

# ASIC CLASS ORDER [CO 13/1128]

## 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 13/1128] under s1020F(1)(c) of the *Corporations Act 2001* (the Act).

Section 1020F(1)(c) provides that ASIC may declare that Part 7.9 of the Act applies in relation to a person or a financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

### 1. Background

The *Corporations Amendment Regulations 2010 (No 5)* established a new shorter Product Disclosure Statement (PDS) regime under Subdivision 4.2B (for superannuation products) and Subdivision 4.2C (for simple managed investment schemes) of Division 4 of Part 7.9 of the *Corporations Regulations 2001*. The shorter PDS regime fully commenced on 22 June 2012.

ASIC Class Order [CO 12/749] *Relief from the Shorter PDS regime* provides interim relief, until 22 June 2014, excluding hedge funds from the shorter PDS regime. Class Order [CO 12/749] was amended by Class Order [CO 12/1592] and [CO 13/632] to extend the transitional period provided to responsible entities of hedge funds who have prepared and given a shorter PDS prior to 22 June 2012 until 1 February 2014, after which they must prepare a full PDS.

### 2. Purpose of the class order

ASIC has reviewed the definition of “hedge fund” and, following constructive direct engagement with industry, has decided to make some amendments to the characteristics which trigger a scheme’s classification as a hedge fund. The changes will refine the definition of “hedge fund” to reduce the number of funds which are specifically excluded from the shorter PDS regime and required to address the benchmarks and disclosure principles in Regulatory Guide 240 *Hedge funds: Improving disclosure* (RG 240) as part of the normal disclosure requirements in Chapter 7 of the Act. This will ensure that ASIC’s disclosure requirements for hedge funds are appropriately targeted at those schemes which pose more complex risks for investors.

A “hedge fund” is defined in Class Order [CO 12/749] as a registered managed investment scheme which:

- a) is promoted by the responsible entity using the expression and as being a “hedge fund”; or
- b) satisfies two or more of the following limbs:
  - use of investment strategies intended to generate returns with low correlation to certain published indices (i.e. ‘complexity of investment strategy’) and/or use of complex investment structures (i.e. ‘complexity of investment structure’);
  - use of debt for the dominant purpose of making a financial investment;
  - use of derivatives (subject to limited carve-outs);
  - use of short selling; and
  - rights to charge a performance fee.

This class order will assist industry by expanding some of the existing carve-outs and providing greater clarity about the operation of some of the characteristics in the definition. An anti-avoidance clause has been inserted to ensure that responsible entities do not structure schemes with the sole or dominant purpose of avoiding those schemes being characterised as hedge funds.

### **3. Operation of the class order**

The class order:

- clarifies that a scheme which pursues a balanced strategy correlated to an index over one or more of the prescribed asset classes will not trigger the complexity of investment strategy limb and expands the types of published indices;
- amends the complexity of investment structure limb to exclude registered schemes and certain foreign schemes from being counted as interposed entities;
- clarifies that derivatives with an expiry date of more than 28 days can still come within the derivatives carve-out for managing financial risk for a period of less than 28 days provided they are closed out within the 28 day timeframe;
- defines “derivatives” to specifically include deferred purchase agreements;
- inserts an additional carve-out to the derivatives limb which allows a scheme to have up to 10% of its net asset value in exchange traded derivatives for any purpose;
- clarifies that where the derivatives limb is triggered and the use of derivatives also triggers the leverage or short selling limbs, then it will only be taken to trigger the derivatives limb and should not be double counted;

- amends the performance fee limb so that it is only triggered where there is a right to a performance fee and the responsible entity discloses to investors that performance fees will be payable in the event the responsible entity or another person satisfy certain criteria related to the performance of the scheme property; and
- inserts an anti-avoidance provision to ensure that responsible entities do not structure schemes with the sole or dominant purpose of ensuring that the scheme does not trigger two or more of the hedge fund limbs.

#### *Complexity of investment strategy*

The list of asset classes covered by published indices used in determining whether an investment strategy is complex has been expanded to include bills of exchange, promissory notes, certificates of deposit or other negotiable short-term money market instruments. This limb has also been amended to make it clear a fund can pursue returns correlated to an index over one or more of these asset classes without triggering this limb of the complexity criterion.

#### *Complexity of investment structure*

A new definition of “interposed entity” has been inserted. The new definition clarifies that in calculating the number of interposed entities, the calculation is to be performed by reference to each separate vertical stream of interposed entities.

Further, the new definition of “interposed entity” excludes:

- registered schemes; and
- certain foreign entities where:
  - the foreign entity is incorporated or registered in an offshore jurisdiction which has a regulatory authority with satisfactory cooperation arrangements in place with ASIC (***prescribed foreign regulatory authority***); and
  - the foreign entity or its operator is specifically authorised by a prescribed foreign regulatory authority to make offers of financial products that comprise rights or interests in the foreign entity to the general public (ie the foreign entity or its operator is specifically authorised to make offers to all classes of investors) in a foreign jurisdiction in relation to which a prescribed foreign regulatory authority regulates financial services.

A list of the prescribed foreign regulatory authorities can be found in Schedule 10F of the *Corporations Regulations 2001*.

#### *Use of derivatives*

The class order makes the following changes to the derivatives limb:

- extends the meaning of “derivatives” in s761D of the Act to include deferred purchase agreements;
- clarifies the existing carve-out which allows the use of exchange traded derivatives to more efficiently gain an economic exposure to the underlying reference assets of those derivatives, but only on a temporary basis, to make it clear that the derivative position (which can have a term of 28 days or more) cannot be held on an ongoing basis by simply rolling the derivative every 28 days; and
- inserts an additional carve-out to allow a scheme to have up to 10% of its net asset value in exchange traded derivatives. This new carve-out is not subject to a defined purpose or duration limit and is intended to provide fund managers with greater flexibility by allowing them to use exchange traded derivatives for any purpose provided the value of those derivatives does not exceed 10% of the scheme’s net asset value. The scheme is able to temporarily exceed the 10% limit for reasons that could not have been reasonably foreseen by the responsible entity (eg due to reasonably unforeseen market movements or large redemption requests) and the exposure is for a period of no more than three consecutive business days. In calculating the derivatives exposure of the scheme, the scheme:
  - is permitted to exclude any exchanged traded derivatives it uses for the dominant purpose of managing foreign exchange or interest rate risks or to more efficiently gain an economic exposure to the underlying reference assets of those derivatives on a temporary basis (less than 28 days); and
  - is to sum the face value or notional amount of each derivative that gives rise to a long exposure and the face value or notional amount of each derivative that gives rise to a short exposure (although derivatives that are otherwise on the same terms and relate to an underlying or reference asset of the same class can be offset against each other).

The class order also clarifies that where the derivatives limb is triggered and the scheme’s use of derivatives could also be characterised as satisfying either the leverage or short selling limbs then it should not be double counted (i.e. only the derivatives limb would be satisfied).

#### *Performance fees*

The operation of the performance fee limb is amended so that it is only triggered where there is a right to a performance fee and the responsible entity has disclosed to investors that performance fees will be payable when the performance fee conditions are satisfied (e.g. the scheme outperforms the relevant benchmark).

#### *Anti-avoidance clause*

An anti-avoidance clause has been inserted into the definition to ensure that responsible entities do not structure schemes with the sole or dominant purpose of avoiding those schemes being characterised as hedge funds. This clause applies prospectively from the commencement of this class order and will have no retrospective operation.

#### **4. Transitional**

The class order contains a transitional provision which allows the responsible entity of a simple managed investment scheme:

- that was either a hedge fund or fund of hedge funds immediately before the commencement of this class order; and
- is no longer a hedge fund or fund of hedge funds following the amendments made by this class order; and
- in relation to which a PDS was in use immediately before the commencement of this class order;

to continue using that PDS until 1 February 2014.

#### **5. Consultation**

ASIC undertook public consultation before making the principal class order. ASIC undertook targeted consultation (with the Financial Services Council and the Australian Investment Managers Association) in making this amending class order.

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

**ASIC Class Order [CO 13/1128]**

This legislative instrument 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 legislative instrument**

The purpose of this legislative instrument is to amend ASIC Class Order [CO 12/749] (the principal class order). The principal class order excludes hedge funds from the shorter Product Disclosure Statement regime. This legislative instrument refines some of the characteristics which trigger a registered managed investment scheme's classification as a "hedge fund" and ensures that ASIC's hedge fund disclosure requirements are appropriately targeted at those schemes which pose more complex risks for investors than simpler managed investment schemes.

**Human rights implications**

This legislative instrument does not engage any of the applicable rights or freedoms.

**Conclusion**

This legislative instrument is compatible with human rights as it does not raise any human rights issues.