

Rachel Howitt  
Senior Lawyer  
Corporations  
Australian Securities & Investments Commission  
GPO Box 9827  
Sydney NSW 2001

By email: [Rachel.howitt@asic.gov.au](mailto:Rachel.howitt@asic.gov.au)

Dear Rachel,

**Regarding Consultation Paper 137: Indirect self-acquisition by investment funds**

The Financial Services Council<sup>1</sup> is the peak body representing the retail & wholesale funds management, superannuation and life insurance industries. The Financial Services Council has over 135 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians.

We thank ASIC for the opportunity to make this submission on the Consultation Paper revisiting the issue of Indirect self-acquisition.

Before commenting on each question raised for feedback in the Consultation Paper we note the following key points. The Financial Services Council:

- welcomes the removal of the sun-setting clause;
- do not believe that any additional condition on the relief is required given the protections that already exist;
- ask that you consider expanding the relief to include controlled custodians and investment linked statutory funds (the latter is particularly relevant for placements); and
- ask you also consider facilitating greater reporting flexibility with regards to frequency but also consider a mechanism to minimise the impacts created by inadvertent non-material reporting non-compliance (cause by human error in the reporting process).

Our feedback on the questions raised in the Consultation Paper follows.

Should you have any questions with regards to this submission, please feel free to contact me on (02) 9299 3022.

Yours Sincerely,

Cecilia Storniolo  
**Senior Policy Manager**

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<sup>1</sup> The Financial Services Council, until recently, was previously known as the Investment and Financial Services Association (IFSA).

# ASIC Consultation Paper 137

## Indirect self-acquisition by investment funds: Further Consultation

### Sunsetting case-by-case relief

#### Proposal 1

**B1** We propose to grant relief from s259C(1) without a sunset clause because we are satisfied the policy settings and conditions in CP 1 are appropriate (subject to the proposals in this paper).

**B1Q1** Do you agree we should grant relief based on CP 1 without a sunset clause?

Yes, we welcome this change. We agree that relief should be granted without a sunset clause on the basis that the requirement for annual renewal creates significant administrative burden and risk of substantial detriment and uncertainty in the event of an inadvertent failure to renew, with no corresponding benefit.

### Additional condition for controlled trustees and responsible entities

#### Proposal 2

**B2** We propose an additional condition on relief from s259C(1) where we permit the issue or transfer of shares of a company to a unit trust or managed investment scheme that has a controlled entity of the company as trustee or responsible entity. The proposed voting test condition will mean relief would cease to apply where the company or any controlled entity's relevant interest in the trust or scheme is more than 20%.

**B2Q1** Do you agree it is appropriate to impose an additional condition on relief for controlled trustees or responsible entities to prevent the company and its controlled entities from having a relevant interest in the trust or scheme of more than 20%?

No we do not agree that it is appropriate to impose additional conditions on relief as raised in B2Q1 on the basis that such a restriction would adversely affect the investing public, without providing any enhanced protection from the risk of self-acquisition. Specifically, we note the following reasons to support our position of no additional conditions:

1. We do not agree that a company or controlled entity's relevant interest of more than 20% in a managed investment scheme that holds the company's shares invokes self-acquisition – the holding of the company's shares will be a small portion of the trust or scheme's portfolio, typically comprising investments across the ASX 200/300. Additionally, having regard to the legal nature of a managed investment scheme, the company or its controlled entity that is invested in that scheme has no interest and no day-to-day control in respect of the scheme's holding of the company's shares. Therefore, whilst the company or a controlled entity may have more than a 20% relevant interest in a fund that holds the company's shares, this does not equate to the company or the controlled entity having an interest of any kind in those shares. In terms of the RE of the scheme holding the company's shares, that RE has a statutory and general law duty to act in the best interests of members as a whole – hence that RE cannot acquire the company's shares simply as a self-acquisition measure on behalf of the company, nor can it prefer the interests of the company or controlled entity that has the relevant interest in the scheme. Additionally, we do not believe that

managed funds, superannuation and platform investors should be denied exposure through these investment vehicles to shares in ASX 200/300 companies simply on the basis that the investment vehicle is operated by a controlled entity of such a company

2. Further, some fund managers “seed” funds which enable the establishment of a track record. It takes time to obtain external investor money and the 20% limit imposes a condition which would not be satisfied for many funds seeded on establishment to establish a track record. Hence, if notwithstanding our view that a 20% condition is not necessary, a 20% condition is imposed, we submit that there should be a phase-in period after establishment (seeding) of a fund, before the 20% condition applies. This would allow a fund to be seeded and then for external investors to be found so that the seed falls below 20% by the end of the phase-in period. If not below 20% by the expiry of the phase-in period, then the relief would not apply. While the appropriate phase-in period would depend on the nature of the fund a phase-in period of 2 years may allow funds to be established and time to ensure external investor money constitutes at least 80% of the fund. This is a critical fund establishment process prohibiting the company’s controlled entity trustees and responsible entities from offering efficiently structured investment vehicles and investors would bear the costs of any restructured, less flexible offerings.
3. In addition, the 20% condition may be inconsistent with industry interfunding arrangements. For interfunding purposes it is common for there to be one fund which holds the direct assets and other funds (with a common trustee or RE) to invest in that fund to obtain indirect exposure to the direct assets. For example, a balanced fund may obtain exposure to Australian shares by investing in a related Australian share fund which directly holds Australian shares. Alternatively a wholesale fee Australian share fund may directly hold Australian shares and a retail fee Australian share fund may invest (potentially up to 100% of the retail fund) in the wholesale fund to indirectly obtain exposure to those Australian shares.
4. It should be noted, that for the reasons above, many investment funds would fail the 20% condition, solely because of efficient interfunding structures, seeding structures and operational structuring of various products and services in the wealth management industry (such as platforms, superannuation master trusts and platforms), hence the 20% condition could not be complied with.

The proposed reliefs listed in Consultation Paper 137 should generally clarify issues around multi-layered structures such as feeder funds and controlled custodians.

It is common practice for feeder funds to invest in other funds which acquire the company’s shares in their investment capacity and also for controlled custodians to hold the company’s shares in their capacity as fund custodian or for other controlled entities who are themselves holding as trustee. . For the avoidance of doubt we believe that relief from section 259C(1) where the trustee (or responsible entity) is controlled should also be available for these multi-layered structures

**B2Q2** Are there any circumstances in which it is necessary for a company or its controlled entities to have more than 20% relevant interest in an investment trust or scheme other than for the purpose of investing the company’s own funds (e.g. temporary control upon establishment of the trust)?

There are a number of circumstances in which a company or its controlled entities may legitimately hold more than 20% of a fund including:

1. at establishment or ‘seeding’ the fund

2. where the fund is used as an interfunding vehicle (ie the fund is used as an intermediary vehicle to gain exposure to another fund in which there are other investors). For example, a balanced fund may obtain exposure to Australian shares by investing in a related Australian share fund which directly holds Australian shares. Alternatively a “retail” fund may invest in a “wholesale” fund (with a common trustee or RE) to obtain economic exposure to shares held by the “wholesale” fund.
3. where the controlled entity holds less than 20%, but other unitholders withdraw from the fund, with the result that the controlled entity’s interest exceeds 20%. In these circumstances, share transactions could become void without any action by the controlled entity, and often without notice.
4. where an asset class fund has more than one investment manager or where a fund is diversified across asset classes (multi-manager funds). Such multi-manager funds provide for efficiencies in operation, particularly in relation to managing relative asset allocations and blending the portfolio’s exposure as between investment managers.
5. where the controlled entity is the trustee of a superannuation fund that offers any of the above-mentioned funds as an investment option or where the investment menus of a controlled entity’s platforms include such funds.

Funds management businesses are structured in this way to offer a diverse product range to investors with scope for either specific targeted exposure by an investor into an Australian shares fund, or diversified exposure where the RE combines the management of the Australian shares fund across investment managers or with other asset sector funds. In each case, the investor may be investing directly in a controlled entity’s managed funds, or they may be investing through either a controlled entity’s platform or a superannuation fund. The alternative for a funds management business is not in our view workable -, that is a 20% condition and non-recognition of multi-layer structures commonly used in the wealth management sector will deny the opportunity for initial seeding, impact efficient inter-funding arrangements for the purposes of distinct retail-wholesale offerings, impact the offering of multi-manager funds within asset sectors or with diversified risk across asset classes, and would entail prohibitive costs and inefficiencies that would ultimately be borne by investors of investment funds (who would forgo the opportunity to achieve exposure to shares prohibited by the self-acquisition prohibition). These costs and inefficiencies would be borne not only by managed funds investors, but also superannuation and platform investors as well.

Further, the proposed 20% condition is unnecessary given the conditions of the existing indirect self-acquisition relief for investment funds – namely the existing conditions that:

- the company’s shares not be voted;
- the 5% holding limit; and
- the regular reporting of holdings to the market,

and these protections are in addition to the statutory and fiduciary duties imposed on trustees and responsible entities to act in the best interests of members/beneficiaries.

<b>B2Q3</b> Do you consider an alternative or additional condition should be imposed?
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We do not consider it is necessary for alternative or additional conditions like the 20% condition, be imposed. This is based on the fact that the existing conditions provide sufficient protection from otherwise inappropriate indirect self-acquisitions. The existing conditions in relation to no voting, a 5% limit and trustee and responsible entity statutory and fiduciary duties are a sufficient protection to ensure no inappropriate use of the relief from the indirect self-acquisition prohibition. Further, the 20% condition would be problematic from a seeding perspective and interfunding perspective (see our response in B2Q1 above).

## Proposed relief for investment-linked statutory funds and related managed investment schemes

### Proposal 3

**B3** (a) We propose to grant conditional relief from s259C for:

- (i) the statutory fund of any controlled entity which carries on the life insurance business of providing investment-linked benefits within the meaning of s31(b) of the Life Insurance Act (investment-linked statutory funds); and
- (ii) managed investment schemes that have a controlled entity as responsible entity in which an investment-linked statutory fund invests (related managed investment schemes).

This relief would be subject to the proposed conditions outlined in CP 1 (as amended by proposal B2 of this paper): see paragraph 10 in Section A of this paper for a summary of these conditions.

(b) We propose that, in addition to the above conditions, relief for investment-linked statutory funds would be subject to the following additional conditions:

- (i) no more than 3% of that portion of the investment-linked statutory fund's shareholder retained profits account which is required for solvency of each fund can be invested in the company's shares; and
- (ii) the relief does not apply to any transfer or issue of shares or units of shares to a shareholder retained profits account of an investment-linked statutory fund if the shareholder retained profits account is in excess of solvency requirements.

(c) We propose that, in addition to the conditions in paragraphs (a) and (b) above, acquisitions of the company's shares by way of participation in an institutional placement would be permitted subject to the following additional conditions:

- (i) participation by investment-linked statutory funds or related managed investment schemes is on the same, or no more favorable, terms as other participants;
- (ii) no more than 15% of the shares issued in the placement are issued to, or for the benefit of, all controlled entities (including but not limited to investment-linked statutory funds or related managed investment schemes); and
- (iii) the company must use its best endeavors to obtain as high a placement price as practicable.

The proposed relief will only apply to related managed investment schemes that would otherwise be able to participate in a placement of the company's shares but for an investment-linked statutory fund holding interests in the scheme.

**B3Q1** Do you agree that investment-linked statutory funds and related managed investment schemes should be able to participate in a placement of the company's shares?

Yes we agree that investment-linked statutory funds and related managed investment schemes should be able to participate in a placement of the company's shares on the basis that the beneficial owners of the investment-linked statutory funds and related managed investment schemes are not controlled entities. Otherwise investors in investment funds will suffer detriment from not having the opportunity to achieve exposure to shares prohibited by the self-acquisition prohibition.

**B3Q2** Do you think a condition limiting the maximum level of participation in a placement by controlled entities is the best way of addressing the risk of preferential treatment?

No we do not agree with a maximum limit.

Pro rata of placement ensures no preferential treatment is given, plus observance of the 5% limit for the overall investment in companies' shares by all of its controlled entities is a more robust control.

And we also note that directors of a company undertaking a placement have a fiduciary duty to place the shares in the most efficient manner on the best terms available having regard to the nature and terms of the placement and the urgency of the funding need. These fiduciary duties mitigate the risk of inappropriate or preferential placements.

**B3Q3** Do you think that this type of relief should be extended to controlled trustees and responsible entities where the company or a controlled entity has a beneficial interest in the trust or scheme? If so, how should we minimise the risks from this type of indirect self-acquisition, given our proposed conditions of relief permit up to 20% of the interests in the scheme or trust to be held by the company or a controlled entity?

We agree that placements should be made available to controlled entities that are trustees and responsible entities. We do not think that investors in these entities' vehicles should be denied the potential exposure to the placement and refer again to these entities' requirement to prioritise members' interests as an appropriate safeguard.

There is no reason in principle why placements should be treated differently to acquisitions, and it would disadvantage other investors in investment funds and distort investment returns to prohibit participation in placements.

Hence we consider that the placement relief should be available to investment funds for which a controlled entity has a beneficial interest in the trust.

**B3Q4** Do you think 15% is an appropriate aggregate maximum limit for participation by all controlled entities? If not, what limit do you think is appropriate?

We consider a maximum limit is not necessary in light of the other conditions of existing relief (no voting, 5% limit, reporting to ASX of holdings) and in light of trustee/RE statutory and fiduciary duties and the fiduciary duties of directors of the company undertaking the placement.

**B3Q5** Do you think it is appropriate to impose a condition which requires the company to maximise the placement price as far as practicable? In practice, are there any reasons why a company would not do this?

No. The Financial Services Council does not believe that a condition which requires a company to have to use its best endeavours to obtain as high a placement price is practicable. While in practice this may occur, it is unnecessary because the other safeguards, including the 5% limit generally and the limited circumstances in which participation in placements is permitted, would ensure that there is no preferential treatment.

We consider that it would be difficult for the regulator to determine how a company must 'maximise the placement price'. The way that the offer price of shares under a placement is determined is not static, and is determined by numerous factors, including an assessment of risk at the time of the offer. How the offer price is determined is more appropriately a function of the board of the company (the directors of course being under fiduciary duties to act in the

best interests of shareholders), which has the requisite expertise and access to professional advice.

Further, a condition of this kind would be virtually impossible to monitor and enforce, and would expose the board of the company to the risk of having their business judgement questioned, contrary to judicial and statutory practice - the test is an unnecessarily simplistic one. The subjective nature of the test will also add a significant element of commercial uncertainty and risk.

For example, during the GFC, many companies needed to urgently access equity funding and the need to raise equity funding urgently may require a greater discount under the placement where the consequences of not finalizing the equity placement by a certain time has material adverse affects on the company (such as under debt covenants).

B3Q6 Do you think that any other safeguards are necessary?

We submit that the existing conditions of ASIC's relief are sufficient

## Proposed relief for index arbitrage

### Proposal 4

**B4** We are considering whether to grant an exemption under s259C(2) of the Corporations Act in limited circumstances (see Proposal B5) to allow controlled entities to acquire shares in a listed parent company for the purpose of index arbitrage and related client-driven activities.

The Financial Services Council believes that such an exemption should be granted.

The alternative, that listed companies are precluded from index arbitrage activity, acts to disadvantage listed entities, and to reduce market efficiency. Index arbitrage by its nature aims at correcting mispricing in the market and therefore helps to improve market efficiency.

## Proposed additional conditions of relief

### Proposal 5

**B5** Should we decide to grant relief for index arbitrage activities, we propose to limit relief in the following way:

- (a) the voting power of the controlled entities in the listed parent company must not exceed 0.5% of the total number of voting shares;
- (b) shares in the listed parent company cannot make up more than 10% (by value) of any basket or portfolio transaction; and
- (c) the net economic exposure of the controlled entities in the listed parent company must not exceed 5% of the shares held as a perfect hedge.

This would be in addition to the CP 1 conditions (as amended by proposal B2 above).

We are considering whether an acquisition of shares in the listed parent company by a controlled entity, other than by way of new issue, may be made by way of a 'market transaction' as defined in the Market Rules of ASX Limited. We are also considering whether to impose a purpose condition.

**B5Q6** Would a condition that limited the acquisition of shares to 'on-market transactions' as defined in s9 of the Act (which would exclude Special Crossings) and transactions between controlled entities be overly restrictive? Why?

We submit that a clause limiting the acquisition of shares to "on market transactions" would be overly restrictive. Limiting acquisitions to "on market" transactions means that participants are not able to undertake transactions which are otherwise permitted by ASX Market Rules, but which are not technically conducted at "an official meeting of a prescribed financial market". This would include many "crossing" transactions which are common market practice. Such transactions do not discriminate (unfairly or otherwise) in favour of controlled entities, and typically undertaken in order to reduce transaction costs and improve efficiencies.

## Disclosure of interests in the company's shares by its controlled entities

### Proposal 6

**B6** We are considering whether the conditions relating to disclosure of aggregated interests (applying to relief under CP 1 and proposed relief under this CP) should be varied so that:

- (a) the periodic disclosure requirement is increased from 14 days to three months; and
- (b) the time required to report a 1% or greater percentage change is changed from one to two days.

**B6Q1** Do you think that periodic disclosure should be required every three months rather than 14 days? If not, what time period do you think is appropriate?

*The Financial Services Council would prefer flexibility in reporting enabling an entity to determine the more appropriate reporting period for their circumstances.*

*That is, providing entities the flexibility to continue to report either*

- *every 14 days or*
- *other period not exceeding 90 days*

We also agree with changing the time to report a 1% or greater change from one to two days (except if there is a takeover bid where reporting ought be required by 9.30am the next trading day in accordance with section 671B(6) Corporations Act).

**B6Q2** Do you think there are any practical difficulties in complying with the current or proposed disclosure requirements?

Yes. Generally, there are practical administrative difficulties in complying with the current disclosure requirements. For example, in a large corporate group, obtaining accurate information and reporting within the required deadlines requires significant resources.

Reducing the frequency of reporting is one way to alleviate this difficulty. The current 14 day requirement is administratively cumbersome and does not provide any materially relevant information to the market where there has not been a 1% or greater change. For example, the 14 day requirement requires "repeat" notices every 14 days even if the holding has not changed.

Extending the reporting period may create difficulty for some investment funds because of the number of fund/vehicles to report over the extended period (ie the volume creates the difficulty here as opposed to the frequency). If there is flexibility to report at a frequency determined by the investment fund but at least every 90 days that may provide the flexibility to allow certain investment funds to report more regularly. Aggregated reporting (or the flexibility to do so rather than at the current granular level – that is at the registered holder, per share level etc) would also assist companies to comply with the reporting requirement.

It is also important to note that minor reporting non compliance renders the relief instrument non-operative. It would not be uncommon for any given reporting period to have tens of trades occurring. Relief that ceases to apply at any given time could lead to hundreds of thousands of share trades becoming void. The level of disruption and uncertainty this creates is enormous. It means the various entities impacted have to apply to void to validate the share transactions. To validate void acquisitions, relevant entities of the group of companies have had to apply to the court under CA s1322. The pervasiveness of these minor breaches created significant uncertainties and disruption with respect to many share acquisitions. Consideration to materiality of reporting non-compliance would also assist in providing companies with certainty and reduce compliance costs.

We would also like ASIC to clarify its position on the application of the 1% percentage change rule over:

- whether this is determined by a change in the controlled entities' holdings; or
- whether this is determined by a change in the controlled entities' holdings with respect to shares on issue

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10/08/2010