

Corporate Advisor

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Simpler disclosure for managed investment products

Draft regulations

Late last year, the Treasury released draft regulations and an example product disclosure statement (PDS) for the simpler disclosure of superannuation and managed investment products. The media release, draft regulations and example PDS can be found [here](#).

Prescriptive approach

The purpose of the regulations is to reduce the length and complexity of PDSs and to help ensure comparability amongst financial products of the same kind. A summary of the proposed reforms are as follows:

1. The regulations are intended to apply to registered managed investment schemes which invest at least 80 percent of their assets in “financial assets”. The term “financial assets” is not defined in the regulations and has not yet been determined, but we expect the definition will be modelled on the definition of that term in ASIC’s standard Australian financial services (AFS) licence conditions. That is, we expect it will include cash, shares, interests in other managed investment schemes, deposit products and presumably derivatives.
2. The regulations prescribe the form and content of PDSs for the schemes which will be covered by the regulations. The prescribed form and content rules include—
 - (a) a maximum length of six A4 pages
 - (b) prescribed section headings and prescribed content under each of those headings
 - (c) another standardised fees and costs table and worked fee example, and
 - (d) general statements about how managed investment schemes are taxed.

In order to keep the content of the proposed PDSs to six pages, the regulations propose that additional information may be incorporated by reference into the PDS by including links to a website.

One size fits all

If simply reducing the length of a PDS that is actually given to investors makes the disclosure more effective, and I am not sure that it does, then the government will say it has achieved one of its objectives through the draft regulations.

However, unless there are significant amendments to the regulations as proposed, then the government is not going to achieve its objective to help ensure comparability amongst products.

Since the Ramsay Report was released in 2002, this is at least the fourth attempt at standardising fees and costs disclosure in a PDS for financial products. Each successive attempt has taken a more prescriptive approach. Whether these attempts have been successful is a matter of opinion.

The risk in taking a prescriptive approach is that one size does not fit all, with the consequence that product issuers are forced to make their own interpretation of the laws as they apply to their product. Generally, this means you cannot compare cost and fee disclosure between different product issuers because everyone has their own take on how fees and costs disclosure works. So if the regulations are not prescriptive enough, consumers will not be comparing apples with apples and the government's objective will not be met. We think the draft regulations fall short in this regard.

Submission

In our submission to the Treasury on the regulations, we outlined a number of concerns and invite you to read the submission. A copy can be found [here](#).

We will continue to lobby the government for clarity on the content of the regulations and will provide you with further updates on this seismic shift in the way disclosure is made in Australia.



If you would like more information, then please contact **Chris Mee** by email or on 07 3239 2961.

Proposed changes to laws affecting group structures

Wide-sweeping reforms proposed

In November 2009, the federal government released a proposal paper entitled “Action against fraudulent phoenix activity”. The paper is available at http://www.treasury.gov.au/documents/1647/PDF/Phoenix_Proposal_Paper.pdf, and was open for submissions until 15 January 2010. The government has flagged proposed amendments to the corporations and tax laws to combat phoenix activity, including changes to fundamental legal concepts that may affect the way all company groups are structured.

The paper deals with reforms to both the taxation and corporations legislation. In summary, the following reforms are being considered:

1. Strengthening anti-avoidance provisions in the tax law to cancel any benefits derived through fraudulent phoenix activity.
2. Making it an offence for an entity not to remit the required PAYG tax amounts.
3. Making it an offence for directors to claim credits in relation to their own income for PAYG amounts that have not been remitted by the company of which they are a director.
4. Making directors personally liable for the debts of a liquidated company in circumstances where a ‘new’ company adopts the same or similar name as its previous incarnation.
5. Changing the *Corporations Act 2001* (Act) to allow the corporate veil to be lifted where a company sets up a subsidiary with insufficient capital to meet the debts that could reasonably be expected to arise (see further comment below).
6. Penalising those who promote fraudulent phoenix activity.
7. Expanding the Australian Securities and Investment Commission’s (ASIC) powers to disqualify directors (see further comment below).

Lifting the corporate veil

In our [October 2009 edition of *Corporate Advisor*](#), we warned that although a group structure is an effective means of organising the affairs of a group of companies in quarantining liability, it should not be assumed that a parent will be completely insulated from liability for its subsidiaries’ actions in all circumstances.

However, the government’s phoenix trading proposals take this concept one step further by seeking to implement the “doctrine of inadequate capitalisation”, a controversial legal concept which has been used in the United States to permit the courts to lift the corporate veil where a company sets up a subsidiary with

insufficient capital to meet the debts it could have reasonably expected to arise. This doctrine was given some support in Australia in the James Hardie Special Commission of Inquiry Report.

The doctrine would be implemented by amending the Act to require other companies in a group to make restitution to a subsidiary and creditors of that entity upon insolvency if the subsidiary is found to have been deliberately or knowingly undercapitalised.

If implemented, then the doctrine of undercapitalisation could lead to a seismic shift in the way groups of companies are structured. In particular, it may no longer be the case that liability can be quarantined in a special purpose vehicle established as a subsidiary of a parent.

ASIC boosts disqualification power

The second major proposal for reform, which goes a lot further than only combating phoenix activity, is a proposal to expand the power of ASIC to disqualify directors.

The law currently provides that ASIC has a power to disqualify a director if he or she has managed two or more failed corporations. The proposed reforms would remove this requirement and replace it with a power conferred on the court or ASIC to disqualify a director for a period of up to five years if the director has been associated with a company that has been wound up and the person's conduct as a director of the company (alone or with others) makes them "unfit" to be concerned in the management of a company.

Conclusion

Whilst the government's proposals are intended to combat phoenix activity, if implemented, then the proposed reforms may fundamentally change the way group companies are structured and may grant ASIC broad powers to disqualify directors on the subjective basis that they are "unfit" to be concerned in the management of a company.

Whilst submissions have now closed, Treasury has not yet indicated what its final view will be in relation to the proposed reforms contained in the paper. We will keep you updated about the proposed reforms.



If you would like more information, then please contact **Kristy Dorney** by email or on 07 3239 2968.

Founder's shares not always restricted

Exit mechanism

Many companies come to a point in their evolution where the founders of the company wish to exit and realise their investment. Listing the company on the Australian Securities Exchange (ASX) provides a useful mechanism by which founders are able to do this.

Restrictions on exit

However, for companies seeking to list their shares, the ASX Listing Rules impose a number of restrictions on particular shareholders dealing with their shares, such as seed capitalists and persons who were involved or had any influence in the company's promotion, listing or initial public offering (promoters).

These restrictions generally include restricting founders from selling their shares on the market for a certain period—usually for up to two years. The ASX's policy for imposing these restrictions is to protect the market for securities in a listed entity from the abnormal effects of the issue and then immediate trading of securities.

Listing Rule requirements

Under the Listing Rules, the ASX imposes an obligation on a company seeking to list to ensure restrictions are applied to certain shareholders by causing the company to enter into restriction agreements with the relevant shareholders. The effect of such agreements is to prevent the shareholder from, amongst other things—

1. disposing of its shares
2. mortgaging its shares, or
3. participating in any return of capital of the company.

The categories of shareholders who are generally required to sign these agreements include founders, seed capitalists and promoters. Whether or not the shares held by these people must be restricted will also depend upon the circumstances in which the shares were issued. For example, a promoter who has provided services to the company and received shares for those services before the company is listed will be caught under the Listing Rules and will have a two year restriction placed on all of its shares. Once a shareholder is caught, the shareholder must enter into a restriction agreement with the company or the ASX will not permit the company to list its shares.

Possible exceptions for founders

Under the Listing Rules, the ASX has a broad discretion to include or exclude certain shareholders who would, in the ordinary course, be required to enter into restriction agreements.

We were recently successful in assisting a number of founders of a company to make an application to the ASX for its shares to be excluded from all restrictions. As a result, the company was able to list while these founding shareholders, who had initially been deemed by the ASX to be promoters of the company under the Listing Rules and therefore automatically required to enter into restriction agreements, were able to hold their shares without entering into restriction agreements and sell their shares on the ASX as soon as the company's shares were listed.



If you would like more information, then please contact **Sarah McDonald** by email or on 07 3239 2957.

Challenging disqualification by APRA from acting as a director

HIH case

Justin Gardener served as a non-executive director of HIH and a member of the HIH Audit Committee and Human Resources Committee from December 1998 until HIH went into provisional liquidation on 15 March 2001.

The Royal Commission's final report on the HIH collapse made no specific findings about any lack of fitness or propriety on Mr Gardener's part, but in May 2006, APRA disqualified him from acting as a director or senior manager of a general insurance company on the ground that he was not a fit and proper person.

Mr Gardener appealed against the disqualification to the Administrative Appeals Tribunal (AAT). The AAT heard evidence from Mr Gardener himself and also from four expert witnesses.

Sufficient diligence

The question for the AAT was whether Mr Gardener exercised sufficient diligence in performing his work as a non-executive director of HIH as could reasonably be expected from a person of his background, skills and experience. That is a subjective test having regard to the circumstances at the time.

Before his appointment to the board of HIH, Mr Gardener had been an audit partner of Andersons. Significantly, in May 1999 (five months after his

appointment), Mr Gardener had raised concerns about the governance of HIH with then CEO Ray Williams, who was “*dismissive to the point of being hostile*”. Mr Williams called an ad hoc board meeting to gauge the response of the other non-executive directors. They all gave unqualified support to Mr Williams. Mr Gardener met with a similar response by the board when he raised further concerns in October 1999. He felt increasingly isolated and considered resigning, always deciding against it.

AAT decision

The AAT considered eight matters that APRA said demonstrated his lack of fitness. The specific matters, and the relevant conduct of Mr Gardener, included the following:

1. Ratification by the board of a \$2 million investment in BTS (of which Rodney Adler was director and shareholder) at a time when HIH cash flow was critical. The investment had been approved by Mr Williams without the approval of the HIH Investment Committee. Mr Gardener questioned the transaction in the board meeting. He was told, and he accepted, that it was an old commitment the company could not avoid.
2. Approval by the board of the Pacific Eagle Equities (PE Equities) transaction, where \$10 million of HIH shares were sold to a unit trust, whose trustee was PE Equities, a company Mr Adler controlled, and the shares were paid for by money lent to PE Equities by a subsidiary of HIH: Mr Gardener questioned the transaction but failed to insist on independent legal advice on its legality. Instead he accepted, without reading, a Minter Ellison advice tabled at the board meeting, unaware that the advice was obtained by Mr Adler, and not independently by the board.
3. Underprovisioning, which was the central cause of the collapse: Mr Gardener was not aware of the external actuary’s concerns about prudential margins and declining operating costs, partly because they were not reflected in the auditor’s reports. Mr Gardener had assumed, wrongly, that the auditors (his former firm, Andersons) had engaged with the external actuary and had reviewed the actuary’s underlying assumptions in preparing their report.
4. Another matter involved Mr Gardener’s membership of the HIH Audit Committee. The experts agreed the Committee’s conduct including meeting only infrequently, allowing management and directors to attend, and failing to review its own terms of reference and performance, fell short of best practice. However, the experts differed on the extent to which Mr Gardener ought to have influenced its governance.

The AAT held in Mr Gardener’s favour on all counts, finding that the evidence showed he had been a diligent and conscientious director who analysed and appropriately questioned material made available to him and acted reasonably in the circumstances. The board and the committees had not followed best practice

in several respects, but that did not translate to a finding against an individual member in the circumstances of this case.

Comment

The AAT had regard to Mr Gardener's subsequent service on boards and committees of a number of private companies and not-for-profit organisations, where he had put into practice the lessons learned from his experience as a director of HIH. On the evidence as a whole, the AAT found APRA had failed to demonstrate that Mr Gardener would not conduct himself properly by today's standards.

Whether a director has discharged his or her duty is a question of fact to be considered in the circumstances of every case. The conduct considered in this decision is not necessarily a standard for conduct in the current climate. McMahon Clarke Legal can advise directors and officers about the standards required from them in discharging their duties, and the options available where specific issues confronting a company need to be addressed.



If you would like more information, then please contact **Amanda Shaw** by email or on 07 3239 2968.

Staff promotions

We are proud to announce the following solicitors have received promotions in recognition of their skills, experience and achievements:

Brit Ibanez

Brit Ibanez has been promoted to the position of associate in the litigation and risk management team. Brit has considerable experience in corporations law matters, (including shareholders' disputes), as well as contractual and joint venture disputes, and estate litigation.

For more information, email **Brit Ibanez** or call 07 3239 2960.

Nathan Shaw

Nathan Shaw has been promoted to the position of associate in the litigation and risk management team. Nathan heads up our debt recovery team, and has a broad range of experience in property and leasing matters, managed investment scheme disputes, insolvency and trade practices disputes.

For more information, email **Nathan Shaw** or call 07 3239 2947.

John Lane-Mullins

John Lane-Mullins has been promoted to the position of associate in the corporate team. John has a broad range of experience in capital raising and corporate advisory transactions, as well as in matters concerning anti money laundering and counter terrorism financing.

For more information, email **John Lane-Mullins** or call 07 3239 2926.

Brendan Ivers

Brendan Ivers has been promoted to the position of associate in the funds management team. Brendan has specialist expertise in the laws relating to managed investment schemes and also has a particular focus on advising clients in relation to banking and finance issues for managed investment schemes.

For more information, email **Brendan Ivers** or call 07 3239 2928.

Laura Hanrahan

Laura Hanrahan has been promoted to the position of associate in the private client and business succession team. Laura specialises in estate planning, business succession and the administration of deceased estates. Laura regularly advises clients in relation to Wills, enduring powers of attorney, business succession agreements and probate applications.

For more information, email **Laura Hanrahan** or call 07 3239 2924.

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