

ASIC CLASS ORDER (CO 07/422)

EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (ASIC) makes Class Order [CO 07/422] *On-market buy-backs by ASX-listed schemes* under s601QA(1) and 655A(1) of the *Corporations Act 2001* (the Act).

Sections 601QA(1)(b) of the Act provides that ASIC may declare that Ch 5C of the Act applies to a person or a specified class of persons as if specified provisions were omitted, modified or varied. Section 655A(1)(b) of the Act provides that ASIC may declare that Ch 6 of the Act applies to a person or a specified class of persons as if specified provisions were omitted, modified or varied.

1. Background

Although the Act does not specifically prohibit on-market buy-backs by responsible entities of registered managed investment schemes, certain requirements in the Act have the effect of preventing or making it commercially difficult for schemes to engage in on-market buy-backs of interests.

Requirements under s601GA(4)

Section 601GA(4) of the Act requires that if members have a right to withdraw, the scheme's constitution must specify the right and set out adequate procedures for withdrawal in a way that is fair to all members. However, the right to withdraw in an on-market buy-back will arise under a market contract rather than being specified in the scheme's constitution.

Further, s601GA(4) of the Act requires the constitution to include an independently verifiable method for calculating the withdrawal price: see Regulatory Guide 134 *Managed Investments: Constitutions* (RG 134). However, in determining the particular buy-back bid price at any particular time, a responsible entity and its advisers may properly consider a number of factors.

Consequently, compliance with s601GA(4) would be impracticable for an on-market buy-back.

The withdrawal procedures for non-liquid schemes in Pt 5C.6

Part 5C.6 of the Act is primarily concerned with ensuring that there are fair procedures to allow members to liquidate their investment and to protect members who remain in the scheme. Many listed registered schemes would be non-liquid schemes. If the right to withdraw may be exercised while the scheme is non-liquid, the constitution must provide for the right to be exercised in accordance with the withdrawal procedures in Pt 5C.6. However, the withdrawal procedures in Pt 5C.6 in relation to non-liquid schemes cannot operate consistently with the Australian Securities Exchange (ASX) Market Rules because for transactions on ASX's market, offers to sell are filled on the basis of price and time priority rather than proportionately.

The takeovers prohibited acquisition provisions in s606

The takeovers prohibition in s606 of the Act aims to prohibit acquisitions of interests that would increase a person's voting power in interests in a listed registered scheme over a statutory threshold without a takeover offer. This could impact buy-backs because buy-backs could have the effect of increasing the voting power of a person if the interests that give the person voting power are not sold into the buy-back but other interests are sold into the buy-back.

However, the risks s601GA(4), Pt 5C.6 and s606 of the Act are intended to address are reduced for certain on-market buy-backs carried out by schemes listed on the licensed financial market of the ASX. This is because all members have an appropriate opportunity to liquidate their investments by selling on-market at any time and will have an equal opportunity to participate in the buy-back or not to do so and have the relative value of their relevant interest increase.

2. Purpose of the class order

[CO 07/422] grants relief from s601GA(4), Pt 5C.6 and s606 of the Act to allow the responsible entity of a registered scheme listed on the ASX that has no more than one class of interests to carry out on-market buy-backs of interests on a similar basis as applies to buy-backs of shares in companies listed on ASX. Its purpose is to ensure on-market buy-backs by ASX-listed schemes are regulated in a way that ensures that the regulatory protections that Parliament intended for registered schemes are not undermined but operate in a commercially sensible manner.

3. Operation of the class order

[CO 07/422] modifies s601GA(4), Pt 5C.6 and s606 of the Act for on-market buy-backs of interests to allow the buy-back to be operated without contravening the Act. The relief is available when all of the following requirements are satisfied:

- (a) the scheme's constitution gives the responsible entity power to buy-back interests in the scheme;
- (b) the buy-back does not materially prejudice the responsible entity's ability to pay its creditors in relation to liabilities incurred by it as responsible entity of the scheme;
- (c) the buy-back is carried out in the ordinary course of trading on the financial markets of the ASX and not by way of a special crossing or priority crossing;
- (d) the responsible entity complies with the ASX Listing Rules (ASXLRs) in relation to the buy-back as if the scheme were a company listed on the ASX (including ASXLR 7.33 which requires that the buy-back price is not more than 5% above the average of the market price for interests);
- (e) the responsible entity does not dispose of the interests it buys-back;
- (f) immediately after registration of the transfer to the responsible entity of interests bought-back, the interests are cancelled;
- (g) member approval is obtained where the buy-back exceeds the '10/12 limit';
- (h) a buy-back within the '10/12 limit' is disclosed to the ASX; and
- (i) any discretions in relation to the setting of the buy-back price are exercised reasonably, and the exercise of any discretions is documented.

The '10/12 limit' for a responsible entity of a registered scheme proposing to make a buy-back is 10% of the smallest number, at any time during the last 12 months, of interests in the scheme.

4. Consultation

ASIC consulted on its propose to grant relief from s601GA(4), Pt 5C.6 and s606 of the Act to allow the responsible entity of an ASX-listed scheme to carry out on-market buy-backs of interests, by publishing Consultation Paper 77 *On-market buy-backs by ASX-listed schemes* in December 2006 and inviting public comments on that consultation paper. ASIC has taken those comments into account in developing [CO 07/422] and Regulatory Guide 101 *On-market buy-backs by ASX-listed schemes* (RG 101).

A Regulatory Impact Statement (RIS) was prepared for [CO 07/422] and RG 101. A copy of the RIS is attached.



ASIC

Australian Securities & Investments Commission

Proposed policy on on-market buy-backs by ASX-listed schemes

Regulation impact statement (RIS)

October 2007

What this regulation impact statement is about

ASIC proposes to develop a policy on on-market buy-backs of interests by the responsible entity of a registered scheme listed on the Australian Securities Exchange (ASX).

This Regulation Impact Statement (RIS) outlines the issues regarding the approach ASIC intends to take in relation to on-market buy-backs by ASX-listed schemes. The RIS will explore the costs and benefits of the different options available to ASIC in this respect. The RIS recommends that ASIC grant class order relief from certain provisions of the *Corporations Act 2001* (Corporations Act) to allow the responsible entity of an ASX-listed scheme to carry out on-market buy-backs of interests where the buy-back takes place in the ordinary course of trading on the ASX. This will:

- (a) enable ASX-listed schemes to utilise a cost-effective, transparent and fair means of returning capital to members;
- (b) avoid placing listed schemes at a regulatory disadvantage to listed companies in relation to capital management techniques where there is no regulatory reason for different treatment of listed schemes and listed companies; and
- (c) ensure that the special regulatory protections that Parliament intended for registered schemes are not undermined but operate in a commercially sensible manner.

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Issue/problem

1. The Corporations Act does not specifically prohibit on-market buy-backs by registered managed investment schemes. However, certain requirements in the Corporations Act have the effect of preventing or making it commercially difficult for such schemes to engage in on-market buy-backs of interests. Specifically:

- (a) **Requirements under s601GA(4)** - s601GA(4) of the Corporations Act requires that if members have a right to withdraw, the scheme's constitution must specify the right and set out adequate procedures for withdrawal in a way that is fair to all members. However, the right to withdraw in an on-market buy-back will arise under a market contract rather than being specified in the scheme's constitution.

Further, s601GA(4) requires the constitution to include an independently verifiable method for calculating the withdrawal price: see Regulatory Guide 134 *Managed Investments: Constitutions* (RG 134). This is difficult to do in the context of on-market buy-backs because the buy-back offer price is likely to change very frequently (in line with the quoted price of the interests).

Consequently, compliance with s601GA(4) would be impracticable for an on-market buy-back.

- (b) **The withdrawal procedures for non-liquid schemes in Pt 5C.6** - Most listed registered schemes would be non-liquid schemes. If the right to withdraw may be exercised while the scheme is non-liquid, the constitution must provide for the right to be exercised in accordance with the withdrawal procedures in Pt 5C.6. However, the withdrawal procedures in Pt 5C.6 in relation to non-liquid schemes cannot operate consistently with the ASX Market Rules. Pt 5C.6 requires that scheme members are given an equal opportunity to make a withdrawal request in response to the withdrawal offer and to have their withdrawal request satisfied in full or on a proportionate basis. In contrast, the trading and settlement rules of the ASX provide that offers to sell are filled on the basis of price and time priority rather than proportionately (i.e. the offer to sell for the lowest price will be chosen or if there are multiple offers at the same price, the one first made will be chosen).
- (c) **The takeovers prohibited acquisition provisions in s606** – Section 606 prohibits certain acquisitions of relevant interests in voting shares. This prohibition could make it difficult for

schemes to engage in on-market buy-backs because it might mean that the proportionate share of those members who do not participate increases. The holding of those members could exceed the permitted threshold when there is not a takeover offer. (Note: Such a problem would also exist for the buy-back of shares were it not for the exception in s611, item 19, which facilitates acquisitions that result from share buy-backs.)

2. The provisions outlined above prevent the responsible entity of registered managed investment schemes from conducting on-market buy-backs. This means that listed schemes are being placed at a regulatory disadvantage to listed companies in relation to capital management techniques.

Objectives

3. ASIC aims to regulate on-market buy-backs by ASX-listed schemes in a way that ensures that the regulatory protections that Parliament intended for registered schemes are not undermined but operate in a commercially sensible manner.

Options

Option 1 – Maintain the *status quo*

4. Maintaining the status quo would mean that registered schemes listed on the ASX would be unable to carry out on-market buy-backs of interests. No relief would be provided to allow ASX-listed schemes to do so except on a case-by-case basis.

Option 2 – Grant conditional class order relief to facilitate on-market buy-backs by ASX-listed schemes

5. If this option were adopted, ASIC would grant conditional relief to allow the responsible entity of a 'non-liquid' registered scheme listed on the ASX to carry out on-market buy-backs of interests where the buy-back takes place in the ordinary course of trading on the ASX.

6. ASX-listed schemes wishing to engage in an on-market buy-back of interests would be required to comply with conditions in order to benefit from the relief granted to ensure that the regulatory protections Parliament intended for registered schemes are not undermined. These conditions would include requiring:

- (a) the buy-back price to be not more than 5% above the average of the market price for interests in the scheme;
- (b) member approval for large-scale buy-backs (i.e. those which exceed the '10/12 limit') to have been obtained within the previous 12 months; and
- (c) small-scale buy-backs (i.e. those within the '10/12 limit') to be announced to the ASX at least 14 days before the buy-back commences.

The '10/12 limit' refers to 10% of the smallest number, at any time during the last 12 months, of interests in the scheme.

Option 3 – Grant unconditional class order relief to facilitate on-market buy-backs by ASX-listed schemes

7. If this option were adopted, ASIC would grant unconditional relief to allow the responsible entity of a 'non-liquid' registered scheme listed on the ASX to carry out on-market buy-backs of interests where the buy-back takes place in the ordinary course of trading on the ASX.

Impact analysis

Affected parties

8. The parties that would be affected by ASIC's proposals are:
- (a) responsible entities of ASX-listed managed investment schemes;
 - (b) scheme members involved in or affected by buy-backs of interests; and
 - (c) ASIC.

9. There are just over 100 schemes listed on the ASX, of which approximately 90% are either property trusts or infrastructure funds. Property trusts and infrastructure funds are likely to be non-liquid schemes having regard to the nature of the assets they hold. Furthermore, approximately 50% of all property trusts and almost all infrastructure funds form part of a stapled group. A typical stapled group is an economic business entity comprising a company and a scheme, where a share in the company and an interest in the scheme are quoted and trade as a single 'stapled security' on the ASX. In a stapled group, each member of the scheme is also a shareholder of the company.

10. It is difficult to ascertain exact figures for how many scheme members would be involved in or be affected by on-market buy-backs of interests in ASX-listed schemes. However, ASIC has given case-by-case relief for approximately 8 listed schemes over the last year for on-market buy-backs. We expect that the relaxation of certain conditions will lead to some increase in on-market buy-backs.

Costs and benefits of each option

Option 1 – Maintain the status quo

Costs

11. If this option were adopted, ASX-listed schemes (without the benefit of individual relief) would effectively be prevented from engaging in on-market buy-backs. This would mean that ASX-listed schemes:

- (a) would be unable to benefit from a cost-effective, transparent and fair means of returning capital to members; and
- (b) would be placed at a regulatory disadvantage to listed companies in relation to capital management techniques.

12. Doing nothing would also impact on ASIC's resources. It is likely that ASIC would continue to receive applications for relief from ASX-listed schemes wishing to conduct on-market buy-backs if it does not grant class order relief from the relevant provisions in the Corporations Act to facilitate this. ASIC would need to continue to devote resources in dealing with the relief applications.

Benefits

13. ASIC would require ASX-listed schemes wishing to carry out on-market buy-backs to comply with s601GA(4), Pt 5C.6 and s606 of the Corporations Act, which would provide protections to scheme members. (However, in the context of on-market buy-backs by ASX-listed schemes, these protections are moot only because ASX-listed schemes are unable to carry out on-market buy-backs so long as they are required to comply with these provisions.)

Option 2 – Grant conditional class order relief to facilitate on-market buy-backs by ASX-listed schemes

Costs

14. If this option were adopted, members would not be given the protection provided by compliance with s601GA(4), Pt 5C.6 and s606 of the Corporations Act. However, the conditions imposed on the relief provide adequate protection to members so that the protection intended by those provisions are not undermined. Further, this option would pose less risk to members than Option 3 (granting unconditional relief) because the conditions imposed will give the necessary protection to members.

15. There may be some costs incurred by schemes in complying with the conditions. If this option were adopted, ASX-listed schemes would incur costs in sending notices to scheme members and convening and holding a members' meeting to obtain scheme member approval for large-scale buy-backs. ASIC sought industry feedback on this issue in our public consultation process. Industry indicated that for the high proportion of listed schemes that form part of a stapled group on the ASX and for listed schemes that hold AGMs as a matter of practice, the incremental costs of obtaining scheme member approval are low. For those listed schemes that would not ordinarily hold an AGM, the costs of holding a meeting of scheme members might be substantial, depending on the number of scheme members. However, relative to the size of the buy-back transaction where the '10/12 limit' will be exceeded, the cost of convening and holding a meeting to obtain scheme member approval will be low.

16. A condition would be imposed under this option requiring schemes to maintain documentation in relation to the exercise of its discretions in respect of the setting of the buy-back offer price. However, when ASIC sought industry feedback in our public consultation process concerning costs on responsible entities of such schemes, all industry respondents indicated that they were negligible.

Benefits

17. This option would benefit responsible entities of ASX-listed schemes by allowing them to carry out on-market buy-backs of interests. This would enable ASX-listed schemes to utilise a cost-effective, transparent and fair means of returning capital to members. It also avoids placing ASX-listed schemes at a regulatory

disadvantage to listed companies in relation to capital management techniques.

18. The imposition of conditions would protect scheme members where the proposed relief is granted. For example:

- The requirement for buy-backs to be carried out in the ordinary course of trading on the ASX will ensure that buy-backs are carried out in accordance with a fair procedure. This is because trades on ASX's trading system operate according to price-time priority, resulting in the better-priced orders taking priority.
- The condition which specifies that the requirements of ASX that apply to share buy-backs under the ASX Listing Rules are to apply to on-market buy-backs by ASX-listed schemes would also protect members. In particular, the requirement that the buy-back price must not exceed the ASX price ceiling (i.e. the buy-back price must not be more than 5% above the average of the market price for interests) will prevent entities from using the buy-back as a means of artificially increasing or manipulating the market price. This requirement would address the risk that the value of holdings of those members who do not participate in the buy-back would be diluted.
- The condition requiring member approval for large-scale buy-backs to have been obtained within the previous 12 months also addresses the risk that the value of holdings of those members who do not participate in the buy-back would be diluted. It also addresses the risk that the buy-back will entrench the responsible entity's control if the responsible entity and its associates hold interests in the scheme and choose not to sell into the buy-back, making it unnecessary for the takeovers prohibition in s606 to be imposed. The condition is consistent with item 19 of s611 in relation to share buy-backs.
- The requirement for small-scale buy-backs to be announced to the ASX at least 14 days before the buy-back commences will ensure scheme members are given sufficient time to become aware of an intended buy-back. The requirement should also promote an equal opportunity to participate in the buy-back, having regard to the fact that the responsible entity is not required to send a withdrawal notice to scheme members under Pt 5C.6.
- The requirement for the responsible entity to have a documented policy regarding discretions it exercises in setting

the buy-back price during the course of an on-market buy-back will help ensure that the responsible entity exercises any discretions appropriately and in the best interests of scheme members.

Option 3 – Grant unconditional class order relief to facilitate on-market buy-backs by ASX-listed schemes

Costs

19. If this option were adopted, members involved in or affected by buy-backs of interests in ASX-listed schemes would not be given any of the protections provided for by the conditions intended under Option 2.

20. Unconditional relief could expose members to possible dilution of interests, unfair procedures and unfettered control of the scheme by the responsible entity (see paragraph 18 above for the benefits of imposing conditions on the relief).

Benefits

21. This option would benefit responsible entities of ASX-listed schemes in that class order relief would enable them to carry out on-market buy-backs of interests without bearing the cost of relief applications or compliance with conditions of relief.

Consultation

22. ASIC began considering whether it should grant class order relief from certain provisions of the Corporations Act to allow ASX-listed schemes to carry out on-market buy-backs of interests in response to industry concerns that the existing regulation of withdrawals from schemes makes it difficult for listed schemes to use the capital management techniques available to listed companies.

23. ASIC published Consultation Paper 77 *On-market buy-backs by ASX-listed schemes* (CP 77) in December 2006, which set out our proposed policy on on-market buy-backs by ASX-listed schemes. ASIC invited written and oral comments on our proposed policy and asked for quantitative and qualitative information, particularly in relation to costs.

24. The consultation period ended in March 2007. ASIC received five written submissions from four listed managed investment schemes and from the ASX. The proposals in CP 77 were generally supported by those who provided submissions. The following are examples of some of the views expressed in the written submissions

- All respondents supported granting relief from s601GA(4), Pt 5C.6 and s606 of the Corporations Act to allow responsible entities of ASX-listed schemes to carry out on-market buy-backs of interests.
- All respondents expressed support for requiring the buy-back price to be not more than the price ceiling imposed by ASX Listing Rule 7.33 (i.e. not more than 5% above the average of the market price for securities in that class).
- All respondents supported the condition ASIC proposed that schemes obtain member approval for large-scale buy-backs within the previous 12 months. However, respondents considered that the requirement to disclose voting intentions and participation intentions (if known to the responsible entity) of any controlling member, the responsible entity and its associates where this information is material to the decision how to vote on the buy-back resolution would be inappropriate because:
 - (i) it is not a requirement imposed by the Corporations Act in relation to share buy-backs;
 - (ii) disclosure of intentions of associates or controlling members is not a matter of which the responsible entity would necessarily be aware and would be confidential and personal information of that associate or controlling member; and
 - (iii) intentions can change.

ASIC has responded to this issue by proposing not to require this disclosure.

- Respondents also expressed support for the condition requiring small-scale buy-backs to be announced to the ASX before the buy-back commences. However, respondents considered that the proposed condition requiring schemes to wait at least 21 days after a buy-back is announced to the ASX before commencing the buy-back is unnecessary, as an on-market buy-back does not require a scheme member to make a specific decision over and above periodic determinations in

respect of their investments. In addition, a waiting period is inconsistent with Ch 3 of the ASXLRs, which works on the principle that the market is fully informed once information is released to the market. However, most submissions indicated that if a notice period is required, a 14-day notice period should apply so that schemes are aligned with companies. ASIC considers that a waiting period is appropriate and proposes to impose a 14-day waiting period which is consistent with the 14-day waiting period imposed by Parliament in respect of on-market share buy-backs (see s257).

- Respondents considered that class order relief should not be limited to ASX-listed schemes and should be extended to registered schemes listed on all prescribed financial markets. Respondents submitted that schemes listed on other prescribed markets have a quoted and independently verifiable market price and noted that all of the other prescribed financial markets (except for APX) have at least one scheme listed. However, ASIC proposes to restrict any class order relief to ASX-listed schemes, and to consider relief for other prescribed markets on a case-by-case basis. This is consistent with our policy in Class Order (CO 05/26) *Constitutional provisions about the consideration to acquire interests* in relation to placements. In addition, ASIC does not consider that there is demonstrated need for relief to be extended to other prescribed financial markets, given that none of the respondents have any schemes listed on the other prescribed markets and none of the other prescribed markets expressed concerns about the restriction.
- Respondents considered it to be unreasonable to require a responsible entity to disclose its pricing policies and how it exercises its discretions in determining the buy-back price of interests for a number of reasons, including that it would be inappropriate to require disclosure during an on-market buy-back because of the potential for the information to distort market pricing. ASIC has responded to these concerns by proposing not to impose this requirement.

Conclusion and recommended option

25. This RIS examines whether ASIC should grant relief from certain provisions of the Corporations Act to allow the responsible entity of an ASX-listed scheme to carry out on-market buy-backs of interests.

26. ASIC considers that Option 2 (granting conditional relief) is the preferable option. Option 2 allows ASIC to provide conditional class order relief from s601GA(4), Pt 5C.6 and s606 of the Corporations Act to enable responsible entities of ASX-listed schemes to carry out on-market buy-backs of interests where the buy-back takes place in the ordinary course of trading on the ASX. Granting conditional class order relief will ensure that scheme members are adequately protected, whilst enabling schemes to utilise a cost-effective, transparent and fair means of returning capital to members. Granting conditional relief also avoids placing ASX-listed schemes at a regulatory disadvantage to listed companies in relation to capital management techniques where there is no regulatory reason for a difference. Although schemes would incur costs in complying with conditions of relief, such costs are likely to be negligible or low relative to the size of the buy-back transaction.

27. ASIC is of the view that Option 3 (granting unconditional relief) would not be appropriate. The benefit for responsible entities of ASX-listed schemes in not having costs for complying with conditions of relief is outweighed by the need to ensure that scheme members are adequately protected. Although the risks s601GA(4), Pt 5C.6 and s606 are intended to obviate are arguably lower for on-market buy-backs carried out by non-liquid listed schemes, conditions of relief are nonetheless important to address dilution and control risks.

Implementation and review

28. ASIC will implement the recommendations in this RIS by giving class order relief and publishing a regulatory guide explaining our relief and what a responsible entity of an ASX-listed scheme should do in conducting on-market buy-backs of interests.

29. ASIC will monitor on-market buy-backs by ASX-listed schemes, including to ensure that buy-backs are carried out in accordance with the conditions of relief. If we find that the regulatory protections that Parliament intended for registered schemes are being undermined, ASIC may review its policy on on-market buy-backs by ASX-listed schemes. There is currently no specific review planned or scheduled.