# ASIC CLASS ORDER [CO 13/656]

# EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

The Australian Securities and Investments Commission (***ASIC***) makes ASIC Class Order [CO 13/656] under subsections 601QA(1) of the *Corporations Act 2001* (the ***Act***).

Subsection 601QA(1) of the Act provides that ASIC may declare that Chapter 5C of the Act applies as if specified provisions were omitted, modified or varied as specified in the declaration.

## 1. Background

Paragraph 601FC(1)(d) of the Act requires that the responsible entity of a registered scheme, in exercising its powers and carrying out its duties, must treat the members who hold interests of the same class equally and members who hold interests of different classes fairly.

Paragraph 601FG(1)(a) of the Act requires that if the responsible entity of a registered scheme acquire an interest in the scheme it must only do so for not less than the consideration that would be payable if the interests were acquired by another person.

On 3 August 1998, ASIC released Regulatory Guide 134 *Managed investments: Constitutions* (***RG 134***) providing guidance designed to assist responsible entities to prepare and lodge a constitution for a managed investment scheme that complies with Chapter 5C of the Act.

On 4 May 2005, ASIC made ASIC Class Order [CO 05/26] which exempted responsible entities of registered managed investment schemes other than timesharing schemes from 601FC(1)(d) of the Act in certain circumstances. These circumstances include:

(a) the offer of interests to foreign members under provisions notionally inserted by Class Order [CO 05/26];
(b) the date of notification for the acceptance of an offer of interests by a wholesale client; and

(c) making offers and issues under an interest purchase plan permitted by ASIC Class Order [09/425] under provisions notionally inserted by Class Order [CO 05/26].

In June 2013 ASIC completed a review of RG 134 and Class Order [05/26] and in implementation of policy to be described in a replacement to be issued for RG 134 makes Class Order [CO 13/656].

## 2. Purpose of the class order

The purpose of this class order is to update and clarify the circumstances in which a responsible entity may be exempt from the requirements under paragraphs 601FC(1)(d) and 601FG(1)(a). This is intended to provide certainty for responsible entities while providing appropriate flexibility for responsible entities in relation to the exercise of their powers and performance of their duties as responsible entity of a registered managed investment scheme and the acquisition of interest in a registered managed investment scheme for which they are the responsible entity.

## 3. Operation of the class order

Paragraph 4(a) of the class order exempts a responsible entity of a registered scheme from the requirements in paragraph 601FC(1)(d) of the Act to the extent that it prevents the responsible entity from making an offer of interests to a member with a registered address outside Australia and New Zealand where:

(a) the scheme is included in the official list of the financial market operated by ASX Limited and the offer complies with the requirements of relevant listing rules of ASX Limited that are applicable to the relevant offer and issue of interests;

(b) where the scheme is not included in the official list of the financial market operated by ASX Limited and the offer is renounceable—appoints a nominee to sell the rights to acquire the interests that are not offered to the non-residents and distribute to each non-resident their proportion of the net proceeds of sale; and

(c) in other cases where it would be unreasonable because of defined circumstances.

Paragraph 4(b) of the class order exempts a responsible entity of a registered scheme from the requirements in paragraph 601FC(1)(d) of the Act to the extent that it prevents the responsible entity from requiring that the date of notification for the acceptance of an offer of interests by a wholesale client occurs before another member. Subparagraph 4(b)(ii) requires that interests offered to wholesale clients

must not be issued before the earliest date on which interests may be issued to other members of the scheme.

Paragraph 4(c) of the class order exempts a responsible entity of a registered scheme from the requirements in paragraph 601FC(1)(d) of the Act where the responsible entity deals with a complaint made by wholesale clients differently from complaints by other members.

Paragraph 4(d) of the class order exempts a responsible entity of a registered scheme from the requirements in paragraph 601FC(1)(d) of the Act where the responsible entity makes offers and issues of interest in a way that is permitted by ASIC Class Order [09/425].

Paragraph 5 of the class order exempts a responsible entity of a registered scheme from the requirements in paragraph 601FG(1)(a) of the Act to the extent that it prevents the responsible entity from relying on the provision for a responsible entity acquiring interests as a result of forfeiture of interests by a member where the constitution of the scheme requires the interests be offered for sale as permitted by subsection 601GAD(9) of the Act as notionally in force because of ASIC Class Order [CO 13/655].

## 4. Documents incorporated by reference

The class order incorporates by reference the following documents:

(a) Rule 7.7 of the Listing Rules of the ASX Limited on 1 June 2013. The relevant listing rule, permits the exclusion of members outside Australia and New Zealand from an offer of interests in a registered scheme in defined circumstances. The rule requires that in the event of exclusion notification must be given of the offer and the exclusion of the member to the excluded member and if the offers are made on a pro rata renounceable basis a nominee for sale of the interest that would have been issued must be appointed and the net proceeds paid to the member. The Listing Rules are available at www.asxgroup.com.au;

(b) ASIC Class Order [09/425] which gives conditional exemption from the requirement for a Product Disclosure Statement to be given by responsible entities of registered schemes when offering interests in a registered scheme under an interest purchase plan. An interest purchase plan is an arrangement under which members may acquire additional interests in a registered scheme up to a maximum monetary amount. This document is registered on the Federal Register of Legislative Instruments; and

(c) ASIC Class Order [13/655] which modifies or varies Chapter 5C of the Act to provide for circumstances in which a responsible entity of a registered scheme may set the consideration to acquire an interest in a registered scheme. This document is registered on the Federal Register of Legislative Instruments.

## 5. Consultation

On 18 September 2012, ASIC released Consultation Paper 188 '*Managed Investments: Constitutions – Updates to RG 134*' (***CP 188***) seeking feedback on proposals to update our guidance on the requirements relating to constitutions of registered schemes under Chapter 5C of the Act. This consultation also covered what relief was appropriate to allow for unequal treatment of members and for forfeiture of interests to the responsible entity. The consultation period closed on the 13 November 2012.

The Office of Best Practice Regulation has approved the attached Regulation Impact Statement for regulation to implement the policy in the replacement of RG 134.

# Statement of Compatibility with Human Rights

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

**ASIC Class Order [CO 13/656]**

This class order is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

## Overview of the class order

ASIC Class Order [CO 13/656] relates to paragraph 601FC(1)(d) of the *Corporations Act 2001* (the ***Act***) which requires that in exercising its powers and carrying out its duties, the responsible entity of a registered scheme must treat the members who hold interests of the same class equally and members who hold interest of different classes fairly. It also relates to paragraph 601FG(1)(a) of the Act which requires that if the responsible entity of a registered scheme acquires an interest in the scheme, must only do so for not less than the consideration that would be payable if the interests were acquired by another person.

Developed in consultation with industry, the class order seeks to update and clarify for responsible entities and their advisers about the circumstances in which a responsible entity may be exempt from the requirements under paragraphs 601FC(1)(d) and 601FG(1)(a) of the Act. This is intended to provide certainty for responsible entities while providing appropriate flexibility for responsible entities in relation to the provisions of the constitution for a registered managed investment scheme.

Class Order [CO 13/656] exempts the responsible entities of a registered managed investment schemes from complying with paragraph 601FC(1)(d) of the Act where an offer is not made to members with a registered address outside of Australia and New Zealand because it would unreasonable to do so and in doing so requires they receive the net proceeds of issue when the option of selling the right to take up the interest is available to non excluded members.

The class order allows for wholesale clients not to be provided with some of the opportunities to have a longer period to consider offerings of interests or to participate in complaints handling procedures.

The class order also grants incidental exemptions to allow the intended operation of other ASIC class orders relating to offers to members that are subject to monetary caps and the responsible entity accepting forfeited interests for sale.

## Human rights implications

This class order does not engage any of the applicable rights or freedoms.

## Conclusion

This class order is compatible with human rights as it does not raise any human rights issues.

ASIC
Australian Securities & Investments Commission

REGULATION IMPACT STATEMENT

# Managed investments: Constitutions—Updates to RG 134

June 2013

## About this Regulation Impact Statement

This Regulation Impact Statement (RIS) addresses ASIC's proposals for ASIC's proposals to review and update Regulatory Guide 134 *Managed investments: Constitutions* (RG 134).

# What this Regulation Impact Statement is about

This Regulation Impact Statement (RIS) addresses our proposals to review and update Regulatory Guide 134 *Managed investments: Constitutions* (RG 134). RG 134 sets out our policy on the content requirements for a constitution of a registered managed investment scheme.

In developing our final position, we have considered the regulatory and financial impact of our proposals. We are aiming to strike an appropriate balance between:

- maintaining, facilitating and improving the performance of the financial system and entities in it;
- promoting confident and informed participation by investors and consumers in the financial system; and
- administering the law effectively and with minimal procedural requirements.

This RIS sets out our assessment of the regulatory and financial impacts of our proposed policy and our achievement of this balance. It deals with:

the likely compliance costs;

the likely effect on competition; and

other impacts, costs and benefits.

# Contents

# Introduction

## Background

A constitution of a managed investment scheme (scheme) that is registered with ASIC is a document that sets out some or all of the rights, duties and liabilities of the responsible entity in its operation of the scheme.

Under s601GA of the *Corporations Act 2001* (Corporations Act), the constitution of a registered scheme must make adequate provision for, or specify, certain prescribed matters. These include:

the consideration to acquire and dispose of an interest in the scheme;

the powers of the responsible entity in making investments, borrowing or dealing with scheme property;

the method for dealing with complaints about the scheme;

winding up the scheme;

the rights of the responsible entity to be paid fees or indemnified out of scheme property; and

any rights of members to withdraw from the scheme.

Note: In this RIS, references to sections (s), Parts (Pts) or Chapters (Chs) are references to the Corporations Act.

The constitution can also contain provisions that deal with obligations and rights outside the content requirements of s601GA.

Under s601GB of the Corporations Act, the constitution must be a document that is legally enforceable as between the members and the responsible entity.

We published Regulatory Guide 134 *Managed investments: Constitutions* (RG 134) in August 1998. RG 134 sets out our guidance on the requirements for constitutions in s601GA and 601GB of the Corporations Act and how we apply these requirements in deciding whether to register a scheme.

We subsequently updated RG 134 in November 1998, June 1999 and September 2000. We have not reviewed and updated RG 134 since 2000.

## Registering a managed investment scheme

As at 1 March 2013, there were 4,141 registered managed investment schemes and 571 responsible entities. For the financial year ending 30 June 2012, we received 191 applications to register a scheme.

There has been a reduction in the number of applications to register a scheme after the global financial crisis. **Table 1** highlights the steady decrease in registered schemes from 1 July 2007 to 30 June 2012.

**Table 1: Total registered schemes from 1 July 2007 to 30 June 2012**

| Financial year | No. of schemes registered | No. of schemes deregistered | Total no. of registered schemes |
|---|---|---|---|
| 2011–12 | 191 | 324 | 4,289 |
| 2010–11 | 240 | 500 | 4,270 |
| 2009–10 | 245 | 435 | 4,339 |
| 2008–09 | 298 | 378 | 4,651 |
| 2007–08 | 519 | 276 | 5,108 |
| 2006–07 | 616 | 252 | 4,680 |

Source: ASIC

Registered schemes fall into eight main classes, including unlisted managed schemes, listed managed funds (exchange-traded funds and listed investment trusts), Australian listed real estate investment trusts (A-REITS), unlisted property schemes, mortgage schemes, infrastructure schemes, agribusiness schemes, and timeshare and serviced strata schemes.

As at 31 December 2012, total unconsolidated assets of public offer (retail) unit trusts were $264.5 billion.[1] The total assets for public unit trusts were $312.2 billion at 31 December 2007.[2] This represents a decrease in total unconsolidated assets of public offer (retail) unit trusts of $47.7 billion after the global financial crisis.

[1] See Australian Bureau of Statistics. However, it should be noted that this excludes the value of many investment types required to be registered as managed investment schemes by the Corporations Act.
[2] See footnote 1.

The size of funds under management of individual registered schemes varies greatly, with the smallest being approximately $1 million and the largest being approximately $90 billion.

To register a scheme, there must be a responsible entity who isa public company that holds an Australian financial services (AFS) licence that authorises it to operate the scheme. The applicant can lodge the application form electronically or in hardcopy.

The application must meet the requirements of s601EA, by including:

- an application form, which states the name and address of the proposed responsible entity and the person who has consented to be the auditor of the compliance plan (Form 5100 *Application for registration of managed investment scheme*);
- a copy of the constitution that meets the requirements in s601GA and 601GB which we assess under our policy in RG 134;
- a copy of the compliance plan that meets the requirements in s601HA which we assess under our policy in Regulatory Guide 132 *Managed investments: Compliance plans* (RG 132); and
- a statement signed by the directors of the proposed responsible entity that the constitution complies with s601GA and 601GB; and the compliance plan complies with s601HA (Form 5103 *Directors' statement relating to application for registration of a managed investment scheme*).

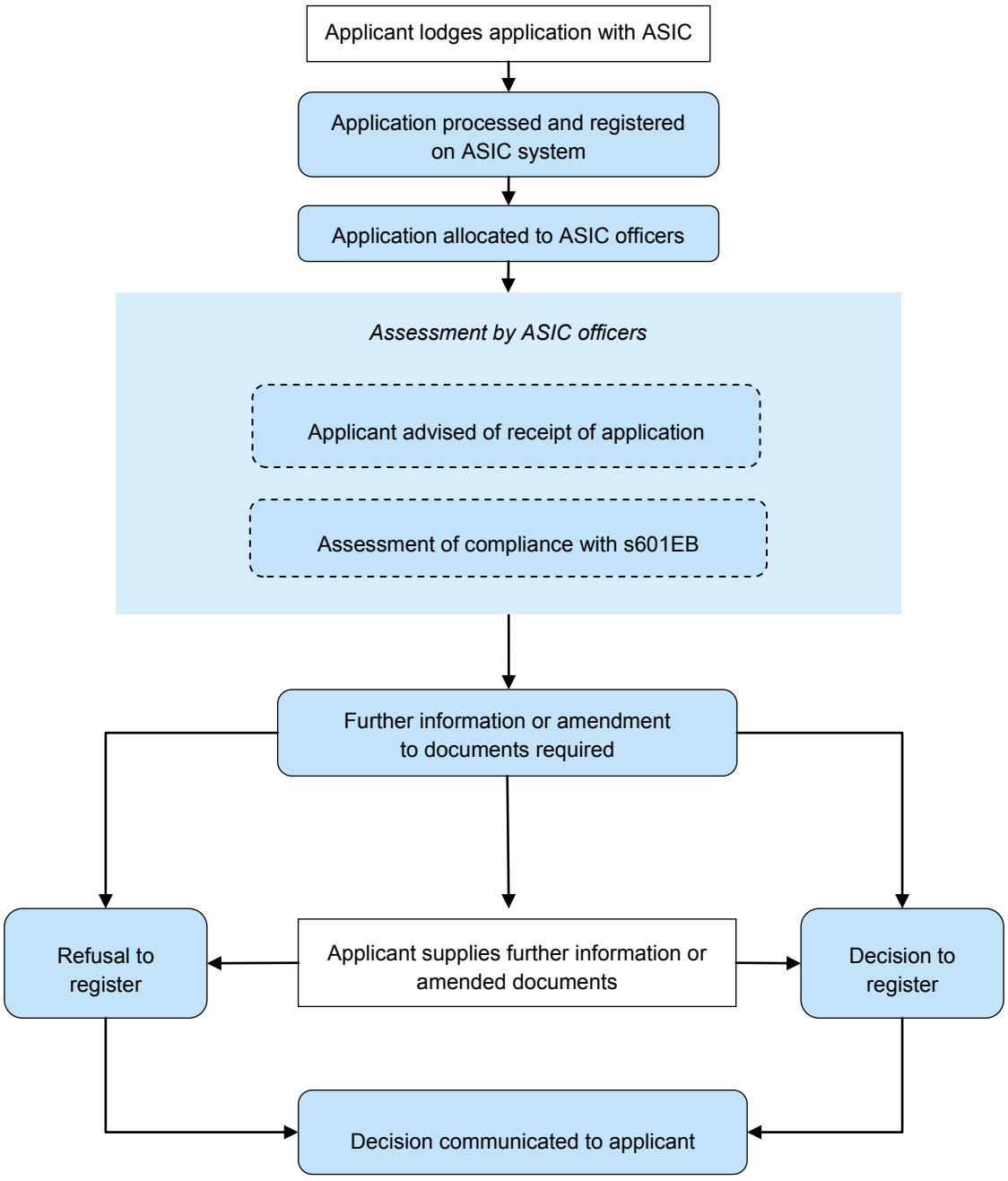
There is no prescribed form for the constitution or the compliance plan. However, the application must state which provisions of the constitution address the matters in s601GA and 601GB.

ASIC must register a scheme within 14 days of lodgement of the application, unless it appears to us that:

- the application does not meet the requirements of s601EA;
- the proposed responsible entity is not a public company that holds an AFS licence authorising it to operate the scheme;
- the constitution does not meet the requirements of s601GA and 601GB;
- the compliance plan does not meet the requirements of s601HA;
- the copy of the compliance plan is not signed by all directors; and
- arrangements are not in place that will satisfy the requirements of s601HG in relation to the audit of the compliance plan.

The process that we undertake to assess an application to register a scheme is set out in **Figure 1**.

**Figure 1: How we assess an application to register a scheme**




Note: Applicants may choose to withdraw their application at any stage of the process.

When we assess whether a constitution meets the requirements of s601GA and 601GB as part of considering an application to register a scheme, we:

take into account RG 134 when considering provisions about powers of the responsible entity in dealing with scheme property, complaints handling, winding up and withdrawal. We do not take into account RG 134 when considering provisions

about the consideration to acquire an interest, as this is outdated;

take into account Class Order [CO 05/26] *Constitutional provisions about the consideration to acquire interests* when considering provisions about the consideration to acquire an interest and when calculating the withdrawal amount;

consider issues we have raised on previous applications, and look to see whether the constitution currently under review has addressed them; and

discuss internally any provisions which we think may be problematic, and the approaches we may previously have taken on similar provisions in other instances.

## Assessing the problem

There are two significant problems with our current approach to assessing constitutions. The first problem is that, as the law and our practices have developed since the original publication of RG 134, it now contains large amounts of inaccurate and out-of-date information. The second problem is that responsible entities and their advisers are uncertain about whether we will register a constitution they have lodged.

### Out-of-date information

We last updated RG 134 when the managed investments regime was in its infancy. Since then, the managed investments industry has seen significant evolution. RG 134 currently contains information that is out-of-date in the following areas:

*The consideration to acquire an interest in the scheme:* RG 134 refers to Class Order [CO 98/52] *Relief from the consideration to acquire constitutional requirement*. However, the content of this class order was substantially altered and replaced by [CO 05/26]. Substantial amendments affect placements, rights issues, forfeited interests, the treatment of foreign members, underwriting and the exercise of a discretion in relation to the consideration to acquire an interest in an unlisted scheme, listed scheme and scheme quoted on the AQUA market. When assessing whether the consideration to acquire an interest in a scheme is adequate, our staff disregard the content of RG 134 and [CO 98/52] and instead currently apply the guidance as it exists in [CO 05/26] for each application.

*Complaints handling.* There are several issues with RG 134 and complaints handling:

RG 134 currently states that we consider there is adequate provision about the method by which complaints can be made if the constitution provides for a complaints handling procedure which will give an effective way for members to efficiently get redress if they suffer loss due to breaches. RG 134 states that, as a minimum, we expect the constitution will include provisions about acknowledging complaints, properly considering complaints, communication, remedies and advising a member of any further avenue for complaint. The requirements under RG 134 currently apply to both retail and wholesale members.

RG 134 does not include references to current requirements in s912A(1)(g) that AFS licensees who provide financial services to retail clients must have a dispute resolution system in place consistent with internal dispute resolution requirements approved by us for s912A(2)(a)(i). As AFS licensees, all responsible entities operating schemes with retail clients are required to comply with s912A(1)(g). These requirements differ from the requirements for complaints handling in RG 134. When assessing complaints handling procedures, our staff take into account s912A(2)(a)(i) and our guidance on what this requires in Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165). RG 165 provides more specific guidance than RG 134, so our staff will generally not focus on RG 134 for each application.

RG 134 states that in assessing complaints handling procedures we will have reference to the Australian Standard on Complaints Handling (AS 4269). AS 4269 has been replaced with Australian Standard on Complaints Handling (AS ISO 100002–2006 *Customer satisfaction: Guidelines for complaints handling in organisations*) (AS ISO 100002). Our staff disregard AS 4269 and instead consider RG 165 and AS ISO 100002–2006).

For responsible entities and their advisers, this means that RG 134 is redundant and provides no assistance to them in drafting provisions about these matters. This is evidenced by data we collected from interviews with 15 groups who lodge high volumes of applications to register a scheme. A majority of the groups also expressed frustration with our policy on the consideration to acquire an interest in the scheme. RG 134 does not contain complete guidance on our current policy in this area. This policy is contained in [CO 05/26], which was released in 2005. These groups considered that our policy in [CO 05/26] was overly complex, and in some cases, gave too narrow a construction to s601GA.

There was also consensus among the groups that RG 134 is out of date and does not reflect our current views on the application of s601GA and 601GB.

For our staff, out-of-date guidance in RG 134 has also led to inefficient operational practices developing. Instead of being able to rely on one document in their assessment of an application to register a scheme, they must use multiple sources to obtain the necessary information. When new staff are assessing a constitution, supervising staff are required to provide more detailed instruction and guidance on the areas of RG 134 that are out of date.

## Uncertainty

RG 134 currently does not contain sufficient guidance about how we will apply s601GA and 601GB in the following areas in particular:

*Fees and indemnities:* RG 134 does not provide any guidance on the content requirements in a constitution for a responsible entity's rights to fees and indemnities. When assessing whether the fees and indemnities are specified, our staff are required to research and apply previous decisions on similar provisions in other constitutions.

*Winding up:* RG 134 states that adequate provision for winding up a scheme has been made if the constitution deals with circumstances under which the scheme may be wound up and provide for an independent audit by a registered company auditor of the final accounts after winding up. No further guidance is given on what constitutes winding up and the steps involved in the process of winding up. Since 2005, there have been a small number of cases where responsible entities have been unable to conduct the winding up of the schemes they operate by relying on the relevant provisions in the constitution. The mode of winding up the scheme has had to be supplemented by orders of the court under s601NF on a number of occasions.[3] Where responsible entities have been unable to conduct the winding up without seeking guidance from the court, the costs of the application to court will have affected on the eventual return to members after winding up.

*Right of withdrawal*: RG 134 states that if there are provisions for a right of withdrawal, the constitution complies if it sets out fair provisions about how members can withdraw and what exit price will apply. No further guidance is provided about the content of withdrawal provisions or our view on fairness. There

[3] See, for example, *Re Stacks Managed Investments Ltd (2005) 219 ALR 532*.

have been several cases where members or responsible entities have sought the assistance of the court in determining whether a right to withdraw exists and the circumstances in which it can be exercised.[4] Where assistance of the court has been sought, members will generally bear the cost of the application to court.

*Legal enforceability*: RG 134 states that we consider that for the constitution to be legally enforceable it should not contain provisions inconsistent with the Corporations Act. In applying the policy on s601GB in RG 134, our staff are required to review each provision in each constitution to ascertain whether it is consistent with all of the provisions of the Corporations Act. This is adds to inefficiencies in assessing applications. No further guidance is provided on what we consider is required for legal enforceability of a constitution. However, there have been several decisions which have commented on s601GB.[5] None of these decisions say that for a constitution to be legally enforceable it should not contain provisions inconsistent with the Corporations Act.

For responsible entities and their advisers, this means that there is no guidance to assist to them in drafting provisions about these matters. Responsible entities and their advisers are uncertain about our view of provisions about fees and indemnities, winding up and withdrawal when assessing a constitution and the types of matters that we would raise concerns with in assessing these provisions They may also incur additional costs in being required to amend provisions of a constitution to address our concerns during the 14-day registration period.

This uncertainty has also affected our staff because they have limited guidance on how they should apply s601GA and 601GB to individual constitutions when assessing an application to register a scheme, resulting in the need to undertake research and hold extensive discussions with other staff. This is evidenced by data we obtained on how long it took to assess an application to register a scheme. We obtained data for 30 applications to register a scheme. The results of our time-recording in part led to our decision to review and update RG 134.

When an application to register a scheme is allocated, it is allocated to a junior officer and a senior officer. The junior officer is primarily responsible for assessing the application. The senior officer supervises the assessment of the application by the junior officer.

[4] See, for example, *AVSuper Pty Ltd v Commonwealth Managed Investments Ltd (2010) 81 ACSR 218*.
[5] See for example *ING Funds Management Ltd v ANZ Nominees Ltd [2009] NSWSC 243*.

We asked both of these officers to record the time taken in five-minute increments to complete each step in the assessment an application to register a scheme.

There was a wide variation in the time a junior officer took to assess applications. The quickest time was 1.67 hours and the slowest time was 15.85 hours. This was a variation of 14.18 hours, with the median time being 8.76 hours. There was less of a variation in the time it took a senior officer to review and assist in the assessment of the application by the junior officer. The quickest time was 0.5 hours, and the slowest 4.92 hours. The median time was 2.21 hours.

Generally, the longest stage in the assessment process for junior officers was the time it took to assess the constitution. This step ranged between 40 minutes and 8 hours, with the majority taking between two and three hours.

Uncertainty about how we will apply our policy also continues to have an adverse impact on responsible entities and their advisers, as evidenced by data we collected from the interviews we conducted with the 15 groups.

All groups said that they generally received letters from us raising issues with the content of their constitutions in the assessment of applications. Most groups said this often caused them difficulties in responding to the letters, and if necessary, amending the constitution within the 14-day registration period.

About half of the groups thought that RG 134 was difficult to understand and did not clear articulate our policy. A quarter of the groups considered that RG 134 was too high level and the content needed to be more detailed.

## ASIC's objectives

A revised RG 134 will provide additional up-to-date guidance on the requirements in s601GA and 601GB, and how we apply them in deciding to register a scheme.

Our aims in revising RG 134 are to:

help protect the rights of investors in schemes;

enhance consistency and transparency for responsible entities and their advisers in how we apply s601GA and 601GB when assessing the constitution of a scheme; and

improve the efficiency of our assessment of applications to register a scheme.

# Options and impact analysis

We consider the following options are available and likely to meet our objectives:

*Option 1:* Release a revised RG 134 on the content requirements for a constitution of a registered scheme.

*Option 2:* Maintain the existing guidance in RG 134 (status quo).

*Option 3:* Prescribe a model constitution, which must be used to register a scheme.

## Option 1: Release a revised RG 134 on the content requirements for a constitution of a registered scheme

Under this option, we would publish a revised RG 134, together with three new class orders to reflect our current views on s601GA and 601GB.[6]

We would retain aspects of our current regulatory approach and provide additional guidance on the requirements for constitutions in s601GA and 601GB and how we apply these requirements in deciding whether to register a scheme. The key additional guidance we propose to include in RG 134 under Option 1 is summarised below:

### Consideration to acquire an interest: s601GA(1)(a)

RG 134 currently states that we consider adequate provision has been made when a constitution provides for an independently verifiable price. [CO 05/26] gives relief to responsible entities to facilitate the exercise of certain pricing discretions.

Relief is available under [CO 05/26] for issues of interests:

in unlisted schemes and AQUA traded schemes based on the value of scheme assets less any liabilities payable out of scheme property;

in listed schemes based on market price;

through placements of quoted interests;

through pro-rata rights issues;

through pro-rata options issues;

[6] These class orders are Class Order [CO 13/655] *Provisions about the amount of consideration to acquire interests and withdrawal amounts not covered by [CO 05/26]*, Class Order [CO 13/656] *Equality of treatment impacting on acquisition of interests* and Class Order [CO 13/657] *Discretions affecting the amount of consideration to acquire interests and withdrawal amounts.*

through dividend reinvestment plans where there are proportionate issues;

where the interests have been forfeited;

when there is no pooling except for money pending further investment;

that occur under Class Order [CO 09/425] *Share and interest purchase plans*; and

where the consideration is affected by differential fee arrangements.

We propose to:

remove the requirement that adequate provision has been made when a constitution provides for an independently verifiable price;

give guidance that what constitutes 'adequate provision' for the consideration to acquire an interest in the scheme depends on the circumstances of the scheme;

create a 'safe harbour' under [CO 13/655] to minimise uncertainty for responsible entities and their advisers about what we consider will constitute adequate provision for the consideration to acquire an interest. Responsible entities can choose to rely on the requirements in [CO 13/655]. If a responsible entity chooses not to rely on [CO 13/655], it can approach us to consult on any alternative provisions proposed;

maintain our position on calculating the consideration to acquire interests in unlisted schemes (including AQUA traded schemes) and listed schemes;

under [CO 13/655], allow a responsible entity of a stapled security to allocate the issue price of a stapled security between its component parts, removing the need for the responsible entity to apply for individual ASIC relief;

remove existing conditions in [CO 05/26] for the issue of interests by way of placements, rights issues and dividend reinvestment plans where other regulatory protections already exist;

maintain our requirements on documentation and record keeping where the responsible entity exercises discretions in relation to the consideration to acquire an interest in the scheme; and

remove existing conditions in [CO 05/26] for calculating the consideration to acquire interests where fees are negotiated and the existing policy in Class Order [CO 03/217] *Differential fees* is complied with.

### Complaints handling: s601GA(1)(c)

We propose to:

clarify that complaints handling procedures for retail clients must be consistent with the dispute resolution requirements for AFS licensees under s912A(2)(a);

allow the responsible entity to avoid duplication by including a provision that it, as an AFS licensee, can comply by including a provision in the constitution stating that it will comply with the dispute resolution requirements approved by us under s912A(2)(a) in dealing with complaints by retail clients; and

where the scheme is open to wholesale clients, maintain our position that the constitution must include provision for dealing with complaints by these clients. However, we propose to allow responsible entities to determine their own complaints handling procedures for wholesale clients, as long as the essential elements of how these complaints are to be dealt with are included in the constitution.

### Winding up: s601GA(1)(d)

We propose to:

give guidance that the constitution should address four key areas: identification of the assets and liabilities of the scheme; distribution of the net proceeds of winding up; identification of the costs of winding up and any payments to maximise the proceeds of winding up;

give guidance that the constitution can include a provision allowing a responsible entity to postpone the realisation of the assets of the scheme on winding up; and

maintain our existing position for an independent audit by a registered company auditor of the final accounts on winding up.

### Fees and indemnities: s601GA(2)

We propose to provide the following additional guidance on fees and indemnities:

All the variables in calculating a fee should be set out in the constitution. Responsible entities can set out a maximum fee or performance fee based on a benchmark.

A right to payment of a fee or expense should not accrue before the responsible entity assumes its role or performs a duty to which the fee relates.

Any payment to a responsible entity for performing a service in the operation of the scheme should be categorised as a fee rather than an expense.

### Right of withdrawal: s601GA(4)

We propose to provide the following additional guidance on a right of withdrawal:

The constitution should address four key areas: the method and criteria for exercising a right to withdraw; the consideration received by members to satisfy withdrawal requests; any restrictions on satisfying withdrawal requests; and what happens when a member ceases to be a member of a scheme in respect of those interests.

If there is a right to withdraw while a scheme is non-liquid, the constitution should state that withdrawals will be made in accordance with Pt 5C.6 and the constitution should not allow requests to be made other than in response to a specific withdrawal offer.

The withdrawal price should generally be calculated on the basis of reasonable and current market valuations of scheme property.

Any power to suspend or delay payment, and the circumstances in which such a power may be exercised, should be expressly stated.

If a member's interests are treated as withdrawn, payment of the withdrawal amount to the member should occur within a certain and reasonable period. We propose to note the requirement in s601KD that withdrawal requests from non-liquid schemes must be satisfied within 21 days and give guidance that we may make further inquiries as to why a timeframe is fair if it exceeds 21 days.

### Legal enforceability: s601GB

We propose to:

add a requirement that to be legally enforceable the constitution should be:

contained in a document that is in a valid form;

executed by the proposed responsible entity; and

expressed to be binding between the responsible entity and all members of the scheme. This responds to issues we have identified in the lodgement of constitutions that have not been appropriately executed by the responsible entity; and

maintain our existing position in RG 134 that the constitution should not contain provisions inconsistent with the Corporations Act. However, we propose to give flexibility to a responsible entity to include a compliance clause in the constitution, which will provide that to extent a provision is inconsistent with the Corporations Act, it will be of no effect.

## Option 2: Maintain the existing guidance in RG 134

Under this option, we would continue to apply our existing regulatory approach, relying on our guidance in RG 134 and [CO 05/26].

This option would see no change in our policy in this area and would not address our aims in revising RG 134. This option also means that responsible entities and their advisers would continue to have uncertainty about our views on s601GA and 601GB and what we will look for in reviewing a constitution as part of assessing an application to register a scheme.

## Option 3: Prescribe a model constitution

Under this option, we would create a model constitution that responsible entities and their advisers would be required to use when registering a scheme.

The model constitution would replace our guidance in RG 134 and [CO 05/26]. There would be no guidance on how we consider a constitution will meet s601GA and 601GB. Responsible entities and their advisers seeking to have a scheme registered would be required to use this model in its entirety.

## Costs and benefits of each option

### Option 1: Release a revised RG 134 on the content requirements for a constitution of a registered scheme

#### Impact on industry

For responsible entities lodging an application to register a scheme after the revised RG 134 comes into effect, the direct cost impact of our final position will vary from responsible entity to responsible entity. Given the diversity of responsible entities and schemes, we expect that costs to meet the revised RG 134 may include the following:

*Minor costs associated with any legal services obtained in preparing a constitution*: We estimate that this cost will be between $3,000 and $10,000 per scheme. Based on the number of schemes registered in the 2011–12 financial year, this would amount to a total industry impact of $573,000 to $1.9 million. However, this is a current cost that responsible entities seeking to register a scheme may already incur. We do not consider that there will be increases in this cost as a result of the revised RG 134.

*Delay if seeking review of draft provisions:* For responsible entities who choose not to rely on [CO 13/655] and request a review of provisions on the consideration to acquire an interest, there may be unknown opportunity costs due to the extra amount of time needed for us to review the draft provisions. This may mean a delay in being able to offer interests in the scheme.

*Additional minor costs:* For existing responsible entities seeking to register a new scheme, two requirements in relation to fees may result in some additional minor costs. These are the right to payment of a fee or expense occurring before the responsible entity assumes its role or performs a duty to which the fee relates and the characterisation of a payment to a responsible entity for performing a service in the operation of the scheme. If existing responsible entities charge these types of fees for all schemes they operate, additional minor costs could include the following:

There may be costs associated with IT system adjustments and operational practices. We estimate that there could be minor costs for existing responsible entities who may charge these types of fees for all schemes they operate associated with reprogramming IT systems (where the administrative functions are performed in-house). The specific costs will vary from responsible entity to

responsible entity depending on the nature of the IT systems used.

Where IT programming changes need to be made, there may be unknown costs in updating operational policies and practices and making sure other systems reflect the changes. The specific costs will vary from responsible entity to responsible entity depending on the nature of their systems, operational policies and practices.

Where the responsible entity has a practice of charging fees in advance, there may be unknown opportunity costs associated with reduced cash in-flow at an earlier point in time. However, we consider this cost is outweighed by the regulatory benefit of avoiding any difficulties in recovering fees already paid from the responsible entity if it does not properly perform its duties.

Note: We cannot quantify the number of existing responsible entities who may be affected under paragraph (c) because we do not have data on the types of fees charged. However, we note that we did not receive any submissions during the consultation process suggesting either of these are widespread practices: see Section 0.

We consider that the size of the scheme will have limited impact on the extent of the costs incurred.

We consider that it is unlikely that the revised RG 134 will have any impact on the attractiveness of registering a managed investment scheme. While there may be some minor costs associated with the requirements, there will also be significant benefits. We did not receive any submissions during the consultation process suggesting that the revised RG 134 would have an impact in this way.

Our revised regulatory guidance in RG 134 will:

clarify our existing policy and procedures in assessing a constitution in the one document;

give responsible entities and their advisers more certainty about what we will look for in reviewing a constitution when we assess whether to register a scheme. It will also provide more detailed guidance on the content requirements under s601GA for complaints handling, winding up, fees and indemnities and withdrawal of interests (which are areas on which the current RG 134 provides limited guidance). This will assist them in drafting constitutions and reduce the number of letter raising issues with the content of constitutions that we currently send;

promote consistency in the application of s601GA and 601GB by our staff when assessing constitutions. This consistent

application of our views on s601GA and 601GB will also assist responsible entities and their advisers in preparing applications to register schemes;

reduce complexity and duplication of existing regulatory requirements, particularly in relation to the consideration to acquire an interest in the scheme and complaints handling for retail clients;

provide sufficient flexibility for responsible entities and their advisers to draft provisions about the consideration to acquire an interest in a scheme, powers of the responsible entity, complaints handling, winding up and withdrawal, that suit the needs of the responsible entity and the scheme it operates. In our view, flexibility for responsible entities in drafting content of the constitution will minimise any potential costs of compliance. We note that most submissions encouraged us to adopt guidance in RG 134 that allowed for flexibility in drafting provisions; and

result in an increase in the efficiency with which we can register a scheme. Currently, a decision on whether to register a scheme is made at the end of the 14-day registration period 60% of the time. This is as a result of us sending letters raising issues with the content of the constitution and responsible entities needing to amend it before registration can occur. If we can register a scheme earlier in the 14-day registration period, a responsible entity may be able to offer interests in the scheme earlier. However, we consider that this is only likely to have a minor impact.

**Impact on members**

At 1 March 2013, there were 4,141 registered schemes and 571 responsible entities. We received submissions suggesting that the majority of existing schemes would not currently comply with all aspects of our proposals in the revised RG 134: see Section 0. However, compliance with the revised RG 134 is not mandatory for these registered schemes and responsible entities: see Section 0.

To the extent that the constitutions of existing registered schemes do not meet any aspect of the revised RG 134, responsible entities could amend the constitution to comply. A responsible entity may elect to amend the constitution of an existing registered scheme to comply with the revised RG 134, for example, where it considers the amendments:

will not adversely affect members' rights and the amendments can be made without member approval;

promote compliance with our current regulatory approach;

maintain consistency between existing and new schemes operated; or

address any potential risks of third party action against the responsible entity.

Where the responsible entity of an existing scheme amends the constitution to comply with any aspect of the revised RG 134, a right of indemnity from scheme property for the costs incurred will generally exist (as long as they were incurred in the proper performance of the responsible entity's duties)

We do not have any way of knowing how many (if any) responsible entities of existing schemes may amend constitutions. We would need to review each of the 4,141 constitutions lodged with us as at 1 March 2013 against the revised RG 134 to determine the extent to which they would already comply. However, even with this information, we cannot predict which responsible entities will choose to amend their constitution.

Whether a responsible entity chooses to amend the constitution will depend on a number of factors. These include where amendments can be made unilaterally, there are no adverse taxation or stamp duty consequences and the changes will be in the best interests of members. Where one or more of these situations exist, we consider it unlikely that the responsible entity will amend the constitution.

As compliance with the revised RG 134 will not be mandatory for existing schemes, we consider that it is unlikely that the implementation of the revised RG 134 requirements would result in actions such as a wind up of an existing scheme or restructuring of the scheme by a responsible entity to avoid the new requirements.

The costs incurred by members where the responsible entity amends the constitution and exercises a right of indemnity from scheme property will vary depending on the nature and extent of the amendments to be made. However, these costs could include the following:

*Cost of amending the constitution:* This includes the cost of obtaining legal advice on whether the amendments can be made by the responsible entity unilaterally or by members' special resolution, the cost of obtaining tax and stamp duty advice on whether the amendments will trigger a resettlement of the trust, and the revenue implications and the costs of convening and holding a members' meeting, which will need to be incurred and effectively borne by the members. The submissions we received suggested that requiring compliance

with the revised RG 134 for existing schemes would be a significant cost. As part of our consultation process, we received submissions estimating that these costs could be from $6.5 million to $8.7 million per scheme if members' meetings are not required to be held, and up to $11 million if members' meetings are required to be held. Given that funds under management are between $1 million and $90 billion, these could be significant costs for smaller schemes by value. We have no ability to ascertain the numbers of smaller schemes by value that could be adversely impacted.

*Cost of updating disclosure:* This includes the costs of amending and distributing updated disclosure documents, considering any requirement for significant event or continuous disclosure notices, and the need to make consequential amendments to the scheme's compliance plan. We received submissions estimating that these costs could be up to $500,000 per scheme to update a Product Disclosure Statement (PDS). We consider these costs would be minor for most existing schemes.

We consider that members of schemes with a smaller membership may incur a greater cost than those with large numbers of members. This is because the overall costs will be distributed among all members.

The revised RG 134 will provide more comprehensive guidance on minimum content requirements for a constitution to meet s601GA and 601GB. In particular, there will be additional guidance on fees and expenses, winding up and withdrawal. We consider that this may result in an increased level of protection for members. This is because the responsible entity will not be able to amend the rights of members as contained in the constitution unless it follows the process in s601GC. In a select number of cases, it may also result in minor increases in the amounts that can be distributed to members on winding up the scheme. This is because there should be a reduced need for responsible entities to incur costs in seeking guidance from the court on winding up.

We believe there is a regulatory benefit for members as a result of our proposal on the right to payment of a fee or expense occurring before the responsible entity assumes its role or performs a duty to which the fee relates. Our proposal means that members are unlikely to experience difficulties in seeking repayment of any fees paid in advance where the responsible entity subsequently does not properly perform the duty to which the fee relates.

#### Impact on Government

The revised RG 134 will provide clearer guidance for staff to apply in assessing a constitution and whether it complies with s601GA and 601GB.

This means that they will not need to spend as much time researching and discussing the approach on aspects of s601GA. We anticipate this will reduce the median timeframe for staff to:

review a constitution from 3.8 hours; and

assess an application to register a scheme from 8.76 for junior officers and 2.21 hours for senior officers.

Since 2007, we have registered between 191 and 616 schemes annually. This equates to two to four full-time equivalent staff members to complete this work. Any reduction in the timeframe for assessing an application to register a scheme will result in a reduction of the number of full-time equivalent staff members needed to complete this work. We can then use the additional resources to complete other work, such as increased pro-active surveillances and work that we do not currently undertake as a result of insufficient resources.

We consider that a reduction in the numbers of letters raising concerns about the content of a constitution may result in us being able to register a scheme earlier in the 14-day registration period. This may lead to minor increases in decision-making efficiency affecting other work because staff will be able to undertake this work sooner.

We will incur minor costs associated with monitoring compliance with the revised RG 134, estimated as the equivalent of a quarter of a full-time equivalent staff member for the first year. This will be between $25,000 and $30,000. Once a responsible entity has registered a scheme, it can amend the constitution under s601GC. Any amendment must be lodged with us. We propose to review a sample of these amendments after approximately six months to ensure that responsible entities are not registering schemes with constitutions that meet the revised RG 134 but then amending them in ways that may be non-compliant. However, we believe these costs will be offset by efficiency savings as a result of clearer guidance in the revised RG 134.

### Summary of analysis

There is no one sector that will bear the economic burden of the costs associated with, or reap the benefits of, this option. Industry, members of schemes and Government will share the costs and the benefits.

Overall, while some of the new requirements may impose additional costs, we do not consider that the revised RG 134 will result in significant costs for industry, members or Government. Rather, we believe the revised RG 134 and [CO 13/655], [CO 13/656] and [CO 13/657] will have a net benefit because:

responsible entities and their advisers will have more certainty about what we will look for in reviewing a constitution, which will assist them in drafting constitutions;

it will promote consistency in the application of s601GA and 601GB by our staff;

it provides sufficient flexibility for responsible entities and their advisers to draft constitutions that meet their needs and the schemes they operate;

there will be an increase in the efficiency with which we can register a scheme, which may assist responsible entities offering interests in schemes quicker and us to use additional resources to complete other work;

it will reduce complexity and duplication of existing regulatory requirements in particular areas; and

members may be afforded greater protection against their rights being changed by the responsible entity without following s601GC.

## Option 2: Maintain the existing RG 134 (status quo)

### Impact on industry

This option to maintain the status quo means that industry will not be faced with any new direct costs, as there is no change to how we apply the requirements for a constitution in s601GA and 601GB in deciding whether to register a scheme.

However, responsible entities may continue to incur existing minor costs. In particular, responsible entities who use external legal advisers may incur costs associated with amending a constitution to address any issues we raise with its content during our assessment. Costs will vary from responsible entity to responsible entity depending on the nature of the amendments made and the charges of the particular law firm used. We consider that the size of the scheme will have limited impact on the extent of the costs incurred. However, if a senior associate in a large law firm spent two hours to liaise with us and amend the constitution an estimated cost would be $1,200 (being two hours × $600 per hour).

If the status quo is maintained, the issues we have identified are likely to continue. In particular, there will continue to be:

outdated policy in RG 134;

a lack of certainty about what we will look for in reviewing a constitution when we register a scheme;

high volumes of letters raising issues with constitutions; and

unnecessary complexity and duplication in parts of our guidance.

We do not consider there will be any incremental benefits for industry in maintaining the status quo.

#### Impact on members

If the status quo is maintained, members will also avoid any direct costs that may be passed on by a responsible entity. However, members of some schemes may continue to be affected by minor indirect costs as a result of the responsible entity indemnifying itself from scheme property for expenses incurred in registering the scheme. These expenses could include additional minor costs associated with amending the constitution to address issues with the content of the constitution raised by us while assessing the application. Costs for individual members will depend on the size of the membership of the scheme.

We consider members will not have the benefit of our additional guidance on the content requirements for a constitution with under s601GA and 601GB and that such content must be amended in accordance with s601GC.

#### Impact on Government

This option also avoids any new costs for Government. However, the costs caused by the lack of clarity in RG 134 will continue to be incurred.

We also consider that our reputation will suffer from continuing to not update our policy to take into account changes that have occurred. We note that RG 134 has not been updated since 2000.

### Summary of analysis

Overall, this option of preserving the status quo has a net regulatory detriment because:

minor costs currently incurred by industry, members and Government will continue to be incurred;

there will continue to be a lack of certainty about what we will look for in reviewing a constitution when we register a scheme;

there will continue to be high volumes of letters raising issues with constitutions;

our reputation will suffer from having outdated policy; and

RG 134 and relevant class orders will continue to contain unnecessary complexity and duplication.

## Option 3: Prescribe a model constitution

### Impact on industry

For responsible entities lodging an application to register a scheme after our model constitution comes into effect, the direct cost impact of our final position will vary from responsible entity to responsible entity. Given the diversity of responsible entities and schemes, we expect that costs to meet the model constitution may include the following:

*Unknown costs in structuring a scheme to meet our model constitution:* Currently, responsible entities can structure a scheme and then draft a constitution that reflects this scheme. If this option was adopted, responsible entities would lose the flexibility to structure a scheme that will meet their commercial objectives. Instead, they will need to design a scheme structure that is capable of being reflected in the model constitution. This may have a greater impact on responsible entities with a smaller market share or new responsible entities looking to establish themselves. Responsible entities may incur unknown lost opportunity costs as a result of having reduced flexibility to design schemes that attract an increased market share because of their novel structure or ability to meet a need in the market.

*Additional unknown costs:* For existing responsible entities seeking to register a new scheme, additional unknown costs could include the following:

There may be unknown costs associated with IT system adjustments and operational practices where the provisions of the model constitution are not consistent with current IT systems and operational practices. The specific costs will vary from responsible entity to responsible entity depending on the how the provisions in the model constitution are drafted, and the nature of the IT systems and the operational practices used.

Where changes to IT programming or operational practices need to be made, there may be unknown costs in updating operational policies and making sure other systems reflect the changes. The specific costs will vary from responsible entity to responsible entity depending on the nature of their IT systems and operational policies.

There may be significant costs for responsible entities of existing schemes in making amendments to constitutions to comply with the model constitution where a right of indemnity against scheme property does not exist. Costs could be incurred where responsible entities are unable to discharge their duty to act in the best interests of members under s601FC of the Corporations Act because the costs of effecting the amendments are high or there are other ramifications.

In these circumstances, responsible entities may be unable to exercise a right of indemnity against scheme property and would personally incur the costs associated with amending the constitution. We have no way of quantifying how many of the 571 responsible entities as at 1 March 2013 may be affected, or whether there may be a greater impact on any specific sector. This is because of the individual nature of constitutions, costs incurred in amending them and other factors specific to a scheme of which we are unaware.

Costs will vary from responsible entity to responsible entity, but could include the following:

*Cost of amending a constitution:* This includes the significant cost of obtaining legal advice on what amendments need to be made, whether the amendments can be made unilaterally, tax and stamp duty advice on whether the amendments will trigger a resettlement of the trust and the revenue implications and the costs of convening and holding a members' meeting. As previously noted, these significant costs could amount $6.5 million to $8.7 million per scheme if members' meetings are not required to be held, and up to $11 million if members' meetings are required to be held.

*Cost of updating disclosure:* This includes the minor costs of amending and distributing updated disclosure documents, considering any requirement for significant event or continuous disclosure notices, and the need to make consequential amendments to the scheme's compliance plan. As previously noted, these minor costs could be up to $500,000 per scheme to update a PDS.

Where responsible entities of existing schemes are unable to discharge their duty to act in the best interests of members in amending the constitution, they will face a choice of being in breach of these duties or being in breach of requirements imposed by us. There may be unknown costs incurred by responsible entities as a result of either breach. For a breach of s601FC, these costs could include inability to obtain professional indemnity insurance or premium increases, increased financing costs and costs associated with any legal proceedings

taken by members to pursue civil remedies under s601MA, 1324 or 1325 of the Corporations Act. Similar costs associated with financial and professional indemnity insurance may exist for a breach of requirements imposed by us. We consider there would be a greater impact for responsible entities who operate fewer and smaller sized schemes, as they may not have significant resources to meet these costs.

However, a model constitution will:

- give responsible entities and their advisers certainty about what a constitution is required to contain to meet s601GA and 601GB;
- reduce costs currently incurred of between $3,000 and $10,000 for legal services incurred in drafting a constitution; and
- result in an increase in the efficiency with which we can register a scheme. We will not need to consult multiple documents, consider issues raised in other applications, discuss problematic provisions internally or send letters raising issues. Where we are able to register a scheme earlier in the 14-day registration period, a responsible entity may be able to offer interests in the scheme earlier. However, we consider that this is only likely to have a minor impact.

**Impact on members**

As at 1 March 2013, there were 4,141 registered schemes. We estimate that all of these schemes would require some change to their constitutions to comply with the model constitution. The extent of the changes will depend on the provisions in the existing constitution. Where a right of indemnity exists against scheme property, members will incur costs in amending the constitution.

The costs incurred in amending constitutions will vary from scheme to scheme, depending on the content of the existing constitution and the operational practices and policies of the responsible entity. However, these costs could include:

- the significant cost of obtaining legal advice on whether the amendments can be made by the responsible entity unilaterally or by members' special resolution, the cost of obtaining tax and stamp duty advice on whether the amendments will trigger a resettlement of the trust and the revenue implications and the costs of convening and holding a members' meeting will need to be incurred and effectively borne by the members. As previously noted, these significant costs could amount $6.5 million to $8.7 million per scheme if no members' meeting is

required to be held, and up to $11 million if members' meetings are required to be held;

the minor costs of amending and distributing updated disclosure documents, considering any requirement for significant event or continuous disclosure notices, and the need to make consequential amendments to the scheme's compliance plan. As previously noted, these minor costs could be up to $500,000 per scheme to update a PDS;

there is a possibility that making some amendments to the constitution could result in a resettlement of the trust. Where this occurs, there could be significant costs associated with:

paying stamp duty;

capital gains tax.; and/or

being able to carry forward any tax benefits.

The costs will vary from scheme to scheme, depending on the assets of the scheme and tax position of the scheme. We consider that members of schemes with a smaller membership may incur a greater cost than those with large numbers of members. This is because the overall costs will be distributed among all members.

However, a model constitution will result in a consistent standard of rights and obligations for content required under s601GA and 601GB. This may result in an increased level of protection for members of some schemes.

**Impact on Government**

If this option is adopted, the Government would incur significant implementation costs. These costs include the following:

*Significant costs associated with drafting a model constitution:* We estimate we will incur costs of between $80,000 and $96,000 in drafting the model constitution. This is equates to one full-time equivalent staff member. To draft the model constitution, we would need to do a substantive review of existing constitutions to minimise the impact of any change. Extensive consultation with industry would also be required.

*Minor costs associated with IT programming:* We estimate that this will cost $1,950, which equates to three days of IT programming.

*Minor costs associated with changing operational practices and procedures:* We estimate that this will cost $9,180, which equates to one month of one senior staff member's time. This would involve a review of existing operational practice in assessing an

application to register a scheme, and updating the scheme registration procedures manual.

*Minor costs of training staff:* We estimate that this will cost $920, which equates to two days of one senior staff member's time. This would involve preparation of training materials and actual training.

There may be unknown costs associated with considering relief applications from the requirement to use the model constitution. We are unable to estimate how many relief applications we might receive, as it depends on the numbers of schemes that may not be able, or wish, to comply with aspects of the model constitution.

Similar minor costs will also be incurred in monitoring compliance with the model constitution as will be incurred for releasing a revised RG 134.

A responsible entity of an existing scheme that amends the constitution to comply with the model constitution may face difficulties if amendments need to be effected by special resolution. Currently, there is some uncertainty in the case law about whether a responsible entity can unilaterally make any amendments to the constitution. As such, we anticipate that most responsible entities would make any amendments to the constitution by way of special resolution. A special resolution must be passed by 75% of all votes cast. Where the requisite majority is not obtained, it will not be possible for the constitution to be amended. In these circumstances, the Government may suffer reputational damage in having requirements that it is unable to impose.

A model constitution will have similar benefits for the Government as releasing a revised RG 134.

### Summary of analysis

Overall, this option of a prescribing a model constitution has a net regulatory detriment because:

- there will be significant costs incurred by industry, members and Government;
- responsible entities will lose the flexibility to structure a scheme that meets their commercial objectives;
- our model constitution may not meet the needs of the whole industry; and
- it could cause some responsible entities to be in breach of s601FC or the requirements imposed by us.

# Consultation

On 18 September 2012, we published Consultation Paper 188 *Managed investments: Constitutions—Updates to RG 134* (CP 188) outlining our proposals for a revised RG 134. The formal consultation period ended on 13 November 2012.

We received submissions from 11 parties, including various responsible entities, industry bodies and legal advisers that act for responsible entities. We have published Report 347 *Response to submissions on CP 188 Managed investments: Constitutions—Updates to RG 134* (REP 347), which provides detailed information about the responses to CP 188 and outlines our responses to the feedback.

Most of the submissions were generally supportive of the proposed revisions.

## Issues raised during the consultation process

The main issues raised by respondents related to the following proposals.

### Compliance by existing registered schemes with revised RG 134

There was strong opposition and disagreement from all nine respondents who addressed this proposal. After considering the submissions made by the various respondents about the legal, operational and cost implications, we will not require responsible entities of existing registered schemes to comply with our revised guidance in RG 134. They can form their own view about whether to amend the constitution (if required) to meet our guidance. RG 134 will only apply only to schemes that seek registration after 1 October 2013.

### Documentation and record keeping

We received four submissions in response to this proposal. Taking into account the lack of opposition to this proposal and submissions about these requirements serving a useful purpose, we have adopted the substance of our proposal. However, we have amended the mechanism used to impose the documentation and record-keeping requirements on responsible entities.

We consider that it is more appropriate to impose these obligations directly as part of a responsible entity's statutory duties, rather than indirectly as a condition of our relief in [CO 13/655]. We also consider that there are important benefits of efficiency, consistency and

transparency in requiring all responsible entities to document their policies when exercising discretions about the consideration to acquire an interest in the scheme.

### Complaints handling procedures for retail clients

We received eight submissions in response to this proposal. Three respondents disagreed with our proposal. However, we consider that it will be more efficient for responsible entities if we align our expectations for the method for dealing with complaints by *retail clients* under the constitution with the existing requirements for retails clients of AFS licensees as proposed. As a result, responsible entities will have only one set of complaints handling procedures for retail clients.

### Different complaints handling procedures for wholesale clients and retail clients

Of the eight submissions we received, three respondents disagreed with our proposal. However, we consider that s601GA(1)(c) requires that the constitution contain complaints handling provisions for wholesale clients if the scheme is open to them. We consider responsible entities should have the flexibility to be able to devise and include their own complaints handling procedures for wholesale clients.

As wholesale clients may be better placed to raise complaints with the responsible entity and have these resolved, we consider that it is unlikely that wholesale clients need the same level of protection afforded to retail clients under s912A(1)(g). A responsible entity may, if it wishes, apply the same procedures to wholesale clients which it will apply to retail clients. This approach is consistent with the views of the majority of respondents.

### Steps involved in winding up

We received eight submissions in response to this proposal. Two respondents agreed with the five key aspects of winding up we identified. However, the majority of respondents did not. They were of the view that our proposed guidance was overly prescriptive. Having taken into account all of the submissions, we have clarified that the constitution should address four key areas: dealing with assets, liabilities and scheme property; distribution of the proceeds of winding up; the costs of winding up; and any payments to maximise the proceeds of winding up.

We consider there is sufficient flexibility in our guidance for responsible entities to draft provisions that suit their needs and the needs of the scheme,

while addressing each of these key aspects of winding up. We have not required that the constitution address the scenario where the responsible entity and/or scheme is insolvent. We note the majority of respondents, notwithstanding the concerns raised, had agreed these four were the key aspects of winding up.

### Independent audit on winding up

We received six submissions in response to this proposal. However, we note that this has been a requirement under RG 134 since it was first published in 1998. Three respondents disagreed with this proposal. Taking into account the submissions raised by the various respondents, we remain of the view that the constitution should include provision for an independent audit of the final accounts after winding up the scheme to be conducted by a registered company auditor or audit firm. We consider that it is an appropriate safeguard on winding up for the accounts to be independently audited.

### Fees: Setting out the variables

We received six submissions in response to this proposal, with five respondents either supporting or not objecting to it. Consistent with the view expressed by the majority of respondents, we consider that to 'specify the right' to a fee, the constitution must set out all the variables that will affect the amount of the fee that will be payable to a responsible entity. We took into account the submission that only the right to be paid a fee is required to be specified. However, we consider that such a view could allow the legislative requirements designed to protect members for amending a constitution in s601GC to be circumvented.

### Fees: Service performed by responsible entity

We received six submissions in response to this proposal. Four respondents disagreed with the proposal. However, we consider that any payment to a responsible entity for performing a service included in the operation of the scheme should be categorised as a fee in the constitution, rather than as an expense.

We note that there is authority for the proposition that a responsible entity (in its capacity as responsible entity) cannot contract with itself (in its personal capacity): see *Macarthur Cook Fund Management Limited v Zhaofeng Funds Limited* [2012] NSWSC 911 at paragraph 117. We consider that this authority may impact on the ability of the responsible entity to characterise a service performed by it for the operation of the scheme as an expense.

### Fees: Payment in advance

We received four submissions in response to this proposal, with one respondent disagreeing with the proposal. We consider that the constitution must not allow for a right of payment of fees in advance of the responsible entity's proper performance of its duties to which the fee relate. We have taken into account the submission about flexibility for responsible entities in payment of fees and indemnities that meet their needs (e.g. to cover expenses). However, we consider that a responsible entity may still face difficulties in recouping fees that have already been paid if it is later determined that it did not properly perform its duties, which may be exacerbated if the responsible entity is paying itself fees in advance. We also note that the majority of respondents either agreed with the proposal or did not object to it.

### Fees: Payment before the responsible entity takes office

We received six submissions in response to this proposal. Three respondents disagreed with the proposal. After considering the submissions made by various respondents about the construction of s601GA(2) and policy reasons for our proposal, we have adopted suggestions that this is unduly restrictive and we will not prohibit a right of indemnity out of scheme property for expenses or liabilities incurred before a responsible entity takes office.

### A 'right to withdraw'

We received five submissions in response to this proposal, with three respondents disagreeing with the proposal. Taking into account the submissions we received, we have clarified what we believe constitutes a 'right to withdraw'. We consider that provisions which allow a member (at their request) to cease to be a member in relation to the interests that are the subject of a withdrawal request can confer a 'right to withdraw', even if the responsible entity has a discretion about whether to accept it.

### Specification of a maximum timeframe for payment after withdrawal

We received six submissions that addressed this proposal and a feedback question that we asked. Five respondents said it was not necessary for us to prescribe a maximum timeframe, and that what a reasonable timeframe is will depend on the type of the scheme, the assets held and other factors. We agree with these suggestions.

For this reason, we have not prescribed a particular timeframe for all schemes to comply with. However, we note that for a non-liquid scheme there is a requirement in s601KD for withdrawal requests to be satisfied within 21 days. We may ask a responsible entity or its advisers to explain why a timeframe is fair if it exceeds 21 days.

# Conclusion and recommended options

We last updated RG 134 when the managed investments regime was in its infancy. Since then, the industry has seen significant evolution. This has led to two significant problems with our current approach to assessing constitutions. The first problem is that, as the law and our practices have developed since the original publication of RG 134, it now contains large amounts of inaccurate and out-of-date information. The second problem is that responsible entities and their advisers are uncertain about whether we will register a constitution they have lodged.

Three options were considered to address the identified problem. Option 1 is to issue new and comprehensive guidance on the content requirements for constitutions of registered schemes. This would replace existing RG 134. Option 2 is to retain our current guidance and practices for assessing constitutions. Option 3 is to prescribe a model constitution, which responsible entities and their advisers would be required to use when registering a scheme.

In assessing the problem, our objectives are to:

help protect the rights of investors in schemes;

enhance consistency and transparency for responsible entities and their advisers in how we apply s601GA and 601GB when assessing a constitution of a scheme; and

improve the efficiency of our assessment of applications to register a scheme.

Our recommended option is Option 1 (issue new and comprehensive guidance). This option will address the inaccurate and out-of-date information in our current guidance and provide greater certainty for responsible entities and their advisers in how we will assess constitutions.

Option 2 (status quo) is not recommended because it does not address any of the identified problems or objectives. Option 3 (prescribed model constitution) is also not recommended as it would reduce flexibility for responsible entities to structure schemes that meet their commercial objectives.

# Implementation and review

## Implementation

Our recommendations in Section 0 would be implemented by publishing the following documents:

a revised RG 134;

new class orders ([CO 13/655], [CO 13/656] and [CO 13/657]); and

a report on submissions received on CP 188 (REP 347).

We expect to publish these documents in June 2013.

There will be a transition period. We will apply the requirements in the revised RG 134 from 1 October 2013 when assessing constitutions lodged as part of an application to register a scheme.

For existing schemes (i.e. schemes registered before 1 October 2013), we will take a no-action position on the requirements in the revised RG 134 as long as the constitution of the scheme meets the requirements in the previous version of RG 134.

## Review

After a scheme is registered, the responsible entity can amend the constitution and lodge an amended constitution or new constitution with us. Currently, we do not review any amended or new constitutions lodged with us after registration.

Over a period of six months from 1 March 2014, we will review a selection of amendments of constitutions of schemes registered after 1 October 2013 (as they are lodged with ASIC). This review will check whether the amendments continue to comply with the revised RG 134.

We will also:

work with responsible entities to ensure that the requirements in the revised RG 134 are understood; and

discuss with responsible entities any concerns we have with amendments to constitutions that do not appear to comply with the revised RG 134.

We propose to issue a report at the end of the six-month review period if we consider additional guidance is required to assist responsible entities.