ASIC

Australian Securities & Investments Commission

REPORT 275

Response to submissions on CP 137 and CP 162 Indirect self-acquisition by investment funds

February 2012

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 137 *Indirect self-acquisition by investment funds: Further consultation* (CP 137) and Consultation Paper 162 *Indirect self-acquisition by investment funds: Further consultation—Employee share schemes* (CP 162) and details our responses to those issues.

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.

Disclaimer

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

This report does not contain ASIC policy. Please see Regulatory Guide 233 *Indirect self-acquisition: Relief for investment funds* (RG 233).

Contents

A Overview/Consultation process 4
Responses to consultation 5
B Responses to CP 137 6
Sunsetting case-by-case relief 6
Additional condition for controlled trustees and responsible entities 6
Relief for participation in placements 8
Disclosure of interests by controlled entities 12
Relief for index arbitrage 14
C Responses to CP 162 16
Calculation of 5% limit 16
Interests acquired under employee share schemes 17
Prudential condition 19
Disclosure of economic exposure through derivatives 20
Appendix: List of non-confidential respondents 21

A Overview/Consultation process

1 Under s259C(1) of the *Corporations Act 2001* (Corporations Act), the issue or transfer of shares (or units of shares) of a company to an entity it controls (self-acquisition) is void unless one of the exceptions in s259C(1)(a)–(d) applies.

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

3 Since then, we have granted interim relief on a case-by-case basis from s259C(1) based on the policy proposed by CP 1.

4 In June 2010, we released Consultation Paper 137 *Indirect self-acquisition by investment funds: Further consultation* (CP 137) to seek feedback on some discrete issues that arose since CP 1 was released. CP 137 included proposals to:

(a) grant case-by-case relief without a sunset clause;

(b) impose an additional condition on relief from s259C(1) for controlled trustees and responsible entities relating to the level of holdings by controlled entities in the trust or scheme;

(c) grant relief from s259C(1) to enable participation in a placement of the company's shares by investment-linked statutory funds and certain related managed investment schemes;

(d) grant limited exemptions under s259C(2) to allow controlled entities to acquire shares in a listed parent company for the purposes of index arbitrage and certain client-driven activities; and

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

5 In June 2011, we released Consultation Paper 162 *Indirect self-acquisition by investment funds: Further consultation—Employee share schemes* (CP 162) to consult on further discrete issues, including the interaction of employee share schemes operated by financial institutions and relief granted to those institutions. We also identified issues relating to some of the standard relief conditions in CP 1 and sought feedback on those issues.

6 This report highlights the key issues that arose out of the submissions received on CP 137 and CP 162 and our responses to those issues. Our policy is contained in Regulatory Guide 233 *Indirect self-acquisition: Relief for investment funds* (RG 233).

7 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question in CP 137 and CP 162. We have limited this report to the key issues.

Responses to consultation

8 We received seven written submissions in response to CP 137 from relevant industry associations, law firms and banks. Three of these submissions were confidential.

9 We received three written submissions in response to CP 162. Two of these submissions were confidential.

10 For a list of non-confidential respondents to CP 137 and CP 162, see the appendix to this paper. Copies of the non-confidential submissions are on the ASIC website at www.asic.gov.au/cp under CP 137 and CP 162.

11 We are grateful to all respondents for taking the time to send us their comments.

© Australian Securities and Investments Commission February 2012

B Responses to CP 137

Key points

After considering the submissions to CP 137, we will:

- provide case-by-case relief from s259C for investment funds and similar entities without a sunset clause;
- not impose an additional condition on the level of holdings in the investment fund by controlled entities;
- amend the timing of disclosure required as a condition of relief; and
- provide relief to permit acquisitions by a controlled entity for index arbitrage and certain client-driven activities.

Sunsetting case-by-case relief

12 Until now, ASIC has granted case-by-case interim relief from s259C based on the conditions in CP 1. Each relief instrument has included a sunset clause so that the relief expires within a 12–24 month period. This was designed to allow us to review our overall policy basis for granting relief.

13 In CP 137, we proposed that our relief no longer be sunsetted as a matter of course because we are satisfied that the policy settings are largely appropriate, based on our experience since the release of CP 1 and considering numerous applications for roll-over of expiring relief.

14 This proposal received unanimous support from respondents, mainly on the basis that granting relief without a sunset clause provides greater certainty to investment funds and other entities relying on the relief. Respondents submitted that the proposal would remove the commercial and administrative costs of regularly applying for interim relief with minimal detriment to regulatory objectives.

ASIC's response

We will generally grant case-by-case relief from s259C without a sunset clause. We can revoke or amend this relief if necessary.

Additional condition for controlled trustees and responsible entities

15 The policy objective in CP 1 for granting relief from s259C for controlled trustees and responsible entities of investment funds was primarily for the benefit of non-controlled investors in a fund, recognising that these investors may otherwise be disadvantaged by not having investment exposure to the particular company.

16 We identified a risk that, without imposing a maximum limit on the company's or its controlled entities' investment in the relevant fund, the benefit of our relief could flow primarily to the company itself rather than third party investors. Further, we were concerned that in such a scenario:

(a) the risk of price opacity may be increased;

(b) there may be an increased potential for corporate collapse; and

(c) there may be implications on the market for control of the company.

17 In CP 137, we proposed an additional condition on our relief for controlled trustees and responsible entities of investment funds. Any relief would cease to apply if the company and its controlled entities have a relevant interest of more than 20% in the scheme or trust (proposed 20% condition).

18 The proposed 20% condition was in addition to the following conditions we usually impose on relief from s259C, which also aim to limit the practical effect of the risks outlined in paragraph 16:

(a) the number of the company's voting shares over which controlled entities can exercise the power to control voting or disposal is limited to 5% of the total number of shares on issue (5% limit); and

(b) the company or its controlled entities are prohibited from voting the shares acquired in reliance on the relief.

19 There was little support in the submissions to CP 137 for the proposed 20% condition. Respondents variously submitted that:

(a) a company could hold a 20% relevant interest in the units or interests of a managed investment scheme without having invested its own funds; and

(b) legitimate commercial reasons exist for a company to hold a significant (greater than 20%) relevant interest in a scheme or trust. Examples include the following:

(i) *Seed capital needs*: Where controlled entities 'seed' a fund to establish a track record before a public offering, they will typically hold more than 20% of the units in the fund.

(ii) *Interfunding*: A greater than 20% relevant interest may arise where one or multiple funds invest in another fund. For example, a retail fund may invest in a wholesale fund for efficiency purposes where the two funds' investment objectives are compatible.

(iii) *Platforms and superannuation*: A platform (wrap or master trust) could contribute to a relevant interest of more than 20% of the units on issue in a particular fund even though those interests are acquired on behalf of investors. A similar situation could exist for interests acquired by managers of superannuation funds.

(iv) *External redemption*: A relevant interest may exceed 20% where other unitholders withdraw from the fund and redeem their units.

20 A range of alternatives to the proposed 20% condition were suggested by respondents, which we considered in the course of reaching our final policy position.

> *ASIC's response*
>
> We will not impose any additional condition relating to holdings of a company or its controlled entities in a trust or scheme.
>
> We consider that the current 5% aggregate limit on the company's shares for all holdings by controlled entities sufficiently reduces the practical risks that can arise from self-acquisition.
>
> Furthermore, it appears likely that a condition limiting relief based on holdings in a trust or scheme would cause significant practical problems by restricting fund management activity as discussed in paragraph 19.

Relief for participation in placements

21 Under the conditions on which we have previously given relief from s259C(1), the company's shares could not be acquired by a controlled entity via a placement without prior approval of the shareholders of the company. This was intended to address the risk of preferential treatment.

22 In CP 137, we proposed that relief from s259C(1) should be granted to allow participation in a placement of the company's shares without shareholder approval in the following circumstances:

(a) participation on behalf of the statutory funds of a controlled entity that carries on the life insurance business of providing investment-linked benefits; and

(b) participation by managed investment schemes that have a controlled entity as responsible entity that would otherwise be able to participate in a placement, but for a life insurance company holding interests in the scheme in relation to an investment-linked statutory fund (related managed investment schemes).

23 We proposed that such participation would be subject to certain conditions:

(a) participation in the placement by the investment-linked statutory fund or related managed investment scheme must be on the same or no more favourable terms than those offered to other participants;

(b) no more than 15% of the shares issued in the placement may be issued to, or for the benefit of, all controlled entities; and

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

24 The overall rationale for this proposal was that holders of the life insurance policies and investors in the related managed investment scheme may be disadvantaged if the life insurance company or related scheme cannot

participate in a placement of the company's shares. We also recognised that the overall economic interest of the company in investments made on behalf of investment-linked statutory funds is very limited. Nevertheless, an incentive for the company to prefer controlled entities in a placement exists.

Who should be allowed to participate in placements?

Investment-linked statutory funds

25 All but one of the respondents were in favour of allowing participation in placements made on behalf of investment-linked statutory funds.

26 One respondent disagreed with our proposal and submitted that a controlled entity should have the objective of earning revenue for the parent company, not from it and, further, that the source of funds via a placement should be obtained from outside the corporate umbrella.

Other types of statutory funds

27 One respondent submitted that other types of statutory funds should also be permitted to participate in placements of the company's shares, given the conditions proposed in CP 137 as well as existing conditions in current relief and the requirements of the *Life Insurance Act 1995* (Life Insurance Act): see paragraph 39 of CP 137.

28 Under the Life Insurance Act, a minimum of 80% of the profits from investments held by a participating statutory fund must be allocated to policyholders.

ASIC's response

We consider that the following types of statutory funds should be permitted to participate in a placement, subject to the specific placement conditions discussed below:

- investment-linked statutory funds; and
- participating statutory funds.

We consider that the primary beneficiaries of any relief given to these two types of statutory funds are the non-controlled, third party policyholders. This is evidenced by:

- the nature of investment-linked statutory funds, being similar to unit trusts, and the limited interest of the shareholder in this type of fund; and
- the limitations on the distribution of profits of participating businesses to shareholders in the Life Insurance Act.

As such, we consider the incentive for a company to prefer these statutory funds in a placement is limited.

We have generally not given relief in the past to investments made by non-participating statutory funds as the 'payout' from these types of policies is generally a set amount that is not linked to the investment held by the statutory fund. We do not intend to alter this position.

Managed investment schemes in which statutory funds invest

29 In CP 137, we proposed that relief to participate in a placement without shareholder approval should also extend to an acquisition by a related managed investment scheme that would otherwise be able to rely on the trustee exception in s259C(1)(b), but for the fact that some interests in the related scheme were held on behalf of an investment-linked statutory fund of a controlled life insurance company.

30 Respondents were generally in favour of this proposal.

> *ASIC's response*
>
> We will extend our relief to related managed investment schemes, in line with our relief to allow participation in a placement on behalf of certain investment-linked statutory funds of life insurance companies.

Other types of controlled trustees and responsible entities

31 We also asked whether we should permit participation in placements by trusts or schemes where a controlled entity or the company has a beneficial interest in the trust or scheme (other than a statutory fund) and therefore cannot rely on the exception in s259C(1)(b). Respondents were generally in favour of this proposal and noted the fiduciary and other duties owed by directors of the responsible entity or trustee as protection against the risks of self-acquisition.

> *ASIC's response*
>
> We will extend our relief to all other institutional entities that are eligible to rely on the relief from s259C. In most instances, the primary beneficiary of this amendment to our policy will be third party investors in the relevant investment fund.
>
> The conditions we will impose (see paragraphs 32–38) limit the risk of preferential treatment of controlled entities.
>
> The existing 5% limit imposed on our relief also acts as an overall limit on the level of interests that can be held by controlled entities.

Conditions of relief for participation in placements

Participation on same or no more favourable terms

32 In CP 137, we proposed that the relevant controlled entities should only be permitted to participate in the placement on terms that were the same or no more favourable than other participants.

33 Respondents generally supported this condition.

> *ASIC's response*
>
> We will impose this condition on our relief, but it will apply to the terms offered to all controlled entities. This ensures that controlled entities do not receive preferential terms in the placement.

15% maximum participation

34 Respondents did not generally support a condition limiting the maximum level of participation in a placement by controlled entities, although none of the respondents expressed strong practical concerns about the proposed 15% maximum level.

35 Respondents argued that this condition is unnecessary for the following reasons:

(a) No such condition is imposed on managed investment schemes or unit trusts in which controlled entities do not have a beneficial interest, as these schemes do not require any relief from ASIC to acquire the company's shares. Accordingly, by imposing a maximum placement participation condition on statutory funds, it was submitted that ASIC may affect the relative competitiveness of a life insurance fund compared with a managed fund structured as a trust.

(b) The duties of the directors of the company and the controlled entities should prevent abuse of the placement allocation process.

36 One respondent proposed a possible alternative condition to limit participation by controlled entities based on their existing pro rata holdings, subject to a level of tolerance above this holding for over-allocations in the event of a shortfall. It was submitted that this would not be inconsistent with general market practice, given it is not uncommon for institutional placements to be made pro rata between existing institutional shareholders who participate in the placement, with a potential for over-allocation if other institutions do not take up their respective proportion of the placement.

37 Another respondent queried whether it was appropriate to include in the limit acquisitions by controlled entities that can participate in the placement without any relief from ASIC by virtue of a statutory exception in s259C(1)(a)–(d). It was submitted that it is not appropriate for ASIC to seek to regulate these entities by alternative means when Parliament has already decided that such acquisitions should not be prohibited under s259C.

ASIC's response

We will impose a condition limiting the allocation to all controlled entities to 15% of shares issued under the placement. We consider this is appropriate because:

- this condition limits the ability of the company to prefer controlled entities in a placement;
- a 15% limit would not unduly fetter the discretion of the controlled entities to participate; and
- the condition helps to ensure arm's length pricing.

> We considered but will not adopt the pro rata condition advanced by one respondent for the following reasons:
>
> - a pro rata condition may in some instances be more restrictive than a 15% maximum condition depending on the existing holdings by controlled entities; and
> - it is a more complex condition than a set percentage limit, which could create difficulties in compliance.
>
> We do not agree with the submission advocating the exclusion from the 15% limit of certain entities that have the benefit of a statutory exception in s259C(1)(a)–(d). We believe that the risks of self-acquisition in a placement increase along with the level of participation of all controlled entities and therefore any maximum limit should include participation by all controlled entities.

Company must maximise the placement price as far as practicable

38 While respondents noted that in practice maximising the placement price as far as practicable was likely to occur, respondents were generally opposed to this condition on the basis that:

(a) it would be difficult to determine compliance with the condition—for example, the meaning of the term ‘as far as practicable’ is not clear and determining whether the board’s judgement was reasonable is a subjective process;

(b) placement price is determined by numerous factors, including urgency, risk and need for funds, making a pricing condition overly simplistic; and

(c) determination of the placement price is properly the function of a well-advised board, with directors being under fiduciary duties to act in the best interests of all shareholders.

> *ASIC’s response*
>
> We will not impose a pricing condition.
>
> We agree with respondents that this condition might be difficult to monitor and enforce in these circumstances. We also consider that the 15% condition will help to ensure that, as the majority of participants are non-controlled institutions, the pricing will be on arm’s length terms.

Disclosure of interests by controlled entities

39 In the past, we granted relief from s259C with the following disclosure conditions:

(a) *Periodic reporting*: The company must announce to the financial market the aggregated percentage total of its voting shares (aggregated interests) for which:

(i) the company’s controlled entities have the power to control voting or disposal; and

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

An announcement must be made on commencement of the relief and every 14 days after the last announcement under paragraph 39(a) or paragraph 39(b).

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

40 In CP 137, we proposed that these conditions should be varied so that:

(a) the requirement for periodic reporting is increased from 14 days to three months. We proposed this change following feedback via applications that indicated that the 14-day requirement was burdensome and may not provide meaningful information to the market; and

(b) the time required to report a change of 1% or more is increased from one to two days. We proposed this change to bring the reporting timetable more in line with substantial holding notice requirements.

41 All but one of the respondents were generally in favour of increasing the length of periodic reporting to three months, submitting it would reduce the administrative burden on the reporting entity. At least one respondent submitted that this requirement should be removed as it is unnecessary and onerous given the requirement to report changes of 1% or more.

42 Respondents were also generally supportive of increasing the reporting time for changes of 1% or more from one to two days.

43 Respondents made the following submissions among others:

(a) Investment funds should be given the flexibility to report more frequently than every three months, as the volume of transactions and therefore length of notices over an extended period could create difficulties.

(b) The disclosure conditions should not require every controlled entity in the group to be separately identified and every transaction separately reported, as this information is not useful to the market, especially if the interest is less than 5%, and creates a significant administrative burden.

44 One respondent was not in favour of amending the reporting timeframes and considered periodic reporting every 14 days was appropriate.

ASIC's response

Under our policy in RG 233:

- periodic reporting is required at least every three months on the basis that an extended reporting period still provides sufficient information to the market to address the risks of insider trading and market manipulation. The company may choose a reporting period to reflect its operations, but it must be no longer than three months. In finalising our policy on this issue, we note that the company will also have an obligation to report to the market changes of 1% or more; and
- the time required to report changes of 1% or more is increased from one to two days to bring this requirement into line with the substantial holding notice requirements.

In relation to the submission on the administrative burden of reporting for separate entities and transactions, we consider that combined reporting would reduce the deterrence effect of the disclosure conditions. We note that entities have existing obligations to comply with the substantial holding notice requirements on an individual basis, so the same systems should be able to capture much of the information needed for disclosure of interests.

Relief for index arbitrage

45 In CP 137, we considered whether to grant conditional case-by-case relief to controlled entities of listed companies who engage in securities dealing for the purposes of index arbitrage and client-driven activities involving self-acquisition.

46 The submissions supported granting relief to facilitate index arbitrage transactions because:

(a) the effect of index arbitrage transactions is to correct mispricing, increase liquidity and improve efficiency in the market (which benefits all investors);

(b) index arbitrage is a market-neutral method of pricing, executing, using and creating 'stock inventory' because the securities dealer is not economically exposed to individual price movements of the underlying securities due to the off-setting futures position; and

(c) index arbitrage is typically the central tool by which 'stock inventory' is generated to facilitate all other client-driven index or portfolio activity.

47 The submissions also supported granting relief to facilitate all the proposed client-driven activities. In particular, the submissions noted that:

(a) these client-driven activities generally involve holding the shares for a short period of time with the sole purpose of executing a client order. However, engaging in these activities for over-the-counter (OTC) and listed derivative products involves holding the shares for a longer period of time to hedge exposure; and

(b) most of the activities also form core parts of index arbitrage.

48 There was support for the proposed conditions of relief, with respondents noting that these conditions generally address the regulatory risks described in CP 137.

ASIC's response

We will grant conditional case-by-case relief to controlled entities of listed companies who engage in securities dealing for the purposes of index arbitrage and other client-driven activities involving self-acquisition, including:

- acquiring company shares as part of a portfolio of securities in exchange for or to redeem interests in an exchange-traded fund on behalf of a client;
- acquiring company shares as part of an exchange for physical transaction entered into with a client;
- hedging to address risks in issuing warrants or index and basket derivatives to a client;
- acquiring a basket of securities for a client; or
- basket securities lending activities.

For more information on the conditions of our relief, see RG 233.

C Responses to CP 162

Key points

After considering submissions received in response to CP 162, we have:

- amended the calculation of the 5% limit to include the company's interests as well as the interests of controlled entities;
- excluded certain employee share scheme interests from the 5% limit;
- not imposed a prudential condition on relief; and
- clarified the requirements relating to disclosure of economic interests.

Calculation of 5% limit

49 As outlined in paragraph 18(a) of this report, as a condition of our interim relief from s259C, the number of the company's voting shares over which controlled entities can exercise the power to control voting or disposal is limited to 5% of the total number of shares on issue (5% limit).

50 In CP 162, we proposed that the 5% limit for the purpose of our relief should include shares over which the following entities have the power to control voting or disposal:

(a) the company itself; and

(b) the controlled entities of the company.

51 Previously, the condition did not require interests held by the company to be included in the 5% limit, only interests held by controlled entities of the company. We consider that there is no persuasive reason for this distinction, given the 5% limit is designed to limit the group's overall control over the parent company.

52 Respondents were generally in favour of this proposal.

53 One respondent was not in favour of this proposal, but we do not agree with this respondent's submission that interests could be counted multiple times under our proposal.

ASIC's response

Under our policy in RG 233, both the interests of the company as well as its controlled entities will count toward the 5% limit, as a condition of our relief from s259C.

Interests acquired under employee share schemes

54 In CP 162, we consulted on whether we should amend the 5% limit where a company acquired significant interests in itself for the purposes of an employee share scheme. We understand that some companies (or their controlled entities) can control disposal of the company's shares in certain instances under an employee share scheme. This power can be exercised by the company, for example, upon forfeiture of entitlements by an employee or upon certain taxation events.

Proposed options

55 We proposed two alternative scenarios in which we would be prepared to modify the 5% limit for interests acquired under employee share schemes.

Option 1: No shareholder approval

56 We proposed the following modification of the 5% limit where shareholder approval was not obtained:

(a) the total aggregate interest in the company's shares held by the company and its controlled entities, including from employee share schemes, must be less than 10% of the company's voting shares, with a maximum of 5% for interests other than those acquired through an employee share scheme;

(b) the employee share scheme must allow employees to direct acceptances into a 'successful' takeover bid or be transferred or cancelled in a scheme of arrangement;

(c) employees must be able to direct voting of shares allocated to them; and

(d) unallocated shares must be reallocated or disposed of within a short period of time.

Option 2: Shareholder approval

57 We proposed the following modification of the 5% limit where shareholder approval was obtained:

(a) there is a maximum of 5% for interests acquired other than through employee share schemes;

(b) the company must obtain shareholder approval of the maximum level of employee share scheme interests, with certain voting restrictions at the meeting;

(c) employees must be able to direct voting of shares allocated to them under the employee share scheme; and

(d) unallocated shares must be reallocated or disposed of within a short period of time.

Responses to our proposals

58 Respondents were generally opposed to both of our proposed options.

59 Some respondents submitted that there is no proper regulatory basis for the 5% limit, given that Ch 6 of the Corporations Act already sets limits on the acquisition of self-interests. They argued that the function of s259C is directed at the maintenance of capital rather than about regulating control. They submitted that applying this limit to financial institutions which require relief from s259C creates an inappropriate divergence in the regulation of the control of these companies versus companies that do not need this relief.

60 These respondents further submitted that if ASIC still believes it is necessary to retain the 5% limit then, subject to appropriate conditions, self-interests acquired under employee share schemes should be excluded from the calculation of that limit for the following reasons:

(a) There are strong policy reasons to promote the use of employee shares schemes. Financial institutions are strongly encouraged, and in some jurisdictions required, to pay a significant portion of employee incentives through at-risk equity incentive plans.

(b) The nature of the power held by the company and its controlled entities is 'technical' and does not represent a material control risk. The company and its controlled entities do not have the power to vote the shares and can only exercise disposal rights in accordance with vesting and forfeiture criteria.

(c) The Takeovers Panel can deal with any mischief which may arise (although it was submitted that such mischief is unlikely).

(d) There is no distortion of the voting power of other shareholders if employees can direct the voting of shares held on their behalf.

61 One respondent also submitted that ASIC should generally allow shareholder approval of self-acquisition of shares that do not fall within the proposed conditions of relief.

> *ASIC's response*
>
> After considering the submissions, we think that in some instances excluding shares acquired for employee share schemes from the 5% limit may be warranted where the nature of the power over the shares is limited and does not pose a significant risk that the company (or its controlled entity) will exercise that power in an inappropriate manner.
>
> In forming this view, we took into account:
>
> - the existing statutory protections on control in Ch 6 of the Corporations Act; and
> - the resulting difference in treatment of financial institutions that require relief from s259C and other companies that do not require similar relief.
>
> We consider that imposing a 5% limit on relief is justified in that one of the purposes of s259C is to address control risks.

Under our policy in RG 233, interests acquired under employee share schemes may be excluded from the 5% limit subject to the following conditions:

- the company has no voting power and exercises power over disposal only in limited circumstances (e.g. in the event of forfeiture or if vesting conditions are not met) and under the rules of the relevant scheme;
- the shares were not acquired in reliance on any relief from s259C;
- unallocated shares are reallocated or disposed of within a short period of time and no further shares are acquired for employee share scheme purposes until any unallocated shares are reallocated or disposed of;
- employees can direct voting of shares allocated to them;
- the employees can direct acceptances into a 'successful' takeover bid and the shares can be transferred or cancelled as part of a merger by scheme of arrangement; and
- self-interests acquired under the employee share scheme are clearly identified in the company's substantial shareholder notice.

Prudential condition

62 We sought feedback on whether, in cases where the 5% limit was exceeded, we should impose a condition limiting the amount of the company's shares held by a controlled trustee or responsible entity to a certain percentage of the fund's assets (prudential condition). This type of condition is designed to address the risk of conflict of interest.

63 In CP 1, we had previously stated that we did not consider that a prudential condition was necessary, but this view was predicated on the 5% limit being strictly imposed.

64 Respondents were opposed to a prudential condition. They noted:

(a) relief from s259C is not an appropriate mechanism to impose prudential regulation;

(b) any prudential regulation should be considered more broadly across all managed investment schemes and trusts rather than in a 'piecemeal' manner;

(c) general law and statutory duties should be sufficient to protect against the improper use of trust money to purchase shares in the holding company; and

(d) such a condition may impinge upon the fund's investment mandate.

ASIC's response

We broadly agree with respondents' submissions. We will not impose a prudential condition on relief where the 5% limit is exceeded.

Disclosure of economic exposure through derivatives

65 In CP 162, we sought feedback on whether the disclosure conditions imposed on our relief (see paragraphs 39–44) should be revised. In the past, we have imposed a condition requiring the company to announce to the market the aggregated percentage total of:

(a) the voting shares over which the company and its controlled entities have the power to control voting and disposal; and

(b) the shares to which the company and its controlled entities have an economic exposure arising from derivatives.

66 We proposed that a company should report two percentage figures:

(a) the percentage level of voting shares in which group entities have the power to control voting or disposal; and

(b) the percentage level of the total net physical and economic exposure.

67 Most respondents favoured reporting a single percentage representing net physical and economic exposure. However, some respondents noted that this disclosure may impose a compliance burden.

ASIC's response

We agree that the percentage level of net physical and economic position should be the most accurate representation of group entities' exposure to the company's shares. However, we also believe that interested parties should be able to monitor compliance with the conditions of the relief instrument, including the 5% limit.

Under our policy in RG 233, two percentage figures will need to be reported:

- *a 'self-interest' position*, reflecting the percentage level of voting shares in which group entities have the power to control voting or disposal; and
- *a 'net economic' position*, reflecting the percentage level of total net physical and economic exposure.

We acknowledge that all reporting requirements involve a level of compliance burden. We have tried to reflect reporting of figures that companies are already likely to be calculating in their risk and compliance systems.

In finalising our policy, we also considered the existing statutory reporting requirements in Ch 6C of the Corporations Act.

Appendix: List of non-confidential respondents

Non-confidential respondents to CP 137	Non-confidential respondents to CP 162
• Agsten, Ms Felicity • Blake Dawson • Financial Services Council • Westpac Group	• Law Council of Australia