ASIC
Australian Securities & Investments Commission

CONSULTATION PAPER 188

Managed investments: Constitutions—Updates to RG 134

September 2012

About this paper

This consultation paper sets out ASIC's proposals for updating our guidance in Regulatory Guide 134 *Managed investments: Constitutions* (RG 134) on the constitutional content requirements of a registered managed investment scheme in s601GA and 601GB of the Corporations Act, and seeks your feedback on the proposals.

We seek feedback on our proposals from responsible entities, their advisers, industry associations, financial consumer and investor advocacy groups, and any other interested parties.

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 September 2012 and is based on the Corporations Act as at the date of issue.

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.

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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 guidance on the constitutional content requirements of registered schemes. 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 Regulation Impact Statement: see Section K, '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 13 November 2012 to:

Michelle Reid
Senior Manager
Investment Managers and Superannuation
Australian Securities and Investments Commission
GPO Box 9827
Melbourne VIC 3001
email: policy.submissions@asic.gov.au

What will happen next?

Stage 1	18 September 2012	ASIC consultation paper released
Stage 2	13 November 2012	Comments due on the consultation paper
Stage 3	March 2013	Updated regulatory guide released

A Background to the proposals

Key points

Sections 601GA and 601GB of the *Corporations Act 2001* (Corporations Act) require that a constitution of a registered managed investment scheme contain certain provisions.

We believe the guidance in Regulatory Guide 134 *Managed investments: Constitutions* (RG 134) should specifically give our view on the requirements in s601GA and 601GB of the Corporations Act, and how we apply them in deciding whether to register a managed investment scheme. We do not intend to give guidance about what might constitute good practice for other types of constitutional provisions.

We want to ensure that responsible entities and their advisers have sufficient certainty about what we will look for in reviewing a constitution when we decide whether to register a managed investment scheme.

We are aiming to improve the efficiency and user friendliness of the process to register a managed investment scheme. The proposals in this consultation paper are the first stage in a project to do this.

We may apply our policy in RG 134 to matters that arise after a managed investment scheme is registered.

Underlying principles

1 A constitution of a managed investment scheme is a document that is legally enforceable between the responsible entity and the members that sets out some or all of the rights, duties and liabilities of the responsible entity in its operation of the scheme.

2 Under s601GA of the Corporations Act, the constitution of a registered managed investment scheme must make adequate provision for, or specify, certain prescribed matters. These include:

(a) the consideration to acquire and dispose of an interest in the managed investment scheme;

(b) the powers of the responsible entity in making investments, borrowing or dealing with scheme property;

(c) the method for dealing with complaints about the managed investment scheme;

(d) winding up the managed investment scheme;

(e) the rights of the responsible entity to be paid fees or be indemnified out of scheme property; and

(f) any rights of members to withdraw from the managed investment scheme.

3 Under s601GB of the Corporations Act, the constitution of a registered managed investment scheme must also be a document that is legally enforceable between the members and the responsible entity of the scheme.

Note: In this paper, references to sections (s), Parts (Pts) or Chapters (Chs) are references to the Corporations Act.

4 Currently, Regulatory Guide 134 *Managed investments: Constitutions* (RG 134) provides guidance that is designed to assist directors of responsible entities to prepare and lodge a constitution for a managed investment scheme that complies with the Corporations Act and enables them to meet their obligations under s601EA(4)(c)(i) in providing a signed statement that the constitution complies with s601GA and 601GB.

5 RG 134 was released in 1998 and was last updated in 2000, when the managed investments regime was in its infancy. Since then, the managed investments industry has seen significant evolution. In light of this, we consider it important to review and update our guidance in RG 134.

Registering a managed investment scheme

6 To register a managed investment scheme with ASIC, an applicant must be a public company that holds an Australian financial services (AFS) licence that authorises them to operate the scheme. The applicant can lodge the application electronically or 'over the counter'. The application must meet the requirements of s601EA, by including:

(a) an application form, which states the name and address of the proposed responsible entity and the person who has consented to be the auditor of the compliance plan (Form 5100);

(b) a constitution that meets the requirements in s601GA and 601GB, which we assess under our policy in RG 134;

(c) a compliance plan that meets the requirements in s601HA, which we assess under our policy in Regulatory Guide 132 *Managed investments: Compliance plans* (RG 132); and

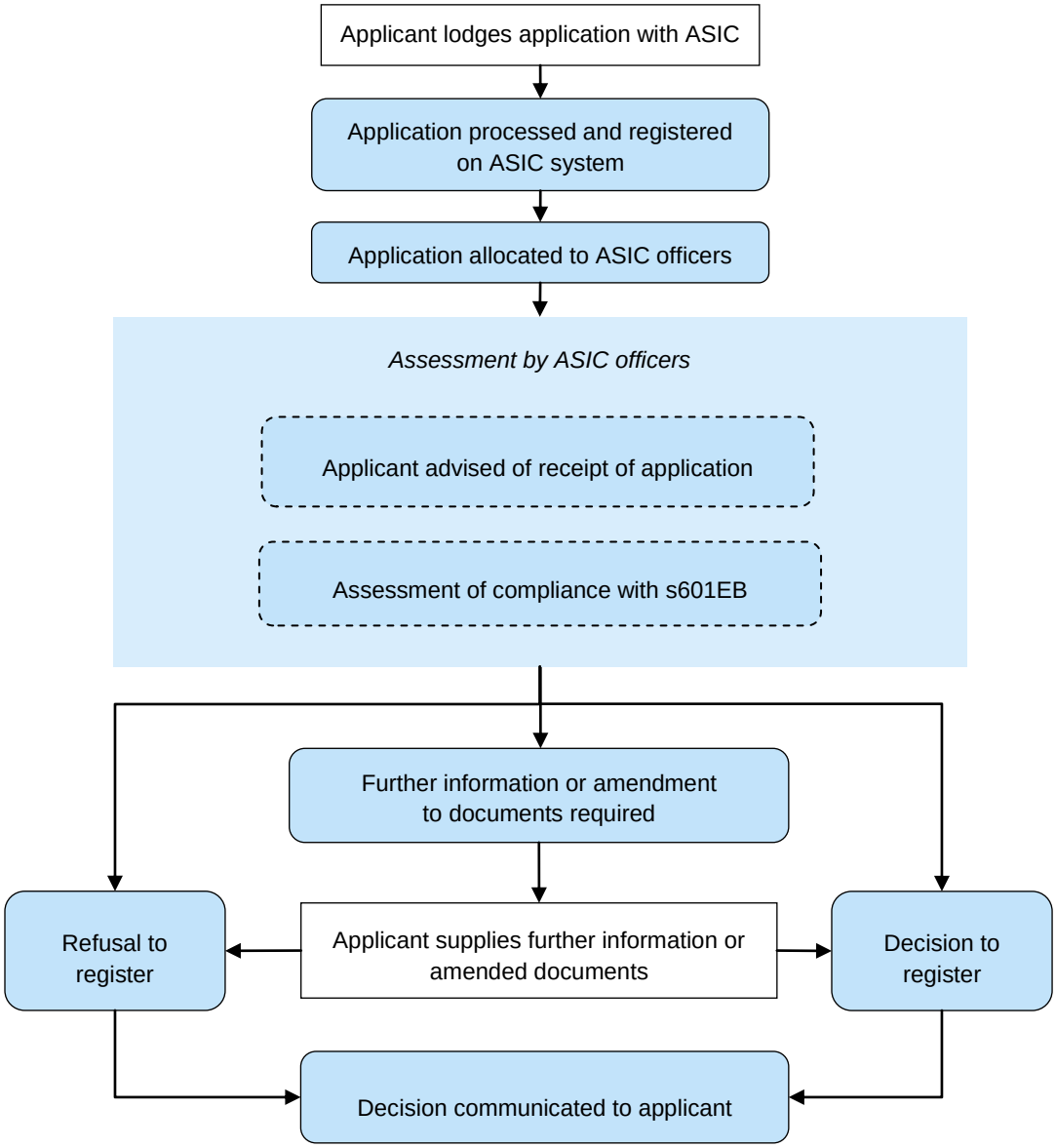
(d) a statement by the directors that requires them to certify that the application complies with s601EB (Form 5103).

7 There is no prescribed form for the constitution or the compliance plan. However, the application must state which provisions of the constitution address the matters in s601GA and 601GB. Ordinarily, we will only consider these provisions when registering the managed investment scheme, and other provisions that appear related.

8 When an application to register a managed investment scheme is lodged with us, we must assess whether it meets the requirements of s601EB. We must register the managed investment scheme within 14 days unless it appears to us that the application does not meet one or more of the requirements in s601EB.

9 The process that we undertake to assess an application to register a managed investment scheme is set out in Figure 1.

Figure 1: Assessing an application to register a managed investment scheme



Note: Applicants may choose to withdraw their application at any stage of the process.

10 Based on the time recording that we undertook, it takes us between 2.3 and 20.77 hours (with an average of approximately 11 hours) to assess an application to register a managed investment scheme.

11 We have received feedback from industry about the efficiency and effectiveness of the process of registering a managed investment scheme.

12 Key themes that emerged were that:

(a) there was a need to update our guidance in RG 134;

(b) it was difficult to achieve certainty that we would register a managed investment scheme by simply applying our guidance in RG 132 and RG 134;

(c) our policy in relation to pricing in Class Order [CO 05/26] *Constitutional provisions about the consideration to acquire interests* was too complex and duplicated many existing legal requirements;

(d) there was a need for 'real-time' information about the issues we find with constitutions and compliance plans; and

(e) it was difficult to amend a constitution or compliance plan late into the 14-day registration period.

13 Following our time recording and industry feedback, we are looking to improve the efficiency and user friendliness of the process to register a managed investment scheme. Our proposals in this consultation paper are the first stage of a project to do this. The next stages of our project will involve:

(a) changes to the online process for an applicant to lodge an application to register a managed investment scheme;

(b) a review of our policy in RG 132; and

(c) a review of the internal process we undertake when assessing an application to register a managed investment scheme.

Our objectives and proposals

14 In developing our proposals, we want to ensure that responsible entities and their advisers have sufficient certainty about what we will look for in reviewing a constitution when we assess whether to register a managed investment scheme under s601EB.

15 We propose that our guidance in RG 134 will specifically give our view on the requirements in s601GA and 601GB, and how we apply them in deciding to register a managed investment scheme. We do not intend to give guidance about what might constitute good practice for other types of constitutional provisions. However, our guidance can also be taken as reflecting what we consider the constitution of a registered managed investment scheme can

contain. We may take action to enforce compliance in circumstances that arise after a scheme is registered.

16 Our proposals on the content requirements for the constitution of a managed investment scheme are set out in Table 1.

Table 1: Proposals to update RG 134—Constitutional content requirements for managed investment schemes

Constitution content	Proposals
Consideration to acquire: Section C	A 'safe harbour' should be created to assist compliance with the 'adequate provision' requirement. The consideration for unlisted managed investment schemes (including schemes traded on the AQUA market of ASX) should be based on the value of the scheme assets less any liabilities payable out of scheme property. The consideration for listed managed investment schemes should be referrable to market price. There should be a focus on mechanisms to prevent dilution and unfairness for members. Conditions for consideration to acquire interests from placements, rights issues and dividend reinvestment plans should be removed where other protections already exist. Conditions for consideration to acquire interests should be removed where fees are negotiated and existing policy is complied with. The responsible entity should be able to apportion the consideration between the component parts of a stapled security.
Powers of the responsible entity: Section D	The responsible entity can determine the level of detail to include in the constitution about its powers to deal with scheme property.
Complaints: Section E	The constitution can refer to the dispute resolution requirements for AFS licensees applicable to retail clients. The constitution should also provide for the essential elements of how complaints by wholesale clients are to be dealt with.
Winding up a scheme: Section F	The constitution should address: • the identification of the assets of the managed investment scheme; • distribution of the net proceeds of realisation of the managed investment scheme; • identification of how the costs of the winding up will be paid; • any ability for members to continue to make payments to maximise the realisation proceeds; and • how winding up will occur if the responsible entity is insolvent and/or there are insufficient assets to indemnify the responsible entity for the winding-up costs. The constitution should include provision for an independent audit of the managed investment scheme accounts on completion of the winding up. The constitution can include a provision permitting a responsible entity to postpone the realisation of the assets of the managed investment scheme on winding up.

Constitution content	Proposals
Payment of fees and rights of indemnity: Section G	Fixed fees are not necessary. A maximum fee or a performance fee based on a benchmark can be set out in the constitution. All the variables in calculating a fee should be set out in the constitutional provision. A right to payment of a fee or expense should not accrue before the responsible entity assumes its role or performs the duty to which the fee relates.
Withdrawal rights: Section H	The constitution should address: • the method and criteria for exercising a right to withdraw; • the consideration received by members to satisfy withdrawal requests; • any restrictions on satisfying withdrawal requests; and • when a member ceases to be a member in relation to the interests that are the subject of the withdrawal request. If there is a right to withdraw while a managed investment scheme is non-liquid, the constitution should state that withdrawals will be made in accordance with Pt 5C.6 of the Corporations Act and the constitution should not permit requests to be made other than in response to a specific withdrawal offer. The withdrawal price should generally be calculated on the basis of reasonable and current market valuations of scheme property. In-specie payments to satisfy withdrawal requests should not unreasonably disadvantage members, and assets transferred should be based on reasonable and current valuations. A power to suspend or delay payment, and the circumstances in which such power may be exercised, should be stated expressly in the constitution. If a member's interests are treated as withdrawn, payment to the member for the withdrawal should be satisfied within a certain and reasonable timeframe.
Extrinsic material: Section I	The constitution should not include provisions that make the terms of the constitution subject to another document other than an Act of Parliament, or regulations or instruments made under an Act. Class Order [CO 98/1808] *Allowing constitutions to use Appendix 15A of the ASX Listing Rules* should be continued.
Legal enforceability: Section J	The constitution should be a document that is validly executed by the responsible entity. The constitution should be expressed to be binding between the proposed responsible entity and all members of the managed investment scheme. We encourage a responsible entity to include a compliance clause in the constitution that will sever any constitutional provisions that are inconsistent with the Corporations Act.

B Implementation of our guidance

Key points

We propose to adopt one of two options in drafting the updated RG 134.

We do not propose to include in RG 134 examples of constitutional provisions that we believe will meet our guidance.

For all managed investment schemes seeking registration with us, we propose a commencement date of 1 May 2013.

For existing registered managed investment schemes, we propose that:

- for amendments that can be made unilaterally by the responsible entity, we expect that constitutions will comply by the next date any other unilateral amendment of the constitution is made on or after 1 May 2013; and
- for other amendments that require member approval, constitutions will comply by the next date a members' meeting is held.

Proposal

Proposal

B1 We propose to adopt one of the following options in drafting the updated RG 134:

Option 1

RG 134 will generally express our views on how we believe a constitution can meet s601GA and 601GB that we will apply when assessing whether a managed investment scheme should be registered, but will leave open that there may be other ways for the constitution to comply.

Option 2

Except for our proposals on issue and withdrawal price, RG 134 will generally provide guidance on when we will object to a constitutional provision involving s601GA and 601GB in our assessment of whether a managed investment scheme should be registered.

We do not propose to include in RG 134 examples of constitutional provisions that we believe will meet our guidance.

For all managed investment schemes seeking registration with us, we propose a commencement date of 1 May 2013.

For managed investment schemes that are already registered with us, we encourage compliance:

(a) if the responsible entity forms the view that the amendments can be made unilaterally, by the next date any other unilateral amendment of the constitution is made on or after 1 May 2013; and

(b) if the responsible entity forms the view that member approval is required to approve the amendments, by the next date a members' meeting is held.

Your feedback

B1Q1 Which of Options 1 or 2 is preferable? Please explain why.

B1Q2 If Option 1 is preferable, are there any particular content requirements where it might be desirable for RG 134 to adopt a different approach? Please provide details.

B1Q3 If Option 2 is preferable, are there any particular content requirements where it might be desirable for RG 134 to adopt a different approach? Please provide details.

B1Q4 Should our guidance include examples of constitutional provisions that we believe will meet our guidance? If so, please provide details on the examples you would find useful.

B1Q5 Do you agree with the proposed timetable for implementation? If not, please explain why and whether there is a more suitable timeframe.

B1Q6 Is there any date other than a members' meeting that might be more appropriate to make amendments to the constitution where member approval is required?

B1Q7 Are there likely to be any practical problems in meeting this timetable? If so, please provide details.

B1Q8 Should we expect all constitutions to be consistent with our proposed guidance? Please give the following details associated with implementing a requirement that all existing constitutions meet our proposed guidance:

(a) any additional costs; and

(b) practical or legal problems.

B1Q9 If we require all constitutions to be consistent with our proposed guidance, should we require compliance by 1 May 2013? Would any extension of the implementation date be required? If so, please explain why.

B1Q10 If we require all constitutions to be consistent with our guidance by a specified date, should we consider taking a no-action position or granting relief on application for those responsible entities who cannot comply because they need to obtain member approval? Furthermore, how long should the no-action position last?

B1Q11 Do you think that amendments to the constitution (if any) to comply with our guidance are likely to require member approval? If so, please give details of which amendments might require member approval.

Rationale

17 In our view, the advantage of Option 1 in expressing how we believe a constitution can meet s601GA and 601GB is that it provides certainty about what we will accept. However, we recognise that responsible entities and their advisers may instead want the certainty provided by Option 2 about when we will object to a constitutional provision. This option would also assist us in promoting what we believe are adequate standards of compliance.

18 At this stage, we do not propose that RG 134 will contain specific examples of constitutional provisions that will meet our guidance. This is because, when we have previously done this, we have observed industry's practice of unnecessarily adopting these examples. We think it is important for responsible entities and their advisers to develop constitutional provisions that actually reflect the structure of the managed investment scheme.

19 We understand that there may be implications for responsible entities of existing registered managed investment schemes in seeking to amend their constitutions to comply with our guidance, including whether this could constitute trust resettlement and whether it is in the best interests of members. However, we also consider this should be weighed against the desirability of having all registered managed investment schemes consistently complying with our guidance.

20 Some modifications to a constitution can be made unilaterally by the responsible entity, and others that adversely affect members' rights require member approval. Depending on the amendments that a responsible entity of a registered managed investment scheme may wish to make, it will need to form a view about whether these can be made unilaterally.

21 If a responsible entity considers that the amendments can be made unilaterally, we think that earlier compliance with our guidance may be possible. However, if the responsible entity considers that the amendments require member approval, we recognise that our expectations for timely compliance need to be tempered with the costs and burden associated with holding a members' meeting. This is why we propose that we would take a measured approach if the responsible entity defers any of these amendments until a members' meeting is held and members approve the amendments.

22 A responsible entity has a continuing obligation to ensure that the constitution complies with s601GA and 601GB under s601FC(1)(f). Under s601FD(1)(f)(i), officers of the responsible entity have a duty to do what a

reasonable person in the officer's position would do to ensure that the responsible entity complies with s601GA and 601GB.

23 In addition, it is an offence under s1308(4) to lodge a statement with ASIC (e.g. a directors' certification) that is false or misleading in a material particular, or has an omission that makes it misleading in a material respect, without having taken reasonable steps to ensure that the document is not false or misleading in a material particular. Specifically, this is relevant to the certifications made by directors in relation to an application for registration of a managed investment scheme. In our view, the directors should not provide a certification of compliance on an assumption that if we consider the constitution does not comply with s601GA, 601GB and 601HA, we will require it to be altered.

C Consideration to acquire

Key points

We propose to revoke [CO 05/26] and create a 'safe harbour', on which responsible entities can rely to meet the requirement that the constitution of a managed investment scheme make adequate provision for the consideration to acquire an interest in the scheme.

We encourage any responsible entity who does not wish to rely on the 'safe harbour' to provide us with a draft of the relevant constitutional provisions before lodging an application to register the managed investment scheme.

We also propose that:

- the responsible entity of an unlisted managed investment scheme (including those quoted on the AQUA market of ASX) should set the consideration to acquire an interest in the scheme based on the value of scheme assets less liabilities;
- the responsible entity of a listed managed investment scheme should set the consideration to acquire an interest in the scheme based on market price;
- the 'safe harbour' should not restrict an interest being acquired by a responsible entity or its associates under a placement or rights issue;
- certain protections for members, which already exist, may not need to be duplicated in the 'safe harbour' for rights issues and dividend reinvestment plans; and
- a responsible entity should be able to apportion the consideration to acquire an interest in a scheme (where the scheme forms part of a stapled security) between the component parts of that stapled security.

Underlying principles

24 Section 601GA(1)(a) of the Corporations Act requires that the constitution of a managed investment scheme must make adequate provision for the consideration that is to be paid to acquire an interest in the scheme.

25 The policy underlying this requirement is to ensure that members have rights about the consideration to acquire an interest in the managed investment scheme because this consideration may affect the value of other members' interests. We also consider that the responsible entity may be subject to a conflict between its interest in further issues, which may increase its remuneration and may be promoted by offering interests at a discount, and the interests of members, which may be to avoid dilution of the value of their interests.

26 Generally, pricing for unlisted managed investment schemes will be based on a calculation that uses the value of scheme property. We believe that it is important in satisfying s601GA(1)(a) to make clear the way in which the scheme property would be valued. We note that, in this way, s601GA(1)(a) is consistent with International Organization of Securities Commissions (IOSCO) principles, which provide that regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing associated with interests in collective investment schemes.

27 Section 601GA(4) provides that, if members are to have a right to withdraw from a managed investment scheme, the constitution must specify that right and set out adequate procedures for making and dealing with withdrawal requests in a way that is fair to all members.

28 The Explanatory Memorandum to the Managed Investments Bill 1997 states that, where members have rights to withdraw from a managed investment scheme, the constitution must address the method for calculating the withdrawal value of the members' interests.

> Note: This section only sets out ASIC's view on the method for calculating the withdrawal value of members' interests. For more information on the other aspects of withdrawal, see Section H.

'Safe harbour'

Proposal

C1 We propose to create a 'safe harbour' on which responsible entities can rely to meet the requirement that a constitution make adequate provision for the consideration to acquire an interest in a managed investment scheme.

C2 We propose that responsible entities can choose either:

(a) to rely on the 'safe harbour' by including constitutional provisions that meet its requirements; or

(b) for the constitution to make adequate provision for the consideration to acquire an interest in the managed investment scheme in another way that does not meet all of the requirements of the 'safe harbour'.

C3 We propose to apply greater scrutiny to constitutional provisions that do not meet all of the requirements of the 'safe harbour' when assessing an application to register a managed investment scheme to determine whether the provisions are adequate in light of the policy that s601GA(1)(a) is intended to effect.

C4 We propose that the 'safe harbour' will be implemented by way of an ASIC class order that will modify s601GA(1)(a) so that a responsible entity or its nominee can set the consideration to acquire an interest:

(a) in an unlisted unitised managed investment scheme (including schemes that have interests traded on the AQUA market of ASX), if it takes into account the value of scheme assets and complies with certain documentation and reporting requirements;

(b) in a listed managed investment scheme, if it takes into account the market price and complies with certain documentation and reporting requirements;

(c) issued under a placement;

(d) issued under a rights issue;

(e) issued under a distribution reinvestment plan;

(f) in a differential fee arrangement with a wholesale client;

(g) issued under an interest purchase plan;

(h) when interests are forfeited; and

(i) as part of a stapled security.

C5 We propose that the 'safe harbour' will also modify s601GAB(4) so that it is clear that a responsible entity or its nominee is able to exercise a discretion to decide on an aspect of the formula used to calculate the withdrawal amount.

C6 We propose that the constitution can include provisions to the effect that the terms of the 'safe harbour' are automatically included in it.

Your feedback

C6Q1 Do you agree with these proposals? If not, why not?

C6Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C6Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C6Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

C6Q5 Do you think that many responsible entities and their advisers will decide not to rely on the 'safe harbour' and take up the opportunity to provide us with a draft of the relevant constitutional provisions before lodging an application to register the managed investment scheme?

Rationale

29 Because s601GA is principles based, differing views exist about the exact content that is required for a constitution to make adequate provision for the consideration that is required to be paid to acquire an interest in a managed investment scheme.

30 We believe that what constitutes 'adequate provision' will depend on the circumstances surrounding the managed investment scheme.

31 We acknowledge that responsible entities and their advisers might face uncertainty about whether a constitution makes adequate provision for the consideration to acquire an interest in a managed investment scheme. This might create an unnecessary layer of complexity for a responsible entity—in particular, when seeking to register managed investment schemes with us—and might also prevent it from being able to take its product to market quickly.

32 To minimise this uncertainty, we propose to create a 'safe harbour' on which responsible entities can choose to rely to ensure that a constitution makes adequate provision for the consideration to acquire an interest in a managed investment scheme when seeking to register a scheme.

33 In creating the 'safe harbour', we are aiming to ensure that the consideration to acquire an interest in a managed investment scheme will be based on the concepts of equity and fairness. In particular, we want to ensure that unfair economic dilution of members' interests in the scheme is prevented.

34 We propose that responsible entities can choose either:

(a) to rely on the 'safe harbour' by including constitutional provisions that meet its requirements; or

(b) for the constitution to make adequate provision for the consideration to acquire an interest in the managed investment scheme in another way that does not meet all of the requirements of the 'safe harbour'.

35 We propose to pay greater attention to constitutions that do not meet all of the requirements of the 'safe harbour', including when assessing an application for registration of a managed investment scheme.

36 We will refuse to register a managed investment scheme if it appears to us that the constitution does not provide adequate provision for the consideration to acquire an interest in the scheme.

37 We must register a managed investment scheme within 14 days of lodgement unless it appears to us that one or more of the criteria in s601EB are not met. Given this timeframe, we encourage any responsible entity that does not propose to rely on the 'safe harbour' to provide us with a draft of the relevant constitutional provisions before lodging an application to register the managed investment scheme. This will assist us in reviewing the proposed constitutional provisions and liaising with the responsible entity about them.

How should consideration generally be calculated?

Proposal

C7 We propose that the 'safe harbour' will require that the constitution include a provision that the consideration to acquire an interest in an unlisted managed investment scheme (including schemes that have interests quoted on the AQUA market of ASX), where each member has a proportionate interest in that scheme, will be based on:

(a) the value of the scheme assets less any liabilities under the constitution that may be met from scheme property (this includes making allowances, such as for transaction costs); or

(b) where there are different prices for interests of different classes, the value of the scheme assets properly attributable to a class of interests in the scheme less any liabilities properly attributable to interests of that class under the constitution that may be met from scheme property.

C8 We propose that the 'safe harbour' will require that the constitution include a provision that the consideration to acquire an interest in a managed investment scheme that is to be listed be determined by reference to market price.

C9 We do not propose that the 'safe harbour' will include managed investment schemes where members do not have a proportionate interest in the scheme, but rather use their contributions in a common enterprise.

C10 We do not propose that the 'safe harbour' will include managed investment schemes that have fixed price consideration.

C11 We propose that the 'safe harbour' will not include s601GAA(7), as notionally inserted by [CO 05/26], in relation to the consideration for managed investment schemes where there is limited or no pooling.

Your feedback

C11Q1 Do you agree with these proposals? If not, why not?

C11Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C11Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C11Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

C11Q5 Are there any circumstances where common enterprise schemes might not use a fixed amount to calculate the issue price and withdrawal price? If so, please provide details.

C11Q6 Are there any situations that you consider will not fall within the terms of the 'safe harbour' that should be included? If so, please provide details.

C11Q7 Are there any circumstances where it may be appropriate for the 'safe harbour' to include provisions in relation to partly paid interests? If so, please provide details.

Rationale

Unlisted unitised managed investment schemes

38 We believe that the consideration to acquire an interest in the type of unlisted managed investment scheme where members have a proportionate interest in the scheme should be based on the value of the scheme assets less any liabilities.

39 We consider that the best available information to determine the value of interests is based on the value of scheme assets because it reflects the actual value of the assets that back each of the interests in the managed investment scheme.

40 We also consider that the consideration to acquire an interest in a managed investment scheme is 'based on' the value of scheme assets less liabilities if the amount produced by the formula substantially affects the pricing outcome, although it need not determine it.

> Note: For example, a provision in a constitution that gives the responsible entity discretion to determine which of the two formulas specified in the constitution (each of which is based on the value of scheme assets less liabilities of the interests) is to be used to set the issue price will be 'based on' the value of scheme assets less liabilities.

41 In particular, we understand that there can be material costs involved in the acquisition and/or disposal of scheme assets which may not necessarily be reflected in the valuation of these assets. These are often described as 'transaction costs'. These costs are additional to any fees that feed into the calculation of the net asset value. The types of costs that may be incurred in acquiring or disposing of scheme assets will depend on the types of assets held by the managed investment scheme.

42 We consider that the inclusion of transaction costs ensures that members who are not acquiring or disposing of interests at a particular time are not disadvantaged by the managed investment scheme bearing costs associated with the need to acquire and dispose of assets in order to satisfy such applications in the consideration. We believe the transaction costs added to calculate the price must be reasonably attributable to the acquisition or disposal of scheme assets.

> Note: A responsible entity has duties to act honestly and to act in the best interests of members. In our view, a responsible entity may not be complying with these duties if it attributes costs to the acquisition or disposal of scheme assets when there is no connection between those costs and the acquisition or disposal of those assets.

43 We understand the responsible entity may not always be able to include the actual costs associated with the acquisition and/or disposal of scheme assets. In these circumstances, we consider it acceptable for the constitution to permit the responsible entity to use an estimate of the acquisition or disposal costs to determine the transaction cost amount. If a responsible entity uses an estimate, we consider that the estimate should seek to provide equity and fairness among members.

> Note: If the responsible entity uses estimates, it should take into account its duties in s601FC.

44 We also recognise that a managed investment scheme may have one or more classes of interests on issue. If an unlisted managed investment scheme only has one class of interests on issue, we believe the consideration to acquire an interest in that scheme should be based on the value of the scheme assets less any liabilities under the constitution that may be met from scheme property. Alternatively, if an unlisted managed investment scheme has more than one class of interests on issue, the consideration to acquire an interest in that scheme may be based on the value of the assets of a class of the scheme less any liabilities attributable to that class under the constitution that may be met from scheme property.

45 We note that there may be some uncertainty about whether an option constitutes an interest in a managed investment scheme. To the extent that an option is an interest in a managed investment scheme, we propose that a responsible entity can set the issue price of options. We do not consider that issuing options, in itself, has the ability to dilute the interests of other members.

Managed investment schemes traded on the AQUA market

46 We believe that the consideration to acquire an interest in a managed investment scheme traded on the AQUA market should be based on the value of scheme assets less liabilities.

47 The AQUA market is a specialised market operated by ASX Limited for managed investment schemes, such as exchange-traded funds, where the underlying assets of these products are thought to comprise assets that have sufficient transparency to enable appropriate pricing during trading on ASX. These types of managed investment scheme have substantially continuous and uncapped facilities for issues and withdrawals, which are intended to ensure arbitrage opportunities to limit divergence between the market price and a price based on net asset value.

48 The value of an interest in this type of managed investment scheme does not generally depend on the management of the assets by the responsible entity, but rather on the value of the underlying assets where substantially continuous issue and withdrawal is available (e.g. on each business day

unless some particular circumstance warranting suspension arises). In these circumstances, we consider that the consideration to acquire an interest in this type of scheme is more accurately priced based on the value of scheme assets less liabilities rather than market price.

Listed managed investment schemes

49 We believe that the consideration to acquire an interest in a listed managed investment scheme should generally be determined by reference to the market price. This is because the market price generally better reflects the underlying value of the interests in the scheme. Market pricing is an independent pricing mechanism that regulates the depth of any discount and establishes an appropriate reference point for measuring it.

50 In our view, consideration to acquire an interest in a listed managed investment scheme that is based on net asset value has the potential to unfairly dilute existing members' interests, particularly if that price is lower than the market price. However, if that price is equal to or higher than the market value, using it will not dilute members' interests.

> Note: For example, a net asset value price might be appropriate when the market on which the managed investment scheme is traded is not overly liquid or deep enough to allow an accurate reflection of the true value of the interest, and interests in the scheme are issued and withdrawn on a frequent basis.

51 We consider that the consideration to acquire an interest in a managed investment scheme is 'based on' market price if the price takes into account the market price. The consideration could also take into account other appropriate criteria identified by the responsible entity.

Common enterprises and other nil price or fixed price managed investment schemes

52 A managed investment scheme where each member has a distinct and individual interest in property used in connection with the scheme does not usually use a fluctuating price. Often this type of scheme is 'contract based'. Examples include agribusiness schemes, contributory mortgage schemes, serviced strata schemes, property syndicates, and horse racing and horse breeding syndicates.

53 We consider that there is unlikely to be much uncertainty for responsible entities and their legal advisers about whether a constitution makes adequate provision for the consideration to acquire an interest in a common enterprise scheme. In our experience, this is because the consideration for almost all of these types of schemes is a fixed amount.

54 In addition, we understand there may be some unitised managed investment schemes that also use fixed dollar price consideration. Similarly, we also consider that there is unlikely to be much uncertainty for responsible entities

and their legal advisers about whether a constitution makes adequate provision for the consideration to acquire an interest in these types of schemes. For this reason, we do not propose that the 'safe harbour' include provisions in relation to a fixed price consideration to acquire an interest in a managed investment scheme.

55 However, we note that in some cases, a managed investment scheme may initially issue interests at a fixed price but subsequently issue any other interests based on 'scheme assets less liabilities'. We propose that the 'safe harbour' will still apply to the subsequent issue of interests based on 'scheme assets less liabilities'.

56 There are some types of managed investment schemes, such as self-managed accounts, that do not involve any monetary consideration to acquire an interest in the scheme. The 'safe harbour' will not apply to these types of managed investment schemes.

57 Currently, s601GAA(7), as notionally inserted by [CO 05/26], allows a responsible entity to set the consideration to acquire an interest in a managed investment scheme if the only contributions pooled or used in a common enterprise made by investors:

(a) are money placed in a bank account held by the responsible entity on trust;

(b) are not proprietary rights, and no income in which a member has any interest is to be paid or worked out by dividing up a pool; or

(c) are used in common or pooled between joint tenants or tenants in common where none of the tenants are associates of the responsible entity and the tenants are known to each other.

58 We are not aware of any responsible entities that currently rely on s601GAA(7), as notionally inserted by [CO 05/26], to set the consideration to acquire interests in managed investment schemes where there is limited or no pooling. Subject to any feedback we receive during consultation, we propose not to include such a provision in the 'safe harbour' on the basis that it is no longer necessary.

Procedures and record-keeping for calculation of consideration

Proposal

C12 We do not propose to make any changes to our policy in [CO 05/26] on the documentation and record-keeping obligations for the calculation of the consideration to acquire an interest in a managed investment scheme.

Your feedback

C12Q1 What value or benefits do the current documentation and record-keeping requirements provide? Please give details.

C12Q2 Do you agree with these proposals? If not, why not?

C12Q3 Are there any practical or administrative problems associated with the application of these proposals? Please give details.

C12Q4 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C12Q5 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

Rationale

59 If a responsible entity exercises a discretion of the type envisaged by s601GAB, as notionally inserted by [CO 05/26], it is required to document the exercise of this discretion and keep appropriate records.

60 In particular, the responsible entity must prepare a document that includes:

(a) a description of the formula or method that is applied to work out the consideration to acquire an interest in the managed investment scheme;

(b) the circumstances in which the responsible entity or nominee may exercise the discretion;

(c) the policy the responsible entity or nominee apply in exercising the discretion, and the date on which the policy was formulated;

(d) what records the responsible entity will keep in relation to the exercise of the discretion;

(e) if the discretion is exercised by a nominee, that this is the case and the name of the nominee; and

(f) if the exercise of the discretion is inconsistent with the ordinary practice of scheme property being valued or the market price of interests being determined, an explanation of why the responsible entity has been unable to do this.

61 In some cases, we understand that a responsible entity or nominee will want to exercise a discretion where there is no written policy for the exercise of that discretion. Where this occurs, the responsible entity must subsequently prepare a document that sets out:

(a) the date on which the discretion was exercised;

(b) if the discretion was exercised by a nominee, that this is the case and the name of the nominee;

(c) how the discretion was exercised;

(d) why it was reasonable to exercise the discretion in the way it was exercised; and

(e) if the exercise of the discretion was inconsistent with the ordinary practice of scheme property being valued or the market price of interests being determined, an explanation of why the responsible entity was unable to do this.

62 The responsible entity is required to keep any policy that documents the exercise of a discretion for seven years after it ceases to be current.

63 A member or a person who has an entitlement to receive a Product Disclosure Statement (PDS) is entitled to be given a copy free of charge of any policy that documents the exercise of a discretion by the responsible entity or nominee. The responsible entity must advise members of this right.

64 The responsible entity must ensure that the records it keeps under s988A are kept in a way that enables the exercise of the discretion in relation to the consideration to acquire an interest in a managed investment scheme to be identified.

65 We believe that requiring a responsible entity to document its policies and procedures on how it calculates the consideration to acquire an interest in a managed investment scheme promotes efficiency, consistency and transparency.

Note: For more information about good practice for unit pricing, see Regulatory Guide 94 *Unit pricing: Guide to good practice* (RG 94).

66 We propose to include these documentation and record-keeping requirements in the 'safe harbour' unchanged.

Calculation of consideration: Placements

Proposal

C13 We propose not to include in the 'safe harbour' the requirement in s601GAA(2)(b), as notionally inserted by [CO 05/26], that restricts the circumstances in which a placement can be made to the responsible entity or an associate.

C14 We propose not to include in the 'safe harbour' the restrictions that exist in s601GAA(12A), as notionally inserted by [CO 05/26], on the underwriting of placements by associates of the responsible entity.

C15 We propose not to include in the 'safe harbour' any limitation on the discount at which interests under a placement can be issued.

Your feedback

C15Q1 Do you agree with these proposals? If not, why not?

C15Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C15Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C15Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

C15Q5 What, if any, additional requirements should there be in the 'safe harbour' to reduce the risk of an unfair discount being applied to the issue of interests under a placement?

C15Q6 Should we permit placements of interests in a managed investment scheme if the scheme is listed or traded on any financial market?

C15Q7 Do the rules of other financial markets provide equivalent protections for members as those of ASX? If not, please give details.

Rationale

67 Currently, s601GAA(2)(a), as notionally inserted by [CO 05/26], requires that a placement can only be made if it involves interests in a managed investment scheme that are quoted on ASX or an approved foreign market. To ensure proper price discovery, we consider that it is important that the quotation of the interests in the class to which the placement relates is not suspended.

68 We consider that making significant placements to entities that are not members can sometimes be crucial to the commercial success of listed managed investment schemes and allows certainty about the level of fundraising that can be achieved.

69 We do not propose to restrict the ability of a responsible entity to issue interests under a placement to itself or to its associates in the 'safe harbour'. This means that the 'safe harbour' will not require placements to an associate of a responsible entity to only be made in certain restricted circumstances, such as where:

(a) the associate holds interests in the managed investment scheme in an eligible fiduciary capacity;

(b) the associate acquires the interests in an eligible fiduciary capacity; and

(c) the proportion of interests that are issued to the associate does not exceed the proportion of interests held by the associate directly before the placement.

70 While we recognise that there is a risk of member disadvantage in placements with associates, we consider these risks are mitigated by the fact that the responsible entity already has obligations in relation to managing conflicts of interest and acting in the best interests of members. We consider that these obligations set high standards and provide sufficient protection.

> Note: Section 601FG also restricts a responsible entity from acquiring an interest in the managed investment scheme it operates unless the interest is acquired for no less consideration than would be paid by another person and it is subject to terms and conditions that do not disadvantage other members.

71 There are particular requirements that currently apply under s601GAA(12A), as notionally inserted by [CO 05/26], in relation to underwriting or sub-underwriting of a placement by an associate. These include that:

(a) there must be an underwriting or sub-underwriting agreement in place, the terms of which are no more favourable to the associate than if it were dealing with the responsible entity on arm's length terms; and

(b) the associate holds an AFS licence that authorises it to deal as an underwriter or sub-underwriter, and contains conditions that require no voting rights to be exercised by the associate and the disposal of the interests to occur:

(i) on market;

(ii) to a person who is not an associate of the responsible entity; or

(iii) to a person who is an associate of the responsible entity that acquires them in an eligible fiduciary capacity.

72 We do not propose to include in the 'safe harbour' a requirement that a placement to an associate underwriter be made under these arrangements. As an AFS licensee, a responsible entity has an obligation to manage conflicts of interest under s912A(1)(aa). A responsible entity also has obligations in relation to related party transactions under Pt 5C.7 and acting in the best interests of members. We think that these existing requirements apply high standards to ensure that related party underwriting agreements are appropriate, and mean that a prohibition is not required.

> Note 1: For more information on the obligation to manage conflicts of interest, see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181).
>
> Note 2: For more information on related party arrangements and transactions, see Regulatory Guide 76 *Related party transactions* (RG 76).

73 There are currently 407 AFS licensees that have underwriting conditions on their AFS licence. The purpose of these conditions is to ensure that underwriting by associates is legitimate underwriting, rather than a placement by stealth.

74 We do not propose to require in the 'safe harbour' that an associate underwriter hold an AFS licence that contains special conditions. In our view, the risks that exist are mitigated by the obligation in s912(1)(aa) for the responsible entity to manage conflicts of interest and its duties in s601FC. However, we may scrutinise carefully any underwriting by an associate that appears to be a disguised placement. We may also consider

whether it is appropriate to make an application for a declaration of unacceptable circumstances to the Takeovers Panel.

> Note: For more information on our policy on disguised placements, see Regulatory Guide 61 *Underwriting—Application of exemptions* (RG 61) and Regulatory Guide 159 *Takeovers, compulsory acquisitions and substantial holding notices* (RG 159).

75 We note that s601GAA(2)(c), as notionally inserted by [CO 05/26], currently imposes a requirement that a placement issue does not comprise more than 15% of interests in that class for it to proceed without sending a notice containing certain particulars to members and obtaining their approval for the placement. This requirement is consistent with ASX Listing Rule 7.1, which states that a listed entity cannot issue more than 15% of interests within the previous 12-month period without security holder approval.

76 On the basis of ASX Listing Rule 7.1 and the duties of a responsible entity, we are not proposing to include any limitation in the 'safe harbour' on the percentage of interests that can be issued under a placement.

77 We consider that information about the use of the money raised from the placement is information that is required in a notice of meeting under s252J. We therefore consider that duplication of this requirement in the 'safe harbour' is unnecessary.

78 The other requirements of s601GAA(2), as notionally inserted by [CO 05/26], will continue to apply and be included in the 'safe harbour'.

Calculation of consideration: Rights issues

Proposal

C16 We propose not to include in the 'safe harbour' the requirement in s601GAA(3)(b), as notionally inserted by [CO 05/26], that the issue of interests in a rights issue be made to all members.

C17 We propose not to include in the 'safe harbour' the requirement in s601GAA(3)(c), as notionally inserted by [CO 05/26], that all the interests offered in a rights issue are offered in the same class.

C18 We propose not to include in the 'safe harbour' the requirement in s601GAA(3)(d), as notionally inserted by [CO 05/26], that all the interests offered in a rights issue are offered at the same price.

C19 We propose not to include in the 'safe harbour' the requirement in s601GAA(3)(g), as notionally inserted by [CO 05/26], that an offer under a rights issue is made to all members at substantially the same time.

C20 As with placements, we propose not to include in the 'safe harbour' the requirement in s601GAA(3)(h), as notionally inserted by [CO 05/26],

that restricts the circumstances in which a rights issue can be made to an associate of the responsible entity.

C21 As with placements, we propose not to include in the 'safe harbour' the restrictions on the underwriting of rights issues by associates of the responsible entity that exist in s601GAA(12A), as notionally inserted by [CO 05/26].

C22 We propose to include in the 'safe harbour' the ability for a responsible entity to treat foreign members differently when making an offer under a rights issue.

Your feedback

C22Q1 Do you agree with these proposals? If not, why not?

C22Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C22Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C22Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

C22Q5 What, if any, additional requirements should there be in the 'safe harbour' to ensure equality of treatment for members?

C22Q6 Should we include provisions on the pricing of options in the 'safe harbour'? Please provide details.

Rationale

79 Currently, s601GAA(3), as notionally inserted by [CO 05/26], allows a responsible entity to set the consideration to acquire an interest in a managed investment scheme, if:

(a) the offer is made to members on a date not more than 20 business days before the date of the offer, and is proportionate to each member's holding at that date;

(b) the offer is made for all interests in that same class (excluding those interests held by foreign members) at the same price and at substantially the same time;

(c) the consideration to acquire an interest is less than the maximum percentage specified in the constitution; and

(d) the exercise price of all options issued is the same, and the means of working out the exercise price is set out in the terms of the option.

80 We propose to remove the current requirements in s601GAA(3), as notionally inserted by [CO 05/26], that:

(a) the issue of interests in a rights issue is made to all members of the managed investment scheme (excluding foreign members) (see s601GAA(3)(b));

(b) all of the interests offered are in the same class (see s601GAA(3)(c));

(c) the price of all of the interests offered is the same (see s601GAA(3)(d)); and

(d) the offer is made to members at substantially the same time (see s601GAA(3)(g)).

81 These requirements are aimed at ensuring that there is an equality of treatment between members who hold the same class of interests. However, we propose to remove these requirements because we consider the responsible entity is already required to comply with the equal treatment duty under s601FC(1)(d). We propose to allow a responsible entity to exclude foreign members from participating in a rights issue because there are often legal or regulatory problems with offers to foreign members meeting that jurisdiction's requirements.

Note: A responsible entity has a duty to treat all members of the same class equally and members of different classes fairly under s601FC(1)(d).

82 We also propose to remove the current requirement in [CO 05/26] that the record date be no longer than 20 business days before the date of the offer: see s601GAA(3)(a). Instead, we propose that a responsible entity will have a discretion to determine the record date. The responsible entity will need to exercise its discretion to determine the record date, taking into account its duties in s601FC.

83 To the extent that an option is an interest in a managed investment scheme, we propose that a responsible entity should have a discretion to set the issue price of options. We also propose that this discretion should only apply where the responsible entity makes a pro rata offer of options to all members and the exercise price of the options offered is the same.

84 We propose to remove the current requirement in [CO 05/26] for the constitution to set out the maximum percentage discount at which an interest can be issued for a rights issue: see s601GAA(3)(f). The aim of this requirement was to guard against the dilution of existing members' interests. Under s601GAA(3)(f), a responsible entity can specify a discount of up to 100%. We have observed the practice by some responsible entities of including a significant discount to provide commercial flexibility for future capital raisings.

85 Instead, we propose that responsible entities can determine the discount at which interests under a rights issue can occur. In determining the discount on the issue price of interests under a rights issue, a responsible entity is under an obligation to ensure that it acts in the best interests of members: see

s601FC(1)(c). A responsible entity should carefully examine the effect of the rights issue on those who cannot or do not take up the offer.

86 For the same reason as in paragraph 70, we do not propose to:

(a) restrict the ability of a responsible entity to issue interests under a rights issue to itself or its associates;

(b) require that:

(i) there must be an underwriting or sub-underwriting agreement in place, the terms of which are no more favourable to the associate than if it were dealing with the responsible entity on arm's length terms; and

(ii) the associate holds an AFS licence that authorises it to deal as an underwriter or sub-underwriter, and contains conditions that require no voting rights to be exercised by the associate and the disposal of the interests to occur:

(A) on market;

(B) to a person who is not an associate of the responsible entity; or

(C) to a person who is an associate of the responsible entity that acquires them in an eligible fiduciary capacity.

Note: We may carefully scrutinise the issue of any interests under a rights issue that has a control purpose.

87 The other requirements of s601GAA(3), as notionally inserted by [CO 05/26], will continue to apply and be included in the 'safe harbour'.

Calculation of consideration: Distribution reinvestment plans

Proposal

C23 We propose not to include in the 'safe harbour' the requirement in s601GAA(5)(a), as notionally inserted by [CO 05/26], that the issue of interests under a distribution reinvestment plan be made to all members.

C24 We propose not to include in the 'safe harbour' the requirement in s601GAA(5)(b), as notionally inserted by [CO 05/26], that all the interests under a distribution reinvestment plan are offered in the same class.

C25 We propose not to include in the 'safe harbour' the requirement in s601GAA(5)(c), as notionally inserted by [CO 05/26], that the price of all of the interests offered under a distribution reinvestment plan is the same.

Your feedback

C25Q1 Do you agree with these proposals? If not, why not?

C25Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C25Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C25Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

Rationale

88 Where the constitution permits part or all of the distributions to be applied as payment for new interests in the managed investment scheme, s601GAA(5), as notionally inserted by [CO 05/26], allows the responsible entity to set the consideration to acquire the interests issued under this distribution reinvestment plan. The responsible entity has this discretion where:

(a) each member (excluding foreign members) can elect to participate wholly or partially in the distribution reinvestment plan;

(b) all the interests issued are in the same class, at the same price and at substantially the same time; and

(c) the consideration to acquire the interest is less than the maximum percentage specified in the constitution.

89 We propose not to include in the 'safe harbour' the current requirements in s601GAA(5), as notionally inserted in [CO 05/26], that:

(a) the issue of interests under a distribution reinvestment plan is made to all members of the managed investment scheme (excluding foreign members) (see s601GAA(5)(a));

(b) the price of all of the interests offered is the same (see s601GAA(5)(c)); and

(c) the offer is made to members at substantially the same time (see s601GAA(5)(d)).

90 We have proposed these changes for the reasons in paragraph 81.

91 We also propose to remove the current requirement in s601GAA(5)(e), as notionally inserted by [CO 05/26], that the constitution set out the maximum percentage discount at which an interest can be issued under a distribution reinvestment plan. This is for the reasons in paragraph 85. However, we may carefully scrutinise any distribution reinvestment plan that is highly dilutive.

Calculation of consideration: Negotiated fees

Proposal

C26 We propose that the 'safe harbour' will allow a responsible entity to set the consideration payable to acquire an interest in a managed investment scheme for a member if it complies with the requirements in Class Order [CO 03/217] *Differential fees*.

Your feedback

C26Q1 Do you agree with this proposal? If not, why not?

C26Q2 Are there any practical problems associated with the application of this proposal? Please give details.

C26Q3 Please give details of any additional costs associated with the implementation of this proposal. If possible, please quantify these costs.

C26Q4 What benefits do you consider will result from this proposal? If possible, please quantify these benefits.

Rationale

92 A responsible entity can set the issue price of interests under s601GAA(6), as notionally inserted by [CO 05/26], where it has differential fee arrangements in place with wholesale clients. This discretion applies where:

(a) the responsible entity and wholesale client agree on the consideration that would be payable under the constitution less a reduction in the fees payable for the issue of the interests;

(b) all members are given a statement that fees may be individually negotiated with wholesale clients in the first communication after a fee reduction is first offered;

(c) the PDS contains a statement that fees may be individually negotiated with wholesale clients; and

(d) the reduction in fees does not adversely affect the fees that are paid or will be paid by any other member.

93 A responsible entity may regularly negotiate lower fees with certain wholesale clients. These fees may be included in the calculation of the price at which interests in the managed investment scheme are issued. We recognise there are commercial benefits for responsible entities in attracting wholesale clients by negotiating commercial rates of fees with them.

94 We propose to allow a responsible entity to set the consideration to acquire an interest in a managed investment scheme that involves a negotiated fee arrangement, as long as it meets [CO 03/217]. We have proposed this to avoid an unnecessary duplication of regulation on negotiated fee arrangements.

95 [CO 03/217] provides a conditional exemption for responsible entities of registered managed investment schemes where the responsible entity differentiates between members in relation to fees based on:

(a) the aggregation of a member's interests across the range of financial products issued by the responsible entity (or its related body corporate), that are regulated under the Corporations Act;

(b) the use of electronic services, or effecting electronic transactions for investments in a managed investment scheme or other financial product issued by the responsible entity, that are regulated under the Corporations Act;

(c) the aggregation of holdings of a member and certain family members across a range of financial products offered or issued by the responsible entity (or related body corporate) according to the value or period of time during which the aggregated interests have been held; or

(d) members who are employees of the responsible entity (or related body corporate), provided that the value of the employees' interests relative to the other members does not exceed 5%.

Note: For more information on [CO 03/217], see Regulatory Guide 136 *Managed investments: Discretionary powers and closely related schemes* (RG 136).

96 To rely on [CO 03/217], a responsible entity must ensure that:

(a) a statement is disclosed to members and included in any PDS:

(i) of the basis on which the differential fee will be calculated and which sets out the fees members will have to bear; and

(ii) that the fee arrangement is to be offered to certain wholesale clients;

(b) the differential fee arrangement does not adversely affect the fees paid or to be paid by any member who is not entitled to participate; and

(c) the differential fee arrangement is applied without discrimination to all members who satisfy the criteria necessary to receive the benefit of the arrangement.

Note: For further information on differential fees, see [CO 03/217].

Calculation of consideration: Interest purchase plans

Proposal

C27 We do not propose to make any changes to our policy on interest purchase plans in s601GAA(4), as notionally inserted by [CO 05/26].

Your feedback

C27Q1 Do you agree with this proposal? If not, why not?

C27Q2 Are there any practical problems associated with the application of this proposal? Please give details.

C27Q3 Please give details of any additional costs associated with the implementation of this proposal. If possible, please quantify these costs.

C27Q4 What benefits do you consider will result from this proposal? If possible, please quantify these benefits.

Rationale

97 Currently, s601GAA(4), as notionally inserted by [CO 05/26], allows a responsible entity to set the consideration to acquire an interest for an interest purchase plan if it meets the requirements of Class Order [CO 09/425] *Share and interest purchase plans*. [CO 09/425] applies to interest purchase plans where:

(a) trading in the relevant class of interests has not been suspended (beyond a minimum period) on ASX;

(b) ASIC has not made certain determinations to prevent an issuer from relying on its relief; and

(c) there are no existing exemptions from particular provisions of the Corporations Act.

Note: [CO 09/425] also contains a number of conditions. For more information on these conditions, see [CO 09/425].

98 An interest purchase plan generally provides existing members with a convenient means of obtaining additional interests in the managed investment scheme. These additional interests are often acquired at a discount to the market price and without brokerage fees or stamp duty.

99 We propose to include this in the 'safe harbour' unchanged.

Calculation of consideration: Stapled securities

Proposal

C28 We propose that the 'safe harbour' will allow a responsible entity to apportion the consideration to acquire an interest in a managed investment scheme (where the interest forms part of a stapled security) between the component parts of that stapled security.

C29 To rely on this aspect of the 'safe harbour', we propose that:

(a) the constitution makes provision for the issue price of the stapled securities;

(b) the constitution makes provision for the responsible entity to allocate a proportion of the issue price of the stapled securities to interests in the managed investment scheme;

(c) the stapled securities are issued in accordance with a fixed price, or formula or method, that is specified in the constitution; and

(d) the responsible entity allocates the proportion of the issue price of the stapled securities to interests in a managed investment scheme in accordance with the constitution.

Your feedback

C29Q1 Do you agree with these proposals? If not, why not?

C29Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C29Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C29Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

C29Q5 Does applying for case-by-case relief to facilitate a stapled structure cause an unnecessary burden? If so, please provide details.

Rationale

100 We regularly grant case-by-case relief for the responsible entity of a registered managed invested scheme that forms part of a listed or unlisted stapled group to:

(a) allow it, its officers and its employees to act, taking into account the stapled group as a whole, rather than its component parts, without breaching s601FC(1)(c) and (e), 601FD(1)(c), (d) and (e) and 601FE(1);

(b) apportion the consideration to acquire an interest in a managed investment scheme between the component parts of the stapled security without breaching s601GA(1)(a);

(c) offer a distribution reinvestment plan for the stapled securities without providing a PDS under s1012D(3)(b); and

(d) provide a financial benefit to a related party (being the other component of the stapled group) without breaching s208(2), as notionally inserted by s601LC.

101 We propose to allow a responsible entity to allocate the consideration to acquire an interest in a managed investment scheme where that interest is a component part of stapled securities if:

(a) the constitution sets out the issue price of the stapled securities;

(b) the constitution allows the responsible entity to allocate a proportion of the issue price of the stapled securities to interests in the managed investment scheme;

(c) the stapled securities are issued at a price, or in accordance with a formula or method, which is set out in the constitution; and

(d) the responsible entity allocates the proportion of the issue price of the stapled securities to interests in a managed investment scheme in accordance with the constitution.

102 The terms of a stapled security require that each of its component parts must be transferred together. ASX permits stapled securities to be listed and traded like individual financial products. Stapled securities that are listed are acquired at market price. The component parts of the listed stapled security are not individually listed and, as such, each component does not have an individual market price. The consideration to acquire stapled securities that are not listed is based on the 'value of scheme assets less liabilities'. These structures mean that a responsible entity cannot technically comply with s601GA(1)(a). The issue price of a listed or unlisted stapled security is the sum of each of its components.

103 Generally, the responsible entity will need to retain a discretion about the allocation of the issue price of the stapled security between its component parts for tax reasons.

104 A responsible entity will no longer need to apply for case-by-case relief from s601GA(1)(a) in order to conduct a 'stapling'. However, a responsible entity may still need to apply for other case-by-case relief.

105 The existing relief in s601GAA(9), as notionally inserted by [CO 05/26], will continue to apply and be included in the 'safe harbour'.

Calculation of consideration: Forfeited interests

Proposal

C30 We propose that the 'safe harbour' will include our substantive policy in relation to s601GAA(8), as notionally inserted by [CO 05/26], on the consideration for managed investment schemes (including timesharing schemes) where the interests are forfeited interests. We propose to provide relief from s601FG to responsible entities of registered schemes that are not timesharing schemes when they comply with the requirements of the 'safe harbour'.

C31 We do not propose to make any changes to our policy in Class Order [CO 03/104] *Relief facilitating the acquisition and sale of forfeited interests in registered time-sharing schemes*.

Your feedback

C31Q1 Do you agree with these proposals? If not, why not?

C31Q2 In what circumstances, if any, do you consider that the operation of the forfeiture of interests in a managed investment scheme will involve an acquisition by the responsible entity or buyers of forfeited interests?

C31Q3 Are there any practical problems associated with the application of these proposals? Please give details.

C31Q4 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C31Q5 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

C31Q6 Is the relief in [CO 03/104] still necessary? If so, are the requirements of the relief in [CO 03/104] still appropriate? Is there a need for relief from s601FG for responsible entities of registered schemes that are not timesharing schemes?

Rationale

106 Currently, s601GAA(8), as notionally inserted by [CO 05/26], allows the responsible entity a discretion to set the price for the sale of interests in a listed managed investment scheme (other than a time-sharing scheme) where the interests have been forfeited by a member for failing to pay an outstanding amount due to, and called for by, the responsible entity. Other relief applies to time-sharing schemes while there is a PDS and associated price list under Class Order [CO 02/315] *Time-sharing schemes—use of loose-leaf price list.* However, forfeiture may occur at a time when this is not the case.

107 [CO 03/104] provides relief from s601FG to a responsible entity of a time-sharing scheme to enable it to acquire, hold and dispose of forfeited interests in the time-sharing scheme. This relief envisages that the operation of forfeiture will involve an acquisition of interests by the responsible entity. It may be that not all arrangements for forfeiture may be said to involve an acquisition under s601GA(1)(a) or 601FG.

Note: For more information on the conditions that apply to this relief, see [CO 03/104].

108 In considering whether the conditions in s601GAA(8), as notionally inserted by [CO 05/26], for non-time-sharing schemes are necessary to provide appropriate safeguards for forfeiting members, we believe that the requirements for the sale of forfeited interests under s245Q may provide sufficient protection.

Withdrawal price

Proposal

C32 We propose that the 'safe harbour' will allow a responsible entity to include a provision in the constitution that the withdrawal price for interests in an unlisted managed investment scheme, where each member has a proportionate interest in that scheme, will be based on:

(a) the value of the scheme assets less any liabilities under the constitution that may be met from scheme property (this includes making allowances, such as for transaction costs); or

(b) where there are different prices for interests of different classes, the value of the scheme assets properly attributable to a class of interests in the scheme less any liabilities properly attributable to interests of that class under the constitution that may be met from scheme property.

C33 We propose that the 'safe harbour' will include the same documentation and record-keeping requirements that apply when the responsible entity exercises a discretion in relation to the consideration to acquire an interest in the managed investment scheme.

Your feedback

C33Q1 Do you agree with these proposals? If not, why not?

C33Q2 Are there any practical problems associated with the application of these proposals? Please give details.

C33Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

C33Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

Rationale

109 If the constitution provides a right to withdraw, s601GAC, as notionally inserted by [CO 05/26], allows the constitution to give the responsible entity or its nominee a discretion to decide on a matter that affects a value included in the formula, or decide on a matter that is an aspect of the method, to calculate the withdrawal amount.

110 The formula that is used to calculate the withdrawal price must be based on the value of scheme assets less liabilities, and can take into account the material costs involved in the disposal of scheme assets.

Note: A responsible entity of a listed managed investment scheme does not give a right to members to withdraw on-market. We note that ASX Listing Rule 1.1, Condition 5, prevents off-market withdrawals. However, other financial markets, such as NSX, do not restrict off-market withdrawals.

111 The same arrangements exist for documenting and keeping records about the exercise of the discretion for the calculation of the withdrawal amounts as apply for the calculation of the consideration to acquire an interest in the managed investment scheme.

Note: For more information on these requirements and their rationale, see paragraphs 60–65.

D Powers of the responsible entity

Key points

We propose that a responsible entity of a managed investment scheme may determine the level of detail to include in the constitution about its powers to invest or deal with scheme property and any powers to borrow or raise money for the purposes of the scheme.

Powers of the responsible entity

Proposal

D1 When considering whether to register a managed investment scheme, we propose not to object to the level of detail included in the constitution about a responsible entity's powers in dealing with scheme property.

D2 We do not propose to give further guidance or provide examples in RG 134 on how the requirements in s601GA(1)(b) or 601GA(3) may be satisfied.

Your feedback

D2Q1 Do you agree with these proposals? If not, why not?

D2Q2 Are there any practical problems associated with the application of these proposals? Please give details.

D2Q3 Do you consider we should provide additional guidance on the constitutional content requirements relating to the powers of the responsible entity?

D2Q4 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

Rationale

112 Currently, RG 134 provides as an example that the constitution will make adequate provision for the powers of a responsible entity if the constitution gives the responsible entity all the powers of a natural person to invest and borrow. Our experience is that this example is often included in the constitutional provisions about the powers of a responsible entity.

113 We consider that the powers of a responsible entity that may be appropriate will depend on the particular managed investment scheme operated by the responsible entity. On this basis, we consider it is appropriate for a responsible entity to have the flexibility to determine the level of detail to include about its powers, taking into account the particular managed

investment scheme operated. This is consistent with the current commercial practice of responsible entities. However, a responsible entity can still include the example in RG 134 in the constitution if it wishes.

114 We consider that, because s601GA(1)(b) relates to the powers of investment rather than how a responsible entity intends to exercise its powers, it is not necessary for the investment strategy to be set out in the constitution. We note that a responsible entity may be required to make known its policy on how it will exercise its powers in the PDS, by reporting to members or under the continuous disclosure regime, because this will generally be information that would be likely to influence persons considering investment or seeking to understand their investment.

E Complaints

Key points

A responsible entity, as an AFS licensee, is required to have in place complaints handling procedures for retail clients that comply with Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165).

We propose that:

- constitutional provisions dealing with complaints by retail clients should be consistent with the requirements for an internal dispute resolution procedure approved by ASIC for s912A(2)(a)(i); and
- a responsible entity may devise, and should include in the constitution, its own complaints handling procedures for wholesale clients.

Adequate provision for dealing with complaints

Proposal

E1 We propose that, for the constitution of a managed investment scheme to make adequate provision for dealing with complaints by retail clients, the complaint provisions should be consistent with the internal dispute resolution requirements for AFS licensees applicable to retail clients approved by ASIC for s912A(2)(a)(i). These are currently set out in Class Order [09/339] *Internal dispute resolution procedures* and noted at RG 165.74.

E2 We propose that a responsible entity, as an AFS licensee, can comply with proposal E1 by including a constitutional provision stating that it will comply with the dispute resolution requirements approved by ASIC for s912A(2)(a)(i) in dealing with complaints by retail clients.

E3 We propose that a responsible entity may devise and include in the constitution its own complaints handling procedures for wholesale clients.

Feedback

E3Q1 Do you agree with these proposals? If not, why not?

E3Q2 Do you consider that relief from the requirements in s601GA or 601GB is necessary for a constitution to include the provision that a responsible entity will comply, as an AFS licensee, with the dispute resolution requirements, as set out in RG 165, in dealing with complaints by retail clients?

E3Q3 As an alternative to proposal E2, should we allow a responsible entity to devise its own complaints handling procedures for retail clients, as long as the procedures address the criteria in RG 165.74?

E3Q4 Should we require that the complaints handling provisions for wholesale clients be consistent with the relevant dispute resolution requirements for retail clients set out in RG 165.74?

E3Q5 Do you consider that, for managed investment schemes with wholesale clients only, a different approach should be adopted for compliance with s601GA(1)(c)? If so, what type of procedures do you think should apply for wholesale clients?

E3Q6 Do you consider that, for managed investment schemes with both retail and wholesale clients, a different standard should apply for dealing with complaints from wholesale clients? If so, what type of procedures do you think should apply for wholesale clients?

E3Q7 Do you see any practical issues that may arise if different approaches are adopted for the retail and wholesale members (e.g. issues about compliance with s601FC(1)(d))? Please give details.

E3Q8 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

Rationale

Complaints handling procedures for retail clients

115 As an AFS licensee, a responsible entity that provides financial services to retail clients must comply with the dispute resolution requirements in s912A(2). Under s912A(2), an AFS licensee must have in place:

(a) an internal dispute resolution procedure that complies with the standards and requirements made or approved by ASIC, and covers complaints made by retail clients against the AFS licensee in connection with the financial services provided under the AFS licence; and

(b) membership of an external dispute resolution scheme that is approved by ASIC and covers complaints made by retail clients against the AFS licensee in connection with the financial services provided under the AFS licence.

116 RG 165 sets out what AFS licensees must do to have a dispute resolution system in place that meets our requirements for the purposes of s912A(2). As outlined at RG 165.74, the key requirements for internal dispute resolution procedures are that an AFS licensee:

(a) adopts the definition of 'complaint' in AS ISO 10002–2006 (RG 165.90);

(b) satisfies the Guiding Principles at Section 4 of AS ISO 10002–2006, and follows Section 5.1—Commitment, Section 6.4—Resources, Section 8.1—Collection of Information, and Section 8.2—Analysis and evaluation of complaints in AS ISO 10002–2006 (RG 165.94–RG 165.97); and

(c) has a system for informing complainants or disputants about the availability and accessibility of the relevant external dispute resolution scheme of which the AFS licensee is a member (RG 165.140).

Note: For more detailed information about dispute resolution requirements for AFS licensees, see RG 165.

117 Given that a responsible entity is an AFS licensee, we consider that it will be more efficient for the responsible entity if we align our expectations for the method for dealing with complaints under the constitution with the AFS licensee internal dispute resolution requirements outlined in RG 165.74. This will prevent the responsible entity from potentially having two distinct complaints handling procedures in place for retail clients.

118 We consider that the constitution should include a provision that outlines that the responsible entity will comply, as an AFS licensee, with the internal dispute resolution requirements in dealing with member complaints. We believe that this is the most efficient way in which a responsible entity can adopt the requirements in RG 165.74 for retail clients.

119 If the alternative of setting out specific procedures for dealing with complaints by retail clients in the constitution is preferred, we consider these constitutional provisions will need to be consistent with the dispute resolution requirements for AFS licensees, as set out in RG 165.74. These internal dispute resolution procedures include:

(a) adopting the broad definition of a complaint in AS ISO 10002–2006;

(b) ensuring that retail clients know about the existence of dispute resolution procedures and how to make a complaint or dispute;

(c) having simple and accessible arrangements for making complaints or disputes;

(d) enabling complaints to be made by any reasonable means (e.g. letter, telephone, email or in person);

(e) immediately acknowledging the receipt of complaints and addressing them promptly in accordance with their degree of urgency;

(f) providing a final response within a maximum of 45 days, informing complainants or disputants of:

(i) the final outcome of their complaint or dispute;

(ii) their right to take their complaint or dispute to external dispute resolution; and

(iii) the name and contact details of the relevant external dispute resolution scheme to which they can take their complaint or dispute;

(g) addressing each complaint or dispute in an equitable, objective and unbiased manner through the complaints or disputes handling process;

(h) not charging for complaints or dispute resolution;

(i) not disclosing personally identifiable information about the complaint or dispute, unless it is needed to address the complaint or dispute;

(j) preparing reports about complaints or disputes for management;

(k) striving for continuous improvement of the complaints or disputes handling process and the quality of products and services;

(l) committing adequate resources, including training;

(m) ensuring there are sufficiently trained staff and sufficient resources to handle any complaints or disputes; and

(n) having procedures in place to record information.

Complaints handling procedures for wholesale clients

120 We note that s601GA(1)(c) requires that the constitution contain provisions for dealing with complaints 'in relation to' the managed investment scheme by members. We consider that this means that the constitution should contain provisions that deal with complaints by all members: both retail clients and wholesale clients (if applicable).

121 We acknowledge that responsible entities and wholesale clients may have in place informal arrangements to resolve disputes and/or agreements that provide assistance in resolving disputes. However, we believe this may not be sufficient for a responsible entity to meet its obligations to ensure that the constitution makes adequate provision for dealing with complaints in relation to a managed investment scheme.

122 We also acknowledge that the requirements of s912A(2) are consumer protection requirements applicable to AFS licensees with retail clients.

123 We consider it may be appropriate for different requirements to apply for wholesale clients who may have the knowledge, resources and bargaining power to have complaints effectively resolved, and may escalate issues through arbitration and the courts.

124 In light of this, we consider the responsible entity should be able to devise and include in the constitution provisions for its own complaints handling procedures for wholesale clients.

125 We recognise that this may be inefficient for a responsible entity, because it may need to develop two sets of complaints handling procedures. In some cases, we also believe that the responsible entity may have difficulty in complying with its duty in s601FC(1)(d) if it chooses to have different procedures for retail and wholesale clients.

126 An alternative option is to require the constitution to contain provisions dealing with complaints for wholesale clients that require the same procedures to apply to wholesale clients as retail clients, with any necessary amendments to address the differences between retail and wholesale clients.

Note: For example, the following requirements could apply for wholesale clients:

(a) having accessible complaints handling procedures;

(b) acknowledging complaints and providing a response within a reasonable time;

(c) having complaints handling procedures that are equitable, objective and unbiased;

(d) ensuring personal information is not disclosed unreasonably;

(e) having procedures in place for record-keeping and reporting; and

(f) having adequate resources to handle complaints, including well-trained staff.

F Winding up a managed investment scheme

Key points

The winding up of a managed investment scheme is a process rather than an event.

We propose that:

- the constitution of a managed investment scheme should address the key aspects of winding up the scheme. These include the identification of scheme assets, the distribution of proceeds, payment of the party conducting the winding up, any ability for members to continue to make payments, and how to proceed in a 'worst-case scenario';
- the constitution should state that an independent audit of the final accounts after winding up the scheme will be conducted by a registered company auditor or audit firm; and
- the realisation of the assets of the scheme on winding up can be postponed for as long as the responsible entity thinks fit.

Adequate provision for winding up a managed investment scheme

Proposal

F1 We propose that to make adequate provision for winding up a managed investment scheme, the constitution must address the key aspects of the process of winding up the scheme for the different circumstances in which the scheme may be wound up.

F2 We propose that the key aspects of winding up a managed investment scheme that the constitution will need to address are:

(a) enabling the identification of the assets of the scheme;

(b) the distribution of the net proceeds of realisation of the scheme;

(c) the identification of how the parties responsible for or involved in winding up the scheme will be paid and in what priority;

(d) any power to require members to continue making payments during the process of winding up the scheme or any ability to accept such payments from members in order to maximise the net proceeds of realisation; and

(e) how the process of winding up the scheme will occur if the responsible entity and/or the scheme is 'insolvent'.

Your feedback

F2Q1 Do you agree with these proposals? If not, why not?

F2Q2 Are there any practical problems associated with the application of these proposals? Please give details.

F2Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

F2Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

F2Q5 Are there any other key aspects of winding up a managed investment scheme that should be addressed in our guidance? If so, please give details.

F2Q6 Are there any key aspects of winding up a managed investment scheme that the constitution should not address for particular types of schemes? If so, please give details of the type of scheme and the reasons why.

Rationale

127 Section 601GA(1)(d) requires that the constitution of a managed investment scheme must make adequate provision for winding up the scheme.

128 Chapter 5C, however, does not prescribe what constitutes winding up a managed investment scheme, or what the process entails. Section 601NE(2) states that the responsible entity of a registered managed investment scheme must ensure that the scheme is wound up in accordance with its constitution and any orders of the court under s601NF(2).

> Note: Consistent with Judd J's views in *Environinvest Ltd* [2009] VSC 33 at [99], we consider that winding up a managed investment scheme is a process rather than an event. As such, we expect that constitutional provisions refer to the process of winding up, rather than only the event of termination.

129 Our regulatory experience has shown some cases where responsible entities have been unable to conduct the winding up of the managed investment schemes they operate in reliance on the relevant provisions in the constitution. The mode of winding up the scheme has had to be supplemented by orders of the court under s601NF on a number of occasions. However, we also note that the Corporations Act, together with the principles of trust law, have demonstrated an ability to provide sufficient assistance in resolving issues associated with winding up managed investment schemes structured as trusts.

> Note: Section 601NF(2) authorises the court to give directions about how a registered managed investment scheme is to be wound up if the court thinks it necessary to do so (including because the relevant constitutional provisions are inadequate or impracticable).

130 We note that the Corporations and Markets Advisory Committee (CAMAC) recognised there were issues in relation to winding up managed investment schemes and made recommendations in relation to winding up in its *Managed investment schemes—Report* in July 2012. We have taken these issues and recommendations into account in developing our proposals. We also consider that a responsible entity may wish to take into account the

issues identified, and recommendations made, by CAMAC in drafting constitutional provisions that deal with key aspects of winding up a managed investment scheme.

131 We understand that there is merit in constitutional provisions about winding up having some flexibility to deal with unforeseen events in winding up the managed investment scheme. At the same time, however, we consider that improving provisions in the constitution about the key aspects of winding up a scheme will reduce the level of procedural complexity, delay and costs that may be involved in winding up a scheme.

132 We consider that the key aspects of the process of winding up a managed investment scheme are set out in paragraphs 133–144.

Identification of assets

133 We consider that a key aspect of winding up a managed investment scheme is being able to identify the scheme property assets in order to realise or deal with them. For this reason, we think the constitution should contain provisions that enable the identification of the scheme property and other assets of the scheme.

> Note: We note that in July 2012, CAMAC, in its *Managed investment schemes—Report*, made recommendations about establishing and maintaining a register of scheme property and requiring the constitution to contain an obligation on the responsible entity to do this.

134 In our view, this may require more specific treatment in some contract-based managed investment schemes where it may be difficult to easily distinguish scheme property belonging to the scheme being wound up and other assets of the scheme that are to be covered in winding up from assets that are outside any winding up, such as certain non-scheme property.

> Note: Examples of this non-scheme property include personal assets of the responsible entity or scheme property belonging to another managed investment scheme operated by the same responsible entity.

Distribution of proceeds

135 We also consider that a key aspect of winding up a managed investment scheme is determining how proceeds will be apportioned. For this reason, we believe the constitution should include provisions about the distribution of the net proceeds of realisation of the scheme.

136 We consider the constitution should explain who will apportion the net proceeds of realisation between members, what criteria will be used to apportion the net proceeds of realisation between members, and the priority of persons.

Costs of winding up

137 We believe that the identification of the party that will bear the costs of winding up the managed investment scheme is an important aspect of winding up the scheme. As such, we consider that the constitution should identify the party that will bear these costs and in what priority this party will be paid.

> Note: For example, the expenses may be borne out of the assets of the responsible entity if there are no assets of the managed investment scheme that can be properly realised to meet the costs of winding up.

Payments to maximise proceeds

138 In our experience, a party winding up a managed investment scheme may require members to continue to make payments during the winding up to maximise the proceeds of realisation (e.g. payments for pesticides in agribusiness managed investment schemes).

139 If there is any ability for members to continue making payments during the process of winding up the managed investment scheme to maximise the net proceeds of realisation or, alternatively, if members are required to continue making payments, we believe that this should be included in the constitutional provisions on winding up the scheme.

Winding up in 'worst-case' scenarios

140 We consider that a key aspect of winding up a managed investment scheme is how the process of winding up the scheme will occur if the responsible entity is 'insolvent' and/or if the assets of the scheme are no longer sufficient to indemnify the responsible entity for its liabilities.

> Note: In *Capelli v Shepard* [2010] VSCA 2 at [93], the Court observed that a managed investment scheme may 'colloquially be characterised as insolvent in the sense that … the liabilities referable to it cannot be satisfied as they fall due from its income or readily realisable assets'.

141 If a managed investment scheme is 'insolvent', provisions that authorise payment out of the realisation of the assets of the scheme will be of no effect, because sufficient assets will not be available to meet the costs and expenses of winding up the scheme. As such, we are proposing that, to make adequate provision for winding up a scheme, the constitution must address the key aspects of the process of winding up the scheme in both the 'best-case scenario' (i.e. where the responsible entity and the managed investment scheme are solvent) and the 'worst-case scenarios' (i.e. where the responsible entity is solvent but the managed investment scheme is 'insolvent' and where the responsible entity and the managed investment scheme are 'insolvent').

142 Our regulatory experience has shown that constitutions have rarely addressed the process of winding up the scheme in the 'worst-case scenarios', resulting in some responsible entities having to seek orders from the court to wind up their managed investment schemes.

> Note: There are different ways that a responsible entity could address this in the constitution, depending on the nature of the managed investment scheme. However, we have observed that the appointment of a 'special scheme liquidator', who is a court-appointed liquidator from the official list, has often been a way that has been adopted.

143 We consider that what constitutes 'adequate provision' for winding up the managed investment scheme will depend on the circumstances of each scheme. As such, we are not proposing to set expectations on how the key aspects outlined above are to be dealt with.

> Note: In deciding whether or not to register a managed investment scheme, we will not make a qualitative assessment of the viability of the key aspects of the process of winding up the scheme addressed in the constitution. As long as the key aspects of the process of winding up the scheme appear to us to be addressed in the constitution, we will consider that the constitution has made adequate provision for winding up the scheme. However, we may still make inquiries with responsible entities after registration about the viability of the winding up procedures set out in the constitution.

144 As outlined above, s601GA(1)(d) requires that the constitution of a registered managed investment scheme must make adequate provision for winding up the scheme. In *Environinvest Ltd* [2009] VSC 33 at [76], Judd J held that an application to wind up a managed investment scheme under s601ND(1)(a) was not limited to merely winding up scheme property, but also encompassed winding up the scheme as a whole. Judd J held at [86] that the 'scheme' is a much broader concept than scheme property, defined by the scheme documents, relationships, objectives, inputs and outputs. He concluded that the scheme to be wound up included, but was not limited to, scheme property. Consistent with these comments, we are proposing to take the view that adequate provision for winding up a managed investment scheme has been made if the constitution sets out the processes in place to wind up the entire scheme and not just scheme property.

Independent audit or review

Proposal

F3 We propose that the constitution of a managed investment scheme should include provision for an independent audit of the final accounts after winding up the scheme to be conducted by a registered company auditor or audit firm.

Your feedback

F3Q1 Do you agree with this proposal? If not, why not?

F3Q2 Are there any practical problems associated with the application of this proposal? Please give details.

F3Q3 Please give details of any additional costs associated with the implementation of this proposal. If possible, please quantify these costs.

F3Q4 What benefits do you consider will result from this proposal? If possible, please quantify these benefits.

Rationale

145 We note that RG 134.24 provides for an independent audit of the final accounts after winding up a managed investment scheme to be conducted by a registered company auditor.

146 However, we have observed numerous constitutions at the point of registration that, rather than mandating an independent audit, contain clauses that provide responsible entities with the discretion to arrange either an independent audit or a review of the final accounts of the managed investment scheme by a registered company auditor after winding up the scheme.

147 We consider that a review provides a lesser level of assurance of the final accounts of a managed investment scheme and only involves an auditor making inquiries (primarily of the persons responsible for financial and accounting matters) and applying analytical and other review procedures. As such, we believe a review has substantially less scope than an audit, and does not enable an auditor to obtain the same level of assurance that would be obtained under an audit—an audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts.

148 We consider that, on winding up a managed investment scheme, it is an appropriate safeguard for the accounts to be independently audited to ensure there has been compliance with the Corporations Act.

Postponement of winding up a managed investment scheme

Proposal

F4 We propose that the constitution of a managed investment scheme can include a provision that permits a responsible entity to postpone the realisation of the assets of the scheme on winding up for as long as it thinks fit, provided that the clause is made subject to the Corporations Act.

Your feedback

F4Q1 Do you agree with this proposal? If not, why not?

F4Q2 Are there any practical problems associated with the application of this proposal? Please give details.

F4Q3 Please give details of any additional costs associated with the implementation of this proposal? If possible, please quantify these costs.

F4Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

Rationale

149 We have observed constitutional provisions that allow a responsible entity to postpone the realisation of a managed investment scheme's assets on winding up when it thinks it is desirable to do so. In our experience, these provisions often also purport to exclude the liability of the responsible entity for any loss or damage attributable to the postponement.

150 We recognise that responsible entities may sometimes need to legitimately postpone the realisation of the managed investment scheme's assets on winding up to maximise the net proceeds of realisation attributable to members. At the same time, however, we consider that the discretion to postpone the realisation of a scheme on winding up may be exercised to the detriment of members and may be used to avoid the timely winding up of a scheme.

> Note: Where a responsible entity decides to postpone the realisation of scheme assets, it should take into account its duties under s601FC(1).

151 We will not object to constitutional provisions that permit responsible entities to postpone the realisation of a managed investment scheme on winding up for as long as the responsible entity thinks fit, provided that, to avoid any doubt as to whether the Corporations Act will prevail, the clause is made subject to the Corporations Act. A responsible entity can meet this requirement either:

(a) by including in the specific provision permitting the postponement of winding up the scheme that the provision is subject to the Corporations Act; or

(b) as part of the effect of the more general compliance clause that makes all the provisions of the constitution subject to the Corporations Act, as discussed at paragraph 209.

G Rights to be paid fees or to be indemnified for liabilities or expenses out of scheme property

Key points

We consider that restrictions on provisions for fees and indemnities apply to application money and withdrawal proceeds.

We propose that:

- the constitution of a managed investment scheme does not have to state the specific amount of the fee that is payable to the responsible entity;
- the constitution can state a maximum fee that may be payable and/or all of the variables that affect the amount of any fee payable; and
- a right to payment of fees or expenses should not relate to conduct before the responsible entity takes office as responsible entity of the scheme, and should not allow for payment in advance of the responsible entity performing its relevant duties.

Proposal

G1 We propose that a responsible entity's right to a fee or indemnity to be payable out of the amount to be paid on withdrawal:

(a) must be stated in the constitution; and

(b) must be available only in relation to the responsible entity's proper performance of its duties.

G2 We propose that a constitutional provision providing for a fee to be payable out of scheme property, as with provision for an indemnity, must ensure that the right will apply only in relation to the responsible entity's proper performance of its duties.

G3 We propose that the constitution must provide that any fee is payable only in relation to proper performance of duties, whether in the particular provision concerning fees, or through operation of a general provision that makes the terms of the constitution subject to the Corporations Act.

G4 We propose that the constitution can include a provision that states a maximum fee that may be payable.

G5 We propose that we will not object if the constitution includes a provision that calculates a variable fee relative to an index, and that a responsible entity may change this index benchmark if the constitution provides that the substituted index must be a similar index and specifies when this can be determined (e.g. if the original index is no longer available or appropriate).

G6 We propose that, to specify the right to a fee, the constitution must set out all the variables that will affect the amount of the fee that will be payable to a responsible entity, including specifying the times at which any variable is to be measured for determining the amount of a particular fee.

G7 We propose that any payment to a responsible entity for performing a service included in the operation of the managed investment scheme must be categorised as a fee rather than an expense and must be specified in the constitution.

G8 We propose that the constitution must not allow for a right to payment of fees in advance of the responsible entity's proper performance of its duties to which the fees relate.

G9 We propose that the constitution must not allow for a right of indemnity out of scheme property for expenses or liabilities incurred before the responsible entity takes office as the responsible entity of the managed investment scheme.

G10 We propose that the constitution must not allow money received for the issue of interests and held pending issue to be withdrawn to pay fees except when an issue of interests occurs.

Your feedback

G10Q1 Do you agree with these proposals? If not, why not?

G10Q2 Are there any practical problems associated with the application of these proposals? Please give details.

G10Q3 For each proposal, do you consider that our guidance would:

(a) be consistent with maintaining and improving the confidence of investors in managed investment schemes;

(b) provide more or less certainty; and

(c) lead to a change of market practice?

G10Q4 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

G10Q5 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

G10Q6 Are there any other discretions that a responsible entity may have that might affect the right to fees or the right to be indemnified for expenses or liabilities out of scheme property that we should include in our guidance?

G10Q7 What levels of variables exist in different types of fees?

G10Q8 To the extent that there are multiple levels of variables in any fee, should there be any limitation on how many of these variable levels should be set out in the constitution? If so, please provide reasons.

G10Q9 Are there any circumstances where it may be more appropriate for a responsible entity performing a service included in the operation of the managed investment scheme to indemnify itself rather than take a fee? If so, please provide details.

Rationale

152 Section 601GA(2) states that, if a responsible entity is to have any rights to be paid fees out of scheme property, or to be indemnified out of scheme property for liabilities or expenses incurred in relation to performing its duties, these rights:

(a) must be specified in the constitution; and

(b) must be available only in relation to the proper performance of its duties.

153 In our view, this provision offers substantial protection to members and is intended to ensure that the rights to be paid fees or to be indemnified are specified in the constitution and only amended in accordance with the provisions for amending a constitution in s601GC. We consider that the provision is also intended to preclude the recovery of fees or the exercise of indemnity rights if a responsible entity fails to properly perform its relevant duties, reflecting the general law on trustee's rights.

154 Under s601GA(2), a provision that gives a right to a fee or indemnity for expenses and liabilities incurred in relation to a responsible entity's performance of its duties will have no effect to the extent that they would apply, other that in relation to proper performance of the responsible entity's duties. We believe that, to 'specify' the right, the constitution itself must state this limitation. However, we consider the responsible entity could meet this either:

(a) by including a specific provision; or

(b) as part of the effect of the more general compliance clause that makes all the provisions of the constitution subject to the Corporations Act, as discussed at paragraph 209.

155 We consider the requirement in s601GA(2) relates to the right to certain fees and indemnities rather than requiring the constitution to state the fixed amount that is actually paid. For this reason, we do not consider that this precludes a constitutional provision that specifies a maximum entitlement or that includes a fee calculated with reference to an appropriate benchmark. We also believe that this provides commercial flexibility for a responsible entity without the need to constantly amend the constitution.

Note: A responsible entity may, for example, commit in the PDS to limit the amount charged in fees and/or some or all indemnities for a certain period.

156 For a right to a fee to be specified, we believe that the time at which the fee accrues and each variable (including timing variables) affecting the amount payable must be detailed in the constitution and not left to the determination of the responsible entity.

157 We propose that any payment to a responsible entity for performing a service included in the operation of the managed investment scheme is a fee that must be included as a fee in the constitution, rather than as an expense. We consider that an expense is generally something that the responsible entity pays to a third party. We believe this means that the constitution should not include provisions for a responsible entity to be paid an hourly rate for certain services involved in the operation of a scheme to be determined by the responsible entity from time to time.

158 In determining if a payment to a responsible entity should be included as a fee, we consider reference should be made to the 'program or plan of action' that is the managed investment scheme being offered to investors, rather than any more narrow construction of what the scheme is, as set out in the constitution.

159 We consider that the constitution must not allow for a right to payment of fees in advance of the responsible entity's proper performance of its duties to which the fees relate, or before the responsible entity takes office. We believe this view is supported by the wording of s601GA(2). In relation to fees in advance, we also consider that this is appropriate because it may be difficult to recoup fees that have already been paid if the responsible entity does not properly perform its duties.

160 Money received for the issue of interests that are not immediately issued must be paid into an 'application money' account under s1017E, and can only be withdrawn to return it to the person who paid for the interests or on the issue of the interests. We consider that money cannot be withdrawn to pay fees except when an issue of interests occurs. In our view, when an interest is issued, money paid for the interest will be a contribution of money to the managed investment scheme and, therefore, scheme property as defined in s9.

> Note: 'Scheme property' is defined broadly in s9, and includes the contribution of money or money's worth to the scheme, and any property or income derived directly or indirectly from the use of the contributions.

161 In the process of withdrawal of an interest, our experience is that money may be placed in a separate fund to facilitate payments of withdrawal proceeds. We consider that money in such an account remains scheme property and any deductions from such an account for fees or to make payments by way of indemnity to the responsible entity must comply with s601GA(2).

H Withdrawal rights of members

Key points

If there is a right for members to withdraw from a managed investment scheme, this right should be stated in the constitution.

We propose that:

- constitutional provisions about withdrawal rights should be consistent with s601GA(4);
- the constitution should address four key areas about withdrawing from a liquid managed investment scheme, including exercising a right to withdraw, the consideration receivable, restrictions on exercising the right to withdraw, and when a member ceases to be a member; and
- constitutional provisions about withdrawal rights must be fair to all members.

Members' 'right to withdraw' must be specified

Proposal

H1 We propose to take the view that a member's 'right to withdraw' from a managed investment scheme is any right of a member to cease to hold an interest in the scheme:

(a) at the request of the member (even if the responsible entity has a discretion whether to accept the request before the right applies); and

(b) exercisable against the responsible entity of the scheme (acting in that capacity) or a person acting on the responsible entity's behalf.

H2 We propose that all constitutions that provide for a right to withdraw (as described in proposal H1) should include provisions that comply with s601GA(4).

H3 We propose that a right of a member against a person other than the responsible entity of the scheme (acting in that capacity) or a person acting on the responsible entity's behalf to transfer interests to that person is not a right to withdraw.

Your feedback

H3Q1 Do you agree with these proposals? If not, why not?

H3Q2 Are there any practical problems associated with the application of these proposals? Please give details.

H3Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

H3Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

H3Q5 Are there any situations involving a withdrawal from a managed investment scheme that you consider s601GA(4) should not apply to? If so, please give details.

Rationale

162 Section 601GA does not require that members must be permitted to withdraw from a managed investment scheme. However, a responsible entity may wish to include provisions in the constitution that permit members to withdraw from the managed investment scheme.

163 Section 601GA(4) applies to a managed investment scheme if members are to have a 'right to withdraw' from the scheme. Part 5C.6 sets out the circumstances in which members can withdraw from a managed investment scheme and distinguishes between withdrawals made when a scheme is liquid and when it is not liquid.

> Note: In some circumstances, we have provided relief from the requirement under s601GA(4) for a managed investment scheme's constitution to specify the right to withdraw and set out adequate procedures for making and dealing with withdrawal requests, and from the withdrawal procedures under Pt 5C.6, such as for on-market buybacks of interests in ASX-listed schemes: see Class Order [CO 07/422] *On-market buy-backs by ASX-listed schemes*.

164 The Corporations Act does not define a 'right to withdraw'. Section 601GA(4) is a non-mandatory provision. That is, responsible entities do not have to offer a right to withdraw. We have found that responsible entities have adopted different views of what constitutes a 'right to withdraw' and, depending on the view, that s601GA(4) does not apply. Our proposals are intended to clarify that if members have a right as described in our proposal, then the constitution must include the provisions as required by s601GA(4).

165 We consider that constitutional provisions that permit a member, at their request, to exit from, and cease to be a member of, a managed investment scheme in relation to the interests that are the subject of the withdrawal request, confer a right to withdraw before the withdrawal occurs. The right may exist at a time after the member's initial request for withdrawal, rather than at the time the request is made, because it is possible, on receiving such a request, that the responsible entity may have discretion to accept or refuse the request.

166 We consider that the requirements under s601GA(4) apply if there is provision for members to request a withdrawal, regardless of how the withdrawal process is initiated or whether it is subject to conditions imposed by the responsible entity, and that a member acquires the right at any time before the withdrawal occurs. In our view, s601GA(4) is intended to ensure

that the constitution addresses the method for exercising a right to withdraw and for calculating the withdrawal value.

> Note: For more detail, see paragraph 9.4 of the Explanatory Memorandum to the Managed Investments Bill 1997.

167 We do not consider that a right to withdraw requires a member to have an automatic or unconditional right to withdraw from a managed investment scheme, because this would unduly limit the operation of s601GA(4) in a manner that is inconsistent with its legislative purpose.

168 We consider a right to withdraw can also exist in circumstances where the responsible entity (either in its personal capacity or via an intermediary) acquires a member's interests by transfer, and pays for those interests directly or indirectly out of scheme property, and note that the member's holding in the register must then be adjusted to cancel the withdrawn interests.

> Note: See *Basis Capital Funds Management Ltd v BT Portfolio Services Ltd* [2008] NSWSC 766 at [142].

169 We consider the right to withdraw does not extend to transfers where the right is not exercised against the responsible entity (which would generally be the case when payment for the interests does not come from scheme property). Accordingly, a 'right to withdraw' does not apply to a transfer of interests between members of the managed investment scheme or where a responsible entity (in its personal capacity) acquires interests from another member. It also does not apply to the forfeiture of partly paid interests where the member does not have a right to forfeiture.

Adequate procedures for making and dealing with withdrawal requests

Proposal

H4 We propose that, for the constitution to have adequate procedures for making and dealing with withdrawal requests, it should address the following four key areas:

(a) the method and criteria for exercising a right to withdraw;

(b) the nature of the consideration to be given to members to satisfy withdrawal requests;

(c) any restrictions on satisfying withdrawal requests; and

(d) when a member ceases to be a member in respect of the interests that are the subject of the withdrawal request.

Your feedback

H4Q1 Do you agree with the proposals? If not, why not?

H4Q2 Are there any additional matters that the procedures should address? If so, please give details.

H4Q3 Are there any matters additional to those outlined under Pt 5C.6 for non-liquid managed investment schemes that the procedures should address? If so, please give details.

H4Q4 Are there any specific situations involving withdrawals from a managed investment scheme that s601GA(4) should not apply to? If so, please give details.

H4Q5 Is it necessary for a responsible entity to have a broad discretion to impose restrictions on members' right to withdraw?

H4Q6 What is a reasonable timeframe for members to be paid a withdrawal amount? Please explain why.

H4Q7 Are there reasons why we should give guidance on what we consider is a reasonable maximum timeframe for payment?

H4Q8 Are there any practical problems associated with the application of these proposals? Please give details.

H4Q9 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

Rationale

170 Section 601GA(4) provides that, if members are to have a right to withdraw, the constitution must set out adequate procedures for making and dealing with withdrawal requests. We believe what constitutes 'adequate procedures' will depend on the circumstances of the managed investment scheme. We consider the procedures for making and dealing with withdrawal requests should cover all key steps in the withdrawal process from commencement to completion because adequate procedures require a constitution to address the entire withdrawal process.

171 While we do not believe it is necessary to state every aspect of the procedures, we consider the key information about the process should be set out in the constitution so as to enable members to determine their right to withdraw from the managed investment scheme. In our view, it is not sufficient to merely state in the constitution that the key elements of the withdrawal procedures are set out in a separate document, such as a PDS.

172 If the right may be exercised while the managed investment scheme is not liquid, s601GA(4) requires that the constitution must provide for the right to be exercised in accordance with Pt 5C.6 and set out any other adequate procedures (consistent with Pt 5C.6) that are to apply to making and dealing with withdrawal requests.

173 The areas to be addressed to ensure the procedures are adequate are set out in paragraphs 174–182.

Exercise of a withdrawal right

174 We consider how a withdrawal right is exercised is important. For this reason, we believe the constitution should provide sufficient information so that it is possible to determine how a member may exercise the right to withdraw and what (if any) pre-conditions apply. This should include the steps that a member will have to take and whether there are any prerequisites that need to be satisfied before a member may request a withdrawal.

> Note: An example is where the exercise of a withdrawal right may be preceded by an offer (or an invitation to offer) that is made by the responsible entity.

175 We do not believe the constitution sets out adequate procedures if the right to withdraw may be exercised subject to any pre-conditions that the responsible entity may in its discretion determine, or subject to pre-conditions that may change from time to time at the responsible entity's discretion.

> Note: An example is that, if members may only exercise the right to withdraw subject to a requirement that the interests have been held for a minimum time period, that period should be specified in the constitution.

Consideration paid to members

176 We consider a key aspect of withdrawing from a managed investment scheme is the consideration that will be paid or given to members. For this reason, we believe there should be provisions about the consideration that will be given to members to satisfy withdrawal requests. This includes:

(a) a price that will apply to the interests that are the subject of the withdrawal request;

> Note: See paragraphs 109–111 for information about pricing for withdrawals and fairness.

(b) when is the consideration paid to members and the maximum period for payment; and

> Note: We may object to any provision that permits the responsible entity to satisfy a withdrawal request within a particular timeframe, if it is subject to any extension that the responsible entity determines.

(c) the nature of the consideration that members will receive.

177 If the consideration may be paid in-specie or in more than one form (such as a combination of cash and other assets), we consider that the responsible entity's duties under s601FC(1)(c) and (d), and the fiduciary relationship with members, means it should consider the rights and interests of all members when deciding the nature of the consideration members will receive, who bears liability for transaction costs associated with the transfer of assets and whether the consent of the withdrawing member is required.

Restrictions on dealing with withdrawal requests

178 If a member's right to withdraw is restricted in certain circumstances or can be restricted at the discretion of the responsible entity, we consider the constitution should describe these restrictions because these are important aspects of the nature of the withdrawal right. In our view, the type of restrictions that should be stated in the constitution include the circumstances in which a responsible entity may suspend and resume withdrawals, the right to impose minimum and maximum limits on the number or value of interests that may be withdrawn by a member, the ability to satisfy requests on a partial or staggered basis, and any other circumstance that fetters a member's right to withdraw.

179 We consider the constitution could set out specific situations (with or without a general residual discretion for the responsible entity to restrict withdrawals) or may simply provide for a general discretion to restrict withdrawals. However, we expect the discretion would be exercised in a manner consistent with the responsible entity's statutory duties and be disclosed to members. We do not believe the constitution should include restrictions that the responsible entity may in its absolute discretion determine, or restrictions that may change from time to time, without further setting out the circumstances in which these can be imposed or changed.

Ceasing to be a member of the managed investment scheme

180 Under s9, a 'member' in relation to a managed investment scheme means a person who holds an interest in the scheme. Ordinarily, we understand the responsible entity will determine if the managed investment scheme is liquid or non-liquid at the time as of which the valuation of the scheme property occurs (valuation time). We consider that the constitution should not include provisions that deem a member to have withdrawn before the valuation time because, until that time, the member has a right to the benefits produced by the managed investment scheme because the member will share in any increase in value of the scheme property and therefore holds an interest.

181 We consider that the constitution should only permit members' interests to be redeemed in accordance with the procedures applicable to liquid managed investment schemes if the scheme is liquid at the valuation time. If, pending the valuation time, a scheme becomes non-liquid after the request is made, we consider that the constitution should only permit members' interests to be redeemed in accordance with the statutory withdrawal restrictions under Pt 5C.6 for non-liquid schemes, which would apply because the valuation date is the relevant date for the withdrawal.

182 Once redemption has taken place, the position of the former member is 'transmuted' from member to creditor (*MSP Nominees Pty Ltd v*

Commissioner of Stamps (South Australia) (1999) 198 CLR 494 at 509), if the withdrawal price is unpaid.

Right to withdraw while a managed investment scheme is not liquid

Proposal

H5 We propose that if members are permitted to withdraw from a managed investment scheme while it is not liquid, the constitution must state the right in the constitution and must state that withdrawals are to be made in accordance with Pt 5C.6 of the Corporations Act.

H6 We propose that requests for withdrawal from a non-liquid managed investment scheme should be made in response to a specific withdrawal offer.

Your feedback

H6Q1 Do you agree with these proposals? If not, why not?

H6Q2 Are there any practical problems associated with the application of these proposals? Please give details.

H6Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

H6Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

Rationale

183 In our view, the statutory framework in Pt 5C.6 applies to withdrawals from a non-liquid managed investment scheme to ensure that withdrawal procedures may operate effectively and members are treated equally, and not to the detriment of members who retain interests in the scheme. In circumstances where the responsible entity proposes that withdrawals will be made in a manner inconsistent with Pt 5C.6, beyond our existing class order relief, we will consider relief on a case-by-case basis applying our policy in RG 136.

184 Apart from any relief we give, we consider that a constitution should not contain provisions that allow a member to exercise a right to withdraw in circumstances other than in response to a current withdrawal offer while the scheme is non-liquid. In our view, Pt 5C.6 requires the exercise of a right to withdraw should be made in reliance on a specific current offer. In our view, withdrawal requests made in response to an offer does not include an offer or other arrangement that effectively allows members to request withdrawals from the managed investment scheme from time to time.

Note: We may provide relief to permit a constitution to provide for a 'standing' or 'rolling' withdrawal offer or arrangement (i.e. an offer that remains open on an ongoing basis and allows a member to request withdrawals on a periodic basis and for a specified period) in certain circumstances.

Fairness to all members

Proposal

H7 We propose that the constitution should require that a withdrawal price is determined on the basis of reasonable and current market valuations of scheme property with due regard for managed investment scheme liabilities and other interests on issue.

H8 We propose that the constitution should require that any discretion to make monetary or in-specie payments to satisfy withdrawal requests should be applied in a manner that does not unreasonably disadvantage a member who is required to accept one form of payment rather than another, or disadvantage members who continue to hold interests in the managed investment scheme.

H9 We propose that, if a responsible entity determines to make in-specie payments by transferring assets to a member to satisfy a withdrawal request, the assets should be based on reasonable and current valuations to ensure that the payment is fair to other members. The responsible entity may provide for the deduction of transaction costs.

Your feedback

H9Q1 Do you agree with these proposals? If not, why not?

H9Q2 Should the constitution permit withdrawal offers to be made by electronic means (e.g. by email)? If so, please explain how offers made by electronic means will be fair to all members.

H9Q3 Should the constitution permit responsible entities to make withdrawal offers to members on the internet, in a newspaper or in some other public medium? If so, please explain how offers made in this manner will be fair to all members.

H9Q4 Are there any practical problems associated with the application of these proposals? Please give details.

H9Q5 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

Rationale

185 Section 601GA(4) provides that the right to withdraw, and any provisions in the constitution setting out procedures for making and dealing with withdrawal requests, must be fair to all members.

186 In our view, constitutional provisions involving withdrawal procedures should not unreasonably disadvantage certain members or be otherwise inconsistent with the Corporations Act. We believe 'fairness' in the context of s601GA(4) means that the provisions in the constitution that affect the price that members will receive on withdrawal, and the procedures for satisfying withdrawal requests, must be fair to all members.

187 Withdrawals involving the redemption of the members' interests from the scheme assets will not only affect the entitlements of withdrawing members, but also the remaining assets to be attributed to the interests of non-exiting members. The price at which members can withdraw, and the procedures that apply to the withdrawal, must be fair because these affect the extent of the right to withdraw, and how it will operate.

> Note: For non-liquid schemes, the concept of fairness applies to any procedures additional to those set out in Pt 5C.6.

188 The constitution must provide for the withdrawal price to be determined in accordance with a method or manner that is fair to all members. We consider 'fairness' requires that constitutional provisions provide that the price should be determined on the basis of market valuations of scheme property that are reasonable and current, having regard to the nature of the scheme property. We believe this is essential to the determination of a price that results in a fair and equitable outcome for all members. It is also consistent with the responsible entity's duty under s601FC(1)(j) to ensure that the scheme property is valued at regular intervals appropriate to the nature of the property.

189 In our view, withdrawal offers should also be made in a manner to ensure that all members to whom the offer is made have access to a copy of the offer. If an offer is only made via the internet or other form of public communication (e.g. in a newspaper), we consider that a responsible entity should consider whether the procedure will be 'fair' and consistent with a responsible entity's duties under s601FC(1)(d).

190 In order that the procedures are fair to all members where a responsible entity determines to make in-specie payments to satisfy a withdrawal request, we believe the assets to be provided should be based on reasonable and current valuations because appropriate valuations affect both the amount that a member is entitled to on withdrawal and the value of the remaining interests.

191 We consider that the 'fairness' of withdrawal provisions depends on whether or not any member (including members redeeming their interests and members who continue to hold interests) is unreasonably disadvantaged. In particular, to the extent that a responsible entity can select particular assets to satisfy payment, that selection must be made on a fair basis and having

regard to the responsible entity's duties under s601FC(1). This also applies to the deduction of transaction costs.

> Note: Responsible entities should also be mindful of their obligation to discharge their duties under s601FC(1)(d) to treat members who hold interests of the same class equally and members who hold interests of different classes fairly when following the withdrawal procedures under its constitution. Although the procedures in the constitution may appear adequate to us at the point of registration, a responsible entity should not assume it will satisfy its duties simply by following those procedures in all circumstances.

192 A responsible entity should have regard to its duties to ensure that the procedures, when applied to particular circumstances, do not unreasonably disadvantage members who continue to hold interests in the managed investment scheme. This includes the responsible entity's selection of specific assets to satisfy a withdrawal request, or a decision to permit members who are associated with the responsible entity to redeem where the managed investment scheme has liquidity issues.

Suspension of withdrawals

Proposal

H10 We propose that if a member has a right to withdraw following a request in the constitution, any power of the responsible entity to suspend or delay the withdrawal process must be stated in the constitution.

H11 We propose that the constitution should set out the specific circumstances when such a power may be exercised, and may provide for a residual discretion to exercise the power as the responsible entity reasonably determines and in accordance with its duties.

H12 We propose that the constitution should provide that when a member's interests are treated as withdrawn, the payment of the withdrawal requests should be made to the member within a certain and reasonable timeframe.

Your feedback

H12Q1 Do you agree with these proposals? If not, why not?

H12Q2 Are there any practical problems associated with the application of these proposals? Please give details

H12Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

H12Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

H12Q5 Should the constitution set out the specific situations in which a responsible entity may suspend withdrawals or, alternatively, is it adequate just to have a general discretionary power?

Rationale

193 A constitution may give responsible entities the ability to suspend a member's right to withdraw. We have observed two types of suspensions:

(a) where the responsible entity has the power to suspend the processing of withdrawal requests for which the member has already acquired a right to withdraw; and

(b) when payment to a member to satisfy a withdrawal request is delayed.

194 We consider that fairness to a member who is withdrawing requires that the constitution provide for a certain and reasonable timeframe within which the obligation to make the payment is satisfied, and any other steps that the member will be entitled to take during that timeframe, once the member has ceased to have the benefit of being a member in respect of interests being withdrawn. As these issues affect the extent of the withdrawal right, and how it operates, we believe the provisions of the constitution should address these with sufficient certainty.

195 We believe the constitution should set out when the responsible entity has any suspension powers in order to make adequate provision for dealing with withdrawal requests. In our view, the right to withdraw exists by virtue of the constitutional provisions and to the extent that it may be restricted when suspension powers are exercised by the responsible entity, those circumstances should be set out in the constitution.

> Note: We may carefully scrutinise any suspension rights that are able to be exercised to the detriment of members, or if the receipt of withdrawal proceeds is able to be deferred on an unreasonable basis.

196 We recognise, however, that the responsible entity's right to suspend is consistent with the concept of 'fairness' in s601GA(4), particularly where the responsible entity is unable to obtain a current valuation of the scheme assets. We believe the constitution should list the circumstances that trigger a power to suspend because these would affect members' withdrawal rights. We recognise the list may not be exhaustive and that it may be desirable for the responsible entity to have a general residual power to suspend or restrict withdrawals in unforeseen circumstances.

197 We recognise that a responsible entity may need to suspend or defer withdrawals and the need to suspend or defer may continue for an extended period of time. We consider responsible entities should ensure that powers in relation to suspension are exercised consistently with their duties under s601FC(1).

> Note: For example, a responsible entity may need to suspend withdrawal if there is an unexpected demand for withdrawal requests, or if circumstances make it difficult to determine the withdrawal price.

I Incorporation of extrinsic material

Key points

We propose that the constitution of a managed investment scheme should not include provisions that make the terms of the constitution subject to another document other than an Act of Parliament, or regulations or instruments made under an Act.

We do not propose to make any changes to our substantive policy in Class Order [CO 98/1808] *Allowing constitutions to use Appendix 15A of the ASX Listing Rules*.

Proposal

I1 We propose that the constitution of a managed investment scheme should not include provisions that make the terms of the constitution subject to another document other than an Act of Parliament, or regulations or instruments made under an Act.

I2 We do not propose to make any changes to our substantive policy in Class Order [CO 98/1808] *Allowing constitutions to use Appendix 15A of the ASX Listing Rules,* which allows a constitution to include provisions required by the ASX Listing Rules.

Feedback

I2Q1 Do you agree with these proposals? If not, why not?

I2Q2 Are there any practical problems associated with the application of these proposals? Please give details.

I2Q3 Please give details of any additional costs associated with the implementation of these proposals. If possible, please quantify these costs.

I2Q4 What benefits do you consider will result from these proposals? If possible, please quantify these benefits.

I2Q5 Is the relief in [CO 98/1808] still necessary? If so, are the requirements for the relief in [CO 98/1808] still appropriate?

I2Q6 Should we extend class order relief to any other types of extrinsic material? If so, please provide details.

I2Q7 Are there any circumstances where it is appropriate for a constitution to be subject to extrinsic material? If so, please give details.

Rationale

198 Before registering a managed investment scheme, we are required to consider whether the constitution 'makes adequate provision for' certain matters or 'specifies' other matters. If the terms of the constitution allow for the provision required under s601GA to be excluded or modified by other documents, it would render our consideration when registering a managed investment scheme ineffectual in promoting compliance with s601GA.

> Note: For example, we have seen constitutional provisions that seek to incorporate the terms of issue of interests of a managed investment scheme, or material included in a PDS.

199 We also believe that s601GC gives context to how the content requirements of s601GA and 601GB should be read. Section 601GC requires that any amendment to the constitution follow one of two processes. In our view, it would be contrary to the legislative intent for a responsible entity to seek to rely on other documents that can be amended through some other process to change the rights of members under the constitution without following the procedure in s601GC.

200 On this basis, we think that making provisions of the constitution subject to other documents may mean that the constitution does not 'make adequate provision for' or 'specify' the matters required by s601GA. [CO 98/1808] provides relief to allow a responsible entity to permit the inclusion of a constitutional provision that incorporates by reference and gives overriding effect to Appendix 15A of the ASX Listing Rules. The relief will mean that changes to the terms of the constitution, as a result of the operation of Appendix 15A, are not required to be made in accordance with s601GC(1)(a) or 601GC(1)(b).

201 We believe that relief to permit inclusion of a provision to the effect of Appendix 15A of the ASX Listing Rules that incorporates by reference and gives overriding effect to the ASX Listing Rules is appropriate. This is because:

(a) the ASX Listing Rules are available to the public;

(b) amendments to the ASX Listing Rules are subject to regulatory oversight; and

(c) amendments to the terms of the constitution are highly likely to be appropriate if the ASX Listing Rules require those amendments in order to maintain listing.

J Legal enforceability

Key points

The constitution of a managed investment scheme is required to be legally enforceable as between the responsible entity and its members.

We propose that the constitution should:

- be contained in a document that is in a valid form and executed by the proposed responsible entity;
- be binding between the responsible entity and all present and future members; and
- not contain provisions that are inconsistent with the Corporations Act.

Enforceability of constitution between members and the responsible entity

Proposal

J1 We propose that, for a constitution of a managed investment scheme to be legally enforceable, it should:

(a) be contained in a document that is in a valid form and executed by the proposed responsible entity;

(b) be contained in a document that is binding between the responsible entity and all members of the scheme; and

(c) only include provisions that are not inconsistent with the Corporations Act.

Feedback

J1Q1 Do you agree with this proposal? If not, why not?

J1Q2 Are there any practical problems associated with the application of this proposal? Please give details.

J1Q3 Please give details of any additional costs associated with the implementation of this proposal. If possible, please quantify these costs.

J1Q4 What benefits do you consider will result from this proposal? If possible, please quantify these benefits.

J1Q5 What benefits are there in having one compliance clause applicable to the whole constitution, rather than having individual constitutional provisions being expressed as subject to the Corporations Act?

Rationale

202 Section 601GB provides that the constitution of a managed investment scheme must be contained in a document that is legally enforceable as between the members of the scheme and the responsible entity.

203 The form of the constitution is not prescribed. However, whatever the form of the constitution, it must be legally binding as between the responsible entity and the members of the scheme.

> Note: The majority of constitutions will take the form of a deed poll. However, some constitutions will take the form of a contractual arrangement between the responsible entity and the members of the scheme. In these circumstances, we expect that the constitution is expressed to be binding between the responsible entity and the members.

204 We consider that the particular form of the constitution will determine the principles by which it will need to be drafted and executed for it to be legally enforceable.

> Note 1: For example:
>
> (a) a deed poll will need to be expressed to be executed as a deed poll, and be executed by the parties authorised to sign on behalf of the responsible entity; and
>
> (b) a contract will need to meet the common law requirements for contracts (including offer and acceptance, consideration and intention to be legally bound), and be executed by the parties authorised to sign on behalf of the responsible entity.
>
> Note 2: The Corporations Act does not mandate how a company must execute documents. However, s127 does set out acceptable methods of execution that other persons may assume to be valid. In summary, under s127, a company may execute a document without using a common seal if the document is signed by two directors or a director and company secretary. A company with a common seal may execute a document if the seal is fixed to the document and the fixing of the seal is witnessed by two directors or by a director and company secretary.

205 We have observed that some constitutions that are lodged with us have not been validly executed. We consider that, to be enforceable, the constitution must be contained in a document that is validly executed by the proposed responsible entity. In our view, this requires that the constitution be executed by the parties authorised to sign for the proposed responsible entity before the application for registration of the managed investment scheme is treated as lodged with ASIC.

206 In our experience, a constitution will generally contain a clause that binds the responsible entity and each present and future member as if each of them had been a party to the constitution. We consider that all constitutions should expressly bind the responsible entity and the members of the managed investment scheme from time to time. This is consistent with the legislative intention of s601GB that the constitution is contained in a document that is lawful and binding between the responsible entity and the members.

207 We consider that s601GB requires that the constitution continues to be contained in a document that is legally enforceable. This means that a method of effecting a modification chosen by the responsible entity when acting under s601GC(1)(b) will need to be one that ensures that, after the modification, the constitution continues to be wholly contained in a document that meets s601GB.

> Note: See *ING Funds Management Ltd v ANZ Nominees Ltd; ING Funds Management Ltd v Professional Associations Superannuation Ltd* [2009] NSWSC 243.

208 To ensure certainty about enforceability, we also consider that the constitution should not include provisions that are inconsistent with the Corporations Act.

> Note: We have objected to the following provisions in undertaking registration of a managed investment scheme on the basis that they are inconsistent with the Corporations Act:
>
> (a) provisions purporting to limit or exclude the liability of the responsible entity for conduct that is contrary to the Corporations Act; and
>
> (b) provisions seeking to entrench the responsible entity—for example, by providing that the voting threshold to replace the responsible entity is a unanimous resolution of members.

209 To assist in ensuring that the constitution is consistent with the Corporations Act, we believe it is open to the responsible entity to include a compliance clause in the constitution, which will provide that to the extent a provision of the constitution is inconsistent with the Corporations Act, it will be severed.

K Regulatory and financial impact

210 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

(a) ensuring responsible entities and their advisers have sufficient certainty about what we will look for in reviewing a constitution; and

(b) improving the efficiency and effectiveness of the process undertaken to register a managed investment scheme.

211 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR);

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

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

213 To ensure that we are in a position to properly complete any required RIS, please give us 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' p. 4.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
AQUA market	The market created by ASX to specifically manage the admission of ETF securities, managed fund products and structured products (collectively referred to as 'AQUA products') on the ASX market and to provide access for AQUA product issuers to clearing and settlement services provided by the ASX Group
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
Ch 7 (for example)	A chapter in the Corporations Act (in this example numbered 7)
[CO 05/26] (for example)	An ASIC class order (in this example numbered 05/26)
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
ETF	Exchange-traded fund
listed managed investment scheme	A managed investment scheme that is included in the official list of a prescribed market in Australia
PDS	Product Disclosure Statement
quoted managed investment scheme	A managed investment that is quoted on a prescribed market in Australia
Pt 7.9 (for example)	A part of the Corporations Act (in this example numbered 7.9)
RG 165 (for example)	An ASIC regulatory guide (in this example numbered 165)
s601GA (for example)	A section of the Corporations Act (in this example numbered 601GA)