

Chapter 3 Definitions

Template for submissions

Name of respondent	Robert <u>Garton Smith</u>
Organization	Primary Securities Ltd
Email	rob@primarysecurities.com.au
Phone	(08) 9430 5262

3.1 Definition of ‘managed investment scheme’

Question 3.1.1

Should arrangements where not all the members of the scheme receive a benefit under the scheme come within the definition of ‘managed investment scheme’ and, if so, how might the definition best be amended to extend to these arrangements?

Submission

Primary Securities is frequently asked to act as RE for very small syndicates, such as mortgage syndicates (“contributory mortgage schemes”).

We have been asked to be involved in crowd sourced funding for loan syndicates where each lender is lending only a small amount of money but there may be many lenders.

Likewise, we would like to be able to form small retail property syndicates (particularly in country towns) for separate properties costing around \$1m.

In each of these situations, if we have to separately register each syndicate, the costs would be prohibitive.

If we could have one registered scheme for smaller syndicates, this will save costs, for example registration, audit, compliance audit, and reporting costs, and at the same time, enable us to comply with the current registration and compliance obligations. A number of forestry schemes were organised on this basis (e.g some of the Australian Growth schemes).

Hence, we support the ability to have schemes for any purpose which contain many syndicates, all governed by the same Constitution, but in respect of which not all members have an interest in every

syndicate.

[However we recognise that the Corporations Act did not intend scheme property to be held only by some of the members. Refer for example to sections 177(4), 601FB(4), 1317H(4) and 1317HA(4). These sections, and possibly others, may have to be amended for a scheme which has many sub-schemes.]

Question 3.1.2

Are there any reasons why the definition should not be amended in this way?

Submission

No.

3.2 Definition of 'member' of a managed investment scheme

Question 3.2.1

Have any problems arisen from the breadth of the definition of 'member' of a managed investment scheme? If so, please give details, including how many schemes and investors may have been affected.

Submission

As CAMAC correctly observes (note 46), in one of the Willmott Forests cases, the Court gave consideration to whether or not the owner of land and head-leases had made contributions to the scheme. Such an extension could cause problems for an RE.

Primary has difficulty sometimes in accommodating mortgagees of interests in agricultural schemes, where we are aware that the rights have been charged to the mortgagee and we are expected to make payment of any distributions to the mortgagee rather than to the holder of the interests. The mortgagee is usually not on the register.

As CAMAC observes, persons may have options to acquire units in a scheme and not be on the register.

Question 3.2.2

Should the definition of ‘member’ of a scheme be made more specific, for instance, by providing that a person is a member of a registered scheme only if the person appears on the register of members?

Submission

Notwithstanding our answer to 3.2.1, no changes are recommended.

Question 3.2.3

Alternatively, if the current broad definition of ‘member’ remains, are any amendments required to other Corporations Act provisions to deal with the administrative consequences for the RE of having this wide definition?

Submission

No. The aberrations that have occurred in agricultural schemes are unlikely to be repeated.

Question 3.2.4

Are there any reasons why the current broad definition of ‘member’ in the Corporations Act should remain as it is or, alternatively, why it should not be changed in a particular manner?

Submission

There are more important issues to attend to.

Question 3.2.5

What, if any, specific rights should be preserved for holders of options over unissued interests in a scheme if it is made clear that those option holders are not members of the scheme?

Submission

The issues mentioned by Primary Securities can be accommodated without changing the rules.

3.3 Definition of 'scheme property'

Question 3.3.1

Have any problems arisen from the current definition of 'scheme property'? If so, please give details, including how many schemes may be affected.

Submission

In agricultural schemes, the right to the trees is usually held by individual scheme members and is equivalent to those trees only on their lot. These trees are not pooled, only after harvest. The few court decisions in which an interest in trees has been held to be scheme property are a distortion of the intention of the legislation. We see this as an issue. What if a liquidator were to the rights to a particular scheme member's trees in pursuing a lien claim, this would operate unfairly to those scheme members who hold those trees.

Likewise, we have arguments with the liquidator of Willmott Forests as to whether insurance proceeds paid for by scheme members individually (rather than by the RE as a whole for the scheme) is scheme property.

Following our appointment as RE, we have had arguments with banks as to whether or not bank accounts relevant to the scheme are scheme property or should be novated to a new RE even if expressly described as trust accounts, and the bank should treat the new RE as the holder of the account. Banks tend to ignore the novation provisions and look to the previous RE for instructions in relation to any bank accounts. In one case the previous RE directed substantial payments to be made by the Custodian of the scheme to various parties (including itself) after the resolution for change of RE by scheme members had been carried but before ASIC had registered that change.

In the case of the Templegate forestry schemes, "maintenance funds" were held by the previous RE in trust for scheme members but these could not be accessed by the scheme members because they were held not to be scheme property but constituted funds set up by the RE out of its own assets to secure the performance of its own maintenance obligations. [There is an inconsistency here because money paid to the RE as fees was not regarded as a "contribution to the scheme" but a payment to the RE. Therefore when the RE acquires assets using that money, the assets do not belong to the scheme members but to the RE personally. See also the Treecorp case.]

In the case of the Willmott Forest schemes, the RE owned the land which was leased to scheme

members. Even though the land was held “in relation to the scheme”, the Supreme Court of Victoria held that the land was not scheme property but the RE had rights of use in relation to the land to enable the scheme to be operated. There were possibly Constitutional law reasons for the court not holding that the land was scheme property, as novation of ownership of the land would have required express wording in sections 601FS and FT.

In the case of Willmott Forests, the former RE entered into Forestry Right Agreements in favour of a subsidiary company (because it could not contract with itself to create a registrable instrument) and had these agreements registered on the title. The Forestry Right Agreements did not expressly state that they rights were held in trust for scheme members. The liquidator disputed the right of the new RE (Primary Securities) to the benefit of these agreements.

Primary Securities has had arguments with liquidators as to whether or not documents and accounts relevant to a scheme are scheme property. And what is the status of minutes of meetings of the board of the previous RE in relation to the scheme?

Whether insurance policies held in relation to a scheme are scheme property or novate to a new RE is also a question which has caused arguments for Primary Securities. In some cases, the insurance policies were worded to terminate upon the previous holder ceasing to the RE of the scheme.

A question also arises whether or not legal privilege belongs to the previous RE or the new RE when an RE changes. Who is entitled to the files? If a firm has been acting for the previous RE as responsible entity, can it then act for the new RE to sue the previous RE? Primary Securities would argue that a novation of all rights has occurred including rights of confidentiality and privilege.

Question 3.3.2

Should the legislation be amended to provide a more comprehensive definition of ‘scheme property’ and, if so, should specific categories of property be added to the current definition or should that definition be replaced with a more general definition?

Submission

The scheme property and novation provisions do need review as (from the perspective of Primary Securities) they have been the cause of too many arguments.

The definition should not include fees because fees will then be held in trust for scheme members which is contradictory.

Question 3.3.3

If specific categories are added to the definition, what should those additional categories be?

Submission

Add:

- Money declared by the RE to be held for the benefit of scheme members.
- Property held by or in the name of some trustee, nominee or agent for the RE including property held on constructive trust.
- The right to access any land, or use infrastructure or rights of way or other assets of an agricultural scheme held by the RE for the term of the scheme (or the continued use of the relevant property for the scheme) where the scheme uses or needs to use those assets.
- Head-leases (or licences) to the RE when scheme members hold sub-leases (or licences).
- Documents in relation to a scheme.
- Insurance in relation to a scheme.
- Bank accounts in relation to a scheme.

Question 3.3.4

If a more general definition is preferred, what should that definition be?

Submission

Add the matters referred to in 3.3.3.

Question 3.3.5

If a more general definition is preferred:

- does it need to deal with the situation where property in relation to the scheme is held on constructive trust for the RE
- should it exclude property relating to the scheme that is property of the RE in its own right?

Submission

See the answer to Question 3.3.3.

In the case of the Compass Hotel Group Trust, the RE was in receipt of a bank guarantee from the management company of the trust. When receivers were appointed over that company for that bank, the bank refused to honour the bank guarantee, claiming that it held security over it, notwithstanding clear documentation that the bank guarantee was not the property of the scheme or the management company but an entitlement of the RE personally. Primary Securities was forced to sue the receivers and the bank.

Question 3.3.6

If specific categories are added to the definition, should the Corporations Act clarify the circumstances in which property ceases to be scheme property and, if so, how?

Submission

See the answer to Question 3.3.3.

Question 3.3.7

If a general definition is adopted, would that definition make it sufficiently clear when property ceases to be scheme property?

Submission

See the answer to Question 3.3.3.

Question 3.3.8

Are there any reasons why there should not be a broader definition of scheme property or, alternatively, why further specific categories of scheme property should not be added to the current definition?

Submission

No.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission