

ASIC CLASS ORDER [CO 13/1406]
EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission
Corporations Act 2001

The Australian Securities and Investments Commission (*ASIC*) makes Class Order [CO 13/1406] *Land holding for primary production schemes* under paragraph 926A(2)(c) of the *Corporations Act 2001* (the *Act*).

Paragraph 926A(2)(c) of the Act provides that ASIC may declare that provisions of Part 7.6 of the Act (other than Divisions 4 and 8) in relation to a person or financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

1. Background

Paragraph 912A(1)(a) of the Act requires a financial services licensee to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly.

Paragraph 601FC(1)(c) of the Act requires the responsible entity of a registered scheme, in exercising its power and carrying out its duties, to 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.

In January 2012, ASIC released Regulatory Guide 232 *Agribusiness managed investment schemes: Improving disclosure for retail investors* setting out ASIC's benchmarks and disclosure principles for responsible entities and others involved with the issue or advertising of interests in agribusiness managed investment schemes.

Following extensive industry consultation during 2012 and early 2013, ASIC has made [CO 13/1406].

2. Purpose of this class order

In many primary production schemes, the underlying land is the property of the responsible entity or its associate or an unrelated third party rather than scheme property. ASIC considers that exposing the scheme to risks of failure due to inadequate protection of interests in land needed for the scheme for the scheme's expected duration is inconsistent with the responsible entity's duties to do all things necessary to ensure that it operates a registered scheme efficiently, honestly and fairly. ASIC considers that the interests in land should be held in a way that protects members from risks outside the scheme's scope, such as the landowner's insolvency.

[CO 13/1406] contains the minimum standards that a responsible entity must meet in relation to the holding of interests in land required for the operation of a registered managed investment scheme to ensure the land holding arrangements enable the scheme to be operated efficiently, honestly and fairly. These standards adopt and extend the requirements for registration of an interest in land in way that is designed to protect members in conditions 44,

45 and 46 *Protection of Underlying Land in Primary Production Schemes* in Pro Forma 209 *Australian financial services licence conditions (PF 209)*, which are imposed on all AFS licensees authorised to operate registered primary production schemes in the capacity as a responsible entity.

We consider that the new requirements in this class order are consistent with the responsible entity's duties under paragraph 601FC(1)(c) of the Act and its duties as an AFS licensee under paragraph 912A(1)(a) of the Act. The purpose of this class order is to reduce the risks of the scheme's ability to operate being affected by the rights of other parties outside the scheme.

3. Operation of this class order

A responsible entity that offers interests in a registered managed investment scheme to retail clients on or from 2 January 2014 must ensure that, from 1 July 2014, it complies with [CO 13/1406]. This means that the responsible entity that is offering to retail clients on 2 January 2014 has almost six months of transition period (between 2 January 2014 and 30 June 2014) to register an interest in land where necessary or take other steps to comply with this class order. AFS licence conditions that reflect Paragraph 44-46 of PF 209 will not apply to a responsible entity that complies with the requirements of this [CO 13/1406] from 1 July 2014.

For interests in a primary production scheme offered to retail clients only before 2 January 2014, [CO 13/1406] does not apply to the responsible entity, but the responsible entity must still meet the conditions in its AFS licence that impose obligations similar to paragraphs 44-46 of PF 209.

This class order modifies or varies Part 7.6 of the Act (other than Divisions 4 and 8) in relation to an AFS licensee by notionally inserting section 912AAB into the Act. Subsection 912AAB(1) of the Act stipulates that the section applies to an AFS licensee that is authorised to operate a registered managed investment scheme that involves primary production activities listed in paragraphs (a) to (d). It is the objective of this subsection that 'primary production' captures a broad range of income producing activities for which the use of land is reasonably required.

Subsection 912AAB(2) of the Act stipulates the requirements for an AFS licensee offering interests in a registered managed investment scheme after 2 January 2014 as explained in the following paragraphs.

The property interest must be registered on the land title register

Paragraph 912AAB(2)(a) of the Act require the AFS licensee to take reasonable steps to ensure that any 'regulatory approvals' that are necessary to carry out the primary production activities are obtained and maintained.

Paragraph 912AAB(2)(b) of the Act requires the AFS licensee to lodge for registration under State or Territory land title laws one or more instruments in registrable form that it reasonably believes will be registered. This would require the AFS licensee to ensure that the instruments creating or transferring the interests in land are properly executed in accordance with the State and Territory land title laws.

We consider that the interest in land required for the operation of the registered scheme must be registered on the land titles register in accordance with the State or Territory land title laws. If it is not possible for an interest in land to be registered in compliance with the provisions applying under the Class Order, ASIC may consider giving relief to the responsible entity if satisfied the purpose of the Class Order is achieved in another way.

Paragraph 912AAB(2)(c) of the Act stipulates the timing of lodging the prescribed instruments with the land title registrar. In particular, the AFS licensee must ensure that each instrument is lodged for registration by the later of 1 July 2014 or immediately after the AFS licensee accepts any contribution from a scheme member.

Paragraph 912AAB(2)(d) of the Act stipulates that the AFS licensee must also do all things that it can do that are necessary to ensure that each instrument is registered promptly after it is lodged. This would require, for example, the AFS licensee to promptly respond to any requisition from the land title registrar.

Paragraph 912AAB(2)(e) of the Act stipulates that the AFS licensee must not accept any contributions from members whose interests in the scheme will be affected by the use of the primary production land, unless it reasonably believes that the instrument will be registered promptly after it is lodged and any regulatory approvals that are outstanding will be obtained promptly after the contributions are accepted.

For a discussion regarding paragraph 912AAB(2)(f) of the Act, please see below.

The interest holder

The AFS licensee must ensure that the property interest is held either by the members collectively, each member in relation to his/her portion, a custodian engaged by the responsible entity, the responsible entity, or a company controlled by the scheme members. Paragraph 912AAB(2)(g) of the Act stipulates which entity can hold the property interest and the requirements for holding the property interest.

Protecting the property interest from any existing and subsequent interests in the same land

The AFS licensee must do all things it can do that are necessary to ensure that any other existing and subsequent interests in the same land cannot have an adverse effect on the property interest in a way that is material to the scheme's operation.

Paragraph 912AAB(2)(h) of the Act stipulates the obligations that need to be satisfied before registration of the land instruments to protect the property interest from any existing interests in the same land. This includes the obligation to do all things the AFS licensee can do that are necessary to ensure that the property interest is protected from existing interests in the same land and to reasonably believe that it will be able to effect that protection. To form this reasonable belief, the AFS licensee would be required to search the land title register and may need to enter into arrangements with the holders of existing interests in the same land. For example, if there is an existing registered security interest in land of the landowner's mortgagee, then the AFS licensee may need to obtain the mortgagee's written consent to postpone the priority of the mortgagee's interests in land to those of the scheme members and register the consent in accordance with State and Territory land title laws.

The exercise of any statutory interests in land created or conferred under a law that applies generally to land in the State or Territory in which the primary production land is located could be beyond the AFS licensee's control. Paragraph 912AAB(2)(h) of the Act would require the AFS licensee to make reasonable inquiries before the registration of the land instruments to determine whether existing statutory interests are being exercised or are proposed to be exercised in a way that may deprive the scheme members of a substantial part of the benefits intended to be produced by the scheme. For example, the AFS licensee may need to search the noticeboards of the State or Territory government or newspapers for any public notice of proposal or plan of road closures, development or installations that may affect the primary production land. If the AFS licensee is not aware of any potential adverse effect, then the obligation in paragraph 912AAB(2)(h) of the Act does not apply. However, if the AFS licensee is aware of any potential adverse effect, then the obligation in paragraph 912AAB(2)(h) of the Act applies.

Paragraph 912AAB(2)(i) of the Act stipulates the obligation to do all things necessary to ensure that, after the registration of the land instruments, the property interest cannot be adversely affected by any subsequent interests in the same land. For example, the AFS licensee may need to lodge a private caveat and the trust deed with the land title registrar to protect the scheme members' interest in land. The obligation in paragraph 912AAB(2)(i) of the Act does not apply to an interest or a right that is created, conferred or consented to by the licensee, as long as the licensee did so in accordance with its duties as responsible entity of the scheme. It also does not apply to an interest or a right that may be created or conferred under a law that applies generally to land in the State or Territory in which the primary production land is located.

The scheme's constitution must facilitate the holding of the property interest

The AFS licensee must ensure that the scheme's constitution gives the licensee the power to require members to make payments to, or as directed by, the licensee to satisfy the payment obligations in relation to the primary production land. In particular, the registered proprietor of the land is generally required to pay for council rates and land tax. Meanwhile, the lessee or sublessee is generally required to pay for utility expenses. In addition, the AFS licensee must hold, or cause its agent to hold, the payments on trust for the paying scheme members or the collective scheme members, as relevant, until they are used to meet the relevant payment obligations.

Paragraph 912AAB(2)(j) of the Act stipulates the content requirement of the scheme's constitution if the land instrument is not an instrument of transfer of a freehold estate or interest in land, such as a lease or a sublease.

Paragraph 912AAB(2)(k) of the Act stipulates the content requirement of the scheme's constitution if the land instrument is an instrument of transfer of a freehold estate or interest in land, such as property purchase agreement.

Paragraph 912AAB(2)(l) of the Act stipulates the holding requirements for amounts paid by scheme's members under the scheme's constitution affected by paragraph (j) or (k).

The terms of the land instrument

Paragraph 912AAB(2)(f) of the Act stipulates the obligation to ensure that the interest holder has the rights required for the scheme's purposes under the terms of the land instrument

conferred either by the instrument or by registration of the instrument. In particular, the AFS licensee must ensure that the rights conferred on the interest holder include, where relevant for the scheme's purposes, rights of access, cultivation, transmission, maintenance, protection, repair, refurbishment and harvesting in relation to the primary production land.

Paragraphs 912AAB(2)(m) and (n) of the Act sets out the obligations the AFS licensee must comply with if the land instrument is not an instrument of transfer of a freehold estate or interest in land. In particular, the AFS licensee must:

- ensure that the terms of the instrument are not less favourable to the lessee, sublessee or other interest holder than they would be if the terms had been negotiated on an arm's length basis between the other parties to the instrument and the AFS licensee acting in accordance with its duties; and
- ensure that the terms of the instrument prohibit any action taken by the other party to the instrument that would have a materially adverse effect on the interest holders' property interests without giving the AFS licensee at least 3 months notice in writing; and
- on receipt of that notice, promptly notify in writing the members whose benefits may be affected about the potential action by the other party to the instrument and about the members' rights to requisition a meeting.

Subsection 912AAB(3) of the Act stipulates that an AFS licensee that complies with subsection 912AAB(2) is taken to comply with any condition in its AFS licence that requires the lodgement of an instrument relating to the primary production land.

4. Consultation

On 20 December 2012, ASIC released Consultation Paper 197 *Holding scheme property and other assets (CP 197)* seeking feedback on our proposals to update our guidance for responsible entities of registered managed investment schemes in holding scheme property and other assets. These proposals would also be relevant for licensed custody providers, managed discretionary account operators, and investor directed portfolio service operators. The consultation period closed on 28 February 2013.

ASIC received 8 non-confidential responses to the proposals in CP 197 from lawyers, industry bodies, custodians, banks and one compliance specialist. CP 197 can be found on ASIC's website.

The Office of Best Practice Regulation has approved the attached Regulation Impact Statement for the regulation to implement our policy in the replacement of RG 133.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

ASIC Class Order [CO 13/1406]

The class order is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the class order

The class order specifies requirements that a responsible entity of certain managed investment schemes that engage in primary production must meet in holding interests in land required for their operation. The schemes affected include those engaged in forestry activities.

The purpose of this class order is to reduce the risks to these schemes' ability to operate as a result of the land on which the production is being carried out being affected by the rights of other parties outside the scheme. Developed in consultation with industry, the class order requires the responsible entity to ensure that the interest in the land that is being used for the scheme is appropriately registered under the relevant State or Territory laws in the name of the members collectively, individually in relation to that portion of the land in which the member has an interest, in the name of a company controlled by scheme members, a person entitled to hold scheme property as a trustee for members or the responsible entity as trustee for members.

The obligations imposed under this class order are consistent with an entity's obligations as an Australian financial services licensee under paragraph 912A(1)(a) of the *Corporations Act 2001* (the *Act*) and as a responsible entity under paragraph 601FC(1)(c) of the *Act*.

Human rights implications

One option that a responsible entity will have in complying with the class order is to have the relevant interest in land registered in the name of members of the scheme. Ordinarily under State and Territory land titles laws, this would result in the members' names being accessible on a public register. Where the scheme member is a natural person, the human right to privacy under Article 17 of the *International Covenant on Civil and Political Rights (Article 17)* may be engaged. Article 17 prohibits unlawful or arbitrary interferences with a person's privacy, family, home and correspondence.

ASIC considers that the class order is compatible with the right in Article 17. The right in Article 17 is not absolute. The right has implied limitations ('unlawful' and 'arbitrary') and may be subject to a permissible limitation where that limitation aims to achieve a legitimate objective, there is a rational connection between the limitation and the objective and the limitation is reasonable, necessary and proportionate. Any limitation imposed on the right by the class order has a clear legal basis, in that it:

(a) *Aims to achieve a legitimate objective* – Having the interest in land registered in the name of members of the scheme seeks to protect those members by ensuring members' interests in

the land cannot be adversely affected either by the interests of others in the land or, as far as possible, by any future interests, unless the interests were properly created by the responsible entity in accordance with its duties or were interests of which the responsible entity was not aware after reasonable inquiry.

(b) *Is reasonable, necessary and proportionate* – Having an option of registering interests in land in the name of members of the scheme is necessary to achieve the legitimate objective described above because if members choose to invest in a scheme that has this feature it can be a way of protecting their rights without requiring them to bear the cost of another person holding the land. Further, the existence of publicly accessible registers of holders of interests in land is a long established and generally accepted feature of State or Territory land registration legislation. Having members’ names accessible on land titles registers is reasonable and proportionate given that such registers are generally publicly available and given that Chapter 2C of the Act already requires responsible entities to maintain registers of members that are publicly searchable and include details of the members’ names.

This class order does not otherwise engage any of the applicable rights or freedoms.

Conclusion

The class order is compatible with human rights. Any interference with the human right to privacy is incidental to its primary operation. Where that interference occurs, it is reasonable, necessary and proportionate in order for scheme members to benefit from the regulatory protections the class order seeks to implement.