

FSC Guidance Note No. 49

Crediting Rates

30 November 2022

FSC Guidance Note No. 49

Crediting Rates

Date of this version: 30 November 2022

Application of this Guidance Note: This Guidance Note should be applied by the Operator of a Scheme (“Scheme Operator”) (whether offered for public subscription or otherwise) in determining the Crediting Rate to be applied to Scheme Interests of Investors except:

- where the Investor’s Interest is subject to a Capital Guarantee;
- where the Investor’s Interest is subject to a defined benefit or outcome;
- where the Scheme Interests are quoted on the Australian Securities Exchange;
- where the Scheme Operator has obtained, in relation to a particular Scheme, an exemption from, or been granted relief under, the applicable legislation (including ASIC relief); and
- where the Interests of other Investors are not affected (other than as provided by law).

Main Purpose of this Guidance Note: The purpose of this Guidance Note is:

- to specify the principles to be adopted in the calculation of Crediting Rates used in determining the Interests of an Investor;
- to provide guidance in the interpretation and application of those principles; and
- to standardise the practices and procedures, and terminology, relating to the valuation of Interests.

Disclaimer: *This document does not constitute any legal, accounting, tax or financial product advice, and does not take into account the objectives, financial situation or needs of any person or the terms of any commercial transaction. Users should obtain their own professional advice tailored to their own circumstances before using this document for their own commercial purposes. The Financial Services Council Ltd (FSC) does not give any warranty with respect to this document and has no responsibility for any loss, damage or liability whatsoever arising from the use of this document. The use of this document is subject to the terms and conditions prescribed by the FSC from time to time in relation to the access, use, transmission or dissemination of this document.*

Table of Contents

	<u>Paragraph</u>	<u>Page</u>
Title	1	4
Application	2	4
Statement of Purpose	3	4
Application of Materiality	4	5
Definitions	5	5
Principles of Crediting Rate Calculation	6	6
Equitable Processes	7	7
Documented and transparent Crediting Rate Calculation process	8	9
Consistent Crediting Rate Processes	9	9
Funding of Errors	10	9

FSC Guidance Note No. 49

1 Title

1.1 This Guidance Note may be cited as FSC Guidance Note No.49 “Crediting Rates”.

2 Application

2.1 **This Guidance Note should be applied by the Operator of a Scheme (“Scheme Operator”) (whether offered for public subscription or otherwise) in determining the Crediting Rate to be applied to Scheme Interests of Investors except:**

- where the Investor’s Interest is subject to a Capital Guarantee;
- where the Investor’s Interest is subject to a defined benefit or outcome;
- where the Scheme Interests are quoted on the Australian Securities Exchange;
- where the Scheme Operator has obtained, in relation to a particular Scheme, an exemption from, or been granted relief under, the applicable legislation (including ASIC relief); and
- where the Interests of other Investors are not affected (other than as provided by law).

2.1.1 This Guidance Note is primarily intended to apply to a Scheme where Investors’ money is pooled so that each Investor has a proportionate Interest in the Scheme Assets. If the property of each Investor is distinct, such that a transaction does not affect the Interests of other Investors, this Guidance Note does not apply.

2.2 **Where a Scheme Operator invests in a Scheme managed by an Associate, this Guidance Note applies, except:**

- where the Scheme managed by the Associate is subject to the laws, regulations, and generally accepted Crediting Rate practices of another country; or
- where the Scheme Operator is unable to influence the process of determination of Crediting Rates, such as where the Associate is not a FSC Member.

2.2.1 Where a Scheme Operator invests in a Scheme managed by an Associate of the Operator it is clearly in the best interests of Investors to ensure that appropriate Principles of Crediting Rate Calculation (refer 6.1) are maintained in both Schemes.

2.2.2 Scheme Operators should, to the best of their ability, ensure that an Associate complies with this Guidance Note.

2.3 **Where there is a conflict between the recommendations of this Guidance Note, applicable legislation, and the Constituent Documents, the recommendations of this Guidance Note should, having regard to the purpose of this Guidance Note (refer 3.1), be modified appropriately.**

2.3.1 It is recognised that Constituent Documents, while complying with applicable legislation, vary where a recommendation of this Guidance Note cannot be met (because to comply would conflict with the applicable legislation or with any Constituent Document) a Scheme Operator should, as far as practicable, comply with the recommendations of this Guidance Note.

2.3.2 This Guidance Note may not cover every situation where a Crediting Rate is used. Where a situation is not covered, a Scheme Operator should have regard to the intent of the Guidance Note as described in the Statement of Purpose (refer to paragraph 3.1) and the Principles of Crediting Rate Calculation (refer to paragraph 6.1).

3 Statement of Purpose

3.1 **The purpose of this Guidance Note is:**

- to specify the principles to be adopted in the calculation of Crediting Rates used in determining the Interests of an Investor;
- to provide guidance in the interpretation and application of those principles; and
- to standardise the practices and procedures, and terminology, relating to the valuation of Interests.

FSC Guidance Note No. 49

- 3.1.1 Scheme Operators are required to provide the value of an Investor's Interest after the application of Crediting Rates for a reporting period.
- 3.1.2 The valuation of Scheme Assets and Liabilities is the key element in the determination of the Crediting Rate used in the determination of an Interest. The principles, practices and procedures to be adopted by Scheme Operators to ascertain the value of Scheme Assets and Liabilities are described in FSC Guidance Note No. 50. 'Valuation of Scheme Assets and Liabilities'.
- 3.1.3 This Guidance Note covers the determination of Crediting Rates following a valuation of Scheme Assets and Liabilities determined in accordance with FSC Guidance Note No. 50 'Valuation of Scheme Assets and Liabilities'.
- 3.1.4 For historical reasons, combined with the recommendation, in the case of certain Schemes, to hold a meeting of Investors (often at Investors' expense) to approve changes to the Constituent Document, there are across the industry a number of variations in practices and procedures used to determine Crediting Rates.
- 3.1.5 It is desirable that there be an industry-wide Guidance Note surrounding the calculation of Crediting Rates which is consistent, fair to incoming, outgoing and continuing Investors, and which enables Investors and others to calculate the investment performance of a Scheme over different periods, and to compare the performance with that of other Schemes and investment opportunities. In particular, subparagraph 601FC(1)(d) of the *Corporations Act 2001* requires a Responsible Entity of a registered managed investment scheme to treat members in the same class equally and members of different classes fairly. Similarly, a superannuation trustee is subject to the covenants to act fairly in dealing with classes of beneficiaries within the fund and to act fairly in dealing with beneficiaries within a class: paragraphs 52(2)(e)(f) of the *Superannuation Industry (Supervision) Act 1993*. In addition various general law obligations apply in these instances requiring, in broad terms, equality of treatment by trustees.

3.2 Where a Scheme Operator is able to vary a Constituent Document without adversely affecting the Interests of Investors or increasing material cost to Investors or Scheme Operators, the Scheme Operator should consider varying the Constituent Document to ensure compliance with this Guidance Note.

- 3.2.1 Consistency across the industry will be fostered where the Constituent Document is brought into line with this Guidance Note.

4 Application of Materiality

- 4.1 Failure to meet the recommendations of this Guidance Note is material if such failure has the potential to adversely affect:
 - an Investor's interest in the Scheme Assets;
 - other users of valuations of Assets and Liabilities;
 - a proper assessment of the investment performance of a Scheme; and
 - a decision by an Investor to allocate scarce resources.

In deciding whether a factor is material, its context, nature and amount usually need to be evaluated together. Further information on materiality, in relation to errors in unit pricing, can be found in Guidance Note No. 51 – 'Errors in Pricing/Crediting Rates when Determining Scheme Interests - Correction and Compensation.

5 Definitions

- 5.1 In this Guidance Note
 - 'Assets' has the same meaning as in FSC Guidance Note No. 50 'Valuation of Scheme Assets and Liabilities';
 - 'Associate' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';
 - "Capital Guarantee" means any guarantee which results in a material difference between the return from the product and the returns on assets (net of any applicable fees and taxes) over the short to medium term or has the potential to do so.

FSC Guidance Note No. 49

- ‘Constituent Documents’ means the material governing documents and governing rules for a Scheme, including but not limited to, the Product Disclosure Statement, Constitution, Trust Deed or Information Memorandum or other relevant disclosure document relating to the Scheme;
- ‘Constitution’ has the same meaning as in FSC Guidance Note No. 5 ‘Industry Terms and Definitions’;
- ‘Crediting Rate Calculation’ means the process or method under which the Crediting Rate is determined and calculated;
- ‘Crediting Rate’ means, in relation to a Scheme, an earning rate which equitably allocates after tax earnings for a defined period to Investors
- ‘FSC Member’ refers to a ‘Full Member’ as defined in FSC’s Constitution;
- ‘Interest’ has the same meaning as in FSC Guidance Note No 48 ‘Scheme Pricing’;
- ‘Investor(s)’ has the same meaning as in FSC Guidance Note No. 5 ‘Industry Terms and Definitions’;
- ‘Liabilities’ has the same meaning as in FSC Guidance Note No. 50 ‘Valuation of Scheme Assets and Liabilities’;
- ‘Net Asset Value’ or ‘NAV’ has the same meaning as in FSC Guidance Note No. 50 ‘Valuation of Scheme Assets and Liabilities’
- ‘Operator’, has the same meaning as in FSC Guidance Note No. 5 ‘Industry Terms and Definitions’;
- ‘Scheme’ has the same as in FSC Guidance Note No. 5 ‘Industry Terms and Definitions’;
- ‘Transaction Costs’ has the same meaning as in FSC Guidance Note No.5 ‘Industry Terms and Conditions’; and
- ‘Valuation Point’ means the time at which a cut-off is made to value the Scheme’s Assets and Liabilities.

6 Principles of Crediting Rate Calculation

- 6.1 The Crediting Rate Calculation process should produce equitable outcomes for Investors. Different classes of Investors should be treated fairly and outcomes should not unduly favour:
- transacting or non-transacting Investors; and
 - current or future Investors.
- 6.2 Equitable determination of Investor Interests should take account of the impact of transacting Investors on the Scheme. Consideration should be given to:
- Transaction Costs;
 - arbitrage opportunities;
 - impact of backdating;
 - frequency of Crediting Rate Calculation;
 - suspension of the application of Crediting Rates and/or processing of Investor transactions;
 - frequency of Asset valuation;
 - rounding adjustments; and
 - allocation of Interests in a Scheme.
- 6.3 The process of calculating Crediting Rates should:
- be documented and transparent;
 - be applied consistently; and
 - be regularly reviewed.

FSC Guidance Note No. 49

7 Equitable Processes

7.1 Allowance for Transactions Costs

- 7.1.1 Scheme Operators should estimate an allowance for Transaction Costs when determining a value to the Interests of an Investor. The amount of any allowance for Transaction Costs should not accrue to the Scheme Operator.
- 7.1.2 The inclusion of an allowance for Transaction Costs in the process of determining the value of an Investor Interest is designed to shield non-transacting Investors from such costs (e.g. Agent/brokerage, stamp duty and legal costs, market bid/offer spreads).
- 7.1.3 Scheme Operators should have a methodology to estimate Transaction Costs and review it at least annually. The methodology should demonstrate a transparent process.
- 7.1.4 The estimation of Transactions Costs should be limited to costs incurred at the point of trade execution to support investment in or divestment of Assets in order to process Investor transactions.
- 7.1.5 Costs should not be netted off, for example, brokerage costs incurred in exchange for provision of research. All such costs should be recorded in full as expenses of the Scheme.
- 7.1.6 In determining a Transaction Cost methodology, Scheme Operators should consider:
- changes to fundamentals of the Scheme or the market, for example, movements in the stamp duty rate;
 - an allowance for market impact where the Scheme holds thinly traded Assets with significant bid-offer spreads (if this has not been previously taken into account in valuing the thinly traded Asset);
 - an allowance for the netting effect of applications and redemptions where this has previously had a significant and regular effect on the amount of Transaction Costs actually incurred by the Scheme; and
 - the general direction of capital flows (i.e. if the Scheme no longer accepts any contributions, only a selling cost allowance need be incorporated).

7.2 Arbitrage opportunities

- 7.2.1 Scheme Operators should understand and document the end-to-end Crediting Rate Calculation process across legacy, current and proposed products and any aspects which may give rise to the opportunity to arbitrage.
- 7.2.2 Opportunities to arbitrage may arise from:
- Crediting Rates being calculated less frequently than the frequency of Asset valuations;
 - Crediting Rates being calculated and applied less frequently than the frequency of transacting;
 - a redemption request being valued using a Crediting Rate based on a NAV calculated prior to receipt of the request;
 - an application accruing earnings using a Crediting Rate based on a NAV calculated prior to the receipt of the application;
 - delays in the end-to-end Asset valuation process, including any delays in service provider processes;
 - the availability of Asset valuation information by instruction cut-off time;
 - the use of stale Asset valuations in the determination of the NAV; and
 - the release of valuation sensitive information prior to it being incorporated into the Crediting Rate Determination.
- 7.2.3 To determine whether a delay exists in Asset valuation that can be exploited by Investors, the relationship between the Valuation Point(s) of the Asset(s) and instruction cut-off times should be investigated.

FSC Guidance Note No. 49

- 7.2.4 Within fund-of-fund structures, additional valuation delays may exist when investing. Scheme Operators should understand the end-to-end valuation process to determine the extent of any delays in Asset valuation.
- 7.2.5 Scheme Operators should consider the adoption of a response plan, to be invoked when an event has occurred that creates an arbitrage opportunity. Actions may include suspension of Asset valuation and/or changes in the frequency of Crediting Rate Calculation.
- 7.2.6 Scheme Operators should have a process in place to minimise arbitrage opportunities
- 7.2.7 Appropriate steps may include:
- monitoring Investor transactions to identify activity that may constitute arbitrage;
 - introducing or increasing fees for frequent switching; and
 - introducing a period of delay to applications or switches to make arbitrage uneconomic.
- 7.2.8 Where inappropriate activity has been identified, Scheme Operators should determine the relevant facts and take action in accordance with powers under the Constituent Documents. Scheme Operators should document decisions made (including a decision to take no action).

7.3 Impact of Backdating

- 7.3.1 Scheme Operators should have a backdating policy which documents monitoring of transactions and the circumstances in which the impacts of backdating will be funded by them.
- 7.3.2 Backdating of an application occurs when the Crediting Rate used to allocate an Interest is based on a NAV determined prior to receipt of the application. Backdating of a redemption request occurs when the Crediting Rate used to cancel the Interest does not include the NAV determined at the time of receipt of the request. Backdating can occur as a result of processing delays and processing errors. Impacts of backdating are not borne by the transacting Investor but by non- transacting Investors.

7.4 Frequency of Crediting Rate Determination

- 7.4.1 Crediting Rates should be determined at least as frequently as Interests are allocated or cancelled.

7.5 Suspension of Crediting Rate Determination and/or Investor Transactions

- 7.5.1 A Scheme Operator should suspend the use of Crediting Rates in circumstances where they cannot reliably be calculated. The Scheme Operator should also consider suspending transactions where a material dilution of an Interest will occur (such as when a significant market movement has occurred).

7.6 Frequency of Asset valuation

- 7.6.1 Valuation of Scheme Assets and Liabilities should occur as frequently as Interests are allocated or cancelled. Where less frequent valuations are made (typically due to the nature of the Asset), Scheme Operators should satisfy themselves that equity is maintained as much as possible as between transacting and non-transacting Investors.
- 7.6.2 Crediting Rates are calculated based on the earnings accrued in respect of Investors between two sequential Valuation Points. Transactions entered into immediately after a Valuation Point will most accurately reflect the true value of an Interest in the Scheme.
- 7.6.3 The method of calculation of Crediting Rates when transactions take place in Schemes which are substantially invested in infrequently valued Assets is referred to in Guidance Note No. 26 'Asset Valuation and Unit Pricing for Infrequently Valued Assets'.

7.7 Rounding adjustments

- 7.7.1 Scheme Operators should not accrue any rounding adjustment. Rounding adjustments should remain in the Scheme at all times.

FSC Guidance Note No. 49

7.8 Allocation etc. of Interests in a Scheme

- 7.8.1 Interests in a Scheme should not be issued or allocated prior to receipt of funds by the Scheme, where potential for a material dilution of Investor Interests exists.
- 7.8.2 The practice of allocating, issuing, reserving, or booking Interests to an Investor in a Scheme prior to the receipt of funds is not acceptable, as it is highly likely to be inconsistent with the Constituent Document or otherwise in breach of law. The term 'receipt of funds' includes receipt of funds into the Scheme application account, receipt of drawdown directions under direct debit arrangements, receipt of promissory notes or negotiable instruments or other rights to payment or intangible property, provided that they are permitted by the Constituent Documents. The practice is unacceptable because the Interests of existing Investors may be diluted by the amount of any increase in the value of the Scheme Assets attributable to the Investor prior to the receipt by the Scheme of the Investor's application moneys. These moneys could have been invested for the benefit of all Investors in the Scheme.
- 7.8.3 Where Scheme Operators invest into internal Schemes as a means of gaining exposure to particular Asset classes, it is acceptable practice to recognise Interests prior to the receipt of funds on the proviso that funds will be received within the settlement date cycle applicable to the underlying assets of the Scheme (e.g. trade date plus 3 for equities). This enables Scheme Operators to trade between Asset classes whilst still maximising exposure to the market.

8 Documented and transparent Crediting Rate Calculation processes

- 8.1 FSC Members should have a policy framework in place that documents the adoption of the Principles of Crediting Rate Calculation. The policy framework should be reviewed regularly and include, at a minimum:
- delegated authorities and accountabilities;
 - reporting requirements;
 - processes to confirm the completeness of, and compliance with, policies;
 - training requirements for policy awareness;
 - the alignment of procedures to policies;
 - ongoing review of policies and procedures; and
 - outsourcing arrangements (where appropriate).

9 Consistent Crediting Rate Processes

- 9.1 Crediting rate policies should be applied consistently and exceptions to policies, processes and procedures should be clearly documented at the time an alternative policy, process or procedure is used.

10 Funding of Errors

- 10.1 Schemes operated on a not-for-profit basis commonly use Crediting Rates. Any errors requiring restitution by the Operator are ultimately funded by Investors. APRA requires that Operators of superannuation funds maintain an operational risk reserve which is funded by a levy on member balances.
- 10.2 Where an error occurs which materially depletes the operational risk reserve the Scheme Operator should replenish the reserve in an equitable manner which does not favour any particular group of Investors.