Chapter 5 Governance framework for schemes

Template for submissions

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5.6 Reform options

Question 5.6.1
Should the current governance framework consisting of compliance requirements (including a compliance plan, a compliance committee in certain circumstances and audit of the compliance plan) and risk management requirements be retained (Option 1) and why? What problems and/or inadequacies have been experienced with the current framework and what steps might be taken to overcome them?

Submission

The various Regulatory Guides dealing with Compliance Plans already require compliance plans to deal with risk management both at the RE level and the scheme level. As a result, Primary includes full risk management issues and steps to be taken in all its compliance plans. In other words, Primary already has in place Option 2.

Primary opposes Option 3 because it confuses the identification of risks with the monitoring of risks. An ongoing risk management committee is an extra cost that is not warranted.

Identification of risks is a complicated business, best left to the RE itself. Primary's method of identifying risks is to have regard to risks commonly identified in the same industry by other REs, but to also require the relevant responsible officer to list all risks relevant to the investment activity and to play an active part in devising the management system, all of which is incorporated into the risk management system statement and transported into the compliance plan, which is regularly reviewed. The compliance committee is quite capable of monitoring the steps to be taken in mitigation of risks as this is parallel to monitoring compliance.

Question 5.6.2
Alternatively:

- should risk management requirements be introduced specifically for schemes, to operate alongside the compliance requirements for schemes and link in with the risk management licensing obligation of the RE (Option 2) and why, or
- should the current compliance requirements be abolished, with compliance to be covered as part of a risk management regime for schemes that could link in with the risk management framework for the REs that operate them (Option 3) and why?

Submission

Yes to Option 2. See the answer to Question 5.6.1.

Given that risks are included in the compliance plan, the risk management system should be incorporated into the compliance system, not the other way round. This is Option 2.

Question 5.6.3
If Option 1 or Option 2 is adopted, should one or more of the following changes (or some other change and, if so, what) be made to the compliance plan requirements:

- remove the liability of the RE and its officers for non-material breaches of the compliance plan to encourage more detailed plans
- define 'compliance plan' in the Corporations Act so that it covers all the company's documents that deal with compliance with the law
- prescribe additional (or alternative) matters that must be included in the compliance plan?

Submission

Yes, remove any liability for non-material breaches of the compliance plan. Do not expand the definition of compliance plan. Prescribe risk management as one of the matters that must be dealt with in the compliance plan.

Question 5.6.4
If additional matters are prescribed, what should those matters be?

Submission

Steps required to mitigate risks.

Question 5.6.5
If alternative matters are prescribed, which of the matters stipulated in s 601HA should be replaced and with what?

Submission

Primary sees no reason to remove any matters stipulated.

Question 5.6.6
If a risk management regime for schemes, to operate in conjunction with the compliance regime, is introduced (Option 2) or if compliance is merged into a risk management regime for schemes (Option 3):

- what should the elements of the risk management regime be
- should the legislation itself set standards for each of these elements or, alternatively, require that the RE set standards for each element
- should the risk management regime be in writing
- should the risk management regime include specific requirements for particular types of risk and, if so, what risks should be subject to specific requirements and what should those requirements be?

Submission

It is not possible to legislate to include the matters which might be risks. There is a danger in doing so as it could focus the responsible entity on inappropriate matters. For example, the matters required to be commented on as risks in property and investment scheme financial statements often bear little relation to the actual risks of the scheme and can tend to lull investors into thinking that these are all the risks there are (e.g. currency fluctuations).

Question 5.6.7
If Option 2 or Option 3 is adopted, how should the scheme's risk management arrangements be supervised? For instance, should a risk committee or an audit committee supervise those arrangements and, if so, what governance arrangements should apply to such a committee?

Submission

Continue as currently by including such matters in the compliance plan and have them audited by the compliance committee, being what Primary Securities does now.

Question 5.6.8
If Option 2 or Option 3 is adopted, should there be a requirement for an audit of the scheme's risk management arrangements?

Submission

Yes as part of the audit of the compliance plan.

Question 5.6.9
Under any of the options, what potential is there for duplicated or inconsistent regulation where the RE:

- is listed in its own right
- is prudentially regulated by the Australian Prudential Regulation Authority

and how might any duplication or inconsistency be avoided?

Submission

Listing makes no difference to what a responsible entity should be doing. This just adds to the matters to be considered in the compliance plan.

Question 5.6.10
What transitional arrangements might be required if Option 2 or Option 3 is adopted?

Submission

Question 5.6.11
Should the oppression remedy and/or the statutory derivative action procedure be available to members of a scheme in relation to the RE of the scheme and why?

Submission

Yes, if appropriate.

5.7 Investment guidelines

Question 5.7.1
Should there be an express requirement for schemes that involve the ongoing investment of members funds to have investment guidelines?

Submission

There is no need for any express requirements.

Question 5.7.2
Should departure from any investment guidelines be permitted in some cases and, if so, subject to what safeguards (for instance, approval by a risk committee)?

Submission

Primary Securities suggests that is not appropriate to be prescriptive as to what risks exist and how they might be mitigated. Every scheme is different and there is a very wide variety of schemes which can be conceived, from agriculture to art. Risks cannot be predicted or prescribed. By prescribing certain risks which are inappropriate to a particular type of investment, investors may be misled into thinking that these risks are significant when there are not. Let the RE do its job.

Question 5.7.3
Should the RE be required to disclose the scheme's investment guidelines and any changes to, or departure from, those guidelines and, if so, how?

Submission

There is no need for any express requirements.

Question 5.7.4
Should a committee (for instance, a risk committee or an audit committee) be given a role in relation to investment guidelines, for instance to certify that a proposed transaction is in accordance with the guidelines or to approve a transaction that departs from the guidelines, either outright or subject to conditions? If so, what governance arrangements should apply to such a committee?

Submission

Only if these are matters covered in the compliance plan.

Other comments

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

Submission

Amendments to the legislation are necessary to increase the transparency of the compliance committee. Currently, if a scheme member has a point of concern regarding a scheme it is often not possible to contact the members of the compliance committee to raise this concern because many REs do not disclose who the members of the compliance committee are, there is no register of members of the compliance committee and ASIC cannot disclose who they are.

The RE should be required to put on its website or otherwise make available to any scheme member the names, addresses, phone numbers and email addresses of the members of the compliance committee.

Compliance committee members should be permitted to disclose scheme information to scheme members, and should have qualified privilege when doing so (section 601JE).

This section on governance deals only with compliance and risk management.

What about management issues and the issue of scheme viability? The main risk for members of all managed investment schemes is that the responsible entity is a poor manager, or is taking advantage of scheme members.

For example, a number of agricultural schemes continue with no prospect of viability as currently managed and scheme members continue to pay fees year after year. The issue is not necessarily that the agricultural activity is not viable, the RE may simply be overcharging for the work done or making no effort to control costs.

Suppose, for example, that a vineyard scheme annually charges its scheme members $60,000 per hectare to run the scheme when the industry average per hectare is $30,000. This is difficult to challenge when you are a scheme member. Agricultural scheme members may not wish to shut the scheme down because their leases will be terminated and hence all their rights, with the result that the

land owner picks up all the assets. Regrettably, one of the only weapons for ASIC when a scheme is in difficulties is termination. Termination of an agricultural scheme, particularly just as the trees are reaching maturity, can operate as a fraud on scheme members because they lose everything.

The scheme needs to be made viable or saved by replacing the RE with an RE which will charge arms length fees and properly monitor sub-contractors and control costs.