



GATEWAY INSIGHTS

March 2011

25 What all fund managers need to know about Managed Investment Schemes & RE's

The constant question

Questions that consistently arise when talking to managers both here and overseas are – what is the difference in Australia between a registered managed investment scheme and an unregistered managed investment scheme and why would one be pursued over the other? For this Insight Gateway have asked Perpetual Corporate Services to contribute their expertise for your interest.

Brief history

The concept of a Managed Investment Scheme (MIS) was introduced through the Management Investment Act 1998 (Cth) (MIA), which is incorporated into Chapter 5C of the Corporations Act 2001 (Act). The MIA replaced the old 'prescribed interest's regime and the dual roles of manager and trustee with a single Responsible Entity (RE). These changes were aimed at delivering increased investor protection.

Registered versus unregistered schemes

Broadly speaking, a MIS allows investors to group together and contribute money to acquire rights to benefits produced by the 'scheme'. Common schemes include cash management trusts, equity trusts, property trusts and mortgage trusts.

Schemes established and operated in Australia are regulated by the Act however, not all schemes are required to be registered.

Registered schemes

A scheme must be registered with the Australian Securities and Investments Commission (ASIC) in any of the following situations:

- It has more than 20 members.
- It is promoted by a person who is in the business of promoting managed investment schemes.
- ASIC has determined that the scheme, and one or more other schemes, are closely related and the total number of members of the combined schemes exceeds 20.

Unregistered schemes

If none of the above situations apply, then the scheme does not need to be registered. Unregistered schemes have some requirements in terms of the interests held, which include, but are not limited to the following:

- A member is required to pay at least \$500,000 to acquire an interest in the scheme.
- Interests in the scheme are offered only to professional investors including those who have been certified by a qualified accountant as having net assets of at least \$2.5 million, or gross income for the past 2 years of at least \$250,000.
- Interests in the scheme are provided for use in connection with a business that has fewer than 100 employees if it is a manufacturing business, or fewer than 20 employees for any other business.

The table below highlights some differences between a registered and unregistered scheme.

Characteristics	Registered scheme	Unregistered scheme
Product issuer	Responsible entity (Australian public company)	Trustee or Manager
Australian Financial Services License (AFSL) required by operator?	Yes. AFSL required to operate the scheme, deal in financial products and provide advice (although exemptions exist in some circumstances).	Yes. AFSL required to deal in financial products, provide advice (although exemptions may exist in some circumstances) and/or provide a custodial service.
Current capitalisation requirements (net tangible assets - NTA)	Scheme assets under \$10m: Minimum \$50,000 Scheme assets over \$10m: 0.5% of the value of scheme assets, up to a maximum of \$5m	None
Scheme registered with ASIC	Yes	No
Constituent document	Constitution	Trust deed
Investor type	Wholesale and retail	Wholesale only, however in some limited circumstances up to \$2

		million can be raised from up to 20 retail investors in any 12 month period under a 'personal offer'.
Disclosure document	Information memorandum (wholesale clients) or product disclosure statement (for retail or wholesale clients).	Information memorandum
Compliance plan Document describing the measures to be applied by the RE to comply with the Act and the Constitution.	Required	Not required
Compliance committee Monitor RE's compliance with the Act, Constitution and Compliance plan. Report to the RE board and where appropriate, to ASIC.	Required where the RE board does not have a majority of independent directors.	Not required
Reporting	<ul style="list-style-type: none"> ▪ Must lodge annual audited accounts with ASIC. ▪ Compliance plan must be audited annually. ▪ Annual reporting and periodic statements must be sent to investors. ▪ Continuous disclosure obligations may be required. 	<ul style="list-style-type: none"> ▪ No lodgement of accounts with ASIC. ▪ No requirement for trust accounts to be audited. ▪ Investor reporting frequency (if at all) is determined by the manager.
Custody of scheme assets	Where RE has less than \$5m in NTA, a custodian must be appointed to hold the scheme's assets*.	Trustee typically holds trust assets.

Benefits	<ul style="list-style-type: none"> ▪ Preferred by institutional investors eg large industry superannuation funds. ▪ Robust licensing and compliance regime for greater investor protection. ▪ Demonstrated experience of RE responsible managers to obtain license. ▪ Offers ability for managers to access retail investors (indirectly) through an investor-directed portfolio services (IDPS) platform. 	<ul style="list-style-type: none"> ▪ Lower set-up and ongoing trust operating costs. ▪ Ease of implementing trust changes – lower number of investors and changes only to the trust deed. ▪ Reduced compliance requirements in comparison to registered scheme.
Challenges	<ul style="list-style-type: none"> ▪ Higher set-up and ongoing operating costs. ▪ Scheme changes trigger amendments across a broader range of documents, some of which require lodgement with ASIC. ▪ Regulatory lodgement requirements. 	<ul style="list-style-type: none"> ▪ Product offering to small investor base. ▪ Limited offering to wholesale investors. ▪ Absence of regulatory framework often sought by investors.

* Exception: where RE manages real property, physical assets and cash deposits and has at least \$500,000 in NTA.

Why managers may choose to launch a registered scheme

One of the primary reasons why a manager would choose to launch a registered scheme is to enable it to be promoted to retail investors. Some product issuers also register their schemes to demonstrate a commitment to compliance and to provide additional comfort to their investors through a regulated environment.

Apart from the regulatory requirements that determine whether a scheme is to be registered or unregistered, there may be some important commercial issues to consider when making this decision. Some of the most common things to consider include the following:

1. Capital raising strategy

It is paramount for a manager to have a clear and concise capital raising strategy when considering the nature of the scheme to be launched as if the manager has any plans to attract retail investors, it is essential to register the scheme. However, it is common practice for managers to initially establish an unregistered scheme that can easily be registered when a retail capital raising strategy is implemented.

If this is the plan, scheme documentation needs to be carefully drafted. Incorrect drafting or poor decisions can be costly to unwind or modify should the manager wish to change the nature of the scheme at a later date.

2. Institutional investor preference

It is important for the manager to understand their target market and investor appetite for registered versus unregistered schemes.

Although it is not a legal requirement to establish a registered scheme if the product is only targeted at wholesale investors, many institutional investors may prefer a registered model. Historically, smaller to medium sized institutional investors prefer registered managed investment schemes. The rationale is that the investor feels comfortable investing into a vehicle that is highly regulated in the Australian market and affords a high degree of investor protection. When discussing a product with wholesale investors, it is good practice to discuss this preference, so appropriate structures can be put in place early.

In-house versus external RE/Trustee

A common issue faced by managers is the decision to undertake the RE/trustee function in house, or to outsource these roles to an independent third party.

For offshore managers, the majority of managers choose to outsource this function for a number of reasons:

- The Australian regulatory environment – offshore managers may not be familiar with Australian laws.
- The added complexity of applying for a specific AFSL to be a RE. A manager cannot rely upon an AFSL exemption if they wish to be their own RE.

- The significant cost involved in establishing and servicing an Australian office and RE function eg ongoing monitoring and technology costs.
- The potential onerous capitalisation requirements, currently up to a maximum of \$5 million (which is anticipated to rise to \$7.5 million).
- Tax and legal considerations, for example Managed Investment Trust (MIT) compliant trusts.

Local managers may also experience some of these same challenges, and often choose to outsource the RE/trustee function.

Commercial considerations

There are also common commercial considerations that may influence the decision to outsource the RE/trustee function, which may include:

- The benefits of partnering with a well-established and reputable external RE/trustee. Many managers see significant value in aligning themselves with the name and brand of a reputable external RE/trustee in order to attract investors, and give them confidence that a professional RE/trustee is protecting their interests.
- The cost benefits of outsourcing a stringent and arduous compliance function. Fees for external RE/trustees are typically calculated on FUM, subject to a minimum fee per annum.

The role of the RE/Trustee

An RE is responsible for the operation of the MIS with specific duties imposed on it under the Act. These duties include to act honestly and in the best interest of investors, treat members equally and fairly and exercise care and diligence.

1. Responsible Entity

a. Fund establishment

- Due diligence on all service providers and appointment of all service providers including but not limited to the investment manager, custodian and the investment administrator.
- Drafting scheme documents such as the constitution, investment management agreement, custody agreement, investment administration agreement, including a compliance plan for the scheme.
- Establishment of the scheme and registration with ASIC.
- Issuing scheme disclosure documents (Product Disclosure Statements or Information Memorandums).

b. Ongoing scheme management

- Lodgement of ASIC documents (financial reports, scheme statements etc).
- Maintenance of RE license requirements.
- Management of ASIC requirements.
- Monitoring agents including custodians and fund administrators.
- Establishment of a compliance committee to meet Corporations Act requirements.
- Maintenance of ongoing compliance.
- Annual review of offer documents and the compliance plan to ensure continued compliance with the law, scheme constitution and transaction documentation.
- Modification of scheme documentation to reflect commercial arrangements.

2. Trustee

As trustee of an unregistered scheme (trust), the trustee has a fiduciary duty to act in the best interests of the scheme's beneficiaries at all times. The trustee performs the following functions to ensure the scheme is being managed appropriately:

- As legal owner of the assets, executes all relevant contracts.
- Monitors the compliance of the investment manager.
- Holds the assets of the trust either directly or through a custodian.
- Administers the trust's bank accounts.
- Processes corporate actions and other transactions.
- Maintains the asset/investment register.
- Provides safekeeping of legal documents (eg share certificates, note certificates) and original transaction documents.
- Signs the trust's financial statements and tax return.

Costs involved in establishing a MIS

The cost of establishing and maintaining a MIS is a key consideration. Some costs to consider include:

- Legal fees
- Tax and audit fees
- Custody fees
- Administration fees
- RE/trustee fees
- Management fees
- ASIC/stamp duty fees eg fund registration, annual scheme statements
- Compliance committee costs (where relevant)

How can Perpetual help?

For more than 124 years as an Australian trust company, Perpetual has been helping businesses and individuals build and protect their assets. Our Corporate Trust business is the leading provider of trustee and transaction support services, holding funds under administration of more than \$200 billion across our business areas as at 31 December 2010. We have provided fiduciary, agency and administration services for a variety of assets classes including equities, debt, alternatives, property and mortgages for more than 20 years. Our clients range from large financial institutions, well-established fund managers (global and domestic) to small boutique and start-up fund managers.

Our services

We can offer your business a range of services or a comprehensive solution, including:

- RE services for registered funds
- Trustee services for unregistered funds
- Custody services for listed, unlisted wholesale and retail funds
- Fund accounting including unit pricing
- Unit registry services
- Standard investor reporting

For more information phone Perpetual's General Manager of Trust and Fund Services, Anna O'Sullivan, on 02 9229 3234 or Gateway Financial Marketing.

[About Gateway](#)

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway's services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Retail Financial Services market.

Our qualifications

Amanda has over 20 years' experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 12 years' experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the retail financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the retail market or have any questions on the above please do not hesitate to contact us on – Edwina 0404 046 179 or Amanda or 0414 658 323.