ASIC
Australian Securities & Investments Commission

CONSULTATION PAPER 137

Indirect self-acquisition by investment funds: Further consultation

June 2010

About this paper

This consultation paper follows Consultation Paper 1 *Indirect self acquisition by investment funds* (CP 1). It seeks feedback on specific aspects of our proposed relief under s259C of the *Corporations Act 2001* (Corporations Act) for indirect self-acquisition by investment funds.

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 paper was issued on 18 June 2010 and is based on the Corporations Act as at 18 June 2010.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on indirect self-acquisition relief. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Business Cost Calculator Report and/or a Regulation Impact Statement: see Section C Regulatory and financial impact.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 30 July 2010 to:

Rachel Howitt
Senior Lawyer
Corporations
Australian Securities & Investments Commission
GPO Box 9827
SYDNEY NSW 2001
facsimile: (02) 9911 2414
email: rachel.howitt@asic.gov.au

What will happen next?

Stage 1	18 June 2010	ASIC consultation paper released
Stage 2	30 July 2010	Comments due on the consultation paper Drafting of regulatory guide
Stage 3	November 2010	Regulatory guide released

A Background to the consultation

Key points

Self-acquisition occurs where shares (or units of shares) in a company are issued or transferred to an entity it controls.

The Corporations Act voids the issue or transfer of shares (or units of shares) of a company to an entity it controls unless certain exceptions apply: s259C.

ASIC has previously consulted on proposed conditional relief from s259C to allow certain controlled entities of financial institutions to acquire the holding company's shares for investors, subject to safeguards designed to minimise the risks associated with indirect self-acquisition.

We intend to finalise our policy on indirect self-acquisition by investment funds, following further consultation on the proposals set out in this paper.

Restrictions on self-acquisition and ASIC relief

1 Under s259C(1) of the Corporations Act, the issue or transfer of shares (or units of shares) of a company to an entity it controls (self-acquisition) is void unless one of the exceptions in s259C(1)(a)–(d) applies.

2 ASIC has the power under s259C(2) to exempt a company from the operation of s259C(1). In October 1998, ASIC released Consultation Paper 1 *Indirect self acquisition by investment funds* (CP 1) to consult on the circumstances in which we should give relief to investment funds from the self-acquisition provisions in s259C.

> Note: For details of the operation of s259C and its exceptions, see page 10 of CP 1 in the Appendix to this paper.

3 Since then, ASIC has granted interim relief on a case-by-case basis from s259C(1) based on the policy proposed by CP 1. Relief has generally been sunsetted to expire on a regular basis so we can periodically review our policy for granting relief.

4 We now intend to finalise the policy proposed by CP 1. The purpose of this consultation paper is to seek feedback on some discrete issues that have arisen since CP 1 was released. For reference, we have included CP 1 as an Appendix to this consultation paper.

Our proposals in CP 1

5 The policy objective of CP 1 was to permit investment funds of financial institutions to acquire the company's shares for the benefit of investors, subject to conditions designed to minimise the risks associated with indirect self-acquisition.

6 CP 1 identified two examples of acquisitions of shares that we proposed should be provided with relief from s259C(1):

(a) *investment-linked statutory funds*—this involves acquisitions in a company's shares by a life company that is a controlled entity that invests in a statutory fund; and

(b) *controlled trustees*—this involves acquisitions by a unit trust in a company's shares, where the trustee of the trust is a controlled entity. In our view, the trustee will not be able to rely on the exception in s259C(1)(b) if the company or any of its controlled entities hold units in the trust (as they would have a beneficial interest in the trust).

Note: See page 11 of CP 1 in the Appendix to this paper for a discussion of:

(a) acquisitions of shares that we considered would contravene s259C(1); and

(b) acquisitions of units of shares that we considered might contravene s259C(1) but where there was some doubt.

7 CP 1 also recognised instances where we did not propose to grant relief. One example was where entities invested their own funds in the company's shares rather than investors' funds.

Note: For a discussion of examples where we did not propose to grant relief, see pages 11 and 13 of CP 1 in the Appendix to this paper.

Regulatory risks of indirect self-acquisition

8 CP 1 outlined the following regulatory risks that could arise through self-acquisition:

(a) improper attempts to secure or consolidate corporate control;

(b) increased possibility of corporate failure;

(c) possible discrimination between shareholders;

(d) insider trading;

(e) market manipulation; and

(f) price opacity.

9 In relation to statutory funds of life companies, the risks of self-acquisition also include conflicts of interest between the interests of policy owners and shareholders of the life company.

Conditions of interim relief

10 Our interim relief granted to financial institutions from s259C(1) based on CP 1 is subject to the following conditions designed to minimise the regulatory risks of self-acquisition:

(a) *Limiting the proportion of a company's shares which may be held by its controlled entities and restrictions on voting*

Our interim relief limits the number of the company's shares which the controlled entities can hold to 5% of the total number of shares on issue and prohibits voting the shares held by controlled entities.

(b) *Limiting the risk of preferential treatment to the company and its controlled entities*

Our interim relief limits new issues of shares to controlled entities to circumstances where there has been approval by shareholders of the company or in one of the specified exceptions in ASX Listing Rule 7.2: participation in a pro rata issue, the issue of shares under a takeover bid, an issue under a dividend reinvestment plan and on conversion of convertible securities issued in the above circumstances. Interim relief also limits purchases of shares by controlled entities to on-market transactions and transactions between controlled entities.

(c) *Disclosure of trading in the company's shares by its controlled entities*

Under our interim relief a company must disclose its controlled entities' percentage interests in its shares every 14 days, must disclose within one business day any 1% or greater percentage change in its controlled entities' interests and must retain records of trading for inspection by ASIC and the relevant securities and futures exchange for a period of one year after the trading occurred.

Note: For details of the conditions, see pages 5–7 and 13–18 of CP 1 in the Appendix to this paper.

11 CP 1 also noted we may give unconditional relief in circumstances where a controlled entity invests in an independent managed investment scheme that holds the company's shares. A scheme is considered independent where it is not a controlled entity itself and neither the company nor its controlled entities influence the decision making of the scheme, other than voting their units in a meeting of members.

12 However, we consider in most cases this type of relief is unnecessary because an investor in a scheme will not normally acquire the share and nor will it acquire a 'unit of a share' for the purposes of s259C merely because the scheme's responsible entity holds shares in the company.

Proposals for further consultation

13 We are undertaking this second round of consultation to seek further specific feedback on some issues that have arisen since CP 1 was released.

14 In Section B of this paper, we seek your feedback on proposals relating to:

(a) sunsetting case-by-case relief;

(b) controlled trustees and responsible entities;

(c) investment-linked statutory funds and related managed investment schemes;

(d) index arbitrage; and

(e) disclosure of interests in the company's shares by its controlled entities.

Note: For a full summary of our proposed relief and conditions, see Table 1 on the next page.

Sunsetting case-by-case relief

15 We propose to grant case-by-case relief in the future without a sunset clause where the relief is contemplated by the proposals in CP 1 and this consultation paper.

Controlled trustees and responsible entities

16 We propose an additional condition on relief from s259C(1) for controlled trustees and responsible entities. This condition relates to the identity of the unitholders of the trust and members of the scheme.

Investment-linked statutory funds and related managed investment schemes

17 We propose to grant relief from s259C(1) to enable participation in a placement of the company's shares by the statutory funds of any controlled entity which carries on the life insurance business of providing investment-linked benefits within the meaning of s31(b) of the *Life Insurance Act 1995* (Life Insurance Act) (investment-linked statutory funds).

18 We also propose to provide this relief for managed investment schemes that have a controlled entity as responsible entity that would otherwise be able to participate in a placement but for an investment-linked statutory fund holding interests in the scheme.

Index arbitrage

19 We are considering whether to grant an exemption under s259C(2) in limited circumstances to allow controlled entities to acquire shares in a listed parent company for the purpose of index arbitrage which will facilitate related client-driven activities.

Disclosure of interests in the company's shares by its controlled entities

20 We are considering whether the conditions relating to the disclosure of interests in the company's shares by its controlled entities should be varied. These conditions apply to the relief in CP 1 and the relief proposed in this document. Under the variation, the periodic reporting period would be increased from 14 days to 3 months and the time required to report a 1% or greater percentage change would be 2 days instead of 1.

Table 1: Original conditions proposed by CP 1 *(CP 1 conditions)*

Relief applies to	Conditions	Reference
See Table 2	• The number of the company's shares the controlled entities can hold is limited to 5% of the total number of shares on issue. • There are prohibitions on voting the shares held by controlled entities. • New issues of shares to controlled entities are limited to circumstances where participation has been approved by the company's shareholders or where one of the specified exceptions in ASX Listing Rule 7.2 applies: (a) participation in a pro rata issue, (b) the issue of shares under a takeover bid, (c) an issue under a dividend reinvestment plan (d) an issue on conversion of convertible securities issued in one of the circumstances in (a)-(c). • Purchases of shares by controlled entities are limited to on-market transactions and transactions between controlled entities. • The company must: – disclose its controlled entities' percentage interests in its shares every 14 days – disclose within one business day any 1% or greater percentage change in its controlled entities' interests – retain records of trading for inspection by ASIC and the relevant financial market for a period of one year after the trading occurred.	CP 1 in the Appendix to this paper at pages 5–7 and 13–18

Table 2: Summary of proposed relief and conditions in CP 137

Relief applies to	Proposed relief	Proposed conditions	Reference
Controlled trustees and responsible entities	Conditional relief from s259C(1) where the trustee (or responsible entity) is controlled	*Additional condition for controlled trustees and responsible entities* • *CP 1 conditions* (see Table 1) with revised disclosure conditions (see below) • Relief will cease to apply where the company or any controlled entity's relevant interest in the trust reaches 20% *(voting test condition)*. • The company must: – disclose its controlled entities' percentage interests in its shares every 3 months – disclose within two business days any 1% or greater percentage change in its controlled entities' interests – retain records of trading for inspection by ASIC and the relevant securities and futures exchange for a period of one year after the trading occurred. (*revised disclosure conditions*)	Section B, proposal B2 and paragraphs 21–28
Investment-linked statutory funds and related managed investment schemes	Conditional relief from s259C(1) for participation in placement of company shares	*Additional conditions for investment-linked statutory funds* • *CP 1 conditions* (see Table 1) with revised disclosure conditions (except that participation in placement is permitted subject to the following conditions) • No more than 3% of that portion of the investment-linked statutory fund's shareholder retained profits account which is required for solvency of each fund can be invested in the company's shares. • The relief does not apply to any transfer or issue of shares or units of shares to a shareholder retained profits account of an investment-linked statutory fund if the shareholder retained profits account is in excess of solvency requirements.	Section B, proposal B3(a) and paragraphs 31–32 Section B, proposal B3(b) and paragraphs 36–37
		Additional conditions for participation in placement of company shares • *CP 1 conditions* (see Table 1) with revised disclosure conditions (except that participation in placement is permitted subject to the following conditions) • Participation by investment-linked statutory funds or related managed investment schemes is on the same, or no more favourable, terms as other participants. • No more than 15% of the shares issued in the placement are issued to, or for the benefit of, all controlled entities (including but not limited to investment-linked statutory funds or related managed investment schemes). • The company must use its best endeavours to obtain as high a placement price as practicable.	Section B, proposal B3(c) and paragraphs 38–48

Table 2: Summary of proposed relief and conditions in CP 137 (cont.)

Relief applies to	Proposed relief	Proposed conditions	Reference
Index arbitrage	Conditional relief from s259C(1) to allow controlled entities to acquire shares in a listed parent company for the purpose of index arbitrage and to facilitate related client-driven activities	• *CP 1 conditions* (see Table 1) with revised disclosure conditions. • The voting power of the controlled entities in the listed parent company must not exceed 0.5% of the total number of voting shares as part of any index arbitrage strategy. • Shares in the listed parent company cannot make up more than 10% (by value) of any basket or portfolio transaction. • The net economic exposure of the controlled entities in the listed parent company must not exceed 5% of the shares held to achieve a perfect hedge. • An acquisition of shares in the listed parent company by a controlled entity, other than by way of new issue, must be made by way of an 'on-market transaction' as defined in s9 of the Corporations Act.	Section B, proposals B4–B5 and paragraphs 49–67
Case-by-case relief from s259C(1) that was previously sunsetted	Conditional relief from s259C(1)	• *CP 1 conditions* (see Table 1) with revised disclosure conditions. • Case-by-case relief from s259C will no longer be sunsetted to expire. • *Voting test condition* (to apply to controlled trustees and responsible entities)	Section B, proposal B6 and paragraphs 69–73

B Proposals for further consultation

Key points

We are seeking further feedback on proposals to deal with issues that have arisen since the release of CP 1. These issues relate to:

- *sunsetting case-by-case relief*—whether s259C relief should continue to be sunsetted;
- *controlled trustees and responsible entities*—to propose a new voting test condition to ensure relief is consistent with the intent of s259C;
- *investment-linked statutory funds and related managed investment schemes*—to consider enabling participation in placements;
- *index arbitrage*—to consider permitting controlled entities to acquire shares in a listed parent company for the purpose of index arbitrage; and
- *disclosure of interests in the company's shares by its controlled entities*—whether ASIC should increase the regular periodic reporting requirement from 14 days to 3 months and the required date to report change in interests from one to two days.

Sunsetting case-by-case relief

21 We have granted interim relief based on the standard conditions in CP 1 on a case-by-case basis. This relief has been given in contexts other than those proposed in CP 1 (as referred to at paragraph 6 of this paper) such as dividend reinvestment plans, employee share schemes, investor directed portfolio services and managed discretionary accounts. The interim relief has generally been sunsetted to expire within a 12–24 month period so ASIC could review the policy basis for granting relief.

Proposal

B1 We propose to grant relief from s259C(1) without a sunset clause because we are satisfied the policy settings and conditions in CP 1 are appropriate (subject to the proposals in this paper).

Your feedback

B1Q1 Do you agree we should grant relief based on CP 1 without a sunset clause?

Additional condition for controlled trustees and responsible entities

Proposal

B2 We propose an additional condition on relief from s259C(1) where we permit the issue or transfer of shares of a company to a unit trust or managed investment scheme that has a controlled entity of the company as trustee or responsible entity.

The proposed voting test condition will mean relief would cease to apply where the company or any controlled entity's relevant interest in the trust or scheme is more than 20%.

Your feedback

B2Q1 Do you agree it is appropriate to impose an additional condition on relief for controlled trustees or responsible entities to prevent the company and its controlled entities from having a relevant interest in the trust or scheme of more than 20%?

B2Q2 Are there any circumstances in which it is necessary for a company or its controlled entities to have more than 20% relevant interest in an investment trust or scheme other than for the purpose of investing the company's own funds (e.g. temporary control upon establishment of the trust)?

B2Q3 Do you consider an alternative or additional condition should be imposed?

Rationale

22 ASIC's policy objective in CP 1 was that relief for controlled trustees and responsible entities be granted primarily for the benefit of non-controlled investors in the trust or scheme. We recognise that non-controlled investors may be disadvantaged from not having investment exposure to the company.

23 CP 1 did not propose any limitations on the company or its controlled entities investing in the relevant trust or scheme. However, we did not intend to facilitate relief where controlled entities hold a controlling interest in the trust or scheme because it would be contrary to the underlying intent of s259C which operates to void transfers or issues to a controlled entity.

24 In this regard CP 1 stated:

> At this stage we do not envisage giving s259C(2) relief to a company in relation to one of its controlled entities investing the entity's own funds in the company's shares (rather than investors' funds). This is because:
>
> (a) it is less likely that the company and its controlled entities would be financially disadvantaged by the prohibition against indirect self investment; and

(b) the risks of price opacity and the possibility of corporate failure are present when indirect self investment of a controlled entity's own funds is permitted.

25 We acknowledge the standard conditions in CP 1 to some extent minimise the risks arising where the company controls or may control the trust or scheme as a member. It is a condition of CP 1 that the company may only issue or transfer 5% of its shares to the trust and the company is prevented from being able to vote these shares. However, where the company or its controlled entities has significant interests in the trust or scheme, a 5% holding of the company's shares has the potential to create undesirable effects such as an increase in the possibility of corporate collapse and possible implications on the market for control of the company.

26 Further, we consider a trustee's fiduciary duties to beneficiaries and a responsible entity's duties to members under the Corporations Act may offer limited protection against the risks of self acquisition where the company, or a controlled entity, is a member of the trust or scheme holding over 20% of the interests.

27 For these reasons we intend to impose an additional condition to those outlined in CP 1 to prevent the issue or transfer of the company's shares to a controlled trustee or responsible entity in circumstances where the company or its controlled entities has more than a 20% relevant interest in the trust or scheme. We consider a holding of more than a 20% relevant interest is well recognised in the Corporations Act as indicative of control.

28 We note that "relevant interest" is a concept used in Chapter 6 of the Corporations Act that does not apply to unit trusts or unlisted or unregistered schemes. We intend to extend the concept of relevant interest for the purposes of this condition to unit trusts and unlisted or unregistered schemes in a manner similar to s604 of the Corporations Act.

Proposed relief for investment-linked statutory funds and related managed investment schemes

Proposal

B3 (a) We propose to grant conditional relief from s259C for:

(i) the statutory fund of any controlled entity which carries on the life insurance business of providing investment-linked benefits within the meaning of s31(b) of the Life Insurance Act (investment-linked statutory funds); and

(ii) managed investment schemes that have a controlled entity as responsible entity in which an investment-linked statutory fund invests (related managed investment schemes).

This relief would be subject to the proposed conditions outlined in CP 1 (as amended by proposal B2 of this paper): see paragraph 10 in Section A of this paper for a summary of these conditions.

(b) We propose that, in addition to the above conditions, relief for investment-linked statutory funds would be subject to the following additional conditions:

(i) no more than 3% of that portion of the investment-linked statutory fund's shareholder retained profits account which is required for solvency of each fund can be invested in the company's shares; and

(ii) the relief does not apply to any transfer or issue of shares or units of shares to a shareholder retained profits account of an investment-linked statutory fund if the shareholder retained profits account is in excess of solvency requirements.

(c) We propose that, in addition to the conditions in paragraphs (a) and (b) above, acquisitions of the company's shares by way of participation in an institutional placement would be permitted subject to the following additional conditions:

(i) participation by investment-linked statutory funds or related managed investment schemes is on the same, or no more favourable, terms as other participants;

(ii) no more than 15% of the shares issued in the placement are issued to, or for the benefit of, all controlled entities (including but not limited to investment-linked statutory funds or related managed investment schemes); and

(iii) the company must use its best endeavours to obtain as high a placement price as practicable.

The proposed relief will only apply to related managed investment schemes that would otherwise be able to participate in a placement of the company's shares but for an investment-linked statutory fund holding interests in the scheme.

Your feedback

B3Q1 Do you agree that investment-linked statutory funds and related managed investment schemes should be able to participate in a placement of the company's shares?

B3Q2 Do you think a condition limiting the maximum level of participation in a placement by controlled entities is the best way of addressing the risk of preferential treatment?

B3Q3 Do you think that this type of relief should be extended to controlled trustees and responsible entities where the company or a controlled entity has a beneficial interest in the trust or scheme? If so, how should we minimise the risks from this type of indirect self-acquisition, given our proposed conditions of relief permit up to 20% of the interests in the scheme or trust to be held by the company or a controlled entity?

B3Q4 Do you think 15% is an appropriate aggregate maximum limit for participation by all controlled entities? If not, what limit do you think is appropriate?

B3Q5 Do you think it is appropriate to impose a condition which requires the company to maximise the placement price as far as practicable? In practice, are there any reasons why a company would not do this?

B3Q6 Do you think that any other safeguards are necessary?

Rationale

Investment-linked statutory funds

29 Under the *Life Insurance Act 1995*, a life company must maintain a separate statutory fund for its investment-linked benefits. Benefits under an investment-linked policy are calculated by reference to "units", the value of which is related to the market value of a specified class or group of investment assets held by the life company. This means the policyholder carries the investment risk on the assets and in particular can receive negative returns in certain circumstances. The life company generally does not provide any guarantee that the value of the amount invested will not fall over time.

30 The investments of an investment-linked statutory fund may include units in a managed investment scheme operated by a responsible entity that is a controlled entity for the purposes of s259C(1). We refer to this type of scheme as a related managed investment scheme in this document.

Need for relief

31 In the absence of relief, we consider that the following acquisitions would contravene s259C(1):

(a) *Acquisitions in a company's shares by an investment-linked statutory fund of a controlled entity*—This is because we do not consider that any of the statutory exceptions in s259C(1)(a)–(d) apply.

(b) *Acquisitions by a controlled responsible entity of a managed investment scheme in which an investment-linked statutory fund of a controlled entity invests*—This is because the exception in s259C(1)(b) for trusts is not available where the company or any entity it controls has a beneficial interest in the trust (apart from certain interests arising from financing transactions). We consider that an investment-linked statutory fund of a controlled entity has a beneficial interest in the relevant managed investment scheme in these circumstances and therefore the exception in s259C(1)(b) does not apply.

32 We note the Explanatory Memorandum to the Company Law Review Bill 1997 states:

> It is envisaged that [ASIC] would exercise this discretion to exempt [from s259C(1)] investments by the statutory fund of a life insurance company on conditions designed to provide appropriate safeguards including ensuring that the holding company is not able to inappropriately exercise control over its own shares.

Existing relief for investment-linked statutory funds

33 We have previously granted relief to investment-linked statutory funds on the conditions outlined in CP 1, including the condition that a controlled entity may acquire company shares by way of new issue only if it is approved by shareholders or satisfies one of the following exceptions in ASX Listing Rule 7.2:

(a) participation in a pro rata issue;

(b) the issue of shares in a takeover bid;

(c) an issue under a dividend reinvestment plan; or

(d) the issue on the conversion of convertible securities which were issued in one of the circumstances outlined in paragraphs (a)–(c).

This condition is designed to address the risk that self investment may lead to a controlled entity being preferred in any issue of securities.

34 We have limited our relief to funds related to investment-linked statutory funds rather than extending it to other types of statutory funds such as those relating to non-participating businesses because these investment-linked funds are similar to unit trusts. Policy owners have a direct interest in the performance of the assets held by the fund and there is normally no capital guarantee or 'smoothing' by the life insurance company.

35 In addition, the interests of the shareholders of the life insurance company in the performance of an investment-linked product are minimal. These interests are generally limited to a small amount of capital (around 0.25% of assets of the fund) held in the shareholder retained profits account. Accordingly, the primary policy basis for granting relief is that it is predominantly policy holders who benefit from the relief rather than the company or its controlled entities.

36 As well as the conditions outlined in CP 1, in order to further minimise the interest of shareholders of the life insurance company in the performance of the investment-linked business (in particular any investment in shares of the controlling company), we have imposed the following additional conditions on relief provided to investment-linked statutory funds:

(a) no more than 3% of that portion of the investment-linked statutory fund's shareholder retained profits account which is required for solvency of each fund can be invested in the company's shares. This

limits the statutory fund's economic interest in the company's shares; and

(b) the relief does not apply to any transfer or issue of shares or units of shares to a shareholder retained profits account of an investment-linked statutory fund if the shareholder retained profits account is in excess of solvency requirements. This means the life company cannot invest surplus shareholder capital in the statutory fund in shares of the related party.

37 We propose to continue to apply these two additional conditions to any relief given to investment-linked statutory funds.

Proposed relief for participation in placements

38 We have received submissions on behalf of certain investment-linked statutory funds and related managed investments schemes which argue that these entities should be able to participate in placements made by the controlling company.

39 We believe there are special characteristics of investment-linked statutory funds that support relief from s259C(1) which allows participation in placements, subject to adequate safeguards. In particular, we note that the Life Insurance Act provides that:

(a) in the investment, administration and management of the assets of a statutory fund, a life company must give priority to the interests of owners and prospective owners of policies referable to the fund;

(b) a director of a life company has a duty to the owners of policies referable to a statutory fund of the company. The director's duty is to take reasonable care, and use due diligence, to see that, in the investment, administration and management of the assets of the fund, the life company:

(i) complies with the Life Insurance Act; and

(ii) gives priority to the interests of owners and prospective owners and policies referable to the fund;

(c) in the event of conflict between the interests of owners and prospective owners of policies and the interests of shareholders of a life company, a director's duty is to take reasonable care, and use due diligence, to see that the company gives priority to the interests of owners and prospective owners of those policies over the interests of shareholders; and

(d) a life company may invest assets of a statutory fund in shares of a related listed corporation provided the total value does not exceed 2.5% of total value of all assets of the fund.

40 Because of the duties owed by the directors of a life company to current and future policy owners, we consider that some similarities can be drawn between investment-linked statutory funds and unit trusts in which the company and its non controlled entities do not have a beneficial interest for the purposes of

s259C. Life insurance policy owners may be disadvantaged by the investment-linked statutory fund being unable to participate in placements.

41 In addition, in relation to related managed investment schemes, we note that non-controlled members of those schemes may be disadvantaged by the inability of the responsible entity to participate in a placement of the company's shares only because an investment-linked statutory fund holds interests in the scheme. Our proposal seeks to address this disadvantage.

Proposed conditions of relief

42 Notwithstanding the above, we consider that any relief which enables investment-linked statutory funds and related managed investment schemes to participate in placements needs to be subject to appropriate safeguards. These safeguards should address the risk of preferential treatment given that:

(a) there is discretion involved in the allocation of shares in a placement; and

(b) there are benefits that might flow to a company from having 'sympathetic' controlled entities on its share register.

43 We are therefore proposing that participation in a placement be subject to the following conditions.

Same or no more favourable terms

44 We consider that participation by investment-linked statutory funds and related managed investment schemes should be on no more favourable terms than other participants. This condition is designed to ensure that the controlled entities do not receive preferential treatment. This should help minimise any perception of a conflict of interest, particularly in the situation where the parent entity has a pressing need for capital.

15% maximum aggregate participation by all controlled entities

45 We consider that no more than 15% of the shares issued in the placement should be issued to, or for the benefit of, all controlled entities. This 15% limit includes participation by:

(a) investment-linked statutory funds and related managed investment schemes; and

(b) other controlled entities that are able to participate in a placement of the company's shares (e.g. through reliance on one of the statutory exceptions in s259C(1)(a)–(d)).

46 We consider that a significant level of participation by non-controlled entities helps to limit any influence controlled entities have over the outcome of the placement. This minimises the risk that the placement is conducted in

a manner which prefers controlled entities. We consider an aggregate limit of 15% strikes a balance between:

(a) safeguarding against the risk of preferential treatment; and

(b) unduly limiting the investment opportunities of investment-linked statutory funds, related managed investment schemes and other controlled entities. We recognise that there may be several related managed investment schemes and other types of controlled entities that may wish to participate in a placement.

47 Some alternative arguments are:

(a) given the similarities between trusts and investment-linked statutory funds, no limit should be placed on the maximum participation of these funds in a placement as no such limit imposed on trusts which have the benefit of the exception in s259C(1)(b). While we agree that there are similarities between trusts and investment-linked statutory funds, as noted above in paragraph 42 we consider that the risk of preferential treatment is present and should be addressed in any relief given to these funds.

(b) controlled entities that already have the benefit of a statutory exception in s259C(1)(a)–(d) should not be included in the maximum participation limit as no such condition is imposed in s259C. While we consider this argument has some merit, we believe that the risks of self-acquisition in a placement increase along with the level of participation of all controlled entities.

Placement price

48 We consider the company should use its best endeavours to obtain as high a placement price as practicable.

Proposed relief for index arbitrage

Proposal

B4 We are considering whether to grant an exemption under s259C(2) of the Corporations Act in limited circumstances (see Proposal B5) to allow controlled entities to acquire shares in a listed parent company for the purpose of index arbitrage and related client-driven activities.

Your feedback

B4Q1 Should this exemption be granted? Why?

B4Q2 Given we refused this relief in 2001, what changes to the market have since occurred that would support such relief?

B4Q3 How would relief benefit people that are third party investors and not associated with the listed parent company or its controlled entities?

B4Q4 Do you agree that granting this exemption would promote liquidity and efficiency in the market for index arbitrage and related customer-driven activities?

B4Q5 Would acquisitions for the purpose of index arbitrage and related customer-driven activities raise any regulatory risks referred to in paragraph 8 that are not addressed by the conditions in Proposal B5?

B4Q6 Should we offer relief for all the client-driven activities listed in paragraph 53, or are some more risky than others?

Rationale

49 Cash futures arbitrage consists of taking opposing positions in the cash and futures markets to extract an arbitrage. The relationship between cash and futures markets is referred to as the basis. An arbitrageur will execute when the basis deviates from the calculated fair value, usually via an electronic trading system. In Australia, cash futures arbitrage primarily occurs between futures quoted on the Sydney Futures Exchange (SFE) and the ASX200 basket index.

50 Relief given to date under s259C(2) has generally been based on the relief proposed in CP 1 where the acquired shares in the listed parent company are assets of a trust or statutory fund held for investors in the fund. The shares acquired for the purpose of index arbitrage are not held in such a fund. Relief for the purpose of index arbitrage and client-driven activities extends the relief in CP 1 to facilitate:

(a) a more complete market; and

(b) client driven transactions.

We recognise that the company and/or its controlled entities may also derive direct commercial benefits from this type of relief.

51 In 2001 we considered and refused an application for exemption under s259C(2) for the purpose of proprietary equity index arbitrage. In that instance we considered that the perceived commercial benefit which would be permitted if the exemption was granted was outweighed by the regulatory risk in doing so. However, we are taking this opportunity to reconsider this issue generally.

52 We recognise that there have been changes in the market since CP 1 was first released. One of these changes is the increasing volume of index-based equities trades reported on the financial market operated by ASX Limited, as well as in other markets. As such, we are now considering whether to grant such an exemption in limited circumstances.

53 Index arbitrage is a widely used and efficient method of generating share inventory as a way to undertake services to clients:

(a) market making, redemption and application services for units in exchange traded funds (ETFs);

(b) exchange of futures for physical (EFP) transactions;

(c) over-the-counter (OTC) and exchange-traded derivatives and warrants over securities represented in an index or baskets of securities;

(d) facilitation services for basket transactions; and

(e) securities borrowing and lending services for index and basket transactions.

54 We have received submissions indicating that granting this relief will promote liquidity and efficiency in the market for index arbitrage and related customer-driven activities. We also understand that granting the relief will allow a company to physically hedge its index and portfolio activities rather than creating a situation where they hold a synthetic short position in their own shares. It is these reasons, and the fact that relief may not be inconsistent with the policy objectives of s259C, that have persuaded us to reconsider our previous position.

55 It has also been submitted to us that the operation of s259C places Australian brokers at a competitive disadvantage to foreign-owned brokers in the Australian market.

56 We are considering the inclusion of extra conditions on the exemption for index arbitrage to reduce the regulatory risks of granting this relief: see Proposal B5.

Proposed additional conditions of relief

Proposal

B5 Should we decide to grant relief for index arbitrage activities, we propose to limit relief in the following way:

(a) the voting power of the controlled entities in the listed parent company must not exceed 0.5% of the total number of voting shares;

(b) shares in the listed parent company cannot make up more than 10% (by value) of any basket or portfolio transaction; and

(c) the net economic exposure of the controlled entities in the listed parent company must not exceed 5% of the shares held as a perfect hedge.

This would be in addition to the CP 1 conditions (as amended by proposal B2 above).

We are considering whether an acquisition of shares in the listed parent company by a controlled entity, other than by way of new issue, may be made by way of a 'market transaction' as defined in the Market Rules of ASX Limited. We are also considering whether to impose a purpose condition.

Your feedback

B5Q1 Do these proposed conditions adequately address the regulatory risks in paragraph 8?

B5Q2 Do you agree with limiting the total number of shares in any index arbitrage activity to 0.5% of the total number of voting shares?

B5Q3 For entities that make up a greater proportion of the index and for which we may grant less than 0.5%, what is the lowest percentage we should grant?

B5Q4 Do you agree with limiting the proportion of shares to 10% (by value) of any basket or portfolio transaction?

B5Q5 Do you agree that a 5% net economic exposure limit is appropriate?

B5Q6 Would a condition that limited the acquisition of shares to 'on-market transactions' as defined in s9 of the Corporations Act (which would exclude Special Crossings) and transactions between controlled entities be overly restrictive? Why?

B5Q7 Should any time limit be set on holdings of shares in the listed parent company? What period would be appropriate?

B5Q8 If off-market transactions are allowed should any other conditions apply? Why?

B5Q9 Should we include a condition that the acquisitions are for the purpose of providing the services to clients in paragraph 53?

B5Q10 Should we include a condition that requires there be appropriate controls to ensure reliable pricing models and input variables?

Rationale

57 We recognise that index arbitrage and related customer-driven activities give rise to risks additional to those set out in CP 1. This is because the shares acquired are not assets of a fund held for investors in the fund.

58 We are conscious of maintaining the policy objectives of s259C in considering whether to grant exemptions from the provision. As such, we are proposing to limit this relief through extra conditions in addition to the conditions outlined in CP 1 (as amended by proposal B2 above).

Five percent aggregate

59 Any shares acquired under relief provided for index arbitrage and related customer-driven activities will count towards the 5% aggregate total number of shares that controlled entities of a listed company may hold at any one time, as permitted by other ASIC relief.

The 0.5% limit

60 In contrast to client-driven activities and activities that utilise client funds, index arbitrage is a proprietary strategy that uses the listed company's own funds to acquire a basket of shares that includes its own shares. At this stage, we intend to limit the total number of shares that a listed entity may acquire in itself specifically as part of any index arbitrage activity. We propose a limit of 0.5%; however, if entities that comprise a larger proportion of the index seek this relief, we may grant less than this amount. We have settled on 0.5% as a relatively small amount which would nonetheless permit index arbitrage activities to be undertaken.

Shares cannot make up more than 10% of the basket

61 To reduce the risk of price manipulation and consistently with the policy goals associated with maintenance of capital, we intend to limit the number of shares of its listed parent company that a controlled entity may acquire or divest as part of any basket or portfolio trade to 10% of that transaction by value.

Net economic exposure of 5%

62 We note that the relief is intended to allow controlled entities of companies listed on a financial market in Australia to provide services to clients in an efficient and price competitive way. It is not intended to provide the holder of relief with the means to take net economic positions in itself. However, we recognise that changes to index weightings or other factors may produce circumstances where net economic positions are unavoidable. For this reason we propose to allow a 5% tolerance level.

Pricing models

63 Pricing models are important because the price data obtained is relevant to the other conditions of relief.

64 Due to the complexity of many pricing models, especially for OTC products, where an entity applies for this relief we will need to be satisfied that they have appropriate controls around the creation of their pricing models and the review of variables against independent market data.

65 We will consider whether it is appropriate to impose a condition that specifies appropriate controls around pricing models and input variables.

Acquisitions by way of a 'market transaction'

66 We have been asked to grant an exemption in circumstances where acquisitions of shares could occur by way of a transaction between controlled entities. We are considering a condition which requires all acquisitions of shares be on-market transactions as defined in s9. This

condition was intended to reduce the risk of preferential treatment being afforded to the controlled entity acquiring the shares, and to provide transparency of on-market transactions, however it will exclude the use of Special Crossings.

67 The alternative to including this condition is to permit the acquisition of shares by a controlled entity to be done by way of a 'market transaction' as that term is defined in the Market Rules of ASX Limited or other relevant market operator, as this would allow the use of special crossings. We note this would require post-trade reporting.

Disclosure of interests in the company's shares by its controlled entities

68 We have granted interim relief on conditions requiring periodic disclosure of interests:

(a) the listed parent company must announce to the relevant financial market the aggregated percentage total of its voting shares (*aggregated interests*) in respect of which:

i. the company's controlled entities have the power to control voting or disposal; and

ii. the company or any of its controlled entities, to their knowledge, have an economic exposure arising from derivatives held by any of them.

An announcement is required 14 days after the last announcement under this paragraph or paragraph (b); and

(b) the company must announce to the financial market any change of 1% or more in the aggregated interests from the most recent notice. Disclosure of the change will be made before the end of 1 business day after the day on which the company became aware of the change.

Proposal

B6 We are considering whether the conditions relating to disclosure of aggregated interests (applying to relief under CP 1 and proposed relief under this CP) should be varied so that:

(a) the periodic disclosure requirement is increased from 14 days to three months; and

(b) the time required to report a 1% or greater percentage change is changed from one to two days.

Your feedback

B6Q1 Do you think that periodic disclosure should be required every three months rather than 14 days? If not, what time period do you think is appropriate?

B6Q2 Do you think there are any practical difficulties in complying with the current or proposed disclosure requirements?

Rationale

69 CP 1 outlines the rationale behind the conditions relating to disclosure of trading: principally that disclosure minimises the risk of insider trading and market manipulation which may occur from self acquisition.

70 The disclosure requirement is similar although not identical to substantial shareholding disclosure in Part 6C.1 of the Corporations Act. A listed parent company that receives conditional relief should be able to use its existing systems and procedures for complying with its s671B substantial holding obligations to report in accordance with the conditional s259C relief.

Periodic disclosure

71 We have received submissions which argue that the 14 day periodic disclosure requirement is administratively burdensome and may not provide meaningful information to the market.

72 We consider that regular periodic disclosure is important in minimising the risk of insider trading and market manipulation. However, we recognise that a period longer than 14 days may still be appropriate in achieving this aim.

1% or greater movements

73 Given that s671B(6) requires a substantial holding notice to be given within two business days after becoming aware of the information, we consider that it is appropriate to bring the requirement to report movements of 1% or greater of the aggregated interests into line with the timing in s671(B)(6), i.e. disclosure should be made within 2 days after the 1% change in aggregated interests occurs.

C Regulatory and financial impact

74 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. We think the proposals for conditional relief in CP 1 and CP 137 will strike an appropriate balance between permitting controlled entities to purchase the company's shares to hold for investors and the regulatory risks that can arise from indirect self-acquisition (see paragraph 8).

75 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:

(a) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;

(b) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and

(c) conducting the appropriate level of regulatory analysis, that is, complete a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).

76 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC Report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

77 To ensure that we are in a position to properly complete any required BCC Report or RIS, we ask you to provide us with as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits.

See 'The consultation process' at the front of this paper.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of the Act
CP 1	Consultation Paper 1 *Indirect self acquisition by investment funds* released in October 1998
investment-linked statutory fund	The statutory fund of any controlled entity which carries on the life insurance business of providing investment-linked benefits within the meaning of s31(b) of the Life Insurance Act
Life Insurance Act	*Life Insurance Act 1995*
related managed investment scheme	A managed investment scheme that has a controlled entity as responsible entity in which an investment-linked statutory fund invests
s259C (for example)	A section of the Corporations Act unless otherwise specified (in this example numbered 259C)
self-acquisition	Where shares (or units of shares) in a company are issued or transferred to an entity it controls

List of proposals and questions

Proposal	Your feedback
B1 We propose to grant relief without a sunset clause because we are satisfied the policy settings and conditions in CP 1 are appropriate (subject to the proposals in this paper).	**B1Q1** Do you agree we should grant relief based on CP 1 without a sunset clause?
B2 We propose an additional condition on relief from s259C(1) where we permit the issue or transfer of shares of a company to a unit trust or managed investment scheme that has a controlled entity of the company as trustee or responsible entity. The proposed voting test condition will mean relief would cease to apply where the company or any controlled entity's relevant interest in the trust or scheme is more than 20%.	**B2Q1** Do you agree it is appropriate to impose an additional condition on relief for controlled trustees or responsible entities to prevent the company and its controlled entities from having a relevant interest in the trust or scheme of more than 20%? **B2Q2** Are there any circumstances in which it is necessary for a company or its controlled entities to have more than 20% relevant interest in an investment trust or scheme other than for the purpose of investing the company's own funds (e.g. temporary control upon establishment of the trust)? **B2Q3** Do you consider an alternative or additional condition should be imposed?
B3 (a) We propose to grant conditional relief from s259C for: (i) the statutory fund of any controlled entity which carries on the life insurance business of providing investment-linked benefits within the meaning of s31(b) of the Life Insurance Act (investment-linked statutory funds); and (ii) managed investment schemes that have a controlled entity as responsible entity in which an investment-linked statutory fund invests (related managed investment schemes). This relief would be subject to the proposed conditions outlined in CP 1 (as amended by proposal B2 of this paper): see paragraph 10 in Section A of this paper for a summary of these conditions. (b) We propose that, in addition to the above conditions, relief for investment-linked statutory funds would be subject to the following additional conditions: (i) no more than 3% of that portion of the investment-linked statutory fund's shareholder retained profits account which is required for solvency of each fund can be invested in the company's shares; and (ii) the relief does not apply to any transfer or issue of shares or units of shares to a shareholder retained profits account of an investment-linked statutory fund if the shareholder retained profits account is in excess of solvency requirements.	**B3Q1** Do you agree that investment-linked statutory funds and related managed investment schemes should be able to participate in a placement of the company's shares? **B3Q2** Do you think a condition limiting the maximum level of participation in a placement by controlled entities is the best way of addressing the risk of preferential treatment? **B3Q3** Do you think that this type of relief should be extended to controlled trustees and responsible entities where the company or a controlled entity has a beneficial interest in the trust or scheme? If so, how should we minimise the risks from this type of indirect self-acquisition, given our proposed conditions of relief permit up to 20% of the interests in the scheme or trust to be held by the company or a controlled entity? **B3Q4** Do you think 15% is an appropriate aggregate maximum limit for participation by all controlled entities? If not, what limit do you think is appropriate? **B3Q5** Do you think it is appropriate to impose a condition which requires the company to maximise the placement price as far as practicable? In practice, are there any reasons why a company would not do this? **B3Q6** Do you think that any other safeguards are necessary?

Proposal	Your feedback
(c) We propose that, in addition to the conditions in paragraphs (a) and (b) above, acquisitions of the company's shares by way of participation in an institutional placement would be permitted subject to the following additional conditions: (i) participation by investment-linked statutory funds or related managed investment schemes is on the same, or no more favourable, terms as other participants; (ii) no more than 15% of the shares issued in the placement are issued to, or for the benefit of, all controlled entities (including but not limited to investment-linked statutory funds or related managed investment schemes); and (iii) the company must use its best endeavours to obtain as high a placement price as practicable. The proposed relief will only apply to related managed investment schemes that would otherwise be able to participate in a placement of the company's shares but for an investment-linked statutory fund holding interests in the scheme.	
B4 We are considering whether to grant an exemption under s259C(2) of the Corporations Act in limited circumstances (see Proposal B5) to allow controlled entities to acquire shares in a listed parent company for the purpose of index arbitrage and related client-driven activities.	**B4Q1** Should this exemption be granted? Why? **B4Q2** Given we refused this relief in 2001, what changes to the market have since occurred that would support such relief? **B4Q3** How would relief benefit people that are third party investors and not associated with the listed parent company or its controlled entities? **B4Q4** Do you agree that granting this exemption would promote liquidity and efficiency in the market for index arbitrage and related customer-driven activities? **B4Q5** Would acquisitions for the purpose of index arbitrage and related customer-driven activities raise any regulatory risks referred to in paragraph 8 that are not addressed by the conditions in Proposal B5? **B4Q6** Should we offer relief for all the client-driven activities listed in paragraph 53, or are some more risky than others?
B5 Should we decide to grant relief for index arbitrage activities, we propose to limit relief in the following way: (a) the voting power of the controlled entities in the listed parent company must not exceed 0.5% of the total number of voting shares; (b) shares in the listed parent company cannot make up more than 10% (by value) of any basket or portfolio transaction; and	**B5Q1** Do these proposed conditions adequately address the regulatory risks in paragraph 8? **B5Q2** Do you agree with limiting the total number of shares in any index arbitrage activity to 0.5% of the total number of voting shares? **B5Q3** For entities that make up a greater proportion of the index and for which we may grant less than 0.5%, what is the lowest

Proposal	Your feedback
(c) the net economic exposure of the controlled entities in the listed parent company must not exceed 5% of the shares held as a perfect hedge. This would be in addition to the CP 1 conditions (as amended by Proposal B2 above). We are considering whether an acquisition of shares in the listed parent company by a controlled entity, other than by way of new issue, may be made by way of a 'market transaction' as defined in the Market Rules of ASX Limited. We are also considering whether to impose a purpose condition.	percentage we should grant? **B5Q4** Do you agree with limiting the proportion of shares to 10% (by value) of any basket or portfolio transaction? **B5Q5** Do you agree that a 5% net economic exposure limit is appropriate? **B5Q6** Would a condition that limited the acquisition of shares to on-market transactions' as defined in s9 of the Corporations Act (which would exclude Special Crossings) and transactions between controlled entities be overly restrictive? Why? **B5Q7** Should any time limit be set on holdings of shares in the listed parent company? What period would be appropriate? **B5Q8** If off-market transactions are allowed should any other conditions apply? Why? **B5Q9** Should we include a condition that the acquisitions are for the purpose of providing the services to clients in paragraph 53? **B5Q10** Should we include a condition that requires there be appropriate controls to ensure reliable pricing models and input variables?
B6 We are considering whether the conditions relating to disclosure of aggregated interests (applying to relief under CP 1 and proposed relief under this CP) should be varied so that: (a) the periodic disclosure requirement is increased from 14 days to three months; and (b) the time required to report a 1% or greater percentage change is changed from one to two days.	**B6Q1** Do you think that periodic disclosure should be required every three months rather than 14 days? If not, what time period do you think is appropriate? **B6Q2** Do you think there are any practical difficulties in complying with the current or proposed disclosure requirements?

Appendix: Consultation Paper 1 *Indirect self acquisition by investment funds* (CP 1)

For reference, we have included CP 1 as an Appendix to this paper.

ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 1

Indirect self acquisition by investment funds

October 1998

Your comments

We invite your comments on the *proposals and issues for consideration* in this paper.

Comments are due by Friday 18 December 1998 and should be sent to:

Allan Bulman
Senior Lawyer
Regulatory Policy Branch
National Office, Melbourne
Australian Securities & Investments Commission
GPO Box 5179AA
Melbourne, Victoria, 3001
Facsimile (03) 9280 3339

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

What this policy proposal is about

1. This paper covers our policy proposals on when we will give relief to financial institutions from the indirect self acquisition provisions under s259C(2). Indirect self acquisition is where the shares in a company are issued or transferred to an entity it controls (see s259C(1)).
2. We propose to give relief to financial institutions on conditions which relate to the regulatory risks of indirect self acquisition. These conditions may relate to:
   (a) the proportion of a company's shares which may be held by its controlled entities and how those shares are voted;
   (b) limiting the risk of preferential treatment to the company, its controlled entities and other shareholders; and
   (c) disclosure of trading in the company's shares by its controlled entities.
3. We also propose to grant relief to controlled entities which invest in funds, that are managed independently of the company and its controlled entities, which in turn invest in the company's shares.

Contents

Our policy proposal — issues for consideration

Policy proposal	Issues for consideration
Regulatory risks of indirect self acquisition	
1 In developing the policy proposal, we considered that the following risks may arise from allowing indirect self acquisition: **(a)** improper attempts to secure or consolidate corporate control (see paragraphs 3-4 policy proposals); **(b)** increased possibility of corporate failure (see paragraph 5 policy proposals); **(c)** possible discrimination between shareholders (see paragraph 6 policy proposals); **(d)** insider trading (see paragraph 7 policy proposals); **(e)** market manipulation (see paragraph 7 policy proposals); and **(f)** price opacity.	**1A** Do you think these are legitimate risks which we should take into account? **1B** Are there other risks which we should take into account? If yes, what are they?
Relief for investment funds	
Who should we give relief to?	
2 We propose to give s259C(2) relief to financial institutions with shares listed on ASX. Relief will allow controlled entities to hold the company's shares for the benefit of investors in funds managed by the controlled entities.	**2A** Should we give relief to companies other than financial institutions? **2B** Should we only give relief to financial institutions whose shares comprise at least a specified percentage of the All Ordinaries Index? If yes, what should that percentage be?

Policy proposal	Issues for consideration
	2C Should we only give relief where a financial institution can show that its business is materially adversely effected as a result of its controlled entities being precluded from investing in its shares?
Conditions regarding improper exercise of control	
3 We propose that relief will be subject to the condition that the company's controlled entities do not acquire interests in more than 5% of the company's voting shares in aggregate. In calculating this percentage limitation, we propose to count a company's shares which a controlled entity has the power to control voting or disposal over. For example, we will: (a) include shares in the company where a controlled entity has the power to control voting or disposal of those shares, irrespective of whether s259C(1) applies to the acquisition of those shares; (b) include any share in the company underlying a derivative where the derivative gives a controlled entity the power to control the vote attached to the share; and (c) exclude shares in the company where no controlled entity has the power to control voting or disposal of the shares (for example where the fund is independently managed - where neither the company nor its controlled entities control or influence the decision making processes in the fund).	**3A** Should this percentage limitation vary depending on the financial institution's weighting in the All Ordinaries Index or any other circumstance? **3B** Should this percentage limitation be lower or higher than 5%? **3C** Should this percentage limitation include any share in the company underlying a derivative acquired by a controlled entity, irrespective of whether the derivative gives the controlled entity the power to vote the share? **3D** Should we only include investments which fall within the strict terms of s259C(1) in calculating this percentage limitation?

Policy proposal	Issues for consideration
4 We propose that relief will be subject to the condition that the company and its controlled entities do not exercise the votes attaching to the company's shares, nor control or influence the exercise of votes attached to the company's shares, under any circumstances.	**4A** Are there circumstances where this voting restriction should be lifted? **4B** Are there any policy justifications for allowing controlled entities to vote the company's shares following the recommendation of an independent adviser?
Prudential conditions	
5 At this stage, we do not intend relief to be subject to a condition limiting the amount of a company's shares held by a controlled entity to a particular percentage of a controlled entity's fund ("a prudential condition").	**5A** Should we impose a prudential condition on managed funds where s259C(2) relief is necessary in relation to those funds?
Conditions relating to preferential treatment	
6 We propose that relief will be subject to the following conditions: (a) all purchases of the company's shares by controlled entities must be made either: (i) on market; or (ii) as a result of a transaction between controlled entities; and (b) any controlled entity must not acquire the company's shares by way of a new issue unless participation in the issue is approved by the company's shareholders or the issue satisifies one of the following exceptions in ASX Listing Rule 7.2: (i) participation in a pro rata issue; (ii) the issue of shares pursuant to a takeover offer; (iii) an issue under a dividend reinvestment plan; and	**6A** Are there any alternative or additional conditions to limit the risk of preferential treatment being afforded to the company, its controlled entities or other shareholders? **6B** Should the condition in sub-paragraph 6(a) apply also to sales of the company's shares? **6C** Should on market purchases be limited to purchases "in the ordinary course of trading" (see s698(5))?

Policy proposal	Issues for consideration
(iv) issue on the conversion of convertible securities which were issued in one of the circumstances outlined in sub-paragraphs (i) to (iii).	
Conditions relating to trading and disclosure	
7 We propose that relief be subject to the following conditions: (a) The company must disclose publicly to a securities exchange, for the purpose of release to a stock market conducted by the securities exchange, the percentage of its shares in aggregate which its controlled entities have the power to control voting or disposal over: (i) every 14 days, from the time of the most recent notice; and (ii) within one day after the company becomes aware of any aggregate change of 1% from the most recent notice. The agreements relevant to the changes in that percentage will be required to be disclosed, as if under Part 6.7. The way we calculate the percentage limit for disclosure is substantially the same as how we calculate the percentage limit for exercise of control referred to in paragraph 3. The only exception is that for the purposes of disclosure, we intend to include any acquisitions by the company or its controlled entities in derivatives over the company's shares on the basis of counting the voting shares underlying each derivative. (b) The company must keep a record of the trading by its controlled entities in the company's shares or derivatives over the company's shares, for inspection by the relevant securities exchange or futures	**7A** Are the following disclosure conditions more appropriate: (a) public disclosure of: (i) the number of the company's shares and derivatives over the company's shares, bought and sold by the controlled entities; (ii) the prices at which the shares and/or derivatives over the company's shares were bought and sold; and (iii) the total number of shares and derivatives over the company's shares held by the controlled entities, within 1 business day, 2 business days or 5 business days after the trading occurred; or (b) disclosure of an intention to trade in shares or derivatives by controlled entities (pre trading disclosure)? **7B** Should the percentage in sub-paragraph 7(a)(ii) be set at a

Policy proposal	Issues for consideration
exchange and ASIC during business hours. The company must keep records for one year after the relevant trading occurred.	level which is different from 1%? **7C** Is it appropriate to exclude from the operation of any of the possible conditions in paragraphs 7 and 7A, funds which closely follow the index? **7D** What are the financial and compliance costs involved in the disclosure alternatives in paragraphs 7 and 7A? **7E** Should different disclosure obligations apply when the company is subject to a takeover bid (for example, pre trading disclosure)? **7F** Should we consider imposing specific restrictions on the manner of trading by controlled entities in the company's shares?
Relief to invest in independent managed investment schemes	
8 We propose to give relief for the controlled entities of financial institutions to invest in independent prescribed interest or managed investment schemes which in turn invest in the company's shares as long as: (a) the scheme is not controlled by the company or its controlled entities; and (b) neither the company nor its controlled entities control or influence the decision making processes in the scheme, other than voting their units in a meeting of unitholders.	**8A** Should this relief be given to companies other than financial institutions? In particular, should similar relief be given to an employee share scheme or superannuation scheme for employees of a company, which is a controlled entity of the company? **8B** Should there be any alternative or additional conditions attached to the relief?

Policy proposal	Issues for consideration
Regulatory and financial impact	
9 We have considered the regulatory and financial impact of these policy proposals. A detailed analysis is in the section of this paper headed "Regulatory and financial impact".	**9A** We would like your comments on the issues raised in the section of this paper headed "Regulatory and financial impact". Your comments will assist us to assess more accurately the regulatory and financial impact of the policy proposals in this paper.

Explanation

The scope of the indirect self acquisition provision

1. Section 259C(1) states that "The issue or transfer of shares (or units of shares) of a company to an entity it controls is void unless:

(a) the issue or transfer is to the entity as a personal representative; or

(b) the issue or transfer is to the entity as trustee and neither the company nor any entity it controls has a beneficial interest in the trust, other than a beneficial interest that satisfies these conditions:

(i) the interest arises from a security given for the purposes of a transaction entered into in the ordinary course of business in connection with providing finance; and

(ii) that transaction was not entered into with an associate of the company or an entity it controls; or

(c) the issue to the entity is made as a result of an offer to all the members of the company who hold shares of the class being issued and is made on a basis that does not discriminate unfairly, either directly or indirectly, in favour of the entity; or

(d) the transfer to the entity is by a wholly-owned subsidiary of a body corporate and the entity is also a wholly-owned subsidiary of that body corporate."

2. The exceptions in s259C(1)(c) and (d) are subject to the condition that within 12 months after the controlled entity receives the shares either:

(a) the entity must cease to hold the shares;

(b) the entity must cease to be a controlled entity; or

(c) the company must have received an extension of time from ASIC

See s259D(1).

3. ASIC has the power in s259C(2) to exempt the company from the operation of s259C(1). The exemption can be subject to conditions.

4. The definition of controlled entity is found in s259E. Paragraph 12.61 of the Explanatory Memorandum to the Company Law Review Bill, 1997, states that the definition was based on the Accounting Standard, AASB 1024.

5. In absence of relief, we consider that the following acquisitions would contravene s259C(1):

(a) Acquisitions in a company's shares by a statutory fund of a controlled entity which is an insurance company.

(b) Where a trustee of a unit trust is a controlled entity, the trustee will not be able to rely on the exception in s259C(1)(b) if the company or any of its controlled entities hold units in the trust (as they would have a beneficial interest in the trust). In that case any acquisition by the trust in the company's shares would contravene s259C(1).

6. In the absence of relief, we consider that there is some doubt as to whether or not the following acquisitions would be acquisitions of units of shares and so contravene s259C(1):

(a) The acquisition by a controlled entity of units in a managed investment scheme (or a prescribed interest scheme) which invests in the company's shares.

(b) The acquisition by a controlled entity of warrants over the company's shares.

7. In *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367 the High Court held that a trustee's right to indemity was a beneficial interest in the trust. The issue in that case concerned the characterisation of a trustee's right of indemnity for the purposes of insolvency law. This is a different context from the question of whether a trustee's right of indemnity is a beneficial interest for the purposes of s259C(1)(b). If a trustee's right of indemnity was taken to be a beneficial interest for the purposes of relying on the exception in s259C(1)(b), the majority of trustees would not be able to rely on the exception. It is unlikely that the legislature intended that result. Therefore, we believe that the term beneficial interest should be given its common meaning which would exclude a trustee's right of indemnity.

Regulatory risks of indirect self acquisition

8. In outlining the regulatory risks in paragraph 1 of the Policy Proposals, we considered:

(a) The Companies and Securities Law Review Committee, Report to the Ministerial Council, *A Company's Purchase of its Own Shares*, September 1987.

(b) The Greene Committee Report (1926 (UK) - Cmd., 2658, paragraphs 30 to 33).

(c) The Cohen Committee Report (1945 (UK) - Cmd., 6659, paragraph 170).

(d) Paragraphs 12.67 to 12.69 of the Explanatory Memorandum to the Company Law Review Bill, 1997.

9. One classic form of discrimination between shareholders is what is commonly described as "greenmailing". This could happen where a shareholder exerts pressure on the company to have a controlled entity buy out the shareholder at a favourable price. In that case, other shareholders and even investors in the controlled entity's fund may be disadvantaged.

10. Allowing indirect self acquisition by a controlled entity, which uses its own funds rather than investors' funds, can create difficulties in valuing the consolidated group of companies. This is because part of the assets of the group include shares in the controlling company. As a general rule and all things being equal, the greater the amount of indirect self investment, the greater the volatility in the controlling company's share price. This is because indirect self investment tends to exaggerate the effect of good and bad news on the share price of the company. We have called this risk price opacity.

Relief for investment funds

Who should we give relief to?

11. In considering who we should give relief to we noted that paragraph 12.67 of the Explanatory Memorandum to the Company Law Review Bill 1997 states that:

> "It is envisaged that [ASIC] would exercise this discretion to exempt investments by the statutory fund of a life insurance company in its holding company on conditions designed to provide appropriate safeguards including ensuring that the holding company is not able to inappropriately exercise control over its own shares."

12. We do not consider that we are bound to give relief only in these circumstances. To date, however, the companies expressing an interest in this relief have been predominantly financial institutions.

13. At this stage we do not envisage giving s259C(2) relief to a company in relation to one of its controlled entities investing the entity's own funds in the company's shares (rather than investors' funds). This is because:

(a) it is less likely that the company and its controlled entities would be financially disadvantaged by the prohibition against indirect self investment; and

(b) the risks of price opacity and the possibility of corporate failure are present when indirect self investment of a controlled entity's own funds is permitted.

Conditions regarding improper exercise of control

14. We recognise that the power to vote is an important economic right attaching to a share and that the managers and trustees of funds will generally regard the considered exercise of their power to vote to be a fiduciary duty. We consider, however, that there is a risk that controlled entities investing in the company's shares may inappropriately use those shares to control the company. As a general rule and all things being equal, the greater the quantum of that investment, the greater the risk. We are, therefore, of the view that controlled entities should not exercise any voting rights, nor control or influence the exercise of voting rights, attaching to the shares in the company which they hold. This condition will only apply to those shares which, but for the operation of a s259C(2) exemption, would contravene s259C(1).

15. Allowing controlled entities to vote by following the recommendation of an independent adviser does not eliminate the risk of improper exercise of control. This is because there will always be the possibility that the adviser may not be completely independent. We consider that the risk of improper exercise of control is of such concern that allowing voting in these circumstances is not justified.

16. Even with voting restrictions, there is still a risk that a large block of shares could be used inappropriately to control a company. A prohibition on voting by a company's controlled entities distorts the voting power of all other shareholders in the company. The degree of this distortion is greater, the more shares cannot be voted as a result of being held by the controlled entities. We are, therefore, of the view that controlled entities should not be able to hold more than 5% of the shares in the company.

17. The risk of inappropriate exercise of control arises when the controlled entities have the power to vote or dispose of the company's shares. This may occur even where an acquisition by a controlled entity in a company's shares does not contravene s259C(1). We propose, therefore, in determining the 5% limitation to include those of the company shares which its controlled entities have the power to control voting or disposal of. This proposed formulation is based on s30 and s31 and will:

(a) Include derivatives where a controlled entity is given voting power in relation to the underlying shares.

(b) Exclude an acquisition of the company's shares in a fund which is managed by a person independent of the company and its controlled entities and where neither the company nor its controlled entities control or influence the decision making processes in the fund.

18. We are initially of the view that if there is a 5% limit on the amount of indirect self investment, the risk of a company's controlled entities attempting to frustrate a takeover bid is sufficiently small that a condition to minimise this risk is not necessary. Depending on the way a takeover offer is drafted, either s32 or s33 may operate to give the bidder an entitlement to the controlled entities' shares in the target company once it has either a controlling interest or the power to vote 20% of the target's shares.

Prudential conditions

19. At this stage we do not propose that relief be subject to any prudential conditions. The majority of funds which are likely to require s259C(2) relief are subject to separate prudential requirements:

(a) In relation to statutory funds of a life insurance company, s43 of the *Life Insurance Act* 1995 states that a statutory fund of a life insurance company is only allowed to invest 2.5% of the assets of the fund in listed companies which are related to the life insurance company.

(b) In relation to public offer superannuation funds, Regulations 13.17A and 13.17AA of the *Superannuation Industry (Supervision) Regulations* determine the extent to which those funds can be invested in a related body corporate of the trustee.

(c) In relation to regulated superannuation funds generally:

(i) The in-house asset rules, in s69 to s85 of the *Superannuation Industry (Supervision) Act 1993*, determine the extent to which a fund can invest in a standard employee sponsor or an associate of a standard employee sponsor.

(ii) Regulation 13.77AA of the *Superannuation Industry (Supervision) Regulations* determine the extent to which a fund can invest in a related body corporate which is a ADI, an approved non-ADI financial institution or a life insurance company (the terms "ADI" and "an approved non-ADI financial institution" are defined in s10(1) of the *Superannuation Industry (Supervision) Act 1993*).

20. We recognise that where a fund is not already subject to any specific prudential requirements relating to indirect self acquisition, such as registered managed investment schemes, there is a risk of a conflict of interest which may arise in investing in the company's shares. Acquisitions of the company's shares by these funds, however, will not always be caught by s259C(2). In addition, these funds will have compliance plans and their responsible entities owe fiduciary duties to the investors. The risk of a conflict of interest in those cases is sufficiently small so as to not justify any prudential conditions.

Conditions relating to preferential treatment

21. There is a risk that self investment may lead to a controlled entity being preferred in any issue of securities. We therefore propose to provide relief on condition that a controlled entity may acquire company shares by way of new issue only if it satisfies one of the following exceptions in ASX Listing Rule 7.2:

(a) participation in a pro rata issue;

(b) the issue of shares pursuant to a takeover offer;

(c) an issue under a dividend reinvestment plan; or

(d) the issue on the conversion of convertible securities which were issued in one of the circumstances outlined in paragraphs (a) to (c).

22. We also propose relief will be on the condition that all purchases of the company's shares must be made either on market or as a result of a transaction between controlled entities. Transactions between controlled entities would be subject to the related party transactions provisions (Chapter 2E and Part 5C.7).

23. The conditions relating to preferential treatment will only apply to those shares which, but for the operation of a s259C(2) exemption, would contravene s259C.

Conditions relating to trading and disclosure

24. We are concerned about the possible risk of insider trading and market manipulation which may occur in allowing indirect self acquisition.

25. In relation to minimising the risk of insider trading, disclosure of trading would:

(a) provide information to the market on trading by controlled entities; and

(b) discourage controlled entities from trading while in possession of inside information.

26. We note that disclosure of trading has been an aspect of applicable regulation in the following situations:

(a) Next day disclosure of on market buy-backs under ASX Listing Rule 3.5. Buy-backs are an exception to the rule against direct self acquisition.

(b) Disclosure of trading by directors within 14 days after the transaction under s235. Trading by directors involves similar policy issues to indirect self acquisition.

27. The examples referred to in paragraphs 26(a) and 26(b), however, are not directly analogous to indirect self acquisition by financial institutions, if adequate confidentiality measures are in place. In that case the funds managers of controlled entities may be less likely to receive price sensitive information about the company's shares than the company itself and its directors. The risk, however, is still present and is greater where the funds management arm contributes a large percentage to group profits.

28. At this stage we propose that relief be conditional on public disclosure by the company, of its shares in aggregate which its controlled entities have the power to control voting and disposal over, every 14 days from the time of the last disclosure. Relief will also be conditional on disclosure within one business day of any changes in that percentage of 1% or more from the time of the last

disclosure. It is anticipated that disclosure will normally be to the ASX for release to its stock market.

29. This disclosure requirement is:

(a) Similar to substantial shareholding disclosure except that it excludes those shares which the controlled entities do not have the power to control voting or disposal and it has no 5% threshold

(b) The same as the percentage calculation in paragraph 3 of the Policy Proposals, with the exception that in this case we intend to include all derivatives over the company's shares. It would be anomalous to exclude derivatives in this case, since it is possible for insider trading and market manipulation to occur in relation to derivatives.

30. We also propose that relief be conditional on the company keeping records of trading by its controlled entities in the company's shares and derivatives over company shares (for a period of one year after trading has occurred). These records will be required to be open for inspection by the relevant securities or futures exchange and ASIC during business hours. This will assist the relevant securities or futures exchange and ASIC in determining whether a contravention of the insider trading provisions or the market manipulation provisions has occurred.

31. In considering possible conditions to reduce the risk of market manipulation, we considered Regulation 240.10b-18 of the Securities Exchange Act 1934 (US). This regulation provides a safe harbour from the US prohibitions relating to market manipulation for companies acquiring their own shares, subject to the following restrictions:

(a) on any given business day, a company's purchases of its shares must be made through one broker;

(b) any purchases by a company in its shares must not be the reported opening transaction in its shares;

(c) any purchases by a company in its shares must not occur during the last half hour before the close of trading on the relevant stock exchange;

(d) a market bid on behalf of a company in its shares must not exceed the highest recorded independent bid or the last recorded sale price, whichever is the higher; and

(e) on any given business day, the number of company's shares purchased through trading on a relevant stock exchange must not exceed 25% of the average daily trading volume for the four calendar weeks preceding the week during which the purchases were made.

32. Retaining trading records, which are open for inspection by the relevant securities or futures exchange and ASIC, will assist in the detection of any market manipulation. At this stage we are of the view that trading restrictions, of a nature similar to those required by Regulation 240.10b-18, are not necessary.

Relief to invest in independent managed investment schemes

33. It is possible that an investment by a controlled entity in an independent managed investment scheme which in turn invests in the company's shares may be prohibited under s259C. This is because it is arguable whether the controlled entity has acquired units of shares.

34. We are of the view that this would be an unintended application of the legislation. We are prepared, therefore, to give relief to companies where their controlled entities invest in completely independent prescribed interest or managed investment schemes. Relief will only be given so long as the scheme is not a controlled entity itself and neither the company nor its controlled entities influence the decision making of the scheme, other than voting their units in a meeting of unitholders.

Regulatory and financial impact

Issue

1. As stated in paragraph 11 of the Explanation, the Explanatory Memorandum to the Company Law Review Bill 1997 states that it is anticipated that ASIC would give relief from the indirect self acquisition provisions "to exempt investments by a statutory fund of a life insurance company in its holding company."

2. There are instances where controlled entities are precluded, absent s259C(2) relief, from purchasing the company's shares to hold for investors. Where the company represents a large proportion of an index, such as the All Ordinaries Index, the controlled entities of the company may be at a significant commercial disadvantage if they are precluded from investing in the company's shares. This is particularly the case where the controlled entity is managing a fund which seeks to mirror the index.

Objective

3. The objective is to allow controlled entities of financial institutions to acquire the holding company's shares for investors, while minimising the risks associated with indirect self investment (referred to in paragraph 1 of the Policy Proposals).

Options

4. The options we have considered in formulating conditions for relief are referred to in the Policy Proposals and the Explanation.

Impact Analysis (costs and benefits)

General

5. We anticipate that providing relief to controlled entities to use investors' funds to purchase the company's shares will provide benefits to those controlled entities. It will give them the flexibility

to invest in their controlling company, which has the potential to enhance returns for investors. It also has the potential to enhance the competitiveness of a company's controlled entities.

6. The potential cost of granting relief without conditions would be that indirect self acquisition by these entities might increase the risk of:

(a) Possible discrimination against shareholders and improper attempts to secure and consolidate corporate control. This may lead to a decrease in shareholder wealth and a lack of confidence in the company by the market.

(b) Insider trading and market manipulation which may create a lack of confidence in the market generally.

7. We acknowledge that most financial institutions have proceedures in place to handle information transfer between various controlled entities and the controlled entities treat their fiduciary and other duties seriously. However, we regard the potential costs associated with the risks referred to in paragraphs 6(a) and (b) occurred to be so great as to justify conditions designed to ameliorate these risks.

8. The risks of price opacity and increasing the possibility of corporate failure would be greater if controlled entities were allowed to invest their own funds in the company's shares. At this stage we do not propose to grant relief in such instances.

Condition Prohibiting Voting

9. The condition that controlled entities not vote the company's shares which they hold may make their funds less attractive to investors on the grounds that the right to vote a share has an economic value. We consider, however, that as the company's shares are only going to constitute a portion of any controlled entity's fund, the actual economic cost of this condition should be minimal.

10. As stated in paragraph 15 of the Explanation, we consider that the costs which may be incurred through the improper exercise of control are such as not to justify allowing a controlled entity to vote the company's shares following the recommendation of an independent adviser.

5% limit

11. We recognise that limiting the company's controlled entities to acquire no more than 5% of the company's shares in aggregate may limit some large institutions from reaping the full advantages of s259C(2) relief. At this stage, however, we are of the view that the

potential effect on the voting power of other shareholders would be effected in a material way if this percentage was increased.

Prudential conditions

12. We are intending at this stage not to impose any prudential conditions (see paragraphs 19 and 20 of the Explanation).

Conditions relating to preferential treatment

13. We consider the costs involved in prohibiting off market transactions between controlled entities and outsiders, in relation to the company's shares, to be minimal. Trading on market provides a certain level of transparency which reduces the risk of discrimination between shareholders.

14. We also consider that limiting controlled entities' ability to subcribe for shares, to situations where all shareholders are likely to benefit, will not impose significant costs on controlled entities.

Conditions relating to trading and disclosure

15. We recognise that disclosure of trading undertaken by controlled entities in the company's shares (see paragraph 7A of the Issues for Consideration) may result in costs to these entities. For example:

(a) It may take a controlled entity time to reach a desired position in the company's shares. By disclosing trading, the controlled entity may signal to the market its future intentions relating to the company's shares. Market participants could potentially arbitrage on that information to the detriment of the controlled entity.

(b) It has been argued that market participants may be able to use pattern recognition software to uncover information about the controlled entities' funds and arbitrage on that information.

(c) Disclosing trading might be extensive and costly.

16. There is, however, a risk that insider trading may occur. Insider trading would undermine market confidence. We are of the view that some disclosure of holdings in the company's shares by controlled entities is necessary. Disclosure of the percentage of a company's shares, which its controlled entities have the power to control voting or disposal over, will still provide useful information to the market, while minimising the potential costs described in paragraph 15.

17. Specific trading restrictions (as described in paragraph 31 of the Explanation) would involve compliance costs. They would also limit the ability of controlled entities to trade when they wanted to which would involve opportunity costs. At this stage we are not considering requiring conditions relating to trading.

18. There will be compliance costs in keeping trading records. We believe, however, that it is likely that these compliance costs will be less than the opportunity costs and compliance costs which would be associated with specific trading restrictions.

Relief for investments in managed investment schemes

19. This relief is effectively comfort relief. It will increase certainty for investment funds. The risks of inappropriate exercise of control is minimised by ensuring that the managed investment scheme is independent. We would interested in your views as to whether there are any significant risks involved in providing relief in this situation.

Consultation

20. ASIC has engaged in significant preliminary consultation with the financial institutions which are most likely to be materially affected by these policy proposals. ASIC's main consultation process consists in the distribution of this Policy Proposal Paper for public comment.

Conclusion

21. At this stage we favour the conditions referred to in the Policy Proposals as the most appropriate balance between minimising the risks of indirect self acquisition through the imposition of conditions and the costs involved in imposing those conditions. You are invited to make submissions on these Policy Proposals, the Issues for Consideration and the issues raised in this section.

Development of policy proposal

1. There has been preliminary consultation with major financial institutions.

2. On 25 June 1998, we sent out letters seeking preliminary submissions from five major financial institutions. A standard copy of this letter can be provided upon request. We received replies from all of those institutions.

3. It is anticipated that interim relief will be given to applicants during the policy formation process. Such interim relief will cease once our policy has been settled.

Key terms

In this policy proposal:

"company" means the company for the purposes of s259C(1);

"controlled entity" means an entity controlled by the company, as defined in s259E;

"derivatives" includes warrants, exchange traded options, swap transactions and other futures contracts which have the company's shares as the underlying security;

"Law" refers to the Corporations Law;

"s259C(2)" (for example) is to a section of the Corporations Law.

What will happen next?

Stage 1

19 October 1998	ASIC policy proposal paper released.

Stage 2

18 December 1998	Comments due on the policy proposal
18 December 1998 to 29 January 1999	Drafting of policy statement

Stage 3

29 January 1999	Policy released

Your comments

We invite your comments on the *proposals and issues for consideration* in this paper.

Comments are due by Friday 19 December 1998 and should be sent to:

Allan Bulman
Senior Lawyer
Regulatory Policy Branch
National Office, Melbourne
Australian Securities & Investments Commission
GPO Box 5179AA
Melbourne, Victoria, 3001
Facsimile (03) 9280 3339

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.