ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 1

Indirect self acquisition by investment funds

October 1998

Your comments

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

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

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What this policy proposal is about

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

Contents

Our policy proposal — issues for consideration

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

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

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

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

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

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

Explanation

The scope of the indirect self acquisition provision

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

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

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

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

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

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

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

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

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

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

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

See s259D(1).

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

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

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

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

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

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

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

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

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

Regulatory risks of indirect self acquisition

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

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

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

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

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

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

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

Relief for investment funds

Who should we give relief to?

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

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

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

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

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

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

Conditions regarding improper exercise of control

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

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

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

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

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

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

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

Prudential conditions

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

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

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

(c) In relation to regulated superannuation funds generally:

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

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

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

Conditions relating to preferential treatment

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

(a) participation in a pro rata issue;

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

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

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

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

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

Conditions relating to trading and disclosure

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

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

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

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

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

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

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

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

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

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

29. This disclosure requirement is:

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

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

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

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

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

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

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

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

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

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

Relief to invest in independent managed investment schemes

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

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

Regulatory and financial impact

Issue

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

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

Objective

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

Options

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

Impact Analysis (costs and benefits)

General

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

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

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

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

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

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

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

Condition Prohibiting Voting

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

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

5% limit

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

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

Prudential conditions

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

Conditions relating to preferential treatment

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

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

Conditions relating to trading and disclosure

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

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

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

(c) Disclosing trading might be extensive and costly.

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

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

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

Relief for investments in managed investment schemes

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

Consultation

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

Conclusion

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

Development of policy proposal

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

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

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

Key terms

In this policy proposal:

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

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

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

"Law" refers to the Corporations Law;

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

What will happen next?

Stage 1

19 October 1998	ASIC policy proposal paper released.

Stage 2

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

Stage 3

29 January 1999	Policy released

Your comments

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

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

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