



ASIC

Australian Securities & Investments Commission

REPORT 373

Response to submissions on CP 196 Periodic statements for quoted and listed managed investment products and relief for AQUA products

October 2013

About this report

This report highlights the key issues that arose out of the submissions ASIC received on Consultation Paper 196 *Periodic statements for quoted and listed managed investment products and relief for AQUA products* (CP 196), and outlines 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.

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

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A Overview/Consultation process

- 1 In Consultation Paper 196 *Periodic statements for quoted and listed managed investment products and relief for AQUA products* (CP 196) we consulted on proposals for relief to allow issuers of interests in registered managed investment schemes (registered schemes) that can be traded on a licensed financial market to report the balances and values required under s1017D of the *Corporations Act 2001* (Corporations Act) on a modified basis.
- 2 CP 196 also covered proposals for relief to facilitate the trading of interests in a registered scheme on the AQUA market of ASX.
- 3 This report is not intended to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 196. We have limited this report to the key issues.

Responses to consultation

- 4 We received eight submissions on CP 196 from industry bodies, licensed financial markets, fund managers, and a securities registrations firm. We are grateful to respondents for taking the time to send us their comments.
- 5 Generally, respondents were supportive of our proposed relief so that issuers of management investment products may report the content in a periodic statement on a modified basis. However, some respondents had concerns about some aspects of the proposed relief, particularly the use of price proxies in reporting transaction details where the actual price at which securities were bought by investors is not known to the issuer.
- 6 Respondents were similarly supportive of our proposed relief to facilitate the quotation of exchange-traded funds (ETFs) on the AQUA market. However, some respondents had concerns about the condition of relief that all members must be given a right to redeem interests in the scheme if quotation of interests in the scheme is suspended from trading for more than five trading days.
- 7 For a list of the non-confidential respondents to CP 196, see the appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 196.

B Periodic reporting

Key points

This section outlines the key issues covered in submissions received on CP 196 about periodic reporting, and our responses to those issues.

It covers:

- obligations under s1017D of the Corporations Act;
- net asset value or market price;
- termination value;
- increase in contributions; and
- reporting the performance of the scheme.

Obligations under s1017D of the Corporations Act

- 8 In CP 196, we proposed to give class order relief from the content requirements for period statements in s1017D(5) to allow responsible entities of registered schemes that are listed or quoted to use a substitute price for transactional values.
- 9 Our rationale for the proposal was to overcome the practical difficulties involved in preparing periodic statements where issuers and their service providers do not know the transaction price at which an investor bought or sold their interests in the scheme on secondary market.
- 10 Several respondents strongly supported the proposal for class order relief. These respondents acknowledged that class order relief would provide the market with greater certainty, efficiency and consistency.
- 11 However, most respondents strongly opposed our view on the obligations arising under s1017D. These respondents argued that s1017D does not give individual investors a right to receive personalised periodic statements for all managed investment products. They considered that issuers have a discretion to determine whether a periodic statement must be provided to individual retail investors.
- 12 Some respondents submitted that investors will receive the content information set out in s1017D from other sources, such as a trade confirmation certificates from the investors' broker and end-of-month holding statements. One respondent submitted that it is more appropriate to have issuers direct investors to the information available from their broker or adviser.

- 13 Another respondent argued that many of the requirements of the Corporations Act (including those in s1017D) as they apply to registered schemes cannot be readily applied to ETFs due to their open-ended nature and transparent underlying pricing mechanism.
- 14 There was general consensus among the respondents that requiring issuers to provide periodic statements would result in significant initial and ongoing compliance costs for responsible entities.

ASIC's response

We consider that it is consistent with the intention of Parliament that issuers of listed and quoted managed investment products comply with the requirements in s1017D, in addition to the reporting and audit requirements of Ch 2M and their continuous disclosure obligations under s675. Based on the discussions we have had with responsible entities, we do not consider the relevant issuers are complying with s1017D, even after taking into consideration s1017D(7).

We acknowledge that investors are given or have access to information provided by issuers and other Australian financial services (AFS) licensees under other statutory reporting and disclosure requirements. However, there are important differences in the information that must be given in a periodic statement. The content requirements for periodic statements in s1017D are intended to provide information about investors' holdings at an individual level for the entire reporting period. In addition, there are requirements for dollar fee disclosure as well as other useful information that the periodic statement provides to investors about their investment and the managed investment scheme that they invest in.

We acknowledge the comments about the likely compliance and operating costs in issuing periodic statements. However, we consider periodic statements are appropriate and necessary to provide investors with information they need to assess the performance of their investment and understand the nature and purpose of transactions in their investment. In response to submissions made about the contents of the periodic statements we have modified the requirements for preparing the statements as outlined below.

Net asset value or market price

- 15 In CP 196, we proposed that, under the class order relief, instead of reporting on the basis of the actual value of the investment of an investor (e.g. on the basis of the price at which the investor has purchased or sold the interests), issuers may report on a modified basis.
- 16 We consulted about whether issuers should report on the basis of:
- (a) the market price of the interests, either on the date of the trade or the date of settlement (market price); or

(b) the net asset value per interest in the scheme on either the date of trade or the date of settlement.

- 17 There was broad opposition from most respondents to our proposal to use net asset value or market price as a price proxy. Respondents submitted that transaction information based on price proxies rather than the actual prices at which transactions have been conducted would be of no practical benefit to investors.
- 18 Some respondents argued that periodic statements based on net asset value or market price has the potential to mislead or confuse investors as the returns would be based on non-actual and non-traded prices. One respondent submitted that the market price fluctuates during the day in such a significant way that disclosing dollar amounts based on market price would not be beneficial or relevant to investors.
- 19 Those respondents opposed to this proposal submitted that price proxies may cause confusion for retail investors who will receive the actual price of their transaction through other means, such as their trade confirmation certificate from their broker. There was a submission that instead of periodic statements being based on a price proxy, issuers should provide guidance to investors as to where accurate information can be found, for example, from their broker or adviser.
- 20 One respondent argued that reporting the return on investment in the periodic statement based on a price proxy would be misleading. The respondent submitted that relief should be provided to allow responsible entities to report the return of the scheme for the whole reporting period (whole of fund return) instead of the actual or estimated return by the investment of the investor.
- 21 We also sought feedback on an alternate proposal to price proxies, where an issuer would be permitted to omit any information that it could only include if it had knowledge of the prices at which investors had actually conducted transactions.
- 22 Respondents were strongly supportive of this approach. One respondent submitted that omitting this information would reflect the reality of the ETF market, as ETF units are acquired on a secondary market, not as primary issues to investors.
- 23 We received a submission on the preparation of periodic statements for stapled securities. The respondent submitted that the price the security trades at is the price of both the component of the security, the interest in the unit trust, and another security (commonly a share in the company). The content requirements for periodic statements in s1017D apply only to the trust component. However, issuers may not be able to calculate the apportionment

between the stapled securities to prepare the statement for the interest in the trust alone.

ASIC's response

Under our class order relief, issuers are not required to report the monetary value of transactions when they do not know the actual transaction price. However, the transaction date and the number of units transacted must be reported in all circumstances. Issuers must also provide a clear and prominent notice in the periodic statement indicating where the investor can obtain the details of their transaction, such as from their broker or adviser.

While issuers are not required to report the monetary value of transactions where the actual transaction price is unknown, they may choose to provide the details of transactions to investors based on net asset value, market price or other appropriate proxy if the issuer considers the information is not misleading and will be useful to investors to understand their investments. If an issuer reports the details of transactions on such a basis, it must satisfy itself that the information will not be misleading or confusing to the investor.

If an issuer has knowledge of the value and volume at which the transaction took place (e.g. in a distribution reinvestment plan), it must include the price and volume of the relevant transaction in the periodic statement.

Issuers must provide all the information required in s1017D (i.e. an investor's opening and closing balances in dollar amounts and fees, charges or expenses). Details of the transactions during the reporting period and the return on investment in dollar amounts do not need to be provided if the issuer does not know the actual transaction price.

However, if an issuer chooses to report the information based on net asset value, market price or other appropriate proxy, the periodic statement must include a clear and prominent explanation of the basis on which the balances and the values have been calculated and the implications of applying that basis.

Under our relief, issuers of stapled securities that are unable to prepare periodic statements for the interest in the trust are only required to prepare the statement using the price of the stapled security. The preparation on this basis should be clearly explained to investors in the periodic statement.

Termination value

- 24 In CP 196, we proposed that periodic statements would not be required to include the termination value if the fees or expenses related to redemption from the scheme are not applicable to retail investors. That is, the termination value would be the same as the closing balance.

- 25 Respondents agreed with the proposed approach of not reporting the termination value where there were no fees or expenses. They submitted that reporting a termination value in these circumstances would provide no practical benefit to investors.

ASIC's response

Under our class order relief, responsible entities are not required to include the termination value in their periodic statements where the termination value is the same as the closing balance.

Increase in contributions

- 26 In CP 196, we proposed that we do not expect any increase in holding in the scheme through on-market acquisitions to be reported, as currently required under s1017D(5)(c). As part of the structure of ETFs, new interests are not generally issued directly to retail investors. In situations where investors are not able to apply for new interests in the scheme, investors may increase their holdings through acquiring interests in the scheme on market.
- 27 Respondents were supportive of the proposal that units acquired on market should not be subject to the reporting requirements of s1017D(5)(c).

ASIC's response

Under our class order relief, any increase in holding in the scheme through on-market acquisition is not required to be reported in the issuer's periodic statement.

Reporting the performance of the scheme

- 28 In CP 196, we proposed that the content of periodic statements should include a report, on an annual and a five-yearly basis, on the performance of the scheme relative to the investment strategy set out in the fund's product disclosure agreement.
- 29 Our rationale for this proposal was to ensure that investors have adequate information to understand their investments.
- 30 A minority of submissions opposed the proposal for an annual and five-yearly report, arguing that a performance report would not materially add to investors understanding of their investments. One respondent submitted that for simple index tracking funds, it is clear what the investment strategy comprises, and the products are against indices for which data is freely available.

- 31 A second respondent argued that Australian Real Estate Investment Trusts (AREITS) relate to the types of assets that will be acquired, as opposed to achieving a performance benchmark or tracking a relevant index. The respondent further submitted that responsible of AREITS are often unwilling to provide financial forecasts due to the nature of the fund.
- 32 Further, some respondents noted that information about the performance of the scheme relative to the investment strategy is usually available on the issuer's website, and should not be reported in the periodic statement.
- 33 Other respondents submitted that s1017D does not currently require issuers of listed and quoted managed investment products to provide such a report. They argued that issuers are already required to provide more information to their investors than traditional managed funds, in addition to the information required under ASX's operating rules.
- 34 Among the submissions, one respondent argued that providing a percentage return indicating the performance of the fund next to a dollar return may be confusing to investors, and such a comparison may not be satisfactorily explained through a disclaimer.

ASIC's response

Under our class order relief, the content of the periodic statement must include a report on the performance of the scheme relative to the investment strategy set out in the fund's Product Disclosure Statement (PDS). We consider that this information is useful for members in understanding how their money has been invested.

Although the disclosure of this information will be a condition of the periodic statement class order relief for quoted interests, we view that such disclosure would in any event be required under s1017D(4).

This requirement may be satisfied by disclosing the performance of the scheme on the issuer's website. An example might be an annual presentation to members, provided the periodic statement contains a summary of the presentation together with information on how the presentation may be accessed.

We have not specified the method for assessing performance of the fund that must be used by issuers. This gives the responsible entity for the scheme flexibility in determining the most appropriate method for providing investors with an assessment of the performance of the fund relative to the investment strategy.

C Relief to facilitate quotation of ETFs on the AQUA market

Key points

This section outlines the key issues covered in submissions received on CP 196 about our proposed class order relief to facilitate the quotation of management investment products on the AQUA market, and our responses to those issues.

It covers:

- members right to redeem interests in the scheme;
- disclosure of portfolio or assets for *in specie* issue or redemption;
- relevant interest; and
- substantial holding relief.

Members right to redeem interests in the scheme

- 35 In CP 196, we consulted on a condition of class order relief that members must be given a right to redeem interests in the scheme if quotation of interests in the scheme is suspended from trading for more than five trading days, unless:
- (a) the scheme has been terminated;
 - (b) it is a non-liquid scheme; or
 - (c) the responsible entity suspends redemptions when it would be reasonable to do so and in doing so the responsible entity would be acting in the best interest of members. If a fee applies to members, the fee must not be disproportionate to the relevant costs to the responsible entity.
- 36 Some respondents were opposed the proposal to allow direct member redemptions in these circumstances. Those respondents noted that direct member redemptions do not form part of the current conditions imposed on responsible entities of ETFs who have been granted relief by ASIC on an individual basis.
- 37 Submissions were made that allowing for direct member redemptions would require existing scheme constitutions to be amended, which may require member approval. One respondent raised a concern that if member approval is not obtained, the responsible entity would be in breach of the proposed condition.

- 38 Respondents also submitted that giving all members the right to redeem in cash would involve additional costs that are not currently associated with the redemption of ETFs which is typically by transfer of assets *in specie*.
- 39 Other submissions noted that the ETF may have to sell assets to generate sufficient cash to pay members' redemptions. ETFs have not been designed to hold large cash levels, and holding additional cash could increase tracking error against the index. This may affect the returns to investors.
- 40 Respondents opposing the proposed condition of relief supported the need for further consultation on the compliance costs associated with this condition. Alternatively, if the condition was imposed, the respondents submitted that an extended transition period would be preferred to allow for responsible entities to implement the changes.
- 41 An alternative condition was proposed by one respondent, in that instead of direct member redemptions, all redemptions would be suspended if quotation of interests in the scheme is suspended from trading for more than five trading days.

ASIC's response

Under our class order relief, members must be given a right to redeem interests in the scheme if quotation of interests in the scheme is suspended from trading for more than five trading days. This condition will not be imposed on exemptions we have previously granted. As the relief applies prospectively, responsible entities will be able to include provisions in new ETF constitutions to facilitate direct redemptions by all members of the scheme in circumstances where trading has been suspended for more than five trading days.

We consider that the right to direct redemptions means that retail investors have a degree of protection against the risk of being locked into non-liquid investment contrary to their expectations if the ETF is suspended for an extended period of time. The right is important because retail investors in particular expect that their investment will be liquid and relatively easy to realise.

In general, ETFs are required to invest in liquid assets that can be easily priced and issuers engage market makers to promote liquidity in ETFs on the secondary market. However, in the absence of a direct redemption right, if an ETF is suspended from quotation, retail investors will have difficulty realising the value of their investment.

While we expect that suspensions exceeding five days are likely to be rare, we consider it is necessary to ensure that retail investors are protected should this occur.

In providing members with a right to redeem interests directly, the responsible entity has discretion in establishing the process by which members can redeem their interests. This flexibility may reduce the compliance costs associated with allowing for direct member redemptions.

Issuers are also not prohibited from charging a fee to investors who exercise this redemption right that is commensurate with the costs of processing the redemption. Any pricing provisions could and would be expected to also cover any taxation liability and transaction costs.

Disclosure of portfolio or assets for *in specie* issue or redemption

- 42 In CP 196, we sought feedback on our proposal for class order relief so that the disclosure of portfolio or assets for *in specie* issue or redemption that is provided to members who are not authorised participants can be delayed up to a time before the commencement of the next trading day after the day on which disclosure is made.
- 43 The relief would be subject to the condition that an indicative net asset value per interest for the scheme is published on the issuer's website so that it is up-to-date within 15 minutes during the day.
- 44 Our rationale for this proposal was to prevent particular trading to be predicted or to enable real-time calculation by the public of an index that may be sold under subscription.
- 45 Respondents were supportive of the proposed relief for the delayed disclosure of index or portfolio information to members who are not authorised participants.
- 46 One respondent argued that the responsible entity should not be required to provide an indicative net asset value per interest for the scheme, as the value may be misleading about the actual value of an interest for the scheme. This may not be in the best interests of members.
- 47 Another respondent submitted that the condition should only apply during normal ASX trading hours.

ASIC's response

We have given class order relief for the delayed disclosure of index or portfolio information to members who are not authorised participants. This relief is provided on the condition that the responsible entity provides an indicative net asset value per interest for the scheme. This indicative value must be published on the issuer's website and be up-to-date within 15 minutes during normal ASX trading hours.

If an issuer considers the indicative net asset value to be misleading and does not wish to rely on the class order relief, it may still apply to ASIC for individual relief. Applications for individual relief will be assessed on their merits and relief granted only if it is considered appropriate in the circumstances.

Relevant interest relief

- 48 In CP 196, we proposed to give relief from s606 to members who have a right to request an *in specie* redemption from an ETF that tracks a broad-based index in which no security is more than 10%.
- 49 Submissions were supportive of the proposal. However, they raised concerns that the relief would have limited application as it only relates to an ETF that tracks an index in which no security is more than 10%. Those respondents argued that few ETFs will satisfy this criterion.
- 50 Respondents also raised concerns that the concentration of indices changes and therefore the condition could cease to be satisfied for a particular ETF from time to time.
- 51 One respondent submitted that an alternate test should be used to determine whether the index is a broad based or recognised index at the time of quotation approval.

ASIC's response

We have given class order relief from s606 as proposed in CP 196. We consider this relief is appropriate as it facilitates the quotation of ETFs on AQUA without compromising the policy intent of s606. The relief is limited to an ETF that has an investment strategy of tracking an index in which, at the time the strategy is first applied, no voting shares covered by Ch 6 of the Corporations Act are likely to comprise more than 10%.

In the unlikely scenario that an issuer considers that the relief given under the class order is inadequate to quote their ETF on AQUA, it can apply for individual relief. Applications for relief will be assessed on their merits at the time of application.

Substantial holding relief

- 52 In CP 196, we sought feedback on a proposal to give relief to members of ETFs who have a right to request *in specie* redemption, to allow them to assume that the composition and weightings of the securities comprised of the index (that the ETF seeks to track) is the same as the creation basket disclosed on that day by the issuer when assessing their obligations (under s671B) to give a substantial holding notice for the securities held by the ETF.
- 53 One respondent was supportive of the proposal for substantial holding relief. A second respondent was supportive of the relief, however argued that requiring issuers to publish the basket of securities daily will incur on-going costs.

ASIC's response

We have given substantial holding relief provided the issuer has published the basket of securities for the day it assesses its obligations under s671B. Publication of the basket of securities daily is consistent with current market practice by ETF issuers.

A member can assess their obligations under s671B assuming the composition of the index is the same as the creation basket disclosed by the issuer at the beginning of the day—that is, the composition and the number of each of the underlying securities of the ETF that correspond to each interest in the scheme remains the same as represented in the creation basket.

D Scope of proposals for relief

Key points

This section outlines the key issues covered in submissions received on CP 196 about the application of the proposed class order relief, and our response to those issues.

It covers:

- the limitation of relief for periodic statements reporting;
- the scope of relief for the quotation of ETFs on the AQUA market; and
- potential AQUA products.

Limitation of proposed relief for periodic reporting

- 54 In CP 196, we proposed that the class order relief for periodic statements reporting would be limited to managed investment products quoted on the AQUA market and listed on ASX.
- 55 One respondent argued that the relief should not be limited in this way, and instead should extend to all publicly listed and traded managed investment products on any licensed financial market.

ASIC's response

We have given class order relief from the content requirements for periodic statements in s1017D(5) only to issuers of interests in managed investments schemes that are quoted on the AQUA market and listed or that can be traded on any licensed financial market.

Scope of proposed relief for the quotation of ETFs on the AQUA market

- 56 In CP 196, we proposed to give class order relief to facilitate the quotation of ETFs on the AQUA market.
- 57 One respondent agreed with our proposal for class order relief. However, they argued that the relief should apply to interests in the scheme that are admitted to trading status on any licensed financial market, as opposed to limiting the scope of the relief to ETFs on the AQUA market. The respondent submitted that other licensed financial markets would be at a competitive disadvantage.

ASIC's response

We have not given class order relief to facilitate the quotation of managed investment products on any financial market. Our class order relief is limited to financial markets that are licensed to quote ETFs, as of the date of the class order (i.e. the AQUA market). In the event of another financial market becomes licensed to quote ETFs, we will be minded to consider providing relief to facilitate quotation of ETFs on that market.

E Short selling relief

- 58 In CP 196, we did not propose to give class order relief to provide exemptions from the short selling prohibitions in the Corporations Act to facilitate the quotation of ETFs on the AQUA market. Currently, market makers must apply for short selling relief on an individual basis.
- 59 One respondent argued that ASIC should consider providing class order relief to assist ETF issuers in planning the product launch of new ETF products and to provide greater certainty in the ETF market.

ASIC's response

We have not provided class order relief from the short selling prohibitions. Market makers will need to continue to apply for individual relief.

We consider this approach allows us to continue to assess the market maker's suitability for relief on a case-by-case basis.

Appendix: List of non-confidential respondents

- ASX Limited
 - Financial Services Council Ltd
 - Property Council of Australia
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