



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 240

Hedge funds: Improving disclosure

October 2013

About this guide

This guide is for those involved in the issue and sale of hedge funds. It sets out our guidance for improved disclosure to investors to help them understand and assess these products.

In seeking to improve disclosure, ASIC aims to ensure that investors and their advisers have the information they need to make an informed investment decision. However, this should not be regarded as an indication that we consider these products to be suitable for all or most retail investors.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This version was issued in October 2013 and is based on legislation and regulations as at the date of issue.

Previous versions:

- Superseded Regulatory Guide 240, issued 18 September 2012, reissued in May 2013

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

Hedge funds can pose more complex risks for investors than traditional managed investment schemes. This is because of their diverse investment strategies, in many cases involving the use of leverage, and complex and offshore structures.

The benchmarks and disclosure principles in this guide set out the specific features and risks of hedge funds that we think should be addressed in a Product Disclosure Statement (PDS) for these products.

The benchmarks and disclosure principles are designed to improve disclosure so that investors can make more informed decisions about investing in products of this kind, and to make comparisons between the products and business models of different funds more straightforward.

In seeking to improve disclosure, we aim to ensure that investors have the information they need to make an informed investment decision. However, this should not be regarded as an indication that we consider these products to be suitable for all or most retail investors.

Disclosure against the benchmarks and disclosure principles should be:

- addressed upfront in the PDS; and
- updated in ongoing disclosure as material changes occur (e.g. in a supplementary PDS).

Who this guide applies to

RG 240.1 This guide is for responsible entities of hedge funds, and those responsible for preparing a PDS for an offer of interests in a hedge fund.

Note: Section 1013A of the *Corporations Act 2001* (Corporations Act) sets out who is responsible for preparing a PDS in various circumstances.

RG 240.2 We encourage other issuers to disclose against the benchmarks and apply the disclosure principles when providing information to investors in similar situations, such as offers of shares in investment companies pursuing investment strategies normally associated with hedge funds or offers to wholesale investors of interests in a hedge fund: see also RG 240.23–RG 240.25.

Note: Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) provides guidance for those offers of securities that require a disclosure document under Ch 6D of the Corporations Act.

What is a hedge fund?

RG 240.3 There are some characteristics that distinguish hedge funds from other managed investment schemes, such as the use of leverage, derivatives and

short selling, or seeking returns with a low correlation to equity, bond or cash markets. These characteristics and other features of hedge funds, such as charging performance fees, mean that investors in these funds can be exposed to more complex risks than investors in funds pursuing more ‘vanilla’ investment strategies.

- RG 240.4 The definition of ‘hedge fund’ used in this guide closely follows the approach taken in Class Order [CO 12/749] *Relief from the Shorter PDS regime*. A hedge fund is a registered managed investment scheme that:
- (a) is promoted by the responsible entity using the expression and as being a ‘hedge fund’; or
 - (b) exhibits two or more of the characteristics of a hedge fund, as set out in Table 1.

Note: [CO 12/749] has been modified by amending Class Order [CO 13/1128] *Amendment of Class Order [CO 12/749]*. Amendments made by [CO 13/1128] have been consolidated into the principal class order [CO 12/749].

Table 1: Characteristics of hedge funds

Characteristic	Description
Complexity of investment strategy or structure	<p>The fund:</p> <ul style="list-style-type: none"> • pursues investment strategies that aim to generate returns with a low correlation to published indices solely or predominantly comprised of equities, bonds and/or cash (or similar products), or any combination of such indices; or • has a complex investment structure that invests through three or more vertically interposed entities (or two or more interposed entities if at least one of the entities is offshore) where the responsible entity of the scheme or an associate has the capacity to control the disposal of the products or two or more of the interposed entities. For this characteristic, interposed entities do not include managed investment schemes registered in Australia, or similar entities incorporated or registered in a prescribed foreign jurisdiction that is authorised by a prescribed foreign regulatory authority to make offers to the general public (i.e. the foreign entity or its operator is specifically authorised to make offers to all classes of investors). <p>Note: The list of prescribed foreign regulatory authorities is set out at Appendix B.</p>
Use of leverage	The fund uses debt for the dominant purpose of making a financial investment.

Characteristic	Description
Use of derivatives	<p>The fund uses derivatives, other than:</p> <ul style="list-style-type: none"> • for the dominant purpose of managing foreign exchange or interest rate risk; • for the dominant purpose of more efficiently gaining an economic exposure, through the use of exchange-traded derivatives, to the underlying reference assets of those derivatives, but only on a temporary basis (i.e. less than 28 days, which cannot be extended by rolling over or replacing the derivative); or • exchange-traded derivatives, provided the notional derivatives exposure of the fund does not exceed 10% of its net asset value (unless the exposure is attributable to circumstances that were not reasonably foreseeable by the responsible entity, such as unforeseen market movements or large redemption requests, and the exposure is for a period of no more than three consecutive business days). <p>Note: For this characteristic, derivatives include deferred purchase agreements.</p>
Use of short selling	The fund engages in short selling.
Charges a performance fee	The responsible entity (or investment manager) has a right to be paid a fee based on the performance of the fund's assets (this is in addition to any management fee the responsible entity or investment manager may have a right to receive) and has disclosed to investors that performance fees will be payable if the responsible entity or another person satisfies the performance criteria.

RG 240.5 The definition of 'hedge fund' and 'fund of hedge fund' (see RG 240.18) uses the expression 'promoted by'. Promotion by a responsible entity includes any promotion caused or authorised by the responsible entity. Therefore, if a responsible entity (or anyone authorised by the responsible entity) uses the term 'hedge fund' in any promotional material, including disclosure documentation, it is a hedge fund for the purposes of this guide.

RG 240.6 A fund may exhibit two or more of the characteristics in Table 1 in relation to a single activity—for example, using a derivative to obtain a short exposure. In these circumstances, we consider that this would only constitute a single characteristic (i.e. the derivatives characteristic) in determining whether the fund is a hedge fund for the purposes of this guide.

RG 240.7 Many schemes do not engage in the relevant strategies covered by the characteristics in Table 1, but the scheme's constitution may reserve the right to do so. These rights (if not used) do not trigger classification as a hedge fund until and unless the strategy is used. However, we would encourage the responsible entity of a fund to disclose against the relevant benchmarks and apply the disclosure principles if the fund will, from time to time, manifest two or more of the characteristics in Table 1.

Complexity of investment strategy or structure

RG 240.8 In determining whether a fund has a complex investment structure that invests through three or more vertically interposed entities (or two or more interposed entities if at least one of the entities is offshore), the calculation of

the number of interposed entities through which the fund acquires an economic interest in a financial product is to be performed by reference to each separate vertical stream of interposed entities.

Note: See Appendix A for further illustration of these concepts.

RG 240.9 A fund may pursue a balanced investment strategy that is not correlated with a single equities, bonds or cash index, but rather is intended to be correlated with a basket of indices covering equity, bond or cash markets. We consider that such a strategy does not trigger classification as a hedge fund.

RG 240.10 In determining whether a hedge fund pursues an investment strategy that is correlated with a relevant index, the index must be widely used throughout the industry. We do not consider that this includes, for example, proprietary indices developed by a hedge fund operator (or an associated entity) for its own use, regardless of whether the index is published.

Use of derivatives

RG 240.11 Not all uses of derivatives will characterise a fund as a hedge fund. Three exceptions allow a fund to use derivatives without triggering characterisation as a hedge fund:

- (a) derivatives used for the dominant purpose of managing foreign exchange or interest rate risk;
- (b) derivatives used for the dominant purpose of more efficiently gaining an economic exposure, through the use of exchange-traded derivatives, to the underlying reference assets of those derivatives, but only on a temporary basis (i.e. less than 28 days, which cannot be extended by rolling over or replacing the derivative); or
- (c) exchange-traded derivatives, provided the notional derivatives exposure of the fund does not exceed 10% of its net asset value (unless the exposure is attributable to circumstances that were not reasonably foreseeable by the responsible entity, such as unforeseen market movements or large redemption requests, and the exposure is for a period of no more than three consecutive business days).

RG 240.12 These three exceptions operate independently of each other. For example, where a fund uses exchange-traded derivatives for the dominant purpose of managing foreign exchange or interest rate risk, this does not count towards the 10% notional derivatives exposure limit for exchange-traded derivatives in RG 240.11(c).

RG 240.13 Where derivatives are used on a temporary basis for the dominant purpose of gaining more efficient economic exposure to the underlying reference assets, a fund will not trigger this characteristic simply because the derivative has a term of more than 28 days, but it will trigger this characteristic if the position is not closed-out within 28 days.

RG 240.14 The ‘notional derivatives exposure’ of a fund to derivatives means the sum of the absolute short and long notional principal amounts of all derivatives, adjusted for any offsetting exposures on the same asset on the same terms.

Note: For example, assume a fund has a \$100 long exposure in one asset (asset A) and \$100 short exposure in another asset (asset B). The fund enters into a \$20 short position on asset A and on the same terms to partly close-out the long position. The fund’s notional derivatives exposure would therefore be \$180—that is, \$80 absolute exposure on asset A (comprised of the \$100 long exposure less \$20 short exposure), plus \$100 short exposure on asset B.

Anti-avoidance

RG 240.15 Our approach to defining what a hedge fund is includes an anti-avoidance mechanism to discourage responsible entities from restructuring their activities to avoid triggering the definition (e.g. by splitting activities across different entities so that no one entity exhibits two or more of the characteristics). We will adopt a measured approach where inadvertent breaches arise or systems changes are under way. However, where we find deliberate and systemic breaches we will take stronger regulatory action.

ASIC relief

RG 240.16 If a responsible entity is uncertain about whether a registered scheme is a hedge fund (or fund of hedge funds), the responsible entity can elect to state that they are a hedge fund and disclose against the benchmarks and apply the disclosure principles in this guide; otherwise, we would expect the responsible entity to seek clarification or relief from ASIC.

Note: Regulatory Guide 51 *Applications for relief* (RG 51) provides guidance for applicants and advisors who are applying to ASIC for relief.

Funds of hedge funds and significant underlying funds

RG 240.17 Many hedge funds gain indirect exposure to a range of investments in financial products by investing in other vehicles (called ‘underlying funds’) that use hedge fund strategies. These vehicles may be managed investment schemes or companies. They may be located in Australia or offshore.

RG 240.18 For the purposes of this guide, a ‘fund of hedge funds’ means a registered managed investment scheme:

- (a) where at least 35% of a fund’s assets are invested by the responsible entity in one or more hedge funds (including a scheme or body in or outside this jurisdiction that would be a hedge fund if it were a registered managed investment scheme); or
- (b) that promotes itself as a fund of hedge funds.

RG 240.19 Responsible entities of funds of hedge funds should make the additional or varied disclosures relating to their whole portfolio as specified in the

benchmarks and disclosure principles as being appropriate for funds of hedge funds.

- RG 240.20 The benchmarks and disclosure principles in this guide cover a range of disclosures relating to the responsible entity, the individuals making the investment decisions, service providers, fund strategies and fund assets. Where a hedge fund has invested in one or more significant underlying funds (being an underlying fund that accounts for 35% or more of the fund of hedge fund's assets), the benchmarks and disclosure principles in this guide should be taken to apply to each such significant underlying fund on a 'look-through' basis. In these cases, responsible entities of funds of hedge funds should disclose against the benchmarks and apply the disclosure principles for each such significant underlying fund and its investments, unless otherwise indicated in the benchmarks and principles. These disclosures would be in addition to disclosures for the fund of hedge funds operated by the responsible entity.
- RG 240.21 Where a hedge fund invests in a number of underlying funds with common or related managers, each of those investments should be aggregated for the purposes of determining whether the 35% significant underlying fund threshold is satisfied. If, when aggregated, the hedge fund's investments meet or exceed the 35% threshold for a single underlying fund or group of related underlying funds, the responsible entity should disclose against the benchmarks and apply the disclosure principles for each such significant underlying fund or group of related funds.
- RG 240.22 Where a hedge fund or fund of hedge funds gains economic exposure through a financial instrument such as a swap or deferred purchase agreement to an underlying fund, the disclosures principles set out in this guide should be applied on a look-through basis, though full disclosure should be made on the intermediate layer or layers, including the identity of the counterparty, the product's material terms and any leverage created through the instrument.

Application to other products

- RG 240.23 While the benchmarks and disclosure principles in this guide are primarily directed at PDSs for hedge funds, we consider that there may be other entities and circumstances that pose similar types of risks to investors. We encourage issuers to disclose against the benchmarks and apply the disclosure principles when providing information to investors in similar situations, such as:
- (a) similar offers to wholesale investors; and
 - (b) offers by investment companies that have some of the features of hedge funds.
- RG 240.24 If a scheme could be characterised as a hedge fund or fund of hedge funds but also falls more specifically within a category of schemes covered by

certain other ASIC disclosure guidance, we would expect the scheme to follow that other more specific disclosure guidance. This includes schemes that are subject to any of the following regulatory guides:

- (a) Regulatory Guide 148 *Platforms that are managed investment schemes* (RG 148);
- (b) Regulatory Guide 45 *Mortgage schemes: Improving disclosure for retail investors* (RG 45);
- (c) Regulatory Guide 46 *Unlisted property schemes: Improving disclosure for retail investors* (RG 46);
- (d) Regulatory Guide 231 *Infrastructure entities: Improving disclosure for retail investors* (RG 231); or
- (e) Regulatory Guide 232 *Agribusiness managed investment schemes: Improving disclosure for retail investors* (RG 232).

RG 240.25 We also encourage issuers to consider any applicable industry standards.

RG 240.26 Where a private equity fund exhibits two or more of the characteristics of a hedge fund, as set out in Table 1, we would not expect that private equity fund to disclose against the benchmarks and apply the principles in this guide.

Interaction with the shorter PDS regime

RG 240.27 The shorter PDS regime established by the Corporations Amendment Regulations 2010 (No. 5) applies to ‘simple managed investment schemes’—that is, a scheme that can realise 80% of its assets at market value within 10 days.

RG 240.28 A hedge fund may be able to realise 80% of its assets at market value within 10 days and fall within the definition of a simple managed investment scheme. However, due to the complexity of hedge fund strategies and investment structures, and the nature of hedge fund investment exposures or activities, we consider the requirements of the shorter PDS regime are not appropriate to ensure that the responsible entity of a hedge fund discloses sufficient information to allow an investor to have the information they reasonably need to make an informed investment decision.

RG 240.29 [CO 12/749] specifically excludes hedge funds and funds of hedge funds from the shorter PDS regime. The definition of hedge fund used in this guide closely follows the approach taken in that class order. This means that we expect all hedge funds and funds of hedge funds to disclose against the benchmarks and apply the disclosure principles in this guide, regardless of whether the fund meets the definition of a simple managed investment scheme.

RG 240.30 Our relief in [CO 12/749] is given on a temporary basis until 22 June 2014, pending further work by the Government on the appropriate long-term treatment of these products.

Improving disclosure for hedge funds

The role of disclosure

- RG 240.31 The disclosure framework in the Corporations Act requires the responsible entity of a hedge fund to:
- (a) disclose upfront to retail investors all the information they reasonably need to know to make a decision about whether or not to acquire the product;
 - (b) provide ongoing disclosure about material matters to help retail investors monitor whether their expectations are being met; and
 - (c) provide periodic disclosure of information that the responsible entity reasonably believes the investor needs to understand their investment in the hedge fund.
- RG 240.32 Our disclosure guidance is not designed to stop or discourage retail investors from taking investment risks, but to help them understand the risks involved in any particular investment or type of investment. This enables them to make a more informed decision about whether the potential reward (the return on their investment) warrants the level of risk involved. This approach should also lead to comparable disclosure by responsible entities of hedge funds, helping investors to compare investments in this sector.
- RG 240.33 Given the risks for retail investors associated with investing in hedge funds, and that many rely on disclosure material to inform their decisions to invest, we think it is necessary to ensure that disclosure provides retail investors with the information they need to make an informed decision about whether or not to invest.

The need for better disclosure to investors

- RG 240.34 Our guidance has been prompted by our experience that, in some cases, inadequate disclosure has contributed to investors not understanding the risks when purchasing a hedge fund product.
- RG 240.35 Hedge funds have a different risk profile (including counterparty and liquidity risk) to other financial asset schemes. Responsible entities of hedge funds and their managers may:
- (a) invest in many types of financial products across diverse markets and in non-mainstream and often less liquid asset classes;
 - (b) use a wider variety of complex investment techniques and more complex investment structures than traditional funds; and
 - (c) borrow money to leverage the funds' investments or invest in assets with embedded leverage, which amplifies the prospects of both significant positive returns and significant losses.

Each hedge fund is different, so the PDS is a key mechanism for making sure that investors understand the investments and strategies the investment manager will be using.

- RG 240.36 Inadequate disclosure occurs when the information required to be disclosed under the Corporations Act:
- (a) is not included in the PDS; or
 - (b) is included in the PDS, but is not clear, concise and effective (e.g. the information is presented in such a dense and complex way that investors are unlikely to understand the true nature of the investment). This problem can be exacerbated if advertising and other sales practices do not highlight risks and thus give a misleading impression of the product.

Benchmarks and disclosure principles for hedge funds

- RG 240.37 We have identified the following benchmarks and disclosure principles, which address the key issues that we think should be:
- (a) highlighted in PDS disclosure relating to hedge funds; and
 - (b) discussed in a manner that allows prospective retail investors to make an informed decision about whether to invest.

Table 2: Summary of benchmarks for hedge funds

Benchmark	Description
1 Valuation of assets	This benchmark addresses whether valuations of the hedge fund's non-exchange traded assets are provided by an independent administrator or an independent valuation service provider.
2 Periodic reporting	This benchmark addresses whether the responsible entity of the hedge fund will provide periodic disclosure of certain key information on an annual and monthly basis.

Table 3: Summary of disclosure principles for hedge funds

Disclosure principle	Description
1 Investment strategy	This disclosure principle is intended to ensure that investors are made aware of the details of the investment strategy for the fund, including the type of strategy, how it works in practice and how risks are managed.
2 Investment manager	This disclosure principle is intended to ensure that investors have the necessary information about the people responsible for managing the fund's investments, such as their qualifications and relevant commercial experience, and the proportion of their time devoted to the hedge fund.

Disclosure principle	Description
3 Fund structure	This disclosure principle is intended to ensure that the responsible entity of the hedge fund explains the investment structures involved, the relationships between entities in the structure, fees payable to the responsible entity and investment manager, the jurisdictions involved (if these involve parties offshore), the due diligence performed on underlying funds, and the related party relationships within the structure.
4 Valuation, location and custody of assets	This disclosure principle is intended to ensure that the responsible entity of the hedge fund discloses the types of assets held, where they are located, how they are valued and the custodial arrangements.
5 Liquidity	This disclosure principle is intended to ensure that investors are made aware of the fund's ability to realise its assets in a timely manner and the risks of illiquid classes of assets.
6 Leverage	This disclosure principle is intended to ensure that investors are made aware of the maximum anticipated level of leverage of the fund (including leverage embedded in the assets of the fund).
7 Derivatives	This disclosure principle is intended to ensure that investors are made aware of the purpose and types of derivatives used by the responsible entity or investment manager, and the associated risks.
8 Short selling	This disclosure principle is intended to ensure that investors are made aware of how short selling may be used as part of the investment strategy, and of the associated risks and costs of short selling.
9 Withdrawals	This disclosure principle is intended to ensure that investors are made aware of the circumstances in which the responsible entity of the hedge fund allows withdrawals and how this might change.

Form and method of disclosure

- RG 240.38 Our disclosure model for hedge funds consists of a combination of disclosure principles and 'if not, why not' benchmarks. Each benchmark and disclosure principle identifies a key risk area that potential investors should understand before making a decision to invest. Failure to disclose against the benchmarks and apply the disclosure principles will result in an increased risk of a PDS not making the disclosure required by the Corporations Act, or not being 'clear, concise and effective', and ASIC issuing a stop order for the offer or taking other action if we consider investors have been misled or deceived or have not received the information required by the Corporations Act.
- RG 240.39 Where we have provided guidance on an 'if not, why not' benchmark in relation to a particular risk or feature, a responsible entity should state in the PDS and other disclosures whether it meets the benchmark and if not, why not.

- RG 240.40 This model of disclosure provides standards by which retail investors can assess financial products for which there are typically few such external benchmarks.
- Note: If a responsible entity cannot meet all aspects of a benchmark, it should state that it does not meet the benchmark and clearly explain which aspects it meets and, for those it does not meet, explain why not and how it deals with the associated risks in another way.
- RG 240.41 Failing to meet one or more of the benchmarks does not mean that a product provided by a particular issuer necessarily represents a poor investment. However, the responsible entity will need to explain what alternative measures it has in place to mitigate the concern underlying the benchmark.
- RG 240.42 Where we have provided guidance on a disclosure principle, this identifies a particular feature or risk of hedge funds that we consider a responsible entity should clearly and prominently address in the PDS. This disclosure will help retail investors to understand the significant benefits, risks and features of the fund.
- RG 240.43 Where Benchmark 1 or Disclosure Principles 6, 7 or 8 are not relevant (e.g. the particular feature does not apply to a fund or the fund does not engage in the particular activity), the PDS need not address that benchmark or principle. Also, a number of specific disclosures referred to in Benchmark 2 or the disclosure principles may not be relevant to particular funds, in which case responsible entities need not disclose against them. For instance, if the fund does not employ leverage, the responsible entity need not disclose the leverage ratio as required by Table 4. Similarly, if the fund does not use an external liquidity facility to provide member redemptions, it need not disclose against RG 240.95(c).
- RG 240.44 The benchmark and disclosure principle information should be:
- (a) addressed upfront in the PDS;
 - (b) updated in ongoing disclosure as material changes occur (e.g. in a supplementary PDS); and
 - (c) supported in, and not undermined by, advertising material.
- RG 240.45 We expect responsible entities to clearly and prominently disclose a summary of the information identified in the benchmarks and disclosure principles in the first few pages of the PDS, with cross-references to where further information can be found in the PDS: see Section D.
- RG 240.46 In the interests of ensuring that existing investors are well informed, a responsible entity may also choose to provide regular reports on this information in other materials (e.g. monthly or quarterly updates), although providing updates in this form will not relieve the responsible entity from its disclosure obligations if any material changes occur. A responsible entity may, when updating certain information that is not materially adverse from the viewpoint of an investor, rely on Class Order [CO 03/237] *Updated information in product disclosure statements* to provide updates on a website if the PDS states that this may occur.

- RG 240.47 We believe that our approach balances:
- (a) responsible entities' obligation to make available disclosure that helps investors make better informed decisions about investing in hedge funds;
 - (b) our requirement to not unduly interfere with the strategies used by hedge funds and flexibility of the market in raising funds; and
 - (c) our mandate to promote efficiency in Australia's capital markets.

Note: The need to strike an appropriate balance between promoting confident and informed investors and financial consumers and allowing markets to operate freely is part of ASIC's mandate under the *Australian Securities and Investments Commission Act 2001*.

- RG 240.48 Our experience indicates that investors need better quality and relevant disclosure, presented in a way best suited to investor understanding.

Timing for implementing improved disclosure

- RG 240.49 Responsible entities of hedge funds should disclose against the benchmarks and apply the disclosure principles in any PDS dated on or after 1 February 2014. We also expect responsible entities to provide the benchmark and disclosure principle information in their ongoing disclosure from that date: see Section D.
- RG 240.50 By no later than 1 February 2014, if an existing PDS is still in use, responsible entities should:
- (a) include the benchmark and disclosure principle information on a website referred to in the PDS (if the omission of this benchmark and disclosure principle information from the PDS is not materially adverse); or
 - (b) update the PDS by a new or supplementary PDS so that it includes the benchmark and disclosure principle information.

B Benchmarks for hedge funds

Key points

Responsible entities of hedge funds should address benchmarks on the following matters in disclosures to retail investors:

- valuation of assets (see RG 240.51–RG 240.55); and
- periodic reporting (see RG 240.56–RG 240.60).

This information should be disclosed clearly and prominently in the PDS and ongoing disclosure for the hedge fund: see Section D.

Benchmark 1: Valuation of assets

- RG 240.51 The responsible entity has and implements a policy that requires valuations of the hedge fund's assets that are not exchange traded to be provided by an independent administrator or an independent valuation service provider.

Explanation

- RG 240.52 This benchmark is intended to support investor confidence in the value of the hedge fund's non-exchange traded assets. The use of independent (i.e. unrelated to the responsible entity or investment manager of the fund) administrators or valuation service providers has become more widespread in recent years, driven largely by investor concerns about the potential for manager misconduct when these functions are performed in-house. While there is often justification for these activities to be performed by responsible entities (including cost efficiencies), we consider it appropriate for a responsible entity that elects not to use independent service providers to perform these functions to advise investors of this fact and tell them why.
- RG 240.53 If the responsible entity does not meet this benchmark, it should explain why not and how it addresses the risks of the lack of independence in valuations and related party conflicts of interest in connection with valuations.
- RG 240.54 The use of an independent third party to value the fund's assets does not relieve the responsible entity from its liability to members in the event these services are not properly performed: s601FB(1). Further, the responsible entity should maintain sufficient expertise to monitor the performance of any asset valuation services provided by third parties.

RG 240.55 Responsible entities of funds of hedge funds should disclose their policy on the use of independent fund administrators or valuation service providers by managers of underlying funds.

Note: We provide further guidance on the use of service providers in the valuation of assets in Regulatory Guide 94 *Unit pricing: Guide to good practice* (RG 94) at paragraphs 4.6 and 5.1.

Benchmark 2: Periodic reporting

RG 240.56 The responsible entity has and implements a policy to provide periodic reports on certain key information, as set out in Table 4.

Table 4: Periodic reporting of key information

<p>Annual (or more frequent) reporting</p>	<p>The responsible entity has and implements a policy to report on the following information as soon as practicable after the relevant period end:</p> <ul style="list-style-type: none"> • the actual allocation to each asset type (see RG 240.73(b)); • the liquidity profile of the portfolio assets as at the end of the period—the representation of asset liquidity (the estimated time required to sell an asset at the value ascribed to that asset in the fund’s most recently calculated net asset value) in a graphical or other form that allows easy comparison with the maturity profile of the liabilities; • the maturity profile of the liabilities as at the end of the period—the representation of maturities in a graphical form that allows easy comparison with the liquidity profile of the portfolio assets; • the leverage ratio (including leverage embedded in the assets of the fund, other than listed equities and bonds) as at the end of the period; • the derivative counterparties engaged (including capital protection providers); • the monthly or annual investment returns over at least a five-year period (or, if the hedge fund has not been operating for five years, the returns since its inception); and • the key service providers if they have changed since the latest report given to investors, including any change in their related party status (see RG 240.69(b)). <p>This information must be given to members as often as, and no later than or as soon as practicable after, any periodic statement required by s1017D (but in any event no later than six months after the end of the relevant period).</p> <p>Note: The information required by this benchmark is in addition to any other specific information required for periodic disclosure under the Corporations Act: see RG 240.125–RG 240.126.</p>
<p>Ongoing availability</p>	<p>The latest report, which addresses the above matters, is available on the hedge fund’s website.</p>

Monthly updates

The following information is available on the hedge fund's website and is disclosed monthly or, if less often, at least as often as investors have the right to redeem their investments and in reasonable time to allow investors to consider that information in making a decision whether to redeem their investment:

- the current total net asset value of the fund and the redemption value of a unit in each class of units as at the date the net asset value was calculated;

Note: If the method of calculating net asset value is not disclosed with the monthly update, investors should be advised where that method is explained and how to access that information.

- the key service providers if they have changed since the last report given to investors, including any change in their related party status; and
- for each of the following matters since the last report on those matters:
 - the net return on the fund's assets after fees, costs and taxes;
 - any material change in the fund's risk profile;
 - any material change in the fund's strategy; and
 - any change in the individuals playing a key role in investment decisions for the fund.

Explanation

- RG 240.57 The Corporations Act requires a hedge fund to give investors a periodic statement at least annually: s1017D. However, we understand that current market practice is to provide investors with more frequent reports and we encourage responsible entities to do this. This benchmark sets out the matters that we consider investors are likely to have an interest in knowing at least annually.
- RG 240.58 We consider that investors are also likely to want to monitor basic investment performance information on their hedge fund investments more often than annually. The benchmark is designed to ensure that investors receive timely, basic fund investment performance information to enable them to closely monitor the ongoing performance of their hedge fund investments and decide on an informed basis whether to stay in or exit their investments. If returns paid to investors over the reporting period are funded other than from investment returns from the fund's assets, this should be clearly stated together with the resulting impact on the redemption value on a per-unit basis for each class of units in the fund.
- RG 240.59 If the responsible entity does not meet this benchmark, it should explain why not and state its policy on what information will be provided, how and when.
- RG 240.60 For funds of hedge funds to meet this benchmark, the responsible entity should disclose against this benchmark in relation to any significant underlying fund, in addition to disclosing in relation to the fund of hedge funds.

C Disclosure principles for hedge funds

Key points

Responsible entities of hedge funds should provide information about the following matters in disclosures to retail investors:

- investment strategy (see RG 240.61–RG 240.64);
- investment manager (see RG 240.65–RG 240.67);
- fund structure (see RG 240.69–RG 240.72);
- valuation, location and custody of assets (see RG 240.73–RG 240.77);
- liquidity (see RG 240.78–RG 240.80);
- leverage (see RG 240.81–RG 240.87);
- derivatives (see RG 240.88–RG 240.90);
- short selling (see RG 240.92–RG 240.94); and
- withdrawals (see RG 240.95–RG 240.97).

This information should be disclosed clearly and prominently in the PDS and ongoing disclosure for the hedge fund: see Section D.

Disclosure Principle 1: Investment strategy

RG 240.61 The responsible entity should disclose the following information:

- (a) a description of the fund's investment strategy, including:
 - (i) the typical asset classes to be invested in;
 - (ii) the typical location and currency denomination of the assets; and
 - (iii) the role of leverage, derivatives and short selling;

Note: For other related disclosures, see Disclosure Principle 6, Disclosure Principle 7, and Disclosure Principle 8.
- (b) an explanation of how the strategy will produce investment returns;
- (c) any key dependencies or assumptions underpinning the strategy's ability to produce investment returns (e.g. market conditions or interest rates);
- (d) what the diversification guidelines or limits are;
- (e) any specific risks associated with the relevant investment strategy;
- (f) disclosure of the key aspects of the fund's risk management strategy; and
- (g) if and how the investment strategy can change and what notification would be provided to investors.

Explanation

- RG 240.62 A clear and concise explanation of the fund's investment strategy is a key requirement to enable an investor to make an informed decision about whether to invest in the fund. This disclosure principle is intended to ensure that investors are made aware of the details of the investment strategy for the fund, including the type of strategy, how it works in practice, and how risks are managed. It should provide sufficient detail for an investor to understand the particular risks involved, and give context to other disclosures—for example, to assess the competency of key investment decision makers to execute the investment strategy.
- RG 240.63 For funds of hedge funds, the responsible entity should apply this disclosure principle as though the reference to 'asset' at RG 240.61(a)(i) reads 'underlying fund' and need not provide the information in RG 240.61(a)(ii) in addition to the disclosures set out at RG 240.73.
- RG 240.64 Responsible entities of funds of hedge funds should also provide sufficient information to explain the strategy for selecting which underlying funds they will invest in and their due diligence process in the selection of underlying funds. Further, for each investment in an underlying fund that exceeds 10% of the hedge fund's assets, the responsible entity should explain why that particular underlying fund was selected and how it fits with the investment strategy.

Disclosure Principle 2: Investment manager

- RG 240.65 The responsible entity should disclose a description of the following:
- (a) the identity of, and information on any relevant significant adverse regulatory findings against, any investment manager appointed by the responsible entity of the hedge fund;
 - (b) the identities, relevant qualifications and commercial experience (including information on any relevant significant adverse regulatory findings against) of any individuals playing a key role in investment decisions and the proportion of their time each will devote to executing the fund's investment strategy;
 - (c) if any of the assets are not managed by the responsible entity, any unusual and materially onerous (from an investor's perspective) terms in the agreement or other arrangement under which any investment manager is appointed and the scope of this appointment; and

Note: If the fund's assets are managed by the responsible entity, the responsible entity should disclose any unusual and materially onerous provisions of the scheme's constitution.

- (d) the circumstances in which the responsible entity is entitled to terminate the investment manager's appointment and on what terms (including any payments).

Explanation

- RG 240.66 This disclosure principle is intended to ensure that investors have the necessary information about the people responsible for managing the fund's investments, as well as the arrangement between the responsible entity and any investment manager.
- RG 240.67 The higher level of fees paid to investment managers of many hedge funds, the complexities of the strategies involved and the prospect held out of exceeding equity, bond or cash industry benchmarks, make the experience and qualifications of the key investment decision makers, and the time that they devote to executing the investment strategy, critical information. The PDS should relate their experience and qualifications to the fund's strategy.
- RG 240.68 For funds of hedge funds, the responsible entity should disclose against this disclosure principle in relation to any significant underlying fund, in addition to disclosing in relation to the fund of hedge funds.

Disclosure Principle 3: Fund structure

- RG 240.69 The responsible entity should disclose the following information:
- (a) the fund's investment structure—that is, the key entities involved (e.g. companies, schemes and limited partnerships), their relationship to each other and their roles, together with a diagram showing the flow of investment money through the structure;
 - (b) the identities of the key service providers (e.g. investment managers, prime brokers, custodian, administrator, valuation service provider and auditor) and scope of their services, where applicable;
 - (c) how the responsible entity ensures that its key service providers will comply with their service agreement obligations;
 - (d) any related party relationships within the structure, including any related party relationships between the responsible entity and the investment managers, or between the responsible entity or investment managers and any underlying funds, counterparties or any key service providers (including executing brokers) to the fund;
 - (e) the existence and nature of material arrangements in connection with the hedge fund that are not on arm's length terms (see Regulatory Guide 76 *Related party transactions* (RG 76));
 - (f) for funds of hedge funds, the due diligence process performed on underlying funds and their key service providers;

- (g) a reasonable estimate of the aggregate amount of any fees and costs that would be disclosed by all underlying funds (that are not listed entities or corporations that are not investment companies) as if each of those entities were a registered scheme disclosing in accordance with Sch 10 of the Corporations Regulations 2001 (Corporations Regulations), but so as to exclude double counting to the extent that those management costs include management costs of the hedge fund;
- (h) the jurisdictions of the entities involved in the fund's structure; and
- (i) the risks of the structure, including any risks associated with holding assets overseas or, for funds of hedge funds, with investing in underlying funds overseas.

Explanation

- RG 240.70 This disclosure principle is intended to ensure that the fund explains the investment structures involved, the relationships between entities in the structure, fees and other costs payable to the responsible entity and investment manager, the jurisdictions involved, the due diligence performed on underlying funds, and the related party relationships within the structure.
- RG 240.71 In relation to RG 240.69(g), management costs incurred in an underlying entity deducted before payment of money to the hedge fund or other underlying entity between the first underlying entity and the hedge fund may be required to be disclosed as management costs of the hedge fund under Sch 10, in addition to the fees and costs for the hedge fund itself. This will be the case if the underlying entity is interposed for the purpose of investment structuring rather than the ownership interest in the underlying entity being itself the asset to which the investment strategy of the hedge fund relates. However, where inclusion of management costs in an underlying unlisted entity is not required by Sch 10, it is still appropriate that disclosure of fees and costs be made to enable investors to understand the relationship between changes to the value of the assets underlying the underlying entity (except for listed entities and corporations that are not investment corporations).
- RG 240.72 For funds of hedge funds, the disclosures at RG 240.69(c) and RG 240.69(e) will usually only be required for the fund of hedge funds, not for the underlying funds.

Disclosure Principle 4: Valuation, location and custody of assets

- RG 240.73 The responsible entity should disclose the following information:
- (a) the key aspects of the valuation policy;
 - (b) the types of assets that the fund does or may invest in and the allocation range for each asset type, using the following asset types (including the assets of underlying funds):
 - (i) Australian listed equities;

- (ii) Australian unlisted equities;
 - (iii) international listed equities;
 - (iv) international unlisted equities;
 - (v) Australian government bonds;
 - (vi) Australian corporate bonds;
 - (vii) international government bonds;
 - (viii) international corporate bonds;
 - (ix) structured products;
 - (x) real property;
 - (xi) infrastructure;
 - (xii) exchange-traded derivatives;
 - (xiii) over-the-counter (OTC) derivatives;
 - (xiv) cash equivalent investments; and
 - (xv) other (provide details);
- (c) any policy about the geographic location of the asset;
- (d) the geographic location of any material asset; and
- (e) the custodial arrangements, including details of the roles provided by custodians. Where assets are not held by a third party custodian, the responsible entity should disclose the types and proportion of those assets relative to the fund's net asset value.

Explanation

RG 240.74 This disclosure principle is intended to ensure that the responsible entity of the hedge fund discloses the types of assets held, where they are located, how they are valued and the custodial arrangements.

Note: Regulatory Guide 133 *Managed investments: Scheme property arrangements* (RG 133) gives guidance on the standards a custodian of scheme property should meet, what the responsible entity should do when it appoints an agent as custodian and what should be included in a compliance plan about holding scheme property.

RG 240.75 The PDS need only disclose the allocation range for those asset types in which the fund does, or may, actually invest.

RG 240.76 Where a hedge fund invests in derivatives, the PDS need not disclose the allocation range for derivatives that are dealt in for the dominant purpose of managing foreign exchange or interest rate risk associated with holding some or all of the fund's other assets.

RG 240.77 For funds of hedge funds, rather than those matters set out at RG 240.73, the responsible entity should disclose:

- (a) its valuation policy;

- (b) the types of underlying funds (including their strategies);
- (c) the allocation ranges;
- (d) any policies on the geographic location of underlying funds, their managers or the geographic focus of their investing;
- (e) the custodial arrangements for the fund of hedge fund's assets and the roles of custody providers; and
- (f) any policies to be applied in relation to the custodial arrangements of underlying funds.

Disclosure Principle 5: Liquidity

- RG 240.78 If the responsible entity of a hedge fund cannot reasonably expect to realise at least 80% of its assets, at the value ascribed to those assets in calculating the fund's net asset value, within 10 days, the responsible entity should disclose:
- (a) a description of any asset class that has a value greater than 10% of the fund's net asset value and cannot be reasonably expected to be realised at the value ascribed to that asset in calculating the fund's most recent net asset value within 10 days; and
 - (b) the key aspects of the liquidity management policy.

Explanation

- RG 240.79 This disclosure principle is intended to ensure that investors are made aware of the fund's ability to realise its assets in a timely manner and the risks of illiquid classes of assets. Disclosure about liquidity becomes even more important under stressed market conditions.
- RG 240.80 In addition, responsible entities of funds of hedge funds should describe their investment policy in relation to the liquidity of underlying funds, and explain any risks posed to the fund of hedge fund's liquidity by the nature of these investments and how that risk will be managed.

Disclosure Principle 6: Leverage

- RG 240.81 The responsible entity should disclose the following information:
- (a) the circumstances in which the hedge fund may use leverage and any restrictions on its use of leverage;
 - (b) the sources of leverage, including the type, the amount and the providers of the leverage;
 - (c) whether any assets are used as collateral, and the extent to which they are otherwise encumbered or exposed to set-off rights or other

legitimate claims by third parties in the event of the insolvency of the responsible entity, a service or credit provider, or a counterparty;

- (d) the maximum anticipated and allowed level of leverage (including leverage embedded in the assets of the fund, other than leverage embedded in holdings of listed equities and bonds) as a multiple of the net asset value of an investor's capital in the fund (e.g. for every \$1 of the fund's net asset value, the fund is leveraged \$x); and

Note: The maximum anticipated and allowed level of leverage may be disclosed alongside the anticipated or typical level of leverage.

- (e) a worked example showing the impact of leverage on investment returns and losses, assuming the maximum anticipated level of leverage (including leverage embedded in the assets of the fund, other than leverage embedded in holdings of listed equities and bonds).

Explanation

RG 240.82 Leverage is the use of financial products (such as derivatives) or debt (such as a margin facility) to amplify the exposure of capital to an investment. This disclosure principle is intended to ensure that investors are made aware of the maximum anticipated and allowed level of leverage of the fund (including leverage embedded in the assets of the fund). Information about the use and extent of leverage is critical because it amplifies both positive returns and losses.

RG 240.83 We expect that leverage will be disclosed as a gross figure (total long positions plus total short positions) even if net leverage (total long positions minus total short positions) is also disclosed. We consider that a net figure alone may not provide sufficient information to investors because a leveraged position may not be offset by an opposite position if the positions do not correlate totally (e.g. the liquidity or maturity profiles may be different). Further, counterparty risk will often not be offset.

RG 240.84 We acknowledge that a leverage ratio is one of a number of ways of measuring market exposure and risk in a fund strategy or portfolio and that, for some fund strategies, these exposures are often measured using different or additional methods (e.g. value at risk). Responsible entities should consider including additional measures of market and risk exposure where relevant and capable of being explained in a clear, concise and effective manner.

RG 240.85 We expect the responsible entity to disclose either:

- (a) the name of the actual provider of the leverage; or
- (b) the class or type of leverage provider (e.g. whether they are prudentially regulated, a local branch of a global investment bank or an unrated related party).

- RG 240.86 We acknowledge that when preparing a PDS, particularly for a new fund, it may be difficult for the responsible entity to know the anticipated level of leverage. We expect that, if the anticipated level of leverage is disclosed as a range, it should be a good faith estimate and as small as reasonably possible, given the fund's strategy and any relevant investment history, to be meaningful to investors.
- RG 240.87 The responsible entity of a fund of hedge funds need only disclose a reasonable estimate of leverage embedded in the underlying funds (except for any significant underlying funds, in which case the responsible entity should disclose the anticipated level of leverage). In addition, the responsible entity of a fund of hedge funds should disclose its investment policy in relation to acceptable types of leverage used by underlying funds and any limits on leverage the fund of hedge funds will set (for each fund or across its portfolio).

Disclosure Principle 7: Derivatives

- RG 240.88 The responsible entity should disclose the following information:
- (a) the purpose and rationale for the use of derivatives (e.g. investment, hedging, leverage and liquidity), including how they form part of the hedge fund's investment strategy;
 - (b) the types of derivative used or planned to be used;
 - (c) the criteria for engaging derivative counterparties (including principal protection providers);
 - (d) the key risks to the hedge fund associated with the collateral requirements of the derivative counterparties; and
 - (e) whether the derivatives are OTC or exchange traded.

Explanation

- RG 240.89 This disclosure principle is intended to ensure that investors are made aware of the purpose and types of derivatives used by the responsible entity or investment manager, and the associated risks.
- RG 240.90 In addition, the responsible entity of a fund of hedge funds should disclose its investment policy in relation to approved types of derivatives used by underlying funds and any limits on exposure to derivatives the fund of hedge funds will set (for each fund or across its portfolio).
- RG 240.91 A hedge fund that uses derivatives, but not to the extent necessary to trigger the derivatives characteristic set out in Table 1, should nevertheless disclose against this principle in relation to its use of derivatives.

Disclosure Principle 8: Short selling

- RG 240.92 If a hedge fund intends or is likely to engage in short selling, the responsible entity should disclose the following information:
- (a) the purpose and rationale for short selling, including how short selling forms part of the hedge fund's investment strategy;
 - (b) the risks associated with short selling; and
 - (c) how these risks will be managed.

Explanation

- RG 240.93 This disclosure principle is intended to ensure that investors are made aware of how short selling may be used as part of the investment strategy, and of the associated risks and costs of short selling. We encourage responsible entities to provide an example showing the potential gains and losses from short selling.
- RG 240.94 In addition to the information in RG 240.92, a responsible entity should disclose its investment policy on investing in underlying funds that may engage in short selling, and disclose the level of short selling permitted (if any) in each underlying fund and across its portfolio. If a fund of hedge funds may invest in underlying funds that may sell short, the responsible entity should explain the risks of short selling.

Disclosure Principle 9: Withdrawals

- RG 240.95 The responsible entity should disclose the following information:
- (a) any significant risk factors or limitations that may affect the ability of investors to withdraw from the hedge fund, including any gating restrictions that may be imposed or the requirement for requests for withdrawal only to be acted on under a statutory withdrawal offer if the hedge fund is not a liquid scheme as defined in the Corporations Act;
 - (b) how investors can exercise their withdrawal rights, including any conditions on exercise;
 - (c) if withdrawal is to be funded from an external liquid facility, the material terms of this facility, including any rights the external liquid facility provider has to suspend or cancel the facility; and
 - (d) how investors will be notified of any material changes to their withdrawal rights (e.g. if withdrawal rights are to be suspended).

Explanation

- RG 240.96 This disclosure principle ensures that investors are made aware of the circumstances in which the hedge fund allows withdrawals and how these might change.
- RG 240.97 Responsible entities of funds of hedge funds with investments in underlying funds, managed accounts or structured products need not disclose this information for those underlying investments.

D Form and method of disclosure

Key points

Responsible entities of hedge funds should disclose against the benchmarks on an ‘if not, why not’ basis and apply the disclosure principles in meeting their disclosure obligations to investors.

This applies to any PDS dated on or after 1 February 2014 and to ongoing disclosure from that date. Existing PDSs still in use should be supplemented or updated to reflect the improved disclosure.

How to disclose against the benchmarks and apply the disclosure principles

- RG 240.98 We expect PDSs for hedge funds to disclose against the benchmarks and apply the disclosure principles. Table 5 explains how we expect responsible entities of hedge funds to provide this information.
- RG 240.99 Our view is that the inherent risks for investors in hedge funds mean that information about the risks addressed by the benchmarks and disclosure principles is required both in the PDS and in ongoing disclosure.
- RG 240.100 We expect that providing the benchmark and disclosure principle information will help responsible entities to produce PDSs that are better focused on the issues that matter to retail investors, and that are more clear, concise and effective.

Table 5: Disclosing against the benchmarks and applying the disclosure principles

Benchmarks	<p>Responsible entities will need to disclose against the benchmarks where relevant: see RG 240.43. We encourage this information to be prominently disclosed in the first few pages of any PDS.</p> <p>If responsible entities meet these benchmarks, they should state this.</p> <p>If responsible entities do not meet a benchmark, they should explain why not, and explain any additional risks that this may pose for the investor. If a responsible entity has alternative systems and controls in place to deal with the issues underlying the benchmark, it should explain this.</p> <p style="text-align: center;">Note: If a responsible entity cannot meet all aspects of a benchmark, it should state that it does not meet the benchmark and clearly explain which aspects it meets and, for those it does not meet, explain why not and how it deals with the associated risks in another way.</p>
Disclosure principles	<p>We expect that responsible entities should disclose the information addressed by the disclosure principles in all but exceptional circumstances: see RG 240.43.</p> <p>If the responsible entity is unable to provide the information—for example, in circumstances where contracts are yet to be entered into—the PDS should disclose the reasons why the information has not been provided and outline how and when investors will be provided with the information.</p> <p>We expect responsible entities to clearly and prominently disclose a summary of the information identified in the disclosure principles in the first few pages of the PDS, and also provide references to where further information on the disclosure principles can be found in the body of the PDS.</p>

Timing for implementing the benchmarks and disclosure principles: New and in-use PDSs

RG 240.101 A responsible entity that has existing investors and new offers of interests under a current PDS should disclose against the benchmarks and apply the disclosure principles: see Table 6. This is based on our view that the inherent risks for investors in hedge funds mean that information about these risks is required in both up-front and ongoing disclosure.

Table 6: Implementing the benchmarks and disclosure principles

Updating existing investors	By 1 February 2014, a responsible entity of a hedge fund should disclose against the benchmarks and apply the disclosure principles in updated disclosure and bring it directly to the attention of existing investors.
Upfront disclosure for new investors	All new PDSs issued on or after 1 February 2014 should disclose against the benchmarks and apply the disclosure principles. If there are material changes to the benchmark or disclosure principle information while the PDS is current, the responsible entity will generally need to issue a new or supplementary PDS. The responsible entity should also communicate the information to existing investors who will not receive the PDS.
Ongoing disclosure	If there are material changes to the benchmark or disclosure principle information, the responsible entity should deal with this in ongoing disclosure. We encourage responsible entities to communicate this information to investors as soon as practicable. In the interests of ensuring that existing investors are well informed, a responsible entity may also choose to provide regular updates on its disclosure in other materials (e.g. monthly or quarterly updates).

Updating existing investors

RG 240.102 We expect responsible entities to provide existing investors with updated disclosure addressing each of the benchmarks in Section B and applying each of the disclosure principles in Section C by 1 February 2014.

RG 240.103 We consider that a responsible entity should use a dedicated page on its website to provide regular updates to investors about material changes to this information. We think this is the easiest and most practical way to keep investors up-to-date.

RG 240.104 Good website disclosure can be an important resource for investors. We think good website disclosure has the following features:

- (a) all material information is included on the website;
- (b) an investor can find material information easily and determine its significance for them;
- (c) any new material information is included on the website as soon as practicable and flagged as 'new'; and

- (d) information is kept on the website for as long as it is relevant, and appropriate records are kept.

Note: Alternative or supplementary means of updating existing investors might be used, such as producing a regular (e.g. quarterly) report and sending it to investors, or issuing a supplementary PDS and sending a copy to existing investors or publishing it on the website and notifying investors that it is available and how to access it.

Upfront disclosure for new investors

- RG 240.105 All new PDSs issued to retail investors on or after 1 February 2014 should disclose against the benchmarks in Section B and apply the disclosure principles in Section C.

Content of a PDS

- RG 240.106 The Corporations Act requires disclosure in the form of a PDS for an issue of interests in a hedge fund to retail investors. The PDS must:
- (a) make specific disclosures, including information about any significant risks associated with holding the product (s1013D); and
 - (b) include all other information that might reasonably be expected to have a material influence on the decision of a reasonable person whether to invest in the hedge fund, when investing as a retail investor (s1013E).

Note: We have issued policy guidance in Regulatory Guide 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (RG 168) on preparing a PDS that complies with the requirements in the Corporations Act. It sets out good disclosure principles and explains how we will monitor the use of PDSs and enforce the PDS requirements.

- RG 240.107 Our benchmarks and disclosure principles relate to matters that, in any event, should be disclosed under s1013D–1013E because they are all matters that might reasonably be expected to have a material influence on the decision of a reasonable person whether to invest in a product, when investing as a retail investor.

Note: The benchmarks and disclosure principles in this guide do not attempt to specify all the information that is required to be included in a PDS by the Corporations Act.

The role of upfront disclosure

- RG 240.108 We expect the responsible entity of a hedge fund to provide the benchmark and disclosure principle information within the first few pages of any PDS.
- RG 240.109 We will consider exercising our stop order powers under s1020E if we consider there is material non-disclosure or misleading disclosure of these matters. We believe that disclosing against the benchmarks and applying the disclosure principles upfront in a PDS promotes compliance with the

requirement that PDSs should be worded in a clear, concise and effective manner by encouraging comparability and uniformity of financial measures and highlighting issues that ASIC and industry experts consider crucial to making an investment decision.

Clear, concise and effective disclosure

- RG 240.110 PDSs must be worded and presented in a clear, concise and effective manner: s1013C(3). A PDS should, therefore, include clear and prominent disclosure of the key features and risks of the investment. For hedge funds, this *includes* the benchmark and disclosure principle information.
- RG 240.111 To ensure the information is prominently disclosed, we consider that responsible entities should set out the benchmark and disclosure principle information in the first few pages of the PDS. This should be presented in as clear a manner as possible (e.g. in a table).
- RG 240.112 Where the benchmark and disclosure principle information is too lengthy to be included in full, the first few pages of the PDS should provide a summary of the information with a clear cross-reference to more detailed disclosure. This could include a well-referenced table that gives investors a brief introduction to the key information and a reference to where the information is further explained.

Updating PDSs

- RG 240.113 If there are material changes to the benchmark or disclosure principle information provided by a responsible entity, a responsible entity with a current offer open will need to provide a new or supplementary PDS if the new information would be materially adverse from the point of view of a reasonable investor considering investing in the hedge fund.
- RG 240.114 We consider that it is good practice to also make the information in a new or supplementary PDS available to existing investors (e.g. in a regular investor update or on the website).
- RG 240.115 Where the updated information is not materially adverse, responsible entities may be able to rely on [CO 03/237] to provide updated benchmark and disclosure principle information on a website, subject to various conditions including:
- (a) the PDS must have included a statement that non-materially adverse information may be updated by a website and that a hard copy of any updated information will be given to a person without charge on request;
 - (b) the updated information is easily accessible to investors; and
 - (c) the PDS was up-to-date at the time it was prepared.

Note: See [CO 03/237] for all applicable conditions that must be fulfilled.

- RG 240.116 By 1 February 2014, if an existing PDS that does not contain benchmark or disclosure principle information remains in use, we expect responsible entities to:
- (a) provide the benchmark and disclosure principle information using a website or other means of communication referred to in the PDS (if the omission of the benchmark and disclosure principle information from the PDS is not materially adverse); or
 - (b) update the PDS by a new or supplementary PDS so that it includes the benchmark and disclosure principle information.
- RG 240.117 The information in a PDS must be up-to-date at the time it is given. We consider that PDSs that do not contain the benchmark and disclosure principle information by 1 February 2014 are unlikely to be up-to-date, given the key nature of this information.

Ongoing disclosure

Effective ongoing disclosure

- RG 240.118 If there have been any material changes to the benchmark or disclosure principle information, including information about the responsible entity's alternative approach to meeting the benchmarks, the responsible entity should explain these in ongoing disclosure.
- RG 240.119 In a PDS, a responsible entity makes a number of statements about how the funds being raised under the PDS will be used, and how the hedge fund will be operated. These statements are part of the basis on which an investor invests their money, and investors should be given the opportunity to monitor the responsible entity's performance against those statements.
- RG 240.120 Good ongoing disclosure, therefore, plays an important role in helping investors monitor their investment and evaluate its performance to consider whether they should withdraw. Ongoing disclosure also helps investors to assess other actions they may wish to take if they believe the hedge fund is not meeting their expectations, including requesting a members' meeting.
- RG 240.121 Responsible entities have a number of obligations to make ongoing disclosure to investors under the Corporations Act: see RG 240.122. Apart from these legal requirements, we encourage responsible entities to use the most efficient and effective methods to regularly communicate key information to investors.

Legal framework for ongoing disclosure

- RG 240.122 Responsible entities of hedge funds have obligations to provide ongoing disclosure to investors under the Corporations Act, including:
- (a) continuous disclosure obligations for listed hedge funds (s674) and hedge funds that are unlisted disclosing entities (s675);
 - (b) periodic statements (s1017D); and
 - (c) notification of any material change to a matter that would be required to be specified in a PDS (s1017B) for registered schemes that are not disclosing entities.

Continuous disclosure for listed hedge funds

- RG 240.123 If the responsible entity of a hedge fund that is subject to continuous disclosure under Ch 6CA becomes aware of information that is not generally available and that a reasonable person would expect, if it were available, to have a material effect on the price or value of the interests in the hedge fund, the responsible entity must lodge a document with ASIC containing the information: s675.

Note: It is good practice for responsible entities to provide investors with access to continuous disclosure documents lodged with ASIC, either by sending investors a hard copy or posting the information on a website used for updating investors. In addition, where the product is quoted in a financial market, it is good practice to provide the disclosure to the market operator as part of a facility for making announcements (this may be required by the operating rules).

- RG 240.124 The benchmarks and disclosure principles reflect information that would reasonably be expected to have a material effect on the price or value of interests in the hedge fund. Material changes to benchmark and disclosure principle information may therefore trigger the requirement in s675, unless the information is already generally available.

Periodic statements

- RG 240.125 A periodic statement must contain certain prescribed information relating to an investor's interest in the product, such as the opening and closing balance, investment returns, and details of transactions in relation to the product: s1017D.
- RG 240.126 In addition, the periodic statement must give the investor the information that the issuer reasonably believes the investor needs to understand their investment in the financial product. This information includes, but is not necessarily limited to, the information set out at Benchmark 2.

Notification of material changes and significant events

- RG 240.127 If a hedge fund is not subject to continuous disclosure obligations under Ch 6CA, the responsible entity must give investors who acquired their interests as retail clients notice of any material change to a matter, or a significant event that affects a matter, that would be required to be specified in a PDS: s1017B.
- RG 240.128 In our view, diversions from the benchmarks or changes to the benchmark or disclosure principle information are material issues that should be covered in notifications to investors under s1017B. Where such changes or events are materially adverse to investors, notifications generally need to be provided before the change or event occurs, or as soon as practicable and, in any event, within three months.
- RG 240.129 We consider that responsible entities of closed schemes should also consider the benchmarks and disclosure principles in meeting their ongoing disclosure obligations as a matter of best practice.

Good practice for ongoing disclosure

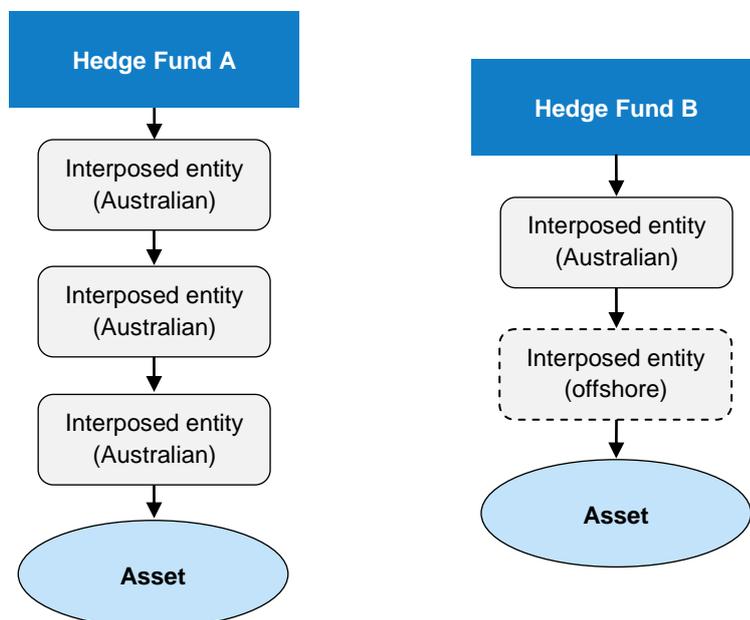
- RG 240.130 It is good practice for a responsible entity to maintain a document addressing the benchmarks on an ‘if not, why not’ basis and applying the disclosure principles, which is updated for material changes that the responsible entity becomes aware of in the ordinary course of managing the hedge fund. This updating allows the responsible entity to provide consolidated updated disclosure to investors on request.
- RG 240.131 It is also good practice for this consolidated disclosure document to be clearly accessible on the hedge fund’s website (if used for updating investors). The consolidated disclosure document should indicate the date it was prepared and last updated.
- RG 240.132 Although it is not necessary to repeat information in these updates on the benchmark and disclosure principle information if it has not changed, we consider it is good practice to provide investors with:
- (a) an overview of any material changes to the benchmark and disclosure principle information since the last update (as far as the responsible entity is aware);
 - (b) if there have been no material changes, confirmation that this is the case;
 - (c) details of how to access the hedge fund’s consolidated disclosure document on the website (if it is available there); and
 - (d) confirmation that they are entitled to a hard copy of the benchmark and disclosure principle information on request.

Note: An alternative would be for responsible entities to provide investors with details of material changes to the benchmark and disclosure principle information using a procedure similar to that applying to the provision of a financial report under s314.

Appendix A: Illustration of interposed entities

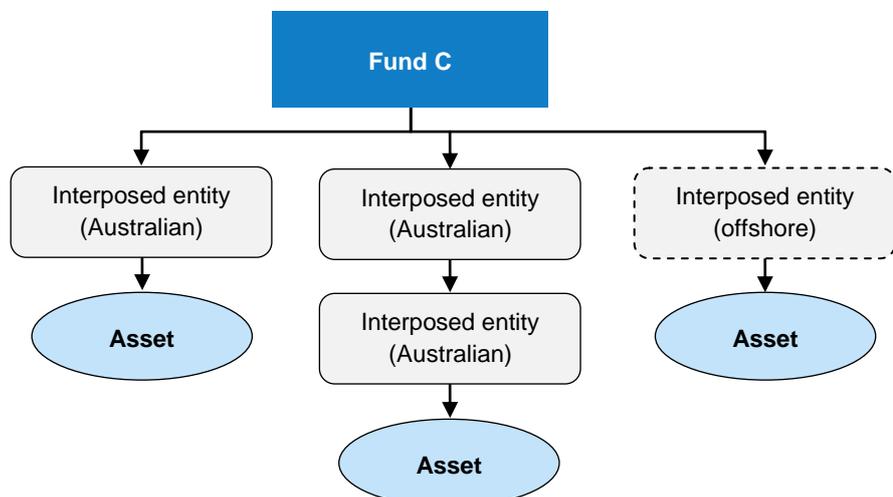
- RG 240.133 A characteristic of a hedge fund is that the fund has a complex investment structure that invests through three or more vertically interposed entities (or two or more interposed entities if at least one of the entities is offshore) where the responsible entity of the scheme or an associate has the capacity to control the disposal of the products or two or more of the interposed entities: Table 1.
- RG 240.134 Figure 1 illustrates the two scenarios of a complex investment structure that invests through a vertical stream of three interposed entities, or two or more interposed entities if at least one of the entities is offshore.

Figure 1: Vertical stream of interposed entities—Complex investment structures



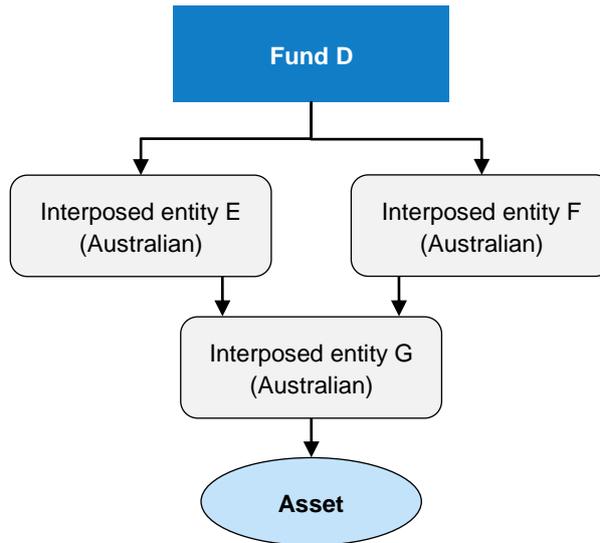
- RG 240.135 Figure 2 illustrates investment through a line of interposed entities. Figure 2 does not constitute a complex investment structure for the purposes of Table 1.

Figure 2: Line of interposed entities



RG 240.136 Figure 3 illustrates a fund that invests directly in interposed entities E and F, and each of those entities invests directly in interposed entity G. There are two vertical streams, with each stream comprising two interposed entities. The first vertical stream comprises entities E and G. The second vertical stream comprises entities F and G. There is no single vertical stream comprising entities E, F and G. Therefore, Figure 3 does not constitute a complex investment structure for the purposes of Table 1.

Figure 3: Separate vertical streams



Appendix B: List of prescribed foreign regulatory authorities

RG 240.137 Table 7 lists those authorities that are prescribed foreign regulatory authorities for the purpose of determining whether an entity should be counted as an interposed entity between a hedge fund and a financial product in which the hedge fund acquires an economic interest.

Table 7: Prescribed foreign regulatory authorities

Austria	Finanzmarktaufsicht of Austria
Belgium	Financial Services and Markets Authority
Bulgaria	Financial Supervision Commission
Canada	Alberta Securities Commission British Columbia Securities Commission Ontario Securities Commission Quebec Autorité des Marchés Financiers
Cyprus	Cyprus Securities and Exchange Commission
Czech Republic	Czech National Bank
Denmark	Finanstilsynet
Estonia	Estonian Financial Supervision Authority
Finland	Finanssivalvonta
France	Autorité des Marchés Financiers
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht
Greece	Hellenic Capital Market Commission
Guernsey	Guernsey Financial Services Commission
Hong Kong	Hong Kong Securities and Futures Commission
Hungary	Pénzügyi Szervezetek Állami Felügyelete
Iceland	Fjármálaeftirlitið of Iceland
Ireland	Central Bank of Ireland
Isle of Man	Isle of Man Financial Supervision Commission
Israel	Israel Securities Authority

Italy	Commissione Nazionale per le Società e la Borsa of Italy
Japan	Financial Services Agency of Japan
Jersey	Jersey Financial Services Commission
Latvia	Finanšu un kapitāla tirgus komisija
Liechtenstein	Finanzmarktaufsicht
Lithuania	Bank of Lithuania
Luxembourg	Commission de Surveillance du Secteur Financier
Malaysia	Securities Commission of Malaysia
Malta	Malta Financial Services Authority
Netherlands	Autoriteit Financiële Markten
New Zealand	New Zealand Financial Markets Authority
Norway	Finanstilsynet of Norway
Pakistan	Securities and Exchange Commission of Pakistan
Poland	Polish Financial Supervision Authority
Portugal	Comissão do Mercado de Valores Mobiliários of Portugal
Romania	Romanian National Securities Commission
Singapore	The Monetary Authority of Singapore
Slovak Republic	Národná banka Slovenska
South Africa	Financial Services Board of the Republic of South Africa
Spain	Comisión Nacional del Mercado de Valores
Sweden	Finansinspektionen
United Arab Emirates	Dubai Financial Services Authority Securities Commodities Authority
United Kingdom	Financial Conduct Authority
United States	Securities and Exchange Commission

Source: [CO 12/749].

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
benchmark and/or disclosure principle information	Information covered by the benchmarks in Section B and/or disclosure principles in Section C of this guide
Ch 6CA	A chapter of the Corporations Act (in this example, numbered 6CA)
[CO 12/749] (for example)	An ASIC class order (in this example, numbered 12/749)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
derivative	In relation to a hedge fund, includes a deferred purchase agreement in addition to any other product that is a derivative under the Corporations Act Note: See [CO 12/749] for the exact definition.
fund of hedge funds	A registered managed investment scheme where the responsible entity invests at least 35% of the hedge fund's assets in one or more hedge funds, or a scheme that promotes itself as a fund of hedge funds: see RG 240.18
hedge fund	A registered managed investment scheme that is promoted as a hedge fund or exhibits two or more of the characteristics of a hedge fund, as set out in Table 1: see RG 240.4 and Table 1
interposed entity	In relation to a hedge fund, means an entity that is interposed between the hedge fund and a financial product in which the hedge fund has an economic interest but does not include an Australian-registered managed investment scheme, or similar entities incorporated or registered in a prescribed foreign jurisdiction that is authorised by a prescribed foreign regulatory authority to make offers to the general public Note: See [CO 12/749] for the exact definition.
OTC	Over the counter
PDS	Product Disclosure Statement
prescribed foreign regulatory authority	A foreign regulatory authority included in Sch 10F of the Corporations Regulations: see [CO 12/749] and Table 7

Term	Meaning in this document
Product Disclosure Statement	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
redemption value	A reasonable estimate of the value receivable by a redeeming investor after payment of all redemption fees and costs
RG 76	An ASIC regulatory guide (in this example, numbered 76)
s675	A section of the Corporations Act (in this example, numbered 675)
shorter PDS regime	The requirements set out in Div 3A of Pt 7.9 of the Corporations Act as modified by Subdivs 4.2 to 4.2C and Schs 10B, 10C, 10D and 10E of the Corporations Regulations, which prescribe the content and length of the PDS for first home saver accounts, margin loans, superannuation products and simple managed investment schemes
significant underlying fund	An underlying fund that accounts for 35% or more of a fund of hedge fund's assets
underlying fund	A managed investment scheme, company or managed account that is a hedge fund or that uses hedge fund strategies. An underlying fund may be located in Australia or offshore

Related information

Headnotes

benchmarks, disclosure, disclosure principles, funds of hedge funds, hedge funds, managed investment schemes, PDS, Product Disclosure Statement, responsible entities, retail investors

Class orders and pro formas

[CO 03/237] *Updated information in product disclosure statements*

[CO 12/749] *Relief from the Shorter PDS regime*

[CO 13/1128] *Amendment of Class Order [CO 12/749]*

Regulatory guides

RG 45 *Mortgage schemes: Improving disclosure for retail investors*

RG 46 *Unlisted property schemes: Improving disclosure for retail investors*

RG 51 *Applications for relief*

RG 76 *Related party transactions*

RG 94 *Unit pricing: Guide to good practice*

RG 148 *Platforms that are managed investment schemes*

RG 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)*

RG 228 *Prospectuses: Effective disclosure for retail investors*

RG 231 *Infrastructure entities: Improving disclosure for retail investors*

RG 232 *Agribusiness managed investment schemes: Improving disclosure for retail investors*

Legislation

Australian Securities and Investments Commission Act 2001

Corporations Act, s314, Ch 6CA, 6D, s674, 675, 1013A, 1013C(3), 1013D, 1013E, 1017B, 1017D, 1020E

Corporations Amendment Regulations 2010 (No. 5)

Corporations Regulations, Sch 10