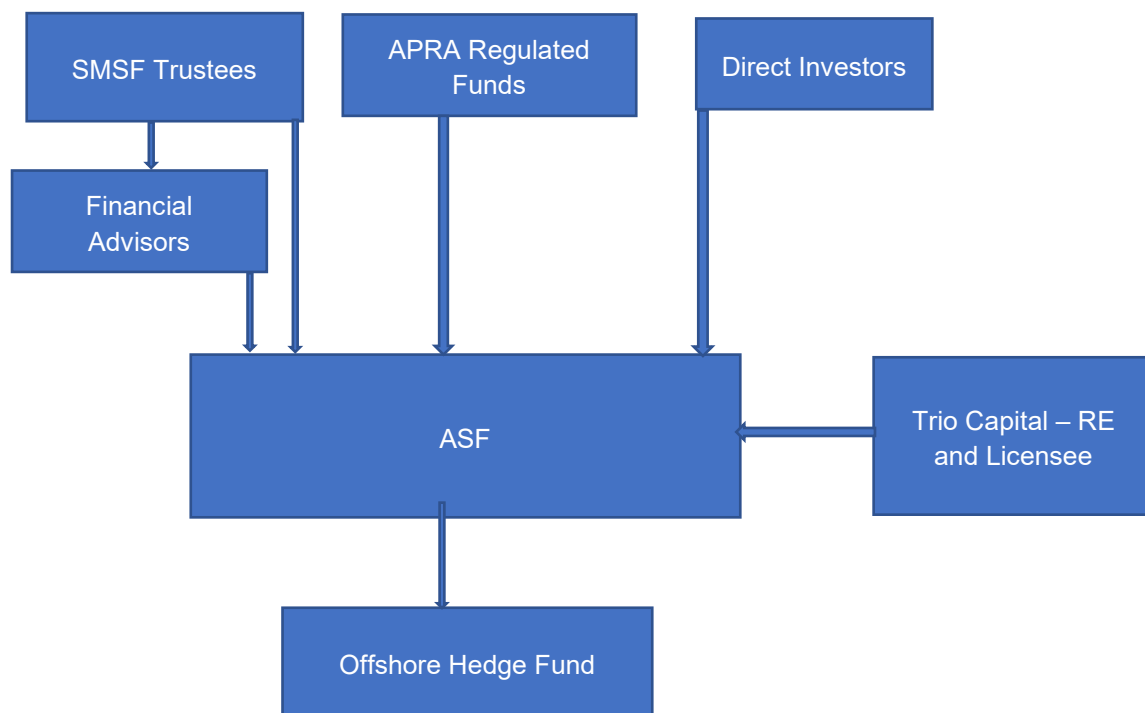
³⁷ Ibid.

³⁸ Ibid, 10.

returns to Trio. Trio accepted the reports without any critical consideration or examination. There was no adequate investigation of the risks associated with these investments, particularly in the face of the reported returns.³⁹ ARPGF invested in various offshore funds that, in turn, invested in a swap contract with a British Virgin Island ('BVI') company. The BVI company collapsed during the 2008 global financial crisis ('GFC'), resulting in investors' losses approximating \$53m.⁴⁰

The following figures show the flow of monies in the ASF and ARGPF respectively.

Figure 4.1 – ASF Flow of Monies⁴¹

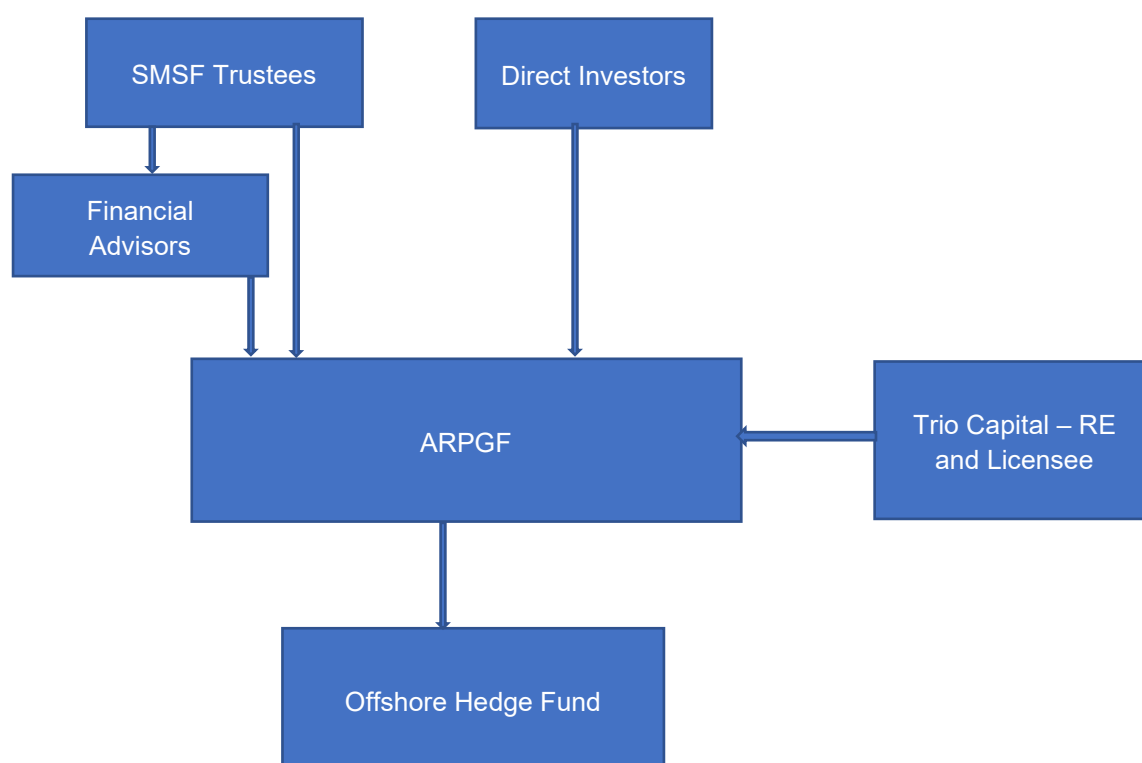


³⁹ Ibid.

⁴⁰ The Treasury '*Review of the Trio Capital Fraud and Assessment of the Regulatory Framework*' (Report, 2013) ('Trio Treasury Review'), 10.

⁴¹ Ibid, 12.

Figure 4.2 – ARGPF Flow of Monies⁴²



The regulatory involvement with Trio by APRA and ASIC from 2003 until 2009 did not detect the fraud or the loss of investments. However, in October 2009, following an alert provided by ASIC from an investigation into ASF as part of its general review of funds, combined with a ‘tip off’ from a market participant of potential fraud,⁴³ APRA froze Trio’s assets.⁴⁴

This fraud could not have occurred but for the repeal in 2007 of sub-section 601FC(4) of the Corporations Act. This repeal enabled REs to invest in unregistered schemes.⁴⁵ The purpose of this repealed provision was to prevent the RE from avoiding the scheme property protection that applied to registered MIS.⁴⁶ As proved to be the case with Trio, investments in offshore funds make it extremely difficult for the gatekeepers

⁴² Ibid.

⁴³ Ibid, xx.

⁴⁴ Ibid, 14.

⁴⁵ *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*.

⁴⁶ Explanatory Memorandum to the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007, [1.37].

to carry out their role. For example, the scheme auditor for ASF did not detect the fraud. The scheme auditor gave a court-enforceable undertaking ('CEU') to ASIC.⁴⁷ The CEU recited, amongst other things, that ASIC was concerned that for the 2008 audit, the auditor had failed to ensure appropriate audit evidence was obtained regarding the existence and valuation of investments. Additionally, ASIC said that for the 2008 and 2009 audits, he had failed to ensure that each audit was planned and performed with an attitude of professional scepticism.⁴⁸

ASIC was particularly pointed in its criticism of the role of the gatekeepers in the collapse.⁴⁹ In its submissions to the Parliamentary Joint Committee on Corporations and Financial Services ('PJC'), ASIC said that the gatekeepers in the MIS legal and regulatory framework are the first line of defence against bad behaviour by perpetrators of issues in the system.⁵⁰ This included the CP, the CC, and the CPA.⁵¹

Following the collapse of Trio and its two funds, five directors of the RE provided CEUs to ASIC, disqualifying them from being involved in the financial services industry for varying time periods.⁵² Amongst the recitals in their respective undertakings, ASIC alleged that they had failed to take all steps that a reasonable person in their position as an officer of the RE to ensure that the RE complied with the CP in contravention of section 601FD(1)(f)(iv) of the Corporations Act. The following breaches of the ASF CP were identified by ASIC:

- (a) independent valuations of the ASF property were not undertaken,⁵³

⁴⁷ Court enforceable undertaking ('CEU') by Timothy Steven Frazer Document No. 027714293, [8(a)] and [8(b)] <<https://download.asic.gov.au/media/1300969/027714293.pdf>>; CEU's contain a set of undertakings from persons who contravene the legislation that ASIC administers, accepted by ASIC as an alternative to, or in conjunction with, other enforcement action and are enforceable in a court: *Australian Securities and Investments Commission Act 2001* (Cth) ('ASIC Act'), 93AA.

⁴⁸ Ibid, [6.2(a)(i)], [6.4].

⁴⁹ Ibid, [5.1].

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² CEUs by Rex John Philpott Document No. 027444202 (15 years) ('Philpott CEU') and Natasha Beck Document No. 027066448 (2 years) <<https://download.asic.gov.au/media/1300903/027444202.pdf>>; David Ronald Andrews Document No. 027066781 (9 years) and David O'Bryen Document No. 02744362 (4 years) <<https://download.asic.gov.au/media/1300849/027066781.pdf>>; Keith Rex Finkelde Document No. 027444363 (4 years) <<https://download.asic.gov.au/media/1300915/027444363.pdf>>.

⁵³ Philpott CEU (n 52), [8.6(d)], [8.7].

- (b) unit prices were not calculated in accordance with the Constitution and the Guide to Good Practice for Unit Pricing.⁵⁴
- (c) due diligence, monitoring and supervision of agents, contractors or external providers and their insurance was not undertaken,⁵⁵ and,
- (d) the procedures for the selection and performance of fund managers were not followed.⁵⁶

Given the failings of the two MIS operated by Trio and the size of the losses suffered by investors, it is important to learn from what occurred so that history is not repeated. The fraud was alarming because, despite the risk management and governance framework including the CP, CC and CPA, these fraudulent activities were not detected.⁵⁷

The notes to the audited financial reports for both the ASF and ARPGF disclosed that Trio had a risk and compliance committee. The notes also disclosed that the CPA attended all of the meetings. The risk and compliance committee was responsible for overseeing how management complied with the RE's risk management policies and procedures, as well as reviewing the adequacy of the risk management framework. Quarterly 'health checks' were sent to all senior managers for completion for the purpose of ensuring there was adherence to the CP for the relevant MIS.⁵⁸ The CPs for both MIS confirm that the risk and compliance committee served the role of the CC.⁵⁹ Because the CPA attended the CC meetings, there must have been a failure with the gatekeeper role of the CC and the CPA. Otherwise, the compliance audit reports would have been qualified. If the CC and CPA had each applied a level of 'professional scepticism' to what they were told by the RE, it must have been patently

⁵⁴ Ibid, [8.10].

⁵⁵ Ibid, [8.14]-[8.15].

⁵⁶ Ibid, [8.18]-[8.19].

⁵⁷ Pelma Jacinth Rajapakse and Nothando Malaba, "Minimising Exposure to Fund Management Fraud in Australia" (2015) 31(1) *Banking & Finance Law Review* 53, 78.

⁵⁸ Audited Financial Statement of ASF for the year ended 30 June 2008 (ASIC Document 025100192), Audited Financial Statement of ASF for the year ended 30 June 2009 (ASIC Document 026046388) and Audited Financial Statement for ARPGF for the year ended 30 June 2008 (ASIC Document 025100202).

⁵⁹ Section 2.2 of the 15/08/2007 version of the ASF Compliance Plan (ASIC Document 023743718) and Section 2.2 of the 27/06/2007 version of the ARPGF CP (ASIC Document 024671852).

obvious to both that proper valuations of scheme property had not been obtained. They should have been familiar with these provisions in the CPs and, therefore, had sufficient knowledge to question what they were told.

The 2005 version of the ASF CP required that the responsible officer ('RO')⁶⁰ report to the CC at least six monthly or alternatively on the occurrence of any failure to value the trust property as required by the constitution and any failure to revalue specific trust property in line with the appropriate valuation methodologies.⁶¹ The 2007 version of the ASF CP required the CFO to ensure that members of the board were aware of the requirements of Chapter 2M of the Corporations Act regarding valuation of scheme property and that the CFO would report to the board before the adoption of the financial statements of the requirement for a valuation. CC members and the CPA, therefore, must, or ought to, have been aware of these provisions in the relevant versions of the ASF CP.

From late 2008 to mid-2009, APRA sought valuations of certain assets from Trio, but Trio was unable to provide basic valuation information.⁶² In accordance with the ASF CP, the members of the CC and the CPA (by reason of their attendance at meetings) should have been aware of this had they read and understood the valuation reporting requirement. There were similar valuation provisions in the CP for the ARPGF.⁶³ Why was the lack of reporting on the valuations, therefore, not questioned by them?

The CPA reports for the years ended 30 June 2006, 30 June 2007, 30 June 2008, and 30 June 2009 for both ASF and ARPGF were in the usual qualified terms as to the inherent limitations of those audit reports.⁶⁴ The reports also included the usual disclaimer of any responsibility for any reliance of any person or users on the audit report, other than the directors of the RE.⁶⁵ The reason for this qualification is that the

⁶⁰ Now called the 'responsible manager' ('RM'); RMs are the people who have direct responsibility for significant day-to-day decisions about the licensee's financial services: Australian Securities and Investments Commission, *AFS licensing: Organisational competence* (Regulatory Guide 105, 23 June 2022), [105.22].

⁶¹ Section F of the 2005 version of the ASF CP.

⁶² Trio Report (n 3), xx, [4.24].

⁶³ ARPGF CP - 2004 version Section F, 2007 version Item 49 and 2008 version Item 49.

⁶⁴ Guidance Statement GS 013 – '*Special Considerations in the Audit of Compliance Plans of MISS*' 2009 Auditing and Assurance Standards Board (GS 013).

⁶⁵ Ibid.

audit is not designed to detect all weaknesses in a CP or the RE's compliance with the same, because the audit is carried out on a test basis.⁶⁶ Therefore, the audit opinion is only given on a reasonable assurance basis with no guarantee that the CP is completely free from any deficiency or that all compliance breaches have been detected.⁶⁷

Nevertheless, the inherent limitations of the audit report are not a valid excuse for a lack of professional scepticism in carrying out the audit procedure.⁶⁸ The literature indicates that high levels of professional scepticism are an important factor for fraud detection.⁶⁹ This is despite a report by the Association of Certified Fraud Examiners finding that only 3% of cases of occupational fraud had been initially detected by external auditors.⁷⁰ While this may indicate that the role of external auditors in preventing fraud is limited, the results may also mean that external auditors are not skilled at identifying such misconduct due to a lack of professional scepticism. An auditor requires a mindset that continuously questions and tests the material and information provided both critically and independently.⁷¹ This mindset requires more than mechanistic decision-making or increasing regulatory checklists to be ticked.⁷²

All of the above CP audit reports stated that the RE had complied with the CPs for the ASF and the ARPGF for the relevant financial year, when this was simply not the case. The inherent limitations of the audit was not a valid excuse for this non-detection of breaches of the CPs.⁷³ This is particularly so, given the significant powers the auditor has to assist in the detection of any contraventions of the Corporations Act.⁷⁴

⁶⁶ Ibid

⁶⁷ Ibid.

⁶⁸ Trio Report (n 3), [5.27]-[5.28].

⁶⁹ Inez G.F. Verwey and Stephen K. Asare 'The Joint Effect of Ethical Idealism and Trait Skepticism on Auditors' Fraud Detection' (2022) 176 *Journal of Business Ethics* 381; Martin Kelly and Patricia Larres, 'Enhancing the auditor's mindset: a framework for nurturing professional skepticism' (2025) 47:1 *Journal of Accounting Literature* 222.

⁷⁰ Association of Certified Fraud Examiners '*Occupational Fraud 2024: A Report to the Nations*' (Report 2024) < <https://legacy.acfe.com/report-to-the-nations/2024/> >.

⁷¹ Edy Sujana and Nyoman Ari Surya Dharmawan 'Audit Quality Improvement and the Role of Risk: Audit as a Moderator' (2023) 17(4) *Australasian Accounting Business & Finance Journal* 223, 226.

⁷² Kelly (n 69), 236.

⁷³ Trio Report (n 3), [5.73].

⁷⁴ Corporations Act, s 601HG(5).

It is possible that everyone might have been misled by the unqualified audits of the financial reports. However, they would not have been misled if they had respectively applied inquiring minds to the facts. The audited financial reports for the ASF for the years ended 30 June 2008 and 30 June 2009 showed that the fund had net assets of \$117,886,674 and \$42,940,626, respectively.⁷⁵ For each of those financial years, the auditor stated that in his opinion the financial report gave a true and correct report of the financial position of the ASF. This opinion of the auditor was clearly wrong.

The financial statements of ARPGF were also audited. The audited financial report for the ARPGF for the year ended 30 June 2008 showed that the fund had net assets of \$69,460,463.⁷⁶ This disclosure in the accounts of the net asset position of the ARPGF was illusory, given the findings of the PJC and Treasury. The auditor also opined that the financial statements gave a true and correct report of the financial position of the fund. This was despite the auditor having failed to independently verify the existence of the overseas fund or the value of the swap contract.⁷⁷ The PJC considered that the principal underlying asset of the ARPGF likely did not exist despite assertions by both APRA and ASIC to the contrary that the asset did exist, but its value had fallen to zero.⁷⁸

The PJC expressed concern that the auditor's opinion concerning the financial statements did not necessarily mean that the assets underlying the financial statements actually existed.⁷⁹ If this was the case, what were the CC and CPA doing? Section C of the 2005 version of the ASF CP and section 4.1 of the 2007 version of the ASF CP set out the procedures for ensuring that the scheme property was clearly identified as scheme property and held separately from the property of the RE and scheme property of any other scheme as required by section 601HA(1)(a) of the Corporations Act.⁸⁰

⁷⁵ Audited Financial Reports of ASF for the years ended 30/06/2008 and 30/06/2009 (available from ASIC upon payment of a fee).

⁷⁶ Ibid.

⁷⁷ Trio Report (n 3), xx.

⁷⁸ Ibid, xxi.

⁷⁹ Ibid, xxii.

⁸⁰ 2005 version of the ASF CP (available from ASIC upon payment of a fee).

Neither the CC nor the CPA detected the fraud. Yet how was it possible for a market participant with no in-house information to detect the possibility of fraud? This market participant observed that ASF had suspiciously smooth returns and drew this to ASIC's attention.⁸¹ It is therefore unfathomable why neither the CPA (despite the inherent limitations of the audit) nor the members of the CC with all their accumulated experience and in-house information identified this feature of the ASF and the ARPGF or make further investigations.

ASIC said in its submissions to the PJC that the content of the CPs was set at a high level with generally little detail.⁸² The CPs were therefore not as effective as intended.⁸³ Despite this criticism by ASIC, there is no requirement in law for the CP to be detailed. The only compulsory requirement is that the CP must comply with section 601HA of the Corporations Act.⁸⁴ This is a low level of prescription, although, in conformity with the ALRC Report 65 recommendation that the law should not specify what constitutes adequate compliance measures. Rather, it was up to the scheme operator to develop and implement appropriate compliance measures addressing minimum mandatory matters. This was to give the operators flexibility to adjust the procedures for the nature and features of the schemes they operate.⁸⁵

Despite the criticisms in the Turnbull Review⁸⁶ and ASIC submissions to the PJC⁸⁷ of the high level at which CPs are drafted, the courts have had little difficulty in finding REs and their officers to be in breach of their respective legislative duties by failing to adhere to the CP of the registered scheme.⁸⁸ The Australian Financial Complaints

⁸¹ Trio Report (n 3), [5.71].

⁸² As ASIC is responsible for registering the schemes which includes a requirement to lodge a CP, it must necessarily have knowledge of the content of the CPs so its statement is difficult to challenge. However, the CPs for ASF and ARPGF did have sufficient detail which, if followed, would have detected the non-compliance and the fraud.

⁸³ Trio Report (n 3), [4.50].

⁸⁴ Corporations Act, s 601HA(4)(c)(ii).

⁸⁵ ALRC Report 65 (n 16), [9.7].

⁸⁶ Malcolm Turnbull *Review of the Managed Investments Act 1998* (Report, 3 December 2001) ('Turnbull Review').

⁸⁷ Trio Report (n 3), [4.50].

⁸⁸ *Agricultural Land Management Ltd v Jackson* (No. 2) [2014] WASC 102; *Australian Securities and Investments Commission v Beekink* [2006] FCA 388 (on appeal the penalty was amended but not the breach findings); *Australian Securities and Investments Commission v Theta Asset Management Limited* [2020] FCA 1894; *Australian Securities and Investments Commission v Linchpin Capital Group Ltd* [2018] FCA 1104; *Australian Securities and Investments Commission v Linchpin Capital Group Ltd* (No 2) [2019] FCA 398; *Australian Securities and*

Authority ('AFCA') also has had no difficulty in making similar findings.⁸⁹ In each of these cases, although the specified procedures in the CP that were not followed may have been at a high level, the CP provisions were sufficiently detailed for the courts to find breaches by the RE and/or the directors of their duties in failing to comply. Similarly to Trio, ASIC was able to determine significant breaches of the CP referred to in the various CEUs.⁹⁰

The conclusion from this case study is that the contents of Trio's CP were sufficiently robust to have brought to the attention of the members of the CC and the CPA that there was non-compliance by the RE with the CP for each MIS regarding the identification and valuation of scheme property. Therefore, the legal and regulatory framework comprising the CC and the CPA (despite the inherent limitations of the audit), designed to protect the retail investor, failed in their gatekeeper role.

More than a 'box-ticking' approach to compliance by the CC and the CPA is necessary, particularly where an MIS invests in offshore entities. Both must be particularly careful and sceptical in monitoring the RE regarding offshore investments because of the fraud that can easily occur where scheme property is invested outside Australia.⁹¹

Although the provisions of the CP would have been sufficient to identify the non-compliance and therefore the fraud, the CP did not have any provisions specifically designed for offshore investments. This leads to the conclusion that if retail investors are to be protected where there are offshore investments, the provisions of the CP must focus more acutely on the following measures that the RE is required to set out in a CP:

Investments Commission v Daly (Liability Hearing) [2023] FCA 29; *Australian Securities and Investments Commission v Daly (Penalty Hearing)* [2024] FCA 3; (appeal dismissed in *Daly v Australian Securities and Investments Commission* [2024] FCAFC 125); *Trilogy* (n 20); (appeal dismissed in *Sullivan* (n 20)).

⁸⁹ *Investors Exchange Limited v Australian Financial Complaints Authority Limited* [2020] QSC 74.

⁹⁰ CEUs, (n 52).

⁹¹ *Trio Capital Limited (Admin App) v ACT Superannuation Management Pty Ltd* [2010] NSWSC 286, [22]; Rajapakse and Malaba (n 57); No statistics on investments by MIS in offshore funds is readily available. Although, in December 2023, 23.3% of managed funds' assets was invested overseas: Australian Bureau of Statistics '*Managed Funds Australia*' (Catalogue No. 5655.0, 7 March 2024), this is not broken down further.

- (i) the arrangements to ensure that all scheme property is clearly identified as scheme property and held separately from property of the RE and property of any other scheme, and
- (ii) the valuation of scheme property at regular intervals appropriate to the nature of the property,⁹²

if such measures are to be adequate.

B. Case Study 2 – Avestra Asset Management ('AAM')

The second example of where the combined operation of the CP, the CC and the CPA (despite the inherent limitations of the audit) failed to protect the retail investor is the case of AAM. AAM was the RE of a registered MIS known as the Avestra Advantage Fund ('AAF').⁹³ It was also the trustee of a number of unregistered wholesale MIS.⁹⁴ AAM took over the role as RE of a number of other registered MIS on 30 January 2014 ('AG Schemes').⁹⁵ Table 4.2 at page 362, shows the MIS for which AAM was the RE or trustee.

Between March and August 2013, AAM acquired shares in a listed company ('AGF') using the scheme property of its registered MIS and the trust property of its wholesale funds to do so. These acquisitions of shares gave AAM a controlling interest in AGF.⁹⁶ This was done for the purpose of AAM affecting a merger or consolidation of AAM's business with the AGF business, thereby realising a 'back door listing' of AAM.⁹⁷ On each occasion when the RE acquired shares in AGF, this was a conflict of interest between the RE's own interest and the interests of the members of its registered and wholesale schemes.⁹⁸ The RE failed to give priority to the interests of the members of the AAF with respect to these conflicts, contrary to its duty in section 601FC(1)(c) of the Corporations Act.⁹⁹ The RE also failed to make any appropriate or required

⁹² Corporations Act, ss 601HA(1)(a) and (c).

⁹³ *Avestra* (n 29), [4].

⁹⁴ *Ibid.*

⁹⁵ *Ibid.*, [34].

⁹⁶ *Ibid.*, [93].

⁹⁷ *Ibid.*, [95].

⁹⁸ *Ibid.*, [5]-[6].

⁹⁹ *Ibid.*, [97].

disclosure to the members of the registered MIS and the wholesale schemes. Rather, the RE attempted to conceal what it was doing from the members.¹⁰⁰

It was agreed between the parties to the proceedings that the acquisition of the shares in AGF had been done with the object of benefiting AAM and its shareholders rather than the investors in the retail and wholesale schemes. The acquisition of these shares in AGF also constituted the giving by AAM of a financial benefit out of the scheme property of the AAF to AAM and/or AGF. This was done without the approval of the members of AAF in contravention of the related party transaction ('RPT') provisions applicable to MIS.¹⁰¹

On 1 April 2013, after AAM acquired 22% of the voting shares in AGF, AGF Funds Management (a subsidiary of AGF) sub-delegated its investment management role with the AG Schemes to Bridge Global Securities ('BGS'), of which two of the directors of AAM were the only directors. Thereafter, BGS used the scheme property of the AG Schemes to make further purchases of shares in AGF, extending the control by AAM of that company.¹⁰² On 1 May 2013, the RE of the AG Schemes objected to the scheme property of those MIS being used for this purpose. AAM dismissed these concerns and proceeded to have itself appointed as a replacement RE of these schemes.¹⁰³ Shares in AGF were also acquired on behalf of one of the wholesale funds in which AAF had a substantial unitholding. This acquisition of shares gave a financial benefit to AAM indirectly out of the scheme property of AAF, for which AAM did not have the approval of the members.¹⁰⁴

In furtherance of AAM's own commercial objectives, AAM used funds of two of the wholesale schemes to acquire shares in AGF. By doing so, it failed to ensure that it provided the financial services covered by its AFS licence efficiently, honestly and fairly in breach of section 912A(1)(a) of the Corporations Act.¹⁰⁵ These actions also

¹⁰⁰ Ibid, [8].

¹⁰¹ Ibid, [97].

¹⁰² Ibid, [100]-[101].

¹⁰³ Ibid, [102].

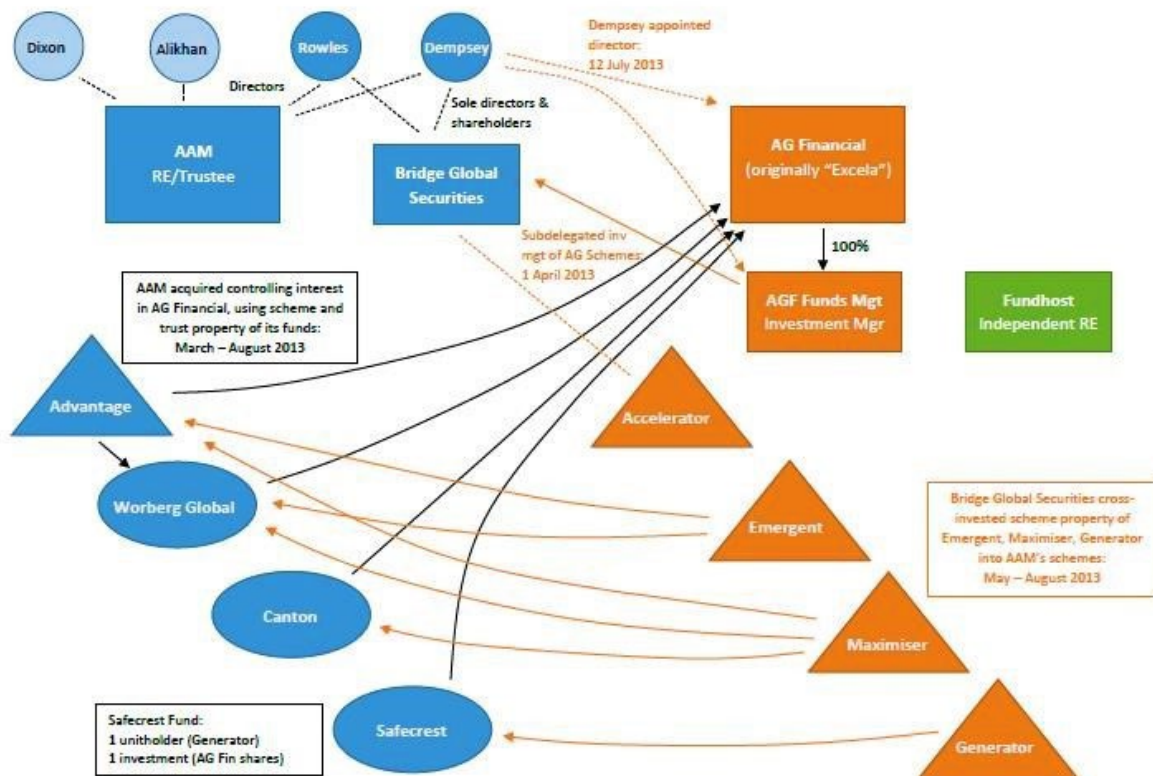
¹⁰⁴ Ibid, [97].

¹⁰⁵ Ibid.

caused AAM to be in contravention of the substantial shareholder notice obligation¹⁰⁶ and takeover prohibition.¹⁰⁷

The following figure illustrates the relationship between the parties and the wholesale and retail funds through which the acquisition of shares in AGF and the cross investments were made.

Figure 4.3 - Avestra Asset Management Group Structure¹⁰⁸



Numerous cross investments out of the scheme property of the AG Schemes were also made in AAM's registered and the wholesale schemes. This was done in breach of the RPT provisions.¹⁰⁹

¹⁰⁶ Corporations Act, s 671B.

¹⁰⁷ Ibid, s 606(1).

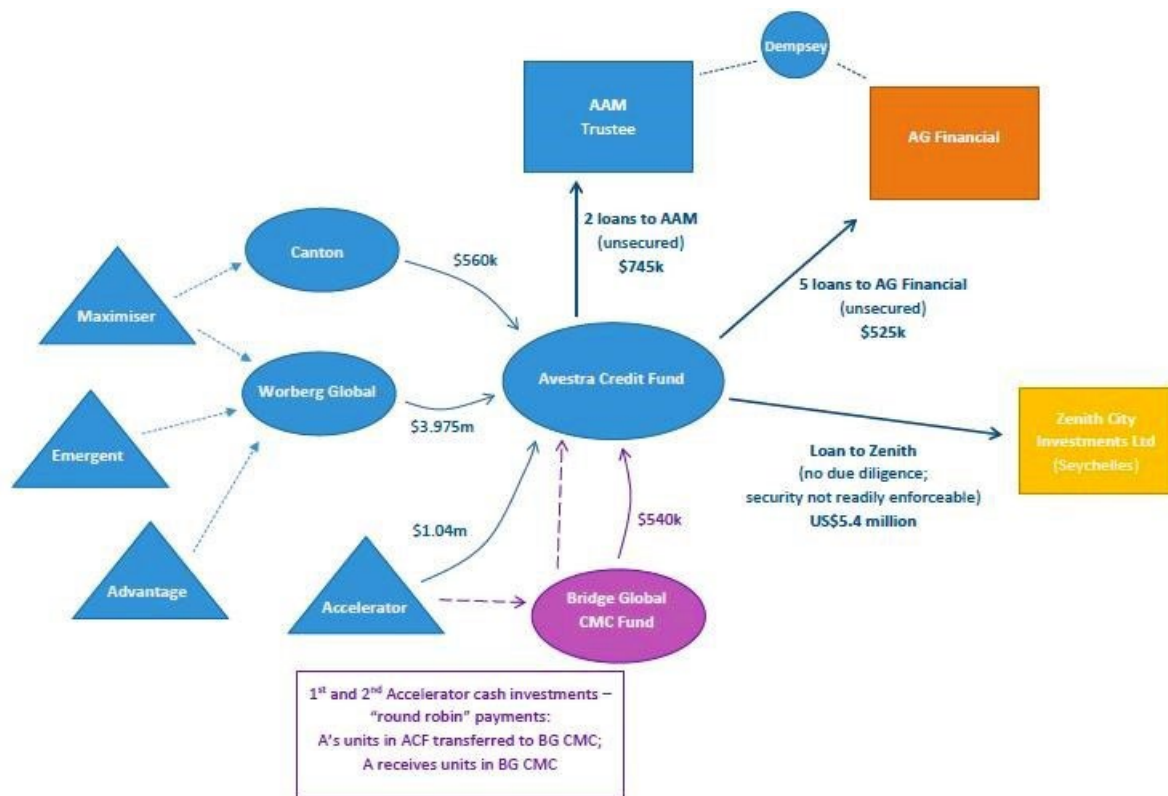
¹⁰⁸ Avestra (n 29), [94].

¹⁰⁹ Ibid, [105].

AAM also established a fund called the Avestra Credit Fund. AAM arranged for investments to be made into that fund by Worberg Global Fund, Canton Fund, the Accelerator Fund and Bridge Global CMC Funds. AAM then granted loans out of the Avestra Credit Fund to itself and to AGF in breach of the RPT provisions applicable to MIS.¹¹⁰

The following figure illustrates the investments made into and the loans out of the Avestra Credit Fund up until 1 July 2014.

Figure 4.4 - Avestra Credit Fund – Money flows¹¹¹



There were numerous other breaches of the Corporations Act by the RE and two of its directors. Effectively, the scheme property of the registered schemes was used for the financial benefit of related parties rather than in the best interests of the investors. The scheme property of registered schemes and trust property of wholesale schemes effectively became a ‘slush fund’ of the RE and two of its directors. The actions of the

¹¹⁰ Ibid, [107]-111].

¹¹¹ Ibid. [108].

RE and the two directors were particularly egregious. They used ‘other people’s money’ for the benefit of themselves or their related parties. They acted in self-interest rather than for duty.¹¹² The two directors were subject to banning and disqualification orders for a period of 10 years.¹¹³

AAM had a CC.¹¹⁴ From documents obtained from ASIC under the *Freedom of Information Act 1982* (Cth) (‘FOIA’) for the purposes of this research project, it is clear that the CC at its meeting on 21 June 2013 identified a potential ‘red flag’ with the operation of the registered MIS of which AAM was the RE. This was the potential conflict of interest arising from AAM using the scheme property of the registered MIS to invest in the wholesale funds of which AAM was the trustee.¹¹⁵ However, despite noting that this had occurred, the CC deferred discussion on the issue.¹¹⁶ In addition, the compliance officer raised an issue concerning conflicts of interest involving the trading accounts not having been documented and recommended that this be done.¹¹⁷

These two issues are not specifically referred to in later minutes of meetings of the CC. The minutes of the meeting of 12 December 2013 merely recorded that one of the CC members (name redacted) updated the committee on recommendations in the audit report concerning policies on conflicts of interest and insider trading. The member said that AAM had policies on both areas and that, as part of ongoing monitoring, an annual conflicts of interest review would be undertaken and Compliance would document the identification of specific conflicts of interest before the next CC meeting. This did not refer to the previously identified issue of AAM using the scheme property of the registered MIS to invest in the wholesale funds of which AAM was the trustee.

The minutes of the meeting of the next CC meeting of 13 March 2014 stated that a named director agreed to circulate the conflicts of interest policy together with the

¹¹² Kant (n 2).

¹¹³ *Avestra* (n 29), [62]-[67].

¹¹⁴ *Ibid*, [139]-[142].

¹¹⁵ *Ibid*; AAM’s Compliance Committee Minutes of Meeting of 21/05/2013 stated that the following matter was to be discussed and followed up at the next compliance committee meeting ‘The potential conflicts of interest in regard to the registered schemes investing in unregistered schemes and potentially charging fees in both of the Schemes which is acceptable provided’.

¹¹⁶ *Avestra* (n 29).

¹¹⁷ Minutes (n 115).

review that had been undertaken and documentation of the specific conflicts of interest to the CC members. There is no reference to the specific issue of AAM using the scheme property of the registered MIS to invest in the wholesale funds of which AAM was the trustee.

This potential conflict of interest issue simply came off the ongoing agenda of later CC meetings.¹¹⁸ This is damning of the CC as a whole. It is not known from the minutes or from the judgment as to why the CC did not deal with this issue, but let it drop off the agenda for future meetings. The conduct by the RE and its officers drew attention to what were RPTs for which the RE had not obtained member approval.¹¹⁹ If the CC had not deferred discussion of this issue and dealt with this 'red flag' at that time, then the issue of the RPTs may have been adequately dealt with before it became a major problem and caused substantial losses to be incurred by retail investors.

In addition, the conflicts of interest register had entries identifying conflicts of interest regarding the cross investments referred to above. It was recorded that the managers were aware of this conflict and would monitor this on an ongoing basis.¹²⁰ All other matters recorded in the register were 'uniformly and perfunctorily recorded as having been subject to disclosure and monitoring and recorded as remaining ongoing'.¹²¹

However, the court took the view that it was the responsibility of the executive member of the committee (who was also a director of the RE) to draw any potential conflicts of interest to the attention of the CC. The court found that the director had failed to inform the CC of numerous conflicts of interest and potential contraventions of the Corporations Act arising in connection with the RE's operation of the schemes.¹²² The court therefore held he had breached his duty as a member of the CC to exercise the degree of care and diligence that a reasonable person would exercise if they were in his position.¹²³

¹¹⁸ *Avestra* (n 29), [140]; Minutes of meeting of compliance committee meetings of 19 June 2014, 29 September 2014, 27 October 2014 and 18 December 2014.

¹¹⁹ Corporations Act, s 601LC.

¹²⁰ *Avestra* (n 29), [133]-[135].

¹²¹ *Ibid*, [138].

¹²² *Ibid*, [61], [139]-[142] & [222].

¹²³ *Ibid*.

Nevertheless, although no regulatory action was taken against the external members of the committee for breaches of their duties, it is hard to see why the external members did not breach their duties by failing to take the RPT issue more seriously. This is particularly so because it is well known that RPTs may lead to 'tunnelling' or 'wealth transfer', resulting in losses to the investors.¹²⁴ Further, although many of the serious breaches of the RPT provision were concealed through not being recorded in the conflicts of interest register,¹²⁵ this concealment may not have occurred if the CC had acted to deal with those RPTs of which they were aware at the time the issue was first flagged.

The CC was required to monitor the extent of the REs' compliance with the CP and to report their findings to the RE of any breach of the Corporations Act of which they become aware or suspect.¹²⁶ The CC did not do so even though they were aware, or at least suspected, that there was a breach by the RE of the RPT provisions because this issue had been raised and deferred.¹²⁷

If the CC had reported suspected breaches of the RPT provisions to the RE, the RE would have had to have taken action, or otherwise the CC would have had to report the matter to ASIC.¹²⁸ All the members of the CC were therefore in breach of their duty to exercise the degree of care and diligence that a reasonable person would exercise if they were in the members' position. Nevertheless, only the executive member suffered a penalty.

The external members of the CC have an important gatekeeper role. In the absence of material to the contrary not raised by ASIC or the court, it is difficult to know why the external members in this case failed so miserably. It may have been that they put too much trust in the executive member. Nevertheless, once the matter was on the agenda of the meetings of the CC, the matter should not have dropped off further agendas. Specific action, rather than deferral, was required if the members were to

¹²⁴ David Millhouse 'Empirical analysis supports Hayne long run reform thesis' (2019) 13(2-3) *Law and Financial Markets Review* 162, 164; Mark J Kohlbeck and Brian W. Mayhew 'Are Related Party Transactions Red Flags?' (2017) 34(2) *Contemporary Accounting Research* 900, 901.

¹²⁵ *Avestra* (n 29), [137].

¹²⁶ Corporations Act, s 601JC(1)(a) and (b).

¹²⁷ *Avestra* (n 29), [140].

¹²⁸ Corporations Act, s 601JC(1)(c).

exercise the degree of care and diligence that a reasonable person would exercise if they were in the member's position.

The conclusion from the above analysis is that external members of a CC need to have a high level of professional scepticism. This requires a mindset that continuously questions and tests the material and information provided critically and independently.¹²⁹ Reports that are given by management should not be accepted at face value. They need to be proactive in exercising their duties and powers if they are to act as important gatekeepers in the MIS legal and regulatory framework. Their role requires more than 'box-ticking'.

Therefore, it is important that external members of the CC have appropriate experience and qualifications enabling them to identify compliance breaches.¹³⁰ Identifying 'red flags' would be made easier if the members know how to do this and what to look for.¹³¹ The importance of having CC members who have the competence to act in that position was recognised by the Turnbull Review,¹³² the Turnbull Review Report,¹³³ and the Trio Report.¹³⁴ Further, ASIC says that it will look to the RE as part of its compliance obligations to take into consideration the experience, qualifications, and skills that each CC member brings to the table when making appointments.¹³⁵ This is to ensure that the CC as a whole can perform its important gatekeeper role.

Notwithstanding the inherent limitations of the CPA's role, in this instance, the CPA did identify material non-compliance with the measures in the CP on two occasions. For the year ended 30 June 2015, the material breaches reported were:

- (a) the investment in the entities related to the directors of the RE, which was a breach of the conflicts policy; and

¹²⁹ Sujana (n 71), 226.

¹³⁰ RG 132 (n 10), [132.177].

¹³¹ Namrata Sandhu 'Red flag behaviours in financial services frauds: a mixed-methods study' (2022) 30(2) *Journal of financial regulation and compliance*, 167, 186.

¹³² Turnbull Review, (n 86).

¹³³ Parliamentary Joint Committee on Corporations and Financial Services *Report on the Review of the Managed Investments Act 1998* (Report, 12 December 2002) ('Turnbull Review Report').

¹³⁴ Trio Capital (n 3).

¹³⁵ RG 132 (n 10), [132.179].

- (b) the RE was convicted of breaching the takeover laws regarding shares acquired by the RE on behalf of various schemes detailed in an ASIC Media Release, which meant that the conflicts policy may have been breached.¹³⁶

The problem with this audit report is that this qualification was made long after the time the first breaches of the conflicts policy identified in the CC minutes of 21 June 2013 were known or should have been known by the CPA. The audit reports for the years ended 30 June 2013 and 30 June 2014 should have identified the breaches of the conflicts policy that were apparent from the CC minutes. No doubt it was the ASIC Media Release to which the auditor refers in his report, that caused this qualification to the compliance audit report rather than any professional scepticism on the part of the auditor. By the time of the qualified report on 30 September 2015, it was too late for the retail investors. The damage had been done much earlier.

There were also material breaches identified by the CPA for the year ended 30 June 2012, but these were not connected with the later breaches of the conflicts policy.¹³⁷ These breaches were relatively minor compared with the conflict issues that took an investigation by ASIC before the CPA qualified his report. When it really mattered, the CP audit (even with its inherent limitations) was useless because the disclosure of breaches was long after the event.

C. Case Study 3 – City Pacific Limited ('CPL')

This case was considered in Chapter 3 in the context of the duties of officers of a RE. The facts are not repeated here. This case is also an example of where the combined operation of the CP, the CC and the CPA (despite the inherent limitations of the audit) failed to protect the retail investor. CPL was the RE of the Pacific First Mortgage Fund ('PFMF'). PFMF had a CP and a CC.¹³⁸ In 2005, there were several issues concerning the PFMF that were 'exciting the interest' of ASIC.¹³⁹ ASIC had concerns about the liquidity of the PFMF. As a result of ASIC's intervention, the RE engaged SV

¹³⁶ Audit Report on the CP for the year ended 30 June 2015 (being document number 7E7347530 lodged with ASIC with respect to the Avestra Advantage Fund ARSN 136 421 497 available to the public upon payment of a fee of \$20).

¹³⁷ CP audit report for the year ended 30 June 2012 lodged with ASIC.

¹³⁸ Trilogy (n 20), [43] and [368].

¹³⁹ Ibid, [71].

Partners ('SVP') to conduct a review of the loan book of the PFMF.¹⁴⁰ There was evidence that the CC met and considered reports from the compliance officer, discussed identified breaches and reported these to the board as required by section 601JC(1) of the Corporations Act.¹⁴¹ However, none of the compliance issues identified by SVP, including the specific issues regarding the AGA facility,¹⁴² were identified by the CC.¹⁴³

The directors sought to defend the claim against them in a novel way by alleging that they had relied upon the CPA, the compliance officer, and the CC to identify the potential breaches arising from the AGA facility.¹⁴⁴ There was evidence that the CC had not identified those compliance issues reported by SVP or the specific issues concerning the facility during the relevant period.¹⁴⁵ However, the court considered that it was difficult to see how the directors could rely on the CPA, the compliance officer, and the CC to identify the potential breaches arising from the AGA facility, given their complicity in backdating documents and their subsequent concealment of the breaches from external scrutiny.¹⁴⁶

This defence failed. The court found that there was a complete disregard by the directors of the provisions of the CP and the policies and procedures put in place under it.¹⁴⁷ The directors were found to have 'thumbed their noses' at these provisions.¹⁴⁸ The court also found that the directors had concealed the breaches or discrepancies from the CC and the CPA.¹⁴⁹ On appeal, the court agreed that because the directors had been a party to the backdating of documents, they were not entitled in their defence to rely upon the management or external persons or bodies, which in the context included the CC.¹⁵⁰

¹⁴⁰ Ibid, [72].

¹⁴¹ Ibid, [368].

¹⁴² See Chapter 3 for further details.

¹⁴³ Trilogy (n 20), [368].

¹⁴⁴ Ibid, [373]-374].

¹⁴⁵ Ibid, [368].

¹⁴⁶ Ibid, [373]-[374], [651]

¹⁴⁷ Ibid, [902] which was not challenged on appeal: *Sullivan* (n 20), [42]-[43]).

¹⁴⁸ *Trilogy*, (n 20).

¹⁴⁹ Ibid, [374].

¹⁵⁰ *Sullivan* (n 20), [651].

The court said that the highly regulated system of the MIS, which includes a CP and the establishment and functions of a CC, ‘all amounts to nought’ if the officers of the RE, who are also gatekeepers, do not comply with their duties.¹⁵¹ There is ‘little point in having a comprehensive constitution and compliance plan if the officers of the responsible entity effectively ignore their provisions, or do not take reasonable steps or act with care or diligence to ensure that they are complied with’.¹⁵²

Notwithstanding the external members of the CC were effectively ‘let off the hook’, there were compliance issues that should have been identified by them. The external expert, SVP, had no difficulty in identifying the breaches.¹⁵³ Although there is nothing in the judgement to assist, because important breaches were not identified by the CC, this is indicative of a ‘box ticking’ approach where the external members of the CC went no further than accepting what they were told by the compliance officer. It seems that they certainly could not have acted proactively or approached their role with any professional scepticism or otherwise the breaches concerning the AGA facility would have been identified. If SVP identified the breaches, why did not the external members of the committee do likewise?

While the CPA did identify some issues,¹⁵⁴ it appears that the audit firm merely accepted the explanations.¹⁵⁵ They did not exercise any professional scepticism to further investigate these issues. If they had done so, despite the ‘cover-up’ by the directors, the significant breaches of the CP that occurred would have been identified.¹⁵⁶

The significance of the breaches that were not identified by the CC or the CPA when they occurred is illustrated by two of the directors being subject to compensation

¹⁵¹ *Trilogy*, (n 20), [900].

¹⁵² *Ibid.*

¹⁵³ *Ibid*, [368].

¹⁵⁴ *Ibid* [119], [370]-[371].

¹⁵⁵ PFMF compliance audit report for Y/E 30/06/2006.

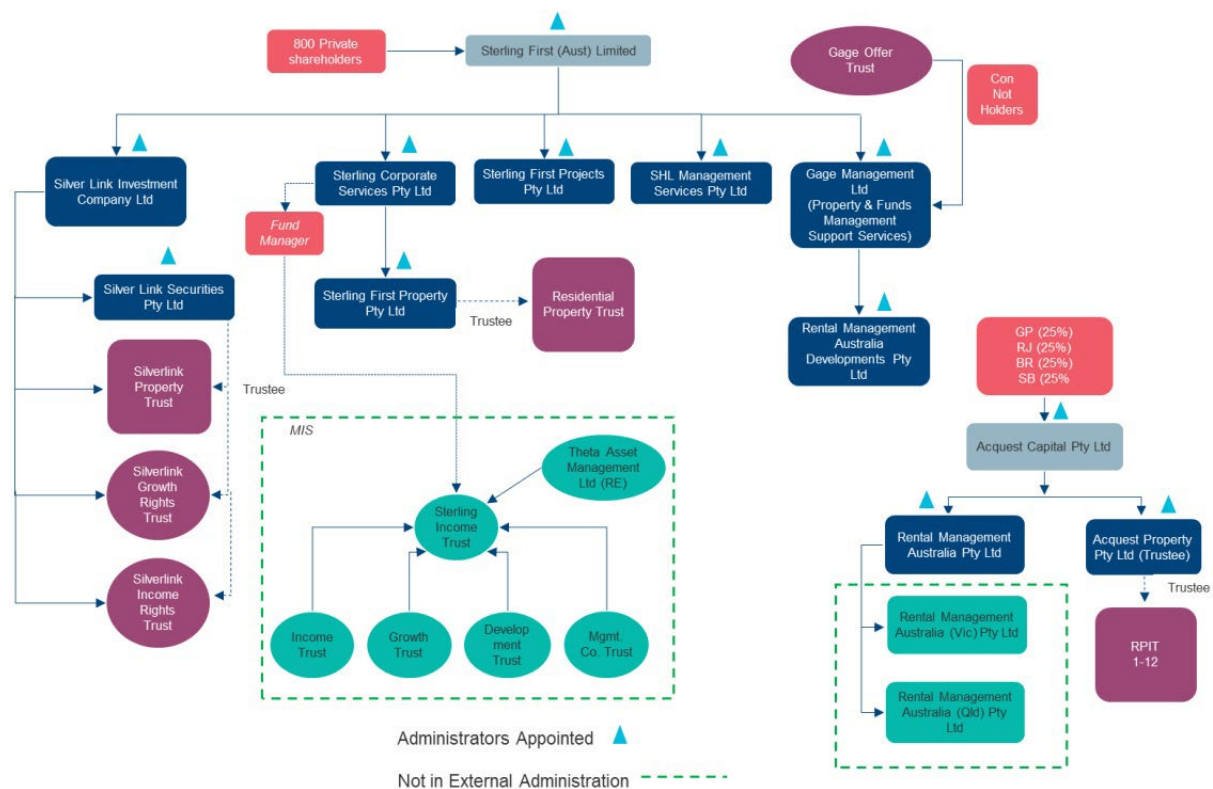
¹⁵⁶ Proceedings that included a claim against the compliance plan auditor were settled for an undisclosed sum: *Trilogy Funds Management Limited v KPMG (A Firm)* [2017] FCA 432; Edmund Tadros and Hannah Wootton ‘Court actions against Deloitte, EY, KPMG and PwC’ *Australian Financial Review (Online)* (March 13, 2023), 8.

orders of \$37,214,088.28 and another two of the directors being subject to compensation orders of \$6,245,974.93.¹⁵⁷

D. Case Study 4 – Sterling Income Trust ('SIT')

The fourth example where the combined operation of the CP, the CC and the CPA failed to protect the retail investor is the case of SIT. The collapse of SIT caused substantial losses to vulnerable elderly investors. The Sterling Group ('SG'), of which SIT formed a part, was established in 2010. It had a complex organisational and operational structure. The following figure illustrates this.

Figure 4.5 - Sterling Group Structure¹⁵⁸



At the time of the collapse of the RE, the SG comprised approximately 50 companies and trusts focused on property-related assets.¹⁵⁹

¹⁵⁷ *Trilogy*, n 20, [929].

¹⁵⁸ Ferrier Hodgson, Sterling First (Aust) Limited (Administrators Appointed) – Voluntary Administrators' Report 30 May 2019, 14.

¹⁵⁹ Senate Economics Reference Committee *Sterling Income Trust* (Report, February 2022) ('SIT Report'), [2.2].

SIT raised funds for the SG through four types of asset classes corresponding to sub-trusts of SIT.¹⁶⁰ There were:

- income units that derived income from property management agreements with a targeted return of 9.25% pa,
- growth units that derived capital growth from the acquisition of new property management agreements with a targeted return of 12% pa,
- development units which were used to acquire property and construct residential homes through subordinated debt loans with a targeted return of 20% pa, and
- first mortgage units/management company units, which were fully redeemed in 2017 and 2018.¹⁶¹

The targeted rates of return should have sent ‘alarm bells ringing’. The Reserve Bank cash rate from 2016 to 2018 was only between 2% and 1.5%. There is an old adage in investing which says, ‘the higher the return, the higher the risk’. However, this was not sufficient to prevent retail investors, including retirees, from investing in SIT.

Prima facie, an investment in the SIT was a good idea. The product was designed around retirees selling their homes, acquiring a forty-year lease in the home, and investing the rest of the proceeds in the SIT, with the income being used to offset their rental payments. The intention was that the retirees could live rent-free for the rest of their lives. The scheme was marketed to retirees as an alternative to downsizing. The idea was that the retirees could free up cash to give them a more comfortable lifestyle with a long-term, secure residential base.¹⁶² Therefore, these investors would likely have been the ‘target market’ in a target market determination (‘TMD’) if the design

¹⁶⁰ Ibid, [2.5]; Note: this is not an unusual structure with registered MIS. ASIC recognises this structure in Australian Securities and Investments Commission, *Funds management and custodial services – Holding assets* (Regulatory Guide 133, 10 December 2024) Note at RG 133.15.

¹⁶¹ *SIT Report* (n 159), [2.12].

¹⁶² Ibid, [2.13].

and distribution obligations ('DDO') had been in place at that time.¹⁶³ The DDO would therefore not have protected them from financial loss.

There was a total of 527 investors who invested approximately \$30,000,000 in SIT. Of these investors, approximately 481 invested \$25,000,000 before ASIC issued stop orders in August 2017. An additional \$4,900,000 was invested by 46 investors after a new PDS was issued in October 2017, before the PDS was declared to be no longer in use in April 2018.¹⁶⁴

There does not appear to have been any fraud involved with SIT. The money went where it was supposed to go. Rather, it appears that the high costs of running the business depleted the money invested.¹⁶⁵ However, clearly, the targeted returns in the PDS were not likely in the face of these costs. Even though the returns were expressed as 'targeted returns', such high returns arguably amounted to misleading or deceptive conduct in breach of the law.¹⁶⁶

ASIC were accused of being 'slow off the mark' to stop the marketing of interests in the scheme to vulnerable elderly investors who lost millions of dollars.¹⁶⁷ The Senate Economics Reference Committee ('SERC') reported that it had serious concerns about the performance of ASIC.¹⁶⁸ This included 'its under-assessment of the gravity of the risks, the timeliness of its response, and its failure to act proactively'.¹⁶⁹

There were 'red flags' that pointed to significant compliance problems with the management of the SIT by the RE. These included:

- (i) Interim stop orders were issued by ASIC on three of the PDSs on 8 August 2017.¹⁷⁰

¹⁶³ Corporations Act, s 994B; see Chapter 7 hereof.

¹⁶⁴ *SIT Report* (n 159), [2.17].

¹⁶⁵ *Ibid*, [2.34]-[2.38].

¹⁶⁶ Corporations Act, s 1041H; ASIC Act, s12DA.

¹⁶⁷ Niall Coburn 'ASIC slow off the mark as retirees lose millions in Managed Investment Scheme' (Thomson Reuters Business Insight 17 December 2020); *SIT Report* (n 159), [4.105].

¹⁶⁸ *SIT Report* (n 159), [4.105].

¹⁶⁹ *Ibid*.

¹⁷⁰ *Theta* (n 88), [73].

- (ii) ASIC issued a final stop order regarding the above three PDSs on 29 August 2017¹⁷¹ (although this was with the consent of the RE).¹⁷²
- (iii) An independent auditor's report dated 29 September 2017 showed that the RE was in financial difficulties with its liabilities exceeding its assets by \$524,350 (which meant it did not comply with its prudential requirements as a RE)¹⁷³ and that its net liability position would increase to \$9,737,564.¹⁷⁴
- (iv) The RE had failed to ensure that the financial statements for SIT were completed and available for audit within 2 months of the relevant period and were lodged with ASIC on or before the lodgement date.¹⁷⁵

The RE had a CC.¹⁷⁶ However, there is no mention of the CC in the judgment in *Theta*,¹⁷⁷ other than that there was one.¹⁷⁸ This lack of commentary in the judgement was likely affected by the court only having before it a Statement of Agreed Facts ('SAF') between ASIC and the defendants.¹⁷⁹ The defendants had also made extensive admissions to ASIC's allegations of breaches of the law. Essentially, there was no contradiction before the court.¹⁸⁰ ASIC must have chosen not to consider the role of the CC in the collapse of SIT, although it held documents related to the role and performance by the CC of its functions (see below). Based on the SAF, the court found that there were significant material breaches of the CP by the RE.¹⁸¹ The court also found that the RE did not have 'an adequate culture of compliance with its

¹⁷¹ Ibid, [74].

¹⁷² Directors' Report for SIT for year ended 30 June 2017, 7.

¹⁷³ ASIC Class Order CO 13/760 which was subsequently replaced by *Financial Requirements for Responsible Entities, IDPS Operators and Corporate Directors of Retail CCIVs Instrument 2023/647*.

¹⁷⁴ *Theta* (n 86), [75]; This was despite the Directors' Report for year ended 30 June 2017 stating the directors believed that the Group would continue as a going concern because they regularly monitored the operations of the sub-trusts of SIT and that financial support was being provided by Sterling First (Aust) Limited and its controlled entities to the Group which enabled it to meet its obligations as and when they fell due.

¹⁷⁵ *Theta* (n 86), [7(f)].

¹⁷⁶ SIT Report (n 159), [2.6].

¹⁷⁷ Ibid.

¹⁷⁸ Ibid, [2.6].

¹⁷⁹ Download from Australian Securities and Investments Commission 'Sterling Income Trust Responsible Entity and its Managing Director penalised' (Media Release 20-292MR, 19 November 2020).

¹⁸⁰ *Theta* n 86, [2].

¹⁸¹ Ibid, [232]–[259]

obligations under the [Corporations] Act'.¹⁸² These were significant material breaches of the CP.

Documents were obtained from ASIC under the FOIA for the purposes of this research project. ASIC has redacted references to other schemes and names of some people referred to in the minutes (including the CC members). Nevertheless, there is sufficient information in the documents produced to draw conclusions about the performance of the CC and the CP audit.

The common theme evident from minutes of the CC is that, in general, the functions of the CC involved no more than a 'box-ticking' exercise with notations of the various registers and reports that were produced to the CC. There is little in the minutes to indicate that there was any more than a mere acceptance by the CC of the veracity of the reports made to it by the RE. There is no questioning or critical analysis of the reports made by the RE to the CC recorded in the minutes.

It was not until 1 August 2018 (after the managing director had reported to the CC that the RE was subject to an investigation by ASIC) that one of the members of the committee queried whether the RE had acted in accordance with the CP and what action would be taken to remove the investment manager.¹⁸³ There is no record of the response to this query or whether the CC took this query any further. This appears to be the last meeting of the CC. A few weeks later, the winding up of the SIT commenced.¹⁸⁴

Despite the finding by the court that the independent auditor's report dated 29 September 2017 showed that the RE was in financial difficulties with its liabilities exceeding its assets by \$524,350,¹⁸⁵ minutes of meetings of the CC for 18 October 2017, 28 February 2018 and 26 April 2018 recorded that there were no issues with the

¹⁸² Ibid, [306].

¹⁸³ The manager was the investment manager, Sterling Corporate Services Pty Ltd, a related entity of the RE; On 02/11/2023, more than 4 years after the collapse of SIT, ASIC announced that three persons had been charged with numerous criminal offences in connection with the collapse: Australian Securities and Investments Commission 'Charges laid following ASIC's investigation into the Sterling Income Trust' (Media Release 23-294MR, 3 November 2023).

¹⁸⁴ Document No. 030206781 lodged with ASIC for SIT.

¹⁸⁵ Ibid, [75].

net tangible assets ('NTA') or forward cash flows. How could this be the case if the CC was carrying out its functions properly?

Over a five-year period from 2013 to 2018, there were a number of reports to the CC of breaches by the RE regarding the auditing and lodgement of financial reports of both the RE and SIT. This is summarised in Table 4.3 (Theta Asset Management: Financial and Audit Issues and Compliance Committee Actions) at page 363. It is apparent from the minutes that no action was taken by the CC despite this continuing problem of late audits and lodgements. This continuing problem should have acted as a 'red flag' to the CC members. Given their duty as members of a CC to exercise the degree of care and diligence that a reasonable person would exercise if they were in the member's position,¹⁸⁶ one would have expected more action from the CC regarding the late audits and lodgements. It is apparent that the committee members must have uncritically accepted explanations by the general compliance manager and/or the managing director. The first time that there was a record in the minutes of ASIC taking the audit issue seriously and the first time that a member of the CC queried whether the RE was in breach of the CP was the last CC meeting on 1 August 2018, 26 days before the commencement of the winding up of SIT.

Table 4.4 (Theta Asset Management: how compliance committee dealt with matters regarding court determined breaches) at page 366, compares the findings of the Federal Court (based on the SAF) with how the CC managed these issues as recorded in its minutes of meeting. This generally shows a mismatch between what was required of the RE and its officers, as determined by the court, and what the CC actually did. Further, the role of the CC largely appears to have been to act merely as a recipient of reports without any directed critical questioning or independent action to ensure that there was real compliance. There was simply 'box ticking' compliance. The minutes reveal that there was no critical thinking concerning the reports made available to the committee. It is hard to fathom the disconnect between what the committee did to ensure compliance and the obvious breaches revealed in the SAF and the court findings. It is apparent that the CC simply failed to critically examine what it was told in the reports for at least 5 years before the SIT was wound up. In

¹⁸⁶ Corporations Act, s 601JD(1)(b).

many instances, the minutes do not disclose any breaches, whereas the SAF did. The CC members, therefore, breached their duty to exercise the degree of care and diligence that a reasonable person would exercise if they were in their position.¹⁸⁷

It was also known to the members of the CC that the audits and lodgement of the financial statements were repeatedly late. The members of the CC did not report these breaches to ASIC. As noted by ASIC in its submissions to the SIT Inquiry, rightly or wrongly, ASIC takes a risk-based approach to investigating MIS. ASIC says this is often triggered by a report from a CC or CPA. The breach report by the RE to ASIC concerning the late lodgement of the audited financial statements and the continued breach of the provisions of the Corporations Act regarding the audit and lodgement by the RE should have resulted in a report by the CC.¹⁸⁸ Any non-compliance by the RE would then have had to have been reported to ASIC.¹⁸⁹ While it is impossible to know whether this would have made a difference to ASIC's response to the breach reports of the RE, it could have made a difference. A CC report would have meant that the breaches were serious, requiring a more rigorous response by ASIC.

The logical conclusion from this is that there was a gatekeeper failure concerning the functions and role of the CC. Given the statutory functions of the CC,¹⁹⁰ it is hard to fathom why the CC did not identify the issues of non-compliance by the RE identified by ASIC for the purposes of the SAF and the court, and either report them to the Board or ASIC as required by law.¹⁹¹ The members are protected by qualified privilege in making such reports, so there is no reason why they could not have reported the non-compliance issues if the breaches had been identified.¹⁹² The managing director was not a member of the CC but attended the meetings.¹⁹³ His presence may have been a psychological influencing factor putting indirect pressure on the CC, even if that was not intended. However, there was no allegation of concealment by the directors, as was the case with CPL and AAM.

¹⁸⁷ Ibid, s 601JD(1)(b).

¹⁸⁸ Ibid, s 601JC(1)(b).

¹⁸⁹ Ibid, s 601JC(1)(c).

¹⁹⁰ Ibid, s 601JC(1).

¹⁹¹ Ibid, s 601JC(1)(c) and (d).

¹⁹² Ibid, s 601JE.

¹⁹³ *Theta* (n 86), [10].

In these circumstances, it is also a puzzle as to why ASIC only sought declarations and pecuniary penalties pursuant to section 1013E and 1013G of the Corporations Act against the RE (but subsequently waived the penalty anyway) and its managing director, plus disqualification orders against the managing director.¹⁹⁴ The other directors of the RE and the members of the CC were not parties to the proceedings. Unfortunately, because this case was dependent on a SAF, it is difficult to know why ASIC took no interest in what the CC did or did not do. ASIC had possession of the material obtained under the FOIA. Why did ASIC not identify the serious failure of the gatekeeper role of the CC?

ASIC's submission to the SIT Inquiry is singularly unhelpful. It is a self-serving justification of its role in the disaster.¹⁹⁵ The role of the CC in the collapse is not dealt with in any of the 96 submissions to the SIT Inquiry, which is surprising. The opprobrium expressed in the submissions is largely directed at the failure of ASIC to act sooner than it did and the lack of a last resort compensation scheme that covers MIS. The transcript for the hearing in the SIT Inquiry also gives no indication that there were any issues raised concerning action or inaction (more to the point) of the CC.¹⁹⁶

This case illustrates that in order for the gatekeeper role of the CC to work effectively, members of the CC must:

- (a) undertake a critical analysis of the reports and explanations they receive from the RE, i.e., their function and role require more than 'box-ticking',
- (b) take note of 'red flags' and investigate such matters properly,
- (c) notify ASIC when required to do so pursuant to section 601JC(1)(b)(ii) of the Corporations Act even where the RE has lodged a breach report with ASIC i.e., the members of the committee should not assume that it is sufficient for there to be a breach report to ASIC where there is non-compliance by the RE even if ASIC has not taken that breach report seriously.

¹⁹⁴ Ibid.

¹⁹⁵ Australian Securities and Investments Commission, Submission No. 1 to Senate Economics Reference Committee *Inquiry into Sterling Income Trust* (November 2021).

¹⁹⁶ Commonwealth of Australia, Official Committee Hansard, Senate, Sterling Income Trust, 16 November 2021 and 18 November 2021.

Despite the above, the CP audit reports for the years ended 30 June 2013 through to 30 June 2018 inclusive were not qualified. How could this be, if they had applied professional scepticism to their task? A reading of the CC minutes would have signalled matters that needed further investigation by the auditor. The role of the CPA, despite the reasonable assurance limitation of the audit report, proved useless in protecting the retail investor.

E. Compliance Monitoring Generally

Regulators in Australia consider CPs or programmes to have an important role in ensuring compliance with the law. Both ASIC and ACCC have obtained compliance program orders from the court as part of the penalties imposed for contravention of relevant legislation.¹⁹⁷ The ACCC has successfully argued that the court should consider whether the company has implemented a compliance system in determining penalties for breaches of the law.¹⁹⁸

However, despite this, research indicates that companies will only implement compliance management systems to the extent required to make those systems look legitimate.¹⁹⁹ According to Parker and Nielsen, the ‘courts and regulators will lack the skills and resources to distinguish genuine, substantive and effective compliance commitment from simply “ticking the boxes”’.²⁰⁰ This research also found that compliance was only improved when there was an investigation by the regulator.²⁰¹ Parker and Nielsen also concluded in a later article that ‘compliance systems are likely, on the whole, to be implemented partially, half-heartedly, and symbolically’ in large Australian businesses.²⁰²

For example, in a case where there was a breach by the Visy companies of the cartel provisions of the former *Trade Practices Act 1974* (now the *Competition and*

¹⁹⁷ See Table 4.5, 369.

¹⁹⁸ *N W Frozen Foods Proprietary Ltd v Australian Competition & Consumer Commission* [1996] FCA 1134.

¹⁹⁹ Christine Parker and Vibeke Lehmann Nielsen, ‘Do Businesses Take Compliance Systems Seriously? An Empirical Study of Implementation of Trade Practices Compliance Systems in Australia’ (2006) 30(2) *Melbourne University Law Review* 441.

²⁰⁰ *Ibid*, 443-444.

²⁰¹ *Ibid*, 453.

²⁰² Christine Parker and Vibeke Lehmann Nielsen, ‘Corporate Compliance Systems Could They Make Any Difference?’ (2009) 41(1) *Administration & Society* 3, 27.

Consumer Act, 2010), the Visy companies had a compliance manual. This compliance manual was cast in the strictest terms with a stern warning that price fixing and market sharing are 'strictly prohibited' and that readers of the document 'must never make (such) arrangements with a competitor'.²⁰³ Despite the strictness of these provisions, the court found that the manual 'might have been written in Sanskrit for all the notice anybody took of it'.²⁰⁴ In other words, the document was worthless, being mere window dressing.

If this is the case with competition and consumer law, it may be that although there is a formal system of compliance necessary to satisfy the minimal legislative requirements, in substance, the compliance arrangements comprising the CP, CC and the CPA may be mere window dressing. Compliance may simply be a 'box-ticking exercise' without any substantive investigation. This certainly is a reasonable conclusion to be drawn from the above case studies. The literature also suggests that this phenomenon of 'box-ticking' compliance is a continuing issue. In 2019, Australia was described as having a 'box-ticking compliance culture'.²⁰⁵ In 2023, Larres and Kelly observed that there is a 'box-ticking compliance attitude which pervades modern business activity'.²⁰⁶ If all that occurs is 'box ticking', then the retail investors suffer twice. Firstly, the retail investor must contribute to the cost of these roles in the fees it has to pay the RE. Secondly, the retail investor can then suffer loss because the cost contribution for which the retail investor is making offers no protection at all.

This takes one back to the statement made by Hanrahan and Ramsay at the commencement of this section to the effect that the whole compliance regime established as part of the legal and regulatory framework in protecting the retail clients has created a compliance industry rather than a culture of compliance. This is what 'box-ticking' compliance creates. There needs to be a movement away from 'box-ticking' to clearly directed scepticism by CCs and CPAs alike if the retail investor is to

²⁰³ *Australian Competition & Consumer Commission v Visy Industries Holdings Pty Ltd (No 3)* [2007] FCA 1617, [319].

²⁰⁴ *Ibid*, [320].

²⁰⁵ David G. Millhouse 'W[h]ither Australia? Will Parliament Act?' (2020) 14:2 *Law and Financial Markets Review* 84, 94.

²⁰⁶ Patricia Larres and Martin Kelly, 'A Framework for Authentic Ethical Decision Making in the Face of Grand Challenges: A Lonerganian Gradation' (2023) *Journal of Business Ethics* 521, 528; also see Kelly (n 69).

be protected, i.e., we can only avoid significant retail investor losses if compliance is treated seriously and is focused.

III. RESEARCH QUESTION 2 - HOW CAN THESE FAILURES BE REMEDIED? (I.E., WHAT THE LAW 'OUGHT TO BE)

In answering Research Question 1, flaws in the effectiveness of the combined operation of the CP, CC, if applicable, and CPA have been identified. These flaws or weaknesses lead to a consideration of what the 'law ought to be', generating propositions for reform that should better protect the retail client.

Based on an analysis of the primary and secondary materials including the results of the Survey and Interviews which have been conducted, and by application of reasoning power to the analysis of that data, conclusions may be drawn that if the following reforms are made to the existing legal and regulatory framework of the MIS regarding combined operation of the CP, CC, if applicable, and CPA, this should strengthen its efficacy and efficiency in protecting retail investors. This is because the combined role of the CP, CC and the CPA as a gatekeeper will be more effective. It will assist in the identification by those members of 'red flags' regarding the operation of the scheme.

A. *First Reform*

As discussed above, similar to the problem with the duties of officers of the RE to the members, there are no entry-level requirements for a person to be a member of a CC. Although ASIC has the power to impose entry-level requirements as a condition of the RE's AFSL, it has not done so.²⁰⁷ Rather, ASIC has sought, through its regulatory guide, to pressure REs into voluntarily imposing entry-level requirements.²⁰⁸ There is no specific legislative support for this. By law, anyone over the age of 18 who is not subject to any disqualification or banning order can be appointed to a CC. No prior education or skills are required.

How can CC members carry out their significant functions if they do not have the required knowledge and skills necessary to identify compliance breaches by the RE?

²⁰⁷ Corporations Act, s 914A.

²⁰⁸ RG 132 (n 10), [132.179]-[132.180].

Although the CC is permitted to commission independent legal, accounting, or other professional advice or assistance at the reasonable expense of the RE, how will they know when it is appropriate to do so if they have no educational qualifications or MIS compliance experience? As Perry puts it, '[s]urely a reasonable person would expect that a person who is responsible for monitoring compliance matters in the provision of financial products and services would be appropriately educated and experienced?'²⁰⁹

If the CC member is to have an effective role as a gatekeeper in the MIS legal and regulatory framework that is more than 'box-ticking', then that member ought to have the knowledge, monitoring abilities and skills to reliably detect misconduct.²¹⁰ Arming CC members with the required knowledge, monitoring abilities, and skills should include a requirement for them to undertake:

- (a) studies in MIS law and, in particular, the various gatekeeper roles, including the CP, CC and CPA, which should ensure that CC members fully understand their role within the legal and regulatory framework,
- (b) studies in historical indicators of fraud and corruption, including training and development of fraud recognition skills, which should assist CC members to better fulfil their gatekeeper role of monitoring compliance by the RE through identification of 'red flags' at an early stage, leading to early reporting both to the RE and/or ASIC,
- (c) training and development of professional scepticism skills to always question and critically test what they are told rather than acting as a 'box ticker' so that they can identify breaches for further investigation at an early stage,
- (d) training in ethical idealism as described by Verwey and Asare, being a concern for the welfare of others, thereby increasing behaviours that reflect a concern for the retail client.²¹¹

²⁰⁹ Mei Ling Perry, 'The Compliance Industry Three Years after Financial Services Reform' (2008) 15(1) *Murdoch University Electronic Journal of Law* 126, 230.

²¹⁰ Miguel Alzola 'Beware of the Watchdog: Rethinking the Normative Justification of Gatekeeper Liability' (2017) 140 *Journal of Business Ethics* 705, 710.

²¹¹ (n 69).

In addition to educational qualifications and training, the CC members should also have experience appropriate for the exercise of the functions of a CC to increase professional judgment capabilities.²¹²

Research by Verwey and Asare shows that high levels of professional scepticism and ethical idealism are important factors for fraud detection.²¹³ Logically, there is no reason why this would not also be transferable or exhibited in other professions, particularly in roles which require similar traits to auditors, such as CC members. Auditors and CC members are important gatekeepers in the legal and regulatory framework of the MIS. In carrying out their roles in that framework, they both need a high level of professional scepticism. Their role is not simply 'box ticking'. Both auditors and CC members need to undertake a critical analysis of the reports and explanations they receive from the RE. They both need to identify 'red flags' and investigate them properly. So much is clear from the Trio Report and the above case studies, particularly the case study regarding SIT.

There is also research that traits such as professional scepticism can be learnt.²¹⁴ Recent research also indicates that intuition and reasoning are important factors in exercising professional scepticism. These factors may also be learnt and developed through repeated experiences in exercising professional scepticism,²¹⁵ as expressed in the following Figure 4.6.

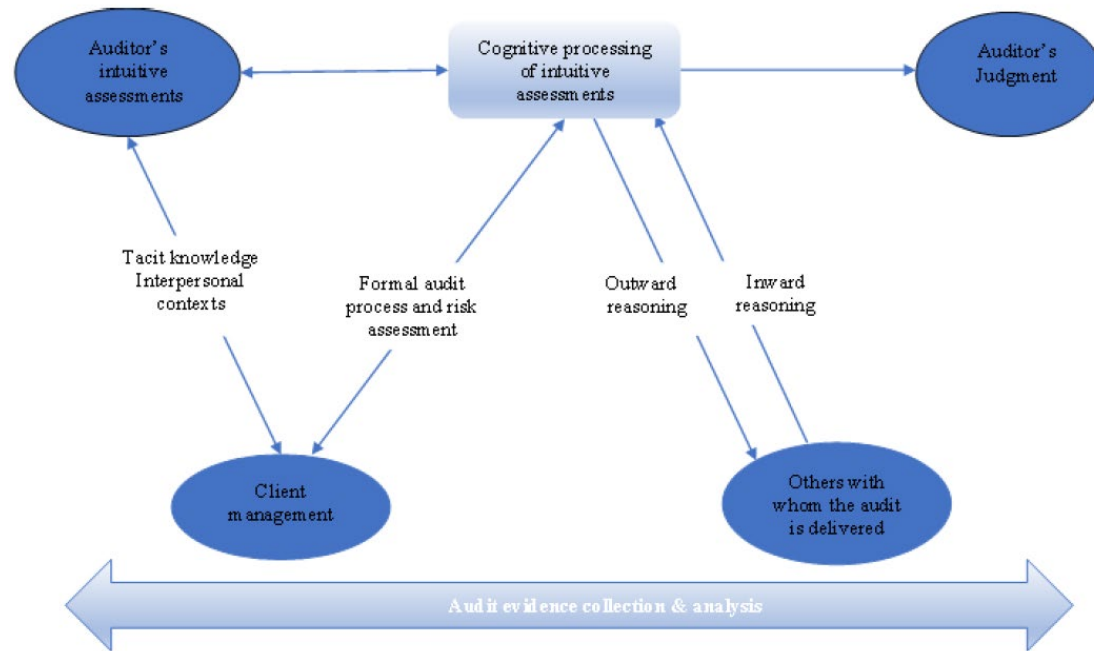
²¹² Andrew West and Sherrena Buckby 'Professional judgement in accounting and Aristotelian practical wisdom' (2023), 36 (1) *Accounting, auditing & accountability journal* 120, 130.

²¹³ (n 69).

²¹⁴ Takiah Mohd Iskander et al 'Inhibiting and driving Factors of Professional Skepticism from the Social Learning Experience' (2015) 10(S2) *International Journal of Economics and Management* 427; Nonna Martinov-Bennie, Maria Cadiz Dyball, Dale Tweedie 'Professional Skepticism through Audit Praxis: An Aristotelian perspective' (2022) 26(2) *International Journal of Auditing* 193.

²¹⁵ Yasser Alnafisah, Mouna Hazgui and Anna Samsonova-Taddei "'The Gut Instinct Gives You Direction and then You Follow It": Exploring the Social-Intuitive Dimension of Auditor Skepticism' (2024) *Journal of Business Ethics* (Springer Nature 3 December 2024), 5.

Figure 4.6 – Development of Auditor Professional Scepticism ²¹⁶



This is similar to Aristotle’s habitual circle at Figure 3.3, page 349. It follows that this trait should also be able to be developed through training undertaken by CC members. In addition, ethical idealism is also a trait that can be developed through training.²¹⁷ In Chapter 3, it was argued that the education and training of directors was important for officers of the RE to develop skills that enable them to instinctively perform their duties in accordance with the law. Similarly, CC members, through education and training, should also develop high levels of both professional scepticism and ethical idealism.

Further, lifting the entry level would give the position of a CC member ‘professional status’ and therefore incentivise the right type of person to accept such a position, which is important for an organisation that manages ‘other people’s money’. Rather than ‘box ticking’, a professional would give critical consideration or examination of the reports and explanations it received from the RE (a feature that was lacking in some of

²¹⁶ Yasser Alnafisah, Mouna Hazgui and Anna Samsonova-Taddei “The Gut Instinct Gives You Direction and then You Follow It”: Exploring the Social-Intuitive Dimension of Auditor Skepticism’ (2024) *Journal of Business Ethics* (Springer Nature, 3 December 2024), 14.

²¹⁷ Martinov-Bennie (n 214).

the above case studies). This incentivisation model is in accordance with the Kolieb diamond regulatory model discussed in Chapter 3.²¹⁸

Although it is old data, Moodie and Ramsay, while noting that it is not a prerequisite for CC members to hold any qualifications or to have any experience, found that members of CCs, as a matter of practice, tended to hold appropriate qualifications. Members tended to be persons from either a financial/accounting background or a legal background, and to a lesser degree, from an operational background.²¹⁹

Nevertheless, they found that CCs were of variable quality resulting from ‘there being no minimal qualifications, training or experience pre-requisites’.²²⁰

As illustrated in the following paragraphs, there is considerable support for this proposed law reform of the role and functions of the CC. It is therefore somewhat surprising that no legislative action along these lines has been taken by successive Governments.

In 2001, the Turnbull Review noted that one perceived weakness of the CC was the lack of any requirement for the members of the committee to have appropriate qualifications and experience. It is therefore recommended that minimum standards be imposed on such members, which should be effected through consultation between ASIC and the industry.²²¹

The PJC, following its inquiry into the Turnbull Review, also recommended that the Corporations Act be amended to require that:

- (a) the CP include detailed minimum standards of competency and integrity which each member must meet,
- (b) any amendments to the CP covering these standards need to be approved by a majority of members before lodgement with ASIC and signed by the members,

²¹⁸ Jonathan Kolieb, ‘When to Punish, When to Persuade and When to Reward: Strengthening Responsive Regulation with the Regulatory Diamond’ (2015), 41(1), *Monash University Law Review* 136; see Chapter 3 above.

²¹⁹ Grant and Moodie (n 31), 26.

²²⁰ Ibid, 79.

²²¹ Ibid, 60, recommendation 10.

- (c) the RE must disclose details of these standards on an annual basis preferably at the same time as details of the committee members are disclosed.²²²

The PJC in the Trio Report also recommended that the Government should investigate options to improve the oversight and operation of CCs, which included legislative requirements as to experience, competence, or qualifications for CC members.²²³

ASIC has also identified this issue as a gap in the legislative provisions.²²⁴ ASIC, in its submissions to the Trio Inquiry, made the observation that there are no current legislative requirements as to experience, competence or qualifications for CC members.²²⁵ This lack of educational training in legal compliance has proven to be an issue in other areas of the provision of financial services, where there have been compliance failures.²²⁶ ASIC also considers that a RE who aims for effective compliance management should have CC members who have relevant tertiary qualifications, work experience and an understanding of the regulatory requirements.²²⁷ This is not supported by specific legislation, which creates a legal issue due to the nature of the regulatory guide.²²⁸ It is very much left to the RE to set its own rules.

If legislation proposed by this first reform was not enacted, ASIC could make this a condition of the RE's licence.²²⁹ However, despite the standard AFSL pro forma conditions applicable to a RE licence being changed 17 times since 2002,²³⁰ ASIC has not imposed such a condition. ASIC could also take a bolder approach with its regulatory guide by requiring CC members to have these qualifications. Section 601HA of the Corporations Act states that the CP 'must set out adequate measures

²²² Turnbull Review Report (n 133), [4.86], Recommendation 7.

²²³ Trio Report (n 3), [7.35],

²²⁴ Ibid, [4.51].

²²⁵ Ibid.

²²⁶ *Australian Securities and Investments Commission v Westpac Securities Administration Limited, re Westpac Securities Administration Limited* [2021] FCA 1008, [57]-[60].

²²⁷ RG 132 (n 10), [132.178].

²²⁸ *Westchester Financial Services Pty Ltd and Australian Securities Commission* [1998] AATA 399, [52].

²²⁹ Corporations Act, s 914A.

²³⁰ Australian Law Reform Commission *Interim Report A Financial Services Legislation* (Report No. 137, November 2021), 360-361.

that the responsible entity is to apply in operating the scheme to ensure compliance with this Act and the scheme's constitution'. Although this does not specifically refer to educational standards, if ASIC imposed such a requirement for CC members, this arguably would be such an adequate measure.

Survey Results	
This proposed reform to the law is supported by the following results of the Survey:	
(a)	68% of respondents agreed their organisation already required an external member of the CC to hold industry-specific qualifications, ²³¹
(b)	80% of respondents agreed their organisation already required an external member of the CC to have experience in the operation of registered schemes, ²³²
(c)	96.2% of respondents agreed their organisation already had guidelines in place to ensure that an external member of the CC is a fit and proper person, ²³³
(d)	80.8% of respondents agreed their organisation undertook independent vetting of proposed appointees to the CC as to their suitability to be a CC member. ²³⁴

Given these responses, there is no reason why all REs should not come into line with this position.

B. *Second Reform*

There is currently no legislative or regulatory requirement for the RE to notify ASIC of the appointment, removal, or resignation of CC members, as there is for the appointment of directors and secretaries of a company. Investors are kept in the dark unless this information is voluntarily disclosed. If there were such a register, the

²³¹ Survey Results, Q18, page 417.

²³² Ibid, Q19. 417.

²³³ Ibid, Q17, 416.

²³⁴ Ibid, Q16. 416.

removal or resignation of a CC member would be publicly available information. Frequent changes of CC members would raise ‘red flags’ both to ASIC and proposed investors that there may be an issue or problem within the management of the RE in the operation of its scheme. This would then enable regulatory action to be taken earlier than might otherwise occur. This information should also be made available on the website of the RE, and the annual report should include a statement of any changes in the composition of the CC during the previous 12 months. This should ensure that information concerning changes in the composition of the CC is readily available to prospective investors.

This proposed reform is supported by the response of Participant 2 in the Interview. This Participant saw no reason why members should not be able to go to the committee members. This Participant also said that a report could be an alarm bell for the committee members.²³⁵ This proposed reform is also supported by the following Survey results.

Survey Results
70.4% of respondents agreed that changes in membership of the CC should be disclosed by publicly available notification to ASIC and in the annual report. ²³⁶

This reform is also supported by the recommendations of the Turnbull Review ²³⁷ and the Turnbull Review Report.²³⁸

C. *Third Reform*

Although it seems to be implied from the fact that if there are at least an equal number of external directors on the board of the RE then no CC is required, there is no express provision that requires external directors to exercise any particular

²³⁵ Interview Transcript, page 468.

²³⁶ Survey Results, Q20, page 418.

²³⁷ Turnbull Review (n 86), 62, recommendation 11.

²³⁸ Turnbull Review Report (n 133), [4.38], recommendation 2.

compliance duties similar to that of the CC (albeit the nature of their director duties to members may cause this to occur in any event). This is a gap in the law.

Therefore, the law should be amended to clarify that if there is no CC, the external directors should be required to perform the legislative functions of the CC as if they were the CC.²³⁹ In addition, the external directors should have the rights of a CC to commission independent legal, accounting, or other professional advice or assistance, at the reasonable expense of the RE.²⁴⁰ Although the external directors are subject to the duties to members in section 601FD(1) of the Corporations Act, in addition in their role as compliance monitor, they should be subject to the duties in section 601JD(1) of the Corporations Act as if they were CC members and should have the qualified privilege which attaches to CC members in section 601JE of the Corporations Act.

Survey Results
This proposed reform to the law is supported by the results of the Survey, which found that 90% of respondents agreed that if their organisation did not have a CC, then the external directors of the Board took an active role in engaging with compliance issues. ²⁴¹

This reform is also supported by the Turnbull Review, which recommended that where there is no CC appointed, the requirements in Chapter 5C of the Corporations Act governing the content of CPs concerning the CC, and the provisions setting out the functions of the CC, should be applied, with appropriate modifications, to the board of the RE.²⁴² The Turnbull Review Report also recommended that the Corporations Act be amended to require that:

²³⁹ i.e., the functions set out in the Corporations Act, s 601JC(1).

²⁴⁰ Corporations Act, s 601JC(2).

²⁴¹ Survey Results, Q30, page 425.

²⁴² Turnbull Review (n 86), 68, recommendation 13.

- (a) those aspects of the CP covering the membership, holding of meetings and so on, as far as appropriate, apply to the board when acting in the compliance monitoring role; and,
- (b) the functions and duties applicable to the CC, as far as appropriate, apply to the board when acting in the compliance monitoring role.²⁴³

D. *Fourth Reform*

The Trio case study illustrates that where a registered MIS is investing in offshore assets, the CP should be strengthened regarding the investments, particularly in the areas of the protection and valuation of scheme property. Therefore, the fourth proposed reform is to require that, where the RE is investing offshore, the provisions of the CP dealing with:

- (a) the arrangements to ensure that all scheme property is clearly identified as scheme property and held separately from property of the RE and property of any other scheme, and
- (b) the valuation of scheme property at regular intervals appropriate to the nature of the property,

must be more acutely focused on procedures to prevent fraud. ASIC can amend its regulatory guide to require this without any legislative action being required because these administrative changes will fall within the requirements of the obligation for the CP to contain 'adequate measures'.²⁴⁴

E. *Fifth Reform*

As seen from the above case studies, under the present accounting standards, the CP audit provides limited protection for the retail investor due to its inherent limitations, being made only on a reasonable assurance basis. Reliance on the report by the retail client is also disclaimed.²⁴⁵ This enables a CPA to escape responsibility for carrying out the CP audit despite any failure to apply the required level of professional

²⁴³ Turnbull Review Report (n 133), [4.54].

²⁴⁴ Corporations Act, s 601HA(1)(a) and (c).

²⁴⁵ (n 64).

scepticism. This problem is not limited to Australia. The USA Securities and Exchange Commission's ('SEC') chief accountant has been quoted as saying he is 'fed up ... hearing from auditors what they do not do'.²⁴⁶ These limitations have also caused pleading difficulties in cases where the CPA has been a defendant.²⁴⁷

The scheme members indirectly bear the costs through the inclusion of the audit cost within the REs' fees, deducted from the scheme property. However, for the above reasons, there is little, if any, benefit for the retail investor from the CP audit. On a cost-benefit analysis, it is hard to justify the inclusion of this audit in the regulatory framework. Nevertheless, the following reforms to the current regulatory framework should rectify the weakness in the current model.

Firstly, as suggested by ASIC and recommended by the PJC, anyone wishing to be appointed as a CPA should be required to obtain specific approval; i.e., merely being a registered company auditor will not be sufficient. This would enable ASIC to impose conditions on the appointment.²⁴⁸ Such conditions should include meeting the prescribed training and experience prerequisites relevant to CP audits. It would ensure that the auditor has high levels of both professional scepticism and ethical idealism, similar to that referred to in the first reform above, for members of the CC. Also, this reform would enable suitably qualified persons other than accountants, such as MIS lawyers and MIS compliance managers, to be appointed, who, because of their qualifications and experience, would be aware of what to look for to identify non-compliance.

Secondly, qualitative standards should be imposed pursuant to which CPAs must conduct their audits.²⁴⁹ Encouragingly, there are moves by the International Auditing and Assurance Standards Board to strengthen standards on fraud detection, requiring

²⁴⁶ Stephen Foley 'Auditors found wanting in role as investor's line of defence' *Financial Times* (UK, 7 May 2024).

²⁴⁷ *Mercedes Holdings Pty Limited v Waters (No 2)* [2010] FCA 472; *Mercedes Holdings Pty Ltd v Waters (No 3)* [2011] FCA 236; *Mercedes Holdings Pty Ltd v Waters (No 5)* [2011] FCA 1428; *Mercedes Holdings Pty Limited v Waters (No 8)* [2013] FCA 601 ; *LM Investment Management Pty Ltd (in liq) v Ernst & Young* [2017] QSC 73; *LM Investment Management Ltd (in liq) v EY (No 2)* [2018] QSC 226.

²⁴⁸ Trio Report (n 3), [4.54], [4.55], [7.34], [7.35].

²⁴⁹ Ibid, [7.35].

auditors to look for misstatements that might be qualitatively, if not quantitatively, material despite the bleatings by auditors.²⁵⁰

IV. RESEARCH QUESTION 3 - ON THE BALANCE OF PROBABILITIES, WILL THE PROPOSED REFORMS TO ADDRESS THESE FAILURES CAUSE REs TO ABANDON THE RETAIL MARKET THEREBY RESTRICTING INVESTMENT CHOICE BY RETAIL CLIENTS

These proposed reforms should not cause REs to abandon the retail market. None of the proposed reforms places onerous obligations on the RE. The reforms should reduce the risk of the RE being in breach of its duties to members through the strengthening of the gatekeeper role that will follow from those reforms. The consequent reduction of risk to the RE in its operation of MIS should reduce the prospects of the RE having to defend any regulatory or class action by retail investors for the loss and damage suffered by them. The costs of such actions will be avoided. In turn, this will avoid reputational damage, the cost of which can be fatal to any business, as evidenced by the fall from grace of AMP.²⁵¹ This reduction in risk should also result in a reduction of professional indemnity insurance, which is proving increasingly difficult to obtain. Therefore, the reforms should result in the cost-benefit ratio of the reforms favouring the benefit over its cost.

A. *First Reform*

The first reform which is to lift the entry level of CC members is consistent with requirements of many professions including financial advisors who are authorised to give personal advice to retail clients.²⁵² It is also consistent with the analysis in Chapter 3 regarding the duties of officers to scheme members. This should enhance the position of the CC member and therefore incentivise the right sort of person to train to take up such a position. As a result, the CC will consist of external members who have a reputational stake in ensuring compliance.²⁵³ Such external members will

²⁵⁰ Foley (n 246).

²⁵¹ Monica J Keneley 'The shifting corporate culture in the financial services industry: Explaining the emergence of the 'culture of greed' in an Australian Financial Services Company', (2023) 65(4) *Business History* 583.

²⁵² Corporations Act, Division 8A of Part 7.6.

²⁵³ Jennifer Payne 'The Role of Gatekeepers' (N Maloney, E Ferren and J Payne (ed), Oxford Handbook of Financial Regulation, 2014), 3-4; Daniel Tibbets 'Tarnished reputations:

go beyond 'box-ticking' rule compliance and adopt the learnt traits of professional scepticism and ethical idealism.²⁵⁴ There should be a greater probability of breaches, including fraud, being identified and reported.²⁵⁵

Given the existing extensive legislative duties of the RE²⁵⁶ and its officers²⁵⁷ to the scheme members, engaging properly trained CC members should not be burdensome or costly for REs. Firstly, this reform will assist these gatekeepers with their role regarding compliance. Secondly, this reform should enhance the marketability of the MIS product to retail investors because they should be able to put their trust in a regulatory regime where the gatekeeper role actually operates as intended. Therefore, this first reform proposal should not cause REs to abandon the retail market. In fact, it may well benefit REs in attracting more investment from retail investors because of the confidence generated by this reform.

Survey Results
The Survey results support this position, with 92.3% of respondents agreeing that their organisation would not reduce the availability of its products to retail investors if members of the CC were required to hold relevant tertiary qualifications and work experience before appointment. ²⁵⁸

B. Second Reform

The second reform is not onerous. Companies must already notify ASIC of the appointment and cessation of directors and secretaries.²⁵⁹ Adding CC members to this list, therefore, cannot be onerous, particularly if there is little movement of committee members. Also, placing the information on the website and inclusion in the annual

gatekeeper liability after janus' (2015) 20(3) *Fordham Journal of Corporate and Financial Law* 745, 748 and 770-771; Richard E. Moberly 'Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers' (2006) 5 *Brigham Young University Law Review* 1107, 1113.

²⁵⁴ Verwey and Asare (n 211).

²⁵⁵ Ibid.

²⁵⁶ Corporations Act, s 601FC(1).

²⁵⁷ Ibid, s 601FD(1).

²⁵⁸ Survey Results, Q72, page 452.

²⁵⁹ Corporations Act, s 205B.

report is very simple and again not onerous. Participant 2 in the Interview had no difficulty in placing this information on its website. Further, full disclosure does make the process much more transparent for investors in MIS. These requirements are only ‘tick the box’ requirements that even a clerk within the organisational structure of the RE can follow and ensure take place. Therefore, this reform proposal should not cause REs to abandon the retail market.

Survey Results
The Survey results support this position, with 92.3% of respondents agreeing that their organisation would not reduce the availability of its products to retail investors if the RE were required to notify ASIC and members of the scheme of changes in the membership of the CC. ²⁶⁰

C. *Third Reform*

The third reform is not onerous. Arguably, there is already an obligation on external directors to take on the role that the CC would have but for the fact that there are at least an equal number of directors on the board of the RE.

Survey Results
The Survey indicates that this is the practice of many REs. Ninety per cent (90%) of respondents to the Survey whose organisation did not have a CC, agreed that the external directors of the Board in their organisation took an active role in engaging with compliance issues. ²⁶¹

D. *Fourth Reform*

The fourth reform only applies where the RE invests offshore. Even if this is onerous, it is a fair trade for the loss of retail investor protection that followed the repeal of

²⁶⁰ Survey Results, Q71, page 452

²⁶¹ Survey Results, Q30, page 425.

section 601FC(4) of the Corporations Act for the benefit of REs in order to make investments offshore previously not permitted.

E. *Fifth Reform*

The fifth reform is not onerous. CPAs must, amongst other things, carry out an audit of the RE's compliance with the CP.²⁶² In doing so, the CPA has a duty to conduct the audit with due skill and care.²⁶³ This proposed reform will ensure that the CPA possesses the skills that they should already have as an auditor to carry out the audit for which they are well rewarded at the cost of the retail client. This reform would also increase competition by opening the market for the appointment of non-accountants.

F. *Conclusion*

Therefore, it should be possible to avoid on-going significant losses being suffered by retail investors without restricting their investment choice due to REs abandoning the retail market if these five reforms are made.

²⁶² Corporations Act, s 601HG(3) and (4) (for an individual), (4A) (for an audit company), (4B) for a lead auditor.

²⁶³ *Frankston & Hastings Corporation v Cohen* (1960) 102 CLR 607, 612, 619, 621, 622, 625, 628.

CHAPTER 5: MIS AND RELATED PARTY TRANSACTIONS (RPTs)

'The Australian NBFE sector has been plagued with abhorrent and egregious conduct associated with related party transactions (RPTs) and consequential conflicts of economic interest.'¹

I. INTRODUCTION

From the analysis of the history of collective investment schemes ('CIS') set out in Chapter 1, three Research Questions were generated concerning different aspects of the legal and regulatory framework designed to protect retail investors where that framework had been found wanting. One of the areas identified concerned RPTs.² In this Chapter, an analysis of this area of regulation of the MIS is undertaken using the methodological and philosophical approaches to research referred to in Chapter 2 to ascertain the answers to the three Research Questions in sections II, III and IV below. The answers identify reforms to the 'law as it is' to improve the legal and regulatory framework to better protect retail investors from harm.

In the context of a registered managed investment scheme ('MIS'), an RPT is a transaction where:

- (a) the benefit is given by any of the responsible entity ('RE'), an entity it controls, its agent or a person it engages,
- (b) the benefit is given out of scheme property or could endanger scheme property; and
- (c) the benefit is given to any of the RE, an entity it controls, its agent or a person it engages, or a related party of any of those persons.³

The requirement to obtain member approval, unless a relevant exception applies, is particularly important for registered MIS because the focus of the RPT provisions, as they apply to registered MIS, is the protection of scheme property which the RE holds

¹ David G Millhouse "Empirical analysis supports Hayne long run reform thesis" (2019) 13(2-3) *Law and Financial Markets Review* 162, 163; 'NBFE' acronym for 'Non-Bank Financial Entities'.

² *Corporations Act 2001* (Cth) ('Corporations Act'), Part 5C.7.

³ Australian Securities and Investments Commission, *Related Party Transactions* (Regulatory Guide 76, 30 March 2011), [RG 76.11].

on trust for the members.⁴ The legislative purpose of the provisions is to protect the members of the registered MIS as a whole.⁵

While the literature referred to below concerns RPTs by public companies, rather than MIS specifically, similar issues arise and therefore are relevant to the consideration of what the 'law ought to be' to deal with flaws in the regulation of RPTs as they affect registered MIS.⁶

Alternative theories exist that seek to explain the underlying nature of RPTs.⁷ These theories work in opposite directions. Academics are also divided between the merits of the two theories.⁸ The first theory is the 'efficient transactions theory'.⁹ This theory is that RPTs are sound business exchanges and efficiently fulfil the underlying economic needs of the fund.¹⁰ Therefore, RPTs are not harmful.¹¹ Rather, there are benefits to be had from RPTs.¹² The second theory is the 'conflicts of interest theory'.¹³ This theory considers that RPTs are potentially harmful.¹⁴ Such transactions may be carried out in the interests of the related party in order to expropriate wealth from the members to the related party, called 'tunnelling'.¹⁵ RPTs may also compromise the

⁴ *Corporations Act 2001* (Cth) ('Corporations Act'), s 601FC(2).

⁵ *Ibid*, s 601LB.

⁶ Chapter 2E of the Corporations Act that applies to public companies is amended to enable those provisions to apply to registered MIS.

⁷ Elizabeth A Gordon, Elaine Henry and Darius Palia, 'Related Party Transactions and Corporate Governance' (2004), 9 *Corporate Governance Advances in Financial Economics* 1; John Hynes Farrar and Susan Watson, (2011) 'Self-Dealing, Fair Dealing and Related Party Transactions - History, Policy and Reform' (2012) 11(2) *Journal of Corporate Law Studies* 495; Alexandra Corlaciuc and Adriana Tiron Tudor 'Related Party Transactions – Overview' (2011) 13(2) *Annales Universitatis Apulensis Series Oeconomica*, 247; Michele Pizzo, 'Related party transactions under a contingency perspective' (2013) 17 *Journal of Management and Governance* 309; Luca Enriques, 'Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)' (2015) 16 *European Business Organization Law Review* 1; Tiffany Dwijaya Hendratama and Zuni Barokah 'Related party transactions and firm value: The moderating role of corporate social responsibility reporting' (2020) 13 *China Journal of Accounting Research* 223; Kinshuk Saurabh 'Separating abusive from efficient related-party transactions: evidence from India' (2023) 31(4) *Asian Review of Accounting* 631, 635; Bilal Al-Dah, Mustafa A. Dah and Moataz El-Helaly, 'Board diversity and related party transactions' (2025) 77 *Finance Research Letters* 107046.

⁸ Farrar & Watson (n 7), 498.

⁹ *Ibid*.

¹⁰ Pizzo, (n 7), 317.

¹¹ *Ibid*.

¹² *Ibid*.

¹³ *Ibid*.

¹⁴ *Ibid*, 311.

¹⁵ *Ibid*, 312.

role of independent directors in monitoring such transactions and may lead to deceptive and fraudulent conduct.¹⁶ ASIC considers that ‘almost by definition’ RPTs involve conflicts of interest.¹⁷ As such, the RE and its officers are required to give priority to the members’ interests.¹⁸ There is also evidence that RPTs are often central to fraud and are likely to have been involved in misappropriation by the CEO or CFO.¹⁹

Although recent literature distinguishes between good and bad types of RPTs, the literature is still divided between the two theories.²⁰ Research indicates that although RPTs do have a negative relationship with firm performance, RPTs can be value-enhancing when there is the presence of business-relatedness among affiliates²¹. The reason for this is that the RPTs are driven by transaction cost concerns rather than expropriation concerns.²²

In Asian countries, which are said to be characterised by highly concentrated ownership structures, recent research indicates that RPTs are a double-edged sword, i.e., they can be both value-destroying and value-enhancing.²³ The research indicates that although related party sales are negatively related to firm value, when firms have a policy of corporate social responsibility (‘CSR’), the outcome of RPTs becomes more positive. The conclusion from this research is that a policy of CSR indicates ethical concerns within the firm that may be the driving force of firms being less opportunistic and more reflective of the firm’s incentives to be trustworthy and ethical,²⁴ i.e., they act for the sake of duty.²⁵

¹⁶ Ibid, 313.

¹⁷ RG 76 (n 3), [76.1].

¹⁸ Corporations Act, ss 601FC(1)(c) and 601FD(1)(c).

¹⁹ Elaine Henry, Elizabeth Gordon, Brad Reed and Timothy Louwers, ‘The Role of Related Party Transactions in Fraudulent Financial Reporting’ (2012) 4(1) *Journal of Forensic & Investigative Accounting* 186.

²⁰ Hong-Da Wang, Chia-Ching Cho and Chan-Jane Lin, ‘Related party transactions, business relatedness, and firm performance’ (2019) 101 *Journal of Business Research* 411

²¹ Ibid.

²² Ibid.

²³ Hendratama, (n 7), 224.

²⁴ Ibid.

²⁵ Immanuel Kant ‘*The Moral Law Groundwork of the Metaphysic of Morals*’ Translated by HJ Paton (Routledge 2005), 10.

Both theories have inconsistencies. RPTs may serve fraudulent or deceptive purposes (conflicts of interest theory), but in other cases may satisfy sound economic needs (efficient transactions theory).²⁶ Therefore, the regulatory response to impose tighter disclosure and monitoring requirements may not achieve the desired result. This may also increase costs and complexity.²⁷ If the costs imposed by increased regulation were to increase too far, the result may lead to REs abandoning the retail market altogether.

Pizzo suggests that a contingency approach to dealing with RPTs with companies allows for an overlap of both theoretical frameworks.²⁸ The aim is to find effective measures that protect investors but do not impose inappropriate or excessive burdens on what may well be sound economic dealings.²⁹ With this contingency approach, the potential risks and benefits associated with specific categories of RPTs are interpreted through the lens of organisational context and institutional environment and then assessed in accordance with existing governance mechanisms.³⁰ This will then affect how RPTs are regulated.

While this literature relates to companies rather than registered MIS, nevertheless, RPTs have also proved to be a persistent problem with collective investment schemes ('CIS'). As far back as 1974, the Rae Committee concluded that,

the positive earning ability of mutual funds and other types of collective investment is liable to be compromised when the effective controllers of the funds have other predominant interests and have the power to enlist the resources of the funds for the advancement of those interests.³¹

The problem of RPTs has continued despite the current legal and regulatory framework governing RPTs designed to protect consumers.³² For example, in 2012, a review by ASIC of REs operating registered MIS in the unlisted property sector

²⁶ Wang (n 20) and Hendratama (n 7).

²⁷ Pizzo, (n 7), 326.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Ibid.

³¹ Select Committee on Securities and Exchange *Australian securities markets and their regulation* (Report, 1974), [12.4].

³² (n 2).

indicated there were inadequate controls to manage RPTs.³³ Further, in 2019, the Hayne Royal Commission ('Hayne') conducted a case study of Colonial First State Investment Limited ('CFSIL').³⁴ CFSIL invested money from the superannuation funds it managed in the MIS, of which it was the RE. Hayne found that its conduct was weighted in favour of generating or retaining fees for its own use or a related party. This was not in the members' best interests. When discovered, CFSIL simply treated the conduct as 'part of the ordinary machinery of business'.³⁵ More recently, in 2023, directors of a RE were held to have been in breach of their duties to members of a MIS because loans were made to related parties without member approval.³⁶

Despite what may be a devastating effect on members if the RE does not obtain member approval for an RPT, the imposition of civil and criminal sanctions for breach of the requirement to obtain member approval, designed to deter wrongful behaviour, has proved problematic. The ALRC Report 65³⁷ recommended that the principles contained in the RPT provisions of the then Part 3.2A of the Corporations Law for public companies should be adapted for use with MIS. The intention was to regulate transactions where a scheme operator or its associates or any other related party could receive a financial benefit from dealings involving scheme assets.³⁸ The ALRC Report 65 also proposed that where there was a breach of the RPT provisions, both the scheme operator and other persons involved in the breach should be liable for a civil or criminal penalty.³⁹

However, because the RPT provisions that apply to registered MIS⁴⁰ were enacted by way of modification of the RPT provisions that apply to public companies,⁴¹ the effect

³³ Australian Securities and Investments Commission 'ASIC review of unlisted property MIS sector' (Media Release 12-168MR, 17 July 2012).

³⁴ Kenneth M Hayne, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, 1 February 2019) ('Hayne') (2), [2.2.6], [2.3.6] and 2.3.8].

³⁵ Ibid, [2.3.8].

³⁶ *Australian Securities and Investments Commission v Daly* (Liability Hearing) [2023] FCA 290, [384], [390], [392], [393]-[394]; *Australian Securities and Investments Commission v Daly* (Penalty Hearing) [2024] FCA 3, [11]-[14]; (appeal dismissed in *Daly v Australian Securities and Investments Commission* [2024] FCAFC 125).

³⁷ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65,1993) ('ALRC Report').

³⁸ Ibid, [10.25].

³⁹ Ibid.

⁴⁰ Corporations Act, Chapter 5C.7.

⁴¹ Ibid, Chapter 2E.

was to exclude the RE from liability for civil or criminal penalties.⁴² Therefore, REs were not directly made accountable. Only a person who is involved in a contravention of the RPT provisions by the RE (but strangely not the RE) is liable for a civil penalty and commits an offence but only if their involvement is dishonest.⁴³

The definition of an RPT for a registered MIS necessarily involves a conflict between the members' interests and the RE's interests because the benefit is given out of, or endangers, scheme property. The RE has a duty to give priority to members' interests where there is a conflict between the members' interests and the RE's interests.⁴⁴ Therefore, where the RPT provisions are contravened, the RE will likely also contravene, or be involved in the contravention, of this duty to scheme members. This link between an RPT and the RE's duties is consistent with the case law, which illustrates that where the RE was in breach of the RPT provisions, the RE was also in breach of its duties to scheme members.⁴⁵ It is also consistent with research that indicates a 100% correlation between the two.⁴⁶

This link between an RPT and the RE's duties is not surprising given the history of the 'no conflicts rule'. Lord Cranworth⁴⁷ held that where a person is subject to fiduciary duties, that person is prohibited from entering into 'engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect'.⁴⁸ This was later modified and narrowed so that the words 'which possibly may conflict' were interpreted to mean that there was 'a real or sensible possibility of conflict'.⁴⁹ Similarly, the High Court

⁴² Corporations and Markets Advisory Committee, *'The establishment and operation of managed investment schemes Discussion paper March 2014'* (Discussion Paper, March 2014) (CAMAC 2014 Discussion Paper), [7.5].

⁴³ Corporations Act, s 209 as amended by s 601LA.

⁴⁴ Corporations Act, s 601FC(1)(c).

⁴⁵ *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342, [765]; *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497, [19]-[20], [32]-[33], [41]-[42], [53]-[54]; *Australian Securities and Investments Commission v Managed Investments Ltd (No 9)* [2016] QSC 109, [759]; *Australian Securities and Investments Commission v Linchpin Capital Group Ltd* [2018] FCA 1104, [51]; *Agricultural Land Management Ltd -v- Jackson [No 2]* [2014] WASC 102, [251]; *Daly* (n 36).

⁴⁶ *Millhouse* (n 1), 176.

⁴⁷ *Aberdeen Railway Company v Blaikie Bros* (1854) 1 Macq 461.

⁴⁸ *Ibid.*

⁴⁹ *Phipps v Boardman* [1967] 2 AC 46; *Chan v Zacharia* (1984) 154 CLR 178.

considered this rule requires a 'significant possibility' of conflict,⁵⁰ or a 'real or substantial possibility of conflict'.⁵¹

The 'no conflicts rule', as modified, gave rise to the 'no profit rule'. This has the effect that a:

fiduciary is liable to account for a profit or benefit if it was obtained (1) in circumstances where there was a conflict, or possible conflict of interest and duty or (2) by reason of the fiduciary position or by reason of the fiduciary taking advantage of opportunity or knowledge which he derived in consequence of his occupation of the fiduciary position.⁵²

Because of this close relationship between the RPT provisions and the duties of the RE to members of the MIS, the anomaly in the RPT provisions that excludes the RE from liability for civil penalties for breach of the RPT provision is avoided. The RE will be subject to a civil penalty if they are in breach of any of its respective statutory duties to scheme members.⁵³ If a court makes a declaration that the RE has contravened that civil penalty provision, ASIC may seek an order for disqualification⁵⁴ or a pecuniary penalty.⁵⁵ The court in such an event may also make a compensation order for the damage suffered by the scheme, including the disgorgement of profit.⁵⁶

The RPT provisions governing MIS have rarely been litigated.⁵⁷ There are only eight reported cases (disregarding appeals) in which these provisions have been considered in the MIS context.⁵⁸ This does not mean that REs do not breach these provisions. In the company context, RPTs have been said to be 'rife in Australian

⁵⁰ *Chan* (n 49) (Deane J), [24].

⁵¹ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 103, (Mason J).

⁵² *Ibid*, [95].

⁵³ Corporations Act, s 601FC(5) and s601FD(3) with s 1317E; cases at (n 45).

⁵⁴ *Ibid*, s 206C.

⁵⁵ *Ibid*, s 1316G.

⁵⁶ *Ibid*, s 1317H.

⁵⁷ Tom Clarke 'Related Party Dealings out of Managed Investment Schemes: Four Quandaries Addressed' (2018) 36 *Corporations and Securities Law Journal* 342, 346

⁵⁸ *Waters v Mercedes Holdings Pty Limited* [2012] FCAFC 80; *Australian Property Custodian (No 3)* (n 45); *Jackson [No 2]* (n 45); *Managed Investments Ltd (No. 9)* (n 45); *Avestra* (n 45); *Linchpin* (n 45); *Walsh & Company Investments Limited as responsible entity of Fort Street Real Estate Capital Fund I, Fort Street Real Estate Capital Fund II, Fort Street Real Estate Capital Fund III and Fort Street Real Estate Capital Fund IV (Plaintiff)* [2020] NSWSC 1746; *Daly (Liability)* (n 36).

listed companies'.⁵⁹ RPTs are also common in non-bank financial entities ('NBFE').⁶⁰ Logically, there is no reason why MIS would not be similarly affected.⁶¹ This is particularly so given the temptation of easy access to 'other people's money'. Although it is some time ago, consistent with later research,⁶² in 2003, in the context of RPTs by public companies, Governance Metrics International Inc ('GMI'), conducted a corporate governance review of the largest 50 listed companies in Australia. GMI was troubled by the large number of RPTs that occurred.⁶³ It described the level of RPTs as 'astounding by US or UK standards'.⁶⁴ A study by the Organisation for Economic Co-operation and Development ('OECD')⁶⁵ found that the potential for the RPT provisions to be abused is viewed worldwide as an important policy issue, even though RPTs are generally not banned.⁶⁶ The OECD also found that although the incidence of RPTs varied widely, on the whole they were significant among member countries.⁶⁷

II. RESEARCH QUESTION 1: HOW DOES THE LEGAL AND REGULATORY FRAMEWORK OF THE MIS FAIL TO PROTECT THE RETAIL INVESTOR REGARDING RPTs?

A. Case Studies

The following case studies are examples of where the 'law as it is' governing RPTs involving registered MIS failed to protect retail investors. Because these cases are deviant, i.e. outside the norm, they revealed causal pathways to understanding this

⁵⁹ Alan Dignam and Michael Galanis, 'Australia Inside-Out: The Corporate Governance System of the Australian Listed Market' (2004) 28(3) *Melbourne University Law Review* 623.

⁶⁰ David G Millhouse 'From Campbell to Hayne: W[h]ither Australia? Australian financial regulation and supervision at a cross-roads' (2019) 13(2-3) *Law and Financial Markets Review* 81, 82 and 88.

⁶¹ Millhouse (n 1), 163.

⁶² Millhouse (n 60), 82 and 88.

⁶³ Dignam (n 59).

⁶⁴ Ibid citing Florence Chong, 'Top 50 Guilty of In-House Deals', *The Australian (Sydney)*, 10 June 2003, 18.

⁶⁵ Organisation of Economic Cooperation and Development 'Related Party Transactions and Minority Shareholder Rights' (Report, 2012) 9, 11.

⁶⁶ Ibid.

⁶⁷ Ibid, 30.

phenomenon, thereby allowing one to deduce what the ‘law ought to be’ in answering Research Question 2.⁶⁸

1. Case Study 1 - Avestra Asset Management ('AAM')

The facts in this case are set out in Chapter 4 at Section (II)(B), 117, so are not repeated here. In short, the RE gave a number of financial benefits out of the scheme property of the registered MIS that it operated without member approval. This was in contravention of the RPT provisions.⁶⁹ Two of the directors used ‘other people’s money’ for the benefit of themselves or their related parties.

This case involved three issues regarding the RPT provisions that reveal weaknesses in the regulatory framework for RPTs relating to registered MIS.

The first issue concerned the drafting methodology used in the RPT provisions.⁷⁰ Rather than setting out the provisions in a comprehensible way so that non-lawyer directors and compliance personnel can easily understand the provisions, the draftsman simply amended the provisions in Part 2E of the Corporations Act that were designed for public companies so that those provisions could apply to registered MIS. Beach J referred to the difficulties created by the drafting methodology of the RPT provisions and, in particular, the interpretation of ‘financial benefit’ and ‘related party’.⁷¹ His Honour illustrated this difficulty by annexing to his judgement, a marked-up version of Part 2E as modified by Part 5C.7 of the Corporations Act.⁷² To enable the provisions to operate effectively:

- (a) a broad interpretation was taken as to what constituted the giving of a ‘financial benefit’, focusing on matters of economic and commercial substance,⁷³ and,

⁶⁸ See Chapter 2 above.

⁶⁹ *Avestra* (n 45), [97], [105], [143].

⁷⁰ Corporations Act. Part 5C.7.

⁷¹ *Avestra* (n 45), [146]-[149], [168]-[180].

⁷² *Ibid*, [146].

⁷³ *Ibid*, [164].

- (b) the expression 'related party' was interpreted as extending to any person who was a related party of the persons who were the giver of the financial benefit.⁷⁴

The second issue concerned the lack of disclosure of the RPTs, even if a meeting of members is not required. Beach J found that the RE not only failed to make appropriate disclosure of the RPTs to members,⁷⁵ but also concealed them.⁷⁶ Beach J said that the concealment was 'undertaken for the purpose of [the RE] avoiding its statutory obligations and regulatory oversight' in contravention of the statutory protections for members regarding RPTs.⁷⁷

The third issue that arose was that, in Kantian terms, two of the officers acted for the sake of self-interest rather than for the sake of duty.⁷⁸ If they had acted out of duty rather than self-interest, the RPTs would not have occurred without member approval.

2. Case Study 2 – Premium Income Fund ('PIF')

The RE was MFS Investment Management Ltd ('MFSIM'). The facts in this case are set out in Chapter 3 at section (II)(D), 162, so are not repeated here. In short, it was held that the directors were in breach of their duties to members by reason of engaging in RPTs without member approval.⁷⁹ The court described the actions of MFSIM's directors as a 'sorry tale of the misuse of other people's money by those who should have known better'.⁸⁰ MFSIM's directors had used the PIF as a 'slush fund'.⁸¹

MFSIM's directors created false documents to hide the payments made by the RE out of scheme property to a related party.⁸² Therefore, far from disclosure of the RPTs, the RPTs were concealed. This was similar to what occurred in *Avestra*.

⁷⁴ Ibid, [175]; also see Table 5.1 (Bespoke RPT provisions for registered MIS), page 371, which illustrates how s 208, as modified by s 601LC of the Corporations Act, would read if Beach J's interpretation and mark-up was applied to that provision.

⁷⁵ *Avestra* (n 45), [8].

⁷⁶ Ibid.

⁷⁷ Ibid, [11].

⁷⁸ Kant (n 25), 10.

⁷⁹ *Managed Investments (No 9)* (n 45), [1]-[3].

⁸⁰ Ibid, [1619].

⁸¹ Ibid, [972].

⁸² Ibid, [1622].

The facts in this case also illustrate the third issue that arose in *Avestra*, namely, the directors acted for the sake of self-interest rather than for the sake of duty.⁸³ If they had acted out of duty rather than self-interest, the RPTs would not have occurred without member approval.

The application of the RPT provisions regarding the PIF was considered in another case. A class action was instituted against the auditors of the PIF.⁸⁴ The operation of s 601LC of the Corporations Act was considered by the Full Court of the Federal Court.⁸⁵ The problem of the drafting methodology that arose in *Avestra* also arose in this case. The court said that the drafting methodology was ‘productive of uncertainty’ and ‘not without difficulty’.⁸⁶

3. Case Study 3 - *Investport Income Opportunity Fund* (‘IIOF’)

The RE of the IIOF was Endeavour Securities (Australia) Ltd (‘Endeavour’). It was a subsidiary of Linchpin Capital Group Ltd (‘Linchpin’), which operated an unregistered MIS. Linchpin lent money raised for the unregistered fund to itself and its subsidiaries. Personal loans were also made to two of its directors. The source of the funds lent by Linchpin was, in part, from IIOF.⁸⁷ The loans made by Endeavour directly or indirectly to related parties to or through Linchpin were not approved by the members of the IIOF, and they were not on arm’s length terms.⁸⁸

Similar to case studies 1 and 2 above,

- (a) there was a lack of disclosure of the RPTs that had occurred in the Product Disclosure Statement (PDS) issued by the RE,⁸⁹ and,
- (b) the directors failed to act in accordance with their duties as officers of the RE, preferring their own interests over those of the members.⁹⁰

⁸³ Kant (n 25), 10.

⁸⁴ *Waters* (n 58).

⁸⁵ *Ibid*, [14].

⁸⁶ *Ibid*.

⁸⁷ *Linchpin* (n 45), [12]-[13].

⁸⁸ *Ibid*. [47].

⁸⁹ *Daly* (n 36), [305]-[311]; also see section (II)(B)(2) of this Chapter, 164, and Chapter 7.

⁹⁰ *Daly* (n 36), [323].

There was a false entry in the conflict register relating to the RPTs. While this might have been an attempt at concealment, there is no indication in the reasons for judgment that this was the case.⁹¹

The arm's length exception was discussed by Cheesman J in his judgment, but he held that the exception was not, on the facts, engaged.⁹²

B. Weaknesses with the RPT legislative framework

1. *Drafting Methodology*

The first weakness in the legal and regulatory framework of the MIS governing RPTs, leading to a failure to protect the retail investor, is the drafting methodology.⁹³ This issue was identified in the first two case studies in section A above. While the courts may have overcome this drafting methodology by interpreting the provisions widely, having regard to the legislative intent, nevertheless, they are not easy provisions to navigate.⁹⁴

Survey Results
This problem is apparent from the results of the Survey, where 60.9% of respondents agreed these provisions were difficult to follow and administer. ⁹⁵

2. *Lack of disclosure*

The second weakness in the legal and regulatory framework of the MIS governing RPTs, leading to a failure to protect the retail investor, is that when an RPT occurs, there is frequently a lack of disclosure to members.⁹⁶ This lack of disclosure was an

⁹¹ Ibid, [318].

⁹² Ibid, [276].

⁹³ Clarke (n 57), [346]; *Avestra* (n 45); *Waters* (n 58).

⁹⁴ A redraft by me of Part 5C.7 of the Corporations Act, having regard to the case law, that would be easier to follow, is at Table 5.1 (Bespoke RPT provisions for registered MIS), page 371.

⁹⁵ Survey Results, Q62, page 447.

⁹⁶ *Avestra* (n 45); *Linchpin* (n 45), [53]; *Daly* (n 36), [8]; *Australian Securities and Investments Commission v Forge* [2007] NSWSC 1489, [111]; Tim Florstedt 'Harmonising Shareholder Protection Laws for Related Party Transactions' (2023) 19(5) *European Company and Financial Law Review* 701, 744-745.

issue that arose in all three case studies. In the case of *Avestra*⁹⁷ and *PIF*,⁹⁸ not only was there no disclosure, but there was active concealment of the RPT.

If the MIS is a disclosing entity,⁹⁹ the RE is required, as soon as practicable, by way of lodgement of a document with ASIC, to disclose any information of which it becomes aware:

- (a) that is not generally available,
- (b) that a reasonable person would expect if it were generally available to have a material effect on the price or value of the interests in the MIS, and
- (c) the information has not been included in a PDS, a Supplementary PDS ('SPDS'), or a Replacement PDS ('RPDS'), a copy of which has been lodged with ASIC.¹⁰⁰

If the MIS is not a disclosing entity, then there is still an obligation to disclose any material change to a matter, or a significant event that affects a matter, being a matter that would have been required to be specified in a PDS for the interests in the MIS prepared on the day before the change or event occurs. This disclosure notice must contain all the information that is reasonably necessary for the holder to understand the nature and effect of the relevant changes or event.¹⁰¹

The importance of these continuing disclosure obligations is emphasised by the courts. The provisions are to be 'construed beneficially to the investing public and in a manner which gives the "fullest relief" which the fair meaning of their language allows.'¹⁰² This is because the main purpose of these provisions is to ensure the market is well-informed. This should lead to greater investor confidence.¹⁰³

⁹⁷ *Avestra* (n 45), [8].

⁹⁸ *Managed Investments (No 9)* (n 45), [1622].

⁹⁹ Corporations Act, s 111AC

¹⁰⁰ *Ibid*, ss 675 and 677.

¹⁰¹ *Ibid*, s 1017B.

¹⁰² *Australia and New Zealand Banking Group Limited v Australian Securities and Investments Commission* (2024) 305 FCR 383, [210] citing *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2016) 245 FCR 402, [92]-[93].

¹⁰³ *Ibid*.

The International Accounting Standard IAS 24 ('IAS 24') also require disclosures about transactions and outstanding balances with an entity's related parties.¹⁰⁴ This is required 'to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties'.¹⁰⁵

These disclosure obligations still apply even if the RE is not required to get member approval. The obligation on the RE to disclose RPTs to members is important because it enables them to evaluate the RPT, including whether the RPT is truly subject to an exception.¹⁰⁶ ASIC also considers that a PDS should disclose related party arrangements even if the arm's length exception applies.¹⁰⁷ The same principle should therefore apply if there is a PDS already on issue or is no longer in use, which does not disclose the relevant RPT. Further, IAS 24 requires that where there is an RPT to which the arm's length exception applies, a statement to that effect must be included in the financial statements.¹⁰⁸ This statement must be substantiated.¹⁰⁹ This places an obligation on the auditor to test the veracity of this statement. However, as the above case studies illustrate, it is easy for management to conceal RPTs.¹¹⁰

3. *Arm's length exception*

The third weakness in the legal and regulatory framework of the MIS governing RPTs, leading to a failure to protect the retail investor, is the arm's length exception.¹¹¹ In the European Union ('EU'), research indicates a lack of elaboration of the nature of any arm's length transaction.¹¹² This should not be the case for two reasons. Firstly, the provisions in IAS 124 referred to above require the RE to substantiate the claim.

¹⁰⁴ International Accounting Standard IAS 24 - *Related Party Disclosures*.

¹⁰⁵ Ibid.

¹⁰⁶ Florstedt (n 96), 716.

¹⁰⁷ RG 76 (n 3), [RG 76.149]

¹⁰⁸ IAS (n 104).

¹⁰⁹ Ibid, [24.21].

¹¹⁰ Also see Moataz El-Helaly 'Related-party transactions: a review of the regulation, governance and auditing literature' (2018) 33(8/9) *Managerial Auditing Journal* 779, 786.

¹¹¹ Clarke (n 57), 346.

¹¹² Florstedt (n 96), 744.

Secondly, the RE must prove the necessary facts, matters and circumstances that engage the exception.¹¹³

For the exception to apply, the transaction must be one in which the giver of the benefit (namely, the RE, an entity that the RE controls, or an agent of, or a person engaged by, the RE) ('Giver') is:

- (a) unrelated to the recipient of the benefit (i.e. the recipient cannot be the Giver or a related party of the Giver)('Recipient'),
- (b) free from any undue influence or pressure,
- (c) through its relevant decision makers, the RE is sufficiently knowledgeable about the circumstances of the transaction, experienced in business and well advised so as to be able to form a sound judgment; and
- (d) concerned only to achieve the best available commercial result for the benefit of the members of the MIS as a whole.¹¹⁴

However, this requires an answer to a 'hypothetical', which is a judgement call by the person making the assessment. As a result, what may be considered as a reasonable commercial result for the members of the MIS as a whole in the transaction is 'a matter of judgment upon which honest and experienced commercial minds may legitimately differ'.¹¹⁵ Combined with the problem with the drafting methodology of the RPT provisions referred to above, this necessarily makes it difficult for a board of an RE to come to a clear conclusion under the exception. Further, the onus is on the person alleging the contravention of the RPT provisions by the RE (e.g., ASIC) to plead and prove each of the elements in sub-clause (a) to (d) of s 208 as modified by

¹¹³ *Australian Securities & Investments Commission v Lewski; Australian Securities & Investments Commission v Wooldridge; Australian Securities & Investments Commission v Butler; Australian Securities & Investments Commission v Jaques; Australian Securities & Investments Commission v Clarke* (2018) 266 CLR 173, 206.

¹¹⁴ *Australian Securities and Investments Commission v Australian Investors Forum Pty Ltd (No 2)* [2005] NSWSC 267, [456].

¹¹⁵ *Investor's Forum* (n 114), [457]; followed in *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1, [747],

s 601LC of the Corporations Act.¹¹⁶ This may explain the small number of decided cases concerning the RPT provisions as they apply to registered MIS.¹¹⁷

4. *Deliberate disregard of or failure to recognise obligations*

The fourth weakness in the legal and regulatory framework of the MIS governing RPTs, leading to a failure to protect the retail investor, is the same issue that arose in Chapter 3 regarding the duties of officers. Officers of the RE either deliberately act in breach of their duties to scheme members or fail to recognise that their actions are in breach of those duties. This is not surprising given the close relationship between breaches of the RPT provisions and breaches by directors of their statutory duties.¹¹⁸ The case law indicates that it is too easy for directors to conceal or hide RPTs.¹¹⁹ The temptation in many instances appears to be too great for many directors. As stated by Participant 2 in the Interview, ‘There is no one to control the greed. They think, “How can I access money I control?” “What assets can I sell?”’¹²⁰

III. RESEARCH QUESTION 2: HOW CAN THIS FAILURE BE REMEDIED? (I.E., WHAT THE ‘LAW OUGHT TO BE)

In answering Research Question 1, a number of weaknesses (i.e., what the ‘law is), which were designed to protect the retail investor, have been identified. These weaknesses lead to a consideration of what the ‘law ought to be’, generating propositions for reform that should better protect the retail client.

Based on an analysis of the primary and secondary materials, conclusions may be drawn as to how the law may be reformed to protect the retail investor. If the following reforms are made to the existing legal and regulatory framework of the MIS regarding RPTs, this should strengthen its efficacy and efficiency in protecting retail investors.

¹¹⁶ Lewski (n 113), [83].

¹¹⁷ Cases at (n 58).

¹¹⁸ Millhouse (n 1), 163.

¹¹⁹ *Australian Securities and Investments Commission v Adler* [2002] NSWSC 171; *Managed Investments Ltd (No. 9)*(n 45); *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452; *Avestra* (n 45).

¹²⁰ Interview Transcript, 462-463.

A. *First Reform*

The first reform flowing from the above analysis is to replace the current RPT provisions with a bespoke rule for registered MIS. This provision would take into consideration the nature of the registered MIS and for whom the protection is required, namely, the retail client.

This should not be by way of reference to Chapter 2E, which was designed for public companies. This is not a suitable method of drafting legislation. RPTs can have a damaging effect on retail investors, where this involves ‘tunnelling’.¹²¹ There are compelling reasons for treating MIS differently from companies regarding the consequences of a breach of the RPT provisions.¹²² This is because the purpose of the RPT provisions is to preserve the scheme property for the benefit of the members as a whole.¹²³

A suggested amendment to the existing law is set out in Table 5.1 (bespoke RPT provisions for registered MIS) commencing on page 371. This is a modification by me of the existing provision as interpreted by Beach J (including His Honour’s mark-up) in *Avestra*.¹²⁴ This proposed amendment to the existing law does not change the law but makes it easier to administer and enforce. The provisions will at least be understandable to the average director and compliance personnel. This proposed reform is consistent with the recommendation of the ALRC Report 65.¹²⁵

Further, such a provision should lead to greater adherence by industry participants and increased enforcement of the provisions by ASIC. Everyone should be able to read and understand the provisions more easily so as to ascertain how these provisions apply to the facts and circumstances of a particular case.

B. *Second Reform*

In Chapter 3, a proposed reform to the law was to professionalise the role of the officer of the RE by requiring an officer of a RE to meet certain professional standards

¹²¹ Pizzo (n 7), 312

¹²² CAMAC (n 42), 100.

¹²³ Corporations Act, s 207 as amended by s 601LB.

¹²⁴ *Avestra* (n 45).

¹²⁵ (n 38), [10.25].

similar to those of financial advisers. Given the close relationship between breaches of the RPT provisions and the breaches by directors of their statutory duties,¹²⁶ this proposed reform should also remedy the problem of directors either deliberately acting in breach of the RPT provisions or failing to recognise that what they were doing was in breach of those provisions. Further, there is considerable research that indicates weak corporate governance increases the probability of ‘tunnelling’ from RPTs.¹²⁷ The proposed reforms set out in Chapter 3 should lead to better corporate governance generally, therefore reducing the risk of tunnelling from RPTs.¹²⁸

Survey Results
The results of the Survey support this reform. The sample consisted of: • 92.6% of respondents whose organisations had minimal professional standards (e.g. education and experience) as a condition of appointment,¹²⁹ • 74.1% of respondents whose organisations required directors to undertake annual continuing professional development,¹³⁰ • 74.1% of respondents whose organisations require directors to have experience in the operation of registered schemes as a condition of appointment,¹³¹ • 96.3% of respondents whose organisations had guidelines to ensure that their directors were fit and proper persons.¹³²

¹²⁶ Millhouse (n 1).

¹²⁷ Steven Balsam ‘Related Party Transactions, Corporate Governance and CEO Compensation’ (2017) 44(5) *Journal of Business Finance & Accounting* 854; Yin-Hua Yeh, Pei-Gi Shu and Yu-Hui Su, ‘Related-party transactions and corporate governance: The evidence from the Taiwan stock market’ (2012) 20 *Pacific-Basin Finance Journal* 755.

¹²⁸ A more detailed discussion on this second reform may be found in Chapter 3 above including the results of the Survey in the context of this reform.

¹²⁹ Survey Results, Q7, page 410.

¹³⁰ Ibid, Q9, page 411.

¹³¹ Ibid Q8, page 411.

¹³² Ibid, Q6, page 410.

Given these features of the sample, the positive results that occurred for compliance with the RPT provisions by the majority of the sample regarding disclosure, and assessment as to whether a meeting of members was required to approve the RPT is not unexpected.

This explains the Survey results deviating from what is revealed by the above literature (including Hayne in 2019, which indicates that RPTs with registered MIS are problematic),¹³³ the above case studies and the views of the courts and ASIC regarding RPTs.

C. *Third Reform*

The third reform flowing from the above analysis is to amend the current RPT provisions in Chapter 5C.7 so that where there is any RPT, even if an exception applies (e.g., the arm's length exemption), the RE is required to:

- make full disclosure to members, including the provision of an independent expert report ('IER'), and
- lodge a copy with ASIC.

This is similar to the explanatory memorandum presently required to be given to members where a meeting is held to approve an RPT.¹³⁴ It is also consistent with the United Kingdom's Financial Conduct Authority move from holding compulsory meetings for RPTs 'towards a more disclosure-based regime' under the listing rules.¹³⁵

The RE would be prohibited from transacting without this full disclosure. The benefit of this is twofold. Firstly, members will be able to assess whether the proposed transaction is fair and reasonable. Secondly, the members will have the opportunity to take action under the current law to call or requisition a meeting of members to block the proposal if the members consider that the transaction is not fair and reasonable.¹³⁶ This reform would be similar to an EU directive applicable to listed companies, which

¹³³ Hayne, (n 34).

¹³⁴ Corporations Act, ss 217 and 218 as amended by s 601LA; RG 76 (n 3) Section D.

¹³⁵ Financial Services Report United Kingdom 4th Quarter 2024 (2024) Financial Services United Kingdom The Economist Intelligence Unit N.A., Incorporated, 20.

¹³⁶ Corporations Act, s 252B, 252D.

requires companies to publicly announce all material RPTs and to provide information about their fairness.¹³⁷ This directive has been described as an ex-ante rule of disclosure.¹³⁸ Research indicates that sole reliance on ex post court reviews of RPTs is not sufficient protection without strong procedural safeguards.¹³⁹ There is also recent research that points to broader RPT disclosure rules being effective in protecting the interests of minority investors.¹⁴⁰ Such broader disclosures should also minimise the current knowledge asymmetry between management and minority investors.¹⁴¹ Similarly, Lin argues that strengthening the information disclosure obligations for Canadian real estate investment trusts ('REITs') would result in better investor protection.¹⁴²

This reform will address the third and fourth weaknesses identified in the RPT provisions in answer to Research Question 1 in section II above at 160. Although this would involve amending the current law, it would simplify the RPT provisions without removing members' rights. Another benefit of this reform is that it avoids problems in navigating the uncertainty surrounding the arm's length exemption referred to above.

This proposed reform to the law has some support.

Survey Results
In the Survey, 44.4% of respondents agreed that they would prefer the law to be amended to permit an RPT if full disclosure is made to members, although the same number of respondents (44.4%) preferred the law to remain as it is. ¹⁴³ The latter

¹³⁷ Directive (EU) 2017/828 amending Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies (17 May 2017), [44].

¹³⁸ Florstedt (n 96), 745; Andreas Engert and Tim Florstedt, 'Which related party transactions should be subject to ex ante review. Evidence from Germany' (2020) 20 *Journal of Corporate Law Studies* 263.

¹³⁹ Alperen Afşin Gözlügöl, 'Blinded by 'Fairness': Why We Need (Strong) Procedural Safeguards in Screening Self-Dealing and Obtaining a Fair Price Is Not the Answer' (2022) 23 *European Business Organization Law Review* 633, 655.

¹⁴⁰ Diah Agustina Prihastiw, Agustina Pratiwi Nugraheni and Octavia Lhaksmi Premetastatic 'Does Related-Party Transactions Disclosure Affect the Value Relevance of Financial Statements' (2023) 15(3) *Jurnal Akuntansi Kontemporer* 121-130, 128.

¹⁴¹ Ibid.

¹⁴² Lin Lin, 'C-REITs and Investor Protection' (2023) 39:2 *Banking & Finance Law Review* 159, 181.

¹⁴³ Survey Results, Q61, page 446.

result may be because 92.6% of respondents agreed that they had already made full disclosure even if the transaction was at arm's length.¹⁴⁴

IV. RESEARCH QUESTION 3: ON THE BALANCE OF PROBABILITIES, WILL THE PROPOSED REFORMS TO ADDRESS THESE FAILURES CAUSE REs TO ABANDON THE RETAIL MARKET THEREBY RESTRICTING INVESTMENT CHOICE BY RETAIL CLIENTS?

The proposed reforms to the identified weaknesses in the regulation of RPTs should not, on the balance of probabilities, cause REs to abandon the retail market.

Firstly, in making the RPT provisions MIS specific, it will be easier for operators of an MIS to understand the law because the provision will be in a comprehensible form. At present, the provisions are almost incomprehensible to the average layman. This reform does not change the law. Because there is no change in the law, it is hard to see how this change could increase the cost of compliance for the RE. Rather there is a benefit received by the RE in the easier administration of the provision than currently exists.

Secondly, full disclosure to members for any RPT is beneficial for both the RE and the members. The RE does not have to overcome some of the difficulties with the current provisions described above. Therefore, the RE and its officers will not be at risk if an RPT occurs with full disclosure. The benefit of this reform to the members is that they will know before a transaction takes place the full details of that transaction. The members can then take action under Chapter 2G.4 of the *Corporations Act* 2001 (Cth) to call or requisition a meeting of members regarding the transaction. It breaks down the present knowledge asymmetry between the Board and scheme members.¹⁴⁵ This should build an element of trust between the RE and investors.

The regulation of registered MIS in this fashion should therefore not act as a deterrent to an RE continuing to operate in the retail market.

¹⁴⁴ Survey Results, Q59, page 444.

¹⁴⁵ Ibid.

Survey Results

The Survey results also indicate that the proposed reforms should not cause REs to abandon the retail market in that:

- (a) 95.8% of respondents did not consider that if the RPT provisions, as they apply to MIS, were specific, rather than cross-referenced to Chapter 2E of the Corporations Act, this would cause their organisation to reduce the availability of its products to retail clients,¹⁴⁶ and
- (b) 92.6% of respondents indicated that their organisation already made full disclosure of RPTs to members of the schemes operated by their organisation, even if it was at arm's length, indicating that this would not be an onerous requirement.¹⁴⁷

¹⁴⁶ Survey Results, Q74, page 453.

¹⁴⁷ Ibid, Q59, page 444.

CHAPTER 6: INSOLVENT RESPONSIBLE ENTITIES OF SOLVENT MANAGED INVESTMENT SCHEMES (MISs)

‘There is little doubt that the risks of investing in a MIS are significantly heightened by ... the lack of any formal insolvency regime to fairly allocate risk between the parties involved’.¹

I. INTRODUCTION

In Chapter 1, an analysis of the history of the MIS was undertaken, leading to three Research Questions being generated regarding a number of problematic areas of the legal and regulatory framework for the MIS designed to protect retail investors. One of these was the issue of insolvent responsible entities (‘REs’) operating solvent schemes.

In this Chapter 6, similar to the earlier chapters, an analysis of this area of regulation of the MIS was undertaken using the methodological and philosophical approaches to research referred to in Chapter 2 to ascertain answers to the three Research Questions referred to in sections II, III and IV of this Chapter. This methodology is designed to identify where the ‘law as it is’ has failed to protect retail investors and what the ‘law ought to be’ to remedy this failure, but in a way that does not overregulate.

While a company is a separate legal person, a MIS is not.² Therefore, although you can have an insolvent RE,³ as a matter of law, a MIS cannot be ‘insolvent’. It is a ‘legal

¹ David A Chaikin and Eve Brown Submission to Productivity Commission, *Inquiry into Financial Services Exports*, titled *An Alternative Australian Trusts Act: Enhancing Australia’s Capacity to Grow and Export Financial Services* (September 2015), 4.

² Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People’s Money* (Report No. 65,1993) (‘ALRC Report’), [8.8].

³ This is because a company is a ‘person’: *Corporations Act 2001* (Cth) (‘Corporations Act’), s 95A; *Acts Interpretation Act 1901* (Cth), s 2C; However, a MIS is an entity for income tax purposes: *Income Tax Assessment Act 1997* (Cth), s 960-100(1)(f).

nonsense' to call a MIS 'insolvent'.⁴ References to a MIS being 'solvent' really mean that the MIS is financially viable or healthy.⁵

Thirty-two years ago, the ALRC Report 65 recommended that where there is an insolvent operator of a so-called 'solvent' MIS, the liquidator of the MIS operator should not be permitted to be the liquidator of that operator's MISs unless a court otherwise orders.⁶ The ALRC also recommended that a temporary MIS operator must be appointed in such circumstances.⁷ These recommendations, if implemented, would have avoided the conflicts that inevitably arise when an external administrator is appointed to a RE. When an external administrator is appointed to the RE, although the MIS members have theoretical rights regarding scheme property held by the RE on trust for them, thereby protecting the retail investor, this has not translated into practice. The problem is created by the members having no representative to protect their rights against the RE, which is in external administration.

The Parliamentary Joint Committee on Corporations and Financial Services ('PJC') noted that, where the RE is in external administration, there is an inherent conflict of interest between an insolvency practitioner's obligation to act in the interests of MIS members and their competing obligation to act in the interests of creditors and shareholders.⁸ ASIC also had concerns with arrangements where the external administrator of the RE represented the interests of both the MIS members and the interests of creditors. In its submission to the PJC, ASIC stated that in

recent failures in the sector, it is apparent that (whatever the legal position) the fact that there is no person in there charged solely with representing the members' interests has undermined growers' confidence in the capacity of the existing insolvency laws to protect their position.⁹

⁴ Nuncio D'Angelo, 'When is a trustee or responsible entity insolvent? Can a trust or managed investment scheme be "insolvent"? (2011) 39 *Australian Business Law Review* 95, 104.

⁵ Ibid.

⁶ ALRC Report 65, (n 2), [8.14].

⁷ Ibid.

⁸ Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (Final Report, September 2009) ('Agribusiness Report'), [3.100].

⁹ Ibid, [3.103].

In one case, the RE, which was in liquidation, acknowledged that the interests of creditors and the interests of members were opposed to each other. In one capacity, it 'should be solicitous of the welfare' of its creditors and in another capacity it 'should be solicitous of the welfare' of the MIS members'.¹⁰

The duties of the liquidator as an officer of the RE to act in the best interests of the members and to give priority to the members' interests do not override the liquidator's duty to those interested in the winding up, such as the creditors, in the event of a conflict between those different interests.¹¹ This means that a replacement RE or temporary RE ('TRE') should be appointed to represent the interests of members of the registered MIS. Otherwise, the actions of the liquidator pursuant to their duties to creditors may cause the interests of members of the MIS to be disregarded in the winding-up process.

When a company that is a trustee becomes insolvent, trust liabilities are liabilities of the company itself and are provable in its winding up.¹² According to strict legal theory, trust assets are the property of the company.¹³ However, this property is subject to equitable obligations of the trustee, which give rise to equitable interests in the beneficiaries. These obligations are engrafted onto, impressed upon, annexed to, but not carved out of, the company's legal ownership of the assets in question.¹⁴ The company trustee, as legal owner of the trust assets, has all the powers incidental to ownership, subject only to the power of the beneficiaries to compel the trustee to exercise the trustee's powers in accordance with the terms of the trust.¹⁵

Therefore, the reference to MIS or scheme creditors is really just shorthand for those creditors of the RE in respect of whose debts the RE is entitled to be indemnified out

¹⁰ *re Gunns Finance Limited (in liq) (recs & mgrs apptd) and re Gunns Plantations Limited (in liq) (recs & mgrs apptd) (No 2)*, [2013] VSC 365, [64].

¹¹ *Timbercorp Securities Limited (in liq) v WA Chip & Pulp Co Pty Ltd* [2009] FCA 901, [11]; *Re Willmott Forests Limited (No 2)* [2012] VSC 125, [96].

¹² *Re Transphere Pty Ltd* (1986) 5 NSWLR 309.

¹³ *Ibid.*

¹⁴ *DKLR Holding Co (no 2) Pty Ltd v Commissioner of Stamp Duties* [1980] 1 NSWLR 510, 518–20; *DKLR Holding Co (no 2) Pty Ltd v Commissioner of Stamp Duties (NSW)* (1982) 149 CLR 431, 474; *Commissioner of State Revenue v Rojoda Pty Ltd* (2020) 268 CLR 281, 307; *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* (2019) 268 CLR 524, 560; *Federal Commissioner of Taxation v Carter* (2022) 274 CLR 304, 320.

¹⁵ *Carter Holt (n 14)*; *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 234.

of the scheme property.¹⁶ Until the RE's right of indemnity is satisfied, the MIS members cannot compel the RE to exercise its powers as the legal owner of the scheme property for their benefit.¹⁷ Where the RE holds scheme property of multiple MISs, in the event of insolvency, the RE will be treated as holding multiple funds, each of which will be directed to different groups of creditors.¹⁸ This is not because the limited nature of the asset and the inherent characteristics of the proprietary interest lead to that outcome.¹⁹ It is because the funds so held can only be applied to satisfy debts incurred to creditors of the relevant MIS.²⁰

There are two principles protecting MIS members that would otherwise apply if the RE were solvent, but which become problematic when an RE is in external administration.

(i) First Principle – Improper Costs

The RE holds scheme property on trust for the members.²¹ Therefore, a trust relationship attaches to the RE by reason of its office.²² As the trustee of the scheme property, the RE has a general right of indemnity for liabilities properly incurred in the administration of the trust.²³

The RE may also have a contractual right to be indemnified out of scheme property if this is specified in the constitution.²⁴ This contractual right of indemnity is qualified. The RE's contractual right of indemnity is available to the RE only if incurred in the proper performance of its duties.²⁵ This limitation reflects the general law position that expenses and liabilities are 'properly

¹⁶ *Stacks Managed Investments Ltd* [2005] NSWSC 753, [44].

¹⁷ *Carter Holt* (n 14), [83].

¹⁸ *Ibid*, [160] citing *Jones (Liquidator) v Matrix Partners Pty Ltd, re Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* (2018) 260 FCR 310, [103].

¹⁹ *Jones* (n 18), [103] and [211].

²⁰ *Carter Holt* (n 14) (Gordon J), [161] and (Bell, Gageler and Nettle JJ), [97].

²¹ Corporations Act, s 601FC(2).

²² *Re Investa Properties Ltd* [2001] NSWSC 1089, [14]; approved in *Wellington Capital Limited v Australian Securities and Investments Commission* (2014) 254 CLR 288, 299.

²³ *Saker, re Great Southern Managers Australia Ltd (Receivers and Managers Appointed) (in liquidation) (no. 2)* [2011] FCA 958, [45]-[51].

²⁴ Corporations Act 2001 (Cth) ('Corporations Act'), s 601GA(2); *Saker, re Great Southern Managers Australia Ltd (Receivers and Managers Appointed) (in liquidation)* [2010] FCA 1080, [33], [51]; *QB4 Capital Pty Limited v Guardian Securities Limited* [2022] FCA 262, [122]; appeal dismissed in *QB4 Capital Pty Limited v Guardian Securities Limited* [2023] FCAFC 72.

²⁵ Corporations Act, s 601GA(2)(b).

incurred' or 'not improperly incurred' in the execution of the trust.²⁶ While this language has been criticised because it expresses a conclusion rather than a statement of the relevant test,²⁷ i.e. it does not provide a 'yardstick by which conduct [of the trustee] can be measured',²⁸ nevertheless

there are numerous cases making it clear that certain breaches by a trustee of its duties will be regarded as sufficiently serious as to deprive a trustee of recourse to the indemnity, while other situations will call for closer consideration of the particular actions of the trustee and the particular duty whose performance exposed the trustee to the cost, expense or liability in question.²⁹

Examples of duties requiring strict compliance by the trustee a breach of which will be regarded as sufficiently serious as to deprive a trustee of recourse to the indemnity include the following duties:³⁰

- (a) duty to keep and render accounts,
- (b) the duty not to allow a conflict between duty and interest,³¹
- (c) the duty not to obtain an unauthorised benefit from the trust,³² and
- (d) the duty to obey the terms of the trust deed.³³

Duties which do not require strict compliance involving the more day-to-day functions of a trustee in the management of a trust that are not so strict such as the duty to exercise the care which an ordinary prudent person would

²⁶ *Bruce v LM Investment Management Limited (no. 2)* [2013] QSC 347, [28] citing *Re Beddoe* [1893] 1 Ch 547, 558.

²⁷ *Gatsios Holdings Pty Ltd v Mick Kritharas Holdings Pty Ltd*; [2002] NSWCA 29.

²⁸ *Morgan, in the matter of Traditional Values Management Limited (in liq)* [2024] FCA 74, [58].

²⁹ *Ibid*, [58].

³⁰ *Nolan v Collie* (2003) 7 VR 287, [51]-[52]; *Ludwig v Jeffrey (No. 2)* [2020] NSWSC 1677, [17]; *Morgan* (n 28), [59]-[60] and [64] citing *Nolan* (n 30), [51]-[52] and *Australian Securities and Investments Commission v Letten (no. 17)* [2011] FCA 1420, [17].

³¹ For MIS: Corporations Act, s 601FC(1)(c), second limb.

³² *Ibid*, s 601FC(1)(e).

³³ *Nolan* (n 30), [51]-[52]; *Ludwig v Jeffrey (No. 2)* [2020] NSWSC 1677, [17]; *Morgan* (n 28), [59]-[60] and [64] citing *Nolan* (n 30), [51]-[52] and *Letten (no. 17)* (n 30), [17].

exercise in conducting the trust business as if it was their own.³⁴ However despite this limitation, trustees have been deprived of their indemnity for breach of this duty.³⁵

The position is conveniently summarised by Gordon J as follows:

[a]t a practical level, a breach of certain ‘core’ duties will as a matter of course result in a loss of the right of indemnity. For all other breaches, the answer will depend on the terms of the trust deed and whether that breach was in bad faith, outside the relevant power and exercised with an absence of care and diligence that a person of [f] ordinary prudence should exercise.³⁶

However mere errors of judgment will not cause a RE’s right to be indemnified to be lost.³⁷

(ii) Second Principle – Clear Accounts Rule

Members of a MIS have the benefit of an equitable remedy known as the ‘clear accounts rule’. Although there is some debate over the extent of the application of this equitable rule,³⁸ the legal principle is clear. As discussed in item (i) above, the RE has a right of indemnity out of scheme property at general law and contractually if specified in the constitution of the MIS. The ‘clear accounts rule’ requires the RE to make good any loss that the RE has caused to scheme property because of any breaches of trust or duties before the RE can assert a lien or claim for the amount payable to the RE pursuant to its right of

³⁴ *Nolan* (n 30) citing *Speight v Gaunt* (1883) 9 App Cas 1. 19 (Lord Blackburn); *Austin v Austin* (1906) 3 CLR 516, 525 (Griffith, C.J); *Fouche v Superannuation Fund Board* (1952) 88 CLR 609, 641 (Dixon, McTiernan and Fullager JJ); For MIS, Corporations Act, s 601FC(1)(c).

³⁵ *Southern Wine Corporation Ltd (in liq) v Frankland River Olive Co Ltd* (2005) 31 WAR 162, [30] (McLure) citing *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367 and *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 247; *RWG Management Ltd. v. Commissioner for Corporate Affairs* [1985] VR 385, 394, citing *Stott v Milne* (1884) 25 Ch D 710, 715; *In the matter of Macquarie Investment Management Limited* [2016] NSWSC 1184.

³⁶ *Letten* (No. 17) (n 30), [64].

³⁷ *RWG* (n 35), 562.

³⁸ *Park & Muller (liquidators of LM Investment Management Ltd) v Whyte No 3* [2017] QSC 230, [124]-[143]; Pranay Jha, ‘A “Clearer” Accounts Rule: Challenging the Inflexible Application of the Clear Accounts Rule’ (2024) 47(3) *Melbourne University Law Review*, 635.

indemnity.³⁹ Importantly the ‘moral foundation’ for the rule will be ‘taken to be apparent to the ordinary person’ so awareness of the rule is not a defence.⁴⁰

The RE will still retain its right of indemnity, but recovery of any liabilities pursuant to that right is limited to the extent to which the amount of the loss is required to be made good by the RE to the scheme property.⁴¹ This counterclaim is not limited to the RE’s right of indemnity for an expense connected with the breach of trust or duty and may apply to any counterclaim that members of the MIS have against the RE.⁴²

The clear accounts rule is essentially a mathematical exercise involving a set off of the amount of the RE’s liability to the members with respect to previous breaches of trust or of its duties against the amount of the RE’s right of indemnity.⁴³ The exercise of the RE’s right of indemnity may be suspended until the counterclaim by the members against the RE is determined.⁴⁴

These two principles are important protections for the retail investor in an MIS. While the claims of creditors are subrogated in equity to the right of indemnity of the RE out of scheme property, this will not apply to the extent to which the right of indemnity is affected by these two principles, limiting the amount recoverable by the RE pursuant to its right of indemnity. Whether, as a matter of practice, this occurs is a moot question. A liquidator, acting in the interests of creditors, is unlikely to agree to reduce the pool of assets available to those creditors from the insolvent RE’s right of indemnity because the costs incurred by the insolvent RE were improper or there are counterclaims by the members of the MIS for breaches of trust or of duties by that insolvent RE required to be set off pursuant to the clear accounts rule.⁴⁵

³⁹ *RWG* (n 35); *Letten* (no 17), (n 30) [19].

⁴⁰ *Lin v Chu* [2025] FCAFC 130, [273].

⁴¹ *Park* (n 38), [139]; *Kordamentha Pty Ltd v LM Investment Management Ltd* [2016] QSC 183, [22].

⁴² *Park* (n 38), [141]; *CB Darvall & Darvall v. Moloney* (no 2) [2007] QSC 337, [19].

⁴³ *Letten* No. 17(n 30), [20].

⁴⁴ *Park* (n 38), [140], [143]; *Warne v GDK Financial Solutions Pty Ltd; Billingham v Parberry* [2006] NSWSC 259, [194].

⁴⁵ *Darvell* (n 42), [17]-20] citing *General Credits Limited v Tawilla Pty Ltd* [1984] 1 Qd R 388, 389-390.

The following two case studies illustrate why a RE in external administration should not be permitted to continue to act as RE of any registered MIS. Rather, consistent with the recommendations of the ALRC Report 65⁴⁶ and the PJC,⁴⁷ the insolvent RE should be replaced by another RE, or another independent person, if retail investors are to be protected.

A. Case Study 1 – *Huntley v Timbercorp*⁴⁸

Timbercorp Securities Limited ('TSL'), which was the RE of 34 registered MIS, was placed in liquidation.⁴⁹ The members of three of the MIS resolved to replace TSL with a new RE, Huntley Management Limited ('HML').

HML sought from TSL and its liquidators documents to which TSL was a party for each of these three MISs. This was on the basis that these documents had statutorily novated to HML pursuant to sections 601FS and 601FT of the *Corporations Act 2001* (Cth) ('Corporations Act').⁵⁰ These documents included the leases of the land on which the MISs were operated and the licences of parts of that land to the investors. TSL claimed that these documents were entered into by TSL in its personal capacity and therefore remained property of TSL⁵¹ and were available to creditors.⁵² HML, as the RE, would not have been able to operate these MIS if these documents were personal property of TSL. But for the actions of HML as the replacement RE, TSL and its liquidators would have retained this property for the benefit of creditors.⁵³

The court agreed with the submissions of HML, holding that the change of RE effected a statutory novation of the various agreements pertaining to the MIS and were not personal assets of TSL available for the benefit of the creditors.⁵⁴ Because there was

⁴⁶ ALRC Report 65 (n 2), [8.14].

⁴⁷ Agribusiness Report (n 8), [3.131].

⁴⁸ *Huntley Management Limited v Timbercorp Securities Limited* NSD 198 of 2010 ('HML Proceedings'); *Huntley Management Limited v Timbercorp Securities Limited* (2010) 187 FCR 151 ('HML Judgement').

⁴⁹ *Ibid*, [2.54].

⁵⁰ Letter from Piper Alderman to Arnold Bloch Leibler dated 16 December 2009 filed in the HML Proceedings.

⁵¹ HML Judgement, [52].

⁵² Timbercorp Securities Ltd 'Defendant's Outline of Submissions' Submission in HML Proceedings (n 48), [3].

⁵³ HML Judgement (n 48), [5], [15], [20]–[21], [23].

⁵⁴ *Ibid*, [44]–[70].

a replacement RE to represent the retail investors, this property was preserved for their benefit rather than the MIS creditors. Otherwise, given the submissions by TSL, which were contrary to the decision of the court,⁵⁵ this valuable property would have been lost to the creditors.

The right and ability to appoint a replacement RE to operate a 'solvent' MIS where the current RE is insolvent is a valuable and basic right of retail investors. As observed by the Organisation for Economic Co-operation and Development ('OECD'):

[t]he regulatory system, industry standards and each CIS should recognise certain basic rights of investors and maintain structures to protect those rights. Basic rights include protection against the insolvency of an operator or an investment manager. Investors have the right to management of the CIS in their sole interest. Investors have a right to competent management.⁵⁶

This right is important because, as the PJC observed, the collapse of a RE does not necessarily mean that each MIS the RE operates, ceases to be a going concern.⁵⁷ The PJC, quoting from a submission by ASIC to the Inquiry, noted that the insolvency of the RE does not automatically mean the MIS operated by the RE is 'insolvent'. ASIC also submitted that the law contemplated the appointment of a TRE or replacement RE in this circumstance.⁵⁸

However, the case law illustrates that there has generally been little or no protection for retail investors in MISs in the event of the insolvency of the RE. The current system of regulation of MIS has not served the retail investor well when a RE is insolvent and goes into external administration.⁵⁹ Case study 1 above illustrates the perils for a retail investor where an insolvent RE remains the operator of a MIS.

⁵⁵ Ibid, [52]; TSL Submissions (n 52).

⁵⁶ Organisation of Economic Cooperation and Development '*Governance of Collective Investment schemes*' (White Paper, 2005), 147.

⁵⁷ Agribusiness Report (n 8), [2.36].

⁵⁸ Ibid.

⁵⁹ Tables 6.1 (Failed Agribusiness Schemes) and Table 6.2 (Estimated Scheme Losses), page 384.

Garry Bigmore KC, who appeared in a number of cases where the problem of replacing an insolvent RE with a replacement RE arose,⁶⁰ observed that, in practice, where the RE fails, the MIS will most likely also fail. This is ‘a bad result for investors and creditors alike’.⁶¹ This observation is supported by the responses of Participant 2 in the Interview.⁶² He said that he had approached a number of liquidators to manage some MISs that were not insolvent to keep them operational as their agent. He said this would have been ‘a perfect solution for the liquidators and the scheme members’. He said that the liquidators just wanted to sell the assets. His experience reinforces the conclusions from case study 1 above.

B. Case Study 2 - LM Mortgage Income Fund (‘LMMIF’)

This was a case where the First Principle applied to reduce the costs recoverable by the insolvent RE of the LMMIF, which was under external administration. The LMMIF was a ‘solvent scheme’, despite holding impaired investments, having a large surplus of assets to be administered.⁶³ This case illustrates the importance of removing an insolvent RE from any operational control of a registered MIS. In this case, the First Principle was enforced because an independent person, rather than the insolvent RE, was appointed by the court to wind up the LMMIF.⁶⁴ The insolvent RE ceased to have operational control of the MIS.

Two small unitholders in the LMMIF applied to the court for a company, Trilogy Funds Management Ltd (‘Trilogy’), to be appointed as TRE to the LMMIF.⁶⁵ Trilogy had indemnified the plaintiffs for their costs so that the plaintiffs were not at risk in making the application.⁶⁶ Trilogy hoped it would be appointed as permanent RE by a meeting of members.⁶⁷ Trilogy, as RE of another MIS (which was one of the feeder funds

⁶⁰ *Bosi Security Services Limited v Australian and New Zealand Banking Group Ltd* [2011] VSC 255; *Re Willmott (No 2)* (n 11); *Gunns Finance* (n 10); *Willmott Growers Group Inc v Willmott Forests Limited (Receivers and Managers Appointed) (In Liquidation)* (2013) 251 CLR 592.

⁶¹ Garry Bigmore, Sam Hopper and Matthew Kennedy, Submission to Companies and Markets Advisory Committee ‘*Managed Investment Schemes – Discussion Paper*’ (June 2011) [16].

⁶² Interview Transcript, page 464.

⁶³ *Bruce 2* (n 26), [30].

⁶⁴ *Bruce v LM Investment Management Limited* [2013] QSC 192, [120] (appeal dismissed in *LM Investment Management Limited (in liq) v Bruce* [2014] QCA 136).

⁶⁵ *Ibid*, [8].

⁶⁶ *Ibid*.

⁶⁷ *Ibid*, [23].

associated with the LMMIF), held 20% of the units in the LMMIF. The application to appoint Trilogy as a TRE for the LMMIF failed.⁶⁸ However, the court was of the view that the LMMIF should be wound up by an independent liquidator appointed by the court, rather than the RE.⁶⁹

Subsequently, an issue over the costs of the RE in the failed proceedings arose.⁷⁰ The issue was whether the RE was entitled to be indemnified out of the scheme property of the LMMIF for its costs, either pursuant to the common law entitlement, section 72 of the *Trusts Act 1973* (Qld) or the constitution of the LMMIF.⁷¹ The court held that in examining whether the RE was entitled to be indemnified out of scheme property, the nature of the trust and the trustee were to be considered.⁷² The court also held that the administrators of the RE occupied a position of trust that was different from a traditional trustee at general law. There were three reasons for this. Firstly, the RE was the trustee of a trust that was established under the Corporations Act as a registered MIS, being a vehicle for commercial investment. Secondly, the RE was well remunerated for its skill in performing the trust. Thirdly, the administrators who were appointed to the RE were also appointed to a trust which was financially stricken and in the process of being wound up.⁷³

The court accepted a submission by Trilogy that the resistance to its application to be appointed TRE of the LMMIF went 'above and beyond what would have been required had the administrators been acting solely in the interests of the fund'.⁷⁴ Therefore, the amount of the costs to which the RE was entitled to be indemnified out of the scheme property of LMMIF was reduced to 20%. In other words, the court found that 80% of the costs were 'improperly incurred'.⁷⁵

This case illustrates the importance of the First Principle in protecting the investors in an MIS. But for the role of the court regarding the legal costs, given the arguments of the administrators of the RE before the court, it is unlikely that the First Principle would

⁶⁸ *Bruce 2* (n 26), [20].

⁶⁹ *Bruce* (n 64), [120].

⁷⁰ *Bruce 2* (n 26).

⁷¹ *Ibid*, [23]-[28].

⁷² *Ibid*, [29].

⁷³ *Ibid*, [30].

⁷⁴ *Ibid*, [32].

⁷⁵ *Ibid*, [33].

have been applied by the RE to reduce the amount recoverable by it. The intervention of the court in appointing an independent person to wind up the LMMIF saved the scheme property of the LMMIF from bearing 80% of the costs of the litigation.

II. RESEARCH QUESTION 1: HOW HAS THE LEGAL AND REGULATORY FRAMEWORK OF THE MIS FAILED TO PROTECT THE RETAIL INVESTOR WHERE THERE IS AN INSOLVENT RE OF A 'SOLVENT' MIS?

The following case studies are examples of where the 'law as it is' did not protect retail investors following the insolvency of RE, where the insolvent RE continued to operate a 'solvent' MIS to the detriment of retail investors. These cases have assisted in determining what the 'law ought to be'.

A. Case Study 3 – Willmott Forests

Willmott Forests Limited ('WFL') was the RE of 30 registered MISs.⁷⁶ In September 2010, WFL collapsed, and external administrators were appointed. Subsequently, the creditors resolved to place the Willmott group of companies (including WFL) into liquidation.⁷⁷ WFL had leased to participants in the MISs, portions of land (which WFL either owned or leased) for a term of years (generally 25 years) on which trees were grown ('Growers' Leases'). In general terms, each participant entered into a forestry management agreement with a company in the Willmott group. Pursuant to this agreement, the company agreed to plant, maintain, and harvest the trees for the participant. Most forestry management agreements provided that the investor would pay the relevant company an initial fee with no further payment until the trees were harvested.⁷⁸

The liquidators of WFL concluded that it was 'very unlikely' that 'a party would be willing to take over as RE of the Willmott MISs in circumstances where that party would be required to assume the liabilities of WFL and fund the continued operation of the Willmott MISs without any income or contributions from individual investors until

⁷⁶ *IMO Willmott Forests Limited* [2015] VSC 138, [1].

⁷⁷ *Willmott Forests Ltd (Receivers & Managers appointed) (in liquidation) v Primary Securities Ltd* [2013] VSC 574, [1].

⁷⁸ *Willmott Growers* (n 60), [10].

harvest'.⁷⁹ There was no one interested in either purchasing the land because the land was encumbered by the presence on the land of the interests created by the MIS operated by WFL, or becoming RE or manager of any of the MIS. Eventually, conditional contracts of sale were concluded with the one purchaser for the land on which the MISs were conducted conditional upon title to the assets the subject of the contract passing to the purchaser free from the encumbrances arising out of the MISs and in particular that title to the trees on the land was to pass to the purchaser at settlement.

The liquidator of a company has the power to disclaim certain property of the company, including property that consists of a contract.⁸⁰ This disclaimer terminates the company's rights, interests, liabilities and property in or in respect of the disclaimer property from the effective date of the disclaimer.⁸¹ This power had been used by liquidators in a number of MIS cases to extinguish the interests of investors in various MISs.⁸² The liquidators sought directions from the court that they could disclaim the Growers' Leases pursuant to this statutory power of disclaimer, which would enable them to sell the underlying land, free of the interests of the Growers in the land under the Growers' Leases.

The plurality held that:

- (i) the liquidators had the power to disclaim the leases to the investors,
- (ii) each lease was 'a contract' for the purposes of s 568(1)(f) of the Corporations Act,
- (iii) the liabilities of the RE (including its obligations to provide quiet enjoyment and not derogate from the grant of exclusive possession) would be terminated from

⁷⁹ Ibid, [15].

⁸⁰ Corporations Act, s. 568(1).

⁸¹ Ibid, s. 568D(1).

⁸² *Timbercorp* (n 11), *Re Timbercorp Securities Ltd (in liq) (No 3)* [2009] VSC 510; *Re Timbercorp Securities Ltd (in liq) (No 4)* [2009] VSC 530; *Re Timbercorp Securities Limited (in liq)* [2010] VSC 50; *Re Gunns Plantations Limited (In Liquidation) (Receivers & Managers Appointed)* [2014] VSC 239; *Re Environinvest Ltd (No 2)* [2010] VSC 323.

the day on which the disclaimer took effect, as would the correlative rights of the tenant,

(iv) each tenant's estate or interest in the land would be terminated.⁸³

As observed by the plurality, 'a tenant whose lease has been disclaimed by the liquidator of a landlord may consider being left to prove as an unsecured creditor in the winding up gives little effective compensation for what has been taken away'.⁸⁴ However, this problem was not raised in the arguments before the court. Therefore, the holding by the investors of what the investors would have regarded as an estate or interest in the land on which their trees were planted was of cold comfort. The decision also defeated a condition of the RE's licence at that time, which required the RE to hold a registered interest in the land on which the trees were located. This condition was designed to protect investors.⁸⁵ If the RE in this circumstance had been replaced, the lease of the land would have been statutorily novated to the replacement RE, thereby preventing disclaimer by a liquidator.

This is a good reason for the adoption of the recommendation of the ALRC 65 Report that the RE should not be permitted to wind up the scheme if it is in external administration unless a court otherwise orders, and that a TRE should be appointed.⁸⁶ However, the following case study reveals a weakness in the regulatory framework that practically makes it difficult for this recommendation to be implemented.

B. Case Study 4 – Timbercorp Almond MISs

TSL was the RE for 34 registered MISs.⁸⁷ It was placed in administration on 23 April 2009.⁸⁸ This proved a death knell to the retail investors. This was notwithstanding that TSL had been paid substantial fees in advance of performance of its obligations and

⁸³ *Willmott Growers* (n 60), [57].

⁸⁴ *Ibid*, [56].

⁸⁵ ASIC Pro Forma 209 conditions 44, 45 and 46 prior to 2 January 2014, s. 912AAB inserted in the Corporations Act initially by ASIC Class Order 13/1406 and then *ASIC Corporations (Land Holding for Primary Production Schemes) Instrument 2024/15* (expired on 1 October 2024 but not renewed).

⁸⁶ ALRC Report 65 (n 2), [8, 14].

⁸⁷ Agribusiness Report (n 8), [2.54].

⁸⁸ *Ibid*, [2.55].

was subject to prudential requirements under its particular AFSL.⁸⁹ Because TSL was in liquidation, there were subsequent defaults by members of the MISs in payment of ongoing fees.⁹⁰ This affected the ability of TSL to carry out ongoing maintenance of the growers' interest in the MISs as required by the MIS documents.

The almond MISs operated by TSL continued to be managed by an operational manager under a short-term arrangement with the liquidator. The evidence was that because of the insolvency of the Timbercorp group and the cash flow deficiencies of the MISs, the MISs could not be properly funded. As a result, the MISs were at imminent and inevitable risk of termination because the purpose of the MISs could not be accomplished.⁹¹

There were two growers' groups established that purported to represent the interests of the members of these MISs ('Growers'),⁹² the Timbercorp Growers' Group ('TGG') and Timbercorp Growers' Almond Committee Inc. ('TGAC').⁹³ Although they fought hard, they failed to prevent the Growers' interests in the MISs from being extinguished to their detriment.

The liquidators of TSL proposed to sell the properties on which the almond MISs were located. An application was made by them to wind up the MISs. This was opposed by the TGG.⁹⁴ The liquidators changed direction. They did not press their application to wind up the MISs but rather applied for a direction from the court that they would be justified in causing TSL to amend the constitutions for the MISs to enable TSL to 'assign, terminate, surrender or otherwise deal with any subleases, licence or joint venture agreement.'⁹⁵ The court made the orders sought.⁹⁶ These amendments were then made by TSL.⁹⁷ The amendments gave TSL the power to extinguish the rights of the Growers in the MISs. A solvent RE could not have done this without a special

⁸⁹ ASIC Pro Forma 209.

⁹⁰ Leon Zwier, Justin Vaatstra and Owen Biggs 'Can Managed Investment Schemes be Restructured in the Context of Insolvency?' in Stewart Maiden (ed) 'Insolvent Investments' (Lexis Nexis Butterworths, 2015) 109, [5.11].

⁹¹ *Bosi* (n 60), [87].

⁹² *Timbercorp (No.3)* (n 82), [10] and [63].

⁹³ *Ibid.*

⁹⁴ *Ibid.*, [12].

⁹⁵ *Ibid.*, [19].

⁹⁶ *Ibid.*

⁹⁷ *Ibid.*, [20]

resolution of the members.⁹⁸ The protective purpose of this amendment power⁹⁹ was thereby rendered nugatory. This was also not in the best interests of the members, contrary to the RE's duties to the members.¹⁰⁰

In case study 1, TSL as RE for the three registered MIS was replaced with a solvent RE. Therefore, this case study 4 illustrates a stark comparison of the outcomes for members of a MIS where:

- an insolvent RE is replaced with a solvent RE, and
- an insolvent RE remains in office.

A purchaser for the land on which the schemes were located was found. The liquidators sought orders that they were justified in entering into and performing sale and purchase deeds for the sale of properties on which the almond projects were located, thereby extinguishing the Growers' rights.¹⁰¹ The liquidators considered that if they had the power to release or surrender the Grower's rights under the registered MISs, the sale of the properties could proceed without winding up the MISs.¹⁰² Following discussions between the various parties, the court made the bulk of the declarations sought by the liquidators. However, the court was unable to determine whether the banks' proposed apportionment of the sale proceeds was according to law. Therefore, the court also directed that the sale proceeds were to be held in trust until the claims by all interested parties in those sale proceeds could be determined.¹⁰³

There were subsequent proceedings to work out the rights to the sale proceeds that were held in trust.¹⁰⁴ The dispute at that stage was only between the banks as the secured creditors and the Growers.¹⁰⁵ The Growers claimed that their rights prior to their extinguishment were valuable and therefore they were entitled to receive that

⁹⁸ Corporations Act, s 601GC(1)(b).

⁹⁹ *Australian Securities and Investments Commission v Lewski; Australian Securities and Investments Commission v Wooldridge; Australian Securities and Investments Commission v Butler; Australian Securities and Investments Commission v Jaques; Australian Securities and Investments Commission v Clarke* (2018) 266 CLR 173, 196.

¹⁰⁰ Corporations Act, s 601FC(1)(c).

¹⁰¹ *Timbercorp (No 3)* (n 82), [1].

¹⁰² *Ibid*, [16].

¹⁰³ *Ibid*, [89].

¹⁰⁴ *Bosi* (n 60).

¹⁰⁵ *Ibid*, [6].

value out of the net proceeds of sale. They also claimed to have priority over the banks pursuant to covenants given by the banks that the banks took the securities over the secured property, 'subject to all of the Growers' Rights'.¹⁰⁶ While the banks accepted that the Growers had priority of payment out of the net sale proceeds, they disputed that those rights held any value at the time of extinguishment.¹⁰⁷

The court said that it was incumbent on the Growers to establish the basis of their entitlement to a share in the net sale proceeds.¹⁰⁸ This required Growers to show that they held rights of a proprietary nature in the assets of the MIS that were sold and converted into the net sale proceeds.¹⁰⁹ It was not sufficient for the Growers to show that their rights, which were extinguished, had value.¹¹⁰ This was because where there is a claim on a fund by two groups, the apportionment is not to be determined by notions of fairness and appropriateness but by appropriate principles of law and equity.¹¹¹ This required the court to consider the nature of the Growers' pre-extinguishment rights and whether they were proprietary in nature.¹¹² If they were proprietary in nature, it was then necessary to determine their value.¹¹³

After referring to the MIS documents, the court concluded:

- (a) for the 2002 MIS, the only rights of a proprietary nature held by the Growers were the almonds that they grew (of which there were none) and not in the land, the almond trees, the capital works, or the water licences,¹¹⁴
- (b) for the 2005, 2006 and 2007 MIS, the Growers had proprietary rights in the land, trees, and capital works, but not the water licenses, which were rights of a contractual nature only.¹¹⁵

¹⁰⁶ Ibid, [7].

¹⁰⁷ Ibid, [8].

¹⁰⁸ Ibid, [30].

¹⁰⁹ Ibid.

¹¹⁰ Ibid.

¹¹¹ Ibid, [28] citing *Re Hazelton Air Charter Pty Ltd* [2002] FCA 529.

¹¹² Ibid, [31].

¹¹³ Ibid.

¹¹⁴ Ibid, [47]-[48], [79].

¹¹⁵ Ibid, [73], [79].

The court held that unless the MIS were viable at the time of extinguishment of these rights, then the rights had no value.¹¹⁶ The MISs were only viable if they were able to continue to operate under their existing structures and were not at risk of imminent and inevitable termination.¹¹⁷ The court held that the evidence established that, when the Growers' rights were extinguished, the MISs could not continue under their then present structure and their termination was imminent and inevitable. Therefore, it followed that their rights had no value.¹¹⁸

The court then dealt with the Growers' contrary arguments. The Growers argued that the insolvency of the RE did not mean that the MISs could not have continued under a revised structure.¹¹⁹ The Growers relied upon a statement in a paper by Barrett J, writing extra-curially, that 'a simple replacement of the [RE] under the statutory provisions should be feasible' where a MIS is 'on a financially healthy footing'.¹²⁰ They argued that if TSL was removed as RE and replaced with a new RE with a new structure to put the MISs on a financially healthy footing, the MISs could run the course of their term without having to be wound up.¹²¹

The court referred to the evidence of Mr Knox regarding the replacement of TSL with HML as RE of the MISs. This evidence was that, although HML was willing to act as a permanent RE, this was 'subject only to confirmation of the liabilities that it would have incurred on assumption of that role'.¹²² HML had only given consent to be a TRE, which required an order by the court. The court found that the appointment of HML as a TRE would not have ensured continuation of the MISs because, having regard to the evidence, it was unlikely that HML would continue as a permanent RE unless the MISs were viable.¹²³ This was because HML was only willing to act as a permanent RE subject to confirmation of the liabilities that it would have incurred on assumption of the role as RE under the statutory novation provisions.¹²⁴ The court concluded that,

¹¹⁶ Ibid, [82].

¹¹⁷ Ibid, [83].

¹¹⁸ Ibid, [83]-[87].

¹¹⁹ Ibid, [88].

¹²⁰ Reginald I, Barrett 'Insolvency of Registered Managed Investment Schemes' (2008) *Banking and Financial Services Law Association, Queenstown, New Zealand*.

¹²¹ *Bosi* (n 60), [88].

¹²² Ibid, [112].

¹²³ Ibid, [127].

¹²⁴ Ibid, [128].

based on this evidence, HML was not prepared to take on the role of permanent RE of the MISs without modification to the statutory novation provisions.¹²⁵ ASIC rejected HML's application for modification of these provisions.¹²⁶

The court referred to an argument by the Growers that it was apparent from the evidence given by the representatives of two REs (including HML) that the market for 'REs for hire' did not seem to be fettered by the potential application of the statutory novation provisions. The court said that this might be the case where the current RE was solvent, but the position was different where the current RE was in liquidation.¹²⁷ The court concluded that there was little chance of the current insolvent RE being replaced. The court held that 'any prospect that the projects would have been continued was wishful thinking'.¹²⁸ This compares with case study 1 above, where the statutory novation principles worked for the benefit of the members. HML, in that case, was appointed as a replacement RE, and the enforcement of the statutory novation principles enabled the MIS to remain operational.

From this case study 4, the conclusion that follows is that, but for the problems with the statutory novation provisions, HML would have consented to it being appointed as RE. As a result, the Growers suffered the loss of their investment because of the extinguishment of their interests in the MISs. They had paid for the planting of the almond trees that were then subsequently sold to a third party. The only persons to obtain any benefit from this expenditure were the creditors and the liquidators.

This decision was appealed in the form of a class action, which was combined with a number of proceedings involving other Timbercorp MISs. The proceedings settled pursuant to a deed of compromise. Growers received a small amount, although their interests, as a matter of law, were worthless.¹²⁹

¹²⁵ Ibid.

¹²⁶ Ibid, [129] and [132].

¹²⁷ Ibid, [133].

¹²⁸ Ibid, [137].

¹²⁹ Ibid, [48].

C. Statutory Novation Provisions – the ‘poison pill’ of the MIS regulatory framework

Case study 4 illustrates that the major reason for the lack of appointment of a replacement RE when the existing RE is in external administration is the ‘statutory novation’ provisions.¹³⁰ While case study 1 shows these provisions may be beneficial for investors once the insolvent RE is replaced, case study 4 illustrates these provisions are not so beneficial where the insolvent RE remains in office.

Although the statutory novation provisions were designed to smooth the transition between the old RE and the new RE,¹³¹ enabling a ‘seamless takeover’,¹³² the provisions also create potential problems for an incoming RE where the existing RE is in external administration. Before consenting to be appointed as RE of the MIS, the incoming RE will need to know what rights, obligations and liabilities it is taking on board if it is appointed and to what documents it is a party. There may be potential liabilities assumed by the incoming RE that it is not aware of.¹³³ While the intention of the novation of liabilities provision was to ensure that the former RE has the right to be reimbursed for expenses properly outlaid, or liabilities properly incurred, on behalf of the MIS,¹³⁴ the effect of the provisions goes beyond this objective.

If the purpose of the statutory novation provisions was merely to ensure that the former RE had the right to be reimbursed for expenses properly outlaid, or liabilities properly incurred, on behalf of the MIS, the former RE has this right anyway. A former RE retains a lien or charge over the scheme property of the MIS for payment of its outstanding fees and expenses.¹³⁵ This equitable lien may be enforced by the former

¹³⁰ Corporations Act, ss 601FS and 601FT; *Timbercorp* (n 51), [4], [12], [44]-[50] followed in *Saker, re Great Southern Managers Australia Ltd (Receivers and Managers Appointed) (in liquidation)* [2010] FCA 1080; *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq)* [2011] VSC 242, [169]; *Perpetual Nominees Limited v Rytelle Pty Ltd (recs & mgrs apptd)* [2012] VSC 209, [3]; *Gunns* (n 10), [149].

¹³¹ *Willmott Forests* (n 77), [78].

¹³² *Gunns* (n 10), [191].

¹³³ Corporations Act, s 601FS(1) & (2)(d); *Australian Olive Holdings Pty Ltd v Huntley Management Limited* (2010) 185 FCR 97.

¹³⁴ Explanatory Memorandum of the Managed Investments Bill 1987, [8.37].

¹³⁵ *Southern Wine Corporation Ltd (in liq) v Frankland River Olive Co Ltd* (2005) 31 WAR 162, [30] (McLure); *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd* (2008) 74 NSWLR 550 [19]; *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 366; *Buckle* (n 15), 234; *Primary Securities Ltd v Willmott Forests Limited* [2016] VSCA 309, [53].

RE by judicial sale or appointment of a receiver.¹³⁶ Therefore, from this perspective, the statutory novation of liabilities is superfluous.

A statutory exception to the assumption of liabilities of the former RE by the new RE is that the new RE does not assume 'any liability for which the former RE could not have been indemnified out of the scheme property if it had remained the MIS's RE'.¹³⁷ It is not clear what sort of liability this exception covers. The exception may refer either to a legal entitlement to indemnity or to the existence of available assets from which the right of indemnity can be satisfied.¹³⁸ If it is the former, then this creates a problem for the incoming RE because it will simply not know whether the scheme property is sufficient to meet all of the liabilities that have been incurred by the former RE. The incoming RE, therefore, will assume personal liability for the shortfall simply because it has taken on the role of RE. This result is unfair. It does not allow the risk of loss to fall where it should fall, namely on the former RE for incurring a debt in excess of the value of the scheme property or the creditor for allowing a debt to be incurred where the risk of recovery was high due to the lack of scheme property.¹³⁹ It is therefore not surprising that 'the automatic vesting of the non-viable combination of liabilities and inadequate rights of recoupment must mean that in the real world there will never be a new responsible entity'.¹⁴⁰

The Corporations and Markets Advisory Committee ('CAMAC') also agreed that the statutory novation provisions were the principal reason why there was a lack of suitable entities to take on the role of a TRE or replacement RE.¹⁴¹ This meant that the continuation of a viable MIS may be jeopardised by the lack of a willing and suitable entity to take up the office of TRE or replacement RE on short notice.¹⁴²

The question arises as to the future of a MIS which, although financially viable, only has an insolvent RE which cannot be replaced due to the lack of clarity as to the operation of the statutory novation provisions. Inevitably, where there is an insolvent

¹³⁶ *Lemery* (n 135).

¹³⁷ Corporations Act, s 601FS(2)(d).

¹³⁸ *Stacks* (n 16), [15].

¹³⁹ *Ibid.*

¹⁴⁰ *Barrett* (n 120), 12.

¹⁴¹ Corporations and Markets Advisory Committee *Managed Investment Schemes* (Report July 2012) ('CAMAC Report'), [5.1.3].

¹⁴² *Ibid.*

RE of a registered MIS, irrespective of whether or not the MIS is ‘solvent’ or financially viable, the external administrator will make an application to the Court to have the MIS wound up.¹⁴³

Survey Results
Although 50% of respondents to the Survey ¹⁴⁴ agreed that their organisation had been approached to replace an insolvent RE in the past 10 years, only 23.1% said that their organisation had replaced an insolvent RE in the same period. ¹⁴⁵

This indicates that there is a gap between the need for replacement of an insolvent RE and the ability of a replacement RE to fill that gap.

The responses to the Survey also indicated the following issues made it difficult for the respondent’s organisation to accept an appointment to replace an existing RE that is insolvent:¹⁴⁶

Survey Results	
Issue	Percentage
statutory novation provisions	21.7%
lack of clarity on what liabilities which may be assumed under the statutory novation provisions	60.9%
lack of access to information to carry out proper due diligence	69.6%
obtaining a variation to the AFSL to enable your organisation to operate the MIS	65.2%
there are no issues that would affect the decision to accept an appointment	4.3%

¹⁴³ *Re PWL; Ex parte PWL Ltd (no. 2)* [2008] WASC 232, [18]; *Rubicon Asset Management Limited* [2009] NSWSC 1068, [25]; *Re Banksia Mortgages Limited* [2013] VSC 451, [9].

¹⁴⁴ Survey Results, Q64, page 448.

¹⁴⁵ *Ibid*, Q63, page 447.

¹⁴⁶ *Ibid*, Q65, page 448.

Therefore, participants in the industry consider these are important areas for law reform, i.e., what the 'law ought to be'.

III. RESEARCH QUESTION 2: HOW CAN THIS FAILURE BE REMEDIED? (WHAT THE 'LAW OUGHT TO BE)

The case studies referred to in section II of this Chapter have identified the following flaws in the effectiveness of the legal and regulatory framework in protecting retail investors where there is an insolvent RE of a 'solvent' MIS have been identified as reflected in the above case studies:

- (a) There is no one to represent the members to enforce the 'improper costs' and 'clear accounts' principles against the insolvent RE.
- (b) The members' interests in the MIS, to the extent that they consist of a contract to which the insolvent RE is a party, may be extinguished by way of disclaimer by the external administrators of the insolvent RE.
- (c) The uncertainty in the interpretation of the statutory novation provisions and the difficulties faced by an incoming RE in identifying potential liabilities and obligations to which they may be subject if appointed.

Reforms to the law are proposed to rectify these identified flaws in the existing legal and regulatory framework of the MIS, which should strengthen its efficacy and efficiency in protecting retail investors. Both reforms should encourage and support the removal of an insolvent RE and replacement with a new RE.

A. First Reform

The statutory novation provisions have proved in practice to be a deterrent to the appointment of a TRE or replacement RE when an insolvent RE goes into external administration. As noted by CAMAC:

the reluctance of entities to undertake this role without sufficient time to undertake due diligence, particularly regarding the obligations and liabilities that the RE would inherit. Also, in some circumstances, the transfer of obligations and liabilities may place a TRE at risk of a secured creditor of the former RE appointing a receiver to the assets of the

MIS that the TRE now controls, thereby reducing the property of the MIS against which the TRE could claim indemnity rights.¹⁴⁷

The inability to find willing REs in the event of insolvency of the existing RE has resulted in retail investors in MIS with insolvent REs losing out to creditors of the RE. There has been no one available to represent the interests of members. This is despite members taking self-help through the formation of grower groups.¹⁴⁸ Ultimately, without a replacement RE, grower groups were doomed to failure because the lack of a replacement RE is a ground for winding up the MIS.¹⁴⁹ Winding up of the MIS and the likely loss of their investment is inevitable if no replacement RE can be found.

The insolvency of a RE, in practice, has led to a transfer of wealth from the retail investor to creditors. It is one thing for a retail investor to suffer a loss from investment risk. It is another thing to suffer loss because the fabric of the regulatory regime of the MIS failed to protect them, contrary to what it was designed to do. The position may well have been different if there were an entity that was willing to be appointed as a TRE or replacement RE. The reluctance created by the statutory novation provisions caused a lack of candidates for appointment of TRE or replacement RE.¹⁵⁰

Although the statutory novation provisions cause the rights, obligations and liabilities of the former RE to be statutorily novated to the new RE,¹⁵¹ it is not clear why it was necessary to novate liabilities. As referred to above, there is no practical relevance for the statutory novation of liabilities because the existing law always provided remedies for the outgoing RE.¹⁵² It has simply added uncertainty to the law.

However, even if the reference to 'liabilities' in the statutory novation provisions was omitted, this still leaves the novation of 'obligations', which is required to allow a

¹⁴⁷ CAMAC 2011 (n 61), 50.

¹⁴⁸ For example, Willmott Growers Group Inc was a party in *Willmott Group* (n 60) and the FEA Growers Group Inc was a party in *Norman, re Forest Enterprises Australia Limited (Administrators Appointed) (Receivers & Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) (no 3)* [2011] FCA 624. TGG also sought to intervene in a number of Timbercorp cases including *Bosi* (n 60).

¹⁴⁹ *Re PWL; Ex parte PWL Ltd (no. 2)* [2008] WASC 232 and *Capelli v Shepard* (2010) 29 VR 242.

¹⁵⁰ *Bosi* (n 60), [117].

¹⁵¹ *HML v TSL* (n 48).

¹⁵² See (n 135) and (n 136).

smooth transition. However, such obligations may give rise to future liabilities, e.g., an obligation to pay future rent.¹⁵³

To deal with this problem, the first reform should be to amend the law to limit the right of recovery arising from those rights, obligations and liabilities of the former RE statutorily novated to the new RE to the extent that the incoming RE or TRE is actually indemnified out of scheme property. This change would eliminate the risks that currently exist for a TRE or a replacement RE to accept an appointment. This is because the incoming RE would not be liable for more than the amount that is recoverable by the RE from exercising its right of indemnity out of scheme property, i.e., once the scheme property is exhausted, the incoming RE has no further liability.

B. Second Reform

CAMAC said that section 601FT of the Corporations Act had simply assumed that it is possible to identify the relevant documentation for each MIS for the purposes of a deemed novation of the contracting parties.¹⁵⁴ The inability of any proposed replacement RE to access the relevant documentation makes it difficult for it to know what risks it will assume if it takes on the role of RE. The reality is that there is a natural reluctance by proposed REs to offer themselves as a suitable replacement for an insolvent RE. REs need to be able to carry out due diligence to ascertain the risks before accepting a role as replacement RE. At present, there is no data room.

Survey Results
The Survey results show that 69.6% of respondents considered the lack of access to information to carry out proper due diligence is a major issue. ¹⁵⁵

Participant 2 also said he had difficulties with access to information in these circumstances.¹⁵⁶

¹⁵³ *Gunns* (n 10).

¹⁵⁴ CAMAC Report (n 141), 62 and footnote 186.

¹⁵⁵ Survey Results, Q65, page 448.

¹⁵⁶ Interview Transcript, 469.

CAMAC therefore made three recommendations which were designed to assist a prospective RE in carrying out due diligence before its appointment as RE or TRE.

Firstly, the RE should be required to maintain a register of agreements related to each MIS that it operates.¹⁵⁷ CAMAC recommended that the requirement to keep the register should be a compulsory provision in the constitution of an MIS. However, this would only give rise to a contractual remedy. ASIC has the power to, and therefore should make it a condition of the licence of all REs that they must maintain such a register.¹⁵⁸ Alternatively, this condition of the licence could be legislated. Either way, this would give ASIC power to deal with any defaulting RE for breach of the conditions of their licence.

To enable due diligence of the MIS to be carried out by a prospective RE, CAMAC recommended that there should be an automatic right of inspection by a prospective RE, subject only to confidentiality obligations. The register would be definitive. Therefore, a prospective RE would be entitled to rely upon the register as a complete statement of the agreements involved in the MIS to which the prospective RE will be bound if it is appointed. A prospective RE would be protected from assuming unknown rights, obligations or liabilities provisions to the extent that the register is defective.

Secondly, CAMAC recommended that a RE should be subject to an obligation to establish and maintain a register of scheme property for each MIS that it operates.¹⁵⁹ This would have comparable obligations and rights as the agreements register referred to above.

Thirdly, CAMAC recommended that an incumbent RE should be subject to an obligation to provide reasonable assistance to a prospective TRE or new RE upon request from at least 5% of MIS members or when directed by court order (for instance, a court may give directions to assist the due diligence exercise of a prospective TRE).¹⁶⁰ While this is not necessary where there is a new RE

¹⁵⁷ CAMAC Report (n 141), [4.3.4].

¹⁵⁸ Corporations Act, ss 914A and 926A(2)(c).

¹⁵⁹ Ibid, [4.4.3].

¹⁶⁰ Ibid, [5.2.3].

appointed,¹⁶¹ this would be a valuable reform where there is only a prospective RE. It would bring this reasonable assistance obligation forward to pre-appointment from post-appointment. This is not unreasonable where the existing RE is in external administration, as an incoming TRE or RE will need to act quickly, armed with full knowledge of what it will be liable under the statutory novation provisions.

Participant 2 went further, stating there should be sanctions for non-compliance. These could include loss of licence, and the current RE would remain responsible for all the liabilities and obligations that would otherwise have statutorily novated to the incoming RE.¹⁶²

It follows that the second reform should be to amend the law in accordance with these three CAMAC recommendations. While there were varied views on this issue in the submissions, these recommendations are not onerous, particularly when, arguably in the case of the first and second recommendations, the RE should be maintaining these records anyway.¹⁶³ This should be complemented with appropriate sanctions for non-compliance. This reform to the legal and regulatory regime of the MIS would vastly improve the current system. This is because prospective REs would be able to ascertain the risks of appointment through a structured due diligence process. They would be able to assess the rights, obligations and liabilities that will be novated to them before taking on the role. Even if the first reform was also adopted, it is hard to imagine that a RE would not want to know in advance of appointment the above information that the second reforms would make accessible.

These changes, if enacted, should facilitate the ability of a prospective RE to be appointed as a TRE or replacement RE in the event of insolvency of the RE. This will

¹⁶¹ Corporations Act, s 601FR; *Wellington Capital Limited v Australian Securities and Investments Commission* [(1995) 182 CLR 544, [14]; *Stacks* (n 16), [56]; *Hancock v Rinehart* [2015] NSWSC 646 at [358]; *Tiger v Barclays Bank Ltd* [1952] 1 All ER 85; *Ogier Trustee (Jersey) Limited v CI Law Trustees Limited* [2006] JRC 158; *Re The Bird Charitable Trust and The Bird Purpose Trust* [2012] JRC 1006.

¹⁶² Interview Transcript, 469; There was some contradiction between 2 of the suggested sanctions. These were (i) that the RE should be liable to the new RE for all liabilities and obligations that novated and (ii) there should be no statutory novation of the liabilities and obligation which should remain with the old RE. However, the effect of what he said was that if there was no disclosure, the liabilities and obligations that would otherwise novate to the incoming RE, would remain with the existing RE.

¹⁶³ Corporations Act, ss 286 & 253M.

also improve the availability of candidates for replacement REs, notwithstanding the statutory novation provisions, because the RE will be able to assess what rights and obligations will be novated to it upon appointment. These proposed reforms would have made a difference in *Bosi*.¹⁶⁴ This is because the proposed candidates for TRE or replacement RE would not have been so reticent to be appointed had they known the extent of the rights, obligations and liabilities that were to be novated to them upon appointment. The evidence was that HML was prepared to be appointed, subject to confirmation of the liabilities that were to be statutorily novated to it.¹⁶⁵

Survey Results
The Survey results support this proposed reform, with 85.2% of respondents agreeing that REs should be required to maintain a register of contracts and scheme property, which is available for inspection in the event of a proposed change of RE.¹⁶⁶ Further, 73.9% of respondents agreed that if the maintenance of a register of contracts and scheme property was a requirement of law, this register should be definitive.¹⁶⁷ Also, 87% of respondents agreed that if their organisation had access to a register of contracts and scheme property maintained by the current RE, their organisation (subject to satisfactory due diligence of those registers) would be more likely than not to consent to an appointment as a TRE or replacement RE that they would under the current law.¹⁶⁸

¹⁶⁴ *Bosi*, (n 60).

¹⁶⁵ *Ibid*, [112].

¹⁶⁶ Survey Results, Q66, page 449.

¹⁶⁷ Survey Results, Q67, page 450.

¹⁶⁸ Survey Results, Q68, page 450.

IV. RESEARCH QUESTION 3: ON THE BALANCE OF PROBABILITIES, WILL THE PROPOSED REFORMS TO ADDRESS THESE FAILURES CAUSE REs TO ABANDON THE RETAIL MARKET THEREBY RESTRICTING INVESTMENT CHOICE BY RETAIL CLIENTS?

Importantly, these suggested amendments are consumer-centric rather than RE or regulator-centric. They are designed to protect the retail client by ensuring continuity of the 'solvent' MIS. However, it is important that the consumer centricity does not cause REs to abandon the market.

A. *First Reform*

Loxton and D'Angelo note that trustees usually limit their personal liability through express limitation of liability clauses. Such clauses limit their liability to the trust assets.¹⁶⁹ They also note that this practice is common and extends to REs and custodians.¹⁷⁰ The first reform, therefore, results in the law matching industry practice.¹⁷¹ This reform reduces the risk to the RE in taking over the role of RE, and therefore. The first reform also does not have any cost to the RE. Therefore, on the balance of the reform has a substantial benefit for the RE probabilities, this should not cause REs to abandon the retail market. The benefits, therefore, outweigh the costs of the reform.

Survey Results
This is supported by the responses to the Survey, with 92% of respondents agreeing that if the law were amended to remove 'liabilities' from the statutory novation provisions, this would not cause their organisation to reduce the availability of its products to retail clients. ¹⁷²

¹⁶⁹ Diccon Loxton and Nuncio D'Angelo 'Trustees' limitation of liability: Myths, mysteries and a model clause' (2013) 41 *Australian Business Law Review* 142.

¹⁷⁰ Ibid, 147.

¹⁷¹ Ibid, 142 at footnote 1 citing *Astley v Austrust Ltd* (1999) 197 CLR 1.

¹⁷² Survey Results, Q76, page 454.

B. Second Reform

Regarding the second reform, the RE, as part of its general duties as a RE, should already keep this information in order to comply with its obligations as a company, RE and trustee.¹⁷³ Therefore, there should be no additional administrative costs to the RE. The second reform would also assist an incoming RE to ascertain whether the MIS is financially viable, which may be important for the RE to know. Given that there should be no additional administrative costs with this second reform and the benefits that flow from having this information available on a changeover of RE, the benefits should outweigh the costs. Therefore, on the balance of probabilities, this reform should not cause REs to abandon the retail market.

Research Results
This reform is supported by 100% of respondents in the Survey who agreed that if the law were amended to require REs to keep registers of contracts and scheme property to assist the due diligence process on a change of RE, their organisation would not reduce the availability of its products to the retail investor. ¹⁷⁴

¹⁷³ Corporations Act, ss 286, 601FC(1)(i), (j) and (k), 601HA(1)(a) and (c); *Income Tax Assessment Act 1936*, s 262A; Australian Securities and Investments Commission Information Sheet 76; *Freeman v Fairlie* [1817] EngR 620; (1812) 3 Mer 24, 36 ER 10, 17-18; followed in *Yates v Halliday* [2006] NSWSC 1346 and *Skaftouros v Dimos* [2002] VSC 198, [11]; *Silkman v Shakespeare Haney Securities Limited (ACN 087 435 783) in its capacity as responsible entity of the Shakespeare Haney Premium Income Fund* (ARSN 106 223 483) [2011] NSWSC 148.

¹⁷⁴ Ibid, Q75, 454.

CHAPTER 7: MIS PRODUCT DISCLOSURE REGIME

'Investors have a limited capacity to meaningfully digest lengthy disclosure documents full of complex information, which are typically prepared principally to reduce legal risk'.¹

I. INTRODUCTION

In Chapter 1, three Research Questions were generated from the analysis of the history of the MIS regarding different aspects of the regulatory framework for the MIS designed to protect retail investors. One of the aspects of the framework identified from this history of the MIS referred to in Chapter 1 concerns product disclosure.

One of the key purposes of the MIS product disclosure regime is investor protection by providing information that will enable prospective investors with or without the assistance of their financial advisers to make an informed decision as to whether to invest in the product.² The product disclosure statement ('PDS') therefore must include information that a client would 'reasonably require' for the purpose of deciding whether to acquire the financial product.³

Another purpose is to address the information asymmetry that exists between a responsible entity ('RE') who understands the nature of their financial product and a retail investor who does not.⁴ There is a view that such asymmetry must be addressed because it is a primary source of market failure.⁵ This is achieved by requiring the RE to provide the retail investor with all information necessary to enable them, with or without the assistance of their financial advisers, to assess the risks of

¹ Benjamin B Saunders, 'Causation in Securities and Financial Product Disclosure Cases: An Analysis and Critique' (2019) 47(3) *Federal Law Review* 496, 500.

² Ibid, 498; Australian Securities and Investments Commission, *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (Regulatory Guide RG 168, July 2022) ('RG 168'), [RG 168.1]; Lachlan Burn, 'KISS, but Tell All: Short-Form Disclosure for Retail Investors' (2010) 5(2) *Capital Markets Law Journal* 141, 161.

³ RG 168 (n 2), [RG 168.143].

⁴ The Treasury *Regulation Impact Statement on Financial Services Disclosure Reform* (13 July 2010) previously at www.treasury.gov.au. (I retained a copy before its removal) (RIS-FSDR), [3]-[4].

⁵ Ibid.

investing in the product offered.⁶ and therefore to make informed choices.⁷ The theory is that the retail investor, armed with full knowledge of the product derived from this disclosed information, will understand the risks of their investment choice and thereby be protected from harm.

The problem with this theory is that disclosure does not work if retail investors do not read and understand the Product Disclosure Statement ('PDS') or at least read it at a level sufficient to understand the key risks and features of the product. As will be seen later in this Chapter, the conclusion is that retail investors are unlikely to read the PDS in any detail, if at all, rendering the utility of disclosure nugatory. There is little incentive for them to do so, given the complexity of the disclosure requirements as discussed later in this Chapter. Research indicates that the amount of information provided under the 'law as it is' overwhelms retail clients. This impedes their understanding of the product.⁸

Alternatively, if the retail investor relies upon the advice provided by a financial adviser rather than reading the PDS themselves, then the quality of the advice they received is important. The following table is my analysis of submissions by investors to the 'Bitter Harvest' Inquiry in 2016. This results of this analysis are indicative of the investors receiving poor quality advice.⁹

Complaint about advice received	Complaint about gearing of investment (on advice)	Unsuitable Investment for the investor despite advice to invest	Did not Read PDS	Lack of Understanding of risks	Commission not disclosed.	Not advised of Ongoing Fees
93	96	42 ¹⁰	2	2	2	6

(Note: Many of the submissions disclosed more than one reason for making the investment, and where this was the case, these investors have been included in each relevant category)

⁶ Ibid, [4]; Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers Bill 2018, (DOD-EM) [1.2].

⁷ Australian Securities and Investments Commission, *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (Regulatory Guide 168, July 2022), [RG 168.39].

⁸ Daniel W. Richards and Maryam Safari, 'Disclosure effectiveness in the financial planning industry' (2021) 13(5) *Qualitative Research in Financial Markets* 672, 682 and 687.

⁹ Senate Economics References Committee *Inquiry into Forestry managed investment schemes* (25 June 2014) ('Bitter Harvest').

¹⁰ This is based on an assessment of the investor's description of their financial position e.g., what was a financial planner doing recommending that a single working mum, with no superannuation and no capacity to support herself in retirement invest in these schemes with the investment being geared (which was one of the submissions –name withheld).

Despite the poor quality advice received in the above Inquiry, a properly qualified financial adviser may assist retail investors in assimilating the often dense and in some instances technically challenging material presented in PDSs. Although the law has been amended to ensure that financial advisers who give personal advice must meet minimum education and training standards,¹¹ this does not apply to persons who give general advice. The Treasury concluded in the Final Report for the Quality of Advice Review ('QAR Report') that the:

regulatory framework for financial advice is complex, difficult to understand and difficult to comply with. These are serious defects. They are an undoubted impediment to consumers being able to access affordable financial advice. They are also an impediment to consumers accessing high quality advice. The regulatory framework has not even proved effective in preventing consumer harm. The regulation applying to the provision of financial advice has accumulated with rapid succession over a short period of time in response to crises and scandals involving financial institutions and financial advisers with each one leading to more patching of the law. The result is not coherent and it is plainly not working'.¹²

The following diagram contained in the QAR Report illustrates the difference between general and personal advice:



¹¹ Corporations Act, Division 8A of Part 7.6.

¹² Treasury 'Quality of Advice Review' (Final Report December 2022) ('QAR Report'), 1.

Research undertaken by ASIC indicates that retail investors may not be able to determine the difference between personal and general advice particularly where there is a personal connection between the retail investor and the financial adviser.¹³

Following a number of Inquiries which reported on weaknesses in the disclosure regime,¹⁴ the Government acted to shore up the weakness in the disclosure model through design and distribution obligations ('DDO').¹⁵ This new DDO regime is superimposed upon an investor empowerment regime of disclosure. This superimposition shifts to the RE, as the product issuer the obligations,

- to determine the suitability of their product for an identified class of hypothetical retail clients i.e. the focus is on hypothetical not actual consumers in a product's target market,¹⁶ and
- ensure that that the product is only distributed to retail clients who fall within that hypothetical class.

For more details, see the discussion in section (II)(D), page 223 below.

Because there is no change in the requirement for disclosure of a financial product to be made to the retail investor, the disclosure regime forms part of the regulatory framework for the protection of retail investors. As identified in Chapter 1, there are issues with the disclosure regime that require examination as set out in this Chapter 7.

¹³ Australian Securities and Investments Commission News 'Findings from consumer research on 'general advice' label (4 May 2021).

¹⁴ 'Bitter Harvest' (n 9); Parliamentary Joint Committee on Corporations and Financial Services *The structure and operation of the superannuation industry* (Report, 2007) (PJC Superannuation Report); David Murray, *Financial System Inquiry* (Final Report, 2014) ('Murray'); Australian Securities and Investments Commission and the Dutch Authority for the Financial Markets Disclosure: Why it shouldn't be the default, (Report No. 632, 14 October 2019) ('ASIC-AFM Report').

¹⁵ *Corporations Act 2001* (Cth) ('Corporations Act'), Part 7.8A.

¹⁶ 'Suitable' in this context means that the financial product is likely to be consistent with the likely objectives, financial situation and needs of a class of hypothetical consumers, not the actual consumer, who fall within an identified target market for the product: Australian Securities and Investments Commission, *Product design and distribution obligations* (Regulatory Guide 274, 10 September 2024), [RG 274.8].

II. RESEARCH QUESTION 1: HOW DO THE MIS PRODUCT DISCLOSURE OBLIGATIONS FAIL TO PROTECT THE RETAIL INVESTOR?

A. Background on disclosure framework

When the *Financial Services Reform Act 2001* (Cth) ('FSRA') was enacted, it adopted two recommendations of the ALRC Report 65. These were:

- (a) all disclosure obligations for CIS should be subject to plain language requirements, and
- (b) the law should prescribe specific matters for inclusion in the document.¹⁷

Firstly, the FSRA required that a product disclosure statement ('PDS') be worded and presented in a 'clear, concise and effective manner'.¹⁸ Secondly, the FSRA prescribed the inclusion in the PDS of specific matters.¹⁹ This was distinct from the more generic requirements for a prospectus that apply to securities.²⁰

It was considered that the new product disclosure rules would benefit both industry and retail investors through the introduction of consistent disclosure standards and ultimately would decrease compliance costs.²¹ The benefit to retail clients was the imposition of a consistent standard of disclosure for functionally equivalent financial products, thereby leading to 'increased consumer confidence and participation in the financial sector'.²² Unfortunately, as will be seen below, this 'wish list' has not been met.

Despite the intention of the FSRA provisions governing disclosure, the current PDS regime (i.e., 'the law as it is') has resulted in PDSs provided to retail investors being overly long and complex. This is largely due to two legal requirements that must be met. On one hand, the PDS must be worded and presented in a 'clear, concise and

¹⁷ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65, 1993) ('ALRC Report 65'), Volume 2, [5.36] and [5.14].

¹⁸ Corporations Act, s 1013C(3).

¹⁹ Ibid.

²⁰ Ibid, Chapter 6D.2.

²¹ Explanatory Memorandum to the Financial Services Reform Bill, 2001 (FSR-EM), [2.36].

²² Ibid, [2.37].

effective manner'.²³ On the other hand, the PDS must not contain a misleading or deceptive statement or omit any of the prescribed content.²⁴ When drafting a PDS, there is a constant tension between these two requirements. This tension is exacerbated by the consequences of non-compliance. If a PDS is not worded and presented in a 'clear, concise and effective' manner, although this may result in a stop order, it is not a criminal offence nor does it give rise to civil liability.²⁵ This is because non-compliance with this provision does not make the PDS 'defective'.²⁶

There may be criminal and civil liability consequences if the PDS is defective.²⁷ A PDS will be defective if there is a misleading or deceptive statement in, or there is an omission of prescribed information from, the PDS, and that statement or omission is or would be 'materially adverse' from the point of view of a reasonable person considering whether to proceed to acquire the financial product concerned.²⁸ The statement or omission will also be 'materially adverse' if a reasonable investor would have, but for the misleading and deceptive statement or omission, been turned away from the investment rather than being more willing to invest.²⁹ Therefore, REs will naturally err on the side of caution to ensure a document is not defective because this is what really matters. Hence, the resultant length.

The prescriptive nature of the PDS requirements has led to what Ben-Shahar and Schneider, in the context of mandatory disclosure as a regulatory tool generally, rather than financial product disclosure specifically, but equally applicable to the latter,

²³ Corporations Act, s 1013C(3); There is a view that this does not concern the length of the PDS but concerns how the information is presented: Andrew J Serpell, 'The Future of Financial Services Regulatory Reform in Australia: Conduct and Disclosure Obligations' (2008) 5 *Macquarie Journal of Business Law* 329, 342. However, a good presentation demands it should not be lengthy. ASIC regards the word 'concise' means 'as short as possible': Australian Securities and Investments Commission, Prospectuses: Effective disclosure for retail investors (Regulatory Guide 228, 12 August 2019), [RG 228.30].

²⁴ Corporations Act, ss 1021B, 1021D, 1021E, 1021F, 1021J, and 1021K for criminal liability and ss 1022A and 1022B for civil liability.

²⁵ Ibid.

²⁶ Corporations Act, ss 952B(1) and 1021B(1).

²⁷ Ibid, ss 1021B, 1021D, 1021E, 1021F, 1021J, and 1021K for criminal liability and 1022A and 1022B for civil liability.

²⁸ Corporations Act, 1021B(1), definition of "defective".

²⁹ *Roadships Logistics Ltd v Tree* [2007] NSWSC 1084, [8]-[9]; see also *TSC Industries Inc v Northway Inc*, 426 US 438 (1976) cited with approval in *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2016) 245 FCR 402, [96].

describe as a ‘quantity problem’³⁰. This ‘quantity problem’ has two major aspects. There is the ‘overload’ effect and the ‘accumulation’ problem.³¹ The ‘overload’ effect occurs when the disclosure is too copious and complex for the retail investor to effectively digest.³² The ‘accumulation’ problem arises because there are so many disclosures that the retail investor can only deal with a fraction of them.³³ This is a feature of the existing financial product disclosure regime.³⁴ Ben-Shahar and Schneider refer to Miller’s ‘magical number seven’, which is roughly the number of items that people can maintain in short-term memory.³⁵ They conclude that lawmakers have no good solution to this problem.³⁶ Ben-Shahar and Schneider further argue that there is no evidence that the benefit of mandated disclosure outweighs the cost.³⁷

Paredes makes a similar point. He says that human beings have limited cognitive capabilities and are unable to absorb all available information. These limited cognitive capabilities cause the retail investor to exclude information and options, either because they are unmanageable and perhaps overwhelming for the retail investor to consider when making an investment decision, or because it will simply be too time-consuming for the retail investor to absorb all available information.³⁸ Therefore, their choices are not always optimal.³⁹ There is also behavioural research indicating retail investors have a limited ability to understand and process information, leading to

³⁰ Omri Ben-Shahar, and Carl E. Schneider, ‘The Failure of Mandated Disclosure’ (2010), 159(3) *University of Pennsylvania Law Review* 647, 686-687.

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*

³⁴ Lydia Velliscig, ‘Season 3: Product Governance. Rethinking Retail Customer Protection in the EU Insurance Market’ (2018) 18(1) *Global Jurist* 1; Wai Yee Wan, Andrew Godwin and Qinzhe Yao, ‘When Is An Individual Investor Not In Need Of Consumer Protection? A Comparative Analysis of Singapore, Hong Kong, and Australia’ (2020) *Singapore Journal of Legal Studies* 190, 196-197.

³⁵ Ben-Shahar (n 30), 687, citing George A. Miller, ‘The Magical Number Seven, Plus or Minus Two: Some Limits on Our Capacity for Processing Information’ (1956) 63 *Psychology Review* 81, 90.

³⁶ Ben-Shahar (n 30), 679.

³⁷ Omri Ben-Shahar, and Carl E. Schneider, ‘The Futility of Cost-Benefit Analysis in Financial Disclosure Regulation’ (2014) 43 *Journal of Legal Studies* S253, S254.

³⁸ Troy A Paredes ‘Blinded by the Light: Information Overload and Its Consequences for Securities Regulation’ (2003) 81(2) *Washington University Law Review* 417, 435-436; see also Andreas Oehler and Stefan Wendt, ‘Good Consumer Information: the Information Paradigm at its (Dead) End?’ (2017) 40 *Journal of Consumer Policy* 179, 183; Matti Turtiainen et al ‘Key investor information disclosure regulation and retail mutual fund flows in the Finnish market’ (2022) 40(4) *International Journal of Bank Marketing* 865, 866 and 868.

³⁹ Oskari Juurikkala, ‘The Behavioural Paradox: Why Investor Irrationality Calls for Lighter and Simpler Financial Regulation’ (2012) 18(1) *Fordham Journal of Corporate & Financial Law* 32, 38.

decision-making paralysis.⁴⁰ The issues of information overload and decision-making paralysis have also arisen in other areas of consumer protection.⁴¹

Information overload is evident in Australia, as revealed by the increasing volume of disclosure requirements prescribed since the FSRA was enacted. Between 2002 and 2023, the disclosure provisions increased in length by 59%.⁴² Prescriptive disclosure upon prescriptive disclosure has occurred, creating complexity in the law. This complexity is exemplified by the complex fee disclosure requirements.⁴³ These are incomprehensible to the average person. They are also difficult for product issuers to understand.⁴⁴ Although an attempt has been made by ASIC to reduce this complexity⁴⁵ with amendments to both to its regulatory guide⁴⁶ and the law,⁴⁷ which apply to PDSs issued after 30 September 2020, the results of the consumer testing comparing the old and new provisions were far from overwhelming.⁴⁸ For example, the ease of understanding the old form of the MIS fees and costs template was found to be better for consumers than the new template.⁴⁹ Consumers also considered that both the old and the new fee and cost templates contained two types of ‘gobbledygook’.⁵⁰ This comprised terminology they did not understand and lists of fees, especially where percentages were mixed with dollar amounts.⁵¹

An analysis of the ‘law as it is’ regulating PDSs reveals the current disclosure requirements:

⁴⁰ Saunders (n 1), 500.

⁴¹ *Trivago N.V. v Australian Competition and Consumer Commission* [2020] FCAFC 185, [102(j) and (k)].

⁴² Australian Law Reform Commission, *Confronting Complexity: Reforming Corporations and Financial Services Legislation* (Final Report No. 141, November 2023), [2.24].

⁴³ ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070.

⁴⁴ Darren McShane *Review of ASIC Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (Report No. 581, July 2018), 32; although amendments were made following this report which made some improvements, the amended version is still difficult for product issuers to navigate and remains complex.

⁴⁵ Australian Securities and Investments Commission *Response to submissions on CP 308 Review of Regulatory Guide 97* (Report No. 637, November 2019).

⁴⁶ Australian Securities and Investments Commission, *Disclosing fees and costs in PDSs and periodic statements* (Regulatory Guide 97, September 2020).

⁴⁷ (n 43).

⁴⁸ Susan Bell Research ‘*Consumer testing of the fees and costs tools for superannuation and managed investment schemes*’ (May 2019), 15; (published by ASIC as Report No. 638, November 2019).

⁴⁹ *Ibid*, cf table 34 and table 36, 69.

⁵⁰ *Ibid*.

⁵¹ *Ibid*.

- (a) are complex and highly specific,⁵²
- (b) are difficult to follow and understand due to both the drafting methodology⁵³ and their complexity,⁵⁴
- (c) lack consistency, varying according to the product being issued,⁵⁵
- (d) are often hard to locate.⁵⁶

Therefore, the PDS is likely to lead to investor disengagement from the disclosure process.⁵⁷

Such is the complexity of the disclosure requirements; in 2021, there were 84 legislative instruments granting relief from, or notionally amending, the disclosure provisions in Part 7.9 of the Corporations Act⁵⁸ and 2,404 individual relief instruments.⁵⁹ Not only does the RE have to navigate the provisions which set out the requirements for a PDS in the Corporations Act, *Corporations Regulations 2001* (Cth) and ASIC Regulatory Guides, but the RE must also ascertain whether there is any applicable legislative instrument.

⁵² Ashley Black and Pamela Hanrahan 'Securities and Financial Services Law' (LexisNexis Butterworths, 10th ed, 2021), [5.48]; DOD-EM (n 6), [1.2]; Bitter Harvest (n 9), [9.74]; Pheobe Tapley and Andrew Godwin 'Disclosure (Dis)content: Regulating Disclosure in Prospectuses and Product Disclosure Statements' (2021) 38 *Company & Securities Law Journal* 315; Australian Law Reform Commission *Interim Report A Financial Services Legislation* (Report 137 November 2021) (ALRC Report 137), [9.6].

⁵³ Garry T Bigmore and Simon Rubenstein, *Rights of Investors in Failed or insolvent Managed investment Schemes*, in Stewart J Maiden, (ed), *'insolvent investments'* (LexisNexis Butterworths, 2015), 237-238

⁵⁴ Asta Zokaityte 'Financial literacy and numeracy of consumers and retail investors' (2016) 11(3) *Capital Markets Law Journal* 405, 412.

⁵⁵ there are product specific requirements for different types of MIS e.g., Australian Securities and Investments Commission, *Mortgage schemes: Improving disclosure for retail investors* (Regulatory Guide 45); Australian Securities and Investments Commission, *Unlisted property schemes: Improving disclosure for retail investors* (Regulatory Guide 46); Australian Securities and Investments Commission, *Infrastructure entities: Improving disclosure for retail investors* (Regulatory Guide 231); Australian Securities and Investments Commission, *Agribusiness managed investment schemes: Improving disclosure for retail investors* (Regulatory Guide 232); Australian Securities and Investments Commission, *Hedge funds: Improving disclosure* (Regulatory Guide 240).

⁵⁶ ALRC Report 137 (n 52), [9.115].

⁵⁷ DOD-EM (n 6), [1.2].

⁵⁸ ALRC Report 137 (n 52), [9.51]-[9.54].

⁵⁹ *Ibid*, [9.58].

This has led to retail clients being presented with large and complex PDSs.⁶⁰ For example, in 2010, in a regulatory impact statement issued by Treasury on financial services disclosure reform ('RIS-FSDR'),⁶¹ Treasury noted that a sample of MIS PDSs selected for a study into consumer comprehension and engagement varied between 32 and 124 pages.⁶² While this research is old, the problem still persists.⁶³ Apart from the simple MIS ('SMIS'), where the size of the PDS is limited to eight A4 pages,⁶⁴ there is no size limitation for other forms of MIS. The retail investor is put off by the sheer volume of information contained in a PDS for a non-SMIS.⁶⁵ The PDS is therefore not an effective tool for communicating key information to retail investors. It is simply too long for the retail investor to effectively digest.⁶⁶ Donald dramatically describes the PDS regime as 'analogous to the Titanic, which was also highly expensive and elaborate to the point of over-engineering but which ultimately sank under the weight of its own ornamentation'.⁶⁷

B. Case Studies

As discussed in Chapter 1, the legal case study can provide examples of where the 'law as it is' has failed, thereby directing reform as to what 'law ought to be'. These studies not only answered Research Question 1 but also identified patterns and common themes from which the proposed reforms flow in answer to Research Question 2. These case studies reveal that retail clients either do not read the PDS, or

⁶⁰ Zokaityte (n 54), 412.

⁶¹ RIS-FSDR (n 4).

⁶² Ibid, [18].

⁶³ A Google Search on 31/07/2024 revealed numerous PDS for MIS (excluding simple MIS ('SMIS') which are restricted to 8 pages) that were over 40 pages with one being 86 pages; also see Gerry Gallery, Natalie Gallery and Kym Irving 'Use and Usefulness of PDSs in the financial planning context' JASSA (2013) *The Finsia Journal of applied Finance* 7, 10; the EU had a similar problem: D. Scheld, O. Stolper and A. Walter 'Double Dutch Finally Fixed? A Large-Scale Investigation into the Readability of Mandatory Financial Product Information' (2021) 44(2) *Journal of Consumer Policy* 151, 170.

⁶⁴ *Corporations Regulations 2001*, definition in reg 1.0.02(1); only applies to registered schemes which invest at least 80% of its assets in a bank account where funds can be withdrawn within three months, or in arrangements where the investments can be realized at market value within 10 days e.g., cash management trusts.

⁶⁵ PJC Superannuation Report (n 14), [6.119].

⁶⁶ Ibid; Kirsty Johnston, Christine Tether, Ashley Tomlinson 'Financial Product Disclosure: Insights from Behavioural Economics' *Ministry of Business, Innovation & Employment Occasional Paper* 15/01 February 2015, 12; Vicki Catherine Waye et al 'Is mandatory disclosure an effective panacea for buyer beware?' (2023) *Journal of Property, Planning and Environmental Law*, [4.5.1].

⁶⁷ M Scott Donald 'All Aboard the PDS Titanic' (2009) (2) *The Finsia Journal of Applied Finance* 29.

if they do read it, they do not do so with any detail. Flowing from this is the need for reform that promotes retail client engagement with the disclosure process.

1. *Case Study 1 -Great Southern Plantations Managers Australia Ltd ('GSMAL')*

A number of proceedings were brought by investors who had invested in MISs promoted and operated by GSMAL.⁶⁸ GSMAL operated 43 registered MIS when the group of companies that included GSMAL ('GSG') collapsed in May 2009. At the time of the collapse, over \$2.2 billion had been invested by 52,000 investors.⁶⁹

The investors alleged that PDSs issued by GSMAL were defective. As a result, they suffered loss and damage.⁷⁰ To succeed, it was necessary for the investors to prove:

- (a) the relevant PDSs contained representations which were misleading or deceptive (described by the investors as 'Misleading PDS Statements),
- (b) the relevant PDSs omitted to include information that was required to be included in the PDSs pursuant to Division 2 of Part 7.9 of the Corporations Act (described by the investors as the 'Relevant Matters'),
- (c) the Relevant Matters were 'actually known' to the relevant persons under s 1013C(2) of the Corporations Act,
- (d) the investors relied on the alleged Misleading PDS Statements in applying for interests in the relevant MISs or would not have invested in the relevant MIS had the Relevant Matters been disclosed,
- (e) the investors suffered loss and damage as a result of being given a 'defective' PDS, and
- (f) GSMAL was liable for that loss and damage.⁷¹

⁶⁸ *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (Receivers and Managers Appointed) (in liquidation)* [2014] VSC 516, [5]; *Agricultural & Rural Finance Pty Limited v Kirk* [2011] NSWCA 67, per Tobias JA [151].

⁶⁹ Christine Brown, Colm Trusler and Kevin Davis 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure' (2010) *Journal of the Securities Institute of Australia*, 7.

⁷⁰ *Clarke* (n 68), [88].[513]-[516].

⁷¹ *Ibid.*

Items (a) to (c) went to causation, and items (d) to (e) went to damage.⁷²

The court held that, to succeed with their action, the investors must prove that:

- (a) the alleged defective PDS was a decisive reason behind their decision to invest in the relevant scheme or schemes,⁷³
- (b) they acted or would have acted in a way that was more beneficial to them had the alleged Misleading PDS Statements not been made or had the alleged Relevant Matters been disclosed.⁷⁴

If the investors were indifferent to a material misrepresentation in the PDS, or it had little bearing on their decision to invest, then the misrepresentation could not have been the cause of their loss or damage.⁷⁵ The court also noted that the authorities were clear that a common element in the test of causation is that a plaintiff must establish that he or she relied on the misleading statement or an omission of a relevant matter.⁷⁶ Croft J held that he could not be 'satisfied that any of the plaintiffs read any part of the PDSs in any detail' and that 'in some cases, the relevant plaintiffs did not read the PDSs at all'.⁷⁷ Further, Croft J found that, apart from one exception, there was 'certainly nothing to suggest that the alleged Misleading Statements or the omission of the Relevant Matters were relied upon by the plaintiffs when making their decision to invest'.⁷⁸

Therefore, even if there were Misleading PDS Statements or omissions of Relevant Matters, the investors were doomed to failure because they simply did not read the PDS or, if they did, it was not read in any detail. There was no reliance. The 'law as it is' in this case resulted in dismissal of the claim, leaving them with no remedy because they did not read the PDS that was designed to protect them.

⁷² Ibid.

⁷³ Ibid, [3565].

⁷⁴ Ibid.

⁷⁵ Ibid.

⁷⁶ Ibid, [3569].

⁷⁷ Ibid, [3588].

⁷⁸ Ibid. [3591].

2. Case Study 2 -*Timbercorp Securities Ltd* ('TSL')

Another group, similar to GSMAL, was TSL. TSL operated 34 registered MIS. These schemes were funded by over 18,000 investors contributing just under \$1.1 billion.⁷⁹

The investors commenced group proceedings against TSL.⁸⁰ It was alleged that TSL, as the RE, had failed to disclose information about risks associated with its financial structure. These risks were alleged to be significant or might have had a material influence on a decision to invest in a scheme and therefore should have been disclosed.⁸¹ This was described as the structural risk that the Timbercorp group of companies ('TGC') might fail because of insufficient cash and the consequential risk to the viability of the schemes managed by TSL.⁸² At trial, the investors argued that, on or after 6 February 2007, events occurred that put the business of TGC at heightened risk of failure ('Adverse Matters'). This included a proposal by the Australian Taxation Office ('ATO') to change its position on the deductibility of up-front fees paid by investors and the tightening of global credit markets.⁸³

The lead plaintiff alleged that if he had been informed of the initial structural risk or any of the Adverse Matters, he would not have invested in the schemes.⁸⁴ However, during the trial, the lead plaintiff reformulated the structural risk into a financing risk. In addition, the Adverse Matters allegations were amended to apply to events that adversely impacted this financing risk.⁸⁵

The investors faced difficulties with their case because, even assuming that the Adverse Matters were properly characterised as a risk (which the court found they were not), the disclosure obligation contained in section 1013D(1) of the Corporations Act is prefaced by words that limit that disclosure obligation. This meant that the disclosure was limited to the extent that a person would reasonably require to make a decision on whether to invest in the financial product.⁸⁶ In the court's view, the lead plaintiff's formulation of the structural risk and the Adverse Matters was not information

⁷⁹ Bitter Harvest (n 9), [2.43].

⁸⁰ *Woodcroft-Brown v Timbercorp Securities Limited (in liq)* [2011] VSC 427.

⁸¹ *Ibid.*, [24].

⁸² *Ibid.*

⁸³ *Ibid.*, [25].

⁸⁴ *Ibid.*, [26].

⁸⁵ *Ibid.*, [613].

⁸⁶ *Ibid.*, [71].

that a retail client would reasonably require in order to make a decision as to whether to invest in the product.⁸⁷

Further, the three experts who gave evidence, including the expert of the lead plaintiff, opined that, for as long as TGC could maintain the support of its banks, there was ‘no significant risk that the Group would not have had the financial capacity to manage any of the schemes through to their contemplated completion’.⁸⁸ The evidence was that TGC had bank support until the end of 2008 or early 2009, when the willingness of the banks to continue that support became uncertain.⁸⁹ This was well after the PDS was issued.⁹⁰ Further, regarding the change by the ATO in its view of deductibility, the evidence was that while this may have had a negative impact on the share price of the listed company in TGC and on forecast performance in the short-term, the actual impact did not threaten the ability of TSL to continue to discharge its contractual responsibilities to scheme investors.⁹¹ Therefore, there were no significant risks that required disclosure.

The key aspect of the case, which led to the failure of the investors to succeed in this claim based on the alleged misrepresentations in the PDS, was that the investors failed to establish that they relied upon those misrepresentations. The court held that it was not persuaded that the plaintiff had read the PDS in any detail because the investor, in fact, did not have time to do so. Rather, he had relied on the recommendation of a financial adviser and was motivated by his anxious desire to obtain a tax deduction.⁹² The court found that another investor in a TSL scheme, who also gave evidence, had not read the PDS in any detail. While he may have glanced at parts of the PDS, the court further held that the investor was willing to invest without careful consideration of the documents.⁹³ The primary judge’s decision was upheld by the Court of Appeal.⁹⁴ Special leave to appeal to the High Court was refused.⁹⁵

⁸⁷ Ibid.

⁸⁸ Ibid, [544].

⁸⁹ Ibid, [551].

⁹⁰ Ibid, [34].

⁹¹ Ibid, [552].

⁹² Ibid, [592].

⁹³ Ibid, 652].

⁹⁴ *Woodcroft-Brown v Timbercorp Securities Ltd* [2013] VSCA 284.

⁹⁵ *Woodcroft-Brown v Timbercorp Securities Limited* [2014] HCATrans 85.

3. Case Study 3 – Food and Beverage Australia Ltd ('FBA')

FBA carried on business as a RE.⁹⁶ It operated a number of schemes. These included a scheme called the Tasmanian Premium Cherries Project ('Cherries Project').⁹⁷ FBA took proceedings against one of the investors in the Cherries Project for failure to pay fees required to be paid pursuant to the relevant scheme documents. The investor in the Cherries Project cross-claimed against FBA for allegedly engaging in misleading conduct and breach of contract, seeking to restore the parties to the same position they were in before he invested.⁹⁸

The investor claimed that the misleading conduct consisted of:

- representations that the investor could obtain loans from an associated company to cover the first four years of grower fees,⁹⁹
- representations that rain covers and bird netting would be installed.¹⁰⁰

The first representation was based on statements in the PDS. While a theoretical prospective investor who read the PDS might have been misled, in this case, the investor had failed to give evidence that he had read or relied upon those statements in the PDS.¹⁰¹ The court found that the investor had not read various parts of the PDS and that, if he did read the PDS, at best, all he did was glance at it in a vague way to obtain a general impression rather than read any passages.¹⁰²

⁹⁶ *Food and Beverage Australia Limited v Nash* [2020] SASC 92, [4].

⁹⁷ *Ibid*, [2].

⁹⁸ *Ibid*, [3].

⁹⁹ *Ibid*, [298]-[300].

¹⁰⁰ *Ibid*, [301].

¹⁰¹ *Ibid*, [314].

¹⁰² *Ibid*, [314]-[320], [390] appeal dismissed in *Nash v Food and Beverage Australia Limited* [2021] SASCA 59, [94]-[95], [121], [128]; special leave to appeal to the High Court was refused: *Nash v Food and Beverage Australia Limited* [2021] HCASL 219.

If the investor had read the PDS, he would have succeeded in recovering his loss and damage flowing from these misrepresentations. Because he did not read the PDS, he could not rely on anything contained in or omitted from the PDS to support his claim.

4. Case Study 4 – *Tomasetti*

In this case, Tomasetti commenced proceedings against his accountants. The claim was with respect to certain investments he made in various agricultural MIS between 2000 and 2005. He claimed that the professional advice he had received about making those investments was deficient in various respects.¹⁰³ This included that the accountants had failed to carry out adequate assessment of investments and whether they were ‘sound, prudent and sensible’ having regard to Tomasetti’s instructions and risk profile.¹⁰⁴ The investments involved borrowings ranging between 75% and 100% of the initial investment, but mostly 90%. In addition to being obliged to repay these loans, there were further costs to be paid. The payments to be made for two of the schemes totalled many hundreds of thousands of dollars. In all, the plaintiffs’ claim for past loss exceeded \$4 million.¹⁰⁵

Tomasetti was senior counsel. Although he specialised in Land and Environment Court matters, he had expertise in property, equity and commercial law.¹⁰⁶ He claimed that when he was away from work, he was not enthusiastic about attending to his financial affairs and that he was risk-averse regarding his personal financial investments.¹⁰⁷ His evidence was that he had never read the prospectus or PDS regarding any of the schemes in which he invested, although he conceded he had read bits of them.¹⁰⁸ Nevertheless, he was not an unsophisticated investor. He was reasonably well experienced in commercial matters generally and was particularly astute with respect to the purchase and development of real estate, about which he made his own decisions. He also had been involved in two farming operations and,

¹⁰³ *Tomasetti v Brailey* [2011] NSWSC 1446, [1]; the precise deficiencies are not clear from the judgement.

¹⁰⁴ *Ibid*, headnote.

¹⁰⁵ *Ibid*, [21].

¹⁰⁶ *Ibid*, [23].

¹⁰⁷ *Ibid*, [27].

¹⁰⁸ *Ibid*, [111]-[115], [134]-[136], [160]

therefore, was aware of the risks with agricultural pursuits.¹⁰⁹ His interest in investing in the schemes was driven by tax minimisation motives.¹¹⁰

Tomasetti failed in his claim.¹¹¹ The court held that his,

negligence was manifest. He is an intelligent man with significant experience in commercial and financial matters; yet he was reckless to an extreme degree. His claim to have made substantial financial commitments by signing documents with a mental blindfold on is astounding. On his own version, his conduct amounted to an almost complete abrogation of any prudent care for his own financial affairs.¹¹²

C. Weaknesses with the disclosure framework

These legal case studies are consistent with the literature and behavioural research referred to in (II)(A) of this Chapter at pages 209-214. They are also consistent with the findings from my analysis of submissions by investors to the ‘Bitter Harvest’ Inquiry in 2016.¹¹³ Although only two of the complainants admitted not reading the PDS, a fair reading of the other complaints indicates that it is unlikely that those complainants read the PDS, let alone relied upon it.¹¹⁴ It is clear that these investors relied solely on the so-called ‘financial product advice’ they were given by financial advisors.¹¹⁵

If investors do not read the PDS or do not read it in any detail, this defeats the purpose of disclosure. The information asymmetry between the RE and the retail investor remains. Mandated disclosure only works if the investors pay attention to the disclosure.¹¹⁶ However, there is little incentive for investors to read the PDS because of the sheer volume of disclosures. This is illustrated by the findings in the RIS-FSDR referred to above. For regulation of product disclosure to work, not only does disclosure of the information have to be made but the users of the information need to use that information effectively. Otherwise, mandatory disclosure is otiose.¹¹⁷

¹⁰⁹ Ibid, [380].

¹¹⁰ Ibid, [372], [522].

¹¹¹ His appeal to the Court of Appeal failed: *Tomasetti v Brailey* [2012] NSWCA 399.

¹¹² Ibid, [817].

¹¹³ Bitter Harvest (n 9).

¹¹⁴ Table 1.1 (My Analysis of submissions to Senate Economics Reference Committee ‘Agribusiness managed investment schemes Bitter Harvest’ (Report, March 2016)), page 340.

¹¹⁵ Ibid.

¹¹⁶ Ben-Shahar (n 37), S269.

¹¹⁷ Paredes (n 38), 418.

The RIS-FSDR considered that effective disclosure means that the information is provided in such a way that retail investors can easily locate and understand all the key information they require to make an informed decision.¹¹⁸ If too much information is provided it will not only be ineffective but eventually investors will reach a saturation point leading to a failure to assimilate information with a paralysis of decision-making¹¹⁹. The sheer volume and size of disclosure in the PDS presented to investors undoubtedly contributes to this paralysis of decision-making.¹²⁰

Successive governments and regulators appear to be conditioned to respond to financial crises and public perceptions of risk with greater and more complex disclosure.¹²¹ Governments cannot adjust their thinking to consider other alternatives. This conditioning means that they are not open to the radical idea that less disclosure may be more effective with a shorter 'key features' approach. This radical idea is better than the current regime because at least the retail investor will have had 'key features' of the financial product disclosed to them. This would reduce the information symmetry that exists. There is no reason why a simple short document could not be used that discloses the 'key features' of the financial product. This is confirmed by research that indicates a short-form key information document increases the retail investor's awareness of key elements of the investment when making an investment decision.¹²²

As successive governments and regulators tighten the disclosure obligations with more detail and complexity, retail investors are more disinclined to read those disclosures. Similar to Newton's third law of motion, 'each action has an equal and opposite reaction'.

The conclusion drawn from the above evidence is that the size of the current form of PDS is anathema to retail investor understanding. Another solution is required if governments are to avoid the continued bad behaviour by investment intermediaries

¹¹⁸ RIS-FSDR (n 61), 6; also see Scheld (n 63), 152-153.

¹¹⁹ Saunders (n 1).

¹²⁰ Johnston (n 66), 12.

¹²¹ Fiona Haines, Adam Sutton and Chris Platania-Phung, 'It's all about risk, isn't it? Science, politics, public opinion and regulatory reform' (2007/8) 10 *Flinders Journal of Law Reform* 415; Eric Windholz and Graeme A Hodge 'Conceptualising Social and Economic Regulation: Implications for Modern Regulators and Regulatory Activity' (2012) 38(2) *Monash University Law Review* 212, 214.

¹²² Turtiainen (n 38), 881.

causing significant losses by retail investors. The problem is created because there is a dilemma between prescribing provisions in the law that are intended to protect retail investors and the resultant complexity of those provisions. The legal and regulatory framework of the MIS regarding MIS product disclosure has failed to protect the retail investor because the information overload has led to the retail investor ignoring what was designed for their protection. The retail investor has shown a reluctance to undertake the daunting task required to read, let alone analyse, the lengthy disclosures that are made. The reliance on disclosure as a regulatory tool is a futile exercise.

In the Interview, Participant 1 said that PDSs were not read by 90% of investors, who relied on their financial adviser.¹²³ This is consistent with the above analysis.

D. *Interaction of DDO provisions with the disclosure framework*

As mentioned in the Introduction to this Chapter 7, the Government acted to shore up this weakness in the disclosure model through design and distribution obligations ('DDO').¹²⁴

Under this new regime, the RE must make a target market determination ('TMD') before engaging in retail product distribution conduct regarding the financial product being offered¹²⁵ and before giving a PDS to a retail client.¹²⁶ The TMD must, amongst other things, describe the class of retail clients that comprises the target market (within the ordinary meaning of the term) for the product.¹²⁷ An example TMD for a mortgage trust is set out in Table 7.1 at page 387.

The TMD is essentially a judgment call by the RE as to whether the features of their product satisfy a suitability test for a defined class of hypothetical investors.¹²⁸ Having made a TMD, the RE and distributors of the product must then take reasonable steps

¹²³ Interview Transcript, page 474.

¹²⁴ Corporations Act, Part 7.8A.

¹²⁵ Ibid, s 994B(2).

¹²⁶ Ibid, definition in s 994A.

¹²⁷ Ibid, s 994B(5)(b).

¹²⁸ Ibid s 994B(8) i.e., it would be reasonable to conclude that, if the product were to be issued, or sold in a regulated sale to a retail client in accordance with the distribution conditions, it would be likely that the retail client is in the target market and that it would likely be consistent with the likely objectives, financial situation and needs of the retail client.

that will, or are reasonably likely to, result in retail product distribution conduct (which includes giving a PDS to the retail client) being consistent with the TMD.¹²⁹ There are criminal sanctions and civil penalty consequences for failing to do so.¹³⁰

Fortunately for the RE, just because the retail product distribution conduct is inconsistent with the TMD or a retail client who is outside the target market acquires the product does not, of itself, mean the RE failed to take reasonable steps.¹³¹

However, despite this concession, the RE cannot rely upon self-certification by the investor that the investor is in the target market or that the product is suitable for the investor.¹³² Also using a questionnaire to establish the investor is in the target market may pose difficulties e.g., if ASIC considers there is a high risk the consumer will not understand the questionnaire.¹³³ The RE therefore bears a heavy onus for ensuring compliance with the TMD. If a questionnaire is used in a form that the consumer will understand, then the RE must actively review the investor responses to ensure that the responses are not inconsistent with the defined target market in the TMD.¹³⁴

A review of interim stop orders issued by ASIC regarding TMDs of REs in the following table illustrates examples where ASIC are of the view that the RE has failed to correctly determine the class of hypothetical investors for whom their product is suitable.

Table 7.3 – Details of Interim Stop Orders for MIS products

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
22/07/2022	Responsible Entity Services Limited	RES Investment Fund	Loan to related party	TMD included two categories of retail investors for whom the product was not in ASIC's view suitable namely: investors intending to use an investment in PPM Units as a core component of their investment portfolio and

¹²⁹ Ibid, s994E(1).

¹³⁰ Corporations Act, s 1311(1) with Schedule 3 and s 1317E.

¹³¹ Ibid, s 994E(2).

¹³² Caroline Chong, 'The Design and Distribution Obligations: An Effective Tool for Consumer Protection?' (2023) 40 *Company & Securities Law Journal* 83, 90 and 91.

¹³³ Australian Securities and Investments Commission 'ASIC issues DDO stop order against Australian Unity Funds Management' (Media Release 24-120MR 5 June 2024).

¹³⁴ Australian Securities and Investments Commission 'ASIC sues Australian Unity Funds Management for failing to confirm product suitability for investors' (Media Release 25-099MR 11 June 2025).

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				investors with an objective of high capital growth or a mixture of capital growth and income should not have been included in the target market.
13/09/2022	Open Corp Funds Management Limited	Australian Residential Property Fund	Residential property	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a capital preservation investment objective, - investors intending to use the product as a core component (25-75%) or potentially as a solution/standalone component (75-100%) of their investment portfolio, - investors with a medium or potentially low risk and return profile, - investors with a need to withdraw their money from the MIS on an annual basis. ASIC's reasoning was that this was because the MIS invested solely in a portfolio of Australian residential property assets, borrowed money to support its investment activities, engaged in property development activities and was relatively low in liquidity. Distribution conditions in the TMD were inadequate
13/09/2022	Fawkner Property Ltd	Private Property Trust No. 20	Commercial Property	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors seeking a capital preservation or potentially a capital guaranteed investment objective, - investors intending to use the product as a core component (25-75%) or potentially as a solution/standalone component (75-100%) of their investment portfolio, - investors with a low risk and return profile, - investors with a medium and potentially short investment timeframe, - investors with a need to withdraw their money from the Trust annually or longer (which includes those needing to withdraw in less than seven years). ASIC's reasoning was that this was because the MIS invested in a concentrated portfolio of commercial property assets and borrowed money to support its investment activities and the investors could not withdraw their money from the MIS in the first seven years of their investment, the investment was not

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				suitable to all retail clients identified in the TMD.
				Distribution conditions in the TMD were inadequate
30/09/2022	Australasian Property Investments Limited	APIL Essential Retail Income Fund	Shopping Centres	TMD included retail investors for whom the product was not in ASIC's view suitable namely: - investors looking to invest in commercial properties with the prospect of capital growth and a secure income stream. - investors who are 'cash rich' entities or retirees looking for a long-term capital investment along with a monthly return, - investors with a 'buy and hold' strategy and do not require immediate access to capital; and - investors with a need for preservation of capital that accrues capital gains/losses over the lifespan of the investment. ASIC's reasoning was that this was because the MIS borrowed money to support its investment activities and investors in the MIS could not withdraw their money until April 2029 and because the PDS disclosed that money invested in the MIS was not guaranteed and the monthly income distribution is based on assumptions and the actual results may be different to the forecast result, it was not suited to retail investors described in the TMD
				Distribution conditions in the TMD were inadequate
17/10/2022	Holon Investments Australia Limited	Holon Bitcoin Fund, Holon Ethereum Fund Holon Filecoin Fund	Crypto assets.	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a potentially medium, high or very high risk and return profile; and - investors intending to use the fund as a satellite component (up to 25%) of their investment portfolio; and - investors intending to use the fund as a solution/standalone component (75-100%) of their investment portfolio.

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				ASIC's reasoning was that this was because the MIS was not suited to the wide target market described in the TMD because crypto assets are highly volatile and complex, making concentrated investments in individual crypto assets very risky and speculative. Investors were likely to experience significant price volatility and deep negative returns in periods of asset price decline. Also, the PDSs disclosed the risk that assets in the MIS could face a total loss of value.
21/10/2022	Westlawn Financial Services Limited	Westlawn Income Fund	- secured and unsecured loans, including five property development loans - credit, leases - other fixed-interest financial assets	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a tolerance for a moderate level of risk with respect to their investment, - investors needing liquidity or needing to make withdrawals during the investment term, - investors seeking to have their capital invested for a minimum period of two years, - investors seeking regular monthly income distributions. ASIC's reasoning was that this was because the type of scheme property was high risk. Distribution conditions in the TMD were not specific enough to ensure the MIS was distributed to consumers in the target market.
21/11/2022	MPG Funds Management Limited	MPG Bulky Goods Retail Trust MPG Essential Services Property Trust	commercial properties	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a tolerance for an undefined 'medium risk', - investors wanting stable and regular income distributions, and - investors needing liquidity or needing to make withdrawals during the investment term for the MIS. ASIC's reasoning was that this was because: - the MIS invested in a concentrated portfolio of commercial properties, - the MIS had an investment term during which investors have no ongoing withdrawal rights and employ leverage, which increased the level of risk for investors. Distribution conditions in the TMDs did not meet the appropriateness requirement under the design and distribution obligations (DDO) because these conditions were not specific enough to make it likely for the Trusts to reach consumers in the target market.

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
25/11/2022	Perpetual Investment Management Limited	Perpetual Pure Microcap Fund Perpetual Geared Australian Share Fund	Australian microcap entities Australian shares	TMD included retail investors for whom the product was not in ASIC's view suitable: - Investors with a capital preservation investment objective. - Investors intending to use the product as a core component (25-75%) or satellite component (up to 25%) of their investment portfolio, - Investors with a potentially low, medium or high risk and return profile, - Investors with a 'Medium' investment timeframe (under 2 years and up to 8 years); and - Investors with a need to withdraw their money on a daily and weekly basis. ASIC was of the view that an investment in both MIS carried higher risks than the description of the target market in the TMD. - The first fund was invested solely in a portfolio of Australian microcap equities carry a significant level of risk due to high price volatility, shallower market depth (with few traders and turnover in share transactions) and the limited operational history of microcap companies - The second fund invested solely in a portfolio of Australian shares and employs leverage, with the MIS being able to take on debts valued at up to 60% of the fund's total assets meaning elevated risks, including the potential for a high level of price volatility and the use of leverage, which increases the chances of investors incurring large losses. TMD did not include any distribution conditions
2/12/2022	Australian Fiduciaries Limited	Global SRI Ethical Alpha Fund Global SRI All Seasons Fund Global SRI Multi-Strategy Fund.	MIS 1 and 2: loans secured by real property and other debt instruments, precious metals, listed and unlisted equity and property development projects	TMD included retail investors for whom the product for all three MIS was not in ASIC's view suitable: - investors who need liquidity during the term of their investments, which is not supported by the Funds' liquidity features - investors with a tolerance for 'medium' to 'high' level of risk whilst the risks associated with the portfolio of investments for two funds and the aggressive return objective of one fund are higher

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
			MIS 3: managed funds and assets, including unlisted managed funds, derivatives, listed equity and commodities, with an investment return objective of CPI (Consumer Price Index) plus 7% per annum.	investors with an undefined 'higher-than-average' net worth. ASIC was of the view that the funds had a high risk investment strategy of the MIS.
				TMD did not include any distribution conditions
08/01/2023	Vasco Responsible Entity Services Limited	Pivotal Diversified Fund	managed funds, including hedge funds, a fund invested in residential and commercial real estate developments and a private equity fund	TMD included retail investors for whom the product for MIS was not in ASIC's view suitable: - investors with a potentially high risk and return profile, when the risks associated with the fund's investments are very high; and - investors with a 'medium' investment timeframe (up to 6 years). ASIC's reasoning was that this was because: - the high risk of the underlying investments in the hedge funds which were exposed to a very high risk strategy that generates absolute returns by trading in listed equities and by using short selling, leverage and derivatives and - the managed fund in which funds were invested by the MIS invested in property development projects is subject to project financing, valuation and construction risks, and the private equity fund was illiquid and leveraged.
				TMD did not include any distribution conditions
18/03/2023	Advance Asset Management Limited	Advance Balanced Multi-Blend Fund Advance International Shares Multi-Blend Fund Advance Property	Not stated but 2 appears to be in international shares and 3 appears to be in property securities	ASIC considered that the TMDs were very broadly drafted and failed to define key concepts. For example, the RE described investors in the target market for the Advance Balanced Multi-Blend Fund as having the tolerance to invest at the 'medium to higher' end and investors in the target markets for the Advance International Shares Multi-Blend Fund and Advance Property Securities Multi-Blend Fund as having the tolerance to invest at the

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
		Securities Multi-Blend Fund (		'higher end of the risk spectrum' but did not define what these concepts meant. It was therefore not possible to accurately determine which retail investors fell within the target market for each MIS.
				TMD did not include any distribution conditions
02/06/2023	Spaceship Capital Limited	Spaceship Earth Portfolio Spaceship Origin Portfolio Spaceship Universe Portfolio	Not Stated	ASIC considered that the TMD's for the 3 MIS were defined too broadly and did not consider the risks and features of those MIS. In particular ASIC had concerns about: • a mismatch between the investment risk profiles of MIS (very high risk) and risk profiles identified for investors within the target markets (medium and high). The target markets included investors who intend to hold the funds as a core component (25–75%) or standalone component (75–100%) and the funds invests in a single asset class (i.e. shares); • a potential investment timeframe of two years or more where the suggested minimum investment timeframe in the PDS is seven years; and • the target markets included investors with a need to withdraw money daily when withdrawals would usually be paid within five business days and may be suspended or delayed for longer than 21 business days.
01/09/2023	K2 Asset Management Ltd	Storehouse Residential Trust	Direct real property	ASIC considered that the target market in the TMS was too broad and did not properly consider the risks and features of the Fund and information within the TMD was inconsistent. In particular ASIC had concerns about • a mismatch between the investment risk profiles of MIS (very high risk) and risk profiles identified for investors within the target markets (medium and high); • the target market includes investors who intended to hold the funds as a core component (25–75%) and the MIS has very low portfolio diversification and is very high risk, • consumers with an investment objective of capital preservation or income generation are potentially in the target market, where capital loss is a material risk and income distributions may not occur regularly, • consumers with an investment time frame of less than two years were potentially in the target market, where the suggested investment timeframe of the MIS was at least five years,

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				the target market includes investors with a need to withdraw money annually when there are restrictions on withdrawals as the MIS is illiquid and underlying assets are aligned with periods of three to five years and there was no commitment to provide redemptions and withdrawals depending on the liquidity of the MIS. TMD contained one distribution condition that the product was only suitable for distribution to consumers who have received general financial product advice. ASIC considered the TMD fails to set out distribution conditions for direct-to-consumer distribution or distribution via financial product advice where such distribution appears likely to occur.
05/06/2024	Australian Unity Funds Management Ltd	Australian Unity Select Income Fund	Contributory mortgages	ASIC had concerns that Australian Unity failed to take reasonable steps likely to result in distribution conduct being consistent with its TMD. Australian Unity relied upon a retail client questionnaire with significant flaws as a key step for compliance with its obligations. The questions and response options were based on and relied predominantly on complex consumer attributes set out in the TMD. However, ASIC's view is that a TMD s not intended to be a consumer-facing document. Therefore, there was a high risk that retail clients would not understand the questionnaire leading to inaccurate responses and distribution of interests in the MIS to retail clients outside the target market.

While the number of interim stop orders may be because the product is not suitable for a retail client (e.g. crypto assets), this is not apparent for all of TMDs (e.g., property investment trusts). The interim stop orders reveal, in general terms, that, notwithstanding the test of suitability is intended to be an objective test,¹³⁵ in reality, unless the target market for the financial product offered by the RE as described in the TMD matches what ASIC, in its subjective view, says it is, regulatory action will occur. Disclosure is irrelevant. Decision-making by the investor as to the suitability of the

¹³⁵ DDO-EM (n 6), [1.54], [1.96].

investment product has been replaced with a paternalistic interventionist approach to investment.¹³⁶ Further, the enforcement strategy of ASIC has moved from the use of interim stop orders to prosecuting product issuers for non-compliance.¹³⁷ This increases the risks assumed by the RE in dealing with retail investors, particularly given the quantum of penalties that may be imposed.¹³⁸ Enforcement action may lead to insolvency of the RE, increasing the risk of substantial losses being incurred by retail investors as discussed in Chapter 6 above. This may occur even where the initial loss caused by the offending conduct concerning the TMD is negligible.¹³⁹ This is a bad result for both the RE and retail investors alike.

The DDO is not a disclosure regime.¹⁴⁰ The DDO does not address the information asymmetry between the RE and retail investors. Although the TMD must be publicly available, it is not information that must be disclosed to the investor. However the investor may access the TMD if they wish to do so.¹⁴¹ The purpose of the public availability is merely to mitigate evidential difficulties in proving non-compliance.¹⁴² The TMD is not, in ASIC's view, intended to be a 'consumer-facing' document.¹⁴³ ASIC also considers that the 'target market' referred to in the TMD must 'not be based on consumer understanding of a product (i.e., a target market should not be all consumers who understand how a product works)'.¹⁴⁴ ASIC considers that it does not matter if investors understand the financial product.¹⁴⁵ This is because under the DDO regime, consumer comprehension is irrelevant.¹⁴⁶ The role of obtaining consumer

¹³⁶ Niamh Moloney 'EU Financial Market Governance and the Retail Investor: Reflections at an Inflection Point' (2018) 37(1) *Yearbook of European Law* 251, 265-271.

¹³⁷ *Australian Securities and Investments Commission v Firstmac Limited* [2024] FCA 737; Australian Securities and Investments Commission, 'ASIC successful in first DDO case against Firstmac' (Media Release 24-151MR, 10 July 2024); 'ASIC Annual Forum 2023: Enforcement session opening remarks' *Financial Law Reporter*, (21 November 2023); Felicity Healy 'ASIC begins enforcement of design and distribution obligations' *Mondaq Business Briefing* (10 August 2022); Karen Chester 'The regulator: The consumer is key' (2022) 38(10) *Company Director* 30.

¹³⁸ *Australian Securities and Investments Commission v Firstmac Limited (Penalty Hearing)* [2025] FCA 12; a penalty of \$8 million was imposed although it could have been as high as \$9.22 billion despite any loss by a retail investor being negligible.

¹³⁹ *Ibid.*

¹⁴⁰ RG 274 (n 16), [RG 274.139]; Chong (n 132), 95.

¹⁴¹ DDO-EM (n 6), [1.49]

¹⁴² *Ibid.*

¹⁴³ RG 274 (n 16), [RG 274.138].

¹⁴⁴ *Ibid.*, [RG 274.82].

¹⁴⁵ *Ibid.*, [RG 274.83]; even if this would be a desirable outcome.

¹⁴⁶ Chong (n 132), 91.

understanding and comprehension remains with the disclosure regime.¹⁴⁷ At best, the TMD merely reduces the availability of financial products to a class of hypothetical investors for whom those products are determined by the RE as suitable. The retail client is treated as incapable of making his/her own decision about the suitability of the financial product.

There is a conflict between the disclosure and DDO regimes. The disclosure regime places the onus on the retail investor (or their financial adviser) to work out whether the product is suitable for them, whereas the DDO regime places the onus on the RE to determine whether the product is suitable for a retail investor who bears the attributes of a specified class of hypothetical investors. The legislation resolves this conflict by favouring the primacy of the DDO regime over disclosure. Firstly, the TMD comes before the PDS is provided.¹⁴⁸ Secondly, the content of disclosures in the PDS and the material which accompanies it, does not, according to the Federal Court, constitute the taking of reasonable steps to ensure any retail product distribution conduct is consistent with the TMD.¹⁴⁹

A problem with the TMD regime is that it may deny retail investors who understand the financial product the right to invest in that product. For example, although a survey undertaken for ASIC showed a significant percentage of investors investing in crypto assets,¹⁵⁰ such products are unlikely to pass the suitability test for many classes of retail investors.¹⁵¹ Given the strict operation of the DDO provisions, combined with ASIC's enforcement strategy, there is a risk that REs may withdraw their products from the retail market.¹⁵² For example, Collaert argues that the European Union ('EU') DDO provisions may cause investment firms to restrict the availability of their products to a narrow target market to reduce the risk of liability claims or sanctions.¹⁵³ In a low-interest-rate environment, this is problematic for retail investors who need greater

¹⁴⁷ However, in any advertising or promotional material the target market for the product must be disclosed or state where the TMD is available: Corporations Act, s 1018A.

¹⁴⁸ Corporations Act, s 994B(2).

¹⁴⁹ *Firstmac* (n 137), [57].

¹⁵⁰ Australian Securities and Investments Commission '*Retail investor research*' (Report No. 735, August 2022).

¹⁵¹ Australian Securities and Investments Commission '*ASIC places interim stop orders on Holon crypto funds*' (Media Release 22-278MR 17 October 2022).

¹⁵² Table 7.3, page 396, for examples of classes of retail clients excluded by the TMD.

¹⁵³ Colaert, Veerle, 'Product Governance: Paternalism outsourced to Financial Institutions?' (2020) 31:6 *European Business Law Review*, 977, 994.

returns than offered by the safest of products.¹⁵⁴ Colaert also proposes a solution to the above problem of retail clients who are not within the target market wanting a particular product. While the distribution obligation should remain limited to the target market, the distributor may still execute an order by a client who, on their own initiative, places an order. This would be subject to the client being given a clear warning that the distributor is unable to assess whether the product is compatible with the client's needs, characteristics and objectives but the client still persists with his/her order being executed.¹⁵⁵

There may also be unintended consequences flowing from the DDO rules. Bednarz argues that these provisions may lead to wide information collection and data profiling of retail investors by product issuers. This includes the use of algorithms and artificial intelligence ('AI'). Bednarz further argues that consumer harms may flow from this.¹⁵⁶ These harms may include privacy breaches, unfair pricing, digital manipulation, discrimination and exclusion of vulnerable consumers.¹⁵⁷ Data profiling and the use of AI would be of considerable assistance to REs and their distributors in determining whether particular consumers are reasonably likely to be in the target market. ASIC considers this information to be helpful to the RE and its distributors in ensuring compliance with their obligations under the new regime.¹⁵⁸

It is too early to find any patterns that may identify unintended consequences, although Bednarz makes a good case for there being at least a possible risk of consumer harm flowing from the consequences of the DDO regime.¹⁵⁹ It is not apparent from the DDO provisions that these issues have been addressed. Further, ASIC is not represented on the Digital Platform Regulators Forum, whose role is to promote regulatory coherence and clarity. ASIC should be represented on that panel,

¹⁵⁴ Ibid.

¹⁵⁵ Ibid, 991-992

¹⁵⁶ Zofia Bednarz 'There and back again: how target market determination obligations for financial products may incentivise consumer data profiling' (2022) 36(2) *International Review of Law, Computers & Technology* 138, 139.

¹⁵⁷ Ibid citing 'EU's Proposal for a Regulation of the European Parliament and of the Council Laying down Harmonised Rules on Artificial Intelligence (Artificial Intelligence Act) and Amending Certain Union Legislative Acts, 21 April 2021', (COM/2021/206 final), recital (37).

¹⁵⁸ RG 274 (n 143), [274.179-274.185].

¹⁵⁹ Ibid.

given the wide use of digital platforms in financial services.¹⁶⁰ This needs to be addressed.

As mentioned in the introduction to this Chapter, the Government's solution to the problem with the disclosure regime was to superimpose highly prescriptive DDO provisions on the already excessively prescriptive and complex disclosure provisions. This has resulted in excessive prescription at two levels of regulating the issue of financial products by the RE. Compliance with both regulatory tools is therefore difficult for REs. The number of interim stop orders imposed by ASIC with respect to TMDs illustrates these compliance difficulties.¹⁶¹

The DDO provisions have their genesis in a joint report by ASIC and the Dutch Authority for the Financial Markets ('AFM') on disclosure. In this joint report, it was stated that 'we cannot assume that disclosure alone, including warnings, will be effective in protecting consumers, enabling informed or good decision making, and driving competition from the demand side'.¹⁶²

When introducing the DDO legislation, the Commonwealth Government said,

the Corporations Act relies heavily on disclosure to assist consumers understand and select appropriate financial products. However, disclosure can be ineffective for a number of reasons, including consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy. The availability of financial advice may not be sufficient to overcome these issues. A consumer may not seek financial advice or may receive poor-quality advice.¹⁶³

This is a tacit admission of the failure of the disclosure regime. The DDO provisions evidence that the Government has moved from regulating solely on the basis of disclosure, advice and financial literacy,¹⁶⁴ to an ex-ante posture of regulating on the

¹⁶⁰ Office of the Australian Information Commissioner 'Digital Platform Regulators Forum 2024 communique' < <https://www.oaic.gov.au/newsroom/digital-platform-regulators-forum-communique-july-2024> >

¹⁶¹ Between October 2021 when the DDO commenced and 23 May 2024, ASIC had issued 87 interim stop orders for TMDs: 24-120MR (n 133); Of these 25 were regarding MIS, Table 7.3, page .

¹⁶² ASIC-AFM Report (n 14), 4.

¹⁶³ DOD-EM (n 6), [1.2].

¹⁶⁴ Stan Wallis 'Australian Financial System Inquiry (Final Report March 1997).

basis of a subjective view of ASIC as to the suitability of a financial product to the retail investor.¹⁶⁵

Murray concluded that provisions such as DDO ‘should strengthen consumer confidence and trust in the system and reduce the number of cases where consumer behavioural biases and information imbalances are disregarded’.¹⁶⁶ Yet the original FSRA provisions enacted in 2001 were supposed to have essentially done the same thing by engendering ‘increased consumer confidence and participation in the financial sector’.¹⁶⁷ Despite Murray’s conclusion, the ALRC considers that the DDO provisions are ‘unnecessarily complex’, lacking any ‘logical structure’ and have a ‘high level of prescriptive detail’. According to the ALRC, these features of the DDO regime inhibit ‘meaningful compliance’ and make ‘it harder to identify the policy objectives of the regime’.¹⁶⁸

The TMD imposes a suitability test on financial products for an identified class of hypothetical retail investors (the target market).¹⁶⁹ The assumption is that if it is suitable for a hypothetical class of retail investors, it must be safe for all members of that hypothetical class.¹⁷⁰ The product will only be suitable for the identified class of hypothetical retail clients if it is reasonable to conclude that if the product is issued to a retail client who falls within that identified class,

- it is ‘likely’ that the retail client is in the target market, and
- the product would ‘likely’ be consistent with the ‘likely’ objectives, financial situation and needs of the retail client.¹⁷¹

There is no requirement in the DDO regime for a retail investor to make his or her own assessment as to the suitability and risks of the investment. The suitability of the product for that retail investor depends upon whether that retail investor has the

¹⁶⁵ David G Millhouse, ‘*Systemic and cyclical failure in Australian financial services and financial products sectors: have weaknesses in law contributed to these failures?*’ (PhD Thesis, Bond University 2018), 105.

¹⁶⁶ Murray (n 14), 195.

¹⁶⁷ Explanatory Memorandum to the Financial Services Reform Bill 2001 (FSR-EM), [2.37].

¹⁶⁸ ALRC Report 141 (n 42), [9.33].

¹⁶⁹ Gail Pearson, ‘Suitability’ (2017) 35 *Company & Securities Law Journal* 464, 470.

¹⁷⁰ Ibid.

¹⁷¹ Corporations Act, s 994B(8); Note: the overuse of the word ‘likely’ in this provision is the work of the legislative draftsman not the author of this thesis.

attributes which place him/her in the target market, which has been predetermined by the RE. The TMD does not allow for individual differences. The TMD only uses the word 'likely'. Individual suitability is left to the work of disclosure in the PDS. The TMD may therefore prevent particular retail investors who fully understand the product from investing in that product.¹⁷² There may therefore be investors who want to invest in that product but who, because they have attributes that place them outside the target market, are prevented from doing so.¹⁷³

Having made a TMD, the RE must take reasonable steps that will, or are reasonably likely to, result in retail product distribution conduct regarding the product being consistent with the TMD.¹⁷⁴ In order to satisfy this requirement, the steps taken by the RE in the circumstances have to be steps that the RE is reasonably able to take that will, or are reasonably likely to, result in retail product distribution conduct regarding the financial product being consistent with the TMD, taking into account all relevant matters, including a non-exhaustive list.¹⁷⁵ To be reasonable steps, the steps must 'result in a real, not fanciful or remote, chance that the distribution conduct will be consistent with the [TMD]'.¹⁷⁶ Importantly, the content or disclosures in the PDS are not reasonable steps and are not relevant matters to be taken into account in determining that the steps are reasonable.¹⁷⁷

Despite the TMD provisions limiting who can invest in the product, the disclosure provisions have been retained 'as is'. No thought has been given as to what disclosure remains necessary. The TMD has the effect that the product will meet the likely objectives, financial situation and needs of the investor if the investor is within the class of hypothetical retail investors who fall within the target market. The DDO regime means that the disclosure in the PDS is only relevant for a retail investor who falls within the class of hypothetical retail investors referred to in the TMD to enable

¹⁷² A target market is not based on consumer understanding: RG 274 (n 16), [RG274.83].
¹⁷³ e.g., research sponsored by ASIC found that 44% of retail investors surveyed owned at least one cryptocurrency investment: Australian Securities and Investments Commission *Retail investor research* (Report No. 735, August 2022) but ASIC had issues with the proposed target market in relation to such investments: Australian Securities and Investments Commission, *ASIC places interim stop orders on Holon crypto funds* (Media Release 22-278MR 17 October 2022).
¹⁷⁴ Corporations Act, s 994E(1).
¹⁷⁵ Ibid, s 994E(5).
¹⁷⁶ *Firstmac* (n 137), [53].
¹⁷⁷ Ibid, [57].

him/her to form his/her own view as to whether the product is suitable to him/her given his/her personal objectives, financial situation and needs.

The production of a voluminous and complex PDS leads to investor disengagement from the disclosure process. The cost of preparation of the PDS will therefore be an unnecessary incurred cost to the RE, which undoubtedly will be passed on to the consumer in the form of increased fees.

This is an ideal time to rethink the application of the disclosure regime because the investor should be protected by the TMD without any self-help required. The disclosure obligation should be amended to incentivise participation of the retail client in the disclosure regime.¹⁷⁸ This could be achieved by reducing the volume of disclosure, resulting in a shorter document merely containing key features of the product. Alternatively, if the volume of disclosure cannot be reduced, at least there should be up-front summary of the key features of the investment.

The results of the Survey are supportive of the use of a short form document or an upfront key feature statement in the PDS to which see the following Tables A and B.

Survey Results	
Table A	
Question 77 in Survey ¹⁷⁹ If retail clients were provided with a simple short form 'Fund Facts Document' do you consider that retail investors would:	
Answer	Percentage
be more likely to read it than a full PDS	96.3
be less likely to read it than a full PDS	0
ignore the document	7.4

¹⁷⁸ Ben-Shahar, Omri and. Schneider, Carl E, 'Coping with the Failure of Mandated Disclosure' (2015) 11(1) *Jerusalem review of legal studies* 83, 93.

¹⁷⁹ Survey Results, Q77, page 455.

Research Results	
Table B	
Question 79 of Survey ¹⁸⁰ If your PDS contained a simple short form Key Information Statement up front do you consider retail investors would:	
Answer	Percentage
read the Key Information Statement but not the rest of the PDS	77.8
read the Key Information Statement and the PDS	14.8
not read the Key Information Statement or the whole PDS	11.1

III. RESEARCH QUESTION 2: HOW CAN THIS FAILURE BE REMEDIED? (WHAT THE LAW 'OUGHT TO BE')

A. *Background on reform to the disclosure framework*

Consistent with the theme in this Chapter, the ALRC has acknowledged that it is widely accepted that the present system of product disclosure is not working.¹⁸¹ The ALRC also said that the current regulatory framework does not coherently implement the underlying policy objectives of disclosure regulation.¹⁸² The ALRC proposes a reform of the financial disclosure regime incorporating an 'outcome-based' standard of disclosure.¹⁸³ Contrary to a previous proposal by the ALRC,¹⁸⁴ the ALRC does not propose an objective standard by reference to a 'reasonable consumer'.¹⁸⁵ The ALRC said the reasons for this were:

¹⁸⁰ Ibid, Q79, page 456.

¹⁸¹ ALRC Report 137 (n 52), [9.62]

¹⁸² Ibid, [9.124]

¹⁸³ Australian Law Reform Commission *Interim Report C Financial Services Legislation* (Report No. 140, June 2023) (ALRC Report 140), [3.125]-[3.131].

¹⁸⁴ ALRC Report 137 (n 52).

¹⁸⁵ ALRC Report 140 (n 183), [3.126].

- that the current requirement for the PDS to be clear, concise and effective was to be amended to require the PDS to also be 'worded and presented in a way that promotes understanding of the information', and
- the applicability of the DDO.¹⁸⁶

However, arguably the current obligation to ensure that information included in the PDS is worded and presented in a clear, concise and effective manner¹⁸⁷ means that if the RE complies with this obligation, the PDS will 'promote the understanding of the information',¹⁸⁸ rendering this recommendation unnecessary. Nevertheless, Proposal C5 still appears to be an objective test, notwithstanding the stated intention of the ALRC for the test to be subjective.¹⁸⁹

The problem with an outcome-based standard of disclosure is that ASIC will need to be able to measure whether the RE has achieved the required outcome. However, outcome-based regulation is difficult to measure.¹⁹⁰ There would therefore need to be some form of performance modelling.¹⁹¹ Firstly, performance modelling would be required for the benefit of ASIC so that it may ascertain whether the RE choice has achieved the purpose of the disclosure provisions and therefore is not in breach of the law.¹⁹² Secondly, performance modelling would be required for the benefit of the RE to understand the effect of the regulation of the disclosure provisions on its business operations.¹⁹³ The difficulty with performance modelling is that the cost undoubtedly will be prohibitive for other than very large operators. Further, retail investors may refuse to participate in the outcomes assessment process. If the Government were to

¹⁸⁶ Ibid, [Proposal C5], 86.

¹⁸⁷ Corporations Act, s 1013C(3).

¹⁸⁸ RG 168 (n 7), [RG168.76].

¹⁸⁹ ALRC Report 140 (n 183), 86.

¹⁹⁰ Iris H-Y. Chiu and Anna Donovan, 'A New Milestone in Corporate Regulation: Procedural Legalisation, Standards of Transnational Corporate Behaviour and Lessons from Financial Regulation and Anti-Bribery Regulation' (2017) 17(2) *Journal of Corporate Law Studies* 427, 434.

¹⁹¹ Rouzbahan Rashidi-Tabrizi, Gunter Mussbacher and Daniel Amyot 'Transforming Regulations into Performance Models in the Context of Reasoning for Outcome-Based Compliance' 2013 *6th International Workshop on Requirements Engineering and Law (RELAW)* 34.

¹⁹² Ibid.

¹⁹³ Ibid.

move from a prescriptive-based to an outcome-based model, significant financial resources would need to be injected by the Government to make the model work.

The ALRC proposed a basis on which the problems with an outcome-based model of regulating disclosure can be overcome. The proposal would be to either legislate or incorporate into regulatory guidance, consumer testing as a safe harbour provision.¹⁹⁴ If the product issuer carries out consumer testing of their product, they would have a defence to a claim of being in breach of the disclosure obligations, or it would be a matter to which the courts should have regard when determining whether there is a breach.¹⁹⁵

Willis also argues that obligations should be imposed on financial firms to demonstrate that a good proportion of their customers understood important and relevant features of their financial products, such as the costs, benefits and risks.¹⁹⁶ Willis suggests that this requirement could be achieved through third-party testing of random samples of their customers.¹⁹⁷ The sanctions suggested by Willis are that the financial firm would be denied the right to enforce a term or charge a fee, rather than criminal or civil penalties.¹⁹⁸

While these approaches are admirable attempts to solve the problem of non-engagement in the disclosure process by consumers, consumer testing is costly and time-consuming. Therefore, while an outcome-based regulation of product disclosure may superficially appear to be a good solution for retail clients, negative unintended consequences need to be considered. For example, if this fundamental change in the regulatory model results in what is tantamount to strict liability when the predicted outcome does not occur, product issuers may withdraw to the wholesale market. As submitted by the defendants in *Clarke*, which Croft J said was correctly submitted,

[t]he legislature plainly recognised that unless issuers' potential liability was appropriately confined, the possibility of significant legal liability would have a chilling

¹⁹⁴ ALRC Report 140 (n 183), [3.129].

¹⁹⁵ Ibid.

¹⁹⁶ Lauren E. Willis 'The Consumer Financial Protection Bureau and the Quest for Consumer Comprehension' (2017) 3(1) *The Russell Sage Foundation Journal of the Social Sciences* 74, 75.

¹⁹⁷ Ibid, 74.

¹⁹⁸ Ibid, 75; although a significant penalty this may be a more palatable sanction to the industry.

effect on the facilitation of investment opportunities and consequent economic activity.¹⁹⁹

Therefore, any reform should not only protect the retail client but also not stifle the retail investor's investment choice through a reduction in the availability of products in the investment market for retail investors.

It is clear from the above case studies and literature review that consumers are already disengaged from the disclosure process. How then can a RE cause investors to participate in consumer testing to establish that the PDS has achieved the required outcome? The natural result flowing from this disengagement is that the RE will be unable to prove that their customers understood important and relevant features of their financial products, such as the costs, benefits and risks. The likely result is that REs will have to exit the retail market when the proposed outcome-based approach was intended to avoid this.

Survey Results
Nevertheless, the results of the Survey were supportive of the outcome-based approach to product disclosure, with 95.57% agreeing that their organisation would not reduce the availability of their products to retail clients if this were adopted. ²⁰⁰

Perhaps it might depend on the nature of the outcome-based process. On the other hand, the two participants in the Interview were negative in their support of an outcome-based approach. In particular, they both would not support this approach if it resulted in strict liability.²⁰¹

A better approach would be to incentivise the retail client to read a document that sets out the key features of the financial product. This approach would promote understanding of the product by the retail client through preventing the retail client from being overwhelmed by the volume of information provided. This can be achieved

¹⁹⁹ *Clarke* (n 68), [486].

²⁰⁰ Survey Results Q81 page 457: Although it should be noted that the DDO commenced in October 2021 whereas the Survey was conducted only a few months later in 2022.

²⁰¹ Interview Transcript, 474.

by providing a separate summary document of the key features in plain English or including a short summary of the key features of the financial product at the front of the PDS. Both approaches should be subject to a short size limitation. Because the retail investor has read a short document with the key features, this should reduce the level of information asymmetry without imposing any strict liability on the product issuer.

As discussed earlier in this Chapter, the DDO regime has reduced the need for a complex and voluminous PDS. Before the PDS is provided to the investor, the TMD initially operates to restrict the class of investors for whom, in the view of the RE, the product is suitable. This opens the opportunity for a short form of document summarising key features of the product that promotes understanding of the investment by retail investors who are within the target market. Promoting retail client comprehension of the financial product would be an appropriate outcome-based approach to retail client disclosure. There is also evidence that concise targeted information is more effective than generalised high-volume information as currently occurs.²⁰²

The first example of how this could work is New Zealand ('NZ'). In NZ, every PDS must contain a Key Information Summary ('KIS').²⁰³ The purpose of the KIS is to provide the issuer's assessment of the most significant aspects of the offer of the financial products that are relevant to a prudent but non-expert person's decision as to whether or not to acquire the financial products. The issuer is also required to have regard to this purpose when preparing the KIS.²⁰⁴ It must be headed in a prominent position as 'Key Information Summary'. This means that the KIS will appear immediately after the information that is required to be included at the start of the PDS.²⁰⁵ As well as having to satisfy this purpose, the KIS has a length limit. If it is with respect to a managed fund (similar to the Australian SMIS), then the limit is either two

²⁰² Andrew Godwin and Ian Ramsay 'Short-Form Disclosure Documents - An Empirical Survey of Six Jurisdictions' (2016) 11(2) *Capital Markets Law Journal* 296, 299.

²⁰³ *Financial Markets Conduct Regulations 2014* (NZ), reg 26(1).

²⁰⁴ *Ibid*, reg 27.

²⁰⁵ *Ibid*, regs 20 and 21.

A4 pages or 1,000 words.²⁰⁶ For other MIS, the limit is either four A4 pages or 2,000 words.²⁰⁷

Although the KIS forms part of a larger PDS, given the restrictions on size and content, the prudent but non-expert person, even if they do not read the whole of the PDS, would be more likely to at least read the material contained in the KIS because they do not have to read more than the first four pages. This will result in that person at least being apprised of the most significant aspects of the offer before deciding to invest in the MIS. This is certainly better than simply not reading the PDS at all. Research has also found that the KIS, although short compared with the PDS, is generally easier to read because of the use of shorter sentences and smaller vocabulary involving less understanding of finance and less jargon.²⁰⁸ In Table 7.2 (comparison of key information documents) commencing at page 395, is a comparative table of the key information documents used in the EU, Canada, Singapore, Australia (for the SMIS only which is restricted to eight pages) and NZ (for the equivalent of the Australian SMIS).

The EU, which has a DDO regime similar to Australia,²⁰⁹ has what is called a 'Key Investor Information Document' ('KIID'). This is a compulsory, pre-contractual, consumer communication which is required to be made available in a durable medium to investors in EU member states regarding all investment products, including the UCITS (which is broadly equivalent to an Australian MIS holding listed securities). The purpose of the KIID is to summarise the key features of a UCITS which will enable retail investors to have sufficient information in respect of an investment product and its risks to enable the retail investors to make an informed decision as to whether they should invest in that product. The Explanatory Memorandum noted that there were asymmetries of information about investment products between retail investors and

²⁰⁶ Ibid, reg 29(2)(c).

²⁰⁷ Ibid, reg 29(2)(d)

²⁰⁸ Aaron Gilbert and Ayesha Scott 'Short and Sweet or Just Short? The readability of Product Disclosure Statements' (2017) 6(7) *Applied Finance Letters* 27, 34-35.

²⁰⁹ MiFID II, Article 16; Directive 2017/593, Articles 9-10; ESMA Guidelines on MiFID II product governance requirements <https://www.esma.europa.eu/sites/default/files/library/esma35-43620_guidelines_on_mifid_ii_product_governance_requirements_0.pdf>; Martin Hobza and Aneta Vondrackova, 'Target market under MiFID II: the distributor's perspective' (2019) 14:4 *Capital Markets Law Journal* 518.

product issuers.²¹⁰ This meant that retail investors were not well equipped to protect their own best interests. It was noted that retail investors often faced confusing and overly complex information about possible investments, where risks and costs of products were difficult to assess or compare, which undermined the efficiency of the investment markets.²¹¹ The KIID is limited to a maximum of two pages, other than for complex structured UCITS, where the limit is three pages.²¹² The KIID must also provide clear information on the investment products and contain certain prescribed information.²¹³ There are presentation and language principles set out in the requirements.²¹⁴ As noted above, there is research that indicates that the KIID increases the retail investor's awareness of key elements of the investment when making their investment decisions.²¹⁵

Canada also has a simple Fund Facts Document ('FFD') for mutual funds (broadly equivalent to the MIS), no more than four pages with prescribed information and statements to be included. This document must state the prescribed information concisely and in plain language and respond as simply and directly as is reasonably possible, only including information necessary for a reasonable investor to understand the fundamental and particular characteristics of the mutual fund.²¹⁶

Singapore has a Product Highlights Sheet ('PHS') which applies to a number of financial products, including unlisted CIS and exchange-traded funds.²¹⁷ The PHS is required to summarise key information in clear, objective and simple language. It must be no more than four pages.²¹⁸ The format varies depending on the type of CIS.

²¹⁰ Proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products COM/2012/0352 final - 2012/0169 (COD).

²¹¹ Ibid.

²¹² Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website, Articles 6 and 37.

²¹³ Ibid.

²¹⁴ Ibid, article 5; has a stated purpose similar to the 'motherhood statement' recommended by the ALRC referred to above (n 186) but with clearer guidelines.

²¹⁵ Turtiainen (n 38), 881.

²¹⁶ Form 81-101F3 - Contents of Fund Facts Document.

²¹⁷ *Securities and Futures Act* (Sgp), s 240AA; SFA Guidelines (SFA 13-G10).

²¹⁸ *Securities and Futures (Offers of Investments) (Offers of Shares and Debentures) Regulations* (Sgp), reg 13A.

A survey of investors to gain feedback on the readability and relative strengths and weaknesses of short form disclosure documents as adopted in six jurisdictions, namely Australia, Canada, European Union, Hong Kong, New Zealand, and Singapore concluded that Australia's version (which was only a SMIS) was 'overwhelmingly considered to be the hardest to read'.²¹⁹ The Canadian FMD was overwhelmingly considered to be the easiest to read.²²⁰ For other types of Australian MIS, such as property and mortgage trusts, where the PDS can be much longer than the prescribed number of pages for the SMIS, the result would no doubt be even worse for Australia. This survey found that the five most influential factors in ranking these disclosure documents were:

- (a) language that was easy to understand,
- (b) clear explanation of the key features,
- (c) appropriate format,
- (d) appropriate length, and
- (e) clear explanation of the investment risks.²²¹

This survey also made a number of counterintuitive findings. Firstly, the more highly educated respondents were more likely to report the document as being the hardest to read and understand. Secondly, the respondents who were more astute about financial matters found the document far less attractive in terms of readability and comprehension than those with less financial astuteness.²²²

The factors that weighed against the Australian form of disclosure document were that the document was seen as too long (8 pages as against three pages in the EU and four pages in Canada), followed closely by the use (or rather poor use) of appropriate language, followed by the document being seen as too cluttered. There were also some other factors that contributed to the decision on this document, which were not as influential in the decision as the above three factors. These were the 'Key Features'

²¹⁹ Godwin and Ramsay (n 202), 297.

²²⁰ Ibid.

²²¹ Ibid 297.

²²² Ibid, 315.

section and the clarity of the explanation of investment risks.²²³ These reasons as to why respondents found the Australian document the hardest to understand are obvious to the layperson. Yet governments and regulators continue to persist with the present regulatory requirements to have detailed and often incomprehensible material.

Based on an analysis of the above primary and secondary materials and by application of reasoning power to the analysis of that data, the conclusion is that if the following reforms are made to the existing legal and regulatory framework of the MIS regarding product disclosure, this should strengthen its efficacy and efficiency in protecting retail investors. Given the effect of the TMD on ensuring the suitability of financial products to particular classes of investors before disclosure is made, there is considerable incentive to reduce the current level of disclosure.

B. *First Reform*

The DDO regime means that the length and complexity of the PDS should be able to be reduced. The target market, which is a hypothetical class or classes of investors for whom the product is judged by the RE to be suitable, limits the distribution of the PDS to persons falling within that target market. Theoretically, the product described in the PDS should be suitable for the retail investor who falls within the target market.²²⁴ Understanding the product should reinforce that pre-determination from the investor's perspective and enable them to make an appropriate choice.

Therefore, only a simple document, similar to the Canadian simple FFD, should be required to be provided to investors in the target market because it has already been determined that the product is suitable for them. Such a document was found to be easier to read than all of the other types of 'simple' disclosure documents, including that of Australia's SMIS.²²⁵

C. *Second Reform*

If the current disclosure regime is not repealed, despite there being no need for a long, complex PDS following the imposition of the DDO regime, which protects the retail

²²³ Ibid, 315.

²²⁴ Corporations Act, s 904B(8) and (8A).

²²⁵ Godwin (n 202).

investor from harm, there should be a requirement that a KIS be contained in the front pages of the PDS in similar terms to the KIS in the NZ PDS provisions.

Both of these proposed reforms would incentivise engagement by a retail client who is in the target market referred to in the TMD with the disclosure process for issues or sales of interests in registered MIS. This should at least give the retail investor, from that investor's subjective view, a reasonable understanding of the key risks, costs, and benefits of the product at the time of investment. By having regard to this brief but key information about the investment, better investment decisions may be made by the retail client or their financial advisers. Having large prescriptive documents has clearly failed and has led to disengagement from the process by the very persons it is designed to protect. If the PDS is not read because it is too long or complex, then there is little use for the document.

These proposed reforms to the law are supported by the results of the Survey referred to in Tables A and B above. With the Interview, the results were divided, with Participant 1 being supportive but Participant 2 not.²²⁶

IV. RESEARCH QUESTION 3: ON THE BALANCE OF PROBABILITIES, WILL THE PROPOSED REFORMS TO ADDRESS THESE FAILURES CAUSE REs TO ABANDON THE RETAIL MARKET THEREBY RESTRICTING INVESTMENT CHOICE BY RETAIL CLIENTS?

The two proposed reforms to the disclosure provisions of the law to remedy the identified weaknesses regarding product disclosure by the RE should not, on the balance of probabilities, cause REs to abandon the retail market. The proposed reforms are not a significant change to the existing regulatory regime.

Firstly, in practice, many PDS have a section at the front that is similar to the KIS. Secondly, an additional executive summary document, such as the Canadian FFD, would be little different from the advertising flyer REs often use. It will just have more prescribed key information expressed in simple language.

The proposed reforms should result in retail clients and their financial advisers making better investment decisions, even if they do not read the whole PDS, because they at

²²⁶ Interview Transcript, page 474.

least have read the key information expressed in a simplified form. Combined with the provision of the target market determination, this would overcome the problems with the current disclosure regime without over-regulation. The Survey results are supportive of the proposed reforms.

Survey Results
In the Survey, 100% of respondents agreed that: (a) if retail investors were required to be provided with a simple summary short form 'Fund Facts Document' with a PDS, or (b) if their PDS was required to include an up-front KIS of no more than four pages at the front of the PDS, this would not cause their organisation to reduce the availability of its products to retail clients.²²⁷

²²⁷ Survey Results Q78 and Q80, pages 455-456.

CHAPTER 8 – RESEARCH REFLECTIONS

I. GENERAL

As identified in Chapter 1, the history of collective investment schemes ('CIS') in Australia is replete with examples of failures of the legal and regulatory regime to the detriment of retail investors. Little has been done to reform this framework since 1998, when the *Managed Investments Act 1998* (Cth) ('MIA') was passed. Despite the purpose of the MIA being to 'improve corporate governance',¹ there have been numerous failures of MIS since 1998. Billions of dollars have been lost by retail investors. This phenomenon has continued up to the present day with a number of managed investment scheme ('MIS') failures in 2024 and 2025. Numerous inquiries have been undertaken and many reports produced.² Recommendations for reform have largely been ignored.

However, as stated in Chapter 1, this thesis is not concerned with MIS failures that are purely due to investment risk because this is not the purpose of the current legal and regulatory framework. As noted by the ALRC Report 65,³

The law governing collective investment schemes cannot - and should not - try to eliminate the investment risks facing investors. If the law attempted this, it would fail. Investors would be deluded into thinking they could not lose their money. Many of the innovative financial products marketed to investors through collective investment

¹ Explanatory Memorandum to the Managed Investments Bill 1997 ('EM-MIA'), [2.6(c)].

² Malcolm Turnbull *Review of the Managed Investments Act 1998* (Report, 3 December 2001) ('Turnbull Review'); Parliamentary Joint Committee on Corporations and Financial Services *Report on the Review of the Managed Investments Act 1998* (Report, December 2002) ('Turnbull Review Report'); Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (Final Report, September 2009) ('Agribusiness Report'); Corporations and Markets Advisory Committee *Managed Investment Schemes* (Report, July 2012) ('CAMAC Report'); Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into the collapse of Trio Capital* (Report, May 2012) (Trio Report); Senate Economics Reference Committee *Agribusiness managed investment schemes Bitter harvest* (Report, 2016); ('Bitter Harvest'); Senate Economics Reference Committee *Sterling Income Trust* (Report, 2022) ('SIT Report'); The Treasury *Review of the regulatory framework for managed investment schemes* (Consultation Paper, August 2023) ('Treasury Review').

³ Australian Law Reform Commission and Corporations and Securities Advisory Committee *Collective Investments: Other People's Money* (Report No. 65, 1993) ('ALRC Report 65'),

schemes would no longer be viable. Investors would have no choices and no ability to accept greater risks for the opportunity of obtaining greater returns.⁴

Rather, the research undertaken for this thesis was concerned with the failures that have occurred under the current framework where the framework was inadequate for the protection of the retail investor from losses (other than from normal investment risk). The research has focused on failures caused by factors other than normal investment risk. This is exemplified by a number of the case studies in Chapters 3 to 7 and some of the reports regarding MIS referred to above.⁵ The ALRC Report 65 is an example of distinguishing between investment loss and loss due to failure of a regulatory framework to provide investor protection.⁶

The aim and purpose of this research project was to contribute to society by finding and developing solutions to this phenomenon described in Chapter 1, moving from what the 'law is' where it has failed the retail investor to what the 'law ought to be' to protect the retail investor without over-regulation. This aim and purpose was met. This thesis could provide a model or blueprint for the Commonwealth Government to make the appropriate changes to the law for the benefit of retail investors. It could also be used by The Treasury to prepare a white paper which could be presented to the Government for legislative and administrative action.⁷

An initial analysis of the primary and secondary materials referred to in Chapter 1 regarding the history of failures with the legal and regulatory framework of the CIS designed to protect the retail investor was undertaken. From this analysis, the following areas of the existing MIS legal and regulatory framework that have been found wanting and failed to protect retail investors were identified:

- (a) the duties of officers of the responsible entity ('RE'),⁸
- (b) compliance arrangements of the RE including the role of the compliance committee,⁹

⁴ Ibid, [2.6].

⁵ Reports (n 2).

⁶ ALRC Report, [2.6]-[2.13].

⁷

⁸ Chapter 3, 48.

⁹ Chapter 4, 99.

- (c) related party transactions,¹⁰
- (d) solvent schemes with insolvent REs,¹¹
- (e) disclosure rules.¹²

The following research questions were applied to each of these identified areas.

1. *Research Question 1*

How do each of these aspects of the legal and regulatory framework of the MIS fail to protect the retail investor?

2. *Research Question 2*

How can these failures be remedied?

3. *Research Question 3*

On the balance of probabilities, will the proposed reforms to address these failures cause REs to abandon the retail market thereby reducing retail investor investment choices?

The aim of Research Question 1 was to identify any aspects of the existing MIS legal and regulatory framework that have failed to protect retail investors. Having regard to the answers to Research Question 1, the aim of Research Question 2 was to guide conclusions on what reforms need to be made to the existing legal and regulatory framework to rectify the identified problems namely what the law 'ought to be'.

Research Question 3 was intended to identify whether the proposed reforms could be implemented without causing REs to abandon the retail market.

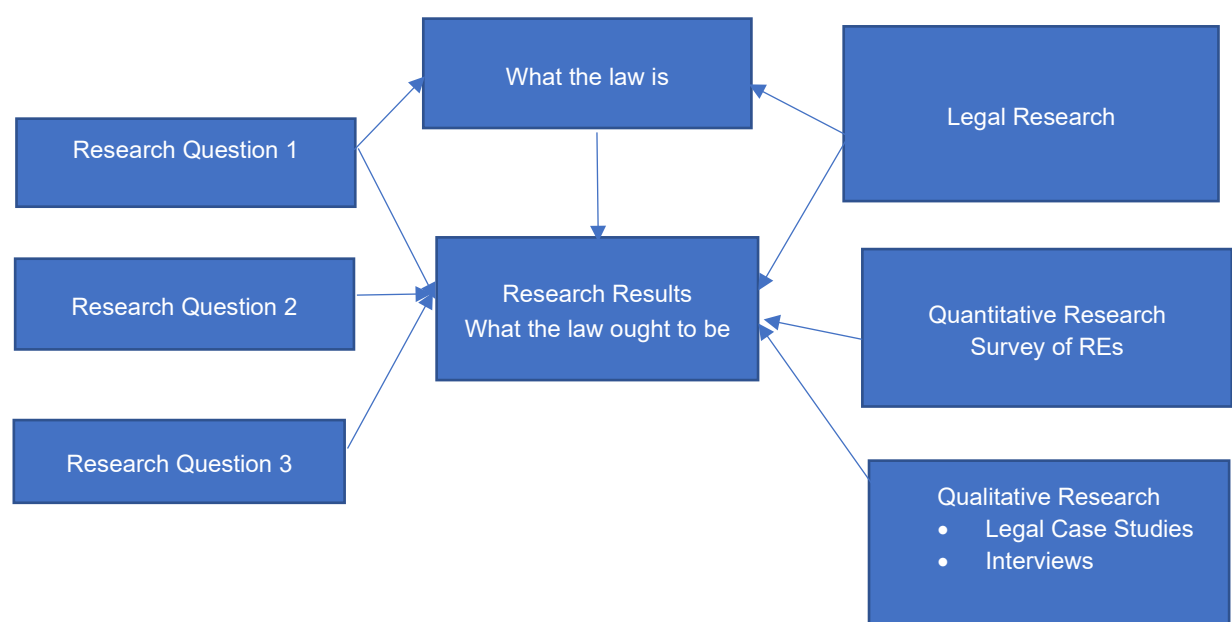
A mixed methodology was used to answer these Research Questions. This comprised a combination of legal, quantitative and qualitative research methods. The application of these methodologies was undertaken to take advantage of the strengths of each of

¹⁰ Chapter 5, 143.

¹¹ Chapter 6, 165.

¹² Chapter 7, 193.

these alternative methodologies.¹³ The aim was to push ‘through settled legal questions to address questions that are complex and unresolved in the legal system’.¹⁴ It was also to assist in triangulation.¹⁵ The following is a diagrammatic illustration of the approach:



The following table is a summary of the proposed reforms flowing from the analysis of the applicable data collected for the purposes of this research project in answering Research Question 2 as applied to each of the areas of the current legal and regulatory framework referred to in Chapters 3 to 7 of this thesis. Research Question 3 was then applied to each of the proposed reforms to ascertain whether on the balance of probabilities, the proposed reforms would not cause REs to abandon the retail market.

¹³ Margaret McKerchar, ‘Philosophical paradigms, inquiry strategies and knowledge claims: applying the principles of research design and conduct to taxation’ (2008) 6(1) *eJournal of Tax Research* 5, 20; Pat Bazeley and Lynn Kemp, ‘Mosaics, Triangles, and DNA: Metaphors for Integrated Analysis in Mixed Methods Research’ (2012) 6(1) *Journal of Mixed Methods Research* 55, 56.

¹⁴ Theunis Roux ‘Judging the Quality of Legal Research: A Qualified Response to the Demand for Greater Methodological Rigour’ (2014) 24 *Legal Education Review* 173, 187.

¹⁵ Mary Yoko Brannen and Mark F Peterson ‘Merging without alienating: interventions promoting cross-cultural organizational integration and their limitations’ (2009) 40 *Journal International Business Studies* 468.

Table of Proposed Reforms

Chapter No.	Chapter Heading	Reform No.	Reform Content	Page No.
3	Duties of Officers of the responsible entity ('RE') to scheme members	1	An officer of a RE must hold industry specific educational qualifications appropriate to the role of an officer of a RE including studies in the legal and regulatory framework of the MIS, the principles of corporate governance, virtue ethics and the professional responsibility of officers of a RE	91
		2	An officer of a RE must undertake compulsory annual CPD in MIS law, corporate governance, virtue ethics and professional responsibility of officers of a RE	96
4	Compliance Plan ('CP'), Compliance Committee ('CC') and the Compliance Plan Auditor ('CPA') as gatekeepers	1	Members of the CC must undertake: (a) studies in MIS law and in particular the various gatekeeper roles including the CP, CC and compliance auditor which will ensure that CC members fully understand their role within the legal and regulatory framework, (b) studies in historical indicators of fraud and corruption including training and development of fraud recognition skills which will assist CC members to better fulfil their gatekeeper role of monitoring compliance by the RE through identification of 'red flags' at an early stage leading to early reporting either or both to the RE and/or ASIC, (c) training and development of professional scepticism skills to always question and critically test what they are	138

Chapter No.	Chapter Heading	Reform No.	Reform Content	Page No.
			told rather than acting as a 'box ticker' so that they can identify breaches for further investigation at an early stage, (d) training in ethical idealism being a concern for the welfare of others thereby increasing behaviours that reflect a concern for the retail client CC members should also have experience appropriate for the exercise of the functions of a CC	
		2	RE must notify ASIC of the appointment, removal, or resignation of CC members and place that information on its website and in its annual report	144
		3	If there is no CC, the external directors should be required to perform the legislative functions of the CC as if they were the CC	145
		4	Where the RE is investing offshore, the provisions of the CP dealing with: (a) the arrangements to ensure that all scheme property is clearly identified as scheme property and held separately from property of the responsible entity and property of any other scheme, and (b) the valuation of scheme property at regular intervals appropriate to the nature of the property,	147

Chapter No.	Chapter Heading	Reform No.	Reform Content	Page No.
			must be more acutely focused on procedures to prevent fraud	
		5	(a) Anyone wishing to be appointed as a CPA must obtain specific approval (b) Qualitative standards must be imposed pursuant to which CPAs must conduct their audit	147
5	MIS and related party transactions ('RPTs')	1	The current RPT provisions to be replaced with a bespoke rule for registered MIS	169
		2	Reforms 1 and 2 in Chapter 3	169
		3	Even if an exception applies the RE must: • make full disclosure to members including the provision of an independent expert report ('IER'), and • lodge a copy with ASIC.	171
6	Insolvent Responsible Entities of 'Solvent' Managed Investment Schemes ('MISs')	1	Limit the right of recovery arising from the rights, obligations and liabilities of the former RE statutorily novated to the new RE to the extent that the incoming RE or TRE is actually indemnified out of scheme property	203
		2	(a) RE must maintain a register of agreements related to each MIS that it operates which is definitive and upon which an incoming RE or TRE can rely (b) RE must establish and maintain a register of scheme property for each MIS that it operates (c) RE must provide reasonable assistance to a prospective	204

Chapter No.	Chapter Heading	Reform No.	Reform Content	Page No.
			TRE or new RE upon request from at least 5% of MIS members or when directed by court order	
7	MIS product disclosure regime	1	A simple document, similar to the Canadian simple Fund Facts Document ('FFD'), should be required to be provided to investors in the target market	247
		2	If the current disclosure regime is not repealed there should be a requirement that a Key Information Statement ('KIS') must be contained in the front pages of the Product Disclosure Statement	247

II. CHAPTER 3 – DUTIES OF OFFICERS

In Chapter 3, an examination of the 'law as it is' regarding the duties of the officers of the RE was undertaken to answer Research Question 1. The analysis of the data identified aspects of the legal and regulatory framework of the MIS failed to protect the retail investor. In particular,

- the penalties that could be or have been proposed have not acted as a deterrent to bad behaviour by officers,
- officers lacked the knowledge and understanding of what was expected of them in managing 'other people's money'.

These enabled Research Question 2 to be answered namely that if the two reforms referred to in the above Table are made to the existing legal and regulatory framework of the MIS (i.e. the 'law as it ought to be'), this should improve the efficacy and efficiency of this aspect of the legal and regulatory framework for the protection of retail clients. These proposed reforms should operate to better protect the retail client from harm through the imposition of educational standards specific to the operation of MIS, both prior to an officer's appointment and then on an annual on-going basis.

These proposed reforms should operate to better protect the retail client from harm for the following reasons:

- (a) the officers will not make poor choices because they know the standards of behaviour required of them,
- (b) the officers will naturally adhere to the legislative standards of behaviour required of them, i.e., act for the sake of duty rather than interest,
- (c) the position of the officers will be professionalised thereby motivating them to comply with the law,
- (d) the officers will understand the ethical component of their legal responsibilities which is essential for legal compliance and good corporate governance.

This should then protect the retail investor from harm because defaults by officer of REs of their duties to members will be less likely to occur.

These two reforms are supported by the Survey results below.

Survey Results - Duties of Officers – Research Question 2 – Proposed Reforms 1 and 2

- | |
|---|
| <ul style="list-style-type: none">▪ 80.8% of respondents agreed that their organisation carried out independent vetting of directors as to their suitability to act as a director,¹⁶▪ 92.6% of respondents agreed that their organisation required directors to hold minimal professional standards (e.g., education and experience) as a condition of appointment,¹⁷▪ 74.1% of respondents agreed that their organisation required directors to have experience in the operation of registered schemes as a condition of appointment,¹⁸ |
|---|

¹⁶ Ibid Q5, Page 407.

¹⁷ Ibid Q7 408.

¹⁸ Ibid Q8, 409.

Survey Results - Duties of Officers – Research Question 2 – Proposed Reforms 1 and 2

- 74.1% of respondents agreed that their organisation required directors to undertake annual CPD,¹⁹
- 96.3 % of respondents agreed that their organisation already had guidelines to ensure that their directors were fit and proper persons.²⁰

In answer to Research Question 3, the conclusion was drawn from the material referred to in Chapter 3 and supported by the below Survey results, that the benefits the RE will obtain from the implementation of the proposed reforms outweigh the costs. Therefore, on the balance of probabilities, the proposed reforms should not lead to REs abandoning the retail market.

Survey Results - Duties of Officer– Research Question 3 – Proposed Reforms 1 & 2

- 84.6% of respondents agreed that their organisation would not reduce the availability of its products to retail investors if officers were required to hold industry-specific qualifications, including in MIS law and ethics.²¹
- 96.2% of respondents agreed that their organisation would not reduce the availability of its products to retail investors if officers were required to undertake annual CPD.²²

¹⁹ Ibid Q9, 410.

²⁰ Ibid Q6, 407.

²¹ Survey Results, Q70, page 450.

²² Ibid, Q73, page 451.

III. CHAPTER 4 - COMPLIANCE PLAN, COMPLIANCE COMMITTEE AND COMPLIANCE PLAN AUDITOR

In Chapter 4, an examination of the 'law as it is' regarding the combined operation of the compliance plan ('CP'), the compliance committee ('CC') (if applicable) and the compliance plan auditor ('CPA') was undertaken to answer Research Question 1. The analysis of the data identified aspects of the legal and regulatory framework of the MIS failed to protect the retail investor. In particular these were:

- box ticking approach to compliance,
- failure to identify 'red flags' requiring further investigation
- lack of supervision of offshore funds,
- lack of professional scepticism,
- reliance by the CPA on the inherent limitations of the CP audit.

These identified failures enabled Research Question 2 to be answered namely that if the five reforms referred to in the above Table are made to the existing legal and regulatory framework of the MIS (i.e. the 'law as it ought to be'), this should improve the efficacy and efficiency of this aspect of the legal and regulatory framework for the protection of retail clients. These proposed reforms should operate to better protect the retail client from harm for the following reasons:

- (i) The first reform should ensure that CC members (or alternatively the external directors) have the required knowledge and skills necessary to identify compliance breaches,
- (ii) The second reform should allow frequent changes of CC members to be drawn to the attention of investors in the MIS and ASIC and thereby identify potential compliance issues,
- (iii) The third reform will fill a current gap in the law where there is no CC because there is an equal number of external directors ensuring that the external directors have the same responsibilities as would a member of the CC,

- (iv) The fourth reform will ensure that where an investment is made in an offshore fund, the provisions of the CP are acutely focused procedures directed at preventing fraud,
- (v) The fifth reform will restrict the reliance by the CPA on the reasonable assurance nature of audits when fraud is involved by ensuring that a CPA meets prescribed training and experience prerequisites relevant to CP audits and the imposition of qualitative standards on the conduct of their audits.

Based on an analysis of the primary and secondary materials, the conclusion reached is that if the five reforms referred to in the above Table are made to this aspect of the legal and regulatory framework of the MIS, this should lead to improved protection of retail clients from harm. The first, second and third reforms are also supported by the following results of the Survey.²³

Survey Results - Compliance Plan, Compliance Committee and Compliance Plan Auditor – Research Question 2	
First Proposed Reform	
• 68% of respondents agreed their organisation already required an external member of the CC to hold industry-specific qualifications,²⁴ ▪ 80% of respondents agreed their organisation already required an external member of the CC to have experience in the operation of registered schemes,²⁵ ▪ 96.2% of respondents agreed their organisation already had guidelines in place to ensure that an external member of the CC is a fit and proper person,²⁶	

²³ Note: the Survey was completed early in the research and before the analysis from other data indicated that proposed reforms 4 and 5 were appropriate not because the Survey may have had negative results to these two reforms.

²⁴ Survey Results, Q18, 417.

²⁵ Ibid, Q19, 417.

²⁶ Ibid, Q17, 416.

Survey Results - Compliance Plan, Compliance Committee and Compliance Plan Auditor – Research Question 2
80.8% of respondents agreed their organisation undertook independent vetting of proposed appointees to the CC as to their suitability to be a CC member.²⁷
Second Proposed Reform
70.4% of respondents agreed that changes in membership of the CC should be disclosed by publicly available notification to ASIC and in the annual report. ²⁸
Third Proposed Reform
90% of respondents agreed that if their organisation did not have a CC, then the external directors of the Board took an active role in engaging with compliance issues. ²⁹

In answer to Research Question 3, the conclusion drawn from the material referred to in Chapter 4 and supported by the Survey results below, is that the reforms are not onerous and should result in the cost-benefit ratio of the reforms favouring the benefit over its cost. Therefore, on the balance of probabilities these reforms should not cause REs to abandon the retail market.

Survey Results - Duties of Officers – Research Question 3
Second Proposed Reform
92.3% of respondents that their organisation would not reduce the availability of its products to retail investors if the RE were required to notify ASIC and members of the scheme of changes in the membership of the CC. ³⁰

²⁷ Ibid, Q16. 416.

²⁸ Survey Results, Q20, page 418.

²⁹ Survey Results, Q30, page 425.

³⁰ Survey Results, Q71, 452

IV. CHAPTER 5 - RELATED PARTY TRANSACTIONS (RPTs)

In Chapter 5, an examination of the 'law as it is' as it applies to RPTs within the MIS legal and regulatory framework was undertaken to answer Research Question 1. The analysis of the data identified aspects of the legal and regulatory framework of the MIS failed to protect the retail investor. In particular these were:

- the method of drafting by reference to RPTs for public companies rather than bespoke rules,
- the failure to disclose transactions involving RPTs even where permitted under an exception,
- the arm's length exception, and,
- the officers of the RE having deliberate disregard of or failure to recognise their duties and obligations.

These identified failures enabled Research Question 2 to be answered namely that if the three reforms referred to in the above Table are made to the existing legal and regulatory framework of the MIS (i.e. the 'law as it ought to be'), this should improve the efficacy and efficiency of this aspect of the legal and regulatory framework for the protection of retail clients. These proposed reforms should operate to better protect the retail client from harm because:

- (a) the first reform will make the RPT provisions easier to follow,
- (b) the second reform is essentially the same two reforms proposed to the duties of officer and so similarly should prepare the officers to be better equipped to adhere to their duties and obligations and act professionally,
- (c) the third reform will ensure full transparency occurs with all RPTs thereby enabling action by members under the existing law if they disagree or action by ASIC because both will be fully informed.

In answer to Research Question 3, the conclusion drawn from the material referred to in Chapter 5 and supported by the Survey results, the regulation of REs operating under the law as it 'ought to be' should not act as a deterrent to an RE continuing to operate in the retail market. The costs outweigh the benefits. Taking into account the research data and the conclusions made with respect to that data together with the Survey Results below, on the balance of probabilities, these reforms should not cause REs to abandon the retail market.

Survey Results - RPTs – Research Question 3 – Proposed Reforms 1 and 3	
•	95.8% of respondents did not consider that if the RPT provisions, as they apply to MIS, were specific, rather than cross-referenced to Chapter 2E of the Corporations Act, this would cause their organisation to reduce the availability of its products to retail clients, ³¹
•	92.6% of respondents agreed that their organisation already made full disclosure of RPTs to members of the schemes operated by their organisation, even if it was at arm's length, indicating that this would not be an onerous requirement. ³²

V. CHAPTER 6 - INSOLVENT RESPONSIBLE ENTITIES OF SOLVENT MANAGED INVESTMENT SCHEMES

In Chapter 6, an examination of the 'law as it is' regarding the insolvency of REs was undertaken to answer Research Question 1. The analysis of the data identified aspects of the legal and regulatory framework of the MIS failed to protect the retail investor. In particular these were:

- there is no one to represent the members when there is an insolvent RE,

³¹ Survey Results, Q74, page 453.

³² Ibid, Q59, page 444.

- the members' interests in the MIS, to the extent that they consist of a contract to which the insolvent RE is a party, may be extinguished by way of disclaimer by the external administrators of the insolvent RE.
- the uncertainty in the interpretation of the statutory novation provisions and the difficulties faced by an incoming RE in identifying potential liabilities and obligations to which they may be subject if appointed.

These identified failures enabled Research Question 2 to be answered namely that if the two reforms referred to in the above Table are made to the existing legal and regulatory framework of the MIS (i.e. the 'law as it ought to be'), this should improve the efficacy and efficiency of this aspect of the legal and regulatory framework for the protection of retail clients. These proposed reforms will operate to better protect the retail client from harm because:

- (a) the members will have someone to represent them in dealing with an insolvent RE,
- (b) possible replacement REs will not be met with uncertainty in the law and therefore more likely to be available to accept an appointment as replacement RE for a solvent scheme.

The two proposed reforms are supported by the Survey results.

Survey Results - Insolvent Responsible Entities of Solvent MIS – Research Question 2 - Proposed Reforms
• 81.8% of respondents agree that their organisation would more likely than not consent to an appointment as a temporary RE or replacement RE than they would under the current law if the statutory novation provisions were amended to exclude the novation of liabilities of the former RE,³³

³³ Survey Results, Q69, page 451

- 85.2% of respondents agreed that REs should be required to maintain a register of contracts and scheme property, which is available for inspection in the event of a proposed change of RE,³⁴
- 73.9% of respondents agreed that if the maintenance of a register of contracts and scheme property was a requirement of law, this register should be definitive,³⁵
- 87% of respondents agreed that if their organisation had access to a register of contracts and scheme property maintained by the current RE, their organisation (subject to satisfactory due diligence of those registers) would be more likely than not to consent to an appointment as a TRE or replacement RE than they would under the current law.³⁶

In answer to Research Question 3, the conclusion drawn from the material referred to in Chapter 6 is that, on the balance of probabilities, these reforms should not cause REs to abandon the retail market. The first reform will provide a substantial benefit for the RE and the second reform will not result in any additional costs to the RE.

Survey Results - Insolvent Responsible Entities of Solvent MIS - Research Question 3 – Proposed First Reform

92% of respondents agreed that if the law were amended to remove 'liabilities' from the statutory novation provisions, this would not cause their organisation to reduce the availability of its products to retail clients.³⁷

VI. CHAPTER 7 - MIS PRODUCT DISCLOSURE REGIME

In Chapter 7 an examination of the 'law as it is' regarding disclosure obligations was undertaken to answer Research Question 1. The analysis of the data identified

³⁴ Survey Results, Q66, page 449.

³⁵ Survey Results, Q67, page 450.

³⁶ Survey Results, Q68, page 450.

³⁷ Survey Results, Q76, page 454.

aspects of the legal and regulatory framework of the MIS failed to protect the retail investor. In particular these were that the current disclosure requirements:

- are complex and highly specific,
- are difficult to follow and understand due to both the drafting methodology and their complexity,
- lack consistency, varying according to the product being issued,
- are often hard to locate.

Therefore, the PDS is likely to lead to investor disengagement from the disclosure process.

These identified failures enabled Research Question 2 to be answered namely that if the two reforms referred to in the above Table are made to the existing legal and regulatory framework of the MIS (i.e. the 'law as it ought to be'), this should improve the efficacy and efficiency of this aspect of the legal and regulatory framework for the protection of retail clients. These proposed reforms should operate to better protect the retail client from harm because retail investors are more likely to read disclosures:

- (a) in a simple short document as per the first proposed reform, or
- (b) a summary of the key features up-front as per the second proposed reform.

The two proposed reforms are supported by the Survey results.

Survey Results - MIS product disclosure regime - Research Question 2 – Proposed Reforms
• 96% of respondents agreed that if the retail clients were provided with a simple short form 'Fund Facts Document' the retail investors would be more likely to read it than a full PDS • 77.8% of respondents agreed that if their PDS contained a simple short form Key Information Statement up front retail investors would read the Key Information Statement but not the rest of the PDS

In answer to Research Question 3, the conclusion drawn from the material referred to in Chapter 5 and supported by the Survey results, is that, on the balance of probabilities, these reforms should not cause REs to abandon the retail market. The proposed reforms are not onerous and for many REs in practice are little different from their present practices. This conclusion is supported by the Survey results.

Survey Results - MIS product disclosure regime - Research Question 3 – Proposed Reforms
In the Survey, 100% of respondents agreed that: • if retail investors were required to be provided with a simple summary short form 'Fund Facts Document' with a PDS, or • if their PDS was required to include an up-front KIS of no more than four pages at the front of the PDS, this would not cause their organisation to reduce the availability of its products to retail clients.³⁸

VII. CONTRIBUTION

The findings of this thesis contribute to the body of scholarly knowledge concerning the legal and regulatory framework of MIS that were designed for the protection of retail investors, where this framework has failed and how this framework may be improved to the advantage of retail investors. The research results from this work may be built upon by other researchers that follow. This thesis should also provide to policy makers:

- (a) an understanding of the flaws in the current legal and regulatory framework,
- and

³⁸ Survey Results Q 78 and Q80, pages 455-456.

- (b) how the proposed reforms flowing from an analysis of that current framework should improve the protection of retail clients who invest in CIS without over-regulating the industry.

Also, as mentioned earlier in this Chapter, the findings of this thesis may be used as the basis of a white paper by policy makers for appropriate changes to the law and the administration of the law for the benefit of retail investors.

An avenue for future research arising out of this thesis would be to use a mixed discipline approach combining legal research with behavioural psychology research to examine the behaviour of individuals connected with the legal and regulatory framework of MIS and how this behaviour may be improved to reduce the risks of retail investors suffering loss (apart from normal investment risk) as a result of bad behaviour by intermediaries in the MIS marketplace. This may strengthen the design of the programmes referred to in the proposed reforms from a behavioural perspective.

From the research undertaken for this thesis, it is argued that the hypothesised or proposed reforms flowing from a consideration of the 'law as it is' should strengthen the efficacy and efficiency of that framework in protecting the retail investor. Further, the research undertaken, indicates that such reforms should not cause REs to abandon the retail market.

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Corporations Legislation Amendment (Simpler Regulatory System) Act 2007 (Cth)

Corporations Regulations 2001 (Cth)

Court Procedures Rules 2001 (ACT)

Criminal Code Act 1995 (Cth)

Crimes Act 1914 (Cth)

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Financial Sector Reform (Hayne Royal Commission Response No. 2) Act 2021 (Cth)

Financial Sector Reform (Hayne Royal Commission Response-Better Advice) Act 2021 (Cth)

Financial Sector Reform (Hayne Royal Commission Response) (2021 Measures No. 1) Regulations 2021 (Cth)

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Financial Sector Reform (Hayne Royal Commission Response-Protecting Consumers) (Mortgage Brokers) Regulations 2020 (Cth)

Financial Sector Reform (Hayne Royal Commission Response-Breach Reporting and Remediation) Regulations 2021 (Cth)

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Financial Sector Reform (Hayne Royal Commission Response) (Claimant Intermediaries) Regulations 2021 (Cth)

Financial Sector Reform (Hayne Royal Commission Response) (Hawking of Financial Products) Regulations 2021 (Cth)

Financial Sector Reform (Hayne Royal Commission Response-Breach Reporting and Remediation) Regulations 2021 (Cth)

Financial Sector Reform Amendment (Hayne Royal Commission Response-Better Advice) Regulations 2021 (Cth)

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Financial Services Compensation Scheme of Last Resort Levy Act 2023 (Cth)

Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023 (Cth)

Financial Services Reform Act 2001 (Cth)

Health Practitioner Regulation National Law 2009 (NSW)

Income Tax Assessment Act 1936 (Cth)

Income Tax Assessment Act 1997 (Cth)

Legal Profession Uniform Continuing Professional Development (Solicitors) Rules 2015 (NSW)

Legal Profession Uniform Law NSW

Managed Investments Act 1998 (Cth)

Migration Agents Regulations 1998 (Cth)

National Consumer Credit Protection Act 2009 (Cth)

Rules of the Supreme Court 1971

Securities and Exchange Board of India Act 1992 (India)

Securities and Futures Act (Sgp)

Securities and Futures (Offers of Investments) (Offers of Shares and Debentures) Regulations (Sgp)

Securities and Futures Ordinance (HK)

Superannuation Industry (Supervision) Act 1993 (Cth)

Supreme Court Rules 1987 (NT) r 13.10

Supreme Court (General Procedure) Rules 2015 (Vic)

Tax Agent Services Act 2009 (Cth)

Tax Laws Amendment (2007 Measures No 3) Act 2007 (Cth)

Taxation Laws Amendment Act (No 7) 1999 (Cth)

Tertiary Education Quality and Standards Agency Act 2011 (Cth)

Treasury Laws Amendments (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth)

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019 (Cth)

Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Act 2023 (Cth)

Trustee Act 1925 (NSW)

Trusts Act 1973 (Qld)

Uniform Companies Act 1961 (repealed)

Uniform Civil Procedure Rules 1999 (Qld)

Uniform Civil Procedures Rules 2005 (NSW)

Taxation Administration Act 1953 (Cth)

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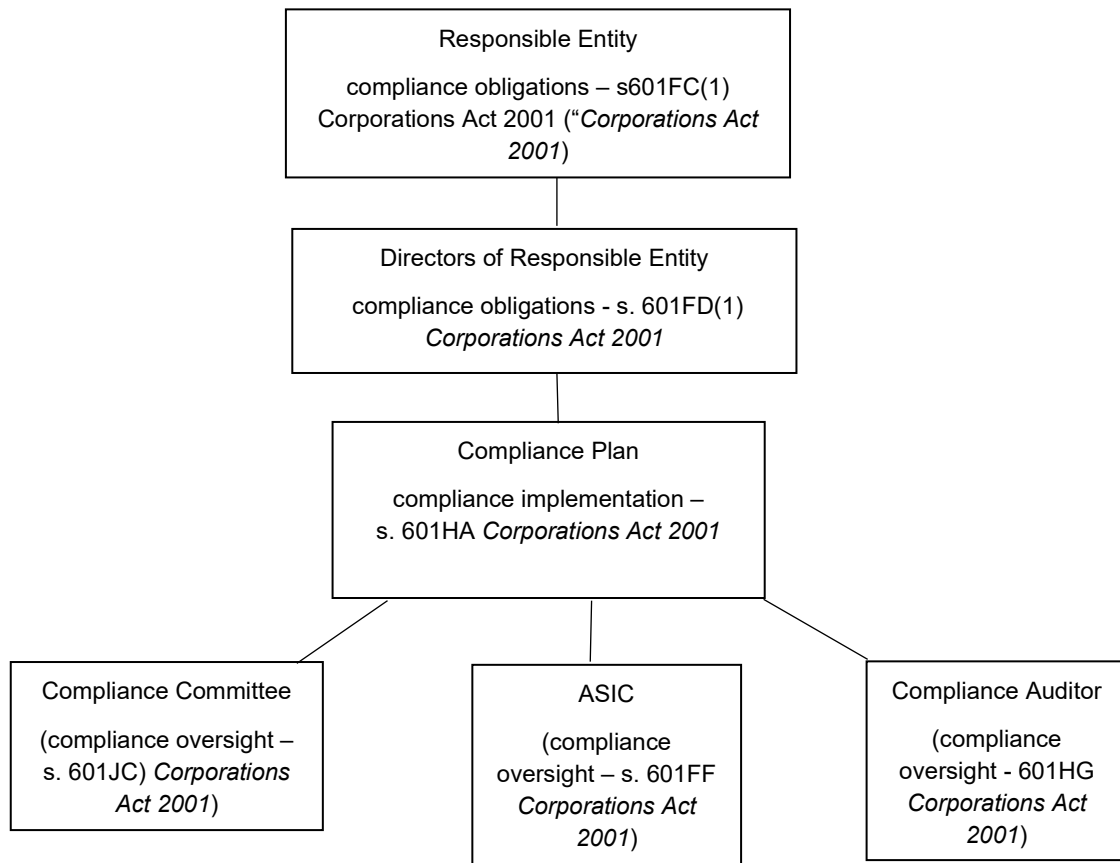
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Appendices to Thesis

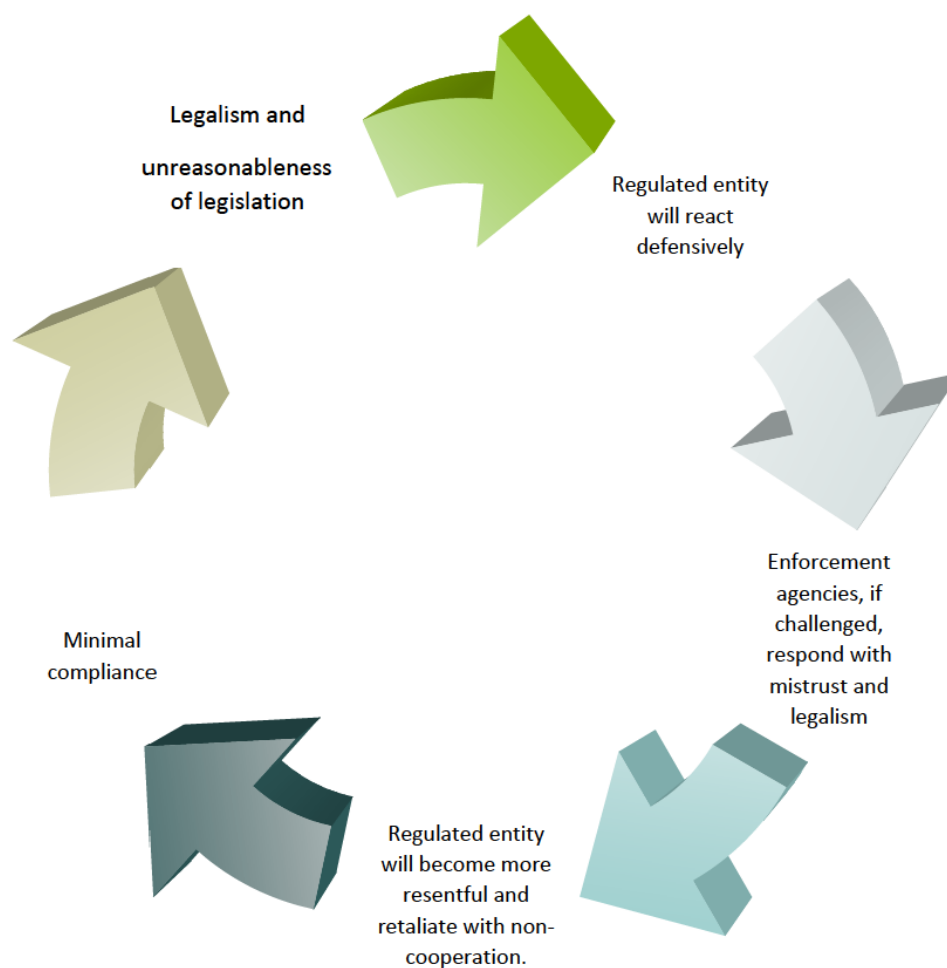
Appendix 1 – Background

I. Figures

A. Figure 1.1 - MIS Governance Structure



B. *Figure 1.2 – Regulation Cycle – Development of Resentment by Regulatee to the Regulator*¹



¹ Marina Nehme Submission to the Senate Standing Committee on Economics '*Australian Securities and Investments Commission Investigation and Enforcement*' (27 February 2023).

II. Tables

A. Table 1.1

My Analysis of submissions to Senate Economics Reference Committee
'Agribusiness managed investment schemes Bitter Harvest' (Report, March 2016)

Complaint about advice received	Complaint about gearing of investment (on advice)	Unsuitable Investment for the investor despite advice to invest	Did not Read PDS	Lack of Understanding of risks	Commission not disclosed.	Not advised of Ongoing Fees
93	96	42 ²	2	2	2	6

(Note: Many of the submissions disclosed more than one reason for making the investment, and where this was the case, these investors have been included in each relevant category)

B. Table 1.2

Hayne Royal Commission: Acts and regulations

Acts	Regulations
<i>Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth)</i>	<i>Financial Sector Reform (Hayne Royal Commission Response) (2021 Measures No. 1) Regulations 2021 (Cth)</i>
<i>Financial Sector Reform (Hayne Royal Commission Response--Protecting Consumers (2019 Measures)) Act 2020 (Cth)</i>	<i>Financial Sector Reform (Hayne Royal Commission Response) (Regulation of Superannuation) Regulations 2020 (Cth)</i>
<i>Financial Sector Reform (Hayne Royal Commission Response--Stronger Regulators (2019 Measures)) Act 2020 (Cth)</i>	<i>Financial Sector Reform (Hayne Royal Commission Response-Protecting Consumers) (Mortgage Brokers) Regulations 2020 (Cth)</i>
<i>Financial Sector Reform (Hayne Royal Commission Response No. 2) Act 2021 (Cth)</i>	<i>Financial Sector Reform (Hayne Royal Commission Response-Breach Reporting and Remediation) Regulations 2021(Cth)</i>
<i>Financial Sector Reform (Hayne Royal Commission Response-Better Advice) Act 2021 (Cth)</i>	<i>Financial Sector Reform (Hayne Royal Commission Response-Advice Fees) Regulations 2021 (Cth)</i>
	<i>Financial Sector Reform (Hayne Royal Commission Response) (Claimant Intermediaries) Regulations 2021 (Cth)</i>
	<i>Financial Sector Reform (Hayne Royal Commission Response) (Hawking of Financial Products) Regulations 2021 (Cth)</i>

² This is based on an assessment of the investor's description of their financial position e.g., what was a financial planner doing recommending that a single working mum, with no superannuation and no capacity to support herself in retirement invest in these schemes with the investment being geared (which was one of the submissions –name withheld).

Acts	Regulations
	<i>Financial Sector Reform (Hayne Royal Commission Response-Breach Reporting and Remediation) Regulations 2021 (Cth)</i> <i>Financial Sector Reform Amendment (Hayne Royal Commission Response-Better Advice) Regulations 2021.</i>

C. Table 1.3

Legal and Regulatory Framework of CIS – Chronology of Events

Year	Event
1955	<i>Companies Act 1955 (Vic)</i>
1958	<i>Companies Act 1958 (Vic)</i>
	Report from the Statute Law Revision Committee upon certain aspects of section 63 of the Companies Act 1958 which relates to unit trust schemes and other matters related thereto
1961	Uniform Companies Acts
1971	Collapse of the Dividend Fund
1974	Select Committee on Securities and Exchange ' <i>Australian securities markets and their regulation</i> ' (Report,1974)
1981	Campbell JK, ' <i>Australian Financial System Inquiry</i> ' (<i>Final Report September 1981</i>)
1981	<i>Companies Act 1981</i>
1982	Collapse of Trustees, Executors and Agency Co. Ltd
1983	Collapse of Balanced Property Group
1986	George Palmer, ' <i>First and Final Report of the Inspector of the Special Investigation into the Balanced Property Trusts</i> ' (Government Printer 1986)
1987	Stock Market Crash
1989	<i>Corporations Law</i>
1990	Collapse of Estate Mortgage
1990	Collapse of Australia-Wide Management
1993	Australian Law Reform Commission and Corporations and Securities Advisory Committee ' <i>Collective Investments: Other People's Money</i> ' (Joint Report,1993)

Year	Event
1997	Stan Wallis, ' <i>Australian Financial System Inquiry</i> ' (Report, March 1997)
1998	<i>Managed Investments Act 1998</i> (Cth)
1999	<i>Taxation Laws Amendment Act (No 7) 1999</i> (Cth)
2001	<i>Corporations Act 2001</i> (Cth)
2001	<i>Financial Services Reform Act 2001</i> (Cth)
2001	Malcolm Turnbull ' <i>Review of the Managed Investments Act 1998</i> ' (Report 2001)
2002	Parliamentary Joint Committee on Corporations and Financial Services ' <i>Report on the Review of the Managed Investments Act 1998</i> ' (Report, 2002)
2007	Parliamentary Committee on Corporations and Financial Services ' <i>The structure and operation of the superannuation industry</i> ' (Report, 7 August 2007)
2007	Repeal of subsection 601FC(4) of the <i>Corporations Act 2001</i> (Cth) (<i>Corporations Legislation Amendment (Simpler Regulatory System) Act 2007</i> (Cth))
2007	<i>Tax Laws Amendment (2007 Measures No 3) Act 2007</i> (Cth) (introduced new tax regime for forestry managed investment Schemes in Schedule 8)
2007	TR 2007/D2 - Income tax: registered agricultural managed investment schemes
2007	TR 2007/8 - Income tax: registered agricultural managed investment schemes
2007	Global Financial Crisis
2007	Collapse of Basis Yield Alpha Fund
2008	Treasury ' <i>Review of Non-Forestry Managed Investment Schemes</i> ' (Issues Paper, August 2008)
2008	Treasury ' <i>Review of Non-Forestry Managed Investment Schemes</i> ' (Report, December 2008)
2008	Collapse of MFS Group and economic failure of its Premium Income Fund
2008	Collapse of Allco
2009	Parliamentary Joint Committee on Corporations and Financial Services ' <i>Inquiry into aspects of agribusiness managed investment schemes</i> ' (Report September 2009)
2009	Parliamentary Joint Committee on Corporations and Financial Services ' <i>Inquiry into financial products and services in Australia November 2009</i> ' (Report 2009)
2009	Collapse of Babcock and Brown
2009	Near collapse of Brisconnect

Year	Event
2009	TR 2007/8 Income tax: registered agricultural managed investment schemes withdrawn
2009	Collapse of Trio Capital including its Astarra Strategic Fund and ARP Growth Fund
2009	Economic Failure of Pacific First Mortgage Fund
2009	Collapse of Timbercorp and Great Southern groups
2010	Collapse of Rewards Group
2010	Collapse of Prime Trust
2011	Treasury ' <i>Wholesale and Retail Clients Future of Financial Advice</i> ' (Options Paper January 2011)
2011	Corporations and Markets Advisory Committee ' <i>Managed Investment Schemes</i> ' (Discussion Paper, June 2011)
2012	Parliamentary Joint Committee on Corporations and Financial Services ' <i>Inquiry into the collapse of Trio Capital May 2012</i> ' (Report , May 2012)
2012	Richard St. John 'Compensation arrangements for consumers of financial services' (Report, April 2012)
2012	Corporations and Markets Advisory Committee ' <i>Managed Investment Schemes</i> ' (Report July 2012)
2012	Richard Sandlant, ' <i>Consumer financial protection: future directions</i> ' (Treasury, Report, 2012)
2012	Collapse of Gunns Group
2013	Treasury ' <i>Review of the Trio Capital Fraud and Assessment of the Regulatory Framework</i> ' (Report, 2013)
2013	Collapse of LM Investment Management
2014	David Murray, ' <i>Financial System Inquiry</i> ' (Report, 2014)
2014	Corporations and Markets Advisory Committee ' <i>The establishment and operation of managed investment schemes</i> ' (Discussion Paper, March 2014)
2016	Senate Economics Reference Committee ' <i>Agribusiness managed investment schemes Bitter harvest</i> ' (Report, 2016)
2017	<i>Corporations Amendment (Professional Standards of Financial Advisers) Act 2017</i> (Cth)
2017	Ian Ramsay, ' <i>Review of the financial system external dispute resolution and complaints framework</i> ' (Report, 6 September 2017)

Year	Event
2018	Sterling Income Trust winding up commenced
2019	Kenneth M Hayne ' <i>Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry</i> ' (Final Report, 1 February 2019)
2019	<i>Treasury Laws Amendments (Strengthening Corporate and Financial Sector Penalties) Act 2019</i> (Cth)
2019	<i>Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019</i> (Cth)
2020	<i>Financial Sector Reform (Hayne Royal Commission Response) Act 2020</i> (Cth)
2020	<i>Financial Sector Reform (Hayne Royal Commission Response--Protecting Consumers (2019 Measures)) Act 2020</i> (Cth)
2020	<i>Financial Sector Reform (Hayne Royal Commission Response--Stronger Regulators (2019 Measures)) Act 2020</i> (Cth)
2021	<i>Financial Sector Reform (Hayne Royal Commission Response No. 2) Act 2021</i> (Cth)
2021	<i>Financial Sector Reform (Hayne Royal Commission Response-Better Advice) Act 2021</i> (Cth)
2021	<i>Financial Sector Reform (Hayne Royal Commission Response) (2021 Measures No. 1) Regulations 2021</i> (Cth)
2021	Australian Law Reform Commission ' <i>Interim Report A Financial Services Legislation</i> ' (Report No. 137. November 2021)
2021	Collapse of Sterling Group
2022	Senate Economics Reference Committee ' <i>Sterling Income Trust</i> ' (Report, 2022)
2023	Australian Law Reform Commission ' <i>Interim Report C Financial Services Legislation</i> ' (Report No. 140, June 2023),
2023	Treasury ' <i>Review of the regulatory framework for managed investment schemes</i> ' (Consultation Paper, August 2023)
2023	Australian Law Reform Commission ' <i>Confronting Complexity: Reforming Corporations and Financial Services Legislation</i> ' (Final Report No. 141, November 2023)
2023	<i>Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Act 2023</i> (Cth)
2023	Sandalwood Properties Limited commences to wind up the entirety of its MIS sandalwood projects

Year	Event
2024	Parliamentary Joint Committee on Corporations and Financial Services 'Wholesale investor and wholesale client test' (Inquiry 2024)
2024	Assets of Shield Master Fund frozen by the Federal Court
2024	Court directs ISG Financial Services Limited to wind up the MIS it operated and receivers were appointed over the property of each MIS to take responsibility for the winding up
2025	Liquidators appointed to the responsible entity of the First Guardian Master Fund and liquidators directed to wind up that fund
2025	Asset preservation orders made against Ferras Merhi ³ and Osama Saad ⁴ and orders restraining them from leaving or attempting to leave Australia regarding their alleged links to the Shield Master Fund and the First Guardian Master Fund.
2025	Appointment of Receivers to Australian Fiduciaries Limited, the responsible entity for three (3) MIS being Global Diversified Alpha Fund, Global Multi-Strategy Fund and Global All Seasons Fund. ⁵

³ *Australian Securities and Investments Commission v Ferras Merhi* VID173/2025.

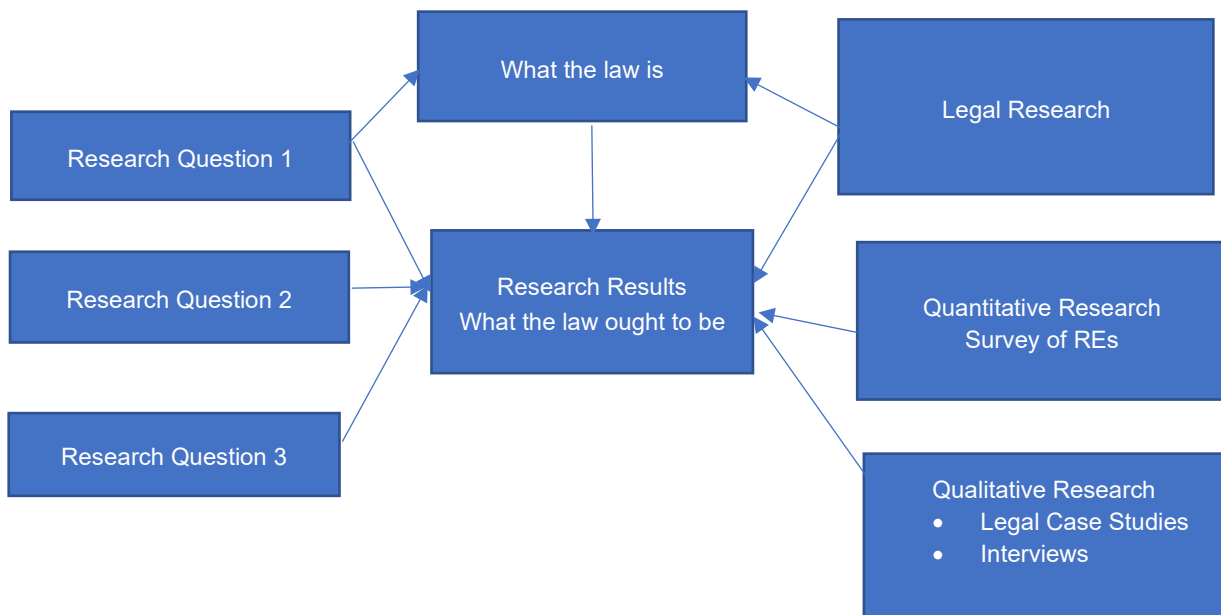
⁴ *Australian Securities and Investments Commission v Osama Saad* VID174/2025.

⁵ *Australian Securities and Investments Commission v Australian Fiduciaries Limited* [2025] FCA 1099.

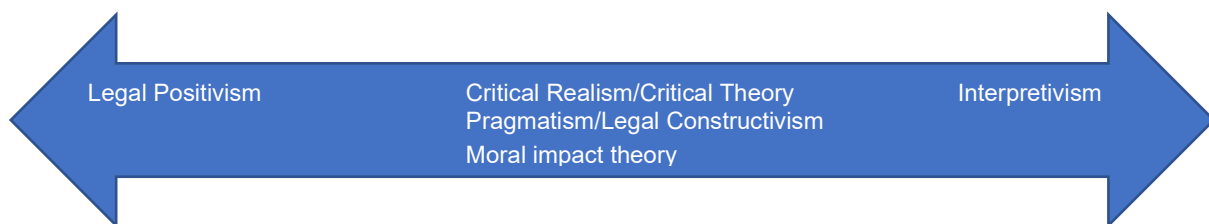
Appendix 2 - Research Methodology

I. Figures

A. *Figure 2.1 - Diagrammatic Representation of the Research Approach of this Thesis*



B. *Figure 1.2 – Research Paradigms*



Appendix 3 – Duties of Officers

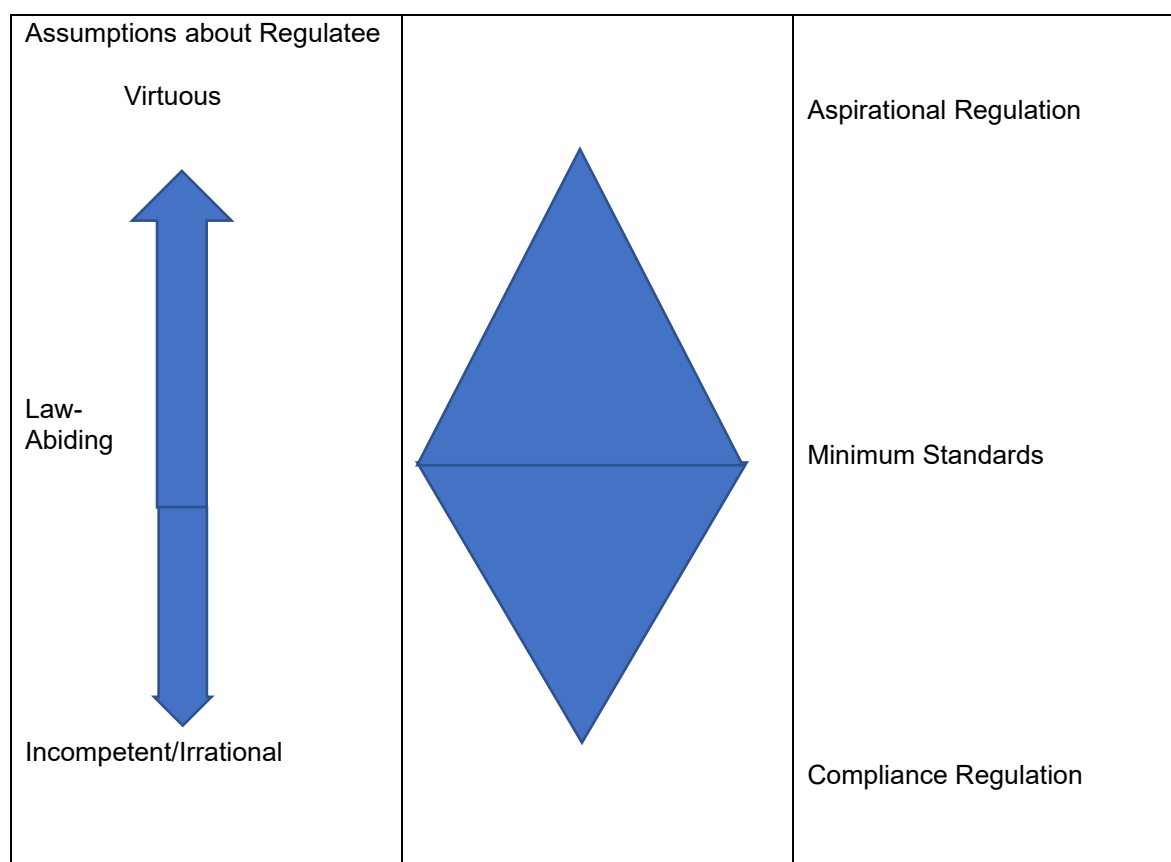
I. Figures

A. Figure 3.1 - Ayres and Braithwaite Regulatory Pyramid¹



¹ Jasper Hedges et al 'The Policy and Practice of Enforcement of Directors' Duties in Australia: An Empirical Analysis' (2017) 40 *Melbourne University Law Review* 905 who copied this from Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

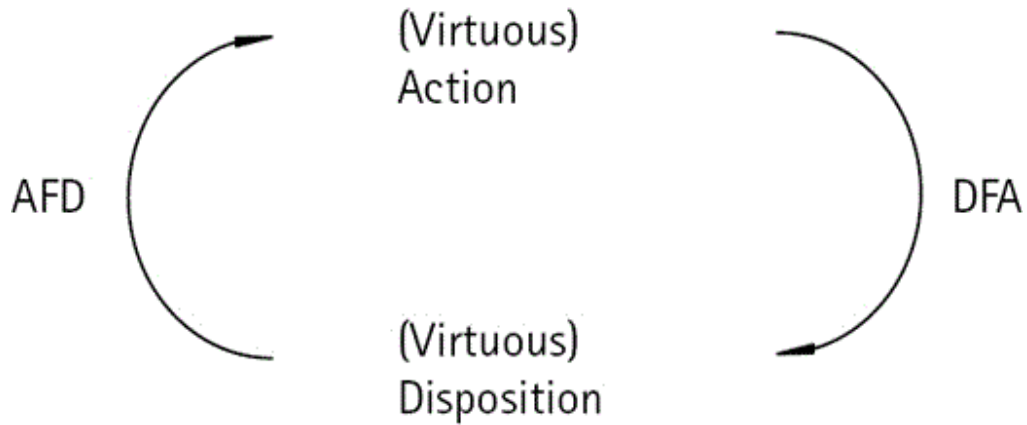
B. *Figure 3.2: The Kolieb Regulatory Diamond* ²



² Jonathan Kolieb, 'When to Punish, When to Persuade and When to Reward: Strengthening Responsive Regulation with the Regulatory Diamond' (2015), 41(1), *Monash University Law Review* 136, 150.

C. *Figure 3.3 The Habituation Circle*³

The Habituation Circle:

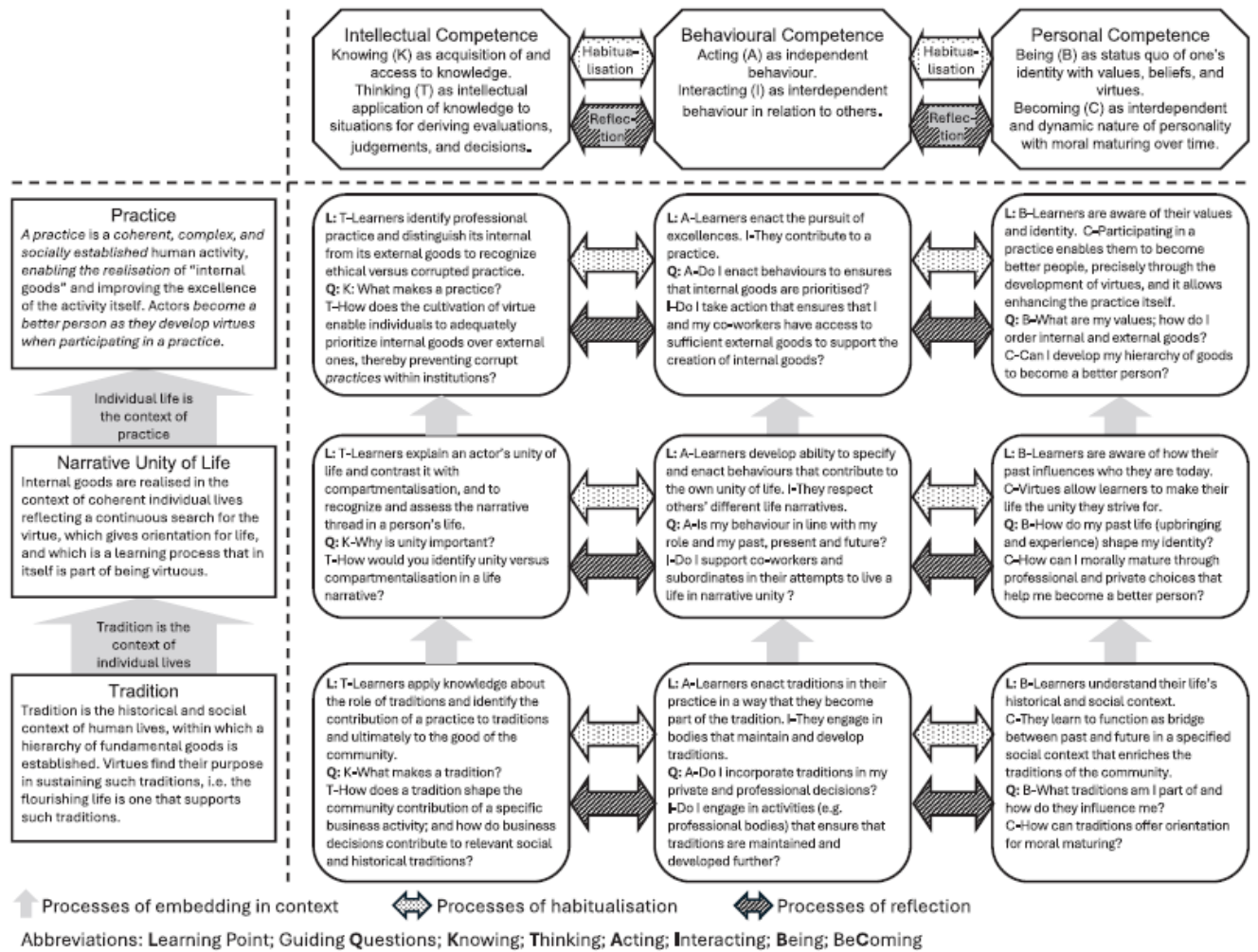


AFD = Action from Disposition Principle: just and moderate actions activate, and therefore presuppose the existence of, a person's justice and moderation.

DFA = Disposition-from-Action Principle: people become just and moderate by doing just and moderate actions.

³ Agnes Callard, 'The Virtuous Spiral: Aristotle's Theory of Habituation' in Manuel Vargas (ed), and John M. Doris (ed), *The Oxford Handbook of Moral Psychology* (Oxford University Press, 14 April 2022), 49 (Figure 3.1).

D. Figure 3.4: The virtue as competence learning framework⁴



4

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II. Tables

A. Table 3.1 –Duties in Common of the RE and its Officers to the members of the MIS

Duties	RE	Officer of RE
act honestly	601FC(1)(a)	601FD(1)(a)
exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's/officer's position	601FC(1)(b)	601FD(1)(b)
act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests	601FC(1)(c)	601FD(1)(c)
not make use of information acquired through being the responsible entity/officer of the responsible entity in order to: (iii) gain an improper advantage for itself/the officer or another person; or (iv) cause detriment to the members of the scheme	601FC(1)(e)	601FD(1)(d)
comply with the scheme's compliance plan	601FC(1)(h)	601FD(1)(f)(iv)

B. Table 3.2 - Duties of Officers of RE to the company under Part 2D.1, at general law and to the members under 601FD(1)

Duties Chapter 2D.1	General Law duties	Duties 601FD(1)
exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director or officer of a corporation in the corporation's circumstances and occupied the office held by, and had the same responsibilities within the corporation as, the director or officer (s 180)	exercise their powers with all reasonable and proper care, skill and diligence ¹	exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position (s 601FD(1)(a) ²
exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose (s 181).	fiduciary loyalty duties ³ comprising: (i) acting bona fide in the interests (also referred to as the 'best interests') of the company and for a proper purpose ⁴ (ii) the 'no conflict' rule and 'no profit' rule meaning that the officer must not enter into a transaction in which their personal interest or duty conflicts with the interests of, or the duty the officer owes to the company ⁵ and the	act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests (s 601FD(1)(b))

¹ *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187; *The Bell Group Ltd (in liq) v Westpac Banking Corporation* (No 9) [2008] WASC 239, [4373]-[4376]; *Daniels v Anderson* (1995) 37 NSWLR 438; *Australian Securities and Investments Commission v Rich* [2009] NSWSC 1229; *Australian Securities and Investments Commission v Cassimatis* (No 8) [2016] FCA 1023, [416]-[427]; *Cassimatis v Australian Securities and Investments Commission* (2020) 275 FCR 533, [451].

² Also see *Macquarie Investment Management Limited* [2016] NSWSC 1184 per Barrett AJA, [72]-[85] approved in *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497, [187].

³ *Trio Capital Limited (Admin App) v ACT Superannuation Management Pty Ltd* [2010] NSWSC 941, [33]; *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296, [174].

⁴ *Angas Law Services Pty Ltd (In liquidation) v Carabelas* (2018) 265 CLR 1, [67] *Streeter v Western Areas Exploration Pty Ltd (No. 2)* [2011] WASCA 17, [447]; However it should be noted that an exercise of power for an improper purpose may be bad even where the bona fides of the directors is not in question which suggests these may be separate obligations: *Whitehouse v. Carlton Hotel Pty Ltd* (1987) 162 CLR 285; Sarah Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Interventions' (1991) 18 *Melbourne University Law Review* 121, 122-124; Elizabeth Klein and Jean J du Plessis, "Corporate Donations, the Best Interest of the Company and the Proper Purpose Doctrine" (2005) 28(1) *UNSW Law Journal* 69, 80.

⁵ *Aberdeen Railway Co v Blaikie Bros* [1843] All ER 249.

Duties Chapter 2D.1	General Law duties	Duties 601FD(1)
	officer must not make a profit as a consequence of their position and if they do, they are bound to disgorge the profit ⁶ .	
not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the corporation (s 182).	reflective of a fiduciary obligation under the general law as per the above ⁷ .	not make improper use of their position as an officer to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme (s 601FD(1)(e))
not improperly use information obtained because they are or have been an officer of the corporation to gain an advantage for themselves or someone else or cause detriment to the corporation (s 183)	reflective of a fiduciary obligation under the general law as per the above ⁸ .	not make use of information acquired through being an officer of the responsible entity in order to gain an improper advantage for the officer or another person or cause detriment to the members of the scheme s 601FD(1)(d)

⁶ *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144, 154, 158; *Cook v Deeks* [1916] 1 AC 554; *Boardman v Phipps* [1967] 2 AC 46, per Cohen LJ at 100 – 103; per Hodson LJ at 106, 110 – 111 and per Guest LJ at 114 - 115, 117; *Warman International Ltd v Dwyer* (1995) 182 CLR 544, 557.

⁷ *Windbox Pty Ltd v Daguragu Aboriginal Land Trust* (No 3) [2020] NTSC 21, [131].

⁸ *Ibid.*

C. Table 3.3 - Penalties for officers of RE

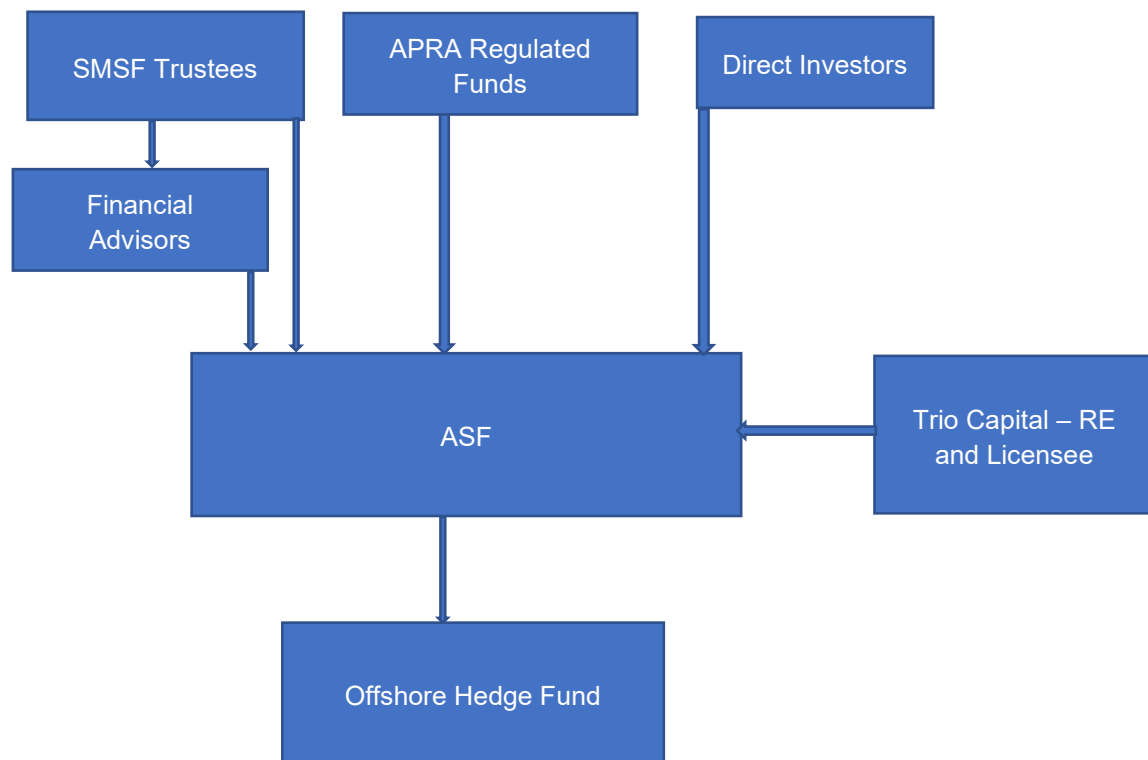
Officer	Scheme Operator	Suspension Period	Pecuniary Penalty and/or imprisonment
Richard Charles Mochalski	Balanced Property Management	Struck off roll of solicitors permanently	(not known)
Peter Bunning	Trustees, Executors and Agency Co.	-	9 months and 3 years to be served concurrently with minimum 6 months
Leigh Jamieson	Trustees, Executors and Agency Co.	-	\$30,000 and 9 months
Richard Lew	Estate Mortgage		3 years for breaches of directors duties
Reuben Lew	Estate Mortgage		2 years for breaches of directors duties
Rex Phillpott	Trio Capital	15 years	-
Natasha Beck	Trio Capital	2 years	-
Eugene Liu	Trio Capital	permanent	-
Keith Finkelde	Trio Capital	4 years	-
David O'Bryen	Trio Capital	4 years	-
David Andrews	Trio Capital	4 years	-
Allan John Mason	Heydon Park	5 years	
Douglas James Crago	Heydon Park	5 years	
Peter Alexander Kinnaid	Heydon Park	2 years	
Peter Cornelius Beekink	Australian Managed Funds	1 year	\$30,000
Hersch Solomon Majteles	Australian Managed Funds	-	\$10,000
Gregory Phillip Gaunt	Australian Managed Funds	-	\$10,000
Andrew Thomas Scott	Centro Properties	-	\$30,000
Romano George Nenna	Centro Properties	2 years	-
William Lionel Lewski	Australian Property Custodian Holdings	15 years	\$230,000
Mark Frederick Butler	Australian Property Custodian Holdings	4 years	\$20,000

Officer	Scheme Operator	Suspension Period	Pecuniary Penalty and/or imprisonment
Kim Jaques	Australian Property Custodian Holdings	4 years	\$20,000
Michael Richard Lewis Wooldridge	Australian Property Custodian Holdings	2 years (split period)	\$20,000
David Michael Hickie	Lion Advantage	2 years	-
Michael Christodoulou King	Managed Investments	20 years	\$300,000
Craig Robert White	Managed Investments	permanent	\$650,000
Guy Hutchings	Managed Investments	25 years	\$350,000
David Mark Anderson	Managed Investments	25 years	\$500,000
Marilyn Anne Watts	Managed Investments	5 years	\$90,000
Paul John Rowles	Avestra Asset Management	10 years	-
Clayton Dempsey	Avestra Asset Management	10 years	-
Stefan Grochowski	Project Management (Aust)	5 years 6 months	-
Ian Edward Stephens	Project Management (Aust)	4 years	-
Robert Patrick Marie	Sterling First	4 years	\$100,000
Michael Stefan Grochowski	Sovereign MF	5 years 6 months	-
Ian Edward Stephens	Sovereign MF	4 years	-
Peter Eugene Daly	Linchpin Capital Group and Endeavour Securities (Australia)	5 years	\$150,000
Paul Nielsen	Linchpin Capital Group and Endeavour Securities (Australia)	4 years	\$100,000
Paul Raftery	Linchpin Capital Group and Endeavour Securities (Australia)	3 years	\$40,000
Ian Comrey Williams	Linchpin Capital Group and Endeavour Securities (Australia)	4 years	\$100,000

Appendix 4 - Compliance Plan, Compliance Committee and Compliance Plan Auditor

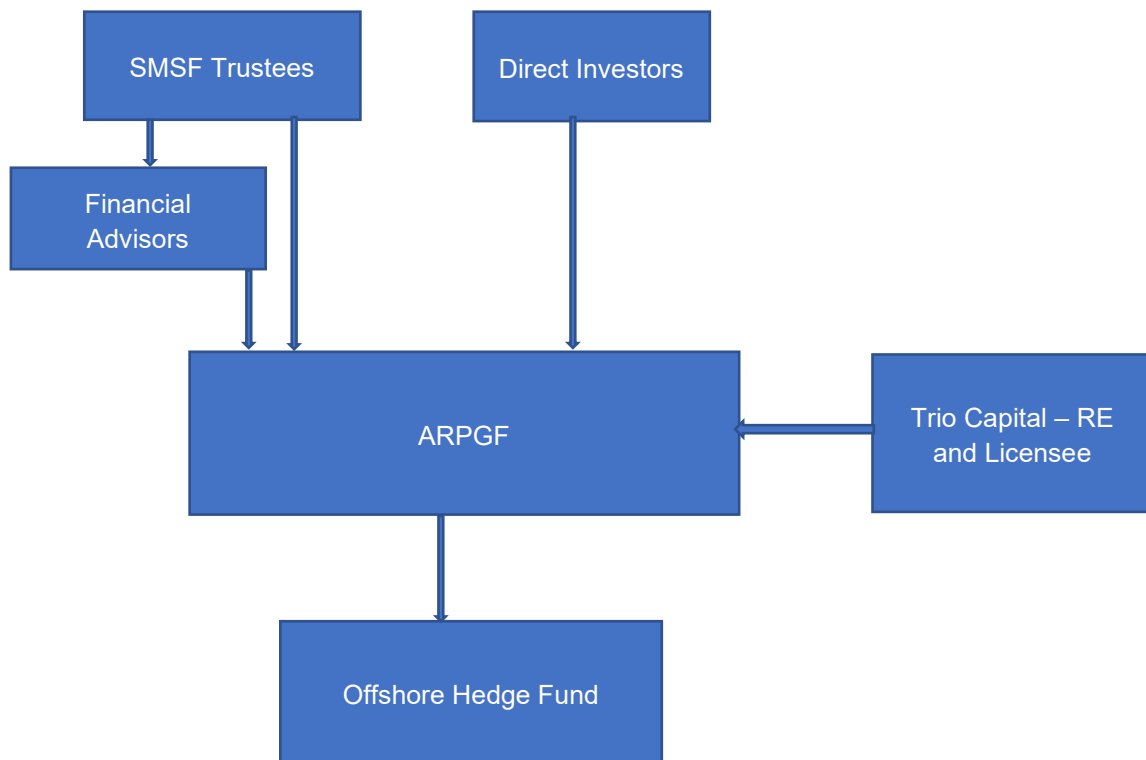
I. Figures

A. Figure 4.1 – ASF Flow of Monies⁶



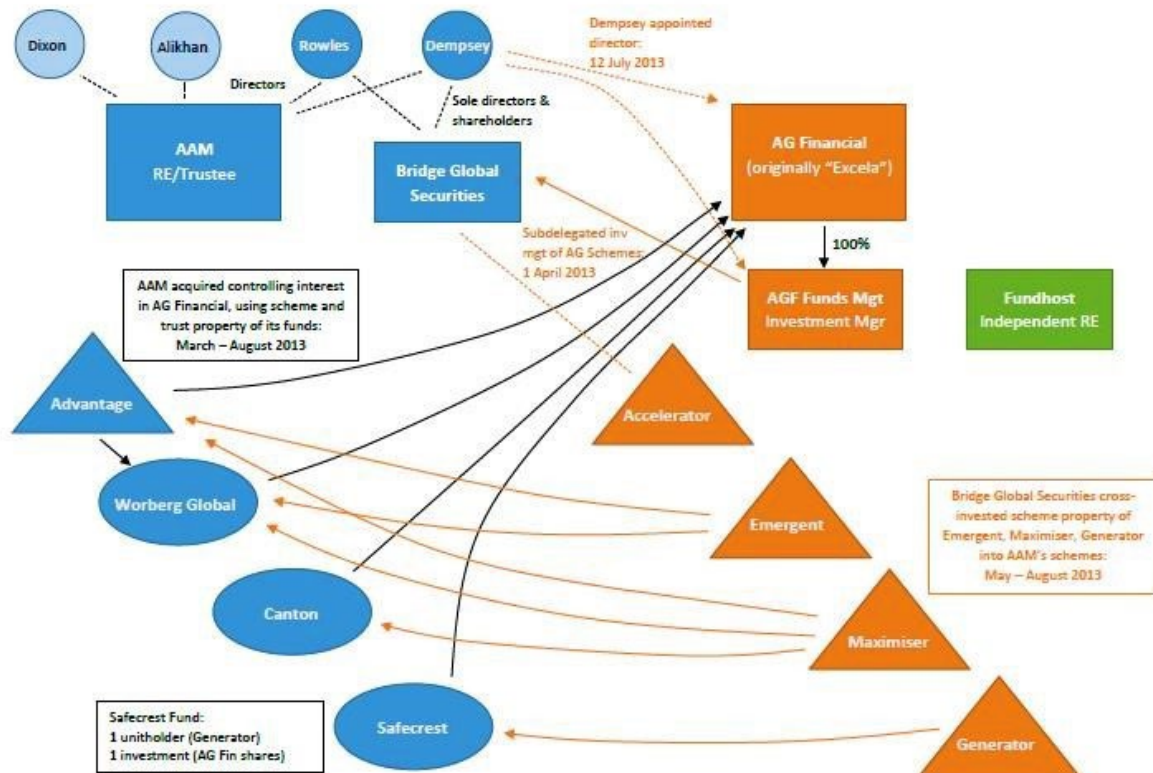
⁶ The Treasury *Review of the Trio Capital Fraud and Assessment of the Regulatory Framework* (Report, 2013).

B. *Figure 4.2 – ARGPF Flow of Monies*⁷



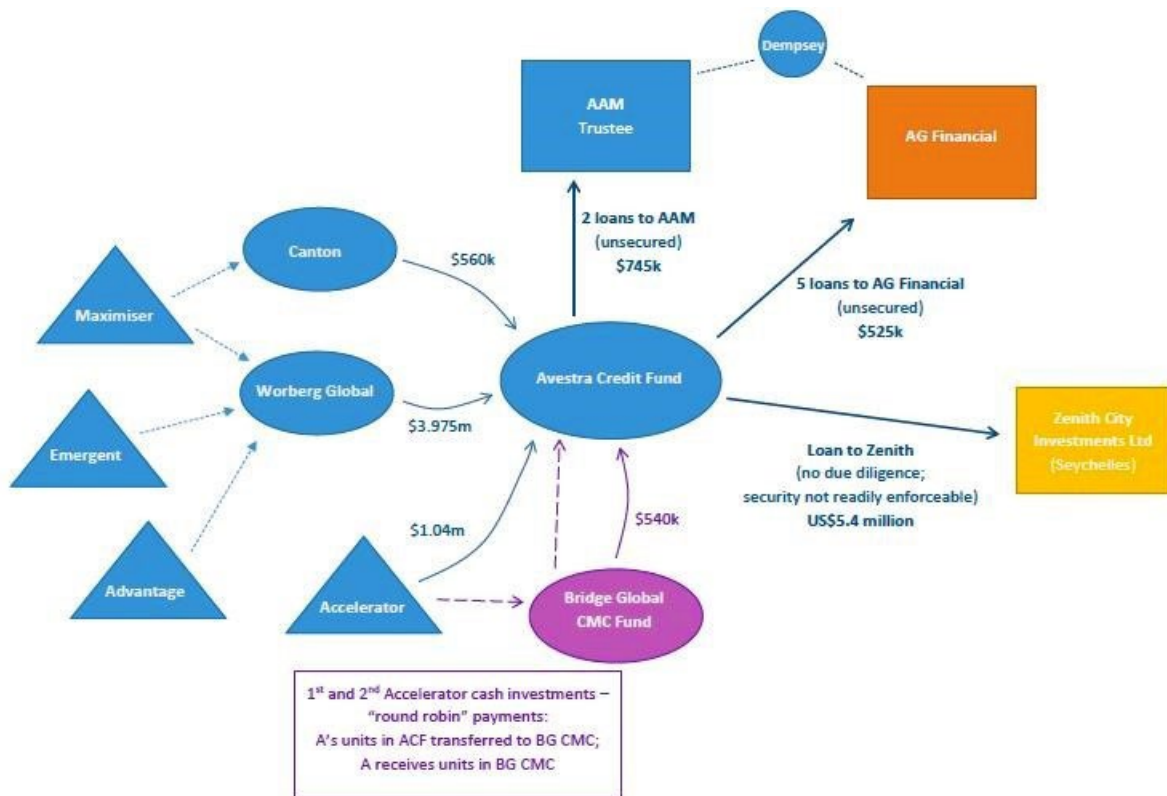
⁷ Ibid.

C. Figure 4.3 - Avestra Asset Management Group Structure⁸



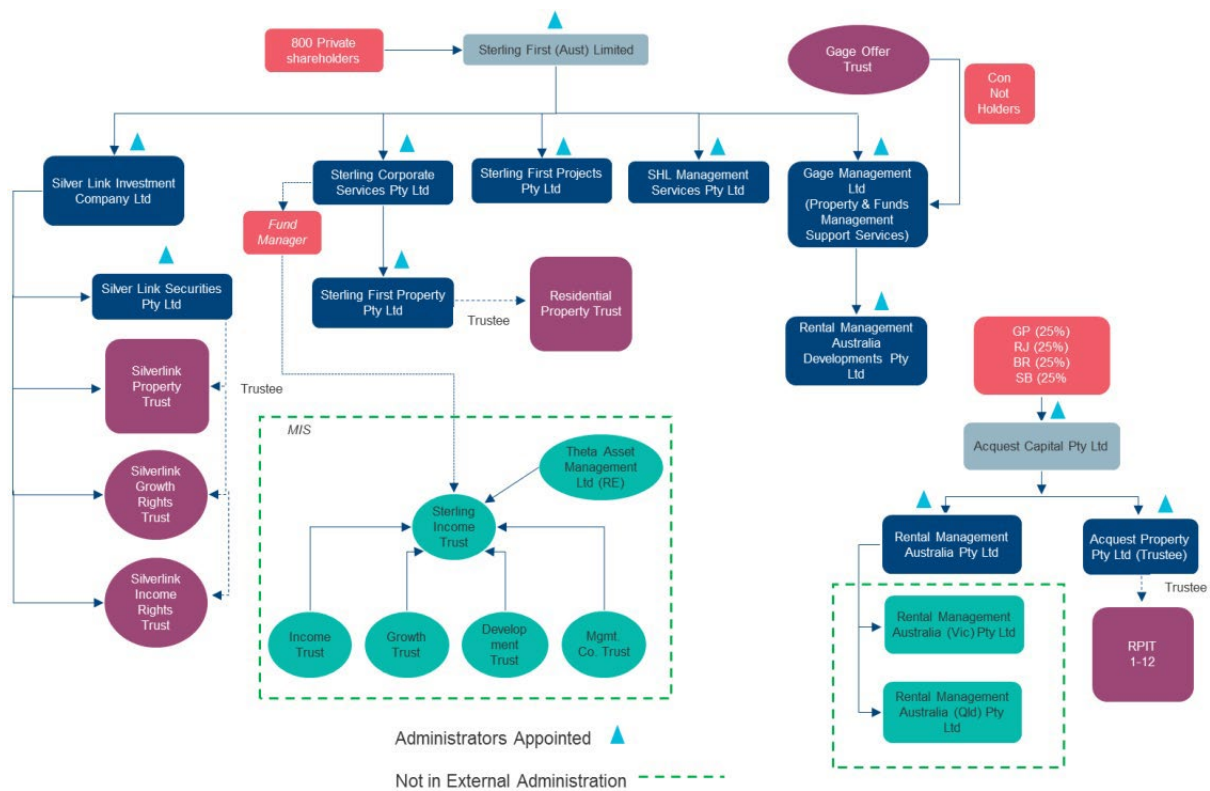
⁸ *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497.

D. *Figure 4.4 - Avestra Credit Fund – Money flows* ⁹



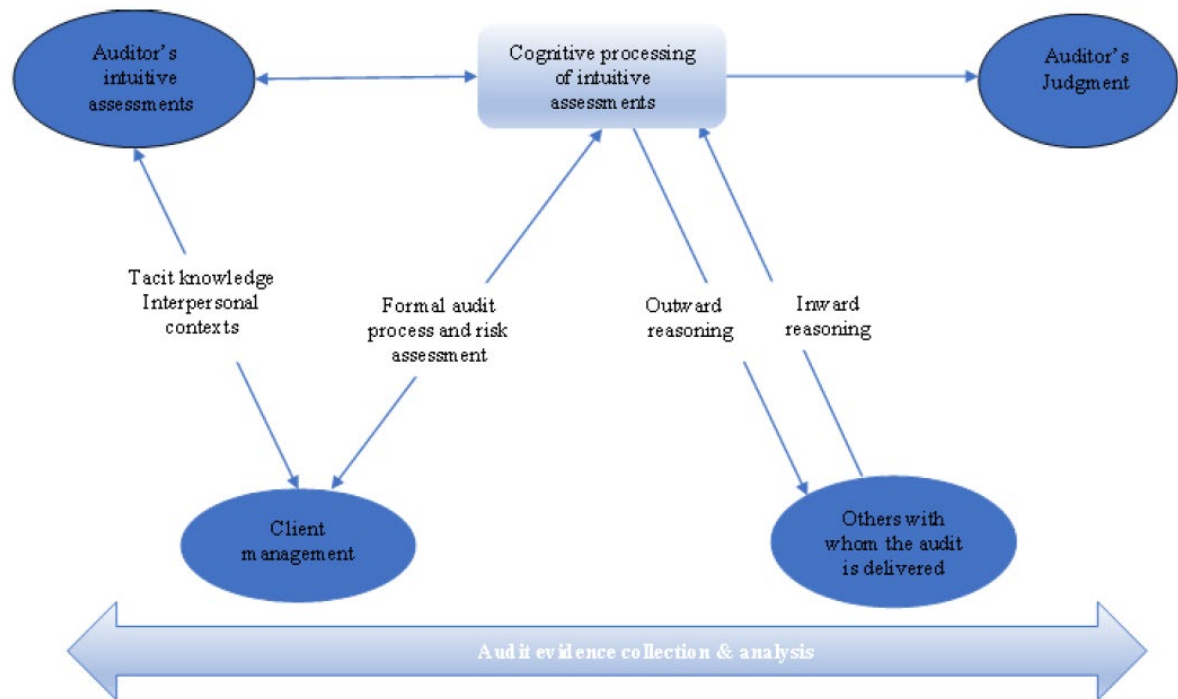
⁹ Ibid.

E. Figure 4.5 - Sterling Group Structure ¹⁰



¹⁰ Ibid, [2.10], Source: Ferrier Hodgson, Sterling First (Aust) Limited (Administrators Appointed) – Voluntary Administrators' Report 30 May 2019, 14.

F. Figure 4.6 – Development of Auditor Professional Scepticism¹¹



¹¹ Yasser Alnafisah, Mouna Hazgui and Anna Samsonova-Taddei "The Gut Instinct Gives You Direction and then You Follow It": Exploring the Social-Intuitive Dimension of Auditor Skepticism' (2024) *Journal of Business Ethics* (Springer Nature, 3 December 2024), 14.

II. Tables

A. Table 4.1 - Comparison of duties of compliance committee members with duties of RE and its officers

Duties	Compliance Committee Member	RE	Officers of RE
Duty to act honestly	s 601JC(1)(a)	s 601FC(1)(a)	s 601FD(1)(a)
Duty to exercise the degree of care and diligence that a reasonable person would exercise if they were in the member's/REs/officer's position	s 601JC(1)(b)	s 601FC(1)(b)	s 601FD(1)(b)
Duty not to make use of information acquired through being a member of the committee/the RE, an officer of the RE in order to gain an improper advantage for the member or another person or cause detriment to the members of the scheme,	s 601JC(1)(c)	s 601FC(1)(e)	s 601FD(1)(d)
Duty not to make improper use of their position as a member of the committee/an officer of the RE to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme	s 601JC(1)(d)	N/A	s 601FD(1)(e)

B. Table 4.2 - Avestra Asset Management's Schemes

AAM-established registered MIS	AAM's wholesale MIS	AG Schemes of which AAM became the RE on 30 June 2014
AAF	Worberg Global Fund	Accelerator Fund
	Canton Fund	Emergent Fund
	Safecrest Fund	Generator Fund
	Avestra Credit Fund	Maximiser Fund

C. *Table 4.3 – Theta Asset Management: Financial and Audit Issues and Compliance Committee Actions*¹²

Date of compliance committee meeting	Financial and Audit Issues
17 July 2013	Asset Manager had recommended change in auditor, but ASIC refused application as there were no exceptional circumstances
16 October, 2013	8 breaches added to register, six of which related to delays in completing and lodging audited accounts for FY 2013
5 February 2014	FY2013 audit for Theta completed and lodged 31/10/2013 FY2013 audit for SIT to be completed
23 April 2014	New position of Finance Manager created to provide assistance and oversight to preparation and ongoing management of the financial statement audits. The new Finance Manager was formerly with the auditing team at the then audit firm. FY2013 audit close to completion – delay blamed on corruption of audit files at the auditor
26 July 2014	FY2013 audit for SIT completed and lodged. Work on half year report commenced and anticipated to be lodged shortly
22 October 2014	half year report lodged. FY2014 audit commenced
11 February 2015	FY2014 audit delayed due to late lodgement and scheduling of the half year audit accounts which were lodged on 10 February 2015
15 April 2015	Interim audited accounts completed and lodged prior to 15 March 2015 due date
28 October 2015	- Breach report that SIT FY2015 financial statements and compliance plan audit were not lodged by 30 September 2015 as required due to technical queries and to late scheduling with the auditor. - Letter of notification sent to ASIC regarding the anticipated late lodgement of the audited financial statements but no response received back from ASIC

¹² Prepared from information contained in the minutes of meeting of the compliance committee and the compliance breach register.

Date of compliance committee meeting	Financial and Audit Issues
17 February 2016	SIT financial statements were delayed and audited accounts only lodged with ASIC on 7 October 2015
27 April 2016	- Breaches added to the register on March 2016 for the delayed SIT interest audit. Not yet completed. Interim audited accounts have not yet been finalised with the auditors. - The fieldwork for SIT has been delayed with extensive queries raised with the audit and technical team of the auditors. The finance manager is working with staff and auditors to complete the audits as soon as possible.
3 August 2016	Delay continues with the fieldwork for SIT with extensive queries raised with the audit and technical team of the auditors. The finance manager is working with staff and auditors to complete the audits as soon as possible.
19 October 2016	- Breach added to breach register for FY2016 SIT statutory reporting. The delay with the interim audit for SIT means that the FY2016 for SIT could not be undertaken. - A breach notification was sent to ASIC prior to 30 September 2016 deadline for lodgement of financial statements. A standard letter from ASIC has been received noting their right to ask for further information from the RE over the delay.
22 February 2017	- Delays continue with the fieldwork for the interim audit of SIT have means that the statutory audit for FY2016 period has not been able to be completed and lodged with ASIC On time. - A breach notification was sent to ASIC notifying them of the delay in the audited accounts. A standard letter from ASIC has been received noting their right to ask for further information from the RE over the delay.
17 May 2017	31 December 2015 and 30 June 2016 audits remain behind schedule. Upcoming IPO will lead to audit finalisation by June 2015. Audit for FY2017 planning meeting scheduled for May 17.
23 August 2017	SIT FY2016 finalised and lodged with ASIC. Fieldwork for SIT half year 31 December 2016 has commenced. Audit for FY2017 yet to commence
18 October 2017	Audit for FY2017 for SIT completed
28 February 2018	Half year audit for FY2017 under way
26 April 2018	Audit for SIT half year 31 December 2017 remains pending completion of audit. A breach notice lodged with ASIC.

Date of compliance committee meeting	Financial and Audit Issues
1 August 2018	• Audit for SIT half year 31 December 2017 remains in progress. A breach notice has been lodged with ASIC. • The managing director (RM) met with ASIC to discuss the SIT audit which ASIC is heavily focusing on as it remains outstanding. ASIC are seeking to understand what is holding up the audit and has arranged for weekly updates from RM until such time as the audit is finalised. The auditors have been requested to attend a conference call with ASIC in the coming week to explain the delay which remains dependant on property valuations and the audit of Sterling First (Aust) Limited. RM noted that ASIC were satisfied with the steps taken to contain any further issues by removing the PDS from use. • DH (seems to be one of the CC members) queried whether the RE had acted in accordance with the compliance plan and queried what action would be taken to remove the Manager of SIT. RM noted that whilst it may be necessary, it was not in the interests of unitholder or the RE at this time to change operations. However, the RE would consider its options to engage directly with Rental Management Australia to manage the rental management rights without Sterling being a party.
On 27 August 2018, the RE commenced the winding up of SIT	
In March 2020 the RE was placed into liquidation	

D. Table 4.4 - Theta Asset Management: how compliance committee dealt with matters regarding court determined breaches

Court determined breaches	How Compliance Committee (CC) dealt with the matters the subject of the breaches
The RE was required to be satisfied that the activities undertaken by each service provider were carried out adequately and KPIs were established for or all relevant service providers to help monitor adherence to service level agreements ¹³	The CC was informed that quarterly reviews for external service providers (ESPs) providing custody, registry and fund accounting were ongoing. The KPI reviews were based on the following criteria: • Fees and expenses • Unit Pricing and valuation • Income and distributions • Applications and redemptions for unit registry services • Custodial • Investment Management. The following meetings of the CC recorded that the following breaches had occurred with ESPs all of which were entered in the breach register by the RE: • 3 August 2016, unit pricing • 19 October 2016, unit pricing • 23 August 2017, distributions • 26 April 2018, unit valuation and pricing (breach also lodged with ASIC) • 1 August 2018, one redemption matter resulting in a complaint. These breaches were rectified according to the breach register. The minutes of 17 May 2017 revealed that the ESP reports were available on Sharepoint which mean the CC members could have accessed these reports if they critically examined whether the RE was in compliance with its obligations under the compliance plan. The minutes of 1 August 2018 recorded that Sterling Corporate Services (SCS) was rated as a poor performer and that the RE was continuing to direct its resources to improve the result but that all other ESPs were rated as good performers and performed in line with expectations. However, this finding was late in the day given the winding up of SIT commenced 26 days later. Apart from the above, the minutes contained a general comment that no issues were identified and/or ESPs performed as expected.

¹³ *Theta* (n 3), [232]-[234], Statement of Agreed Facts (SAF), [234]-[236] (Download from Australian Securities and Investments Commission 'Sterling Income Trust Responsible Entity and its Managing Director penalised' (Media Release 20-292MR, 19 November 2020).

Court determined breaches	How Compliance Committee (CC) dealt with the matters the subject of the breaches
The RE was required maintain a register of related parties, ensure that potential conflicts of interest were disclosed, and all significant, non-standard transactions were subject to prior review by the Board, which was required to obtain external legal advice and/or disclosure details of transactions where necessary.¹⁴	According to the CC minutes this register was maintained by the RE and additions to the register reported to the CC. The minutes of 17 July 2013 record that ASIC had written to the RE indicating that it should include conflicts for its corporate authorised representatives in the register and the reasons why this had no impact. A related party of the RE, Garigal Financial Services was recorded as providing accounting and registry services but that this was being undertaken at an arm's length basis. It was also recorded that RM had been appointed as the sole director of the trustee of a wholly owned sub-trust of the SIT. Otherwise, it was generally reported that all such transactions had received Board approval and were undertaken on an arm's length basis.
The RE was required to ensure that disclosure documents, including any PDS, contained all relevant references to related parties as required by law and/or disclosed the relevant information to unitholders of the fund as appropriate¹⁵.	There is no reference to this requirement in the minutes. The minutes record in general terms that disclosure documents or promotional material were available within Sharepoint (a platform for shared access, interaction, and collaboration) but no specific reference was made to related parties' disclosure in any PDS. However, after the final stop orders were issued by ASIC regarding the PDSs (see above), the minutes of 26 April 2018 record that it had been determined with the REs legal advisors that a supplementary PDS may be required to bring greater clarity to parts of the PDS and that RM was working with the lawyers to determine the appropriate conclusions. Interestingly, it is only at this time that a request was made for the CC to be provided with a product flow chart/diagrammatic elements which the RE agreed to provide. The scheme was not far off failing and yet at this late stage, the CC did not understand key features of the SIT. What were they doing for many years before that time?
The RE was required to identify and document all conflicts of interest which was required to include an assessment and evaluation of each identified conflict and the steps required to ensure it was avoided or managed (¹⁶).	According to the minutes this register was maintained by the RE and additions to the register reported to the CC. Apart from the related party transactions referred to above, no other conflicts were specifically identified in the minutes although on several occasions it was reported that a new conflict had been recorded on the register without any further identification.

¹⁴ *Theta Decision*, [235]-[238], SAF, [237]-[243].

¹⁵ *Theta Decision*, [239]-[241], SAF [237]-[243].

¹⁶ *Theta Decision*, [242]-[244], SAF [244]-[246].

Court determined breaches	How Compliance Committee (CC) dealt with the matters the subject of the breaches
The RE was required to ensure that material released to the public was reviewed and signed off by the Board and the Managing Director prior to release to ensure that the material was accurate and not misleading in any way. ¹⁷	This requirement is not referred to in any of the minutes of the CC. In fact, in the minutes for the meeting of 22 October 2014 it was recorded that the Board had resolved to delegate responsibility for reviewing and signing off of all marketing material to the Sydney compliance team. Material was to be added to the CompliSpace system ¹⁸ to enable reporting to the Board.
The RE was required to use the services of a reputable independent provider to process applications and redemptions and to ensure these were processed in a timely manner. ¹⁹	This requirement is not referred to in any of the minutes of the CC. This is surprising. A competent member of a CC that complies with its duties ought to be fully apprised of the contents of the CC.
The RE was required to use the services of a reputable independent provider to carry out the unit pricing including ensuring that valuations and unit prices were correct and calculated in a timely manner and that any error was reported to the RE in a timely manner. ²⁰	This requirement is not referred to in any of the minutes of the CC. This is surprising. A competent member of a CC that complies with its duties ought to be fully apprised of the contents of the CC.
The RE was required to have a due diligence program with respect to each PDS for the SIT and to verify material statements by reference to source documents maintained in central due diligence files and to ensure that the PDS was accual with no material omissions and subject to an external legal review and sign off. ²¹	This requirement is not referred to in any of the minutes of the CC. However, the breach register (which was provided to the CC) as of 1 August 2018, recorded that a named law firm had produced a possibly defective offer document and information had been sought from that law firm as to the offer document content. ASIC had also requested due diligence material from a person whose name is redacted. However, it is not clear as to whether this related to the SIT or some other scheme.
The RE was required to ensure that all financial statements of the RE and the SIT were completed and available for audit within 2 months of the relevant year. ²²	This problem was reported continuously to the CC over a 4-year period. However, despite the breaches being reported to ASIC by the RE, only a standard form letter was sent back by ASIC who took no action. This may explain the lack of action by the CC.

¹⁷ *Theta Decision*, [245]-[247], SAF [247]-[249].

¹⁸ This is a software programme for assisting organisations that in highly regulated industries to meet their governance, risk and compliance and policy management.

¹⁹ *Theta Decision* (n 3) [251]-[253], SAF [250]-[252].

²⁰ *Theta Decision* [251]-[253], SAF, [253]-[255].

²¹ *Theta Decision*, [254]-256], SAF [256]-[258].

²² *Theta Decision*, [257]-[259], SAF [259]-[261].

E. Table 4.5 - Cases where compliance program orders were made by a court

Regulators	
ASIC	ACCC
<i>Australian Securities and Investments Commission v Superannuation Warehouse Australia Pty Ltd</i> [2015] FCA 1167	<i>Australian Competition & Consumer Commission v Real Estate Institute of Western Australia Inc</i> [1999] FCA 18
<i>Australian Securities and Investments Commission v Westpac Banking Corp (No 3)</i> [2018] FCA 170	<i>Australian Competition and Consumer Commission v Terania Pty Ltd</i> [2008] FCA 732
<i>Australian Securities and Investments Commission v Port Philip Publishing Pty Ltd</i> [2019] FCA 1483	<i>Australian Competition & Consumer Commission v Renegade Gas Pty Ltd (trading as Supagas NSW)</i> [2014] FCA 1135
<i>Australian Securities & Investments Commission v AMP Financial Planning Pty Ltd (No 2)</i> [2020] FCA 69	<i>Australian Competition and Consumer Commission v Multimedia International Services Pty Ltd</i> [2016] FCA 439
<i>Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd</i> [2022] FCA 1105	<i>Australian Competition and Consumer Commission v Ozsale Pty Limited</i> [2016] FCA 1049
<i>Australian Securities and Investments Commission v Commonwealth Securities Limited</i> [2022] FCA 1253	<i>Australian Competition and Consumer Commission v Pental Limited</i> [2018] FCA 491.
<i>Australian Securities and Investments Commission v Westpac Banking Corporation (Penalty Hearing)</i> [2024] FCA 52	<i>Australian Competition and Consumer Commission v Oticon Australia Pty Limited</i> [2018] FCA 1826
<i>Australian Securities and Investments Commission v Lanterne Fund Services Pty Limited</i> [2024] FCA 353	<i>Australian Competition and Consumer Commission v Bupa Aged Care Australia Pty Ltd</i> [2020] FCA 602
	<i>Australian Competition and Consumer Commission v viagogo AG (No 3)</i> [2020] FCA 1423
	<i>Australian Competition and Consumer Commission v Sumo Power Pty Ltd</i> [2021] FCA 712
	<i>Australian Competition and Consumer Commission v Booktopia Pty Ltd</i> [2023] FCA 194

Regulators	
ASIC	ACCC
	<i>Australian Competition and Consumer Commission v Techtronic Industries Australia Pty Ltd</i> [2023] FCA 1574
	<i>Australian Competition and Consumer Commission v Meg's Flowers Pty Ltd</i> [2024] FCA 1435.

Appendix 5 – Related Party Transactions

A. Table 5.1 - Bespoke RPT provisions for registered MIS

Part 5C.7 Related Party Transactions

Division 1 – Need for member approval

Section 601LA Chapter 2E applies with modifications

Repealed

Section 601LB – Purpose of Chapter 5C.7

The rules in this Chapter are designed to protect the interests of the scheme's members as a whole, by requiring member approval for giving financial benefits to the responsible entity or its related parties that come out of scheme property or that could endanger those interests.

Section 601LC – Need for member approval for financial benefit

(1) If all the following conditions are satisfied in relation to a financial benefit:

- (a) the benefit is given by:
 - (i) the responsible entity of a registered scheme, or
 - (ii) an entity that the responsible entity controls, or
 - (iii) an agent of, or person engaged by, the responsible entity,(Giver Limb)
- (b) the benefit either:
 - (i) is given out of the scheme property, or
 - (ii) could endanger the scheme property
- (c) the benefit is given to:
 - (i) the Giver of the benefit, or
 - (ii) the responsible entity, or
 - (iii) an entity that the responsible entity controls, or
 - (iv) an agent of, or person engaged by, the responsible entity, or

- (v) a related party of any of the persons referred to in (i) to (iv) ⁽¹⁾,
(Recipient Limb),

then for the person referred to in the Giver Limb to give the benefit either:

- (b) the person referred to in the Giver Limb must:
 - (i) obtain the approval of the scheme's members in the way set out in sections 601LCG to 601LCP and
 - (ii) give the benefit within 15 months after the approval or the giving of the benefit must fall within an exception set out in sections 601LCB to 601LCF, or
- (c) the giving of the benefit must fall within an exception set out in sections 601LCB to 601LCF.

(1) If:

- (a) the giving of the benefit is required by a contract; and
- (b) the making of the contract was approved in accordance with subparagraph (1)(d)(i) as a financial benefit given to the entity or related party; and
- (c) the contract was made:
 - (i) within 15 months after that approval; or
 - (ii) before that approval, if the contract was conditional on the approval being obtained;

member approval for the giving of the benefit is taken to have been given, and the benefit need not be given within the 15 months.

- (2) Subsection (1) does not prevent the responsible entity from paying itself fees and exercising rights to an indemnity, as provided for in the scheme's constitution under subsection 601GA(2).

Section 601LCA - Consequences of breach

- (1) If the responsible entity or entity contravenes section 601LC:
 - (a) the contravention does not affect the validity of any contract or transaction connected with the giving of the benefit; and
 - (b) the responsible entity or entity is not guilty of an offence.

Note: A Court may order an injunction to stop the responsible entity or entity giving the benefit to the related party (see section 1324).

- (2) A person contravenes this subsection if they are involved in a contravention of section 601LC by a responsible entity or entity.

Note 1: This subsection is a civil penalty provision.

¹ *Avestra* (n 58), [167].

Note 2: Section 79 defines *involved*.

Note 3: This section has an extended operation in relation to a retail CCIV: see section 1227A.

- (3) A person commits an offence if they are involved in a contravention of section 601LC by a responsible entity or entity and the involvement is dishonest.

Division 2 – Exceptions to the requirement for member approval

Section 601LCB - Arm's length terms

Member approval is not needed to give a financial benefit on terms that:

- (a) would be reasonable in the circumstances if the responsible entity or entity and the related party were dealing at arm's length; or
- (b) are less favourable to the related party than the terms referred to in paragraph (a).

Section 601LCC – Remuneration and reimbursement for officer or employee

Benefits that are reasonable remuneration

- (1) Member approval is not needed to give a financial benefit if:
- (a) the benefit is remuneration to a related party as an officer or employee of the following:
 - (i) the responsible entity;
 - (ii) an entity that the responsible entity controls;
 - (iii) an entity that controls the responsible entity;
 - (iv) an entity that is controlled by an entity that controls the responsible entity; and
 - (b) to give the remuneration would be reasonable given:
 - (i) the circumstances of the responsible entity or entity giving the remuneration; and
 - (ii) the related party's circumstances (including the responsibilities involved in the office or employment).

Benefits that are payments of expenses incurred

- (2) Member approval is not needed to give a financial benefit if:
- (a) the benefit is payment of expenses incurred or to be incurred, or reimbursement for expenses incurred, by a related party in performing duties as an officer or employee of the following:
 - (i) the responsible entity;
 - (ii) an entity that the responsible entity controls;

- (iii) an entity that controls the responsible entity;
 - (iv) an entity that is controlled by an entity that controls the responsible entity; and
 - (b) to give the benefit would be reasonable in the circumstances of the responsible entity or entity giving the remuneration.
- (3) For the purposes of this section:
- (a) a contribution made by a body corporate to a fund or scheme for the purposes of making provision for, or obtaining, superannuation benefits (including defined benefits) for an officer of the body, or for dependants of an officer of the body, is remuneration provided by the body to the officer of the body; and
 - (b) a financial benefit given to a person because of the person ceasing to hold an office or employment as an officer or employee of a body corporate is remuneration paid or provided to the person in a capacity as an officer of the body.

Section 601LCD – Indemnities, exemptions, insurance premiums and payment for legal costs for officers

Indemnities, exemptions and insurance premiums

- (1) Member approval is not needed to give a financial benefit if:
- (a) the benefit is for a related party who is an officer of the responsible entity or entity; and
 - (b) the benefit is:
 - (i) an indemnity, exemption or insurance premium in respect of a liability incurred as an officer of the responsible entity or entity; or
 - (ii) an agreement to give an indemnity or exemption, or to pay an insurance premium, of that kind; and
 - (c) to give the benefit would be reasonable in the circumstances of the responsible entity or entity giving the benefit.

Note: Sections 99A to 199C may prohibit giving an indemnity or exemption or paying an insurance premium for an officer.

Payments in respect of legal costs

- (2) Member approval is not needed to give a financial benefit if:
- (a) the benefit is for a related party who is an officer of the responsible entity or entity; and
 - (b) the benefit is the making of, or an agreement to make, a payment (whether by way of advance, loan or otherwise) in respect of legal costs incurred by the officer in defending an action for a liability incurred as an officer of the responsible entity or entity; and
 - (c) either:

- (i) section 199A does not apply to the costs; or
 - (ii) if section 199A applies to the costs--the officer must repay the amount paid if the costs become costs for which the company must not give the officer an indemnity under that section; and
 - (d) to give the benefit would be reasonable in the circumstances of the responsible entity or entity giving the benefit.
- (3) In working out for the purposes of subsection (1) or (2) whether giving the benefit is reasonable in the circumstances:
- (a) assess whether it would be reasonable on the basis of the circumstances existing:
 - (i) if the benefit is given under an agreement--at the time when the agreement is or was made; or
 - (ii) if the benefit is not given under an agreement--at the time when the benefit is or was given; and
 - (b) disregard any other financial benefit given or payable to the officer by the responsible entity or entity.

Section 601LCE – Benefits to members that do not discriminate unfairly

Member approval is not needed to give a financial benefit if:

- (a) the benefit is given to the related party in their capacity as a member of the scheme; and
- (b) giving the benefit does not discriminate unfairly against the other members of the scheme.

Section 601LCF – Court order

Member approval is not needed to give a financial benefit under an order of the court.

Division 3 – Procedure for obtaining member approval

Section 601LCG - Resolution may specify matters by class or kind

A resolution under this Division may specify anything either in particular or by reference to class or kind.

Section 601LCH - Company must lodge material that will be put to members with ASIC

- (1) At least 14 days before the notice convening the relevant meeting is given, the responsible entity must lodge:
 - (a) a proposed notice of meeting setting out the text of the proposed resolution; and
 - (b) a proposed explanatory statement satisfying section 601LCJ; and
 - (c) any other document that is proposed to accompany the notice convening the meeting and that relates to the proposed resolution; and

- (d) any other document that any of the following proposes to give to members of the scheme before or at the meeting:
 - (i) the responsible entity;
 - (ii) a related party of the responsible entity to whom the proposed resolution would permit a financial benefit to be given;
 - (iii) an associate of the responsible entity or of such a related party;and can reasonably be expected to be material to a member in deciding how to vote on the proposed resolution.

(2) If, when the notice convening the meeting is given, ASIC:

- (a) has approved in writing a period of less than 14 days for the purposes of subsection (1); and
- (b) has not revoked the approval by written notice to the responsible entity;

subsection (1) applies as if the reference to 14 days were a reference to the approved period.

(3) ASIC may give and revoke approvals for the purposes of subsection (2).

Section 601LCI – Requirements for explanatory statement to members

(1) The proposed explanatory statement lodged under section 218 must be in writing and set out:

- (a) the related parties to whom the proposed resolution would permit financial benefits to be given; and
- (b) the nature of the financial benefits; and
- (c) in relation to each director of the responsible entity:
 - (i) if the director wanted to make a recommendation to members of the scheme about the proposed resolution--the recommendation and his or her reasons for it; or
 - (ii) if not--why not; or
 - (iii) if the director was not available to consider the proposed resolution--why not; and
- (d) in relation to each such director:
 - (i) whether the director had an interest in the outcome of the proposed resolution; and
 - (ii) if so--what it was; and
- (e) all other information that:

- (i) is reasonably required by members of the scheme in order to decide whether or not it is in the responsible entity's interests to pass the proposed resolution; and
 - (ii) is known to the responsible entity or to any of its directors.
- (2) An example of the kind of information referred to in paragraph (1)(e) is information about what, from an economic and commercial point of view, are the true potential costs and detriments of, or resulting from, giving financial benefits as permitted by the proposed resolution, including (without limitation):
 - (a) opportunity costs; and
 - (b) taxation consequences (such as liability to fringe benefits tax); and
 - (c) benefits forgone by whoever would give the benefits.

Note: Sections 180 and 181 require an officer of a corporation to act honestly and to exercise care and diligence. These duties extend to preparing an explanatory statement under this section. Section 1309 creates offences where false and misleading material relating to a corporation's affairs is made available or furnished to members.

Section 601LCJ - ASIC may comment on proposed resolution

- (1) Within 14 days after a responsible entity lodges documents under section 601LCH, ASIC may give to the responsible entity written comments on those documents (other than comments about whether the proposed resolution is in the best interests of the scheme members).
- (2) If the responsible entity is listed, ASIC may consult with the relevant market operator for the purposes of giving comments to the responsible entity.
- (3) Subsection (2) does not limit the persons with whom ASIC may consult.
- (4) ASIC must keep a copy of the written comments it gives to a responsible entity under subsection (1), and subsections 1274(2) and (5) apply to the copy as if it were a document lodged with ASIC.
- (5) The fact that ASIC has given particular comments, or has declined to give comments, under subsection (1) does not in any way affect the performance or exercise of any of ASIC's functions and powers.

Section 601LCK - Requirements for notice of meeting

The notice convening the meeting:

- (a) must be the same, in all material respects, as the proposed notice lodged under section 601LCH; and
- (b) must be accompanied by an explanatory statement that is the same, in all material respects, as the proposed explanatory statement lodged under that section; and
- (c) must be accompanied by a document that is, or documents that are, the same, in all material respects, as the document or documents (if any) lodged under paragraph 601LCH(1)(c); and

- (d) if ASIC has given to the responsible entity, under section 601LCJ, comments on the documents lodged under section 601LCH--must be accompanied by a copy of those comments; and
- (e) must not be accompanied by any other documents.

Section 601LCL - Other material put to members

Each document (if any) that:

- (a) did not accompany the notice convening the meeting; and
- (b) was given to members of the scheme before or at the meeting by:
 - (i) the responsible entity; or
 - (ii) a related party of the responsible entity to whom the proposed resolution would permit a financial benefit to be given; or
 - (iii) an associate of the responsible entity or of such a related party; and
- (c) can reasonably be expected to have been material to a member in deciding how to vote on the proposed resolution;

must be the same, in all material respects, as a document lodged under paragraph 601LCH(1)(d).

Section 601LCM - Proposed resolution cannot be varied

The resolution must be the same as the proposed resolution set out in the proposed notice lodged under section 601LCH.

Section 601LCN – Voting on resolution

- (1) If any votes on the resolution are cast in contravention of subsection 253E, it must be the case that the resolution would still be passed even if those votes were disregarded.
- (2) If a poll was duly demanded on the question that the resolution be passed, subsections (3) and (4) apply in relation to voting on the poll.
- (3) In relation to each member of the scheme who voted on the resolution in person, the responsible entity must record in writing:
 - (a) the member's name; and
 - (b) how many votes the member cast for the resolution and how many against.
- (4) In relation to each member of the scheme who voted on the resolution by proxy, or by a representative authorised under section 250D, the responsible entity must record in writing:
 - (a) the member's name; and
 - (b) in relation to each person who voted as proxy, or as such a representative, for the member:
 - (i) the person's name; and

- (ii) how many votes the person cast on the resolution as proxy, or as such a representative, for the member; and
 - (iii) how many of those votes the person cast for the resolution and how many against.
- (5) For 7 years after the day when a resolution under this Division is passed, the responsible entity must retain the records it made under this section in relation to the resolution.
- (6) An offence based on subsection (3), (4) or (5) is an offence of strict liability.

Note: For *strict liability*, see section 6.1 of the Criminal Code .

Section 601LCO - Notice of resolution to be lodged

The responsible entity must lodge a notice setting out the text of the resolution within 14 days after the resolution is passed.

Section 601LCP - Declaration by court of substantial compliance

- (1) The Court may declare that the conditions prescribed by this Division have been satisfied if it finds that they have been substantially satisfied.
- (2) A declaration may be made only on the application of an interested person.

Section 601 LCQ - Related parties

Controlling entities

- (1) An entity that controls a responsible entity is a related party of the responsible entity.

Directors and their spouses

- (2) The following persons are related parties of a responsible entity:
 - (a) directors of the responsible entity;
 - (b) directors (if any) of an entity that controls the responsible entity;
 - (c) if the responsible entity is controlled by an entity that is not a body corporate--each of the persons making up the controlling entity;
 - (d) spouses of the persons referred to in paragraphs (a), (b) and (c).

Relatives of directors and spouses

- (3) The following relatives of persons referred to in subsection (2) are related parties of the responsible entity:
 - (a) parents;
 - (b) children.

Entities controlled by other related parties

- (4) An entity controlled by a related party referred to in subsection (1), (2) or (3) is a related party of the responsible entity unless the entity is also controlled by the responsible entity.

Related party in previous 6 months

- (5) An entity is a related party of a responsible entity at a particular time if the entity was a related party of the responsible entity of a kind referred to in subsection (1), (2), (3) or (4) at any time within the previous 6 months.

Entity has reasonable grounds to believe it will become related party in future

- (6) An entity is a related party of a responsible entity at a particular time if the entity believes or has reasonable grounds to believe that it is likely to become a related party of the responsible entity of a kind referred to in subsection (1), (2), (3) or (4) at any time in the future.

Acting in concert with related party

- (7) An entity is a related party of a responsible entity if the entity acts in concert with a related party of the responsible entity on the understanding that the related party will receive a financial benefit if the responsible entity gives the entity a financial benefit.

Section 601LCR - giving a financial benefit

- (1) In determining whether a financial benefit is given for the purposes of this Act:
- (a) give a broad interpretation to financial benefits being given, even if criminal or civil penalties may be involved; and
 - (b) the economic and commercial substance of conduct is to prevail over its legal form; and
 - (c) disregard any consideration that is or may be given for the benefit, even if the consideration is adequate.
- (2) Giving a financial benefit includes the following:
- (a) giving a financial benefit indirectly, for example, through one or more interposed entities;
 - (b) giving a financial benefit by making an informal agreement, oral agreement or an agreement that has no binding force;
 - (c) giving a financial benefit that does not involve paying money (for example by conferring a financial advantage).
- (3) The following are examples of a financial benefit being given to or received by a responsible entity or related party:
- (a) giving or providing the finance or property to the responsible entity or related party;
 - (b) buying an asset from or selling an asset to the responsible entity or related party;
 - (c) leasing an asset from or to the responsible entity or related party;
 - (d) supplying services to or receiving services from the responsible entity or related party;
 - (e) issuing securities or granting an option to the responsible entity or related party;
 - (f) taking up or releasing an obligation of the responsible entity or related party.

Section 601LCS – General duties still apply

A director is not relieved from any of their duties under this Act (including sections 180 and 184), or their fiduciary duties, in connection with a transaction merely because the transaction is authorised by a provision of this Chapter or is approved by a resolution of the members of the scheme under a provision of this Chapter.

Section 601LD – Omission of section 213, 214 and 224

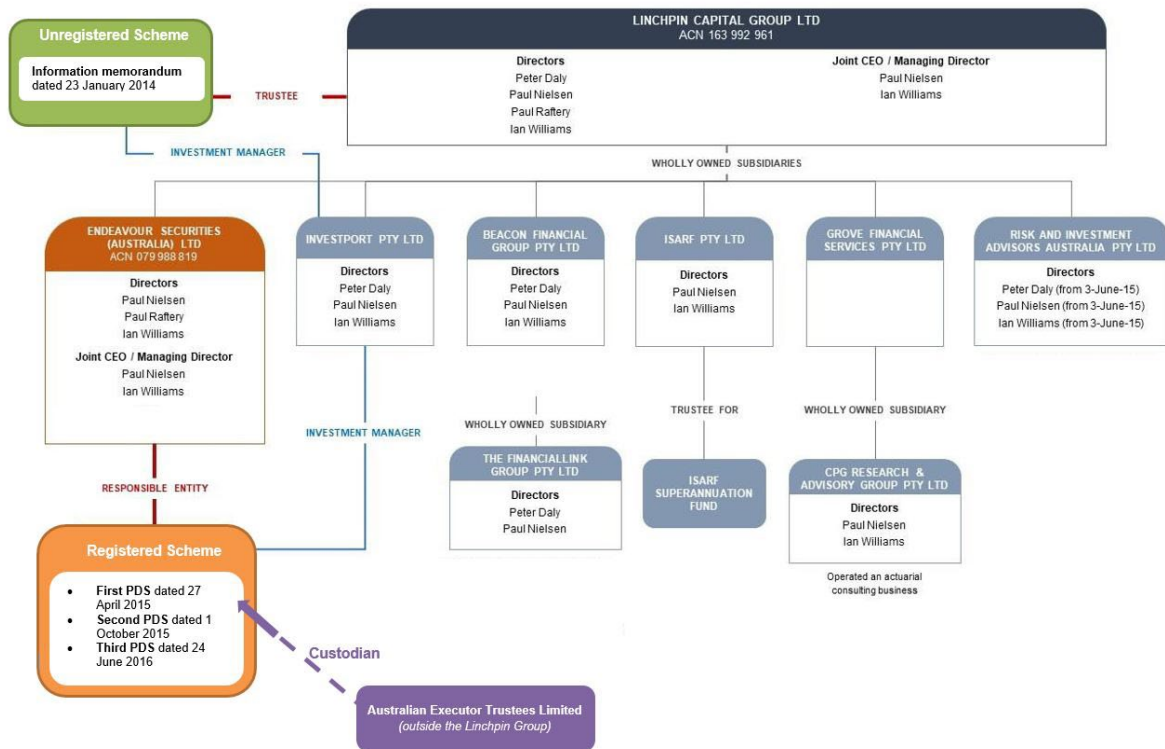
Repealed.

Section 601LE Modification of section 225

Repealed.

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B. Table 5.2 – Corporate Structure of Linchpin Capital Group Ltd and the two MIS¹



¹ Annexure A to the judgement in *Australian Securities and Investments Commission v Daly (Liability Hearing)* [2023] FCA 290.

C. Table 5.3 – Survey Responses for RPTs

Survey Question	Answer	Percentage of Respondents
Does your organisation make full disclosure of related party transactions to members of the scheme which it operates even if it is at arm's length?	Yes	92.6%
	No	7.4% ¹
When assessing whether a meeting of members is required to approve a related party transaction does your organisation:	obtain an external valuation?	36.0%
	obtain an external sign off by legal firm?	68.0%
	obtain an external sign off by an auditor?	4.0%
	make its own assessment?	32.0%
	ignore the issue?	0.0% ²

¹ Survey Results, Q59, page 444.

² Ibid, Q60, page 445.

Appendix 6 - Solvent Schemes

A. Table 6.1 –Failed Agribusiness Schemes¹

Date	Name	Amount Raised (\$million)	No of MIS	No of Investors
April 2010	FEA Plantations	426 ²	17	13,000
May 2010	Great Southern	2,000	43	43,000
September 2012	Gunns	600	16	49,000
February 2008	Palandri	155	5	3,200
May 2010	Rewards Group	250	43	8,400
April 2009	Timbercorp	1,100	34	18,000
September 2010	Wilmott Forests	400	14	8,000

B. Table 6.2 – Estimated Scheme Losses

Date	Responsible Entity	Scheme(s)	Investor Losses (\$million)
2008	MFS Investment Management Ltd	Premium Income Fund	143.5 ³
2008	Primary Yield Agricultural Investments Ltd (formerly Environinvest)	Various agribusiness schemes	70 ⁴
2008/2009	Allco and Babcock & Brown	Several Listed Funds	4,400 ⁵
2009	Great Southern Projects	43 Schemes	4,000 ⁶

¹ Kevin Davis and Henry Herkes 'Agribusiness MIS Failures: Policy lessons from the Quintis failure' (2019) 31(7) *Company & Securities Law Journal* 1, 3, said to be sourced from <https://www.ato.gov.au/uploadedFiles/Content/ATP/downloads/GEN_ATP_21849_TAS.xls> (viewed 1 June 2018), scheme websites and media reports.

² Senate Economics Reference Committee 'Agribusiness managed investment schemes - Bitter harvest March 2016' (Report, 2016), [2.39]

³ Australian Securities and Investments Commission 'MFS executives found to have dishonestly breached duties' (Media Release 16-158MR, Australian Securities and Investments Commission, 23 May 2016).

⁴ Mike Taylor 'Investors out of pocket as MIS is place in liquidation' *Money Management* (14 November 2008).

⁵ Tony D'Aloisio 'Regulatory issues arising from the financial crisis for ASIC and for market participants' (Speech, Securities & Derivatives Industry Association 12th Annual Conference, 29 May 2009), 4-5

⁶ 'Managed investment schemes face uncertain future' *ABC Premium News* (Sydney 19 May 2009).

Date	Responsible Entity	Scheme(s)	Investor Losses (\$million)
2009	Trio Capital Ltd	Astarra Strategic Fund and ARP Growth Fund	176 ⁷
2009	City Pacific Ltd ⁸	Pacific First Mortgage Fund	514 ⁹
2010	Prime Trust	Prime Retirement and Aged Care Property Trust	550 ¹⁰
2013	LM Investment Management Ltd	LM First Mortgage Income Fund	394.39 ¹¹
2019	Theta Asset Management Ltd	Sterling Income Trust	16.71 ¹²
2024	Keystone Asset Management Ltd	Shield Master Fund	Estimated between 270 and 255 ¹³
2024	Falcon Capital Ltd	First Guardian Fund	446 ¹⁴

⁷ Parliamentary Joint Committee on Corporations and Financial Services '*Inquiry into the collapse of Trio Capital May 2012*' (Report 2012), [9.1].

⁸ City Pacific Ltd was removed as responsible entity of the Pacific First Mortgage Fund and replaced by Trio Capital Management Ltd on 25 June 2009: *Trilogy Funds Management Limited v Sullivan* [2013] FCA 185, [6].

⁹ Mike Taylor 'Unit holders in the Pacific First Mortgage Fund have received a rude shock, with a confirmation from Balmain Trilogy Group that the gross assets of the fund have been written down to the tune of \$448.9 million for the year to 30 June' *Money Management Newsletter* (19 November 2009).

¹⁰ 'High Court decision on Prime Trust directors' (Media Release 18-366MR, 4 December 2018); Kevin Davis '*Financial Institution Failures: An Australian Perspective*' in Kevin Davis '*Bank and Financial Institution Management in Australia*' (e-book www.kevindavis.com.au, February 2023), 6.

¹¹ Affidavit of David Whyte of 9 April 2024 filed in proceedings *Bruce v LM Investment Management Limited No. 3383 of 2013* paragraph [145] indicates a total distribution to unitholders will be 19.86 cents in the dollar and the financial statements for the 6 months ended 31 December 2023 of the LMMIF shows 492,125,624 units on issue; LM Investment Management operated 7 registered MIS in total which together, including the LMMIF, 12,000 investors lost most of the \$800m invested: Davis (n 10), 6.

¹² *Australian Securities and Investments Commission v Theta Asset Management Limited* [2020] FCA 1894, [296]-[297]

¹³ Laura Dew 'How much could investors recover from Shield Master Fund?' *Money Management* (6 December 2024).

¹⁴ Hanan Dervisevic 'First Guardian investors may lose their super. Should you be worried about yours?' *ABC News* (11 July 2021).

Date	Responsible Entity	Scheme(s)	Investor Losses (\$million)
2024	ISG Financial Services Limited	ISG Private Access Fund, ISG Real Estate Equity Fund	145 ¹⁵
2025	Australian Fiduciaries Limited	Global Diversified Alpha Fund, Global Multi-Strategy Fund Global All Seasons Fund.	TBD ¹⁶

¹⁵ Australian Securities and Investments Commission 'Supreme Court orders ISG Financial to wind up its registered managed investment schemes' (Media Release 24-200MR, 3 October 2024).

¹⁶ Australian Securities and Investments Commission 'ASIC takes steps to appoint receivers to Australian Fiduciaries Ltd as investigation continues' (Media Release 25-104 16 June 2025).

Appendix 7 - Disclosure Rules

A. Table 7.1: Sample Target Market Determination

TARGET MARKET DETERMINATION **XYZ Mortgage Fund** **ARSN 111 222 333**

ABOUT THIS DOCUMENT

This Target Market Determination (TMD) is required to be provided pursuant to section 994B of the *Corporations Act 2001* (Cth) (the Act). The TMD seeks to offer consumers, distributors and staff with an understanding of the class of consumers for which this product has been designed, having regard to the objectives, financial situation and needs of the target market.

This document is not a Product Disclosure Statement (PDS) and does not provide a summary of the product's terms and conditions. It does not take into account any person's individual objectives, financial situation or needs and does not provide financial advice. Persons interested in investing in this product should refer to the PDS for the XYZ Mortgage Fund and any supplementary documents which provide the relevant terms and conditions for the XYZ Mortgage Fund before making a decision about this product.

TMD APPLICATION

Fund	XYZ Mortgage Fund
Fund ARSN	111 222 333
Issuer & Responsible Entity	XYZ Mortgage Managers Limited
Issuer ABN	98 111 222 333
Issuer AFSL	1111111
Date Approved	30/06/2025
TMD version	1

TARGET MARKET SUMMARY

This product is likely to be appropriate for a consumer seeking monthly income and capital preservation to be used as a small allocation of their portfolio where the consumer has a medium investment time frame, a medium risk/return profile and needs medium term access to capital.

DESCRIPTION OF TARGET MARKET

Note: This section is required under section 994B(5)(b) of the Act.

TMD Indicator Key

The Consumer Attributes for which the product is likely to be appropriate have been assessed using a red/amber/green rating methodology with appropriate colour coding:

In target market	Potentially in target market	Not considered in target market

Consumers are unlikely to be within the target market for this product if:

- one or more of their Consumer Attributes correspond to a **red rating**; or
- three or more of their Consumer Attributes correspond to an **amber rating**.

Consumer Attributes	TMD Indicator	Product Description Including Key Attributes
Consumer's investment objective		
Capital Growth	Not considered in target market	The Fund does not provide for capital growth. Capital losses can occur in circumstances where an asset of the Fund incurs a capital loss. Therefore, it is higher risk and more volatile than cash or fixed income securities. The Fund is designed to source loans secured by registered first mortgages held over Australian real estate to generate consistent and regular income returns as well as capital stability where the total amount of interest payable over the duration of the first mortgage is paid upfront. The Fund aims to provide investors with a monthly distribution based on the net returns from the loans, cash, and any other investments held by the Fund.
Capital Preservation	Potentially in target market	
Capital Guaranteed	Not considered in target market	
Income Distribution	In target market	

Consumer Attributes	TMD Indicator	Product Description Including Key Attributes
Consumer's intended product use (% of Investable Assets)		
Solution/Standalone (75-100%)	Not considered in target market	The Fund offers exposure to a portfolio of loans secured by registered first mortgages over real property comprising a mix of office, retail, residential (where the borrower is a company) hotels/pubs, specialist property such as child care, aged care, construction/development, rural and vacant land. At present, the Fund's loans are geographically concentrated in South Australia with a single loan or single borrower may exceed 17% of the Fund's assets. Accordingly, the Fund's portfolio diversification is Low (see diversification definitions below).
Core Component (25-75%)	Not considered in target market	
Satellite/small allocation (<25%)	In target market	
Consumer's investment timeframe		
Short (≤ 2 years)	Not considered in target market	The Fund invests in first mortgages for a maximum term of 24 months. The Fund is considered an illiquid investment within the meaning of the Act. The minimum suggested timeframe for holding an investment in the Fund is two years.
Medium (> 2 years)	In target market	
Long (> 5 years)	In target market	
Consumer's Risk (ability to bear loss) and Return profile		
Low	Not considered in target market	The Fund aims to provide monthly income distributions to investors while maintaining a unit price of \$1.00 per unit. However, the returns from the Fund are not guaranteed and the Fund is illiquid.
Medium	In target market	
High	In target market	
Very High	In target market	

Consumer Attributes	TMD Indicator	Product Description Including Key Attributes
Consumer's need to withdraw money		
Daily	Not considered in target market	Investments in the Fund are illiquid. There is no established external secondary market for the sale of units in the Fund. However, investors may arrange for their own private sale of units with the approval of the Issuer. There is no right for investors to require their units to be purchased either by the Issuer or by any other person, or to have their units redeemed.
Weekly	Not considered in target market	
Monthly	Not considered in target market	
Quarterly	Not considered in target market	
Annually or longer	Potentially in target market	

APPROPRIATENESS

Note: This section is required under RG 274.64–66.

The Issuer has assessed the product and formed the view that the product, including its key attributes, is likely to be consistent with the likely objectives, financial situation and needs of consumers in the target market as described above, as the features of this product in Column 3 of the table above are likely to be suitable for consumers with the attributes identified with a green TMD Indicator in Column 2.

DISTRIBUTION CONDITIONS/RESTRICTIONS

Note: This section is required under section 994B(5)(c) of the Act.

Distribution Condition	Distribution Condition Rationale
Only suitable for distribution through specified distributor – ABC Capital Holdings Pty Ltd	The Issuer considers that the distribution conditions will make it more likely that the investors who acquire the Fund are in the target market.

Review Triggers

Note: This section is required under section 994B(5)(d) of the Act

Material change to key attributes, fund investment objective and/or fees.

Material deviation from benchmark / objective over sustained period.

Change in the Application Price or, when available. Withdrawal Price for Units from \$1.00 per Unit.

Key attributes have not performed as disclosed by a material degree and for a material period.

Determination by the issuer of an ASIC reportable Significant Dealing.

Material or unexpectedly high number of complaints (as defined in section 994A(1) of the Act) about the product or distribution of the product.

The use of Product Intervention Powers, regulator orders or directions that affects the product

Mandatory Review Periods

Note: This section is required under section 994B(5)(e) and (f) of the Act.

Review Period	Maximum period for review
Initial review	1 year
Subsequent review	At least once every year since the date of the last review of the TMD (for whatever reason).

Distributor Reporting Requirements

Note: This section is required under section 994B(5)(g) and (h) of the Act.

Reporting requirement	Reporting period	Which distributors this requirement applies to
Complaints (as defined in section 994A(1) of the Act) relating to the product design, product availability and distribution. The distributor should provide all the content of the complaint, having regard to privacy.	Within 10 business days following end of calendar quarter.	ABC Capital Holdings Pty Ltd
Significant dealing outside of target market, under s994F(6) of the Act. See Definitions for further detail.	As soon as practicable but no later than 10 business days after distributor becomes aware of the significant dealing.	ABC Capital Holdings Pty Ltd
To the extent a distributor is aware, dealings outside the target market, including reason why acquisition is outside of target market, and	Within 10 business days following end of calendar quarter.	ABC Capital Holdings Pty Ltd

Distributor Reporting Requirements

Note: This section is required under section 994B(5)(g) and (h) of the Act.

Reporting requirement	Reporting period	Which distributors this requirement applies to
whether acquisition occurred under personal advice.		

DEFINITIONS

Term	Definition
Consumer's investment objective	
Capital Growth	The consumer seeks to invest in a product designed to generate capital return. The consumer prefers exposure to growth assets (such as shares or property) or otherwise seeks an investment return above the current inflation rate.
Capital Preservation	The consumer seeks to invest in a product to reduce volatility and minimise loss in a market downturn. The consumer prefers exposure to defensive assets (such as cash or fixed income securities) that are generally lower in risk and less volatile than growth investments.
Capital Guaranteed	The consumer seeks a guarantee or protection against capital loss whilst still seeking the potential for capital growth (typically gained through a derivative arrangement). The consumer would likely understand the complexities,
Income Distribution	The consumer seeks to invest in a product designed to distribute regular and/or tax effective income. The consumer prefers exposure to income-generating assets (typically, high dividend-yielding equities, fixed income securities and money market instruments).
Consumer's intended product use (% of Investable Assets)	
Solution/Standalone (75-100%)	The consumer intends to hold the investment as either a part or the majority (up to 100%) of their total <i>investable assets</i> (see definition below). The consumer typically prefers exposure to a product with at least High <i>portfolio diversification</i> (see definitions below).
Core Component (25-75%)	The consumer intends to hold the investment as a major component, up to 75%, of their total <i>investable assets</i> (see definition below). The consumer typically prefers exposure to a product with at least Medium <i>portfolio diversification</i> (see definitions below).
Satellite (<25%)	The consumer intends to hold the investment as a smaller part of their total portfolio, as an indication it would be suitable for up to 25% of the total <i>investable assets</i> (see definition below). The consumer is likely to be comfortable with exposure to a product with Low <i>portfolio diversification</i> (see definitions below).
Investable Assets	Those assets that the investor has available for investment, excluding the residential home.

Term	Definition
Portfolio diversification (for completing the key product attribute section of consumer's intended product use)	
Low	Single asset class, single country, low or moderate holdings of securities - e.g. high conviction Aussie equities.
Medium	1-2 asset classes, single country, broad exposure within asset class, e.g. Aussie equities "All Ords".
High	Highly diversified across either asset classes, countries or investment managers, e.g. Australian multi-manager balanced fund or global multi-asset product (or global equities).
Consumer's intended investment timeframe	
Short (≤ 2 years)	The consumer has a short investment timeframe and may wish to redeem within two years.
Medium (2-5 years)	The consumer has a medium investment timeframe and is unlikely to redeem within two to five years.
Long (> 5 years)	The consumer has a long investment timeframe and is unlikely to redeem within five years.
Consumer's Risk (ability to bear loss) and Return profile	
Low	The consumer is conservative or low risk in nature, seeks to minimise potential losses (e.g. has the ability to bear up to one negative return over a 20 year period and is comfortable with a low target return profile. The consumer typically prefers defensive assets such as cash and fixed income.
Medium	The consumer is moderate or medium risk in nature, seeking to minimise potential losses (e.g. has the ability to bear up to four negative returns over a 20 year period) and comfortable with a moderate target return profile. The consumer typically prefers a balance of growth assets such as shares, property and alternative assets and defensive assets such as cash and fixed income.
High	The consumer is higher risk in nature and can accept higher potential losses (e.g. has the ability to bear up to six negative returns over a 20 year period) in order to target a higher target return profile. The consumer typically prefers predominantly growth assets such as shares, property and alternative assets with only a smaller or moderate holding in defensive assets such as cash and fixed income.
Very High	The consumer has a more aggressive or very high risk appetite, seeks to maximise returns and can accept higher potential losses (e.g. has the

Term	Definition
	ability to bear six or more negative returns over a 20 year period and possibly other risk factors, such as leverage). The consumer typically prefers growth assets such as shares, property and alternative assets.
Consumer's need to withdraw money	
Issuers should consider in the first instance the redemption request frequency under ordinary circumstances. However, the redemption request frequency is not the only consideration when determining the ability to meet the investor's requirement to access capital. To the extent that the liquidity of the underlying investments or possible liquidity constraints (e.g. ability to stagger or delay redemptions) could impact this, this is to be taken into consideration in completing this section.	
Daily/Weekly/Monthly/ Quarterly/Annually or longer	The consumer seeks to invest in a product which permits redemption requests at this frequency under ordinary circumstances and the issuer is typically able to meet that request within a reasonable period.
Distributor Reporting	
Significant dealings	Section 994F(6) of the Act requires distributors to notify the issuer if they become aware of a significant dealing in the product that is not consistent with the TMD. Neither the Act nor ASIC defines when a dealing is 'significant' and distributors have discretion to apply its ordinary meaning. The Issuer will rely on notifications of significant dealings to monitor and review the product, this TMD, and its distribution strategy, and to meet its own obligation to report significant dealings to ASIC. Dealings outside this TMD may be significant because: • they represent a material proportion of the overall distribution conduct carried out by the distributor in relation to the product, or • they constitute an individual transaction which has resulted in, or will or is likely to result in, significant detriment to the consumer (or class of consumer). In each case, the distributor should have regard to: • the nature and risk profile of the product (which may be indicated by the product's risk rating or withdrawal timeframes), • the actual or potential harm to a consumer (which may be indicated by the value of the consumer's investment, their intended product use or their ability to bear loss), and • the nature and extent of the inconsistency of distribution with the TMD (which may be indicated by the number of red or amber ratings attributed to the consumer). Objectively, a distributor may consider a dealing (or group of dealings) outside the TMD to be significant if: • it constitutes more than half of the distributor's total retail product distribution conduct in relation to the product over the reporting period, • the consumer's intended product use is <i>Solution/Standalone</i>, or • the consumer's intended product use is <i>Core component</i> and the consumer's risk (ability to bear loss) and return profile is Low.

B. Table 7.2 – Comparison of key information documents

KIID – EU	FFD - Canada	PHS Singapore	Shorter PDS – Australia (simple MIS only)	PDS for managed funds – NZ (equivalent to the Australian simple MIS)
2 pages or three pages for complex structured UCITS products	4 pages	4 pages	8 pages	12 pages or 6,000 words
the name of the product and the identity of the producer	Introduction	Name of product	About [name of responsible entity]	Key information summary
What is the product	Quick Facts	Key Product Features	How [name of simple managed investment scheme] works	How does this investment work?
	Investments of the Fund		Benefits of investing in [name of simple managed investment scheme]	Description of your investment option(s)
What are the risks and what could I get in return?’	Risks	Key Risks	Risks of managed investment schemes	What are the risks of investing?
	Suitability	Suitability		
	Past Performance		How we invest your money	
What are the costs?	Costs of Buying, Owning and Selling the Fund	Fees and Charges	Fees and costs	What are the fees?
How long should I hold it and can I				

KIID – EU	FFD - Canada	PHS Singapore	Shorter PDS – Australia (simple MIS only)	PDS for managed funds – NZ (equivalent to the Australian simple MIS)
take money out early?				
	Impact of Income Taxes on Investor Returns		How managed investment schemes are taxed	What taxes will you pay?
				Who is involved?
		Valuations and Exiting from this Investment (for unlisted CIS)		
How can I complain?	Statement of Rights		How to apply (includes information about cooling off and complaints)	How to complain
				How to apply
Other relevant information	More Information about the Fund	Contact Information		Where you can find more information

C. Table 7.3 – Details of Interim Stop Orders for MIS products

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
22/07/2022	Responsible Entity Services Limited	RES Investment Fund	Loan to related party	TMD included two categories of retail investors for whom the product was not in ASIC's view suitable namely: - investors intending to use an investment in PPM Units as a core component of their investment portfolio and - investors with an objective of high capital growth or a mixture of capital growth and income should not have been included in the target market.

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
13/09/2022	Open Corp Funds Management Limited	Australian Residential Property Fund	Residential property	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a capital preservation investment objective, - investors intending to use the product as a core component (25-75%) or potentially as a solution/standalone component (75-100%) of their investment portfolio, - investors with a medium or potentially low risk and return profile, - investors with a need to withdraw their money from the MIS on an annual basis. ASIC's reasoning was that this was because the MIS invested solely in a portfolio of Australian residential property assets, borrowed money to support its investment activities, engaged in property development activities and was relatively low in liquidity.
				Distribution conditions in the TMD were inadequate
13/09/2022	Fawkner Property Ltd	Private Property Trust No. 20	Commercial Property	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors seeking a capital preservation or potentially a capital guaranteed investment objective, - investors intending to use the product as a core component (25-75%) or potentially as a solution/standalone component (75-100%) of their investment portfolio, - investors with a low risk and return profile, - investors with a medium and potentially short investment timeframe, - investors with a need to withdraw their money from the Trust annually or longer (which includes those needing to withdraw in less than seven years). ASIC's reasoning was that this was because the MIS invested in a concentrated portfolio of commercial property assets and borrowed money to support its investment activities and the investors could not withdraw their money from the MIS in the first seven years of their investment, the investment was not suitable to all retail clients identified in the TMD.

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				Distribution conditions in the TMD were inadequate
30/09/2022	Australasian Property Investments Limited	APIL Essential Retail Income Fund	Shopping Centres	TMD included retail investors for whom the product was not in ASIC's view suitable namely: - investors looking to invest in commercial properties with the prospect of capital growth and a secure income stream. - investors who are 'cash rich' entities or retirees looking for a long-term capital investment along with a monthly return, - investors with a 'buy and hold' strategy and do not require immediate access to capital; and - investors with a need for preservation of capital that accrues capital gains/losses over the lifespan of the investment. ASIC's reasoning was that this was because the MIS borrowed money to support its investment activities and investors in the MIS could not withdraw their money until April 2029 and because the PDS disclosed that money invested in the MIS was not guaranteed and the monthly income distribution is based on assumptions and the actual results may be different to the forecast result, it was not suited to retail investors described in the TMD
				Distribution conditions in the TMD were inadequate
17/10/2022	Holon Investments Australia Limited	Holon Bitcoin Fund, Holon Ethereum Fund Holon Filecoin Fund	Crypto assets.	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a potentially medium, high or very high risk and return profile; and - investors intending to use the fund as a satellite component (up to 25%) of their investment portfolio; and - investors intending to use the fund as a solution/standalone component (75-100%) of their investment portfolio. ASIC's reasoning was that this was because the MIS was not suited to the wide target market described in the TMD because crypto assets are highly volatile and complex, making

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				concentrated investments in individual crypto assets very risky and speculative. Investors were likely to experience significant price volatility and deep negative returns in periods of asset price decline. Also, the PDSs disclosed the risk that assets in the MIS could face a total loss of value.
21/10/2022	Westlawn Financial Services Limited	Westlawn Income Fund	- secured and unsecured loans, including five property development loans - credit, leases - other fixed-interest financial assets	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a tolerance for a moderate level of risk with respect to their investment, - investors needing liquidity or needing to make withdrawals during the investment term, - investors seeking to have their capital invested for a minimum period of two years, - investors seeking regular monthly income distributions. ASIC's reasoning was that this was because the type of scheme property was high risk. Distribution conditions in the TMD were not specific enough to ensure the MIS was distributed to consumers in the target market.
21/11/2022	MPG Funds Management Limited	MPG Bulky Goods Retail Trust MPG Essential Services Property Trust	commercial properties	TMD included retail investors for whom the product was not in ASIC's view suitable: - investors with a tolerance for an undefined 'medium risk', - investors wanting stable and regular income distributions, and - investors needing liquidity or needing to make withdrawals during the investment term for the MIS. ASIC's reasoning was that this was because: - the MIS invested in a concentrated portfolio of commercial properties, - the MIS had an investment term during which investors have no ongoing withdrawal rights and employ leverage, which increased the level of risk for investors. Distribution conditions in the TMDs did not meet the appropriateness requirement under the design and distribution obligations (DDO) because these conditions were not specific enough to make it likely for the Trusts to reach consumers in the target market.

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
25/11/2022	Perpetual Investment Management Limited	Perpetual Pure Microcap Fund Perpetual Geared Australian Share Fund	Australian microcap entities Australian shares	TMD included retail investors for whom the product was not in ASIC's view suitable: - Investors with a capital preservation investment objective. - Investors intending to use the product as a core component (25-75%) or satellite component (up to 25%) of their investment portfolio, - Investors with a potentially low, medium or high risk and return profile, - Investors with a 'Medium' investment timeframe (under 2 years and up to 8 years); and - Investors with a need to withdraw their money on a daily and weekly basis. ASIC was of the view that an investment in both MIS carried higher risks than the description of the target market in the TMD. - The first fund was invested solely in a portfolio of Australian microcap equities carry a significant level of risk due to high price volatility, shallower market depth (with few traders and turnover in share transactions) and the limited operational history of microcap companies - The second fund invested solely in a portfolio of Australian shares and employs leverage, with the MIS being able to take on debts valued at up to 60% of the fund's total assets meaning elevated risks, including the potential for a high level of price volatility and the use of leverage, which increases the chances of investors incurring large losses. TMD did not include any distribution conditions
2/12/2022	Australian Fiduciaries Limited	Global SRI Ethical Alpha Fund Global SRI All Seasons Fund Global SRI Multi-Strategy Fund.	MIS 1 and 2: loans secured by real property and other debt instruments, precious metals, listed and unlisted equity and property development projects	TMD included retail investors for whom the product for all three MIS was not in ASIC's view suitable: - investors who need liquidity during the term of their investments, which is not supported by the Funds' liquidity features - investors with a tolerance for 'medium' to 'high' level of risk whilst the risks associated with the portfolio of investments for two funds and the aggressive return objective of one fund are higher

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
			MIS 3: managed funds and assets, including unlisted managed funds, derivatives, listed equity and commodities, with an investment return objective of CPI (Consumer Price Index) plus 7% per annum.	investors with an undefined 'higher-than-average' net worth. ASIC was of the view that the funds had a high risk investment strategy of the MIS.
				TMD did not include any distribution conditions
08/01/2023	Vasco Responsible Entity Services Limited	Pivotal Diversified Fund	managed funds, including hedge funds, a fund invested in residential and commercial real estate developments and a private equity fund	TMD included retail investors for whom the product for MIS was not in ASIC's view suitable: - investors with a potentially high risk and return profile, when the risks associated with the fund's investments are very high; and - investors with a 'medium' investment timeframe (up to 6 years). ASIC's reasoning was that this was because: - the high risk of the underlying investments in the hedge funds which were exposed to a very high risk strategy that generates absolute returns by trading in listed equities and by using short selling, leverage and derivatives and - the managed fund in which funds were invested by the MIS invested in property development projects is subject to project financing, valuation and construction risks, and the private equity fund was illiquid and leveraged.
				TMD did not include any distribution conditions
18/03/2023	Advance Asset Management Limited	Advance Balanced Multi-Blend Fund Advance International Shares Multi-Blend Fund	Not stated but 2 appears to be in international shares and 3 appears to be in property securities	ASIC considered that the TMDs were very broadly drafted and failed to define key concepts. For example, the RE described investors in the target market for the Advance Balanced Multi-Blend Fund as having the tolerance to invest at the 'medium to higher' end and investors in the target markets for the Advance International Shares Multi-Blend Fund

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
		Advance Property Securities Multi-Blend Fund (		and Advance Property Securities Multi-Blend Fund as having the tolerance to invest at the 'higher end of the risk spectrum' but did not define what these concepts meant. It was therefore not possible to accurately determine which retail investors fell within the target market for each MIS. TMD did not include any distribution conditions
02/06/2023	Spaceship Capital Limited	Spaceship Earth Portfolio Spaceship Origin Portfolio Spaceship Universe Portfolio	Not Stated	ASIC considered that the TMD's for the 3 MIS were defined too broadly and did not consider the risks and features of those MIS. In particular ASIC had concerns about: • a mismatch between the investment risk profiles of MIS (very high risk) and risk profiles identified for investors within the target markets (medium and high). The target markets included investors who intend to hold the funds as a core component (25–75%) or standalone component (75–100%) and the funds invests in a single asset class (i.e. shares); • a potential investment timeframe of two years or more where the suggested minimum investment timeframe in the PDS is seven years; and • the target markets included investors with a need to withdraw money daily when withdrawals would usually be paid within five business days and may be suspended or delayed for longer than 21 business days.
01/09/2023	K2 Asset Management Ltd	Storehouse Residential Trust	Direct real property	ASIC considered that the target market in the TMS was too broad and did not properly consider the risks and features of the Fund and information within the TMD was inconsistent. In particular ASIC had concerns about • a mismatch between the investment risk profiles of MIS (very high risk) and risk profiles identified for investors within the target markets (medium and high); • the target market includes investors who intended to hold the funds as a core component (25–75%) and the MIS has very low portfolio diversification and is very high risk, • consumers with an investment objective of capital preservation or income generation are potentially in the target market, where capital loss is a material risk and income distributions may not occur regularly,

Media Release Date	Issuer	MIS	Scheme Property	ASIC's Issues with TMD
				- consumers with an investment time frame of less than two years were potentially in the target market, where the suggested investment timeframe of the MIS was at least five years, - the target market includes investors with a need to withdraw money annually when there are restrictions on withdrawals as the MIS is illiquid and underlying assets are aligned with periods of three to five years and there was no commitment to provide redemptions and withdrawals depending on the liquidity of the MIS. TMD contained one distribution condition that the product was only suitable for distribution to consumers who have received general financial product advice. ASIC considered the TMD fails to set out distribution conditions for direct-to-consumer distribution or distribution via financial product advice where such distribution appears likely to occur.
05/06/2024	Australian Unity Funds Management Ltd	Australian Unity Select Income Fund	Contributory mortgages	ASIC had concerns that Australian Unity failed to take reasonable steps likely to result in distribution conduct being consistent with its TMD. Australian Unity relied upon a retail client questionnaire with significant flaws as a key step for compliance with its obligations. The questions and response options were based on and relied predominantly on complex consumer attributes set out in the TMD. However, ASIC's view is that a TMD is not intended to be a consumer-facing document. Therefore, there was a high risk that retail clients would not understand the questionnaire leading to inaccurate responses and distribution of interests in the MIS to retail clients outside the target market.

D. Table 7.4 - Article 5 of EU Key Information Document (KIID) Requirements

Article 5	
Presentation and language	
1.	A key investor information document shall be: (a) presented and laid out in a way that is easy to read, using characters of readable size; (b) clearly expressed and written in language that communicates in a way that facilitates the investor's understanding of the information being communicated, in particular where: (i) the language used is clear, succinct and comprehensible; (ii) the use of jargon is avoided; (iii) technical terms are avoided when everyday words can be used instead; (c) focused on the key information that investors need.
2.	Where colours are used, they shall not diminish the comprehensibility of the information in the event that the key investor information document is printed or photocopied in black and white.
3.	Where the design of the corporate branding of the management company or the group to which it belongs is used, it shall not distract the investor or obscure the text.

Appendix 8 – Quantitative Research

Redcap Analysis of Survey Responses

1. What is your role within your organisation?

Total Count (N)	Missing	Unique
27	0 (0.0%)	11

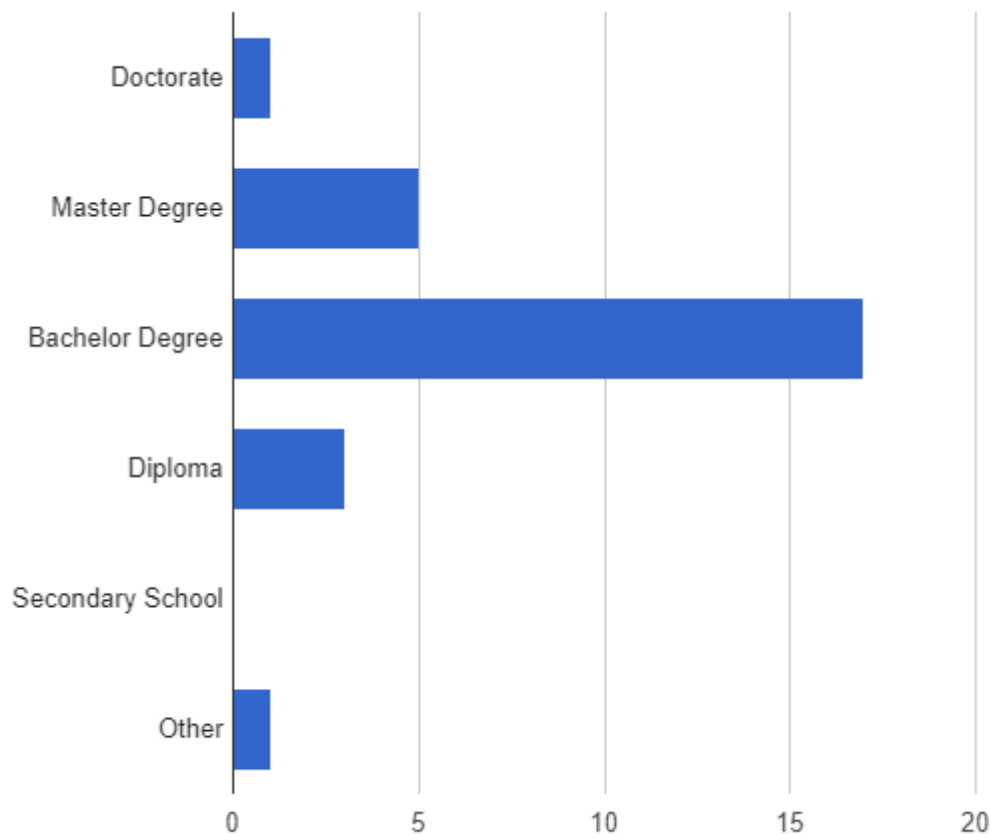
Counts/frequency: Director (external) (2, 7.4%), Director (executive) (10, 37.0%), Compliance committee member (external) (2, 7.4%), Compliance committee member (internal) (5, 18.5%), Compliance officer or equivalent (6, 22.2%), Other compliance personnel (3, 11.1%), Chief Executive Officer (7, 25.9%), Chief Financial Officer (2, 7.4%), Chief Operating Officer (2, 7.4%), Investment Management (2, 7.4%), Accounting (0, 0.0%), General Administration (1, 3.7%)



2. What is your highest educational qualification?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	5

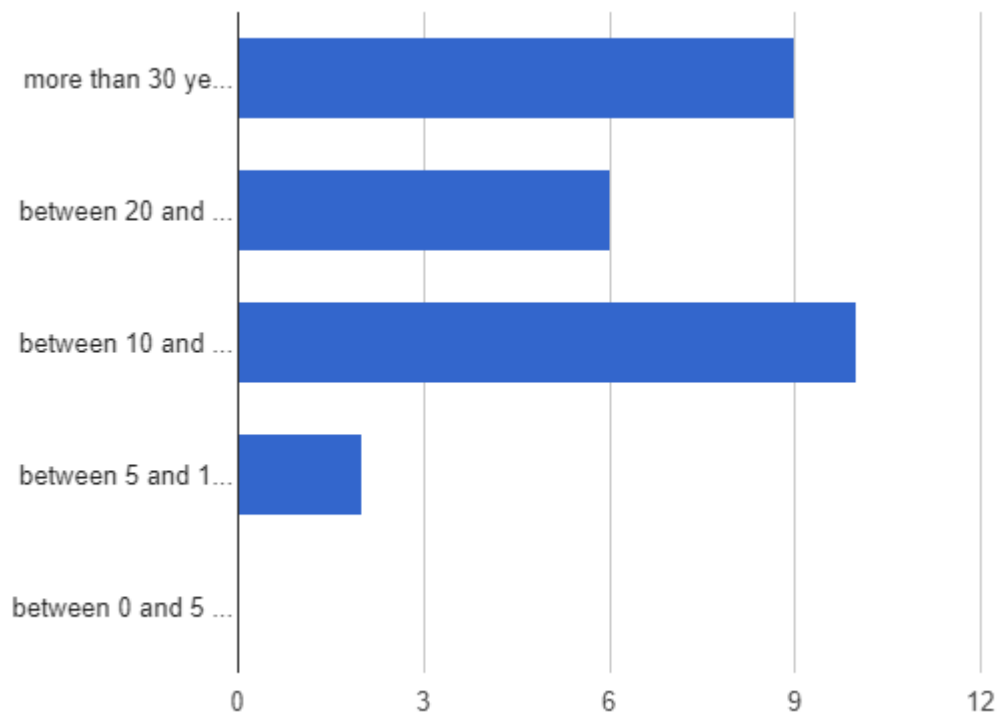
Counts/frequency: **Doctorate** (1, 3.7%), **Master Degree** (5, 18.5%), **Bachelor Degree** (17, 63.0%), **Diploma** (3, 11.1%), **Secondary School** (0, 0.0%), **Other** (1, 3.7%)



3. How many years have you been employed or been involved in the managed investment scheme industry? Choose one option only. For example if you have had 25 years experience you would choose the second answer "between 20 and 30 years" only.

Total Count (N)	Missing*	Unique
27	0 (0.0%)	4

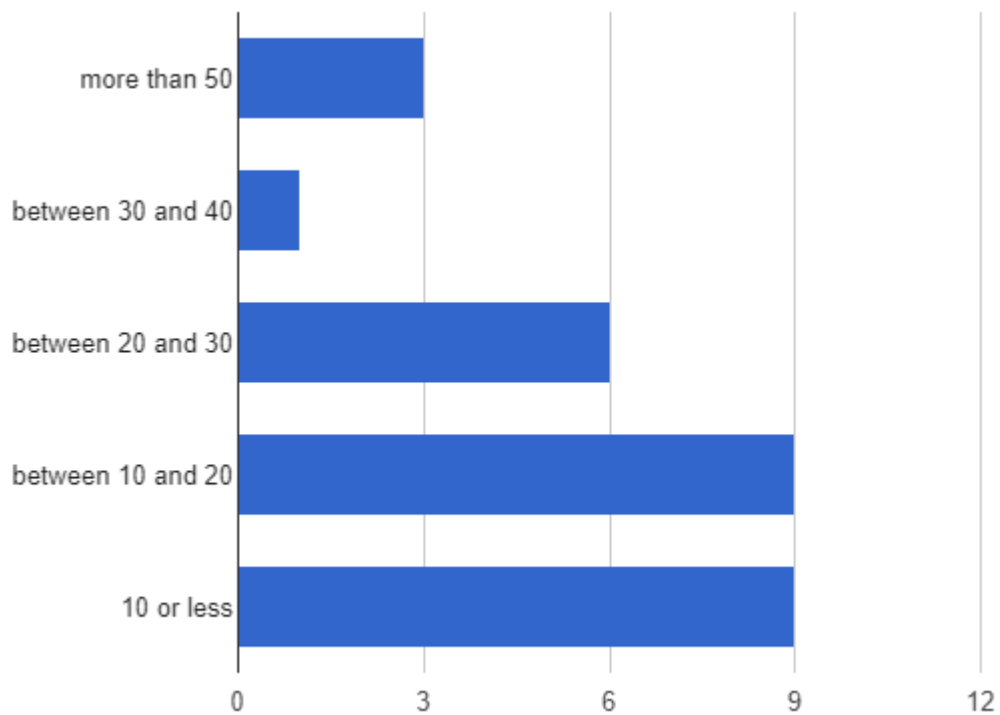
Counts/frequency: **more than 30 years** (9, 33.3%), **between 20 and 30 years** (6, 22.2%), **between 10 and 20 years** (10, 37.0%), **between 5 and 10 years** (2, 7.4%), **between 0 and 5 years** (0, 0.0%)



4. How many registered schemes does your organisation operate? Choose one answer only. For example, if your organisation operates 25 schemes you would choose the third answer "between 20 and 30.

Total Count (N)	Missing*	Unique
27	0 (0.0%)	5

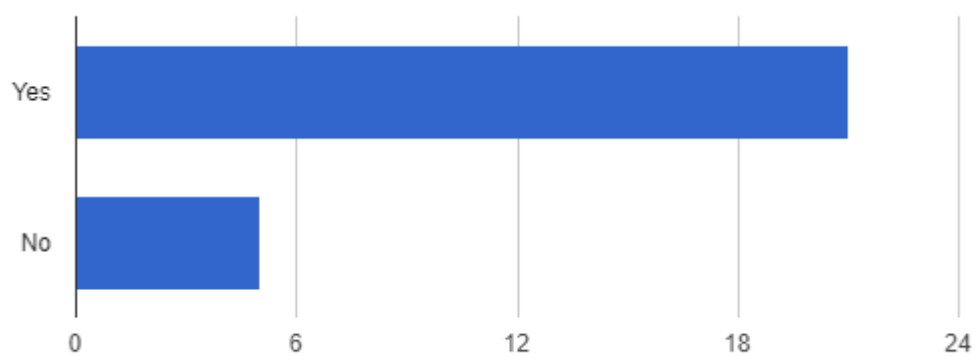
Counts/frequency: more than 50 (3, 11.1%), between 30 and 40 (1, 3.7%), between 20 and 30 (6, 22.2%), between 10 and 20 (9, 33.3%), 10 or less (9, 33.3%)



5. Are the directors of your organisation subject to independent vetting as to their suitability to act as a director of a responsible entity (RE)?

Total Count (N)		Missing*	Unique
26		1 (3.7%)	2

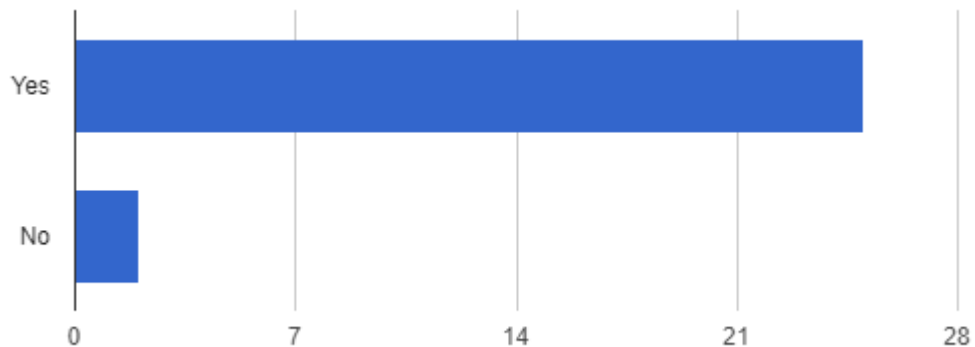
Counts/frequency: **Yes** (21, 80.8%), **No** (5, 19.2%)



6. Does your organisation have guidelines to ensure that a director of your organisation is a fit and proper person?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

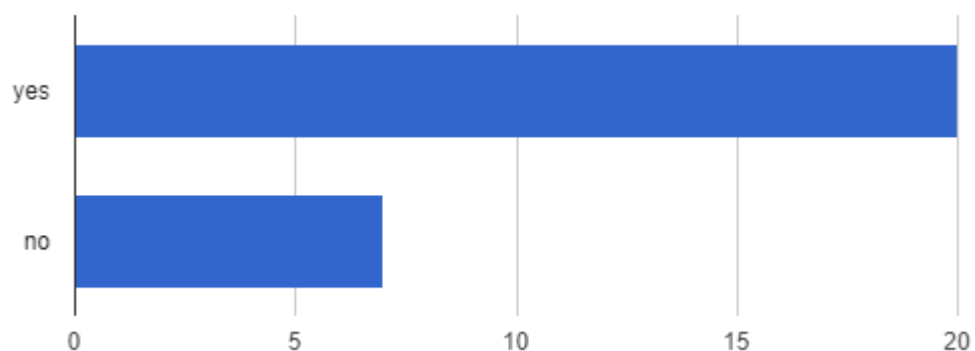
Counts/frequency: Yes (26, 96.3%), No (1, 3.7%)



7. Does your organisation require directors to hold minimal professional standards (e.g. education and experience) as a condition of appointment?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

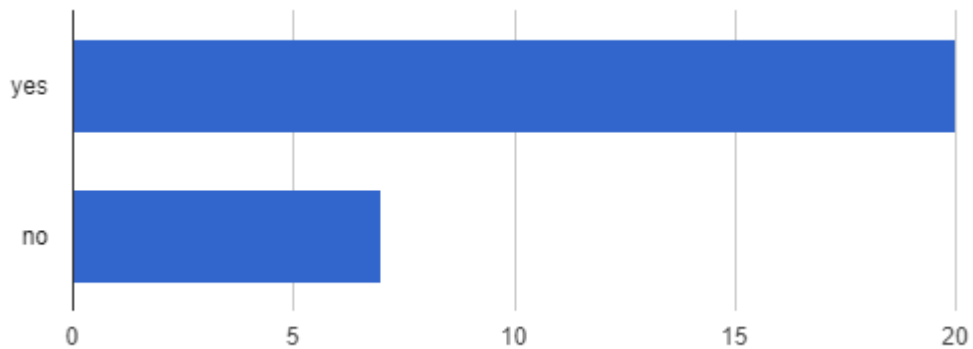
Counts/frequency: Yes (25, 92.6%), No (2, 7.4%)



8. Does your organisation require directors to have experience in the operation of registered schemes as a condition of appointment?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

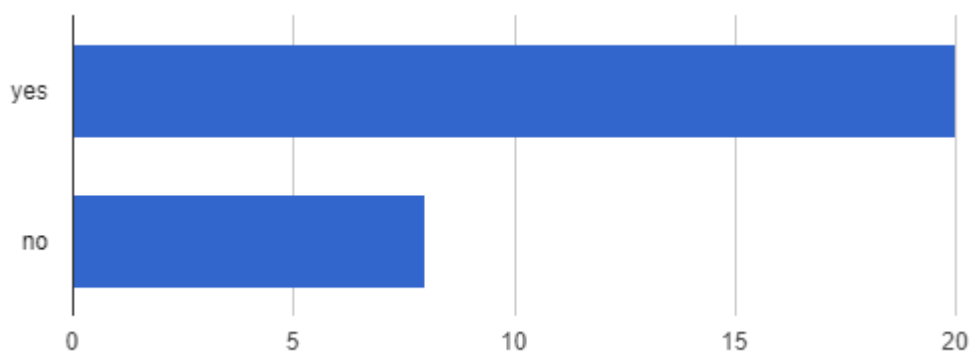
Counts/frequency: **yes** (20, 74.1%), **no** (7, 25.9%)



9. Are the directors of your organisation required to undertake annual continuing professional development (CPD)?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

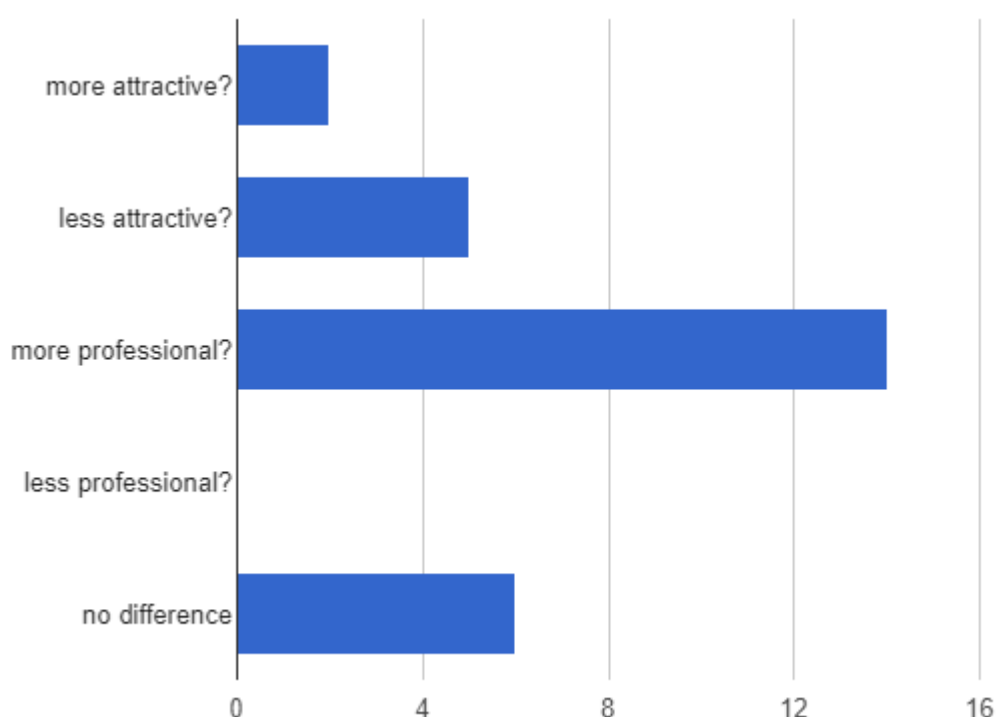
Counts/frequency: **yes** (20, 74.1%), **no** (8, 29.6%)



10. If officers of an RE were required to hold industry specific qualifications including studies in corporate governance and ethics do you consider that this would make the position:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	4

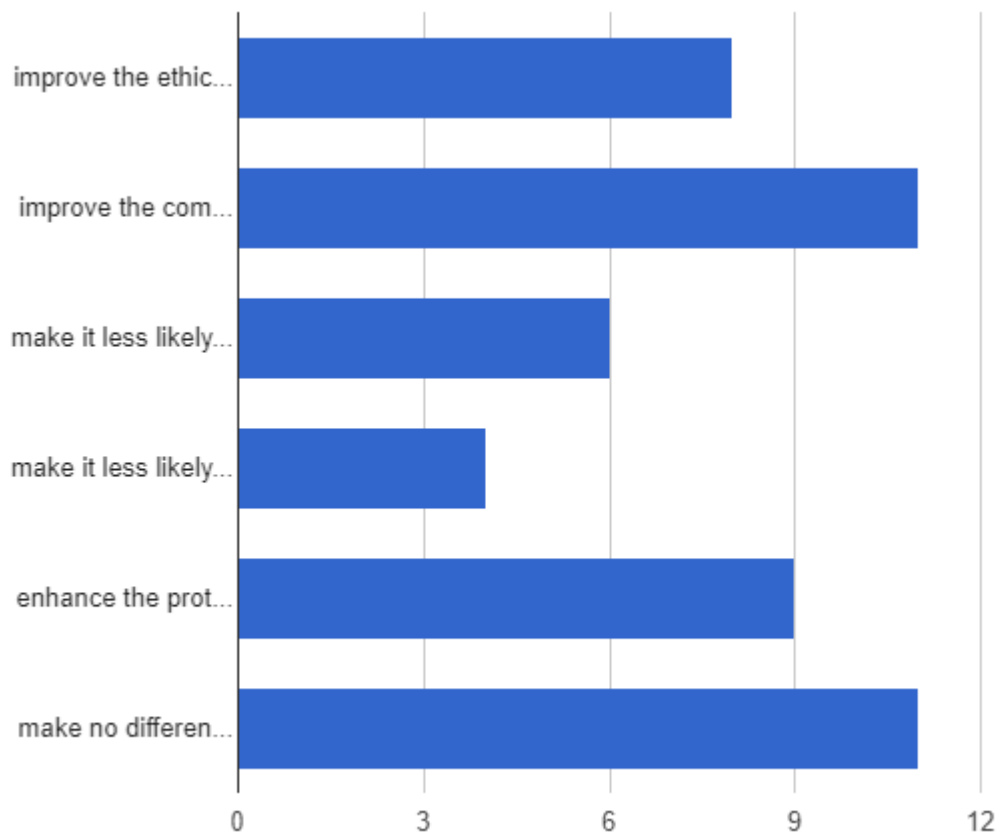
Counts/frequency: more attractive? (2, 7.4%), less attractive? (5, 18.5%), more professional? (14, 51.9%), less professional? (0, 0.0%), no difference (6, 22.2%)



11. If the directors of your organisation were required to hold industry specific qualifications including studies in corporate governance and ethics do you consider that this would:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	6

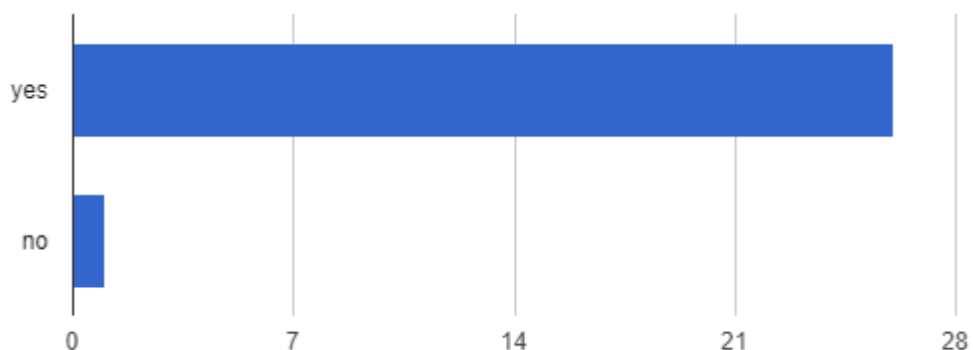
Counts/frequency: improve the ethical tone of your organisation? (8, 29.6%), improve the compliance culture of your organisation? (11, 40.7%), make it less likely that there would be breaches of duties by the RE? (6, 22.2%), make it less likely that there would be breaches of duties by the officers of the RE? (4, 14.8%), enhance the protection of retail investors in the schemes operated by your organisation? (9, 33.3%), make no difference? (11, 40.7%)



12. Do you consider the observance by the RE and its officers of their respective duties as important protections for retail investors who invest in your organisation's schemes?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

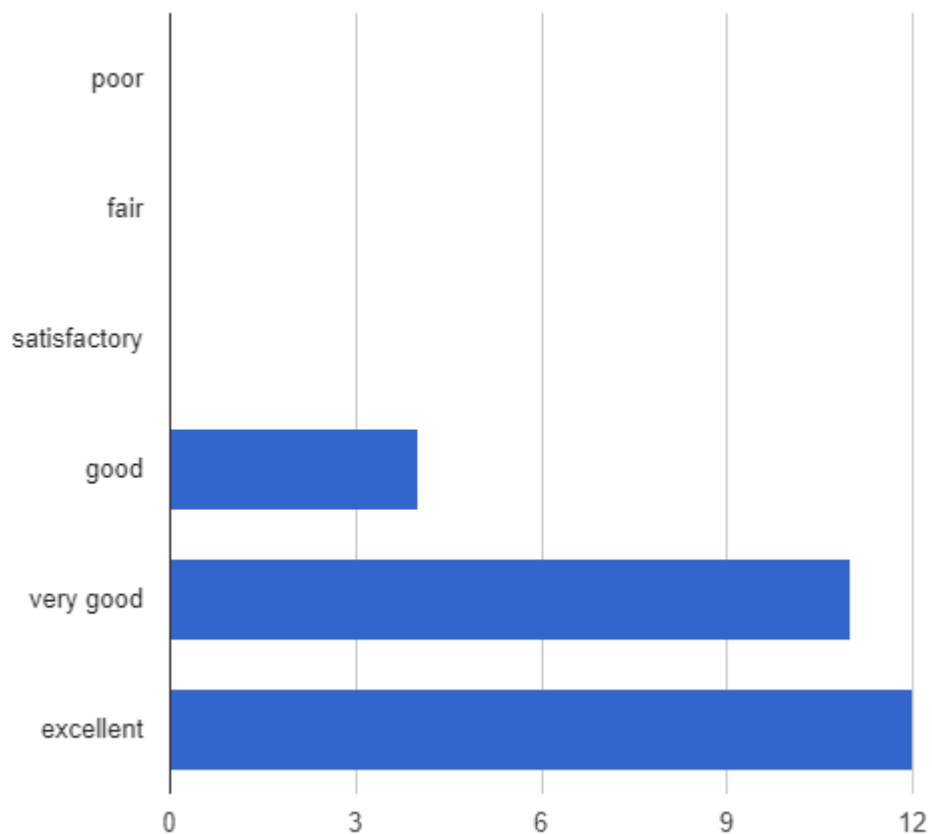
Counts/frequency: **yes** (26, 96.3%), **no** (1, 3.7%)



13. In your opinion, is the observance by the officers of your organisation of their duties to members:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	3

Counts/frequency: **poor** (0, 0.0%), **fair** (0, 0.0%), **satisfactory** (0, 0.0%), **good** (4, 14.8%), **very good** (11, 40.7%), **excellent** (12, 44.4%)



14. In your organisation are systemic and recurring problems of non-compliance reported to those with sufficient authority to correct them:

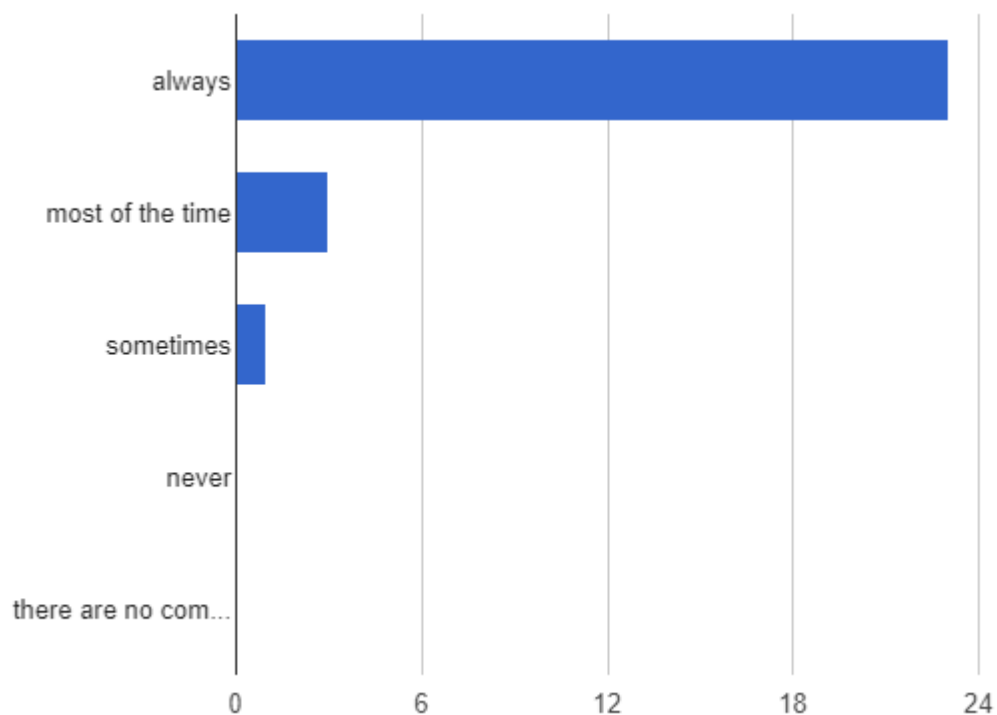
Total Count (N)	Missing*	Unique
26	1 (3.7%)	3

Counts/frequency: **always** (21, 80.8%), **most of the time** (4, 15.4%), **sometimes** (0, 0.0%), **never** (1, 3.8%)

15. Are compliance failures in your organisation investigated to understand their cause:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	3

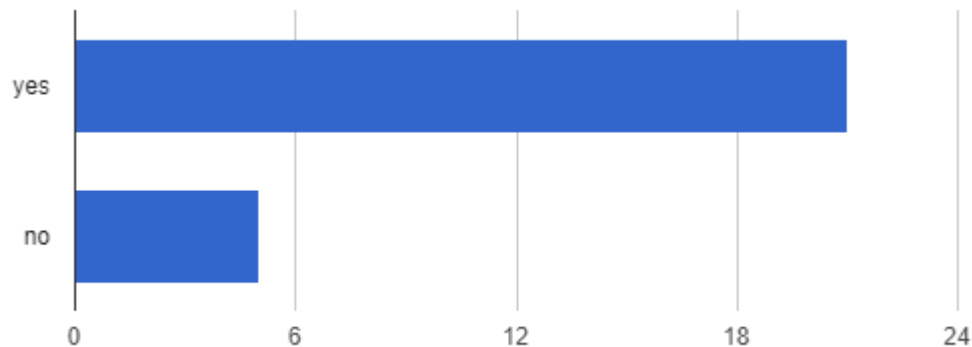
Counts/frequency: **always** (23, 85.2%), **most of the time** (3, 11.1%), **sometimes** (1, 3.7%), **never** (0, 0.0%), **there are no compliance failures** (0, 0.0%)



16. If your organisation has a compliance committee, are proposed appointees subject to independent vetting as to their suitability to be a compliance committee member?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

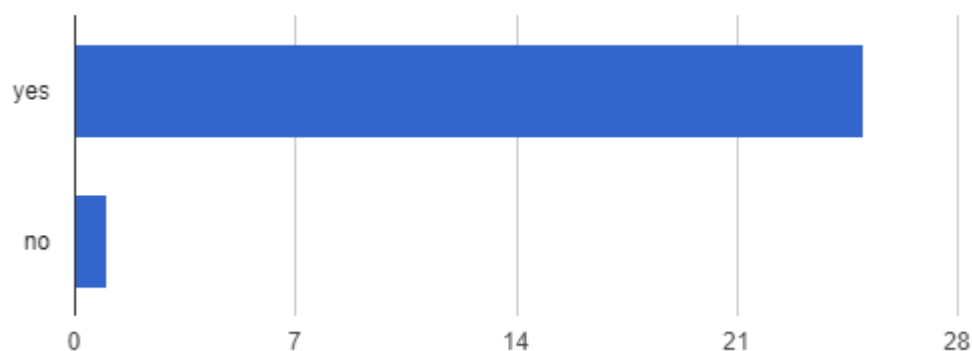
Counts/frequency: **yes** (21, 80.8%), **no** (5, 19.2%)



17. If your organisation has a compliance committee, are there guidelines to ensure that an external member of the compliance committee is a fit and proper person?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

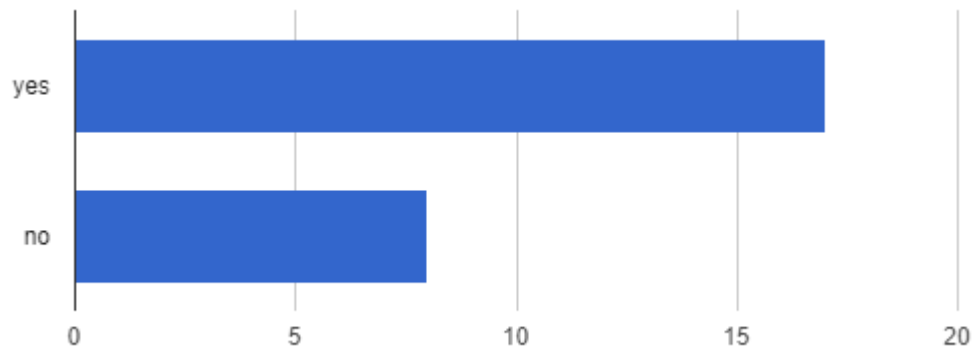
Counts/frequency: **yes** (25, 96.2%), **no** (1, 3.8%)



18. If your organisation has a compliance committee, does your organisation require an external member of the compliance committee to hold industry specific qualifications ?

Total Count (N)	Missing*	Unique
25	2 (7.4%)	2

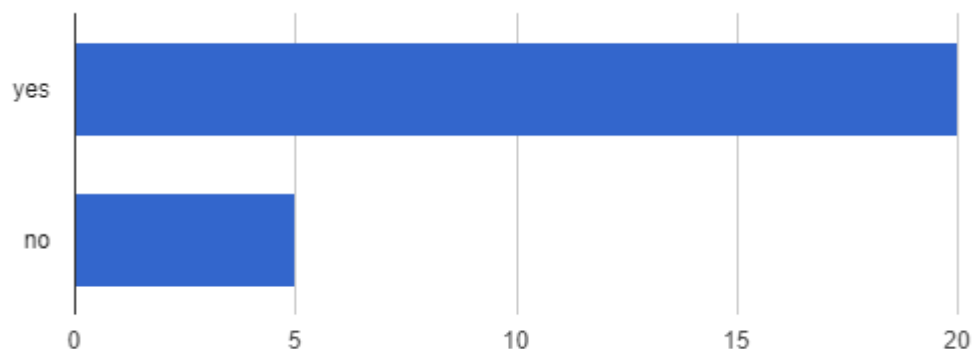
Counts/frequency: **yes** (17, 68.0%), **no** (8, 32.0%)



19. If your organisation has a compliance committee, does your organisation require an external member of the compliance committee to have experience in the operation of registered schemes?

Total Count (N)	Missing*	Unique
25	2 (7.4%)	2

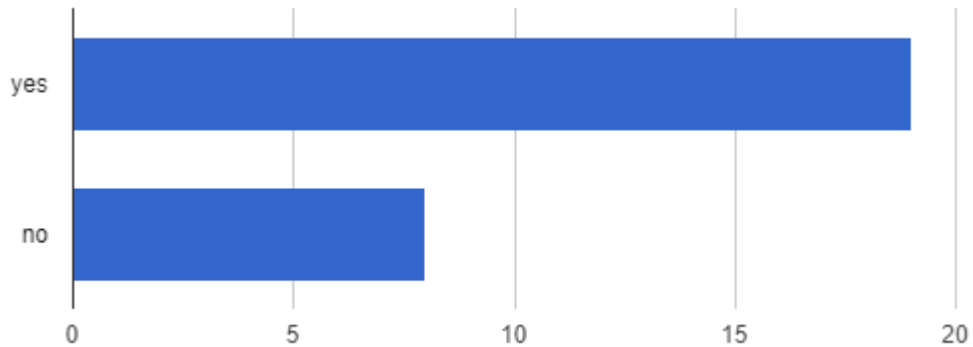
Counts/frequency: **yes** (20, 80.0%), **no** (5, 20.0%)



20. Do you agree that changes in membership of the compliance committee should be disclosed by publicly available notification to ASIC and in the annual report?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

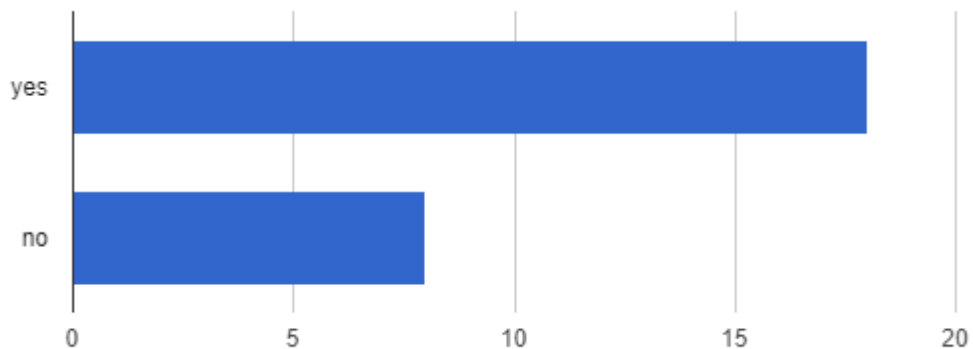
Counts/frequency: **yes** (19, 70.4%), **no** (8, 29.6%)



21. If your organisation has a compliance committee, has the compliance committee ever reported breaches of the Corporations Act, constitution or compliance plan in relation to any of its schemes to the Board?

Total Count (N)	Missing*	Unique
26	<u>1 (3.7%)</u>	2

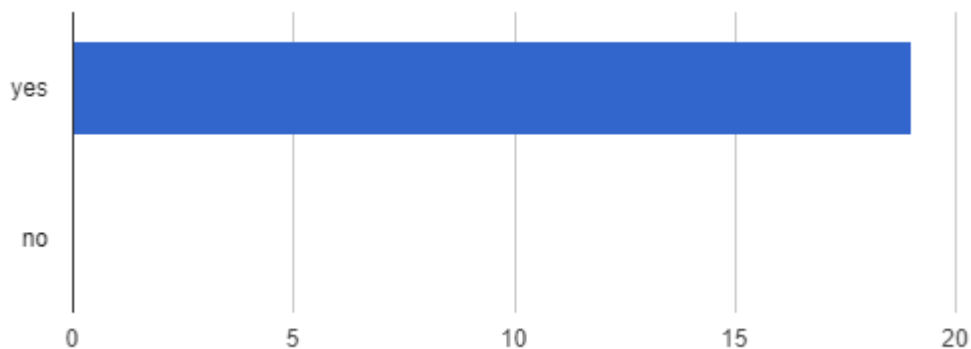
Counts/frequency: **yes** (18, 69.2%), **no** (8, 30.8%)



22. If your compliance committee has reported breaches of the Corporations Act, constitution or compliance plan for any of its schemes to the Board, did the Board take corrective action?

Total Count (N)	Missing*	Unique
19	8 (29.6%)	1

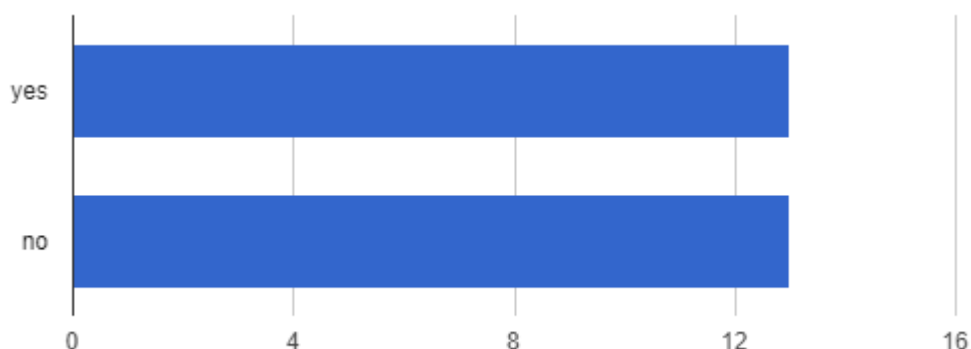
Counts/frequency: **yes** (19, 100.0%), **no** (0, 0.0%)



23. If your organisation has a compliance committee, has the compliance committee ever reported breaches of the Corporations Act, constitution or compliance plan in relation to any of its schemes to ASIC?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

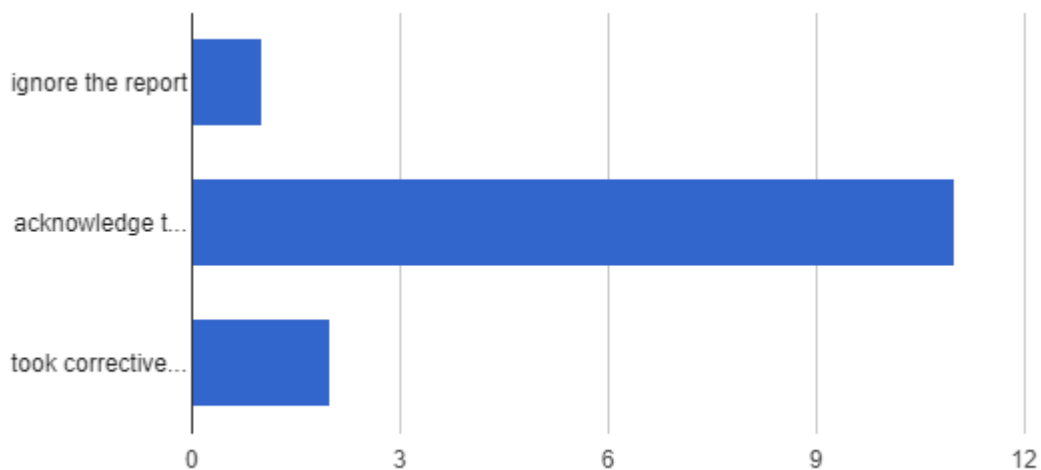
Counts/frequency: **yes** (13, 50.0%), **no** (13, 50.0%)



24. If the compliance committee has reported breaches of the Corporations Act, constitution or compliance plan of any of its schemes to ASIC, did ASIC:

Total Count (N)	Missing*	Unique
14	13 (48.1%)	3

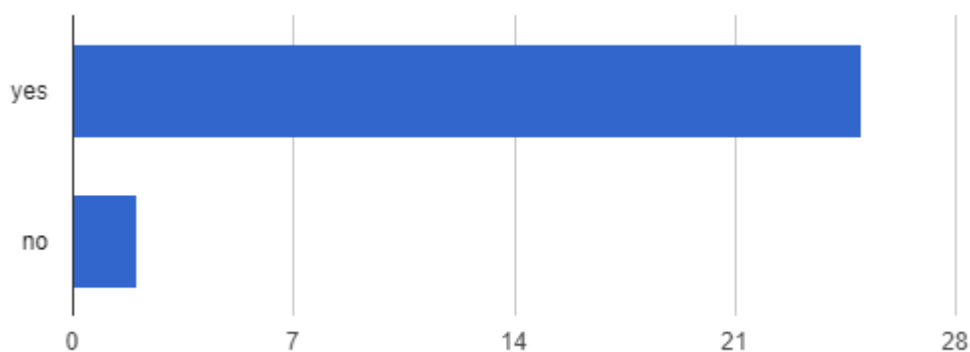
Counts/frequency: ignore the report (1, 7.1%), acknowledge the report but took no action (11, 78.6%), took corrective action (2, 14.3%)



25. Do you consider the compliance committee has an important role in protecting retail investors?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

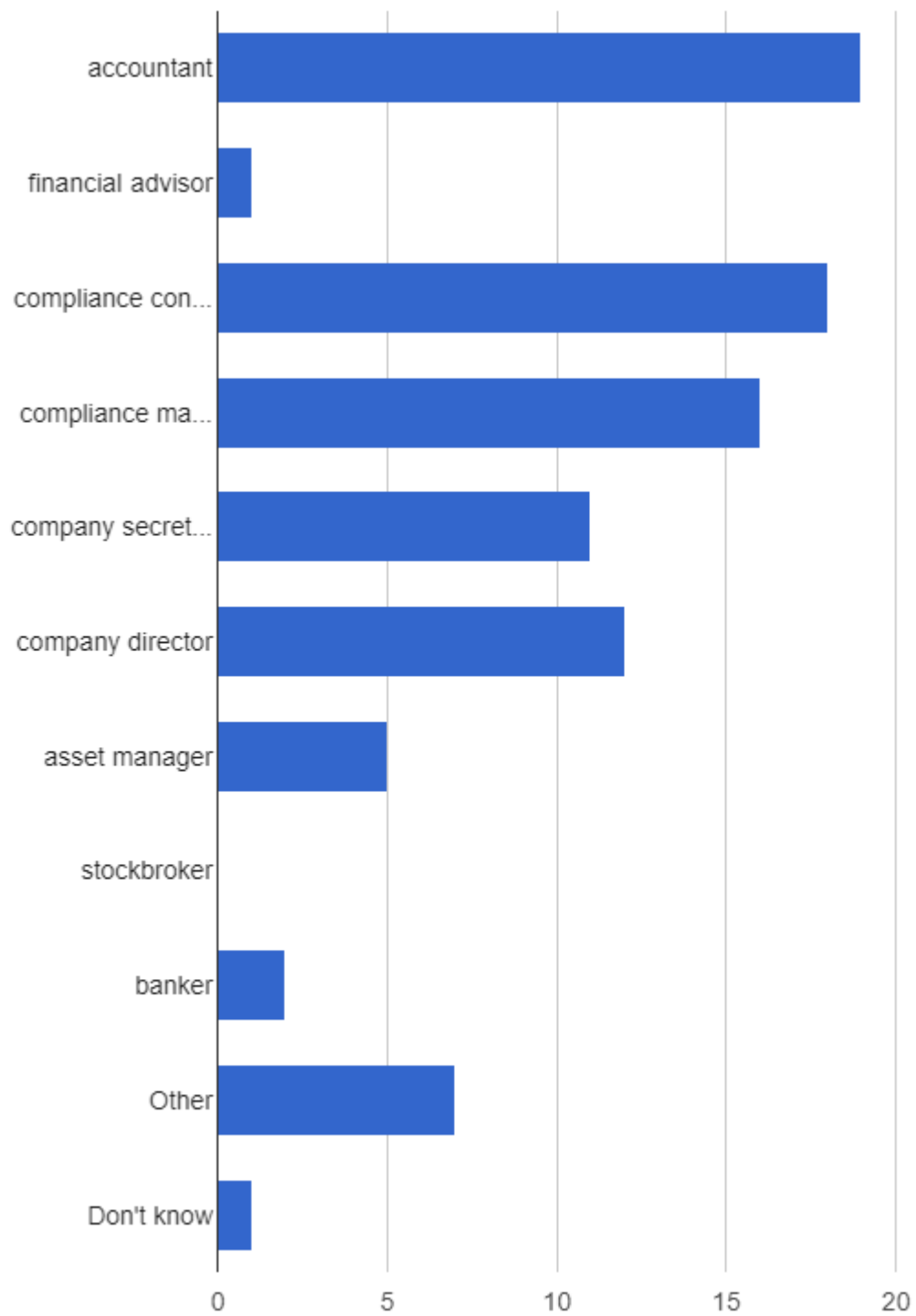
Counts/frequency: yes (25, 92.6%), no (2, 7.4%)



26. If your organisation has a compliance committee, are the external members of your compliance committee members of past members of any of the following professions?

Total Count (N)	Missing*	Unique
25	<u>2 (7.4%)</u>	10

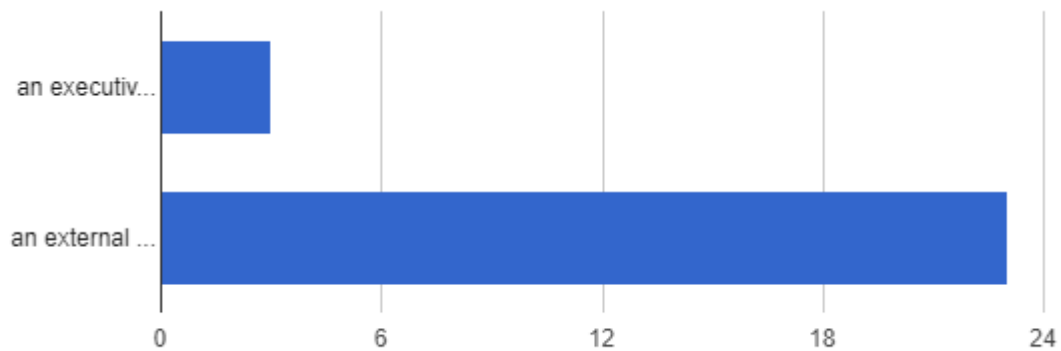
Counts/frequency: accountant (19, 76.0%), financial advisor (1, 4.0%), compliance consultant (18, 72.0%), compliance manager or similar (16, 64.0%), company secretary (11, 44.0%), company director (12, 48.0%), asset manager (5, 20.0%), stockbroker (0, 0.0%), banker (2, 8.0%), Other (7, 28.0%), Don't know (1, 4.0%)



27. If your organisation has a compliance committee, is the Chairperson:

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

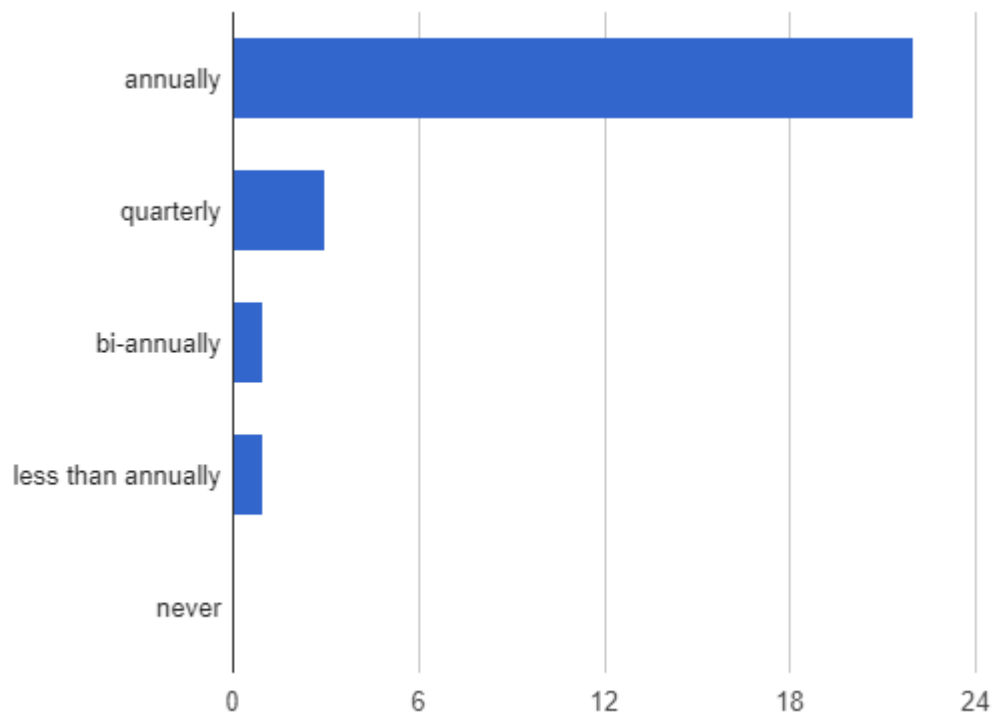
Counts/frequency: **an executive member** (3, 11.5%), **an external member** (23, 88.5%)



28. How often does your organisation review its compliance plan?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	4

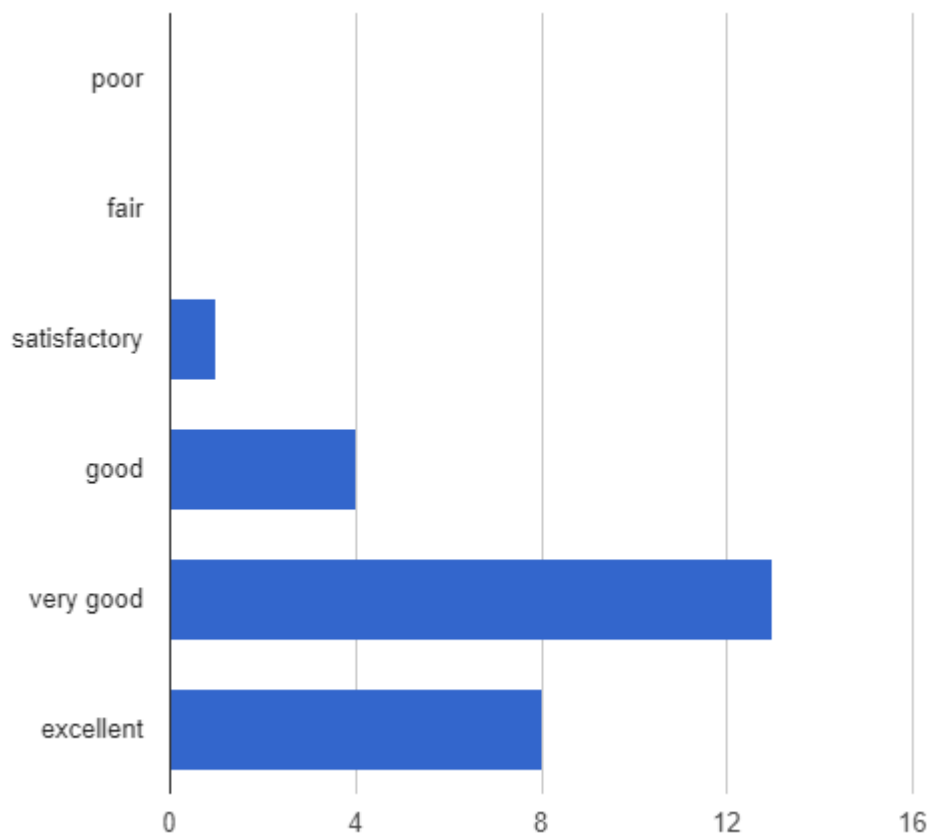
Counts/frequency: **annually** (22, 84.6%), **quarterly** (3, 11.5%), **bi-annually** (1, 3.8%), **less than annually** (1, 3.8%), **never** (0, 0.0%)



29. If your organisation has a compliance committee, do you consider the performance of your compliance committee is:

Total Count (N)	Missing*	Unique
26	1 (3.7%)	4

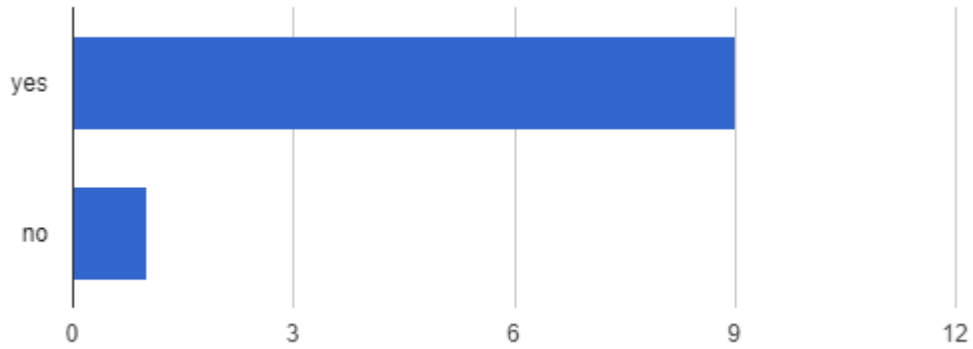
Counts/frequency: **poor** (0, 0.0%), **fair** (0, 0.0%), **satisfactory** (1, 3.8%), **good** (4, 15.4%), **very good** (13, 50.0%), **excellent** (8, 30.8%)



30. If your organisation does not have a compliance committee, do the external directors of the Board of your organisation take an active role in engaging with compliance issues?

Total Count (N)	Missing*	Unique
10	17 (63.0%)	2

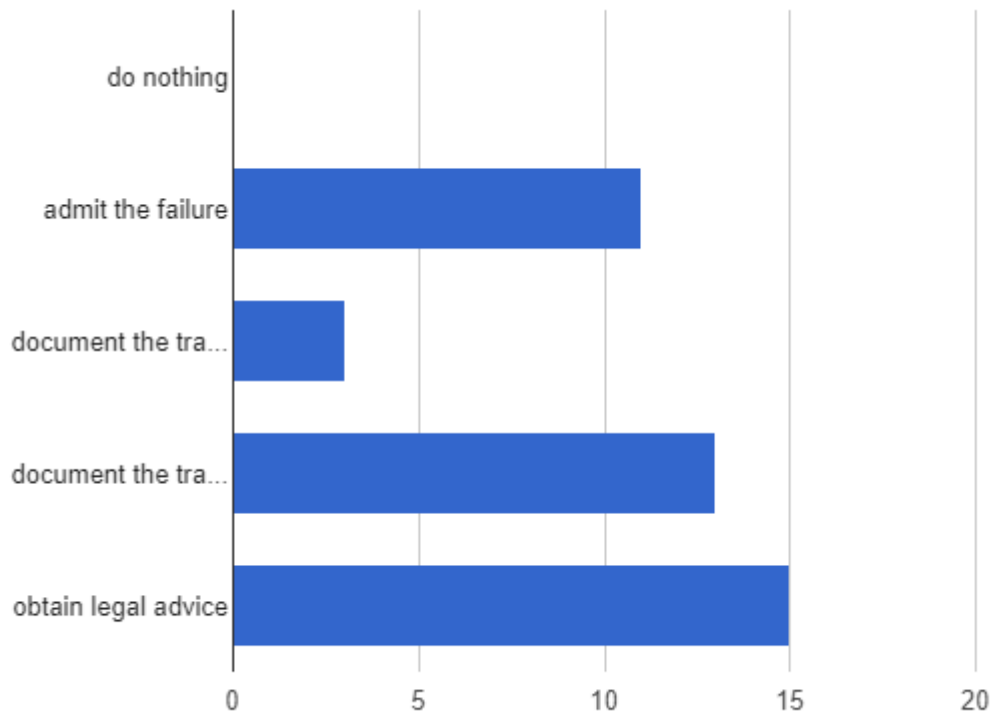
Counts/frequency: **yes** (9, 90.0%), **no** (1, 10.0%)



31. If there was an accidental failure to document a transaction which of the following would you consider to be the appropriate response:

Total Count (N)	Missing*	Unique
26	1 (3.7%)	4

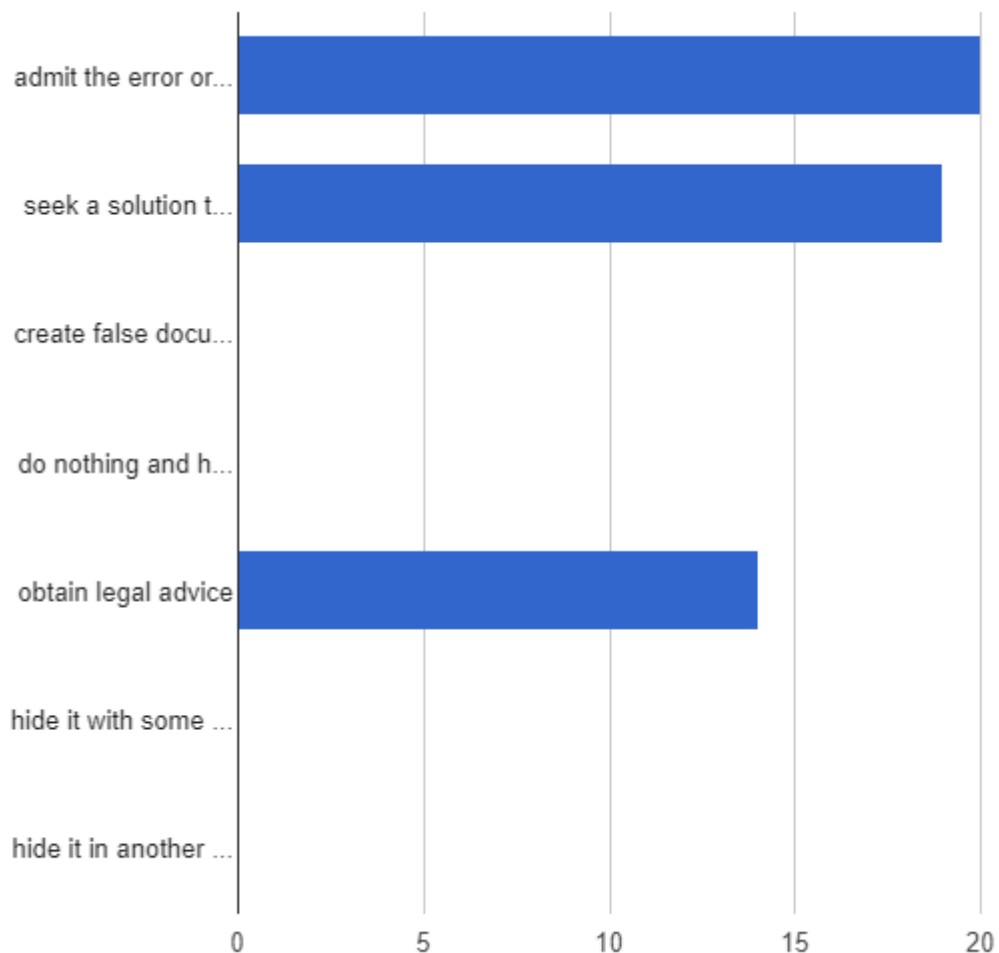
Counts/frequency: **do nothing** (0, 0.0%), **admit the failure** (11, 42.3%), **document the transaction and backdate the document** (3, 11.5%), **document the transaction that records when the transaction occurred without backdating** (13, 50.0%), **obtain legal advice** (15, 57.7%)



32. If an error or mistake was made which of the following responses would you consider to be appropriate:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	3

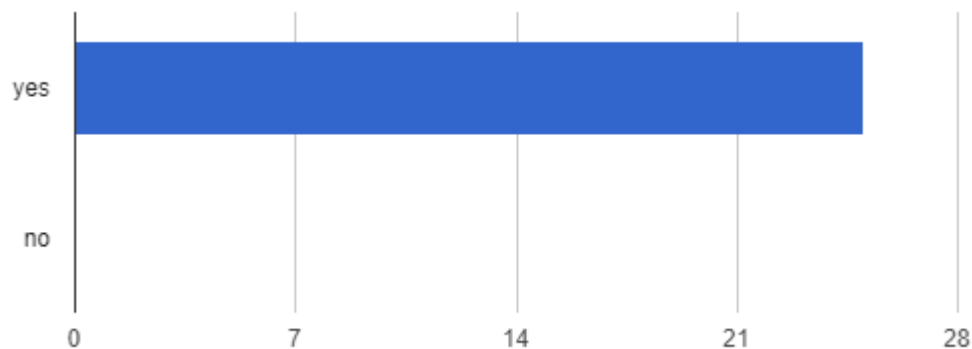
Counts/frequency: admit the error or mistake (20, 74.1%), seek a solution that protects the members of the scheme (19, 70.4%), create false documents to hide the error or mistake (0, 0.0%), do nothing and hope the problem goes away (0, 0.0%), obtain legal advice (14, 51.9%), hide it with some creative accounting (0, 0.0%), hide it in another way (0, 0.0%)



33. Does your organisation have specific rules to exclude directors who have a vested interest in a matter from participating in the decision-making process in relation to that matter?

Total Count (N)	Missing*	Unique
25	2 (7.4%)	1

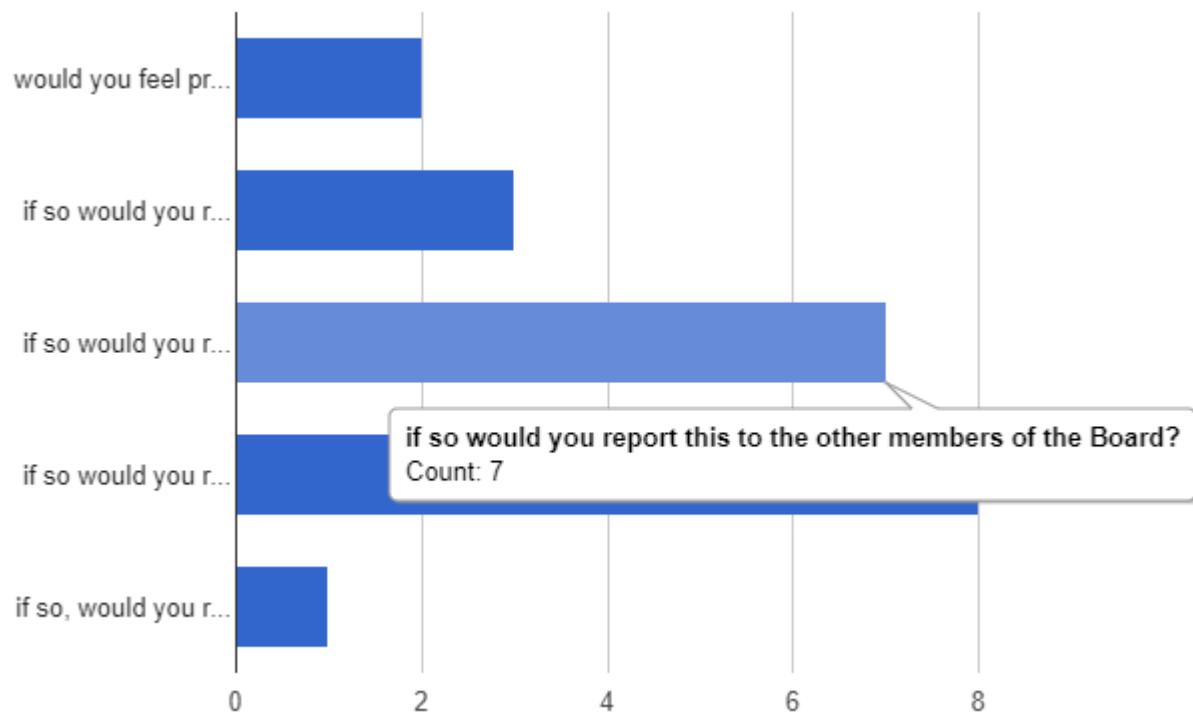
Counts/frequency: **yes** (25, 100.0%), **no** (0, 0.0%)



34. If a member of your Board held or controlled directly or indirectly more than 50% of the voting shares in your organisation:

Total Count (N)	Missing*	Unique
10	17 (63.0%)	5

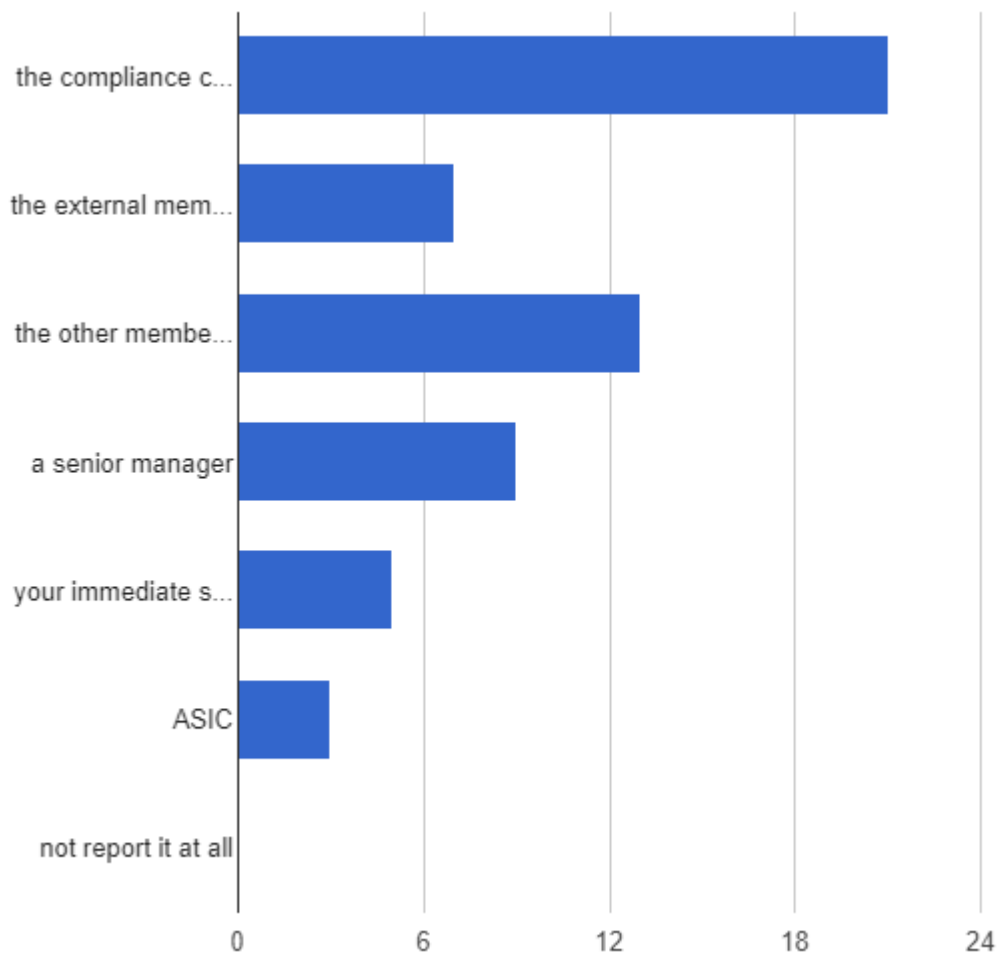
Counts/frequency: **would you feel pressured to follow directions by that member of the Board to act in a manner that you considered contrary to the interests of members of the schemes?** (2, 20.0%), **if so would you report this to your line manager?** (3, 30.0%), **if so would you report this to the other members of the Board?** (7, 70.0%), **if so would you report this to the external members of the compliance committee?** (8, 80.0%), **if so, would you report the matter to ASIC?** (1, 10.0%)



35. If you considered the actions of an officer of your organisation may have been in breach of their duties as an officer of a RE would you report this to:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	6

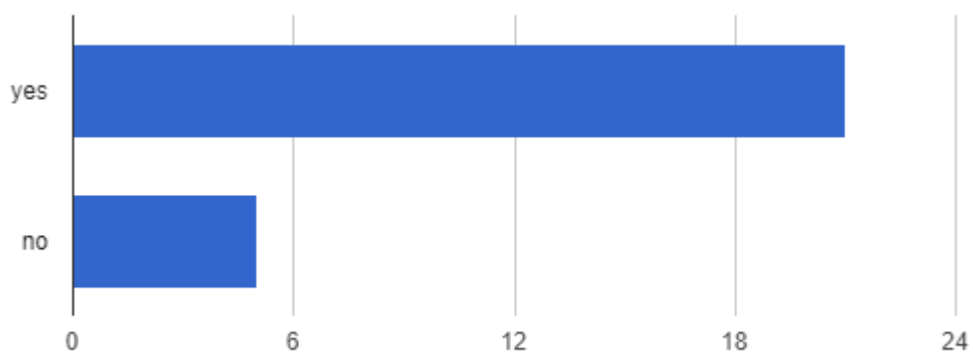
Counts/frequency: the compliance committee (if you have one) (21, 77.8%), the external members of the board (if you have them) (7, 25.9%), the other members of the board (13, 48.1%), a senior manager (9, 33.3%), your immediate supervisor (5, 18.5%), ASIC (3, 11.1%), not report it at all (0, 0.0%)



36. Does your organisation have a whistleblower policy?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

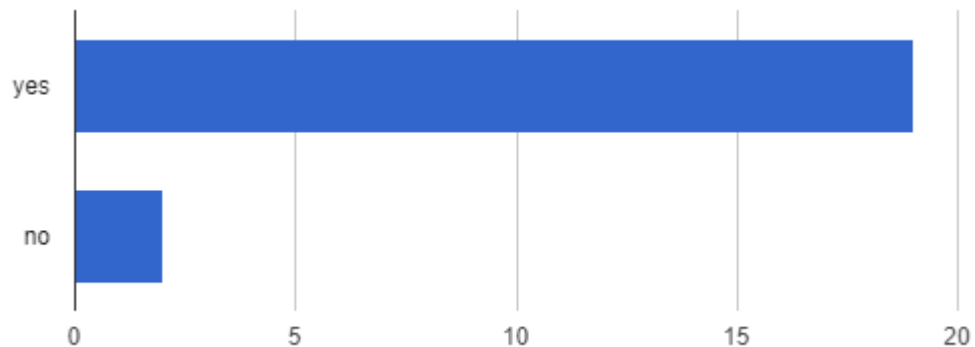
Counts/frequency: **yes** (21, 80.8%), **no** (5, 19.2%)



37. If your organisation has a whistleblower policy, would you report serious breaches of the Corporations Act by your organisation or its officers to ASIC?

Total Count (N)	Missing*	Unique
21	6 (22.2%)	2

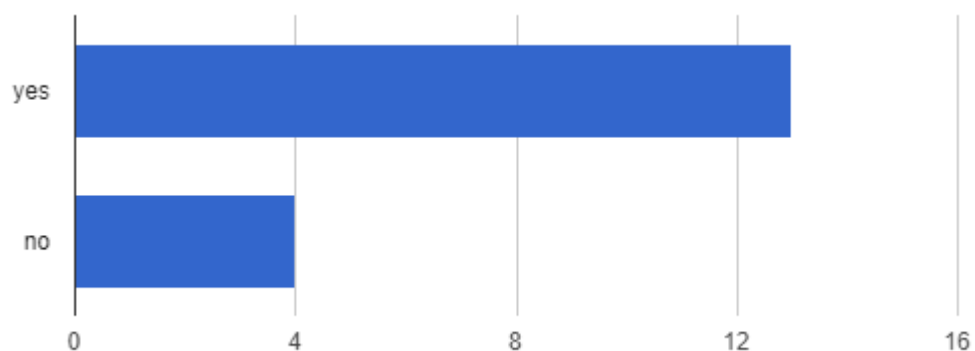
Counts/frequency: **yes** (19, 90.5%), **no** (2, 9.5%)



38. If your organisation does not have a whistleblower policy, would you report serious breaches of the Corporations Act by your organisation or its officers to ASIC?

Total Count (N)	Missing*	Unique
17	10 (37.0%)	2

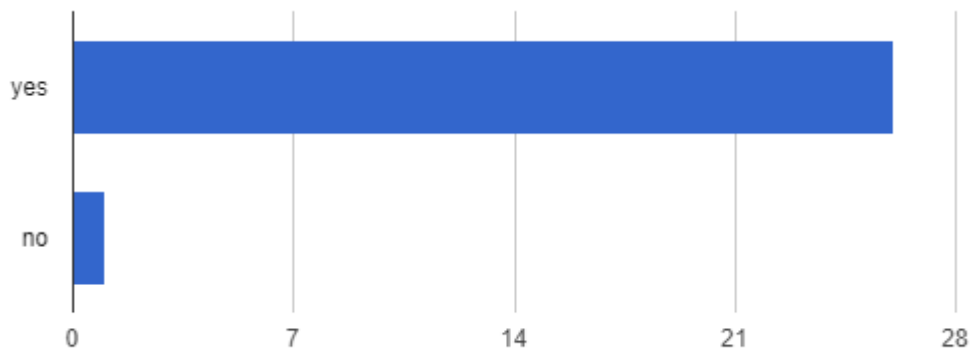
Counts/frequency: **yes** (13, 76.5%), **no** (4, 23.5%)



39. Do you consider your organisation has a good ethical tone at the Board level?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

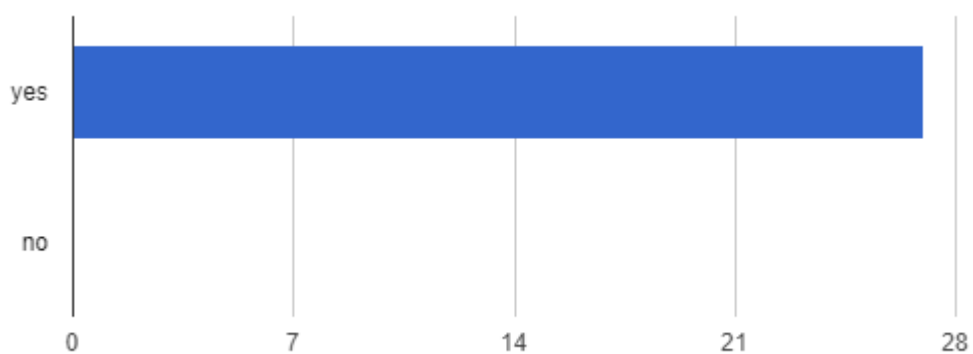
Counts/frequency: **yes** (26, 96.3%), **no** (1, 3.7%)



40. Are the compliance roles and responsibilities in your organisation clearly documented?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	1

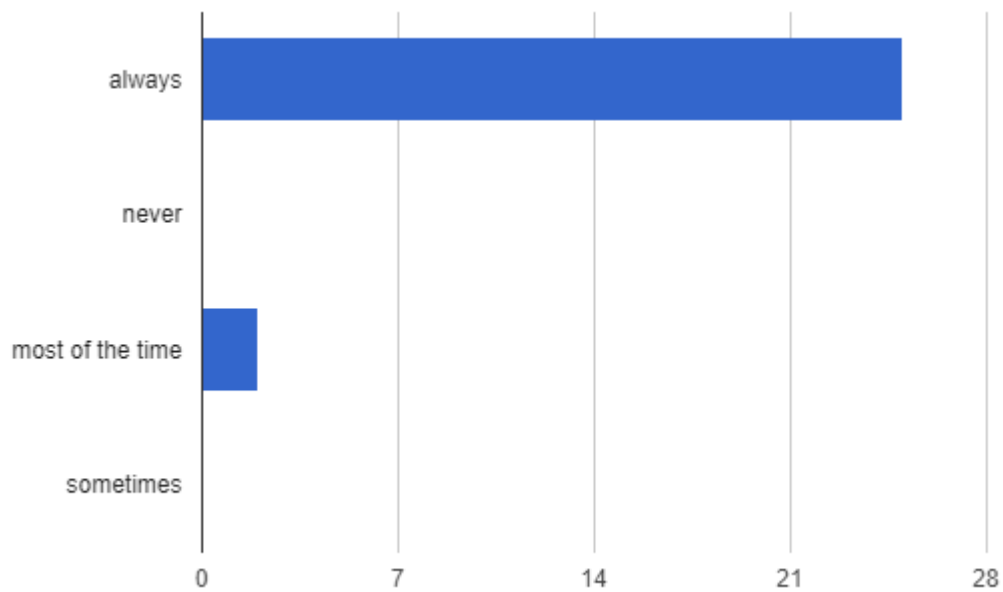
Counts/frequency: **yes** (27, 100.0%), **no** (0, 0.0%)



41. Do you consider your organisation adheres to the requirements of the compliance plan for each scheme which it operates:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

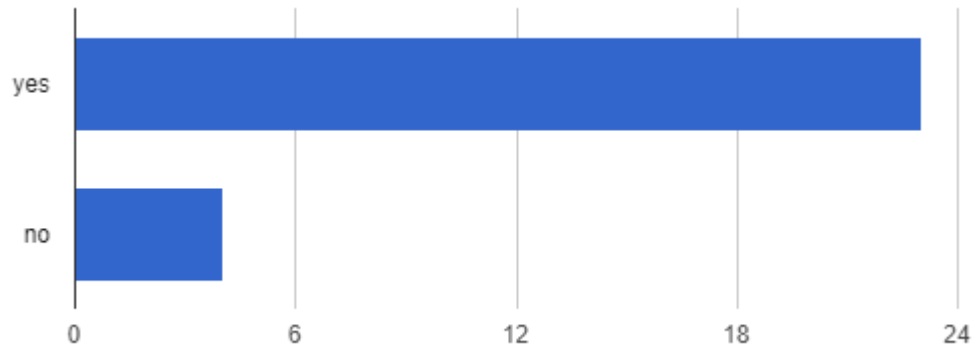
Counts/frequency: **always** (25, 92.6%), **never** (0, 0.0%), **most of the time** (2, 7.4%), **sometimes** (0, 0.0%)



42. Do you consider the compliance plan has an important role in the protection of retail investors who invest in your organisation's schemes?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

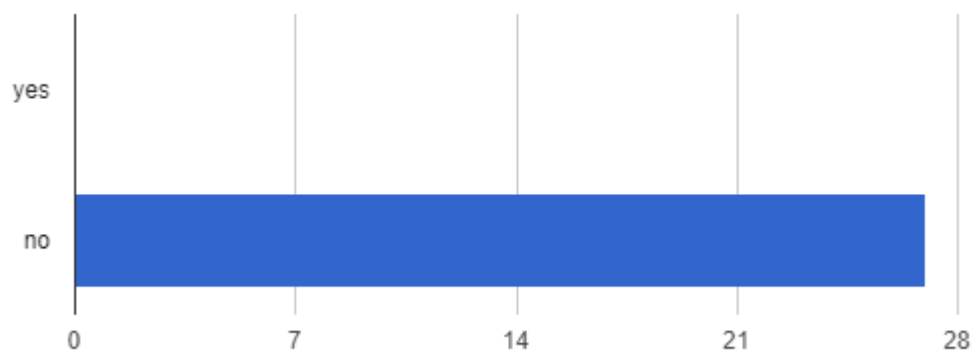
Counts/frequency: **yes** (23, 85.2%), **no** (4, 14.8%)



43. Do you consider your organisation only pays lip service to compliance issues?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	1

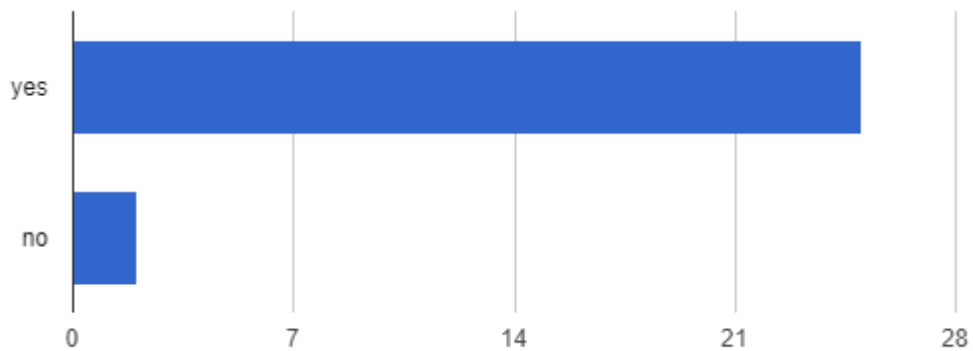
Counts/frequency: **yes** (0, 0.0%), **no** (27, 100.0%)



44. Do you consider your organisation has a compliance focused culture?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

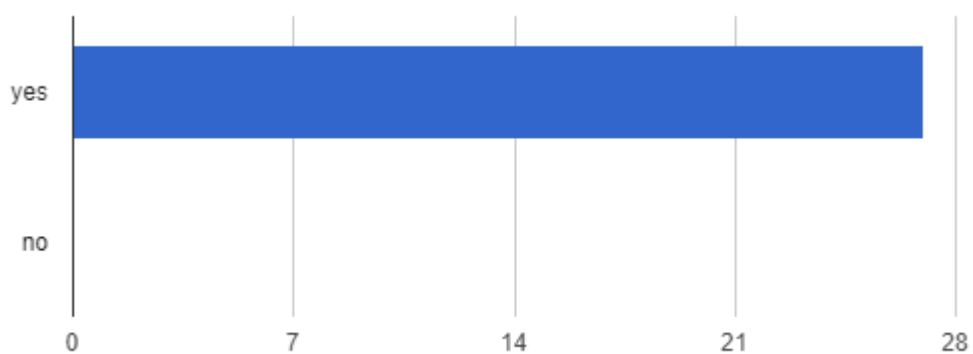
Counts/frequency: **yes** (25, 92.6%), **no** (2, 7.4%)



45. Does the compliance officer/compliance manager in your organisation have direct access to the Board?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	1

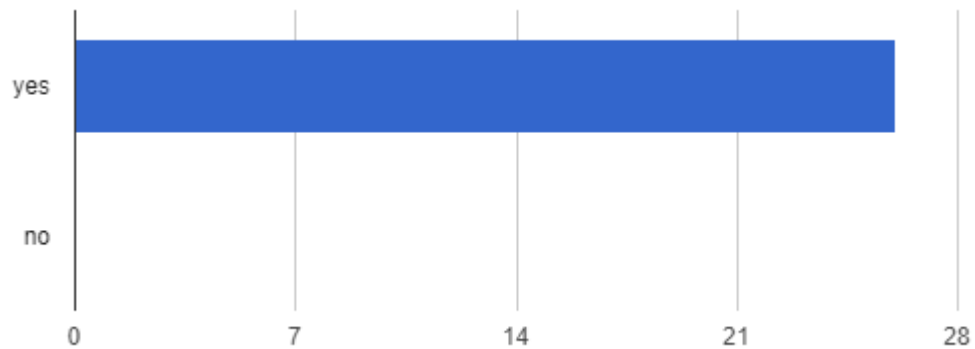
Counts/frequency: **yes** (27, 100.0%), **no** (0, 0.0%)



46. If you have a compliance committee does the compliance officer/compliance manager attend the compliance committee meetings?

Total Count (N)	Missing*	Unique
26	<u>1 (3.7%)</u>	1

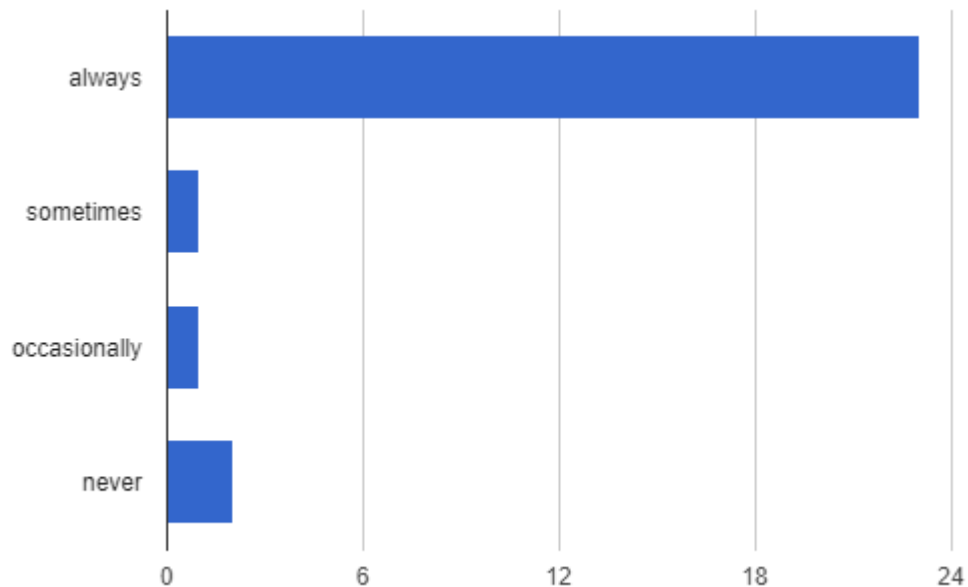
Counts/frequency: **yes** (26, 100.0%), **no** (0, 0.0%)



47. Does the compliance officer/compliance manager in your organisation attend Board meetings:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	4

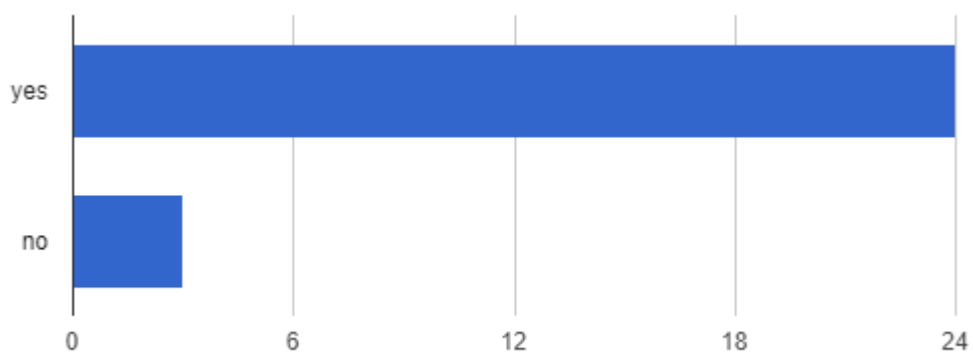
Counts/frequency: **always** (23, 85.2%), **sometimes** (1, 3.7%), **occasionally** (1, 3.7%), **never** (2, 7.4%)



48. Do you consider your organisation allocates adequate resources to compliance?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

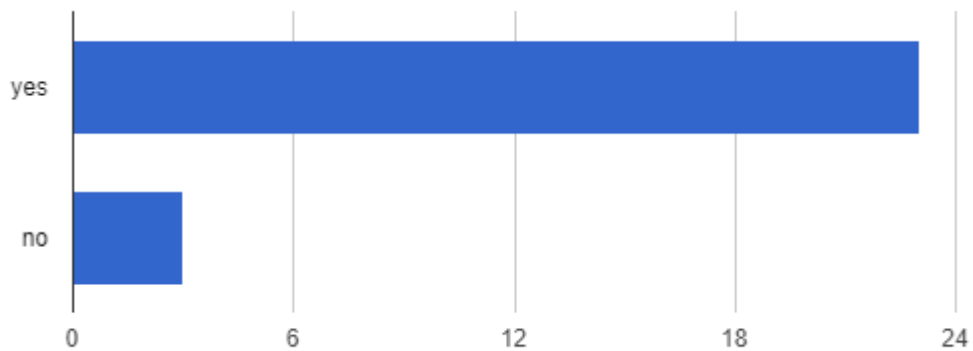
Counts/frequency: **yes** (24, 88.9%), **no** (3, 11.1%)



49. Does your organisation provide training for compliance personnel?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

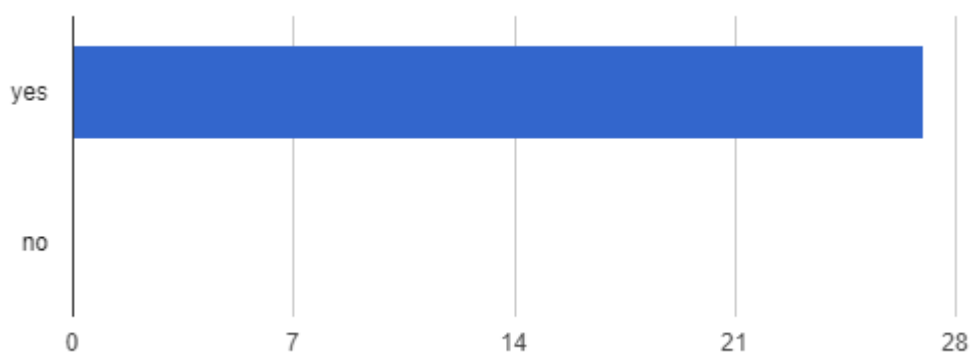
Counts/frequency: **yes** (23, 88.5%), **no** (3, 11.5%)



50. Would you consider reporting what you consider to be serious compliance breaches to ASIC?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	1

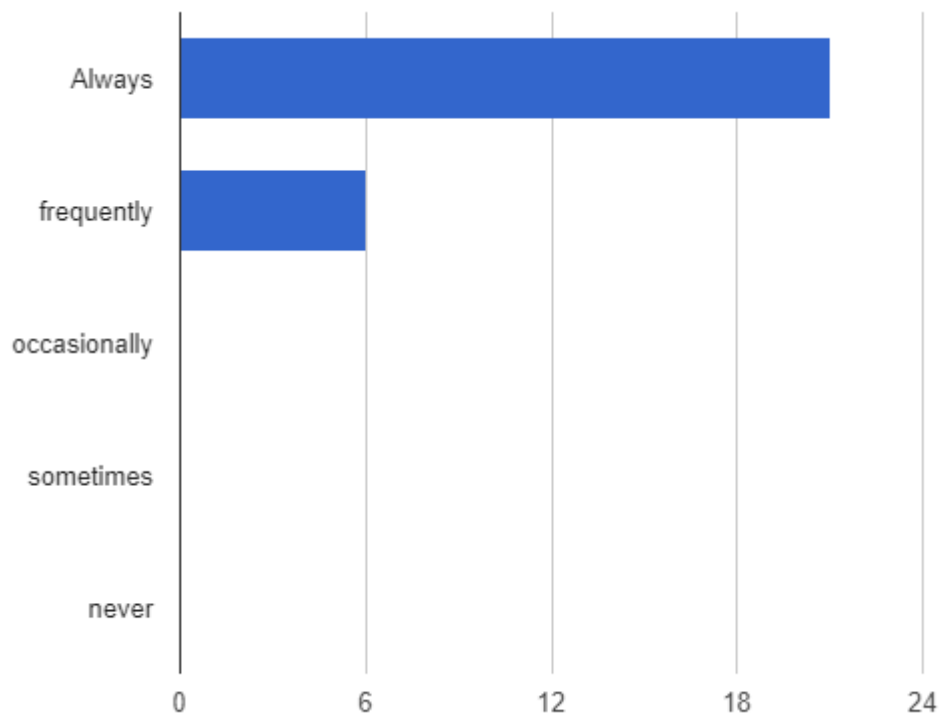
Counts/frequency: **yes** (27, 100.0%), **no** (0, 0.0%)



51. In your organisation, is compliance advice to line managers followed:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

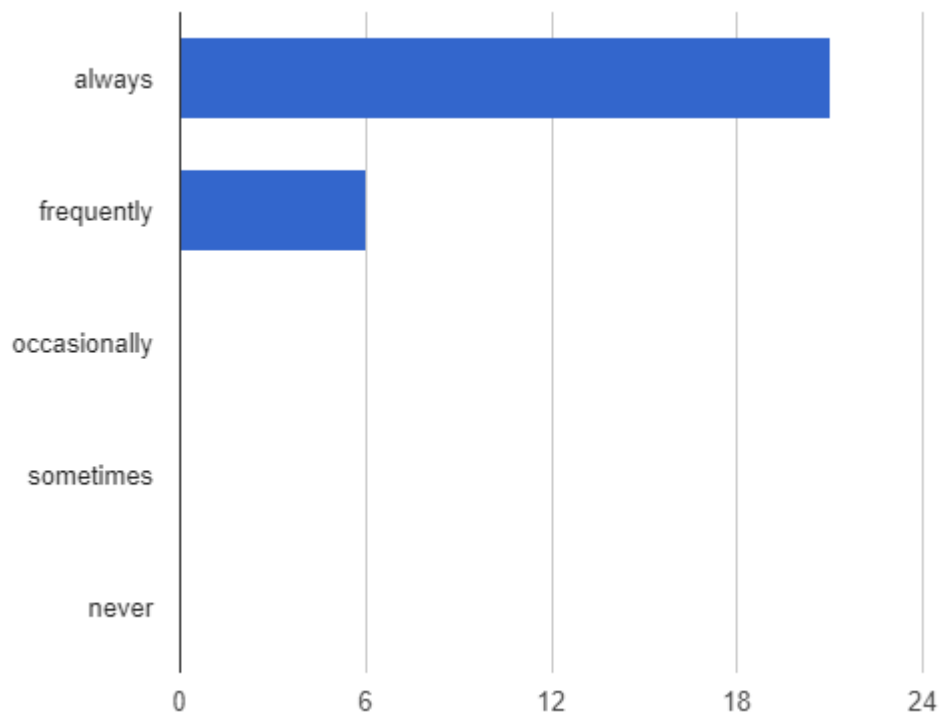
Counts/frequency: Always (21, 77.8%), frequently (6, 22.2%), occasionally (0, 0.0%), sometimes (0, 0.0%), never (0, 0.0%)



52. In your organisation is compliance advice to the Board followed:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

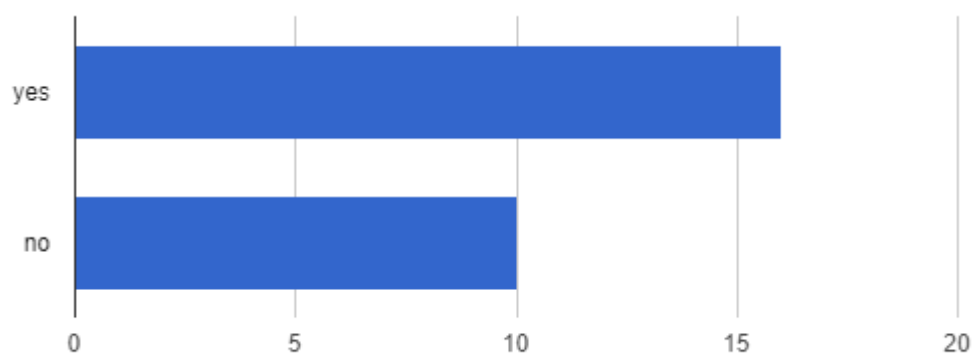
Counts/frequency: always (21, 77.8%), frequently (6, 22.2%), occasionally (0, 0.0%), sometimes (0, 0.0%), never (0, 0.0%)



53. Does your organisation remunerate staff with bonuses by reference to the profit made by the organisation?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

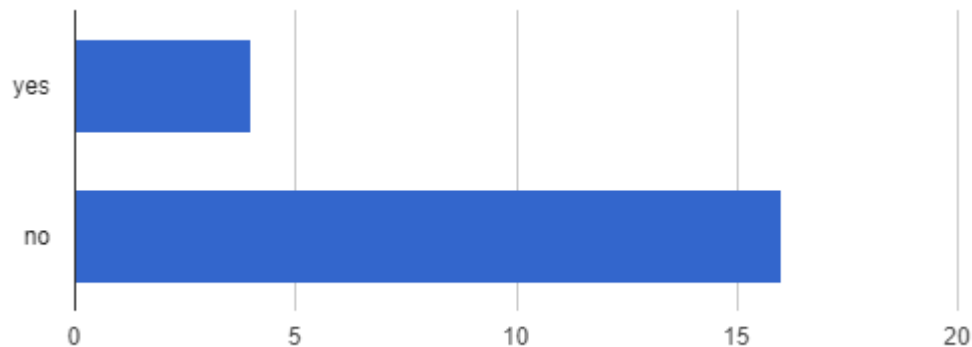
Counts/frequency: **yes** (16, 61.5%), **no** (10, 38.5%)



54. If your organisation remunerates staff with bonuses by reference to the profit made, do you consider this affects the decision-making by those members of staff?

Total Count (N)	Missing*	Unique
20	7 (25.9%)	2

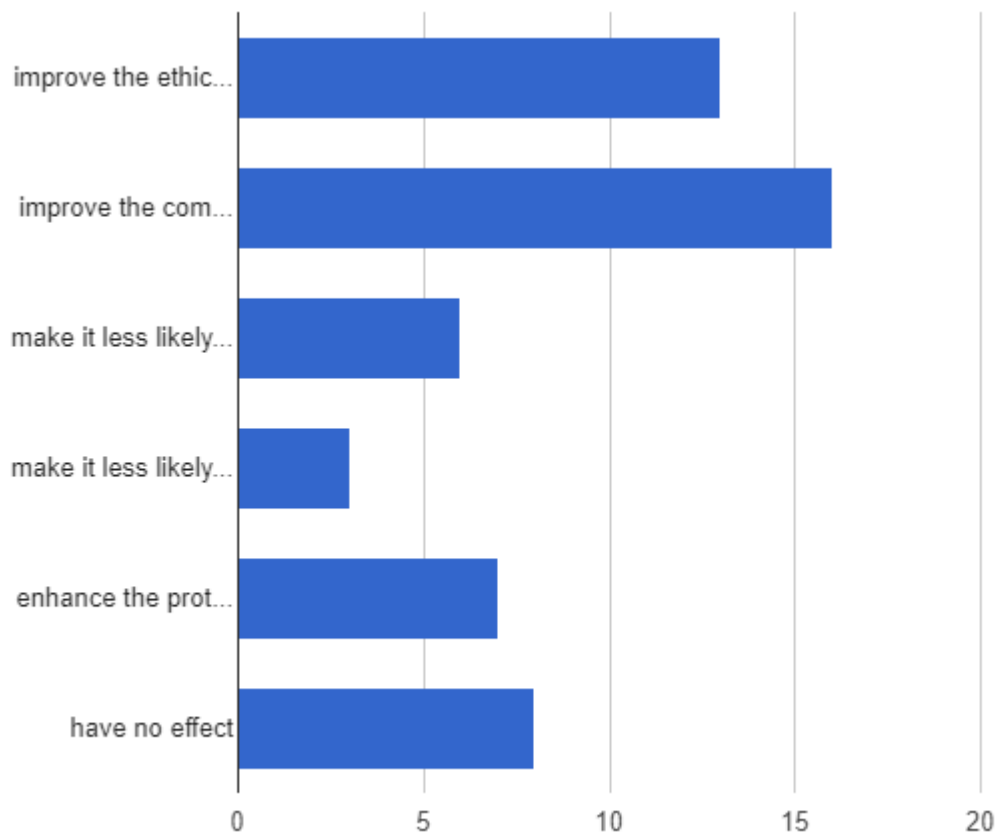
Counts/frequency: **yes** (4, 20.0%), **no** (16, 80.0%)



55. Do you consider that ethics training of the staff in your organisation would:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	6

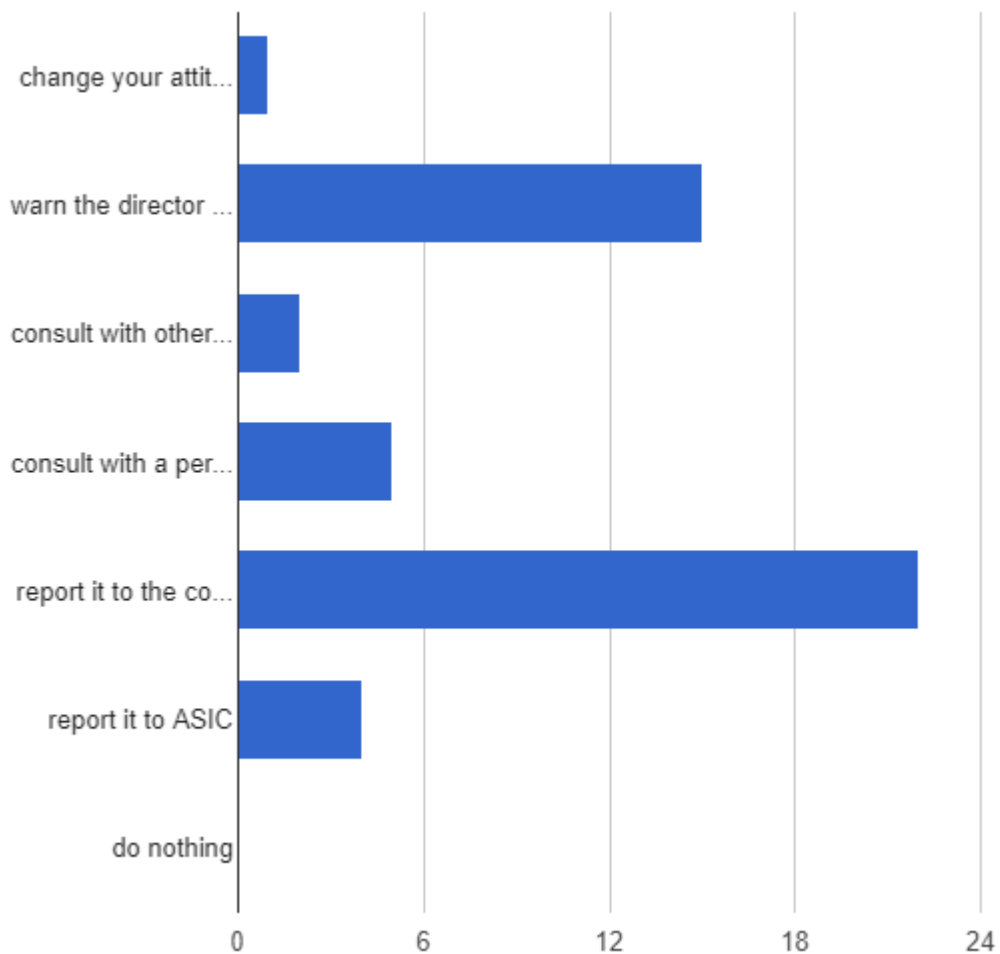
Counts/frequency: **improve the ethical tone of your organisation?** (13, 48.1%), **improve the compliance culture of your organisation?** (16, 59.3%), **make it less likely that there would be breaches of duties by the RE?** (6, 22.2%), **make it less likely that there would be breaches of duties by the officers of the RE?** (3, 11.1%), **enhance the protection of retail investors in the schemes operated by your organisation** (7, 25.9%), **have no effect** (8, 29.6%)



56. If you observed a director of your organisation benefiting from a transaction that was in your view detrimental to the members of the scheme would you:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	6

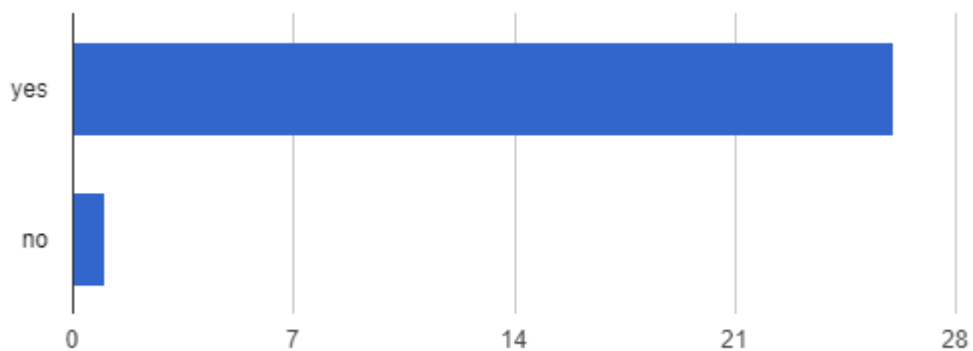
Counts/frequency: change your attitude towards corporate governance (1, 3.7%), warn the director concerned (15, 55.6%), consult with other staff members as to what action you should take (2, 7.4%), consult with a person you respect as to what action you should take (5, 18.5%), report it to the compliance committee or external directors (22, 81.5%), report it to ASIC (4, 14.8%), do nothing (0, 0.0%)



57. Do you consider that the Board of your organisation behaves ethically?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

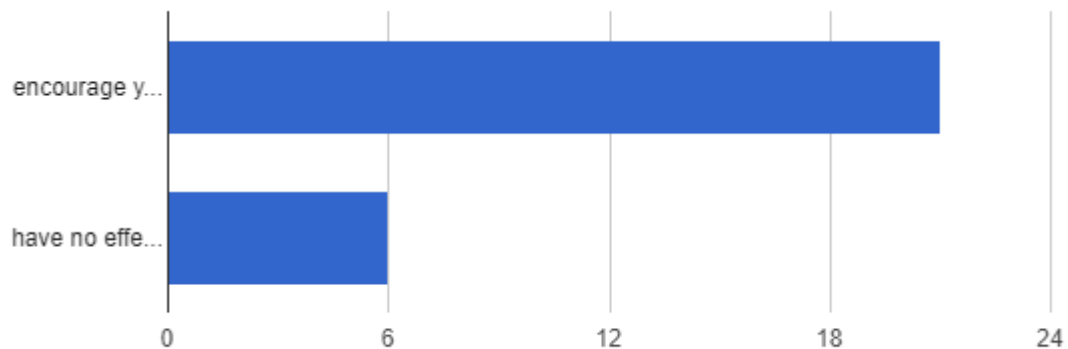
Counts/frequency: **yes** (26, 96.3%), **no** (1, 3.7%)



58. If you consider that the Board of your organisation behaves ethically does this:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

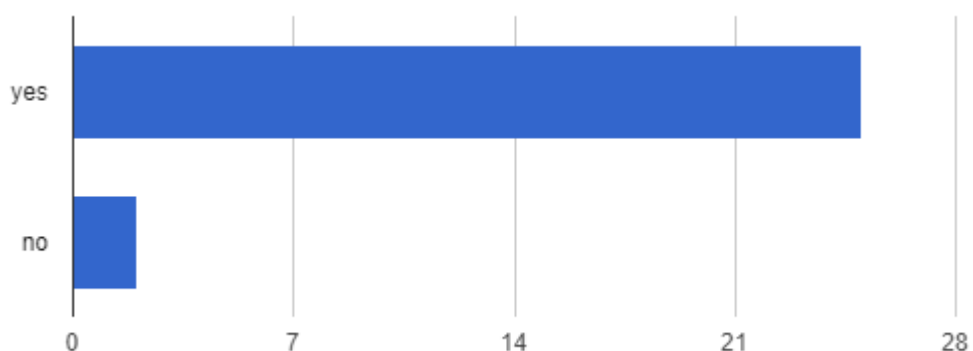
Counts/frequency: encourage you to behave ethically (21, 77.8%), have no effect on you (6, 22.2%)



59. Does your organisation make full disclosure of related party transactions to members of the scheme which it operates even if it is at arm's length?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

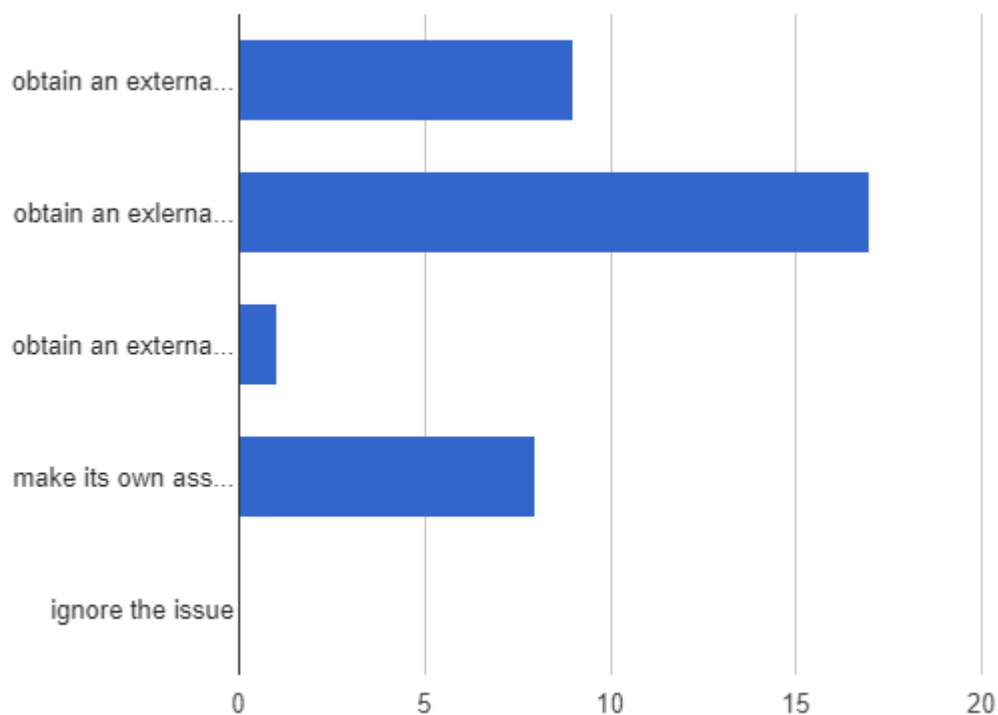
Counts/frequency: yes (25, 92.6%), no (2, 7.4%)



60. When assessing whether a meeting of members is required to approve a related party transaction does your organisation:

Total Count (N)	Missing*	Unique
25	2 (7.4%)	4

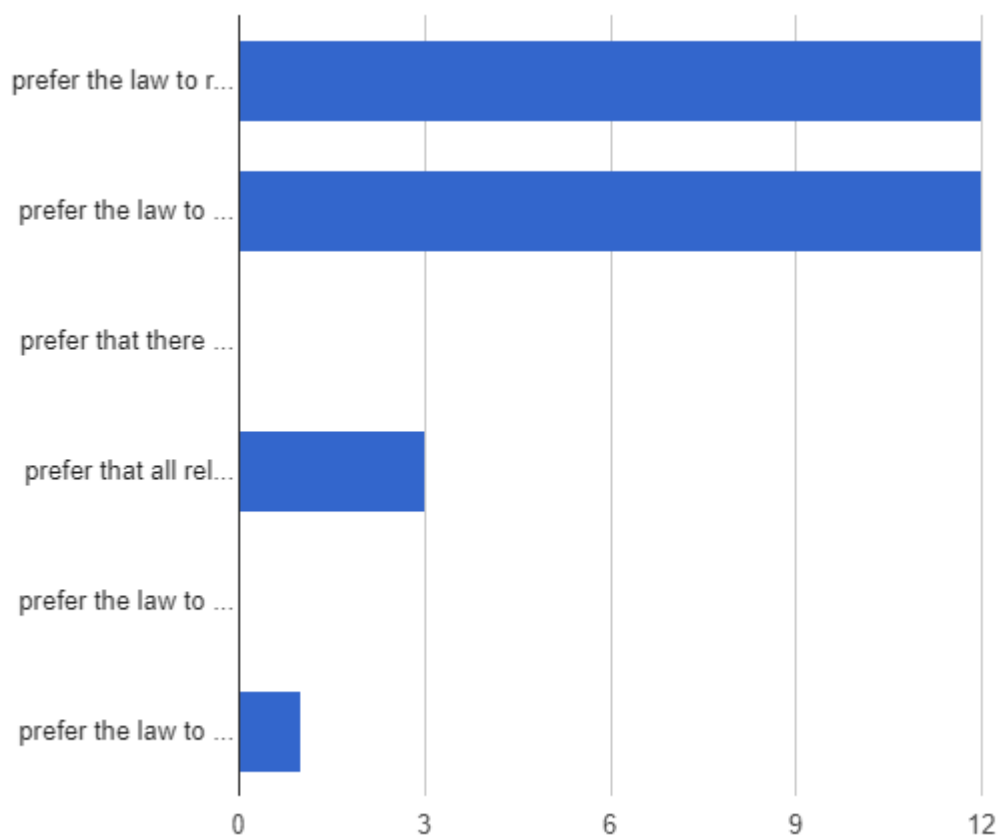
Counts/frequency: **obtain an external valuation?** (9, 36.0%), **obtain an external sign off by legal firm?** (17, 68.0%), **obtain an external sign off by an auditor?** (1, 4.0%), **make its own assessment** (8, 32.0%), **ignore the issue** (0, 0.0%)



61. In relation to related party transactions would you:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	4

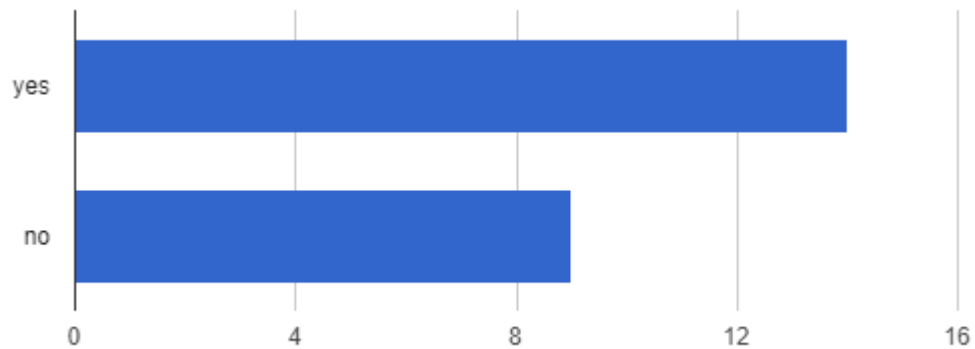
Counts/frequency: prefer the law to remain as it is (12, 44.4%), prefer the law to permit the transaction if full disclosure is made to members (12, 44.4%), prefer that there be no arm's length exception (0, 0.0%), prefer that all related party transactions be approved by ordinary resolution of the members (3, 11.1%), prefer the law to permit the transaction if the value is less than 10% of the net asset value of the fund (0, 0.0%), prefer the law to permit the transaction if the value is less than 5% of the net asset value of the fund (1, 3.7%)



62. Do you find the existing provisions in Chapter 5C.7 of the Corporations Act in relation to related party transactions by the RE difficult to follow and administer?

Total Count (N)	Missing*	Unique
23	4 (14.8%)	2

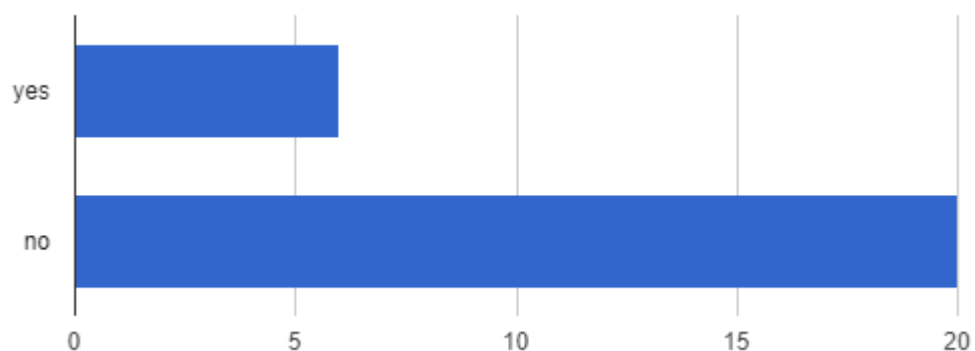
Counts/frequency: **yes** (14, 60.9%), **no** (9, 39.1%)



63. Has your organisation in the past 10 years replaced an insolvent RE of a solvent scheme?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

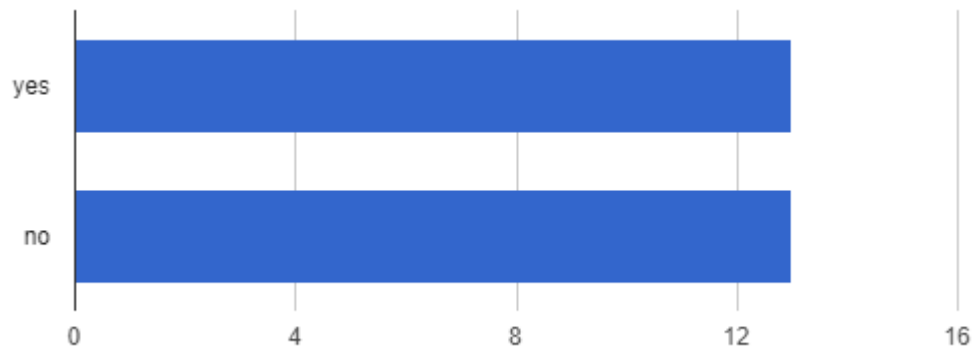
Counts/frequency: **yes** (6, 23.1%), **no** (20, 76.9%)



64. Has your organisation in the past 10 years been approached to replace an insolvent RE of a solvent scheme?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

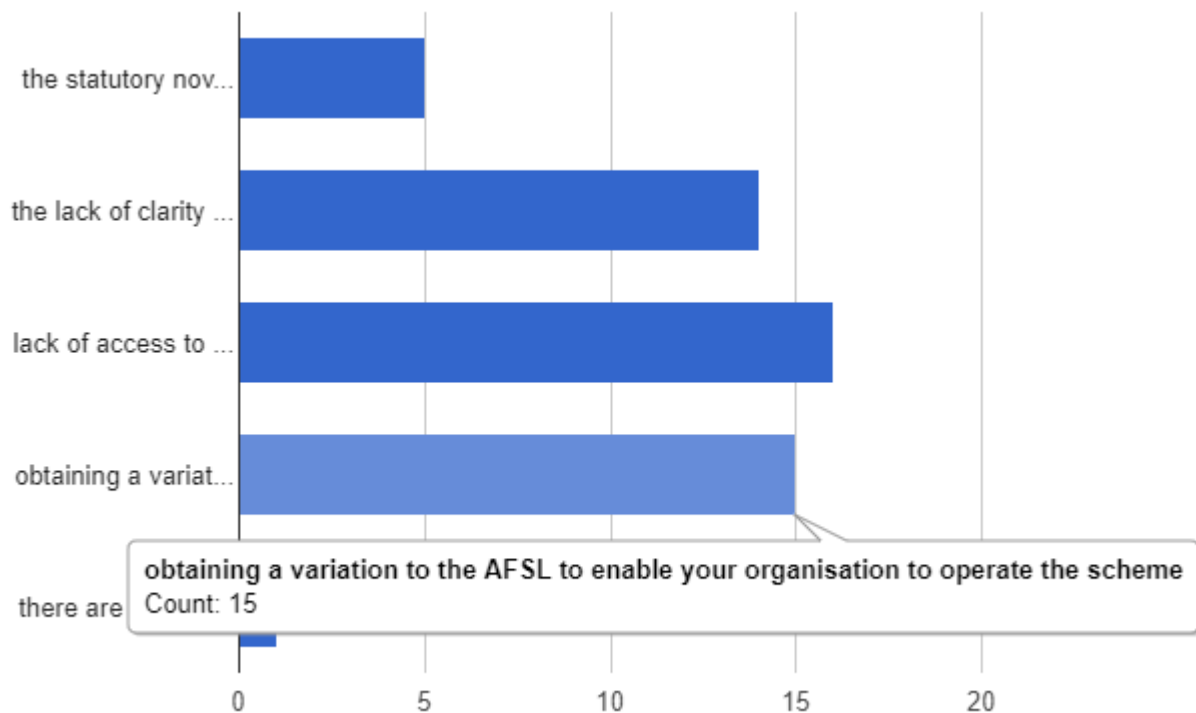
Counts/frequency: **yes** (13, 50.0%), **no** (13, 50.0%)



65. Which of the following issues do you consider make it difficult for your organisation to accept an appointment to replace an existing RE:

Total Count (N)	Missing*	Unique
23	4 (14.8%)	5

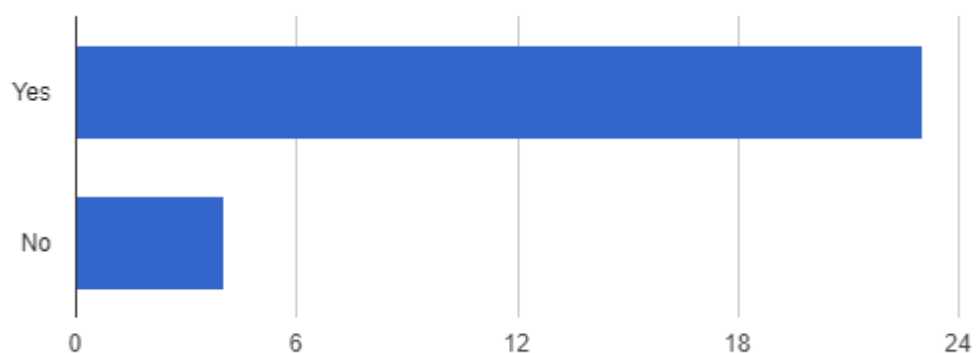
Counts/frequency: **the statutory novation provisions** (5, 21.7%), **the lack of clarity on what liabilities which may be assumed under the statutory novation provisions** (14, 60.9%), **lack of access to information to carry out proper due diligence** (16, 69.6%), **obtaining a variation to the AFSL to enable your organisation to operate the scheme** (15, 65.2%), **there are no issues that would affect the decision to accept an appointment** (1, 4.3%)



66. Should REs be required to maintain a register of contracts and scheme property which is available for inspection in the event of a proposed change of RE?

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

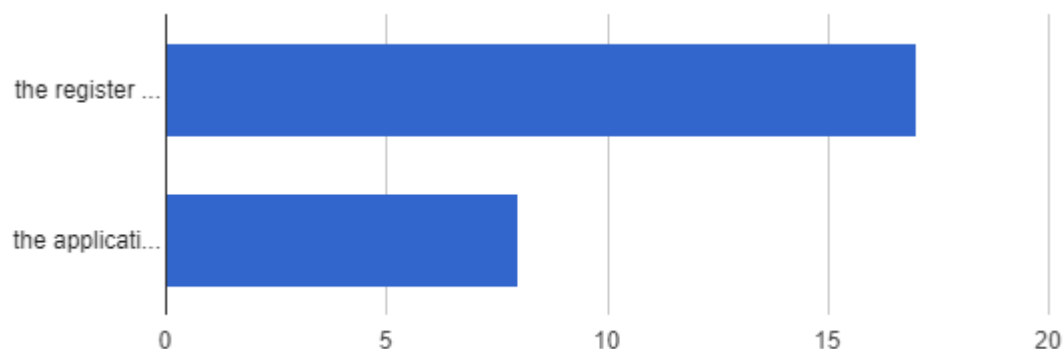
Counts/frequency: Yes (23, 85.2%), No (4, 14.8%)



67. If a register of contracts and scheme property was a requirement of law, do you agree that:

Total Count (N)	Missing*	Unique
23	4 (14.8%)	2

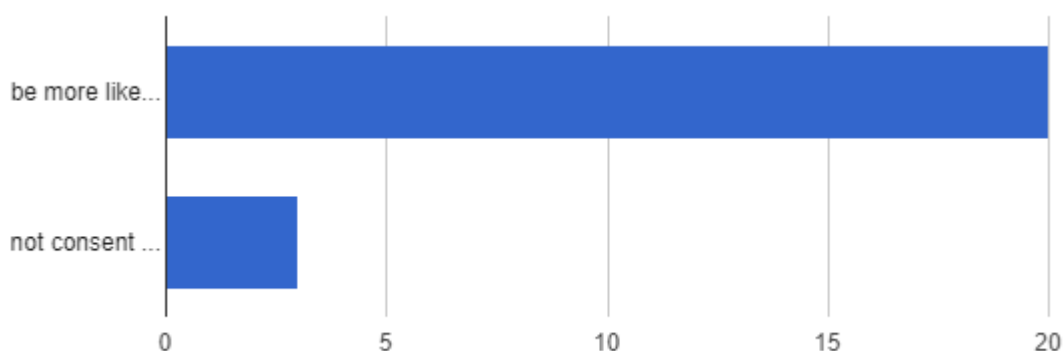
Counts/frequency: the register should be definitive (17, 73.9%), the application of the statutory novation provisions to a contract not in the register should only be at the election of the incoming RE (8, 34.8%)



68. If your organisation has access to a register of contracts and scheme property maintained by the current RE, would your organisation (subject to satisfactory due diligence of those registers):

Total Count (N)	Missing*	Unique
23	4 (14.8%)	2

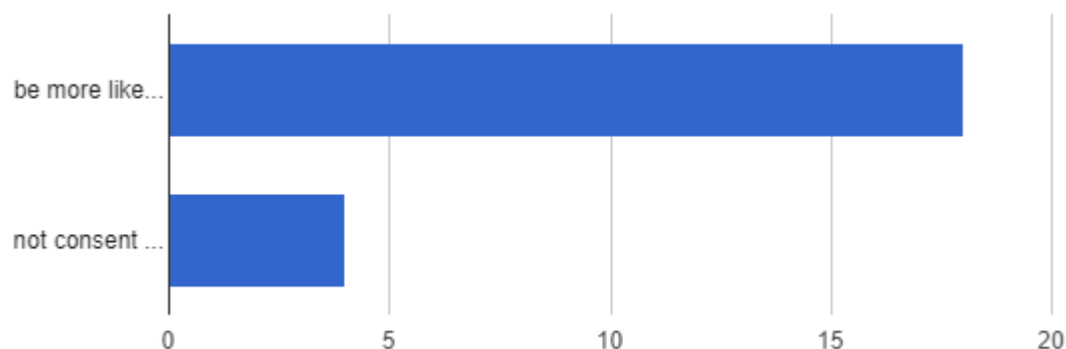
Counts/frequency: be more likely than not to consent to an appointment as a temporary RE or replacement RE than it would under current law (20, 87.0%), not consent to an appointment as a temporary RE or replacement RE as a matter of policy (3, 13.0%)



69. If the statutory novation provisions were amended to exclude the novation of liabilities of the former RE, would your organisation:

Total Count (N)	Missing*	Unique
22	5 (18.5%)	2

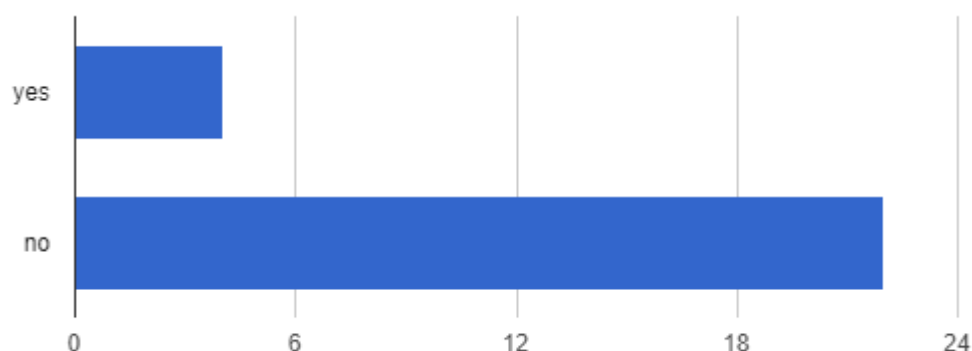
Counts/frequency: be more likely than not to consent to an appointment as a temporary RE or replacement RE than you would under the current law (18, 81.8%), not consent to an appointment as a temporary RE or replacement RE as a matter of policy (4, 18.2%)



70. If the law was amended to require officers to hold industry specific qualifications including in MIS law and ethics would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

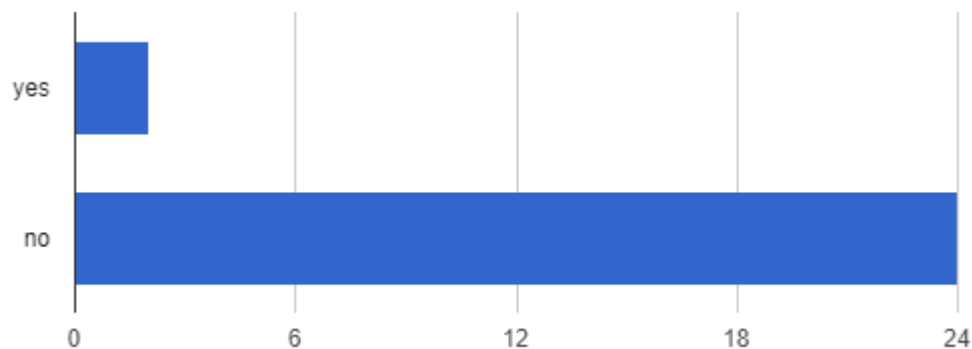
Counts/frequency: yes (4, 15.4%), no (22, 84.6%)



71. If the law was changed to require the RE to notify ASIC and members of the scheme of changes in the membership of a compliance committee, would this cause your organisation to reduce the availability of its products to retail clients ?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

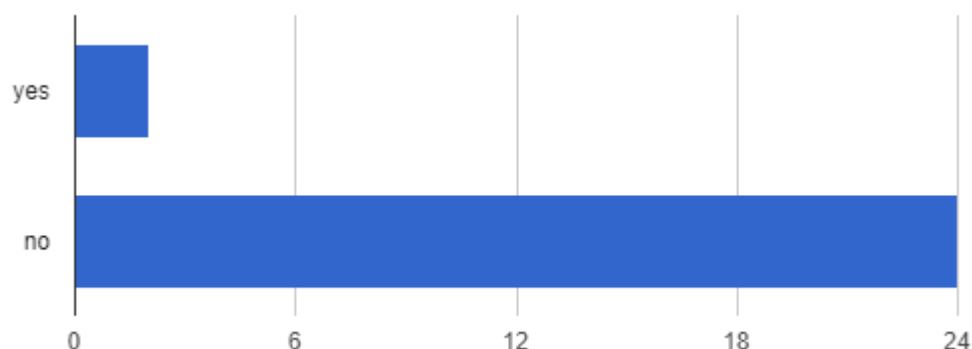
Counts/frequency: **yes** (2, 7.7%), **no** (24, 92.3%)



72. If the law was amended to require a member of the compliance committee to hold relevant tertiary qualifications and work experience before appointment would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

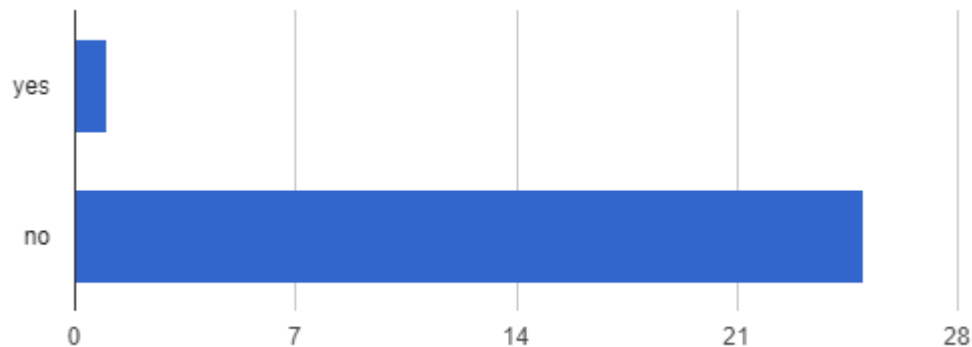
Counts/frequency: **yes** (2, 7.7%), **no** (24, 92.3%)



73. If the law was amended to require officers to undertake annual CPD would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*	Unique
26	1 (3.7%)	2

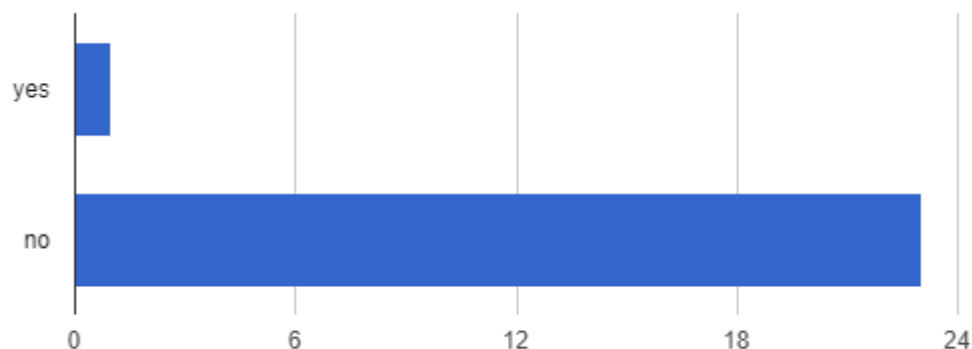
Counts/frequency: **yes** (1, 3.8%), **no** (25, 96.2%)



74. If the related party transaction provisions as they apply to MIS were specific rather than being cross-referenced to Chapter 2E of the Corporations Act would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*	Unique
24	3 (11.1%)	2

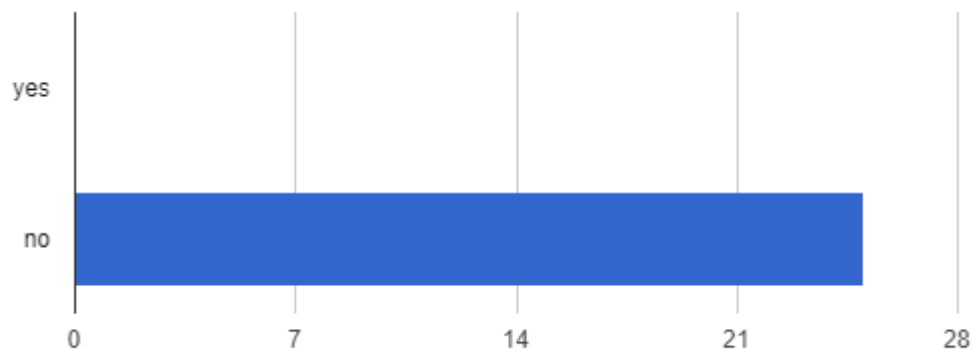
Counts/frequency: **yes** (1, 4.2%), **no** (23, 95.8%)



75. If the law was amended to require REs to keep registers of contracts and scheme property so that in the event of a proposed change of RE, due diligence could be carried out by an incoming RE, would this cause your organisation to reduce the availability of its products to the retail investor?

Total Count (N)	Missing*	Unique
25	2 (7.4%)	1

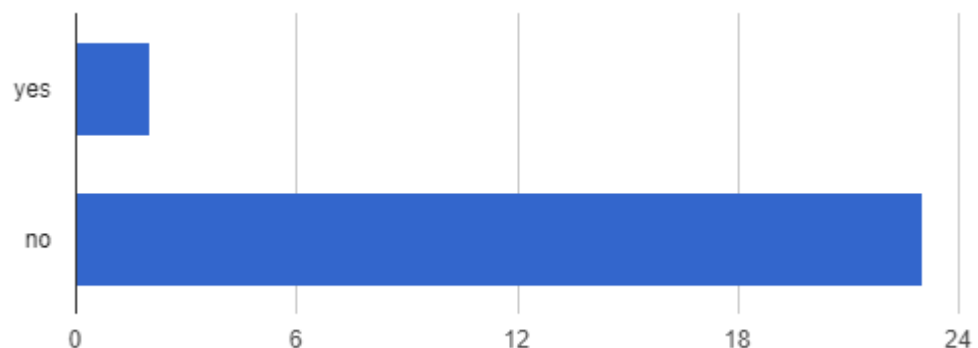
Counts/frequency: **yes** (0, 0.0%), **no** (25, 100.0%)



76. If the law was amended to remove "liabilities" from the statutory novation provisions, would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*		Unique
25	2 (7.4%)		2

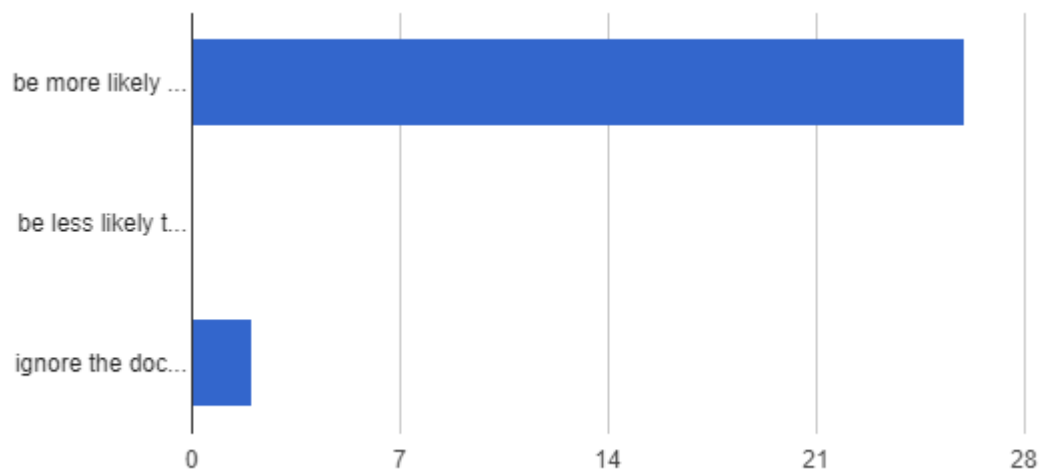
Counts/frequency: **yes** (2, 8.0%), **no** (23, 92.0%)



77. If retail clients were provided with a simple short form "Fund Facts Document" do you consider that retail investors would:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	2

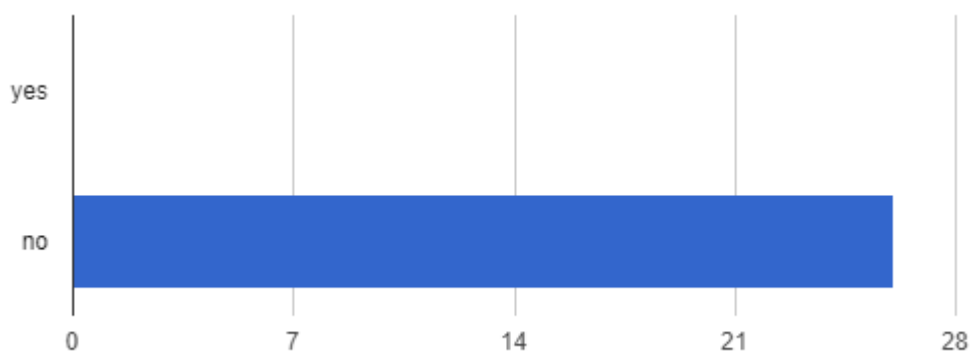
Counts/frequency: be more likely to read it than a full PDS (26, 96.3%), be less likely to read it than a full PDS (0, 0.0%), ignore the document (2, 7.4%)



78. If retail investors were required to be provided with a simple summary short form 'Fund Facts Document' with a PDS, would this cause your organisation to reduce the availability of its products to retail investors

Total Count (N)	Missing*	Unique
26	<u>1 (3.7%)</u>	1

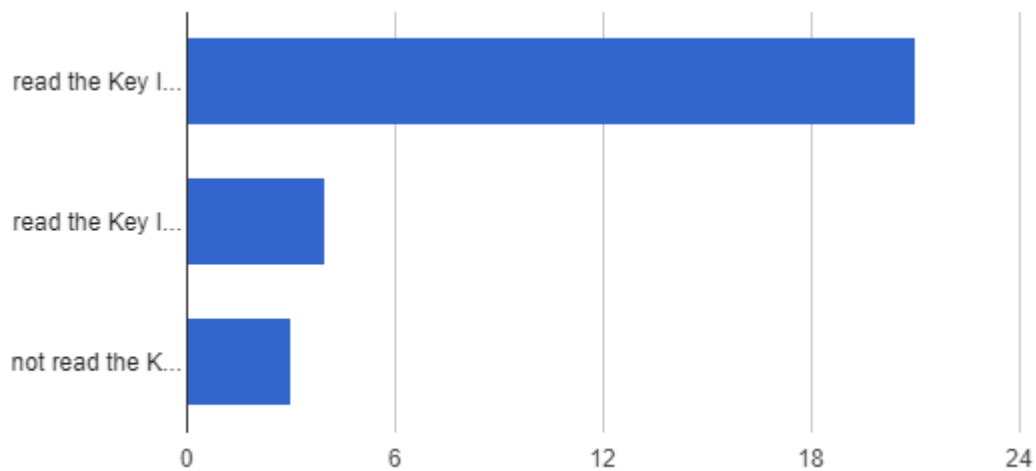
Counts/frequency: yes (0, 0.0%), no (26, 100.0%)



79. If your PDS contained a simple short form Key Information Statement up front do you consider retail investors would:

Total Count (N)	Missing*	Unique
27	0 (0.0%)	3

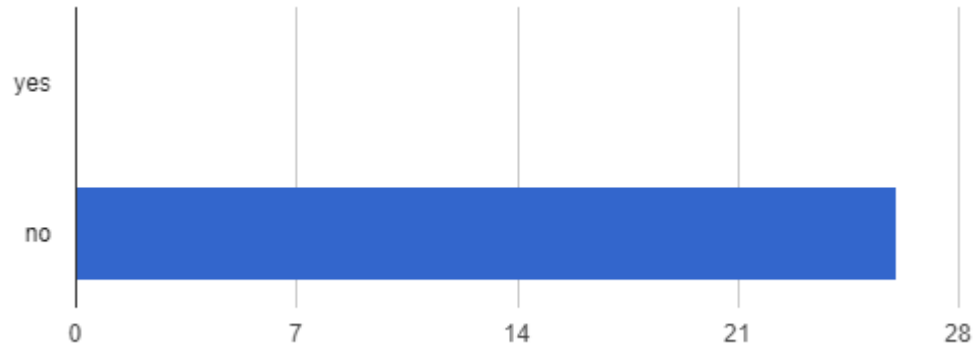
Counts/frequency: read the Key Information Statement but not the rest of the PDS (21, 77.8%), read the Key Information Statement and the PDS (4, 14.8%), not read the Key Information Statement or the whole PDS (3, 11.1%)



80. If you were required to include in a PDS an up-front Key Information Statement of no more than four pages at the front of the PDS, would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*	Unique
26	<u>1 (3.7%)</u>	1

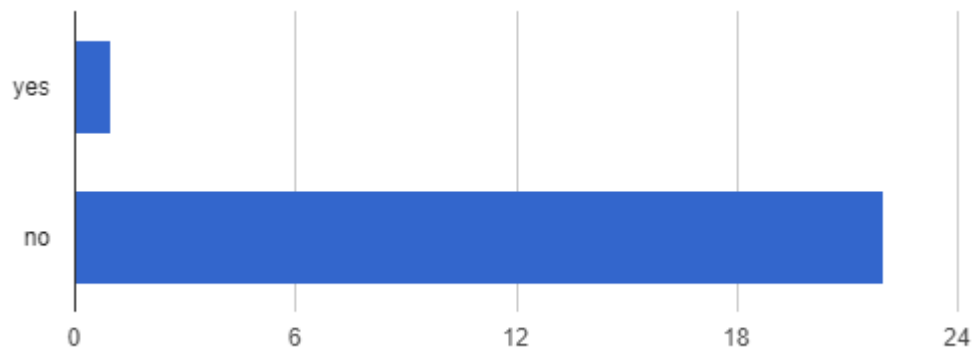
Counts/frequency: yes (0, 0.0%), no (26, 100.0%)



81. If the product disclosure provisions were changed to an outcomes-based model would this cause your organisation to reduce the availability of its products to retail clients?

Total Count (N)	Missing*	Unique
23	4 (14.8%)	2

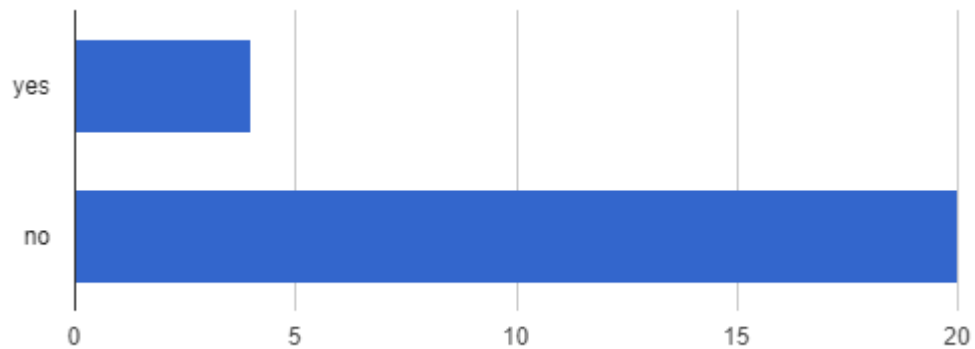
Counts/frequency: **yes** (1, 4.3%), **no** (22, 95.7%)



82. as your organisation reduced the availability of product to retail investors as a result of the design and distribution obligations?

Total Count (N)	Missing*	Unique
24	3 (11.1%)	2

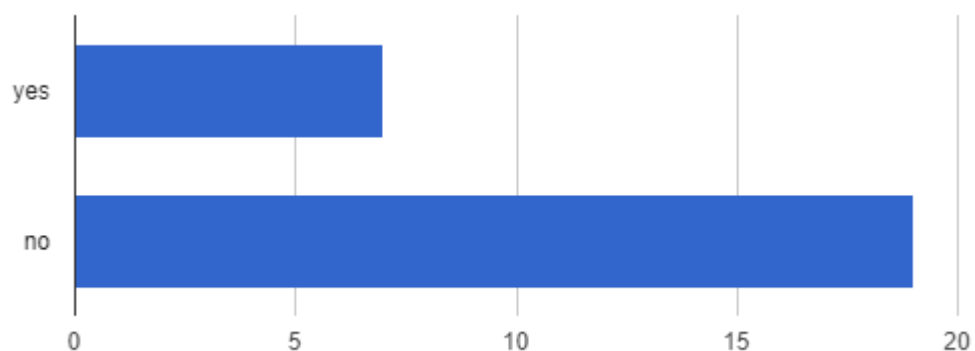
Counts/frequency: **yes** (4, 16.7%), **no** (20, 83.3%)



83. Has your organisation increased its fees as a result of the introduction of the design and distribution obligations?

Total Count (N)	Missing*	Unique
25	2 (7.4%)	2

Counts/frequency: **yes** (7, 28.0%), **no** (19, 76.0%)



Appendix 9 – Qualitative Research

As stated in Chapter 2 of the body of the thesis, in answering the Research Questions, a mixed methodology was used. This comprised a combination of legal, quantitative and qualitative research methods. The application of these methodologies was undertaken to take advantage of the strengths of each of these alternative methodologies.¹ The aim was to push ‘through settled legal questions to address questions that are complex and unresolved in the legal system’.² It was also to assist in triangulation.³ Figure 2.1 (Diagrammatic Representation of the Research Approach of this Thesis) at page 346 is a diagrammatic illustration of the approach.

As part of this research project, qualitative research in the form of an interview of two managing directors or REs who have been in the MIS industry prior to the *Managed Investments Act 1998* and who survived the crashes in the MIS industry after the global financial crisis (GFC) was undertaken.

The interview is an accepted form of qualitative research and, in fact, is the most common method of qualitative research.⁴ The qualitative interview is used in all kinds of qualitative research, including positivist, interpretive and critical theory.⁵ There is no reason why it cannot be used in conjunction with legal research methodology and quantitative research.

Although small-N studies are criticised as failing to generalise because the small sample means the results are not representative, Tsoukas argues that this is a

¹ Margaret McKerchar, ‘Philosophical paradigms, inquiry strategies and knowledge claims: applying the principles of research design and conduct to taxation’ (2008) 6(1) *eJournal of Tax Research* 5, 20; Pat Bazeley and Lynn Kemp, ‘Mosaics, Triangles, and DNA: Metaphors for Integrated Analysis in Mixed Methods Research’ (2012) 6(1) *Journal of Mixed Methods Research* 55, 56.

² Theunis Roux ‘Judging the Quality of Legal Research: A Qualified Response to the Demand for Greater Methodological Rigour’ (2014) 24 *Legal Education Review* 173, 187.

³ Mary Yoko Brannen and Mark F Peterson ‘Merging without alienating: interventions promoting cross-cultural organizational integration and their limitations’ (2009) 40 *Journal International Business Studies* 468.

⁴ Michael D. Myers ‘Overview of Qualitative Research’ in ‘*Qualitative Research in Business and Management*’ (Thousand Oaks, CA: Sage, 2013) 5, 8.

⁵ Michael D. Myers and Michael Newman ‘The qualitative interview in IS research: Examining the craft’ (2007) 17 *Information and Organization* 2.

statistical view of life, not appropriate for case studies.⁶ He further argues that, with small-N case studies, the particular refines the general.⁷ One moves from craving for the general, where the particular is subsumed in the general, to craving for greater elucidation.⁸ From the epistemology of the particular, one can find family resemblances rather than overarching features.⁹ This aids the understanding of the existing phenomenon. Because life is experienced by concrete individuals in concrete cases even the most general of concepts take their particular shape in particular settings.¹⁰ In the law, the craving for generality instead of the particular can lead to jurisprudential error.¹¹

The interviews were designed to provide more in-depth answers than was the case with the survey and to bring to light any other issues that the other methodologies might not achieve.

A semi-structured interview was used. The interview questions and the results of the interview are set out below.

⁶ Haridimos Tsoukas, 'Craving for generality and small-N studies: a Wittgensteinian approach towards the epistemology of the particular in organization and management studies' in David Buchanan and Alan Bryman (ed), *The SAGE Handbook of Organizational Research Methods* (SAGE 2009), 289.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid, 298.

¹⁰ Ibid, 299.

¹¹ John Glover 'Wittgenstein and the Existence of Fiduciary Relationships: Notes Towards a New Methodology' (1995) 18(2) *UNSW Law Journal* 443, 451

Transcript of Interviews¹

Interview Question	Answers by Participant 1	Answers by Participant 2
How long have you been involved in the managed investment scheme industry?	I have been in the MIS industry since 1997. Before that I was a financial planner since 1992.	Since 1981. First this was from preparation of prospectuses and approved deeds as a lawyer. I gave a paper to the Law Society on prescribed interest schemes. I then went through the changeover from prescribed interest schemes to managed investment schemes under the Managed Investments Act 1997.
What is your role within your organisation?	Managing Director	Managing Director
How many registered schemes does your organisation operate?	Only two now. The [name withheld] MIS. Also have a legacy Macadamia Nut scheme we took over from another RE who did not have the capacity to run it. It will be wound up within the next couple of years. It is not going under. It will cease to trade because of low Macadamia nut prices occurring. There is a problem of agribusiness schemes with the vesting of all income in the investors because the scheme requires capital to continue.	Currently eight. However, since we have been in operation, we have been probably operated between 50 and 100 schemes.
What kind of registered schemes does your organisation operate?	Agribusiness	Property, financial assets, derivatives, forestry and mortgages.
What approximate amount of funds under management does	\$2 billion.	\$300 million

¹ The responses are edited to remove references that may be defamatory or to protect the identity of the participants in accordance with the conditions of Ethics Approval. Although one of the participants said: 'I have no issue with my being named or [name of his organisation] being named or quoted and consent to being named and quoted, unless any particular information or statement is designated by me to be confidential or the source not to be disclosed.' to be consistent the confidentiality obligation has been maintained for both participants.

Interview Question	Answers by Participant 1	Answers by Participant 2
your organisation currently have?		
If you had a magic wand, what changes would you make to the current legal and regulatory framework	Difficult question. There is a distinction between agribusiness MIS and other MIS. If you invest in a trust, there is an obligation on the trustee to be trustworthy. There is a whole history of trusts and duties of trustees. There is a tradition in England and Australia regarding trusts. Many people in that field are acutely aware of this tradition but not everyone. Some people breach the trust. Tax effective MIS. A lot aren't trusts. If I take a forestry scheme, the distinction was that it was just a contractual scheme. The duty of a contractor is different from a trustee. They see their role first and foremost in making money for themselves out of the contract. Being a contractor places the RE as a contractor their interests at least equal with investors and in many instances in practice puts their interests before the investor. A trustee is the servant of the beneficiary. There is a different mindset. This is the psyche of what is going on. A question of trust. If it was trust, the arrangement could have been different. Not just about making money. Problems still exist in the finance industry where funds managers promote the scheme. What I am seeing most commonly are promoters of high yield investment schemes . The common	I would not allow a single responsible entity. We should go back to the old way of dual responsibility. In so many situations oppressed unitholders cannot get any sense out of the RE who is not observing its statutory duties or out of ASIC. We were approached to replace the RE for the [name of projects]. We needed a higher NTA so we could not take it on. [name of RE] had lost two-thirds of client monies. The members came to us to rescue them from receivers. To protect them, I did not name them in the Notice of Meeting. We were appointed as the replacement RE by the members to protect themselves. [the appointment was challenged by the RE in court] To protect them it cost me one million dollars. They are still the RE but delisted. These are two examples of where I was attempting to look after unitholders. ASIC did nothing. I recognise having an overseer can sometimes be expensive. AJ: (Additional question) Do you think it is too much of a temptation for the unsupervised single responsible entity? Participant: Yes exactly. There is no one there to control the greed. They say to themselves "How can I access money I

Interview Question	Answers by Participant 1	Answers by Participant 2
	feature is the aggressive pushing of products. All of a sudden you hear of a fund blowing up say in the eastern suburbs but you never saw it publicly. What is occurring is aggressive promotion either privately among friends and relatives or publicly. Some funds have attributes of Ponzi schemes. You start to tick boxes where the manager chases new investment capital if not to pay to prior investors, then at least to recapitalise for bad investments. The common feature is that they are investment schemes comprising investment operations with aggressive promotion and bad investments. The bad investments is the next level of going into a deeper level as to what is going wrong. A lot of investment managers are good at promotion but not at operating the scheme. If you look at failed finance operations examples being [named two schemes which had gone under] these are privately operated funds likely to fall over when there are economic downturns. One has to wonder how often promoters of these operations are knowingly receiving funds from new investors while knowing that the investment operation is failing or flawed. In a lot of cases there is knowing deceit and in other cases self deception when end is near or they become deluded by the self deception. Common things.	control?" and "What asset can I sell"? AJ: (Additional question) Do you therefore think that there should be a separate body to investigate and prosecute for fraud? Participant: No, I do not think there should be a separate organisation. I have a great respect for ASIC. For 40 years I was able to deal with [a named lady] in ASIC. Unfortunately, she has left ASIC. Returning to the question this concerns the collapse of REs. This happened with agribusiness schemes because they were Ponzi schemes. They were reliant on excessive income from subscriptions each year for current expenditure. This cannot happen again if you exclude REs from charging their assets for liabilities of other group members. Mortgage funds went down too. In the case of (name of organisation) [it was] revealed that (name of organisation) RE had mortgaged all of its assets to secure debts of other companies. A RE should not be able to charge its assets in relation to a business not connected with the business of the RE. Another change would be that if a RE is insolvent ASIC should remove its AFSL immediately and not sit on its hands to protect creditors.

Interview Question	Answers by Participant 1	Answers by Participant 2
	There are examples in the AFR this week of investments with features that mean they are likely to fail. In one they are advertising 15% returns payable monthly. There is no discussion of the risks. They must be lending on second or third mortgages to property developers. It will inevitably fall over. (The participant then took me to his computer to show an example of what he had been describing to me. [website referred to]) Look at this. (First, he pointed to the description of the company which said: “[name of promoter] is a specialist property investment and property fund manager dedicated to creating exclusive investment opportunities for sophisticated investors, self-managed super funds, financial advisers and their clients.” He then showed that it was promising a return of 15-18% pa. He pointed out the small print which said “returns not guaranteed” compared with the large print for the return. Also pointed out the representation “high performing investments opportunities for the truly sophisticated investor”.) There is no way you can promise that return unless they are lending at high rates to property developers. They are associated with a related party [name of company] which is their development manager. (He then referred to a recommendation from one of their clients whose occupation	(<i>long pause</i>). I should rethink that. Probably ASIC should leave the AFSL in place. I would never had been able to take over the scheme which would have gone to the liquidators. The RE should not mortgage or charge assets for any other company in the group. We have taken over [a number of] schemes [schemes were named in interview]. We tried to take over others where we were unsuccessful. We were looking to take over [name of RE] schemes and the [name of RE] forestry schemes taken over by [name of RE] before it collapsed. Then there is the [name of organisation] schemes. We called a meeting for one of the [...] schemes. We wrote to all growers in all of the schemes. We ran around looking for money. [name of company] stepped in. I said to [name of company] that it would be good to appoint us as RE, ASIC would be happy and the growers would be happy. I said to the liquidators to appoint us as their agent to run the scheme and keep it going. No, they just wanted to sell it all. The schemes were not insolvent, just the RE. This would have been a perfect solution for the liquidators and the scheme members. I said this to both [name of organisation] and [name of organisation] liquidators.

Interview Question	Answers by Participant 1	Answers by Participant 2
	was stated to be a rigger from [named suburb of Sydney]) The term “sophisticated investor” is used but just because someone has \$500,000 to invest or assets of \$2.5million does not make them sophisticated. We wrote to [name of promoter] and it was clear that they were deluded. These types of operations don’t differ from religious sects that have a charismatic leader that is deluded and thinks they are God. Actually, they have a psychological disorder. I have developed an eye for these operations. I can spot the type of promoter. With [name of promoter] they were doing full page ads. I looked at some of their videos. [name of CEO] and others promoting the schemes were not sophisticated or intelligent. Clearly, they were marketing driven with an aggressive approach. I phoned their 1800 number and the salesman put on to me was even more aggressive. I told them I was phoning for my mother to invest, that she needed her money to live on and if lost would have put her on the aged pension instead. The response was very aggressive. I was put on to the aggressive marketing people rather than the investment people. What would I change? I would bring in the police. The person responsible for my mum and the rigger referred to	

Interview Question	Answers by Participant 1	Answers by Participant 2
	in the [name of website] ad is ASIC. ASIC has demonstrated that it is incapable of stopping investment operations like this. It is one thing to regulate it is another thing to stop this. Do they think you will pick up your dog droppings? With investment operations, there is an enormous conflict of interest between the promoter and the investor leading to greed and then in turn leading to fraud. There is a spectrum of promoters. On one end is a promoter who has a skill in investment operation and identifying conflict and equally managing it because they are aware of their obligation to represent skills honestly and utilise skills diligently. Over time you might see people like this but who get overconfident of their skills. Being an investment manager is challenging. The funds management industry is difficult because there is no one who can beat the index. The next level of the spectrum are people who have conflicts and are not skilful but make up for it with promotion. At the other end are people defrauding the investors. They prey upon less sophisticated investors. I would change the whole of ASIC. I would probably constitute a new organisation to police the laws regarding promotion of investments. If you want to protect consumers you need police experienced in white collar crime who have the skills to monitor these	

Interview Question	Answers by Participant 1	Answers by Participant 2
	suspicious ads including young undercover police. Sure enough, my enquiry was followed up by an aggressive salesman. Who takes my mother's money will squander it and if lost, my mother will have to go on the age pension. This is costing Governments money by not policing with a proper budget. Leave ASIC to do regulatory work. Most ASIC employees are legally trained not policemen. Lawyers like to defend. No doubt looking at [named person] and [named person] they are sociopaths. Asking ASIC as lawyers to supervise the whole marketplace and discern personality disorders is asking too much. ASIC is not structured like a police force. The nation of savers needs a police force to protect savings. If you have a specialist force economies of scale knowledge and experience can make the force more effective.	
What aspects of the legal and regulatory framework for protection of retail investors investing in managed investment schemes do you consider problematic, if any? Why?	Have a specialist police force rather than ASIC to enforce the law.	Some of the things I have already said like directors have no idea of their duties. If you are a lawyer, you know that your client's interests are paramount. If you're a lawyer your client's interests are paramount. Others do not know, only lawyers. Probably the single responsible entity status rather than the dual supervisions does not help.
What do you consider are the strengths of the legal and regulatory framework for protection of retail investors	The disclosure requirements. The red tape is not insurmountable. Not that high a bar. Disclosure obligations are	Compliance Plans are now big. However, they are very useful by listing what you have to do. We have a spreadsheet to

Interview Question	Answers by Participant 1	Answers by Participant 2
investing in managed investment schemes, if any? Why	robust. Accounting standards are robust. These two things in conjunction are sufficient for "truth will out".	follow to ensure compliance. Strangely my compliance plans are more similar. We all know what are in them. Yes, I would retain that and therefore the compliance committee. There are no rules about who is a member of the committee and scheme members do not know them. I put them on our website. There is no reason why members therefore cannot go to them. Can be an alarm bell to the committee members. Let them do so. There is no control over who should be on the compliance committee. I have really good people on the compliance committee. I have former lecturers in company secretarial matters. Statutory duties are one of the strengths.
What do you consider are weaknesses in the legal and regulatory framework for protection of retail investors investing in managed investment schemes, if any? Why?	The problem is when the promoter is being deceptive. It takes time for this to be picked up. The Australian Corporations Act, MIS Act and accounting standards are good. It is just the policing that is no good. Where is there in our system, institutions to detect fraud and white-collar crime? With misleading and deceptive conduct there is very little activity to prevent fraud which by the time it is done it is left to the investor but there is no help. When the police pursue fraud, they are set up to pursue the fraud. Generally speaking, fraud is not actually investigated while the promoter is in full flight. Timing of the	Target market determinations are utterly useless. How do you know whether you are giving general advice and that you are not going to take into account your personal circumstances. You must decide this with the TMD. TMDs give the impression you are taking their circumstances into account when you do a TMD. Everyone you are thinking about my personal circumstances. Completely contradictory particularly with the objective test. In the regulatory guide ASIC tries to exclude it. The Westpac case ⁽²⁾ is enough to throw in my licence. My new

²

The case referred to is *Westpac Securities Administration Ltd v Australian Securities and Investments Commission* (2021) 270 CLR 118.

Interview Question	Answers by Participant 1	Answers by Participant 2
	investigation is critical. Investigation after organisational collapses is 2 years late or it is 3 years when a report is handed down whereas investigation before the collapse could prevent millions of dollars being lost. Sophisticated investors are actually unsophisticated investors. Long-term this has an effect on the social security bill, people's confidence and confidence in the funds management industry. This encourages investors into less orthodox investments.	compliance officer looked at the Westpac case. All REs should be required to be authorised to give personal advice. The law makes it too hard for a lazy entrenched RE to be replaced. First there is the requirement for an extraordinary resolution. This is hard. You need a bar. The first meeting could be the bar. If not, enough people turn up at the adjourned second meeting only an ordinary resolution should be required. This will make the current RE work hard to get the numbers at the first meeting. If a meeting has been called the proposed RE should be entitled to inspect all contracts entered into by the current RE to ensure there are no liabilities or obligations that will novate to the proposed replacement RE. Of course, an incumbent RE would say "F___ Off". Sanctions should be loss of licence and the RE should be liable to the new RE for all liabilities and obligations that novated. If do not disclose there is no statutory novation of the liabilities and obligation but remains with the old RE.
Have you ever had a surveillance visit from ASIC?	No.	Yes, once in around 2012. [name of ASIC employee] from ASIC with whom I had been dealing with for a long time was helpful. There was only one recommendation in relation to takeover of schemes. Prior to doing a takeover I should do an internal report. I said it was all in my head. You have to be

Interview Question	Answers by Participant 1	Answers by Participant 2
		careful. All these risks because of the statutory novation. We want to see you do a takeover report. I now do a full analysis and present it to the board. There is some cause for concern. The weakness was that [name of organisation] used this report to say we were associates.
If so, what was your experience in dealing with ASIC? Was it helpful? If so, how was it helpful? If not, in what way was it not helpful?	When our stock was being shorted and the shorter was engaging in misleading and deceptive conduct, we received a notice from ASIC. However, they did nothing to deal with the problem created by the overseas shorter. They treated us as the criminal not the overseas short seller.	Yes, it was helpful. It reinforced our relationship with ASIC and it did provide us with a good procedure for takeovers.
What criteria does your organisation use in identifying suitable candidates for appointment to your board?	People whom we have a chance to get to know. You have to get right people you can trust as well as getting to know them.	The nature of the business of RE is too dangerous unless you are an executive officer. Therefore, our directors must be an executive officer. They must have a very good understanding of managed investments. For example, [name of staff member] worked in our back office. She did a law degree while she worked with us. She is now in the front office as a director and so the back-office experience is a good background. Toni Smith who operates the forestry schemes has a long experience and is a smart cookie. To be a director you need a good understanding of financial services. You need to be more than RG 146 compliant. You need to do some Kaplan courses. You should be

Interview Question	Answers by Participant 1	Answers by Participant 2
		qualified to give financial advice
What does your organisation take into account when appointing a person to be an officer or director?	Values and interests are honest, skilful and diligent.	A lot are RG 146 compliant. Enable them to then do Kaplan courses who are very good. In an ideal world you would ensure that they have a law or commerce or financial planning degree as well as being RG 146 compliant. I am qualified in law, tax and financial services and more than RG 146 compliant. Therefore, I have to do CPD for all which adds up to many hours. This includes ethics in the law and financial services aspects
If the entry level required for a person to qualify to hold the position of an officer of a responsible entity was lifted by requiring minimum educational qualifications and experience similar to responsible managers, what effect would this have on your organisation	Nothing. Barriers to entry are prudent. Representing you were a skilful manager of money and considering investors risk taking.	I want someone with experience in managed investments or corporate governance. Also, MIS, accounts and financial services corporate governance.
Would your fees charged to investors be materially higher?	No.	Probably. Just adds a tiny margin to the costs.
Do you have a compliance committee?	Yes.	Yes
If so, what criteria do you use when appointing members of the compliance committee? what does your organisation take into account when appointing a person as a member of the compliance committee?	I would have to get my compliance manager to answer this but she is not in today.	I want someone with experience with managed investments or corporate governance. Should have people with MIS, accounting standards, finance and corporate governance.
If not, do the external directors take the role of the compliance	Not Applicable.	Not Applicable.

Interview Question	Answers by Participant 1	Answers by Participant 2
committee in managing compliance? otherwise, how do you manage your compliance?		
What aspects of the current legal and regulatory framework of registered schemes for the protection of retail investors do you find challenging from a compliance perspective, if any?	None	What I have said before.
ASIC in Regulatory Guide RG 132 states: “To ensure compliance committee members retain the necessary knowledge and skills to continue to carry out their duties and functions, they should complete adequate ongoing training and educational programs”. Do you agree? If not why not?	Not necessarily	Hard enough anyway. No, I don't agree.
How does your organisation manage related party transactions?	We have a very disciplined procedure. Whenever we have one we actually have a procedure and RPT policy in place. We have regard to the law. We are mindful to cross check against the law. Whenever this occurs it is signed off by the Board. There are several parts to any resolution which are specifically addressed as part of the regulation.	We have never had to have a meeting to approve an RPT. Anything that looks like it might be an RPT, we get an accountant's report to say whether it is fair and reasonable before the Board approves the transaction.
Have you found any issues when managing related party transactions under the current related party transaction provisions and if so what were these issues?	No.	No.
Is there anything you would change with the current related	Generally, when RPTs occur when the organisation fails.	No.

Interview Question	Answers by Participant 1	Answers by Participant 2
party transaction provisions with respect to registered schemes?	The police force should investigate. However, the industry will lobby against it.	
Have you ever replaced an existing responsible entity of a registered scheme?	Yes, once.	Yes
If so, how did you manage the replacement process?	The underlying investment was sustainable. There were no problems because we could see the liabilities.	The replacement procedure has usually been hostile. We have been appointed by a court a few times. It is brutal and nasty. The current RE won't give information to us. I would write to liquidators stating what I expected to receive and copied in ASIC. This was difficult. However, after the takeover then became more professional and cooperative.
What factors do you consider would affect your decision on whether to replace an existing responsible entity of a registered scheme?	Don't have any.	With a benign replacement we expect every document. They have no business withholding any document. We have had to recite their cooperation requirements.
What do you consider are hurdles for your organisation to navigate in accepting an appointment as a replacement responsible entity?	None.	I am very aware of the statutory novation and always a risk that you do not know. During the hearings regarding Timbercorp I was cross-examined. "You are aware you company will be taking on every liability of the current RE. You will be liable for \$400million". Kept threatening me. We just take on the fees of the old RE. Hurdles? Only liabilities. Would never get it across if too many members because of the extraordinary resolution requirement.

Interview Question	Answers by Participant 1	Answers by Participant 2
What do you find challenging in drafting product disclosure statements?	Nothing.	No problem with them.
Do you think product disclosure statements are too long for retail investors to understand?	They are not read by 90% of investors. They are relying on their financial adviser. They are trusting the adviser to read it. Probably would change because of this. Of the 10% who read this information they would find it useful.	I do not think they are too long. No suggestion for change.
If product disclosure statements are in your view too long, what do you consider should be done to reduce the size?	I do not have a view on this.	Not Applicable.
Do you consider a short summary document provided with the product disclosure statement would be helpful for retail investors in understanding the key aspects of the financial product you are offering?	Yes. It would be helpful to have a summary that is cross-referenced.	No, confusing if separate. Would be confusing. Had issues with a Part A and Part B PDSs because didn't have the property. Dangerous if short.
Would you support an outcome-based model for product disclosure statements?	I would say in the long run money. It is really whether the investor has earned returns of a quantum appropriate for the investment and whether returns are consistent with the promises made. There needs to be some thought not to be overly officious. Consequences of underperformance needs to be appropriate. Publicity of the ranking of lowest performance would be appropriate.	No.
Would your answer be the same if this involved strict liability?	Should not be strict liability.	Yes.