

ASIC CLASS ORDER [CO 13/721]

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 13/721] (the Class Order) under paragraphs 601QA(1)(a), 655A(1)(b), 673(1)(b) and 1020F(1)(a) of the *Corporations Act 2001* (the *Act*).

Paragraph 601QA(1)(a) of the Act provides that ASIC may exempt a person from a provision of Chapter 5C of the Act.

Paragraph 655A(1)(b) of the Act provides that ASIC may declare that Chapter 6 of the Act applies to a person as if specified provisions were omitted, modified or varied as specified in the declaration.

Paragraph 673(1)(b) of the Act provides that ASIC may declare that Chapter 6C of the Act applies to a person as if specified provisions were omitted, modified or varied as specified in the declaration.

Paragraph 1020F(1)(a) of the Act provides that ASIC may exempt a person or class of persons from all or specified provisions of Part 7.9 of the Act.

1. Background

In December 2012, ASIC released ASIC Consultation Paper 196: *Periodic statements for quoted and listed managed investment products and relief for AQUA products* (which is available from ASIC's website at www.asic.gov.au) (CP 196). In CP 196, ASIC sought feedback on the following proposals which are addressed in the Class Order:

- (a) Equal treatment relief for responsible entities of exchange traded funds (ETFs) that are quoted on the AQUA market operated by ASX Limited;
- (b) Material change and significant event disclosure relief for the issuers of ETFs that are quoted on the AQUA market; and
- (c) Relevant interest and substantial holding relief for relevant interests acquired through the underlying securities in an ETF.

The Class Order also makes consequential changes to the beneficial tracing provisions so that the relevant interest relief does not affect their operation.

Exemption: Equal treatment relief in withdrawal from an AQUA ETF

Under section 601FC(1)(d) of the Act, a responsible entity for a registered scheme is required to treat the members who hold interests of the same class equally, and

members who hold interests of different classes fairly, in exercising its powers and carrying out its duties. This requirement applies to the responsible entity of an ETF.

ETF operators generally seek to allow ongoing applications for and withdrawals of interests in the ETF at a price based on the ETF's net asset value by authorised participants who have entered an arrangement with the responsible entity. By contrast, retail investors do not typically acquire or dispose of these quoted products by applying to the responsible entity for an issue or withdrawal, and are usually prohibited from withdrawing or being issued with units directly. Instead, retail investors generally engage in transactions in relation to these products by buying or selling on the relevant secondary market.

Relief is required from s601FC(1)(d) of the Act for a responsible entity of an ETF to be permitted to treat retail investors and authorised participants who hold interests of the same class unequally by allowing only the authorised participants to apply for and redeem their interests.

Exemption: Equal treatment relief for the provision of information to authorised participants

ETFs have also sought to disclose index or portfolio information to members who are not authorised participants on a delayed basis to reduce the risk of 'front running'. Front running may occur if the responsible entity of an ETF is required to disclose information that would enable particular trading to be predicted or enable real time calculation by the public of an index that may be sold under subscription.

Relief is required from s601FC(1)(d) of the Act for a responsible entity of an ETF to be permitted to treat retail investors and authorised participants who hold interests of the same class unequally by providing index or portfolio information disclosure to authorised participants before other members.

Exemption: Ongoing disclosure relief

Section 1017B of the Act requires an issuer of a financial product, when the product is acquired by a retail investor, to notify the holder of the product of the following changes:

- (a) any material change to, or significant event that affects, a matter that would have been required to be specified in the financial product's PDS, had the PDS been prepared the day before the change or event occurred; and
- (b) any other change, event or other matter of a kind specified in regulations made for the purposes of s1017B(1A)(b) of the Act.

However, an issuer does not need to give a notice under s1017B of the Act if the financial product is a managed investment product that is an ED security. We consider that there is uncertainty regarding the classification of certain AQUA ETF products as ED securities under s111AFA of the Act. Because of this, there is also uncertainty as to whether the issuers of certain AQUA ETF products are required to give notices under s1017B of the Act.

Separately, the AQUA rules impose continuous disclosure obligations on ETF issuers, which include the disclosure of information that must be disclosed to ASIC under s675 of the Act. Section 675 of the Act applies to unlisted disclosing entities and in essence requires the disclosure of information that:

- (a) is not included in a PDS or is publicly available; and
- (b) if it were available, would have a material effect on the price or value of the ED security.

Declaration: Relevant interest relief

Section 606 of the Act prohibits the acquisition of a relevant interest in issued voting shares in a listed company, an unlisted company with more than 50 members or a listed managed investment scheme, which would result in an increase in voting power to a point above 20% (and below 90%), unless acquired under one of the exceptions in s611 of the Act.

The purpose of this prohibition is to promote an efficient, competitive and informed market for the acquisition of control over voting shares or interests. However, this prohibition also extends to relevant interests in the underlying securities of an ETF acquired by reason of acquiring an interest in the ETF. We consider the rights attaching to interests in an ETF in respect of the underlying securities of the ETF to be sufficiently remote or tenuous that they are unlikely to be used as a means of gaining control of the issuer of those securities.

Declaration: Substantial holding relief and beneficial tracing

Section 671B of the Act requires a person to provide information to a listed company, or the responsible entity of a listed managed investment scheme, in certain circumstances, including if the person:

- (a) begins to have or ceases to have a substantial holding in the company or scheme; or
- (a) has a substantial holding in the company or scheme and there is a movement of at least 1% in their holding.

However, the relevant interest of a person in securities of a listed company or scheme that arises because the person holds interests in an ETF may fluctuate with any changes in the composition of the index being tracked by the ETF that occur during the day. As a consequence, it may be difficult for a person in this situation to determine when they are required to provide information in accordance with section 671B of the Act.

Similarly, a person being required to respond to a beneficial tracing notice may have difficulty complying with this obligation if the relevant interests fluctuate during the day. This may in turn affect the efficacy of the information included in registers required to be maintained by entities about relevant interests in their securities.

2. Purpose and operation of the Class Order

Exemption: Equal treatment relief in withdrawal from an AQUA ETF

The purpose of the equal treatment relief for withdrawal provided by the Class Order is to allow the responsible entities of ETFs to only permit authorised participants to apply for and withdraw interests by making an application for an interest or a withdrawal of an interest to the responsible entity of the ETF.

The equal treatment relief for withdrawal seeks to promote market liquidity in ETFs, and to facilitate the pricing of interests in ETFs on the secondary market. As in other jurisdictions, this process aims to ensure that the market price of interests in an ETF will generally reflect the current net asset value of the ETF through arbitrage.

In some cases, this relief will also avoid possible adverse technical consequences of satisfying withdrawals by transferring of the securities held by the ETF that make up the interest. In relation to withdrawals by non-Australia tax residents, these consequences may extend to an inability to appropriately apply and effect the imposition of tax liability on the member.

Paragraph 4 of the Class Order exempts the responsible entities of AQUA ETFs from paragraph 601FC(1)(d) of the Act to the extent that it would prevent a responsible entity from treating members who hold interests of the same class differently in relation to permitting only authorised participants to withdraw from the scheme.

Paragraph 4 only applies to the responsible entity of an ETF where all of the conditions outlined in paragraph 5 of the Class Order are satisfied:

- (a) There is a Product Disclosure Statement in relation to interests in the AQUA ETF that are admitted or are to be admitted to Trading Status, which contains a statement to the effect that the responsible entity will not treat members of the same class equally to the extent that it restricts withdrawal from the fund to authorised participants who are Australian residents for tax purposes;
- (b) The Product Disclosure Statement contains a statement to the effect that only authorised participants may withdraw from the fund except in exceptional circumstances, but other members may transfer their interests on the AQUA market;
- (c) The Product Disclosure Statement contains a statement to the effect that when interests in the AQUA ETF are suspended from quotation for more than 5 consecutive Trading Days, members have a right to withdraw from the fund and receive payment for their interests in money within a reasonable time of request, unless:
 - i. the AQUA ETF is being wound-up;
 - ii. the AQUA ETF is not a liquid registered scheme; or

- iii. the responsible entity of the AQUA ETF suspends withdrawals in accordance with the AQUA ETF's constitution;
- (d) The constitution of the AQUA ETF does not permit a greater withdrawal fee per interest to be payable by a member who is not an authorised participant than the withdrawal fee per interest that would generally be payable by an authorised participant withdrawing the minimum parcel and receiving withdrawal proceeds in cash, while interests in the AQUA exchange traded fund are quoted; and
- (e) ASIC has not notified in writing the responsible entity of the AQUA ETF that it is excluded from reliance on the exemption.

Exemption: Equal treatment relief for the provision of information to authorised participants

The equal treatment relief for the provision of information to authorised participants allows the responsible entities of ETFs to provide index or portfolio information disclosure to members who are authorised participants before members who are not authorised participants, to reduce the risk of 'front running'.

While ASIC expects a high level of transparency about how indexes underlying ETFs are constituted, this relief seeks to avoid responsible entities of an ETF being required to disclose information that may enable particular ETF trading to be predicted, or real-time calculation by the public of an index that may be sold under subscription.

Paragraph 6 of the Class Order exempts the responsible entities of AQUA ETFs from paragraph 601FC(1)(d) of the Act to the extent that it would prevent a responsible entity from providing information about the following matters to authorised participants before other members:

- (a) information about the index the AQUA ETF aims to track as its investment strategy; and
- (b) scheme property including:
 - i. the number and class of securities and any other property required to acquire an interest in the AQUA ETF by authorised participants on the Trading Day that first ends after the information is provided; and
 - ii. the number and class of securities and any other property transferred on withdrawal from an interest in the AQUA ETF by authorised participants on the Trading Day that first ends after the information is provided.

Under paragraph 7 of the Class Order, the relief only applies where:

- (a) there is a Product Disclosure Statement in relation to interests in the AQUA ETF that are admitted or are to be admitted to Trading Status, which contains

statements to the effect that the responsible entity will provide information about the index the fund aims to track as its investment strategy and the number and identity of assets in the AQUA ETF to authorised participants before other members; and

- (b) ASIC has not notified the responsible entity in writing that it is excluded from reliance on the relief.

Under paragraph 8 of the Class Order, this relief applies on the condition that the responsible entity must:

- (a) publicly disclose any information which has been disclosed to authorised participants as permitted under the exemption before the commencement of the trading day after the day on which that disclosure was made to authorised participants; and
- (b) take reasonable steps to ensure that the following information is publicly available and updated every 15 minutes during each Trading Day:
 - i. where the AQUA ETF has only one class of interests – the indicative net asset value per interest in the AQUA ETF; or
 - ii. otherwise – the indicative net asset value per interest for each class of interests.

Exemption: Ongoing disclosure relief

The purpose of this relief is to clarify the disclosure obligations of ETF issuers and to facilitate the obligation under the AQUA rules for ETF issuers to disclose information that must be disclosed to ASIC under s675 of the Act.

Paragraph 9 of the Class Order exempts the responsible entities of AQUA ETFs from section 1017B of the Act in relation to a class of interests in the fund that are admitted to Trading Status as ETF Securities for as long as the conditions in paragraph 10 are met.

The conditions in paragraph 10 require the responsible entity of the fund to:

- (a) comply with the provisions of the Act that apply to an unlisted disclosing entity; and
- (b) include statements in any Product Disclosure Statement for interests in the AQUA ETF to the effect that the responsible entity will comply with the provisions of the Act that apply to an unlisted disclosing entity as if the AQUA ETF were an unlisted disclosing entity.

Declaration: Relevant interest relief

The purpose of this relief is to ensure that the ability to lodge a withdrawal request by the authorised participants who are members of the ETF under the acquisition and withdrawal facility offered by a scheme does not by itself give these members a

relevant interest in any securities held by the ETF. The relief only applies when the ETF tracks a broad-based index in which no security is more than 10%.

The weighting of a class of security in the ETF is relevant to whether we provide relevant interest relief because a high weighting in one class of security represents an increased likelihood that the ETF is being used to acquire a relevant interest in that security. In those circumstances, it is not appropriate for relevant interest relief to be granted.

Paragraph 11 of the Class Order modifies the effect of Chapters 6 and 6C of the Act by applying them to all persons as if subsections 609(19A) – 609(19E) were inserted. This paragraph references CO [12/1209], which is available on the Federal Register of Legislative Instruments or ASIC's website www.asic.gov.au

The effect of notionally inserted subsection 609(19A) is that a member of a registered scheme who is an authorised participant does not have a relevant interest in securities that form part of the scheme property of the scheme merely because the scheme has an acquisition and withdrawal facility (ie. because they have the right to control disposal of the underlying securities through the right to delivery of the securities to them if they withdraw from the scheme). This applies when all of the following are satisfied:

- (a) interests in the scheme are admitted to Trading Status as ETF Securities on the AQUA market;
- (b) the current PDS contains a statement to the effect that the investment strategy for the scheme is to make investments that are expected to result in the value of an interest in the scheme changing in proportion to the value of a published index of securities, ignoring the effect of fees and other costs (including taxes) in relation to the scheme; and
- (c) the current PDS contains a statement to the effect that at the time the investment strategy for the scheme disclosed in the current PDS was first published in a Product Disclosure Statement for interests in the scheme, there were reasonable grounds to believe that implementation of the investment strategy would not be likely to lead to scheme property including securities in a class of securities that:
 - (i) would represent more than 10% by value of scheme property; and
 - (ii) were, or would result in the responsible entity having a relevant interest in, securities which the takeovers prohibition applies to.

Under notionally inserted subsection 609(19B), subsection 609(19A) ceases to apply in relation to any securities when a member makes a withdrawal request in relation to those securities.

This modification results in persons holding relevant interests in securities underlying an ETF through their interest in the ETF having their relevant interests being disregarded under s609 of the Act until a request for withdrawal of their interest in the

ETF is made. When a person makes a request for withdrawal of their interest in the ETF, the person is taken to acquire a relevant interest in the underlying securities at that time by a transaction in relation to the securities.

If the member makes a withdrawal request only in relation to some of the member's interests in the scheme, subsection (19A) may still apply in relation to the member's remaining interests.

Notionally inserted subsection 609(19C) relates to withdrawal requests made by a member of a scheme who has a relevant interest in securities that form part of scheme property because subsection (19A) has stopped applying in relation to the scheme other than because of subsection (19B). This may be because interests in the scheme have ceased to be admitted to Trading Status, or because the current PDS no longer contains the statements required by paragraphs (19A)(b) and (19A)(c).

The effect of notionally inserted subsection 609(19C) is to treat the member as having acquired the relevant interest at the time of the withdrawal request through a transaction in the securities, for the purposes of section 606 of the Act. At that time the member's voting power is also taken to have increased from what it had been before the withdrawal request if the votes attached to those securities were disregarded to what it was after the withdrawal request (taking the votes attached to those securities into account).

Notionally inserted subsection 609(19D) has the effect of disregarding, for the purposes of item 9 in the table in section 611, any increase in a member's voting power in the previous 6 months because subsection (19A) stopped applying in relation to securities, where the member has not made a withdrawal request in relation to the securities.

Nominally inserted subsection 609(19E) defines the terms "acquisition and withdrawal facility", "Australian resident for tax purposes", "authorised participant", "current PDS", "ETF Security", "Trading Day", "Trading Participant" and "Trading Status" for subsections 609(19A)-609(19E).

Declaration: Substantial holding relief and beneficial tracing

The purpose of the part of the declaration relating to beneficial tracing is to assist compliance with these obligations by removing the uncertainty that may result from any fluctuations in the composition of the index, and therefore their interest in the underlying securities, that may occur during the day.

Section 672B of the Act requires a person given a direction under section 672A of the Act (a "beneficial tracing notice") to disclose certain details connected with relevant interests. Additionally, section 672DA of the Act requires that a listed company or the responsible entity for a listed managed investment scheme keep a register of certain information, including information relating to relevant interests held in the company's shares or interests in the scheme.

Paragraph 12 of the Class Order varies the application of Chapter 6C of the Act as it applies to all persons as if nominal section 671AA and subsections 671B(7A) and 672B(1AA) were inserted.

The effect of section 671AA is to disregard notionally inserted paragraph 609(19A)(c) for the purposes of Chapter 6C of the Act and the definition of **substantial holding** in section 9 of the Act. This means that the weighting of an ETF in a class of securities will not affect whether a member of the ETF is entitled to the substantial holding relief provided by the remainder of the declaration.

Subsection 671B(7A) affects the substantial holding requirements of a member of a registered scheme who does not have a relevant interest in the securities of the scheme because of subsection 609(19A). Under subsection 671B(7A), such a member is taken to have, for the purposes of section 671B of the Act and the definition of **substantial holding** in section 9 of the Act, a relevant interest as calculated with reference to the number and classes of securities that would be transferred to the member in accordance with the most recent disclosure of the responsible entity in relation to a withdrawal request.

Subsection 671B(7A) only has effect where:

- (a) interests in the scheme remain admitted to Trading Status as an ETF Security on the AQUA market; and
- (b) the responsible entity offers an acquisition and withdrawal facility.

The variation allows persons holding a relevant interest in securities held by an ETF through their interest in an ETF, including persons who have had that relevant interest disregarded under section 609 of the Act through s609(19A), to calculate whether they have a substantial holding for the purposes of s671B of the Act with reference to the full particulars of the parcel of securities held by the ETF most recently disclosed by or on behalf of the responsible entity of the ETF.

Unlike the relevant interest relief, it is not required that the index being tracked by the ETF be comprised of no more than 10% of any one security for the substantial holding relief to apply. Subject to the conditions being satisfied, it is intended that the substantial holding relief apply regardless of the composition of the ETF.

Notionally inserted subsection 672B(1AA) provides that if a member of a registered scheme does not have a relevant interest in securities that form part of scheme property because of subsection 609(19A), then for the purposes of section 672B and 672DA, the member is taken to have a relevant interest in securities that the member has a relevant interest in for the purposes of section 671B because of subsection 671B(7A).

Some of the terms in the Class Order are defined by reference to the operating rules of ASX Limited (ACN 008 624 691) on 9 October 2013. The operating rules of the ASX Limited are available on ASX Group's website <http://www.asxgroup.com.au/>.

4. Consultation

ASIC issued Consultation Paper 196: *Periodic statements for quoted and listed managed investment products and relief for AQUA products* in December 2012. ASIC received submissions from a range of industry associations and private industry bodies. ASIC also met with a number of interested parties as part of the consultation process. The submissions and feedback were considered in the making of this Class Order.

Statement of Compatibility with Human Rights

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

This legislative 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

This class order modifies provisions of the *Corporations Act 2001* (the *Act*) affecting requirements on responsible entities and issuers of exchange traded funds that are quoted on the AQUA market operated by ASX Limited. The modified provisions allow responsible entities of exchange traded funds to only allow withdrawal from the funds by authorised participants, and to provide index or portfolio information to authorised participants before it is provided to other members.

The modified requirements for issuers of exchange traded funds clarify their disclosure requirements, with the effect that they must comply with the provisions of the Act that apply to an unlisted disclosing entity as if the fund were a disclosing entity.

The class order also modifies provisions of the Act relating to relevant interests, substantial holdings and beneficial tracing. These modifications result in certain interests in securities held indirectly through an interest in an exchange traded fund no longer being considered as relevant interests for the purposes of Chapters 6 and 6C of the Act. The modified requirements also facilitate disclosure of substantial holdings by persons holding an interest in securities underlying an exchange traded fund through their interest in an exchange traded fund, disclosure required in response to beneficial tracing notices, and facilitate compliance with the requirement to keep a register of information relating to relevant interests.

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.