



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 54

Proposed relief for constitutions of registered managed investment schemes

October 2004

What this consultation paper is about

1 This Consultation Paper sets out proposals for ongoing class order relief from certain content requirements for the constitution of a registered managed investment scheme. The effect of the proposals is that a responsible entity will not breach s601GA of the *Corporations Act 2001* (the Act) if it has a discretion to determine some components of the consideration to acquire, or the amount payable upon withdrawal ("withdrawal payment") of an interest in the scheme.

Note: Section 601GA is currently modified by ASIC Class Order [CO 98/52].

2 Our interim position on registered managed investment scheme constitutions was issued on 8 July 2004: see ASIC Information Release [IR 04/31] *ASIC announces interim position on transaction costs for managed investment scheme constitutions*. With the publication of this Consultation Paper we have decided to extend the interim position, which was to expire on 31 December 2004, until 31 March 2005. This will allow enough time to consult and consider the submissions on this Paper. This interim position involves:

- (a) taking a no-action position where the constitution of any existing registered managed investment scheme does not comply with s601GA because components of the consideration to acquire or the withdrawal payment are determined at the discretion of the responsible entity; and
- (b) being prepared to grant interim relief on a case by case basis with respect to the constitutions of new schemes seeking registration that do not comply with s601GA because components of the consideration to acquire or the withdrawal payment are determined at the discretion of the responsible entity.

3 This Consultation Paper is not in our usual format for consulting on policy proposals. It reflects the discrete and technical nature of the proposed relief.

4 We invite you to comment on the proposals, and on the questions that are included. We will not treat submissions as confidential unless we receive a specific request to treat the whole or part of a particular submission as confidential.

5 Comments are due by **Tuesday, 30 November 2004** and should be sent to:

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Registered management investment scheme constitutions and s601GA

6 Paragraph 601GA(1)(a) of the Act requires the constitution of a registered managed investment scheme to make ‘adequate provision’ for the consideration to acquire an interest in the scheme. Subsection 601GA(4) provides that if members of the scheme have the right to withdraw, the constitution must specify that right and set out ‘adequate procedures’ for making and dealing with withdrawal requests.

7 Paragraph 601EA(4)(a) requires a copy of the scheme constitution to be lodged with ASIC when an application to ASIC is made for registration of the scheme. Paragraph 601EB(1)(e) provides that ASIC must refuse to register the scheme if it is of the opinion that the constitution does not meet the requirements of s601GA.

Our interpretation of s601GA

8 As set out in ASIC Policy Statement 134 *Managed investments: Constitutions* [PS 134], we consider ‘adequate provision’ to acquire an interest in the scheme to have been made if the constitution provides for an ‘independently verifiable’ price, i.e. one that can be ascertained without reference to extrinsic materials: see [PS 134.18]. The Act requires that the constitution set out provisions enabling calculation of the consideration. Members have rights about the consideration for an issue of interests because the consideration for an issue of an interest to another may affect the value of a member’s interest: see [PS 134.28]. If any party who has an interest in the scheme can influence the amount of the consideration, the constitution will not comply with s601GA: see [PS 134.29]. Therefore, if the responsible entity can influence the amount of the consideration, the constitution will not comply with s601GA.

Note: See [PS 134] for further information.

Existing ASIC class order relief from s601GA

9 Under Class Order [CO 98/52] *Relief from the consideration to acquire constitutional requirement* we have allowed the responsible entity to determine the price at which interests in a scheme are issued (other than in accordance with the scheme constitution) in certain defined circumstances, e.g. individual negotiation of fees with wholesale clients, placements and rights issues. We have granted this relief because in these cases the consideration to acquire cannot be determined independently, and investor protection will not be reduced: see [PS 134.19].

Rationale for proposed relief

10 Participants of the managed funds industry have made representations to ASIC that compliance with the requirements for the consideration to acquire or the withdrawal payment can be unduly burdensome and impracticable from a commercial perspective. This is because, in certain circumstances, the responsible entity must make determinations affecting the amount payable (ie. some limited discretion is necessary from time to time).

11 For example, the responsible entity may need to make a determination for the following components of the consideration to acquire or the withdrawal payment:

- (a) the value of the interest;
- (b) the transaction costs; and
- (c) the entry or exit fees.

These concepts are explained in greater detail in the 'Background' section of this Paper in paragraphs 24 and 25. We have received submissions that it may not be practical to set out the amount payable for each of these items at the time the constitution is prepared.

12 However, we need to balance these commercial considerations against the need to protect investors. We consider that the investor protection outcome intended by s601GA can be achieved while reducing the burden on the responsible entity if full details of transaction costs, entry/exit fees charged and valuations are disclosed in the Product Disclosure Statement (PDS) for the scheme rather than the scheme constitution. We note that, in exercising any discretion, the responsible entity will have to act with reasonable care and diligence and in the best interests of members under s601FC. Further details of our proposed relief follow.

Our proposals for ongoing relief

Transaction costs

13 We propose giving relief so that the constitution of a registered managed investment scheme will not breach s601GA if it allows the responsible entity to determine an adjustment for transaction costs in the consideration to acquire or the withdrawal payment.

14 The relief will apply while the following requirements are satisfied:

- (a) the constitution provides that an adjustment is determined by the responsible entity to make an allowance for **complying transaction costs**;
- (b) the responsible entity documents:
 - (i) the methodology by which it will determine complying transaction costs; and
 - (ii) for any estimate of these costs applying from time to time:
 - (A) the basis on which the estimate is made; and
 - (B) why it is reasonable;
- (c) the responsible entity discloses the following matters in any PDS for the scheme first given after the date of relief:
 - (i) that the responsible entity will make a transaction cost adjustment to the consideration to acquire or the withdrawal payment to avoid an adverse impact on existing scheme members who are not acquiring interests or making a withdrawal;
 - (ii) a general description of the methodology used to calculate the transaction costs, including how and when transaction costs will be recovered;
 - (iii) the types of amounts included in transaction costs; and
 - (iv) the amount or, if the amount is not known, an estimate of the amount that is likely to be charged for transaction costs, and any circumstances in which a different amount or estimate will apply.

Note: These disclosure requirements are consistent with ASIC's revised fee disclosure model, which was released on 16 June 2004. See page 8 of that document.

15 The term ‘**complying transaction costs**’, in relation to the consideration to acquire or withdrawal payment for an interest in the scheme will only include costs that are incurred to buy or sell scheme assets made because of the acquisition or withdrawal of an interest. It will be defined as:

- (a) the actual amount necessary (or the responsible entity’s reasonable estimate of the actual amount necessary) to avoid an adverse impact on other scheme members because of a particular acquisition or withdrawal of an interest; or
- (b) the responsible entity’s reasonable estimate of the *average* amount necessary to avoid an adverse impact on other scheme members because of the acquisition or withdrawal of an interest (excluding where an estimate is made under subparagraph (a) above) if:
 - (i) the responsible entity made the estimate no more than 12 months previously; and
 - (ii) the responsible entity has no reason to believe that if it made a new estimate of that amount, the new estimate would materially differ from the existing estimate.

16 The purpose of imposing an adjustment for transaction costs is to ensure that scheme members who are not acquiring or withdrawing interests in the scheme at a particular time are not disadvantaged. This would occur if the scheme had to pay costs to buy and sell assets to satisfy applications for the acquisition or withdrawal of interests in the scheme. In effect, under our relief, these costs are borne by the members whose acquisitions or withdrawals cause the expenses to be incurred, rather than by the scheme members as a whole.

17 The costs included in the transaction costs component are likely to vary according to the types of assets held by the scheme. For example, if a scheme invests in shares, we would expect the transaction costs to include brokerage. Costs such as management fees payable to the responsible entity, general administrative costs associated with running the scheme and fees paid to advisers would not be complying transaction costs because they do not relate to the acquisition or disposal of scheme assets.

Entry and exit fees

18 We propose giving relief so that a constitution will not breach s601GA if the consideration to acquire or the amount payable upon withdrawal is affected by a discretion of the responsible entity as to the fees payable when a person acquires an interest or makes a withdrawal from the scheme. The relief would apply if:

- (a) the constitution provides for a maximum fee; and
- (b) the actual fees that are payable by any retail client in relation to an interest are specified in a PDS for the interest that is given to the member before the member acquires the interest.

This ensures that scheme members and prospective scheme members are made aware, at the time they decide whether to join the scheme, what entry and exit fees they will be required to pay.

Note: Other important ASIC policy documents relating to fees, such as Class Order [CO 02/214] *Differential fees*, ASIC's revised fee disclosure model (June 2004) and Policy Proposal Paper *Dollar disclosure* (August 2004), can be found on our website at www.asic.gov.au.

Valuing an interest in the scheme

19 We propose giving relief so that the scheme constitution does not breach s601GA if it permits the responsible entity, for the purpose of valuing an interest in the scheme, to determine:

- (a) that an item should be recognised in the valuation of the interest; and
- (b) the amount attributable to that particular item.

20 The relief would apply if the following requirements were satisfied:

- (a) the responsible entity makes the determination in order to provide a true and fair value of the interest;
- (b) at the time the determination is made, the responsible entity could lawfully recognise the item and attribute the determined value to the item in a statement of financial position for the scheme prepared under Chapter 2M of the Act;

Note: Chapter 2M relevantly includes requirements to comply with applicable Australian Accounting Standards and to provide a true and fair view of the scheme's financial position.

- (c) the responsible entity documents its determination for the purposes of paragraph (a) above and why that determination is reasonable;
- (d) the responsible entity keeps a copy of any document prepared under paragraph (c) above for at least 7 years after it was current; and

Note: Such documents may be kept electronically.

- (e) the responsible entity discloses a general description of the policies it will apply in exercising those discretions in each PDS that is first given after the date the relief is issued.

Mechanics of class order relief

21 The proposed class order relief will involve ASIC using its power under paragraph 601QA(1)(b) of the Act to modify s601GA (as currently modified by Class Order [CO 98/52]). The effect of the modification will be that the requirements in paragraph 601GA(1)(a) and subsection 601GA(4) are not contravened where the responsible entity has a discretion to determine transaction costs, entry/exit fees, or the valuation of interests, if the requirements set out in paragraphs 13 to 20 of this Paper are met.

Facilitating proposed class order relief

22 We recognise that if the proposed class order is executed upon the expiry of our no-action position and the interim relief in March 2005, there may be scheme constitutions that do not comply with s601GA as modified by the new class order. Those constitutions will need to be amended to ensure that they comply.

Matters for consultation

23 We seek comments and/or submissions relating to the following matters:

1. whether the proposed relief would create any significant practical problems for the responsible entity (e.g. conflict with, or impact on, other duties contained in Chapter 5C of the Act);
2. what the costs and benefits of implementing the proposals would be (based on relevant information, including quantitative information);
3. whether participants of the managed funds industry consider that any relief, additional to what has been proposed, is necessary to resolve the issues raised in this Paper;
4. whether there are other options, beyond what we have proposed in this Paper, which ought to be considered; and
5. whether there are any other issues, at an industry level, associated with meeting the statutory requirements of section 601GA (in addition to those mentioned above) that need to be resolved.

We will not treat submissions as confidential unless we receive a specific request to treat the whole or part of a particular submission as confidential.

Comments are due by Tuesday 30 November 2004 and should be sent to:

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Background

Consideration to acquire or withdrawal payment for interests in the scheme

24 Typically the consideration payable to acquire an interest in the scheme consists of three components. One component of the consideration is the amount that reflects the value of the interest in scheme property that the member acquires. Another component is a fee payable to the responsible entity for its services (and to enable the responsible entity to pay commissions to financial product advisers). The other component is a transaction costs component added on to the value of the interest. The transaction costs component represents an allowance for the costs incurred by the scheme in order to acquire assets so that the additional interest in the scheme is issued.

25 When an interest is withdrawn from the scheme, there may similarly be three components relevant to the amount of the withdrawal payment. One component reflects the value of the interest in scheme property that the member had at the time of withdrawal. Another component may be a fee payable to the responsible entity for its services, which is deducted from the proceeds paid to the member. A transaction costs component—representing an allowance for the costs incurred by the scheme in disposing of scheme assets so that the scheme has cash available to meet the withdrawal requests—may also be deducted from the withdrawal proceeds and therefore affect the amount of the withdrawal payment.

26 We consider that, to comply with s601GA in its current form, all components of the consideration to acquire or withdraw an interest must be provided for in the constitution. The constitution should not leave these matters to the discretion of the responsible entity.

Transaction costs

27 We consider that the transaction costs will not be independently verifiable if the constitution permits the amount of transaction costs payable in respect of the consideration to acquire or the withdrawal payment to be determined by the responsible entity.

Entry and exit fees

28 We consider that the consideration to acquire or the withdrawal payment will not be independently verifiable if the constitution permits any fee payable to acquire or withdraw an interest to be determined by the responsible entity (whether by the effect of waiver, rebate or otherwise).

Valuing an interest

29 Typically the consideration payable for an interest is determined (leaving aside transaction costs and fees) by reference either to the market price of the interests, in the case of a listed scheme, or to a formula for determining the value of the interest. The formula typically divides the value of the scheme's net assets, subject to certain provisions or adjustments, by the number of interests in the scheme on issue.

30 An appropriate market price for the interests is independently verifiable because it can be ascertained by an auditor and is not influenced by the responsible entity.

31 If the price of the interest is determined by reference to the value of the scheme's net assets, then the method by which scheme assets, liabilities and other provisions or adjustments will be determined must be independently verifiable from the terms of the constitution.

32 We consider that the consideration to acquire or the withdrawal payment will be independently verifiable if the constitution permits the responsible entity to determine whether something should be recognised in the calculation of net asset value as an asset, liability or deduction from net asset value. We also consider that the consideration to acquire or the withdrawal payment will not be independently verifiable if the constitution permits the responsible entity to decide the method used to value any of the scheme assets, liabilities or deductions from net asset value.