



ASIC

Australian Securities & Investments Commission

REPORT 381

Response to submissions on CP 208 ASX Managed Funds Service: Relief from the application form requirement

January 2014

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 208 *ASX Managed Funds Service: Relief from the application form requirement* (CP 208) 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.

This report does not contain ASIC policy. Please see Class Order [CO 13/1621] *Exemption and declaration for the operation of mFund*.

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A Overview/Consultation process

- 1 In Consultation Paper 208 *ASX Managed Funds Service: Relief from the application form requirement* (CP 208), we consulted on proposals to grant the relief applied for by ASX Limited (ASX), subject to certain conditions, to facilitate the introduction of ASX Managed Fund Service (AMFS).
- 2 AMFS has since been renamed mFund Settlement Service (mFund). It is a facility through which offers to acquire and dispose of financial products can be made to the issuers.
- 3 CP 208 was issued on 30 May 2013. The consultation period ended on 11 July 2013. However, we extended our submission period until 7 August 2013 to accommodate further submissions.
- 4 CP 208 was relevant for investors, responsible entities, ASX market participants, settlement participants, dealers, brokers, financial advisers, platform operators and potential providers of similar facilities to the proposed mFund. We sought feedback on our proposals, suggestions of any alternative approaches and information on any other issues.
- 5 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 208. We have limited this report to the key issues.
- 6 For a list of the non-confidential respondents to CP 208, see the appendix to this report. Copies of the submissions are on our website at www.asic.gov.au/cp under CP 208.

Responses to consultation

- 7 We received 22 responses to CP 208 from brokers, fund managers, and industry associations. Eleven of the 22 submissions were confidential. We are grateful to respondents for taking the time to make their submissions.
- 8 This report highlights the key issues that arose out of the submissions received on CP 208, and our responses to those issues. Feedback received on CP 208 helped make our decision on ASX's relief application. This report explains any modification we have made to key aspects of our proposals in CP 208 in making Class Order [CO 13/1621] *Exemption and declaration for the operation of mFund*.

B Relief from application form requirement

Key points

This section sets out the background to our proposals, contained in CP 208, to grant relief to ASX to facilitate the introduction of mFund.

It outlines the key issues covered in the submissions received on CP 208 and our responses to those issues.

It also covers other issues raised in the submissions.

Background

- 9 Subsection 1016A(2) of the *Corporations Act 2001* (Corporations Act) generally requires that a responsible entity may only issue a managed investment product to retail investors after receiving a completed application form that was included in, or accompanied, a Product Disclosure Statement (PDS) that was given to the retail investors and was not defective when the application was made. A *managed investment product* includes an interest in a registered managed investment scheme: see s761A and 764A(1)(b).
- 10 Currently this obligation is generally complied with by retail investors completing a paper application form and sending it by post or electronically to the responsible entity, along with their application money and a form of identification (e.g. a copy of their driver's licence). The responsible entity then issues the managed investment product and mails the retail investor a letter confirming the investor's new product.
- 11 The mFund is a service where a 'settlement participant' (as defined in ASX Settlement Operating Rules), upon receiving an investor's instruction to acquire or redeem interests in a registered scheme, completes an application form on the Clearing House Electronic Sub-register System (CHES) that transmits the information to the responsible entity. The investor can give their instructions through their financial advisers, brokers or ASX trading participants.
- 12 Financial advisers, ASX trading participants, brokers and settlement participants (collectively referred to as 'the intermediaries' in this report) are required to hold an Australian financial services (AFS) licence.
- 13 ASX sought relief from the obligation under s1016A(2) to permit the responsible entity to:

- (a) issue an interest in a simple managed investment scheme to a retail investor in response to an application submitted electronically on the investor's behalf by the settlement participant; and
 - (b) rely on an electronic confirmation from the settlement participant that the retail investor was given a PDS before the application was made.
- 14 The relief sought is, in principle, an extension to our policy in Class Order [CO 02/260] *Product Disclosure Statements—application forms created by a licensee*. [CO 02/260] permits the responsible entity to issue a managed investment product to retail investors who apply using an application form prepared and partly completed by an AFS licensee, if the responsible entity has 'reasonable grounds' to believe that the form was distributed with a PDS. However, the responsible entity must comply with the conditions of [CO 02/260], including that the responsible entity take all reasonable measures to ensure that the licensee provides the PDS to the applicant.
- 15 In the case of the mFund, ASX has proposed that the reasonable grounds requirement can be satisfied by relying on the electronic confirmation from the settlement participant that the PDS was given to the retail investor before the application was made by the investor. However, we are particularly concerned by the effect such reliance will have on investor confidence—for example, if the settlement participant makes its representation based on its reliance on the representation of a broker, who in turn has relied on the representation of an ASX trading participant or a financial adviser.
- 16 In CP 208, we proposed to give relief to allow responsible entities to issue interests in *simple managed investment schemes* (as defined in reg 1.0.02 of the Corporations Regulations 2001) after receiving applications from CHESS (i.e. through mFund). As the relief will remove responsible entities' obligation to ensure that the brokers have provided a PDS to retail investors, we are mindful to maintain the system of checks and balances that ensures investors receive PDSs, as intended by s1016A(2).
- 17 On that basis, we also proposed to impose certain obligations on ASX, the responsible entities and the intermediaries, in the form of conditions on exemptions or declarations in class orders and/or modifications to the ASX Operating Rules and Procedures (ASX Operating Rules) and the ASX Settlement Operating Rules and Procedures (ASX Settlement Rules).

Summary of our proposals

- 18 In proposal B1 of CP 208, we proposed to issue a class order to exempt responsible entities that use mFund from the obligations in s1016A, provided they comply with the conditions of the class order. ASX also proposed to

modify the ASX Operating Rules and the ASX Settlement Rules. Overall, responsible entities would be required to:

- (a) provide all legally required disclosures and communications to ASX for inclusion in its ‘document library’, which will be accessible by ASX market participants;
- (b) send a notice (transaction confirmation) to each retail investor within five business days of issuing the products, providing details about the latest version of the PDS (identified by date) and its availability;
- (c) promptly notify ASX in writing when they reasonably believe that a retail investor was not provided with the PDS; and
- (d) keep for seven years the records demonstrating the provision of the transaction confirmation, an electronic copy of all CHESS applications, and all requests for a PDS by retail investors.

19 In proposal B2 of CP 208, we proposed to modify Pt 7.6 of the Corporations Act to impose obligations on the intermediaries that use mFund. ASX also proposed to modify the ASX Operating Rules and the ASX Settlement Rules. Overall, the intermediaries would be required to:

- (a) observe the content and functional requirements for capturing mFund product orders from retail investors when designing client interfaces;
- (b) give a retail investor a PDS before each application is made; and
- (c) keep for seven years records of the retail investors’ acknowledgement that they have been given the PDS and to provide such records if requested by ASX.

20 In proposal B3 of CP 208, we sought feedback on any alternative procedures to maintain the system of checks and balances that ensures retail investors receive the PDS.

Submissions on our proposals

21 All respondents agreed with our proposal to grant relief. In relation to our proposed conditions, some respondents raised specific issues, which include:

- (a) the effectiveness of the transaction confirmation provided under s1017F in ensuring the provision of the PDS to retail investors, because they are less likely to read the confirmation due to disengagement or reliance on the intermediaries;
- (b) the lack of avenues for responsible entities to verify with the intermediaries or ASX that the intermediaries have provided the current PDS to retail investors, noting that the intermediaries could fail to download the current PDS or ASX’s system could experience errors when uploading the current PDS; and

- (c) the regulation of the liability to compensate retail investors provided with out-of-date (defective) PDS, noting that in using mFund the responsible entity and the intermediaries will generally be unaffiliated and not have any bilateral distribution agreement.

ASIC's response

As a result of this consultation, our relief requires that the relevant PDS, which is the current PDS when the simple managed investment scheme is issued, should be identified by date. In particular, the settlement participants must enter into CHES the date of the PDS that was given to the retail investors; CHES will subsequently send the message to the responsible entity. We consider that this CHES message will give the responsible entity sufficient and unambiguous information to determine whether the investor was given the relevant PDS. Further, we consider that including the date of the relevant PDS in the transaction confirmation will allow the retail investor to determine whether they were given the relevant PDS.

We understand that the responsible entity's liability for a defective PDS under s1016E and 1016F generally depends on the responsible entity's awareness that the PDS was, became or has become defective. We will take into account the concerns about the lack of affiliation between the responsible entity and the intermediaries when imposing the obligations in the Class Order. We consider it appropriate to exempt the responsible entities from the liabilities under s1016E and 1016F as long as the responsible entity relies on the CHES message that the relevant PDS was given and the responsible entity sends the transaction confirmation informing the retail investor of the date of the relevant PDS. This means that the investor may have recourse to the intermediaries or ASX, whichever party that made the error.

The responsible entity is also required to inform ASX if they become aware of a retail investor not receiving the relevant PDS. When there is a systemic non-compliance by the intermediaries, ASX will be required to investigate the 'participants' (as defined in the ASX Operating Rules and ASX Settlement Rules) and report such cases to ASIC. The participants must keep records for seven years demonstrating that the relevant PDS was given to the investor either by them, the financial adviser, or the broker.

Other issues

- 22 Most respondents requested that we allow mFund to facilitate applications and redemptions in financial products other than interests in simple managed investment schemes, so that mFund could gain economies of scale.
- 23 Some respondents also requested that we extend the proposed relief to any participant that provides services equivalent to those provided by mFund, to ensure neutral competition between fund and platform providers.

ASIC's response

The mFund is a new type of service in the Australian financial services industry and, while we consider that the controls we have implemented (to ensure that the relevant PDSs are given to retail investors) are adequate, these controls have not been put into practice. We consider that it is important for mFund to operate effectively and the controls to be proven adequate in practice before considering expanding mFund to financial products beyond the interests in simple managed investment scheme.

Similarly, the decision to grant the relief from s1016A(2) to mFund relies largely on:

- the infrastructure of ASX and ASX Settlement;
- the fact that both of these entities hold an Australian market licence and a clearing and settlement facility licence, respectively; and
- the fact that the funds offered through mFund will be transacted under the ASX Operating Rules and transactions will be settled under the ASX Settlement Rules.

We are generally minded to consider granting similar relief to other industry participants. Such relief applications will be considered on their individual merits at the time of application and in keeping with our policy for granting relief, as described in Regulatory Guide 51 *Applications for relief* (RG 51).

- 24 One respondent recommended that we 'modernise' s1016A to permit the use of real-time electronic applications and investments in financial products without a 'wet signature', by making the relief widely available in the wealth management industry and on a permanent basis.

ASIC's response

Under s1020F(1)(c), ASIC has the power to make a declaration that Pt 7.9 applies in relation to all persons and financial products as if s1016A was omitted, modified or varied. However, we consider that such a suggestion is beyond the scope of ASX's relief application. We also consider that a repeal of s1016A is appropriately done by way of a legislative reform considered by Parliament.

It is our view that the Corporations Act does not prescribe a 'wet signature' on application forms for financial products. Further, Pts 7.6–7.9 of the Corporations Act allow financial services disclosures to be delivered online or electronically. We therefore consider that retail investors can use application forms derived from online or electronic disclosure documents. We have given relief in Class Order [CO 10/1219] *Facilitating online delivery of PDSs, FSGs and SOAs* and provided guidance in Regulatory Guide 221 *Facilitating online financial services disclosures* (RG 221).

Appendix: List of non-confidential respondents

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- Association of Independently Owned Financial Professionals
 - BNY Mellon Investment Management Australia Limited
 - BT Financial Group
 - Eight Investment Partners Pty Limited
 - Financial Services Council
 - Investment Science Asset Management Pty Ltd
 - Legg Mason Asset Management Australia Limited
 - Praemium Australia Limited
 - Select Asset Management Limited
 - SMSF Professionals' Association of Australia Limited
 - Stockbrokers Association of Australia
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