ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 30

Investment funds: Takeover and substantial holding relief

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Your comments

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

Comments are due by 31 December 2001 and should be sent to either:

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What this paper is about

1. This discussion paper considers issues raised by investment funds within large financial services groups concerning the takeover prohibition in s606 and the substantial holding provisions in s671B of the *Corporations Act 2001* (Act). We have received several applications by investment funds for relief from these provisions in recent years.

2. In their applications investment funds claim that:

(a) an investment fund may be prevented from acquiring securities in a company for the benefit of fund members because group holdings are close to the 20% takeover threshold in s606. The investment fund's voting power reflects the holdings of its related bodies corporate for the purposes of the takeover prohibition. This is the case even if the investment fund operates independently from related bodies corporate in acquiring, disposing of or voting securities.

(b) compliance with the requirement to disclose substantial holdings in companies within two business days signals the fund's investment moves to other traders. This may add to the costs of investing.

3. The purpose of this paper is to analyse these claims, encourage public debate and identify a range of options. The paper does not set out firm ASIC proposals. The outcome of this initiative may be:

(a) ASIC exemptions or modifications;

(b) legislative amendment;

(c) maintaining the status quo; or

(d) a mix of these.

Options include "relief" from the takeovers prohibition and substantial holding provisions. This means relief by ASIC exemption or by legislative amendment. Legislative amendments are a matter for the Government and Parliament. As administrator of the Act, we have discussed these issues with the Commonwealth Department of the Treasury, and will continue to do so.

4. The overarching question in this paper is whether the interests of fund members justify relief from takeover and substantial holding regulation. This regulation is designed to protect shareholders (as well as to promote an efficient, competitive and informed market): s602. This is a balance of the interests of fund members and those of various stakeholders: shareholders, company directors, traders and market professionals.

5. Applications by investment funds for ASIC exemption or modification are driven by growth in:

(a) overseas investment funds seeking to invest in Australia. Overseas funds may expect that comparable takeover and substantial holding requirements will apply to them here; and

(b) the size and number of investment funds within a group, for example because of consolidation of financial services groups and growth in superannuation.

6. In preparing this paper, we have analysed regulation of investment funds, takeovers and substantial holdings in comparable jurisdictions overseas. In each of these jurisdictions, regulation applying to investment funds is less strict in some respect compared to regulation in Australia.

7. This paper is divided into 3 sections:

Section A considers the **takeover prohibition** and investment funds. Options include:

(a) **Status quo (Option A1)**
Paragraph 22;

(b) **"Disaggregation" relief (Option A2)**
This relief would allow investment funds operating within a corporate group to disaggregate their holdings from those of the rest of the group for the purposes of the takeovers prohibition. The relief would allow the investment fund on the one hand and the rest of the group on the other to purchase up to 20% of a company each. Relief would apply only where the investment fund operates independently from the rest of the group – paragraph 23;

(c) **New exemption in s611 (Option A3)**
This relief would create a new exemption in s611 from the takeover prohibition for acquisitions by investment funds beyond 20% on an aggregate (group) basis. Relief would apply only where the investment fund operates

independently from the rest of the group. The relief would cover purchases by the investment fund, but not purchases by the rest of the group – paragraph 30;

(d) **Voting beyond 20% (Option A4)**
Restriction on voting beyond 20% on an aggregate (group) basis – paragraph 45; and

(e) **30% ceiling (Option A5)**
Set a ceiling on relief at say 30% voting power on an aggregate (group) basis – paragraph 49.

Section B considers **substantial holding provisions** and investment funds. Options include:

(a) **Status quo (Option B1)**
Paragraph 68

(b) **"Disaggregation" relief (Option B2)**
This relief would be similar to disaggregation relief in Option A2 – paragraph 69;

(c) **Delayed disclosure (Option B3)**
This relief would allow investment funds more time to give substantial holding information under s671B. The time would be say 5 business days instead of 2 – paragraph 81;

(d) **Higher threshold (Option B4)**
This relief would allow investment funds to acquire up to 10% of the votes in a company before giving substantial holding information, instead of 5% – paragraph 102.

Section C considers what **investment funds** would have relief.
Options include:

(a) **List of investment funds (Option C1)**
This option sets out a list of investment funds that would be covered by any relief and discusses why relief would be limited to these investors – paragraph 108.

(b) **Index funds (Options C2)**
This option would limit relief to index funds only – paragraph 110.

In each section we have listed issues for comment. A consolidated list of issues for comment is located on page 36.

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Discussion

A Takeovers prohibition: s606

8. An investment fund may be prevented from acquiring securities in a company or listed managed investment scheme for the benefit of fund members because its voting power may reflect the relevant interest of related bodies corporate for the purposes of the main takeover prohibition in s606.

9. Under s606 a person is prohibited from acquiring a relevant interest in voting shares if because of the transaction the person's voting power, or another person's voting power, increases from:

(a) 20% or below to more than 20%; or

(b) from a starting point that is above 20% and below 90%.

10. The two critical elements of the takeover prohibition in s606 are the concepts of *voting power* and *relevant interest*. Voting power is defined in s610 to include the votes of associates. The votes of each body corporate that controls the investment fund or which is under the control of an entity which controls the investment fund must be taken into account: definition of "associate" s12(2)(a).[1]

11. In addition, a related body corporate will have the relevant interests in any securities that the investment fund has if:

(a) the voting power of the related body corporate in the investment fund is above 20%; or

(b) the body corporate controls the investment fund: s608(3).

Similarly, the investment fund will often have the relevant interests that a related body corporate has.

Relief from s606

12. An issue is whether an investment fund should have relief from s606 so that it is not prevented from investing in a company because

[1] Financial Services Reform Act 2001 repealed or amended the old s9 and s10 to 17 definitions: Part 1 of Schedule 3.

its voting power, reflecting the relevant interests of its related bodies corporate (aggregate or group voting power), would exceed 20%.

13. It would be appropriate for the investment fund to have relief only if it operated independently from the rest of the group. Otherwise, the investment fund together with its related bodies corporate could acquire control of a company without making a takeover bid. The purposes of Chapter 6 in s602 would not be fulfilled. These include that all holders have a reasonable and equal opportunity to participate in any benefits accruing to holders through the acquisition of control: s602(c).

More than one investment fund

14. A question is whether more than one investment fund, operating independently from each other and the rest of the group, would have the relief, so that an investment fund is not prevented from investing in a company by relevant interests of related bodies corporate including other investment funds. This could mean that under the relief group entities may control a majority of the company: see further paragraphs 24,32 and 49.

Why should an investment fund have takeover relief?

15. If an investment fund is prevented from investing in securities because of the relevant interests of related bodies corporate, fund members will not gain exposure to potential returns from the securities. Fund members may be disadvantaged particularly where the securities are significantly represented in major equity indices. This would increase the risk that the members' return is below the market return.

16. Also, an investment fund suggested to us that when the aggregate voting power of a group in a company is close to the 20% threshold, compliance with s606 is difficult without ceasing to trade in shares of the company. Because of independent operation of group entities, more than one entity may acquire securities in a company on the same day, unaware of the acquisition by its related body corporate.

Current solutions

17. There may be current solutions to this problem:

(a) The investment fund, if authorised,[2] could gain synthetic exposure to the performance of shares in a company through derivatives. A person does not have a relevant interest in securities merely because of an exchange traded option over the securities or a right to acquire the securities given by a futures contract, until the obligation to make or take delivery arises: see s609(6).

(b) In the past we have been willing to exempt an investment fund from s606 where the fund is externally managed. We have been willing to give relief where:

(i) the investment fund has entered into a management agreement with a manager that is not its associate;

(ii) the investment fund authorises the manager to exercise power to vote or dispose to the exclusion of the investment fund; and

(iii) the manager in exercising voting and investment powers must consider the terms of the agreement and the interests of fund members.

Less likely to seek control?

18. Investment funds may be less likely than other investors to seek control of companies in which they invest.[3] This may be a reason for relief from s606, which regulates changes of control. An aspect of the policy behind exemptions in s609 from the "relevant interest" concept is that certain types of holder, or participants in certain types of transaction, are less likely to seek control (for example, financiers or bare trustees).

19. Generally the objective of investment funds is to manage funds:

(a) on behalf of persons to whom they owe a fiduciary duty; and

(b) in accordance with an investment policy or client mandate expressed in disclosure documents or constitutions. (For example, we expect that disclosure documents for registered managed investment schemes specify the

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[2] For example, to use derivatives, the responsible entity of a registered managed investment scheme requires a licence that authorises it to operate the "Derivatives" category of scheme: a scheme that uses derivatives for hedging or any other purpose – Policy Statement 130 *Managed investments: Licensing* (PS 130.21 – PS 130.23).

[3] Policy Statement 128 *Collective action by institutional investors* (PS 128.16)

investment policy for the scheme: see Policy Statement 134 *Managed investments: constitutions* at [PS 134.38].)

Investment funds may be less likely to invest in or vote securities in concert with or under the direction of a related body corporate. This is because a fund has obligations to its members that may not coincide with the interests of related bodies corporate.

20. This does not mean that no investment fund will acquire shares and vote in concert with or under the direction of related bodies corporate to obtain control. In some circumstances, seeking control may be consistent with the investment fund's fiduciary duty to act in the interests of its members.[4] Constitutions and management agreements often give very broad discretions, for example "absolute discretion" over investment or exercise of voting rights.

21. Compliance with the takeover provisions and the principles in s602 overrides the investment fund's duties to its members. An investment fund that does act in concert with, or under the direction of, a related body corporate in acquiring or voting shares (even consistently with its duties to members) would be subject to the following:

(a) relief would not apply: see paragraph 37;

(b) we would revoke the relief so that the investment fund could not rely on it in the future; and

(c) the investment fund may risk a declaration of unacceptable circumstances from the Takeovers Panel (Panel) under s657A.

Option A1: status quo

22. The first option is to maintain the status quo, so that the holdings of investment funds and the rest of the group must be aggregated. The interests of fund members may not justify the risk that investment funds will in fact seek control. Investment funds may do so in concert with or on direction of related bodies corporate.

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[4] See for example the duty of a responsible entity to act in the best interests of members: s601FC(1)(c). Investment funds may need to take positive steps in managing the investments of the fund, or in securing certain investments, in the interests of the fund: *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515. But the investment fund could not put the interests of its group ahead of those of its investors.

Issues relating to Option A1

1. Should investment funds have relief from s606 or should the status quo be maintained?

2. Is it more appropriate that any change is effected by ASIC exemption or legislative amendment?

3. Do the current solutions adequately address the problems raised by investment funds?

Option A2: disaggregation relief

Relief so that that the holdings of the investment fund would be disaggregated from those of the rest of the group.

23. An option for relief would be to allow investment funds to disaggregate its holdings from those of its related bodies corporate. This would involve relief so that:

(a) the investment fund and its related bodies corporate are not associates; and

(b) the investment fund may ignore relevant interests derived from the relevant interests of related bodies corporate (and vice versa).

24. An example of disaggregation relief is if:

(a) a corporate group consists of two investment funds;

(b) relief is available for more than one investment fund in the group;

(c) the investment funds operate independently from each other and the rest of the group; and

(d) the rest of the group consists of two other related bodies corporate,

the group may have the following holdings in a company.

Investment funds: each could acquire up to 20% voting power (2 x 20%).

Rest of the group: the two other related bodies corporate could acquire up to 20% voting power between them.

In theory, the maximum group voting power in a company would be 60%.

Associates

25. Under this option, investment funds would have relief so that in calculating voting power for the purpose of s606 the investment fund and its related bodies corporate are not associates merely because of s12(2)(a). In other words:

(a) the investment fund may ignore the relevant interest of a related body corporate; and

(b) a related body corporate of the investment fund may ignore the relevant interest of the investment fund.

The relief would not apply to subsidiaries of the investment fund. This is because it is not likely the investment fund and subsidiary would operate independently. The investment fund and its subsidiary are likely to be in the same "business unit" within the corporate group.

Relevant interest

26. Related bodies corporate of investment funds would also have relief from the relevant interest provisions for the purposes of s606 for related bodies corporate of the investment fund who:

(a) have the power to exercise or control the exercise of rights to dispose or vote: s608(1) and (2); or

(b) control the investment fund: s608(3)(b).

27. Such relief would be on condition that the related body corporate does not actually use its control over disposal or voting. It would be a condition that the related body corporate does not:

(a) use any power to exercise, or control over the exercise of, the right to vote the investment fund's securities; or

(b) use any power to dispose of, or control over the exercise of a power to dispose of, the securities.

Other conditions discussed below at paragraph 37 are designed to ensure that the related body corporate does not use its control, and that the investment fund operates independently.

28. Because of relief from the associate definition discussed in paragraph 25, the investment fund and related bodies corporate will not automatically be associates. Because they are not associates, the investment fund will not have the relevant interest in securities of its:

(a) holding company; and

(b) related bodies corporate,

because of the operation of s608(3)(a). Section 608(3)(a) deems a person to have the relevant interest of a body corporate in which it has at least 20% voting power.

29. Again, the relief would not apply to subsidiaries of the investment fund.

Option A3: New exemption in s611

Relief creating a new exemption under s611 for an investment fund. An acquisition by the investment fund beyond 20% would not breach s606.

30. As an alternative to disaggregation relief, an option would be a new exemption in s611 for investment funds. Section 611 sets out acquisitions of relevant interests in a company's voting shares that are exempt from the prohibition in s606. The exemption would allow an investment fund to acquire securities even if because of the transaction the voting power of the investment fund or a related body corporate increased past 20% on an aggregate (group) basis, or increased from a starting point above 20% and below 90%. The investment fund would only be able to rely on the exemption if it operated independently from related bodies corporate. Related bodies corporate could not purchase securities beyond 20% under the relief.

31. The exemption would not apply where the investment fund alone holds more than 20% in the company; that is, where the voting power of the investment fund (and its subsidiaries) ignoring relevant interests of, or derived from, its related bodies corporate (except its subsidiaries) exceeds 20%. Relief is not appropriate where the investment fund itself holds a controlling stake in the company.

32. An example of relief creating a new exemption in s611 is if:

(a) a corporate group consists of two investment funds;

(b) more than one investment fund has relief;

(c) the investment funds operate independently from each other and the rest of the group; and

(d) the rest of the group consists of two other related bodies corporate,

the group may have the following holdings in a company:

Investment funds: each could acquire up to 20% voting power (2 x 20%).

Rest of the group: the two other related bodies corporate would be constrained from purchasing more securities once the aggregate (group) voting power has reached 20%.

Under this example, the maximum group voting power in a company would be between 40% and 60% depending on whether the rest of the group acquired its voting power before the investment funds.

Another example, where there is only one investment fund in the group, is:

(a) the investment fund holds voting shares to which 3% of votes attach; and

(b) the rest of the group holds voting shares to which 15% of votes attach; and

(c) the investment fund acquires further voting shares to which 3% of votes attach.

Neither the investment fund nor the rest of the group would breach s606. However, because the aggregate (group) voting power is 21%, the rest of the group would be unable to acquire further voting shares (except under another exemption in s611).

Disaggregation relief v exemption in s611

33. Relief creating a new exemption in s611 would be narrower than disaggregation relief, because future acquisitions by related bodies corporate would breach s606. The related body corporate would have voting power beyond 20%. While the investment fund would no longer be constrained by the investment decisions of related bodies corporate, related bodies corporate would be constrained by decisions of the investment fund.

34. Disaggregation relief is broader because it allows the investment fund on the one hand and related bodies corporate on the other to comply separately with the s606 threshold.

35. Relief creating a new exemption in s611 would reflect more closely the policy that the investment fund should not be prevented from acquiring securities for the benefit of fund members because of relevant interests of related bodies corporate.

36. Disaggregation relief would reflect more closely the policy that the relevant interests of an investment fund and its related bodies

corporate should not be counted together if the investment fund operates independently. If the investment fund and the rest of the group act independently, neither the investment fund nor the rest of the group should be constrained from acquiring securities up to 20%.

Issues relating to Options A2 and A3

4. Should investment funds have either "disaggregation" relief or relief creating a new exemption in s611? Which option do you prefer?

5. Should more than one investment fund in a group have the relief?

Precondition of takeover relief

Investment fund is independent

Relief from the takeovers prohibition would be on condition that the investment fund operated independently from the rest of the group. Chinese wall requirements would apply.

37. Investment funds would have relief from s606 only where all of the following are satisfied:

(a) the organisational structure of the investment fund's corporate group is such that powers of the investment fund to acquire or dispose of securities (investment powers) or powers to vote the securities are exercised independently;

(b) effective information barriers ("Chinese walls") are in place. Chinese walls are internal rules and procedures developed by an organisation to prevent information that one part of the organisation possesses from being communicated to another part. In the context of investment funds, Chinese walls would need to be in place to ensure that the investment fund:

(i) exercises its voting and investment powers independently; and

(ii) knows nothing about investment, voting or control decisions or intentions of related bodies corporate that have not yet been disclosed to the market; and

(c) related bodies corporate do not share officers or employees involved in the exercise of investment or voting powers.

38. The House of Lords commented that the starting point must be that unless special measures are taken, information moves within a firm: *Prince Jefri Bolkiah v KPMG* [1999] 1 All ER 517, 529. It held: "an effective Chinese wall needs to be an established part of the organisational structure of the firm, not created ad hoc"–p530.[5]

39. The United States Securities and Exchange Commission (SEC) gives case-by-case disaggregation relief for financial institutions from substantial holding (beneficial ownership reporting) requirements in Rule 13d-3[6]: see paragraph 78. The requirements in paragraph 37 are consistent with the SEC guidelines on disaggregation. The SEC said: "one factor militating against" treating a financial institution as separate from a group would be "participation in a common compensation pool that may align voting and investment decisions".[7] We agree that this would be a factor in whether the investment fund is independent under paragraph 37(a). Another factor affecting whether the investment fund operates independently from its related bodies corporate is the physical location of the fund in relation to the rest of the group: see Hong Kong requirements at paragraph 57(d).

40. The SEC guidance also requires that an appropriate compliance plan must be put in place to ensure that voting or investment decisions are made independently by related bodies corporate.

41. The minimum requirements for an appropriate compliance plan would be for the group to:

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[5] Lord Millett noted the Financial Services Authority Core Conduct of Business Rules "contemplate the existence of established organisational arrangements which preclude the passing of information in the possession of one part of the business to other parts of the business". Lord Millett also set out the description of Chinese walls by the Law Commission *Fiduciary Duties and Regulatory Rules* (1992) "as normally involving some combination of the following organisational arrangements: (i) the physical separation of the various departments in order to insulate them from each other – this often extends to such matters of detail as dining arrangements; (ii) an educational programme, normally recurring, to emphasise the importance of not improperly or inadvertently divulging confidential information; (iii) strict and carefully defined procedures for dealing with a situation where it is felt that the wall should be crossed and the maintaining of proper records where this occurs; (iv) monitoring by compliance officers of the effectiveness of the wall; (v) disciplinary sanctions where there has been a breach of the wall."

[6] *Exchange Act* Regulation 240.13d-3.

[7] Securities and Exchange Commission *Amendments to Beneficial Ownership Reporting Requirements* Release 34 - 39538 Part F5.

(a) maintain and enforce written policies and procedures reasonably designed to prevent the flow of information to and from the investment fund and related bodies corporate;

(b) obtain an annual independent assessment of the operation of the policies and procedures established to prevent the flow of information among related bodies corporate. [8]

42. The SEC has also required a financial institution to obtain an independent audit attesting to the adequacy of the Chinese walls in place.

Regulatory risks

43. We note that the effectiveness of Chinese walls has been recently questioned in both Australia and the United States in the context of multi-service financial institutions. At particular issue recently has been the function of Chinese walls between business units of these organisations to safeguard the independence of research analysts. There may be informal or unspoken incentives, expectations or inclinations for an investment fund to support an investment or control move by its related bodies corporate once these moves are public.

44. The level of risk that investment funds do not in fact act independently or that Chinese walls are breached must be acceptable for us to proceed to implement disaggregation relief or relief creating a new exemption in s611.

Issues relating to pre-conditions of relief

6. Are these Chinese wall requirements adequate to ensure the independence of investment funds? Are additional requirements appropriate?

7. Is there a risk that investment funds would act in concert with or under direction of a related body corporate despite these requirements?

[8] Securities and Exchange Commission, *Release No. 34-39538* p17

Option A4: Voting beyond 20%

A restriction on voting beyond 20% on an aggregate (group) basis.

45. We could restrict voting beyond 20% on an aggregate (group) basis. This condition could be in addition to the condition concerning the independent operation of the investment fund: see paragraph 37. Two options are:

(a) restricting the investment fund or related body corporate that acquires securities beyond 20% from voting those securities. (In the case of the relief creating a new exemption in s611, the investment fund could be restricted from voting shares acquired under the exemption); or

(b) requiring that all group entities holding securities take a pro rata "haircut" on the number of shares that they can vote, so that the group does not vote beyond 20%.

46. Where we give relief from s606, this is often on condition that the power of the holder to exercise votes in excess of 20% voting power is restricted. An example is that our relief for brokers selling down large blocks of shares is on condition that the broker does not exercise votes exceeding 20% voting power without our consent: Policy Statement 31 *Acquisitions and disposals by broker acting as principal* at [PS 31.7](c).

47. However, such a restriction on voting may be in tension with our policy that investment funds should be encouraged to actively participate in corporate governance issues.[9] We consider participation in corporate governance issues is an important aspect of the investment fund's role. The investment fund may vote to protect its investment on behalf of fund members.

48. A pro rata "haircut" restriction on voting by each group entity may alleviate the concern that the investment fund is not restricted from voting.

[9] See for example Policy Statement 128 *Collective action by institutional investors* [PS 128.3].

Issues relating to Option A4

8. Should investment funds be restricted from voting beyond 20%? If so, which of the options for restriction should be adopted?

9. Would the voting restriction discourage the investment fund from participating in corporate goverance issues?

Option A5: 30% ceiling on relief

A ceiling on the relief of say 30% voting power on an aggregate (group) basis. A ceiling would be particularly useful where more than one investment fund has relief from s606.

49. We could set say a 30% aggregate voting power ceiling on the relief:

(a) in the case of disaggregation relief – voting power would be calculated on an aggregate (group) basis for the purposes of the ceiling (that is, ignoring the relief from the "associate" and "relevant interest" concepts). If the investment fund or a related body corporate acquired a relevant interest beyond 30% voting power, they would breach s606; or

(b) in the case of relief creating a new exemption under s611 – the relief would not apply to an acquisition by an investment fund beyond 30% voting power.

50. An aggregate ceiling may be particularly useful where more than one investment fund in a group has received disaggregation relief, or relief creating a new exemption in s611. In theory, if several investment funds in a group had disaggregation relief, it would be possible for each to hold up to 20% voting power, and for other related bodies corporate to hold a further 20%.

51. As the voting power of a corporate group increases, there may be greater commercial incentives for an investment fund and its related bodies corporate to control a company together by voting their securities as a block.

52. On the other hand, there may be a greater commercial incentives for an investment fund and related bodies corporate to vote securities as a block where the group's voting power in a company is just above 20% and the group's control is marginal. The group

may have greater need of the investment fund's votes in seeking to exercise control.

53. Introducing a limit of 30%, as the point at which it becomes more likely that the investment fund and its related bodies corporate vote as a block, is in tension with the 20% threshold in s606. Parliament chose the 20% threshold because "in most cases it would fall short of…the point beyond which control can be said to have passed."[10] The Eggleston Committee, which recommended a 15% threshold, said:

> *It seems to be generally agreed that [one third of voting power (33.3%)] is too high. In the case of a company with large numbers of small shareholders it is unlikely that any one shareholder would need to control as much as one third of the voting power to gain control of the company.*[11]

Issues relating to Option A5

10. Is there a greater commercial incentive for investment funds to act in concert with related bodies corporate as their aggregate voting power increases beyond 30%? Is 30% an appropriate maximum ceiling on relief?

11. Are there other means to ensure that the investment fund does not exercise control?

Overseas jurisdictions

54. While the United States gives case-by-case disaggregation relief for financial institutions from substantial holding reporting requirements, the United Kingdom, Canada and Hong Kong give some disaggregation relief from takeovers regulation.

United Kingdom

55. The London City Code takeover threshold is 30% of voting rights, rather than 20%, for all persons, including investment funds.[12]

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[10] Explanatory Memorandum *Companies (Acquisitions of Shares) Bill* 1980 para 46.

[11] Company Law Advisory Committee to the standing Committee of the Attorneys-General *Second Interim Report* (1969) para 27.

[12] *The City Code on Takeovers and Mergers* Rule 9.1

56. The Code provides disaggregation relief for certain purposes. There is disaggregation relief for investment managers from the Substantial Acquisition Rules.[13] SARs restrict the speed with which a person may increase their holding of shares to between 15% and 30% of the voting rights. Disaggregation relief applies where the UK Panel accepts that one part of a group is operating independently and without regard to the interests of any other part.

Holdings of a fund manager are counted with those of a bidder if a related body of the fund manager advises on the bid. This does not apply where the fund manager is exempted by the Panel: Rule 7.2(b).[14]

Hong Kong

57. Relief similar to that in the UK is available in Hong Kong. Funds may apply to the Securities and Futures Commission for Exempt Fund Manager (EFM) status. The SFC is prepared to grant EFM status to funds whose activities are carried on separately from, and are not influenced by, corporate finance operations. This means that the SFC does not normally regard the EFM as acting in concert with clients of corporate finance operations. The SFC requires a detailed application containing such things as:

(a) group structure;

(b) any past examples of co-operative action by the fund with the rest of the group, including any consultative arrangements;

(c) common directorships between the fund and the rest of the group;

(d) the physical location of the fund in relation to the rest of the group;

(e) Chinese wall procedures;

(f) financial interests of directors and executives of the fund in the performance of the group, for example common bonus pools and options schemes; and

(g) any services shared by the fund and any other part of the group: for example library and research departments.

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[13] Note 2 to SAR 5.

[14] *The City Code on Takeovers and Mergers* Definition of "Connected fund managers" para (3) and Rule 9.1. A fund manager is exempt where it manages investment accounts on a discretionary basis and is recognised by the Panel as exempt: "Exempt Fund Manager" definition.

Canada

58. A Canadian National Instrument[15] permits "eligible institutional investors"[16] to treat securities that are owned or controlled through a business unit separately from securities owned or controlled through any other business unit. The National Instrument covers "securities regulation related to" takeover bids (as well as substantial holding requirements: see paragraph 79). The following conditions must be satisfied:

(a) decisions on acquisition, disposal or voting of securities owned or controlled by a business unit are made in all circumstances by that business unit;

(b) the business unit is not a joint actor with any other business unit in respect of the securities;

(c) no entity that participates in the formulation of acquisition, disposal or voting decisions of the business unit participates in the formulation of such decisions for other business units, except for:

  (i) preparing research reports;

  (ii) monitoring compliance with regulatory requirements; and

  (iii) setting or monitoring compliance with general investment policies; and

(d) the eligible institutional investor has reasonable grounds for believing that each business unit complies with the takeover provisions.[17]

ASIC precedent: Policy Statement 88

59. Under our Policy Statement 88 *Trustee and nominee companies* [PS 88] we gave case-by-case exemptions from the takeover prohibition for trustees of approved deeds. This was because interests in securities of the trustee held under several different approved deeds may have breached the takeover prohibition. This was an unintended effect of the Corporations Law: see [PS 88.14].

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[15] National Instrument 62-103 *The Early Warning System and Related Takeover Bid and Insider Reporting Issues* (March 2000)

[16] "Eligible institutional investor" means a financial institution, a pension fund, a mutual fund that is not a reporting issuer or an investment manager in relation to securities over which it exercises discretion to vote, acquire or dispose without the express consent of the beneficial owner.

[17] *National Instrument 62-103* Part 5.1

We exempted the trustee from the takeover prohibition, on condition that it kept records of:

(a) the number and percentage of voting shares in each company held in relation to each scheme; and

(b) the aggregated number and percentage in each company held in relation to all schemes.

60. The ASC said at [PS 88.13] that without relief the trustee:

> *may have to advise the management companies for which it acts as trustee that no further acquisitions in a particular company can be made. This is because the shares held by the trustee under a number of trusts may exceed 20%, even if the shares under the control of one management company are less than 20%.*

61. This relief under [PS 88] should be distinguished from relief for investment funds. We stated at [PS 88.4] that the exemption was on the basis that:

> *in practical terms, [the trustee] has no real power over voting and disposal of the shares except in unusual circumstances when management companies breach their obligations or retire.*

In contrast an investment fund usually has power over voting and disposal.

B Substantial holding provisions: s671B

62. Under s671B, once an investment fund begins to have a substantial holding in a listed company or listed managed investment scheme or changes its substantial holding by 1% the investment fund must give the company and the securities exchange substantial holding information within 2 business days.

63. Under the definition of "substantial holding" in s9, an investment fund will have a substantial holding in a body if the investment fund or its associates have a relevant interest in shares carrying at least 5% of votes.

64. Section 671B, like s606, applies the "associate" and "relevant interest" concepts. This means that the votes of the investment fund and related bodies corporate are counted together for the purposes of s671B. For example, if the investment fund has 4% of total votes and a related body corporate of the investment fund acquires voting

shares with 1% of total votes, the investment fund must give substantial holding information under s671B.

65. Australia's substantial holding provisions originate from the recommendations of the Cohen Committee:

> *…the intention thereof is to enable a shareholder to know who his co-adventurers are and the public to find out who controls the business to which they are contemplating investment or to which they are considering granting credit.*[18]

66. The rationale behind the substantial holding provisions is that holders, directors and the market are provided with sufficient information to enable them:

(a) to identify the controllers of substantial blocks of voting shares;

(b) to identify the associates of those substantial holders;

(c) to know the details of any special benefits a person may have received for disposing of their interest; and

(d) to know the details of any agreements or special conditions or restrictions which may affect the disposal of shares or the way in which they are voted.[19]

67. In addition, the substantial holding provisions promote the principle that the acquisition of control takes place in an efficient, competitive and informed market: s602(a).

Option B1: Status quo

68. The first option is to maintain the status quo, so that the investment fund must disclose its holdings of 5% or more on an aggregate (group) basis within 2 business days.

Option B2: "Disaggregation" relief

Disaggregation relief from the substantial holding provisions. The condition that the investment fund operates independently would apply.

69. An option would be disaggregation relief from the substantial holding provisions, in addition to or instead of disaggregation relief from the takeover prohibition. The condition concerning the

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[18] *Report of the Committee on Company Law Amendment* UK (1945) p39.

[19] NCSC Policy Release 110 *Substantial shareholding notices* para 3.

independent operation of the investment fund would apply to this relief: see paragraph 37.

Why should investment funds have relief?

Less likely to seek control?

70. Investment funds may be less likely to seek control of companies in which they invest. Although this does not mean that no investment fund will seek control, in concert with or on direction of related bodies corporate: see paragraph 20. That investment funds may be less likely to seek control would be a reason for relief only if the purpose of the substantial holding provisions is limited to identifying the controller of a company or bidders, or potential bidders. We do not consider that the purpose of the substantial holding provisions is limited to this.

71. One intention of substantial holding provisions identified by the Cohen Committee was to enable a shareholder to "find out who controls the business": see paragraph 65.

72. However, the intention of the substantial holding provisions extends beyond this: see paragraph 66. Information about the identity of any controller of a substantial block, and the terms on which the block was acquired, is useful to the market. In any event, blocks of shares held by investment funds have the potential to change and influence control, for example if:

(a) a bidder acquires its pre-bid stake from an investment fund; or

(b) an investment fund sells into a bid.

Sharing sensitive information

73. The SEC suggested a reason for disaggregation relief from substantial holding provisions is that requiring a corporate group to aggregate holdings of diverse business units means that they must share sensitive information, when it is not otherwise necessary for business purposes.[20]

74. Corporate group may address this issue by establishing systems for reporting to a central compliance unit, without breaching Chinese walls. Effective systems to facilitate substantial holding

[20] Securities and Exchange Commission *Amendments to Beneficial Ownership Reporting Requirements* Release 34-39538 Part F5.

disclosure reduce the scope for insider trading by informing the market.

Disaggregated information more useful?

75. Some people have suggested that substantial holding information is more useful to the holders, directors and the market on a disaggregated basis where the investment fund operates independently from its related bodies corporate. However, we consider that if a group provides information in compliance with s671B(3) and (4) and the prescribed forms, there is sufficient information to identify:

(a) which group entities hold a parcel of shares and in what capacity; and

(b) in particular, whether the investment fund is the holder of the shares or has an indirect relevant interest for example under s608(3)(a).

Other reasons

76. Disaggregation relief would also reduce the cost of "free-riding" or "front-running", because the investment fund (and its related bodies corporate) would have to give substantial holding information much less often. We discuss the free-riding and front-running issues below in the context of relief allowing the investment fund to delay substantial holding disclosure: see paragraph 88 and 90. Delayed disclosure relief would more directly address this issue.

77. We do not consider that the cost of establishing and maintaining compliance systems for substantial holding disclosure is a reason for relief from s671B. This is a cost that persons other than investment funds face. Parliament weighed the benefits of substantial holding provisions against the costs when it introduced, and amended, substantial holding provisions.

Overseas jurisdictions

78. The SEC gives disaggregation relief for financial institutions from substantial holding (beneficial ownership reporting) requirements in Rule 13d-3.[21] The SEC stated that aggregation may not be required in "those instances where the organizational

[21] *Exchange Act* Regulation 240.13d-3.

structure of the parent and related entities are such that the voting and investment powers…are exercised independently".[22]

79. In Canada, disaggregation relief for separate business units of "eligible institutional investors" applies to substantial holding requirements, the "early warning system", as well as takeovers: see paragraph 58. The Ontario Securities Commission, in adopting the relief stated:

The primary purpose of the proposed National Instrument is to provide exemptions from the early warning requirements…to certain institutional investors that have a "passive intent" with respect to their ownership or control of securities of reporting issuers and to permit those persons to disaggregate securities that they own or control…[23]

ASIC precedent: Policy Statement 88

80. It is imptortant to note that [PS 88] did not give relief from the substantial holding provisions. The ASC stated:

> *If the ASC grants relief from s 615 to a trustee it becomes even more important that the trustee's holding is properly disclosed. The ASC will not relieve a trustee from compliance with the substantial shareholding provisions. In particular, the ASC will not extend the time for lodgement of notices.* [PS 88.17]

This reasoning does not support disaggregation relief from the substantial holding provisions in s671B.

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[22] Securities and Exchange Commission *Amendments to Beneficial Ownership Reporting Requirements* Release 34-39538 Part F5.

[23] Ontario Securities Commission *Notice of National Instrument 62-103 The Early Warning System and Related Take-over Bid and Insider Reporting Issues.*

Issues relating to Options B1 and B2

12. Should investment funds have disaggregation relief for the purposes of the substantial holding provisions in s671B or should the status quo be maintained?

13. If investment funds have disaggregation relief from s671B, should this relief be as well as or instead of disaggregation relief from s606?

14. Should any change be effected by ASIC exemption or legislative amendment?

15. Is there a concern that reporting aggregate substantial holdings requires diverse business units within a group to share commercially sensitive information?

Option B3: Delayed disclosure

Relief so that the investment fund would have 5 rather than 2 business days to give substantial holding disclosure.

81. An option would be for an investment fund to have relief allowing them more time to give substantial holding information under s671B: say an extension from 2 business days to 5 business days.

82. Persons must give substantial holding information:

(a) within 2 business days after they become aware of the information; or

(b) during the bid period of a takeover bid, by 9.30am on the next trading day: s671B(6).

Timely disclosure

83. The 2 business day deadline is designed to ensure that substantial holding information is given to the market on a timely basis. A judgment on the New Zealand substantial holding provisions emphasises the purpose of these provisions "to compel, in fast-moving markets, the immediate disclosure of the identity of persons who become substantial security holders": *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 511.

84. The deadline is 9.30am on the next trading day during the bid period because it is even more important that the bidder, target, holders and the market are informed immediately about changes to substantial holdings in the target: s671B(6)(b). It is very unlikely that we would extend the relief to delay disclosure during the bid period. In addition, during a takeover bid it is less likely that front-running will be a problem. Market dynamics change so that the offer (and the possibility of an improved or rival offer), rather than acquisitions or disposals by the investment fund, are likely to drive price movements.

85. We are also unlikely to give relief to delay substantial holding disclosure during a corporate event, that is, during the period:

(a) after a corporate event has been announced; until

(b) after the meeting of holders to approve the event.

A "corporate event" means a scheme of arrangement, buy-back that needs holder approval, capital reduction, election of directors or any other action that requires holder approval.

Why should investment funds have relief?

Less likely to seek control?

86. An argument for relief to delay disclosure is that an investment fund may be less likely to seek control of a company. However, the intention of the Australian substantial holding provisions extends beyond identifying controllers or potential bidders. Investment funds have the potential to change or influence control by selling to the bidder. Information about the identity of any controller of a substantial block, and the terms on which the block was acquired, is useful to the market.

87. This means it is a less likely outcome of our process that we would give relief to delay disclosure.

Free-riding

88. At least one investment fund has argued that the requirement to lodge a notice within 2 business days encourages "free-riding". The investment fund argued that because of its size and reputation, others will follow it in acquiring or disposing of the securities, moving the price against the investment fund. Investment funds incur significant costs in analysing investments. Fund members pay for this analysis through fees. However, this may be a concern only if the investment fund has not finished its investment move or unwound its position within 2 business days. If an investment fund

finishes its acquisitions within 2 business days, it will actually benefit from free-riding, which may push up the market value of its new investment.

89. Information about the acquisitions and disposals of major investors is important market information. The fact that the information may move the market price demonstrates this. The purpose of the substantial holding provisions is that the market is provided with information about acquirers or disposers of substantial blocks of shares and the terms of the acquisition. This information should be provided on a timely basis: see paragraph 83. It is a less likely outcome of this process that we would give relief to delay disclosure.

Front-running

90. The investment fund also argued investors may "front-run" it. In this context, front-running means taking a position in shares or options on the basis of recent acquisitions or disposals by an investment fund anticipating more of these acquisitions or disposals. This moves the market price against the investment fund, increasing its cost of investing.

91. The investment fund argued that "front-running", and other trading in reaction to acquisitions or disposals by investment funds, is often short-term or speculative, so that it contributes to market volatility.

92. Australian Stock Exchange Limited (ASX) has initiated a second trial of delayed disclosure of block trades. Under the 8 month trial, very large principal-facilitated single stock transactions[24] can be reported to the market by 9.45am the trading day after they are made, rather than immediately.

93. ASX stated the primary purpose of the block trades delayed reporting trial "is to reduce implicit transaction costs if these trades are immediately reported (eg market impact costs, opportunity costs)". ASX said:

> *…participants are exposed to the risk of significant market movement (in part caused by other participants front-running the*

[24] *These are "Block Special Crossings" of a minimum $10M for the top 11 equity securities, $5M for the top 12 to 50 equity securities and $2M for all others.*

stock) when unwinding their position, or accumulating stock the subject of a short sale.[25]

94. While ASX acknowledged that delayed reporting would decrease post-trade transparency, it believed that delayed reporting would increase the willingness of brokers to participate in on-market trades, increasing liquidity.

95. We consider these are primarily trade reporting rather than substantial holding issues. We have not yet finalised our view in relation to ASX submissions on delayed trade reporting pending receipt of the results of the trial

96. As the ASX trial delays reporting until 9.30am the next trading day, this is not a precedent for delaying substantial holding disclosure beyond 2 business days.

Overseas jurisdictions

97. In the United States, the standard disclosure period for holdings of 5–10% is 10 calendar days after the holding is acquired.[26] Institutional investors have up to 45 calendar days after the end of the calendar year to report beneficial holdings of between 5–10%.[27] Once institutional investors have a substantial holding of 10% or more, they must in addition report holdings within 10 days after the end of the month.[28] The SEC's rationale for allowing institutional investors more time to disclose substantial holdings is to "allow the marketplace, as well as the staff of the Commission, to focus more quickly on acquisitions involving the potential to change or influence control."[29] We consider that the purpose of the Australian provisions goes beyond identifying potential controllers or bidders: see paragraph 70.

98. In Canada, the standard disclosure period for holdings of 10% or more is 2 business days. Institutional investors have up to 10 days after the end of the month in which the holding was acquired to disclose substantial holding information.[30]

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[25] ASX *New Reporting Regime for Large Single Stock Trades (Trial)* p4.

[26] *Exchange Act* s13

[27] *Exchange Act* rule 13d-2(b)

[28] *Exchange Act* rule 13d-2(c)

[29] Securities Exchange Commission *Release No, 34-39538*

[30] Ontario *Securities Act* s101

ASIC precedents

99. Under [PS 31], we give brokers selling down a large block of shares relief from s671B until 9.30am on the third day after the broker acquired the securities: see [PS 31.9]. After this time, the broker must immediately give the substantial holding information. The policy of this relief is:

> *Additional substantial shareholding notices from brokers in relation to shares which were bought and onsold within 48 hours would be likely to reduce clarity for the market.* [PS 31.5]

100. The relief from s671B for brokers is for very short-term holdings. Any relief for investment funds would cover longer-term investments. No question of the market being confused by disclosure of transitory acquisitions and disposals arises.

101. In [PS 88], we particularly emphasised that we would not give relief for trustees to delay substantial holding disclosure: "In particular, the ASC will not extend the time for lodgement of notices" – see [PS 88.17].

Issues relating to Option B3

16. Should investment funds have more time to give substantial holding information or should the status quo be maintained?

17. If we delay disclosure for investment funds, what is the shortest period of time required to alleviate free-riding and front-running?

18. Should we give this relief in addition to or as an alternative to disaggregation relief from s606?

19. Should any change be effected by ASIC exemption or legislative amendment?

20. How important to holders, directors and the market is timely disclosure about changes in substantial holdings of investment funds?

21. Is timely disclosure by investment funds less important because they are less likely to seek control of a company?

Option B4: Increased substantial holding threshold

Relief raising the substantial holding theshold from 5% to say 10% of votes in the company.

102. An increased substantial holding threshold could apply to investment funds. The threshold could be increased from 5% to 10% of total votes attaching to voting shares. An increased threshold is a less likely outcome of this process: see paragraph 105.

103. In the United Kingdom, the substantial holding threshold is 3%. Investment funds are allowed to acquire up to 10% of the issued shares in a company before being deemed to have a substantial holding.[31] Jurisdictions such as Canada[32] and Hong Kong[33] have substantial holding thresholds of 10%.

104. Relief to increase the threshold would reduce the cost of "free-riding" or "front-running", because acquisitions or disposals where the relevant interest of the investment fund is between 5% and 10% will not be disclosed to the market. Though delayed disclosure relief more directly addresses this issue.

105. Five percent of the total number of votes is the point chosen by Parliament at which a holding is a substantial block about which holders, directors and the market should be informed. In January 1991, the threshold was reduced from 10% to 5%. This was a deliberate decision by Parliament. The reduction in the threshold was part of a decision to amend and simplify the mix of substantial holding and beneficial tracing provisions. In considering relief we would not regard as persuasive an argument that our current disclosure threshold is inappropriate per se.

106. It may be less likely that an investment fund seeks control of a company: paragraph 70. However, ASIC considers that if the intention of s671B extends beyond giving the market information about controllers of companies, bidders and potential bidders, no higher threshold should apply to investment funds.

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[31] *Companies Act 1985* s199(2A)

[32] Eg Ontario *Securities Act* s101(1).

[33] *Securities (Disclosure of Interest) Ordinances* s4 - 6

Issues relating to Option B4

22. Should the status quo be maintained? Do you consider that such a change is appropriate given that in 1991 the substantial holding threshold was reduced from 10% to 5%?

23. Should we consider giving this relief in addition to, or as an alternative to, disaggregation relief from s671B or relief to delay disclosure?

24. Should any change be effected by ASIC exemption or legislative amendment?

C Investment funds

107. Who would be covered by any relief?

Option C1: List of investment funds

Limit relief to a list of "investment funds".

108. One option would be to limit the persons who have any relief to "investment funds", bodies corporate whose primary functions are to pool the funds of persons to whom the body owes a fiduciary duty and invest the funds of any of the following:

(a) a registered managed investment scheme;

(b) a regulated superannuation fund, an approved deposit fund or a pooled superannuation trust within the meaning of the *Superannuation Industry (Supervision) Act 1993*;

(c) a statutory fund of a registered life insurance company within the meaning of the *Life Insurance Act 1995*; or

(d) similar overseas investment funds.

The definition would also include an investment company, an incorporated investment fund.[34]

This definition is similar to that in our Policy Statement 128 *Collective action by institutional investors* [PS 128].

[34] Using the definition of "investment company" in reg 7.3.12(3) as a guide: a body corporate that carries on a business of investing money subscribed under a prospectus in securities.

109. Relief would be limited to these investment funds because:

(a) it is of more concern to investment funds that s606 may prevent them gaining a market weighting in a company due to other group holdings, increasing the risk that members will receive less than market returns; and

(b) investment funds may be less likely to seek control. They may be constrained by their investment policy and fiduciary duties to fund members see paragraphs 19 and 70; and

(c) any relief would be to address disadvantages for fund members, not the entity itself.

Option C2: Index funds

Limit relief to index funds.

110. An option would be to limit the relief to index funds. Index funds are funds that invest in a portfolio of securities designed so that their value tracks a nominated market index, a benchmark for returns. Index funds are less likely than other investment funds to seek control of companies. The investment policies of index funds expressed in disclosure documents may restrict the fund's investment discretion, although discretions in constitutions and management agreements may be expressed broadly. There is an analogy available with the bare trustees. Bare trustees have an exemption under s609(2) in part because their discretion to invest or vote is very limited. Index funds are passively managed.[35]

111. If an index fund is prevented from acquiring or disposing of securities because of relevant interests of its related bodies corporate, this may cause an increased tracking error (deviation from the benchmark). An index fund argued that this could mean its client mandate is not met. Although we are aware that some funds are permitted substantial tracking errors under their investment policy.

112. Conditions could apply setting a maximum tracking error for the investment fund or limiting the over-exposure of the fund to a company by reference to the company's weighting in an index.

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[35] Rather than actively managing the fund, index funds use proprietary "black box" techniques to maintain close correlation with the index. They may not alter holdings in anticipation of market movements. They may not have a cash buffer.

Life insurance companies

113. There is a question whether:

(a) "disaggregation" relief from s606 and s671B; and

(b) relief creating a new exemption under s611,

should extend to a life insurance company where shareholders of the company share in the profit or surplus of a statutory fund.

114. In this case obligations of the life company to:

(a) investors in the life policies; and

(b) shareholders of the life company (including its related bodies corporate),

are more likely to coincide, so that it may be more likely that the life company acts with, or under the direction of, related bodies corporate: see paragraph 19. Though we would impose conditions on relief to ensure that the life company operates independently: see paragraph 37.

Issues relating to Options C1 and C2

25. Should other entities have relief?

26. Should relief be limited to index funds on the basis that their investment discretion is limited?

27. If we limit our relief to index funds should we include a condition specifying a maximum tracking error or limiting over-exposure to a company by reference to the company's index weighting? What should the terms of the condition be?

28. Should the relief cover life insurance companies where the life company's shareholders (including related bodies corporate) share in the profit or surplus of the statutory fund?

29. Should we in any other way limit the relief by reference to the type of investment fund?

Consolidated options and issues

Section A: The takeover prohibition and investment funds

Issues relating to Option A1. This option maintains the status quo so that the holdings of investment funds and the rest of the group must be aggregated.

1. Should investment funds have relief from s606 or should the status quo be maintained?

2. Is it more appropriate that any change is effected by ASIC exemption or legislative amendment?

3. Do the current solutions adequately address the problems raised by investment funds?

Issues relating to Options A2 (disaggregation relief) and A3 (new exemption in s611). Option A2 allows investment funds operating within a corporate group to disaggregate their holdings for the purposes of the takeovers prohibition where they operate independently from related bodies corporate. Option A3 creates a new exemption in 611 from the takeovers prohibition for acquisitions by investment funds where they operate independently from related bodies corporate.

4. Should investment funds have either "disaggregation" relief or relief creating a new exemption in s611? Which option do you prefer?

5. Should more than one investment fund in a group have the relief?

Issues relating to the independence precondition.

6. Are these Chinese wall requirements adequate to ensure the independence of investment funds? Are additional requirements appropriate?

7. Is there a risk that investment funds would act in concert with or under direction of a related body corporate despite these requirements?

Issues relating to Option A4. This option restricts voting beyond 20% on a group basis.

8. Should investment funds be restricted from voting beyond 20%? If so, which of the options for restriction should be adopted?

9. Would the voting restriction discourage the investment fund from participating in corporate goverance issues?

Issues relating to Option A5. This option sets a ceiling on relief at 30% voting power on a group basis.

10. Is there a greater commercial incentive for investment funds to act in concert with related bodies corporate as their aggregate voting power increases beyond 30%? Is 30% an appropriate maximum ceiling on relief?

11. Are there other means to ensure that the investment fund does not exercise control?

Section B: The substantial holding provisions and investment funds

Issues relating to Options B1 (status quo) and B2 (disaggregation relief). Option B1 maintains the status quo so that the investment fund must disclose its holdings of 5% or more on a group basis within 2 business days. Option B2 allows investment funds to disaggregate their holdings for the purposes of the substantial holding provisions where they operate independently from related bodies corporate.

12. Should investment funds have disaggregation relief for the purposes of the substantial holding provisions in s671B or should the status quo be maintained?

13. If investment funds have disaggregation relief from s671B, should this relief be as well as or instead of disaggregation relief from s606?

14. Should any change be effected by ASIC exemption or legislative amendment?

15. Is there a concern that reporting aggregate substantial holdings requires diverse business units within a group to share commercially sensitive information?

Issues relating to Option B3. This option allows investment funds more time to give substantial holding information under s671B.

16. Should investment funds have more time to give substantial holding information or should the status quo be maintained?

17. If we delay disclosure for investment funds, what is the shortest period of time required to alleviate free-riding and front-running?

18. Should we give this relief in addition to or as an alternative to disaggregation relief from s606?

19. Should any change be effected by ASIC exemption or legislative amendment?

20. How important to holders, directors and the market is timely disclosure about changes in substantial holdings of investment funds?

21. Is timely disclosure by investment funds less important because they are less likely to seek control of a company?

Issues relating to Option B4. This option allows an investment fund to acquire up to 10% of the votes in a company before giving substantial holding information.

22. Should the status quo be maintained? Do you consider that such a change is appropriate given that in 1991 the substantial holding threshold was reduced from 10% to 5%?

23. Should we consider giving this relief in addition to, or as an alternative to, disaggregation relief from s671B or relief to delay disclosure?

24. Should any change be effected by ASIC exemption or legislative amendment?

Section C: Investment funds

Issues relating to Options C1 and C2. Option C1 gives relief to a list of "investment funds". Option C2 limits relief to index funds.

25. Should other entities have relief?

26. Should relief be limited to index funds on the basis that their investment discretion is limited?

27. If we limit our relief to index funds should we include a condition specifying a maximum tracking error or limiting over-exposure to a company by reference to the company's index weighting? What should the terms of the condition be?

28. Should the relief cover life insurance companies where the life company's shareholders (including related bodies corporate) share in the profit or surplus of the statutory fund?

29. Should we in any other way limit the relief by reference to the type of investment fund?

Regulatory and financial impact

115. We have considered the regulatory and financial impact of the options in this paper.

116. Our objectives in developing this discussion paper are:

(a) To analyse a number of options for change including:

(i) disaggregation relief from the takeovers prohibition in certain circumstances;

(ii) new exemption in s611 for investment funds;

(iii) disaggregation relief from the substantial holding provisions in certain circumstances;

(iv) delayed disclosure of substantial holdings; and

(v) an increase in the substantial holding threshold.

(b) To analyse these options for change against the purposes of the takeovers provisions stated in s602. These include that:

(i) the acquisition of control of voting shares or interests takes place in an efficient, competitive and informed market;

(ii) holders and the target have sufficient information about the bidder and the bid and reasonable time to consider the bid; and

(iii) holders have a reasonable and equal opportunity to participate in any benefits of the bid.

(c) To analyse these options for change against the intention of the substantial holding provisions in s671B:

(i) to identify the controllers of substantial blocks of voting shares;

(ii) to identify the associates of those substantial holders;

(iii) to know the details of any benefits a person may have received for disposing of their interest; and

(iv) to know the details of any agreements which may affect the disposal of shares or the way in which they are voted.

(d) To compare the regulation of investment funds, takeovers and substantial holdings in jurisdictions overseas with Australia's regulatory regime.

117. We do not think that the options would increase the financial impact of complying with Chapter 6 and s671B, as the purpose of the options would be to relieve an investment fund (and, under some options, its related bodies corporate) from restrictions or obligations under these Chapters.

118. Each of these options should balance the interests of investment funds on behalf of fund members with maintaining the policy of takeover and substantial holding regulation. For example, relief to delay substantial holding disclosure must balance:

(a) addressing the problem of free-riding; and

(b) the interest of holders, directors and the market in knowing on a timely basis who controls substantial blocks of shares.

119. So that we can assess more accurately the regulatory and financial impact of the options, we seek comments on our discussion paper including:

(a) the likely regulatory impact of the options;

(b) the likely financial impact of the options;

(c) whether the options take sufficient account of the purposes of takeover and substantial holding regulation.

120. In particular, do you consider that the condition concerning the independent operation of the investment fund would increase the financial impact of takeover or substantial holding provisions: see paragraph 37? Do you think that the financial impact is justified in view of the purposes of Chapter 6 and s671B?

Development of options

121. We have developed this discussion paper having regard to:

(a) Explanatory Memoranda and draft Bills, including for the *Corporate Law Economic Reform Act 1999*;

(b) *Financial Services Reform Act 2000*;

(c) the following ASIC Policy Statements:

[PS 31] Acquisitions and disposals by broker acting as principal

[PS 88] Trustee and nominee companies

[PS 128] Collective action by institutional investors

[PS 130] Managed investments: licensing

[PS 134] Managed investments: constitutions

(d) *Report of the Committee on Company Law Amendment* (Cohen Committee Report), United Kingdom (1945);

(e) the following cases: *Prince Jefri Bolkiah v KPMG* [1999] 1 All ER 517; *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515; and *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500;

(f) United States references: Securities and Exchange Commission *Amendments to Beneficial Ownership Reporting Requirements* Release 34-39538 and *Exchange Act* Regulation 13d;

(g) Canadian references: National Instrument 62-103 *The Early Warning System and Related Takeover Bid and Insider Reporting Issues* (March 2000); Ontario *Securities Act*; Ontario Securities Commission *Notice of National Instrument 62-103 The Early Warning System and Related Take-over Bid and Insider Reporting* Issues;

(h) United Kingdom references: *The City Code on Takeovers and Mergers; Companies Act 1985*;

(i) Hong Kong references: *Securities (Disclosure of Interest) Ordinances*

(j) Company Law Advisory Committee to the standing Committee of the Attorneys-General *Second Interim Report* (1969);

(k) ASX Business Rules; ASX *New Reporting Regime for Large Single Stock Trades (Trial)*;

(k) informal consultation with the Panel executive, Treasury, Investment and Financial Services Association Limited and a practitioner with experience of these issues;

(n) texts and articles including: Renard and Santamaria *Takeovers and Reconstructions in Australia* (1990-); Ford, Austin, Ramsay *Ford's Principles of Corporations Law* (2000-); Davis *The Law of Superannuation in Australia* (1992-); Hanrahan *Managed Investments Law and Practice* (1999-); and Ali and Gold "The next generation of index trackers: exchange traded funds and investment duties of fiduciaries" (2000) 18 *Corporations and Securities Law Journal* 570.

Key terms

122. In this discussion paper:

"Act" means *Corporations Act 2001* (Cth);

"ASIC" means the Australian Securities and Investments Commission;

"ASX" means Australian Stock Exchange Limited;

"free-riding" means where other investors follow an investment fund in acquiring or disposing of the securities because of the investment fund's size and reputation;

"corporate event" means a scheme of arrangement, buy-back that needs holder approval, capital reduction, election of directors or any other action that requires holder approval.

"disaggregation relief" means relief from the "associate" and "relevant interest" concepts so that the holdings of an investment fund would be disaggregated from that of the rest of the group and vice versa;

"front-running" means taking a position in shares or derivatives on the basis of recent acquisitions or disposals by an investment fund anticipating more of these acquisitions or disposals;

"index fund" means an investment fund that invests in a portfolio of securities designed so that its value tracks a nominated market index;

"investment fund" means a body corporate whose primary functions are to pool the funds of persons to whom the body owes a fiduciary duty and invest the funds of any of the following:

(a) a registered managed investment scheme;

(b) a regulated superannuation fund, an approved deposit fund or a pooled superannuation trust within the meaning of the *Superannuation Industry (Supervision) Act 1993*;

(c) a statutory fund of a registered life insurance company within the meaning of the *Life Insurance Act 1995*; or

(d) similar overseas investment funds; and

an investment company, an incorporated investment fund.

"Panel" means the Takeovers Panel.

"relief" means relief from the current provisions of the Act, whether by:

(a) ASIC exemption or modification; or

(b) legislative amendment.

Your comments

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

Comments are due by 31 December 2001 and should be sent to:

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Australian Securities & Investments Commission
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Melbourne, Victoria, 3000
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Email: andrew.fawcett@asic.gov.au

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.