

FSC Guidance Note No. 8.00



Related Party Transactions

July 1999

Main features of this Guidance Note are:

- **to specify the principles to be adopted in relation to the conduct of a Related Party Transaction between a Scheme and a party related to the Scheme or in Scheme interests by, or on behalf of, a Related Party;**
- **to provide guidance in the interpretation and application of those principles;**
- **to standardise the practices and procedures relating to the conduct of Related Party Transactions; and**
- **to specify the basis of proper disclosure of such Related Party Transactions.**

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1 Title

1.1 This Guidance Note may be cited as FSC Guidance Note No. 8.00 'Related Party Transactions'.

2 Guidance Note and Commentary

2.1 The guidelines set out in this Guidance Note are shown in bold print. Commentary is shown in normal print immediately after the guideline to which it relates, as an aid to interpretation of the Guidance Note.

3 Date of Issue

3.1 19 July 1999

4 Effective Date

4.1 This Guidance Note should be applied in relation to a member's operations on or after 1 August 2000. Earlier application of this Guidance Note is permitted and encouraged.

5 Application

5.1 This Guidance Note should be applied by the Operator of a Scheme (whether offered for public subscription or otherwise) in relation to that Scheme.

5.2 Where there is a conflict between the requirements of this Guidance Note, applicable legislation, and the constitution of a Scheme, the requirements of this Guidance Note should, having regard to the purpose of the Guidance Note, be modified appropriately so that, as far as is practicable, the Operator complies with the requirements of this Guidance Note.

6 Statement of Purpose

6.1 The purpose of this Guidance Note is:

- to specify the principles to be adopted in relation to the conduct of a Related Party Transaction between a Scheme and a party related to the Scheme or in Scheme interests by, or on behalf of, a Related Party;
- to provide guidance in the interpretation and application of those principles;
- to standardise the practices and procedures relating to the conduct of Related Party Transactions; and
- to specify the basis of proper disclosure of such Related Party Transactions.

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6.1.1 FSC considers that the nature and extent of Related Party Transactions is information that prospective and existing Investors in a Scheme would reasonably expect to be disclosed. Knowledge of the nature and extent of Related Party Transactions and the relationship between the transacting parties may affect the perceptions of a Scheme held by Investors and others.

It should be noted that the matters discussed in this Guidance Note are the subject of a number of legal requirements, some of which are applicable to the operation of public companies, whilst others are relevant only to Schemes.

Accordingly, where there are points of law at issue or there are relevant Industry Standards, including Accounting Standards, it is of critical importance that Operators obtain appropriate and timely advice.

7 Application of Materiality

7.1 Failure by a Scheme Operator to adopt or implement this guidance note is material if such failure has the potential to adversely affect the confidence of Investors, prospective Investors, other Scheme Operators, and other interested parties involved in the investment funds industry.

8 Definitions

8.1 In this Guidance Note:

- 'Associate' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- 'Investors' means those persons, whether they be natural persons or not and including responsible entities, managers and trustees, in whose name an interest in a Scheme may be registered from time to time;
- 'Operator', in relation to a Scheme has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- 'Related Party' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- 'Related Party Transaction' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions'; and
- 'Scheme' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions'.

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9 General Principles

9.1 Related Party Transactions

9.1.1 Related Party Transactions occur in the managed investments, superannuation and life insurance industries. In the vast majority of cases they are either beneficial or at least neutral as far as the interests of Investors are concerned. However, there is the potential for abuse and the topic requires considerable attention. A Related Party Transaction may expose a Scheme to costs, risks and opportunities that would not have existed in the absence of the relationship. Related Party relationships may, therefore, have a material effect on the performance, financial position, and financing and investing of a Scheme.

9.2 Why is disclosure important?

9.2.1 Disclosure of a Related Party Transaction allows prospective and existing Investors and others to better understand the effects of the Related Party Transaction on the Scheme, and provides an opportunity to assess situations which could give rise to a conflict of interest. Full disclosure should include disclosure in a Scheme's offer or other documents of prospective and on-going Related Party Transactions, in addition to disclosure of completed Related Party Transactions in the financial reports of the Scheme.

9.2.2 Proper disclosure of Related Party Transactions assists the transparent operation of a Scheme by describing and defining the effect of Transactions subject to conflicts of interest between a Related Party and a Scheme.

9.2.3 **Although a Related Party Transaction may give rise to a conflict of interest, such a Related Party Transaction might not be prohibited under the Law provided the Related Party Transaction is entered into in the best interests of Investors. The existence of a general obligation for Operators to act in the best interests of Investors generally means that Operators should ensure that Related Party Transactions are conducted at arm's length and on a commercial basis and not to diminish or endanger the Scheme's property. An Operator should achieve 'best execution' for the interests of the Scheme and act independently of any other affiliations.**

9.2.4 **Accordingly, whilst recognising that each FSC member's precise legal position may differ, FSC considers that prospective and existing Investors in a Scheme should be adequately informed of any significant Related Party Transactions (eg. outsourcing the unit pricing to a Related Party) carried out or proposed to be carried out by the Operator of that Scheme. Consideration must be given to the need for the Operator to issue a specific notice informing existing Investors and others of the occurrence of the Related Party Transaction and the action proposed to be undertaken by the Operator.**

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9.3 The legal position

9.3.1 The Corporations Law (“Law”), Australian Accounting Standards (“Standards”), the *Superannuation Industry (Supervision) Act 1993 - Section 153 Determination* (“Determination”), the Life Insurance Act 1995 (“Life Act”) and the Income Tax Assessment Acts 1936 and 1997 (as amended) (Income Tax Act) (referred to collectively as the Relevant Legislation) all deal with Related Party Transactions, and FSC members will, of course, need to observe these where applicable. FSC strongly recommends that members seek specific legal advice as to the application of the Law, the Standards, the Determination the Life Insurance Act and the Income Tax Act to their circumstances. In particular, the Law and the Standards are directed at companies and their application requires careful interpretation.

9.3.2 FSC members should be aware that the Constitutions and Governing Rules for their Schemes may also contain restrictions or other provisions concerning Related Party Transactions.

9.3.3 Operators are generally subject to certain obligations and fiduciary responsibilities under the Relevant Legislation to act in the best interests of Investors.

9.3.4 The procedures for entering into a Related Party Transaction should be adequately documented to clearly evidence the due diligence carried out by the Operator. Each Related Party Transaction should be properly documented and disclosed.

9.4 Definition of Related Party

9.4.1 Whilst it is not currently possible to precisely define who might be a “Related Party” in the context of a Scheme, FSC considers that the definition of a Related Party of a public company in Part 2E.2A of the Law (especially section 243F) serves as a useful guide.

The categories of related parties could include:

- the Operator, the trustee or their agents of the Scheme;
- a related body corporate of the responsible entity or trustee;
- an Associate of the Operator or the trustee (ie a director or secretary of the Operator or trustee or of their related bodies corporate);
- a parent, spouse, child or other close relative of a director or secretary of the Operator or trustee (or of their related bodies corporate); and
- an entity over which any of the person mentioned above exerts significant control or significant influence.

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9.4.2 FSC notes that Operators are required to comply with the reporting standards set out in AASB1017: “Related Party Transactions” and AAS22: “Related Party Transactions”.

9.5 What needs to be disclosed?

9.5.1 **FSC recommends that its members should disclose all Related Party Transactions, which would involve the conferring of a material financial benefit on/from a Related Party.**

9.5.2 **It is reasonable that Investors in a Scheme are advised that an Operator intends that the Scheme enter into, or has completed Related Party Transactions which confer a material financial benefit to/from a Related Party.**

9.5.3 Guidance as to the meaning of a “financial benefit” can be found in section 243G of the Law. Section 243G provides that in deciding whether a financial benefit is given the economic and commercial substance of the Related Party Transaction should prevail over its legal form. Also, the consideration given by the Related Party in return for receiving the benefit should be disregarded in establishing what needs to be disclosed, but of course is significant in justifying Related Party Transactions. Essentially, FSC’s members should have regard to the substance of their dealings rather than to their form.

9.5.4 For additional guidance, six examples of the giving of a financial benefit are provided in Section 243G(4):

- acquiring or supplying services;
- lending money, guaranteeing or providing security for a loan;
- forgiving a debt or releasing or not enforcing an obligation;
- selling or leasing assets;
- issuing securities or granting options; or
- giving money or property.

9.5.5 It should be noted that this Guidance Note is designed to ensure that the assets of the Scheme are applied only for the benefit of the existing Investors in that Scheme. This means that, in general, the Guidance Note is concerned with the payment or receipt of financial benefits that relate to goods or services or both to a Related Party that:

- come out of the Scheme property;
- could diminish or endanger the Scheme property; or
- could adversely affect those interests.

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9.6 Application of Materiality

9.6.1 This Guidance Note applies to a Related Party Transaction, which confers a material financial benefit on the Related Party. The FSC considers that the “materiality” of a financial benefit will differ depending on a number of factors, including:

- **the magnitude of the benefit;**
- **the financial impact on the Scheme (e.g. the proportion of the Scheme’s assets affected by the Related Party Transaction); and**
- **the number and frequency of Related Party Transactions with one or more Related Parties.**

9.6.2 Therefore, in determining whether an individual event or an aggregate of events would be considered material, both the amount and the nature of the event must be considered. An event may not be material in amount, but be considered to be material in nature and therefore, must be disclosed to Investors. In addition, the Accounting Standards require disclosure of transactions involving directors and their director related entities, as these transactions are considered to be material because of their nature.

9.7 Application to Associates

9.7.1 FSC members should ensure that an Associate is aware of the matters set out in this Guidance Note before the FSC member recommends investing the Scheme’s assets in a Scheme managed by the Associate.

9.8 Inconsistencies

9.8.1 Where there is an inconsistency between any matter set out in this Guidance Note and Relevant Legislation, the Listing Rules of the Australian Stock Exchange or the Scheme’s Constitution or Governing Rules, the matters set out in this Guidance Note are not intended to apply to the extent of the inconsistency.

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9.9 Principles Applicable to Related Party Transactions

9.9.1 **An Operator should, prior to initiating, and during the term of an agreement governing, a Related Party Transaction, ensure that such a Transaction meets and continues to meet the following criteria:**

- **it should be in the best interests of potential and existing Investors as a whole;**
- **it should be fair value and be reasonable;**
- **it should be properly documented; and**
- **it should be appropriately disclosed.**

9.9.2 Maintenance and retention by the Operator of proper documentation relating to and recording of the Related Party Transaction allows a Related Party Transaction to be scrutinised by regulators and others. Such documentation should be readily accessible to regulators and other interested parties.

9.10 Application of Principles relating to Related Party Transactions - Transactions between a Scheme and a Related Party to a Scheme

9.10.1 **A Related Party Transaction (either as principal or as agent) between a Scheme and a party related to the Scheme should be demonstrably conducted in the best interests of Investors as a whole.**

9.10.2 Examples of Related Party principal Transactions include, but are not limited to the following:

- The purchase and sale of Scheme interests by a Related Party (refer clause 9.13);
- the rental by a Related Party of real property owned by a Scheme;
- the acquisition of investments from - or the disposal of Scheme assets to - a Related Party;
- the provision of credit facilities to a Scheme by a Related Party;
- the provision of investment management services to a Scheme by a Related Party; and
- the provision of Administration Services, such as unit pricing or Scheme accounting, to a Scheme by a Related Party.

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9.10.3 Examples of Related Party agency Transactions include, but are not limited to the following:

- an investment Transaction made on behalf of a Scheme executed by an agent, such as a stockbroker, who is a Related Party to the Operator;
- the management of real property owned by a Scheme by a licensed real estate agent who is a Related Party to the Operator; and
- the completion of foreign exchange Transactions on behalf of a Scheme by a bank which is a Related Party to the Operator.

9.10.4 The general obligation to act in the best interests of Investors means that the Operator is required to ensure that principal and agent Transactions with a Related Party are conducted at arm's length and on a commercial basis or better. In originating such a Related Party Transaction, the Operator should maintain appropriate records to justify such Transaction, the price, and any other terms and conditions upon which the Related Party Transaction was entered into. This should, for example, include the rationale for the Related Party Transaction as well as details of the terms upon which the Related Party Transaction was made. The records must be similar to those maintained for transactions with non-related parties. A report by an independent party as to the reasonableness of the price and any other terms and conditions upon which a Related Party Transaction has occurred may be appropriate in certain circumstances.

9.11 Reimbursable expenses

9.11.1 **In accordance with the Constitution or Governing Rules of a Scheme, an Operator may be entitled to reimburse itself for specified expenses incurred in relation to the operation of the Scheme. Where such reimbursable expenses are incurred, the amount reimbursed should be no more than that which would be payable by a Scheme for a similar Transaction conducted on an arm's length, commercial basis by a non-related party to the Scheme.**

9.11.2 **Where a party provides services provided to a Scheme related to the Scheme, the amount of a reimbursable expense may incorporate an amount representing an allocation of overheads. Such allocations are, at least in part, subjective. FSC's members should ensure that the method of allocation of overhead expenses included in an amount reimbursed from the assets of a Scheme is fair and reasonable, and is properly documented. It may be appropriate for an Operator to obtain an independent third party review of the basis and terms upon which an amount of reimbursable expenditure is calculated.**

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- 9.11.3 An amount of reimbursable expense incurred in relation to more than one Scheme may be required to be apportioned among several Schemes. The methodology adopted to determine the apportionment of such expenses among those Schemes should be fair and reasonable, and properly documented. An independent review of the basis of apportionment may also be appropriate.
- 9.12 Soft dollar arrangements**
- 9.12.1 Soft dollar arrangements in relation to a Scheme should be of demonstrable benefit to the prospective or existing Investors and should be properly disclosed. Soft dollar arrangements may arise where a Related Party receives services from another entity in return for an undertaking to place business on behalf of a Scheme with the provider. The services provided are generally of a type which will benefit the Operator by allowing it to provide a better service itself, and for which the Scheme derives no direct cash payment.**
- 9.12.2 To maintain transparency in the operations of a Scheme, FSC's members should ensure that a soft dollar arrangement complies with the FSC Guidance Note No. 10.00 'Soft Dollar Dealing'.**
- 9.13 Application of Principles relating to Related Party Transactions – Transactions in Scheme Interests by a Related Party**
- 9.13.1 Investment in a Scheme by a Related Party should be for bona fide investment purposes.**
- 9.13.2 Unless the nature of a Scheme involves short term investment, investment in a Scheme by a Related Party should be for a period of time similar to that expected by the Operator of a non-Related Party in that Scheme, and should be determined in relation to the bona fide investment objectives of the prospective or existing Investor.**
- 9.13.3 While the price at which a Related Party Transaction of interests in a Scheme is evaluated is determined in accordance with the Constitution or Governing Rules of a Scheme and in accordance with FSC Standard No. 8.00 'Scheme Pricing', there may be benefits of investment in interests of a Scheme that are not reflected in the price at which those interests are transacted.
- 9.13.4 The timing of a Related Party Transaction in Scheme interests by a Related Party may also confer a short-term advantage to the Related Party. For example, an income distribution payable by a Scheme may be 'bought' at the expense of a fall in the capital value of the investment purchased.

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9.13.5 Further, a Related Party, especially an Operator, may have knowledge in relation to the Scheme that is not generally available to others. For example, knowledge of aggregate sales and redemptions of Scheme interests may provide an indication of the level of realised capital gains to be distributed by the Scheme and a prospective revaluation of Scheme assets may not be reflected in the price at which interests in a Scheme are transacted.

In considering the above issues, FSC members should be aware of regulations relating to insider trading and should have in place appropriate policies in relation to staff dealings (such as those incorporated within the FSC Guidance Note No. 7.00 'Personal Trading').

9.14 The terms and conditions under which a Related Party Transaction in Scheme interests is entered into should be no more favourable than the terms and conditions that would be available to a non-Related Party transacting a similar transaction.

9.14.1 An Operator should ensure that no preference is given to a Related Party who enters into a Related Party Transaction in Scheme interests, which would be to the detriment of the existing Investors in the Scheme. In particular, no priority of treatment in relation to a disposal of interests in a Scheme should be offered to a Related Party.

9.14.2 In view of the sensitivity of Related Party Transactions between a Scheme and a Related Party, it may be appropriate for a member to obtain an independent review of the Related Party Transaction prior to its initiation. In any event, there should be proper documentation relating to the basis under which the Related Party Transaction was entered into.