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The registration
of new managed
investment schemes
becomes more
challenging

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ASIC defines 'transaction costs' in constitutions of registered managed investment schemes

Constitutions that include what is considered to be a fairly standard definition of 'transaction costs' and that have been lodged with, and accepted by, ASIC in the past are now being rejected, reports lawyer Janna Vynokur.

Background

The *Corporations Act* requires a scheme's constitution 'to make adequate provision for the consideration that is to be paid to acquire an interest in the scheme (s601GA(1)(a))'. Also, 'if members have a right to withdraw, the constitution must specify the right and set out adequate procedures in a way that is fair to all members (s601GA(4))'.

For calculating the issue price of a unit, the Australian Securities & Investments Commission (**ASIC**) considers that adequate provision has been made when a constitution provides for an 'independently verifiable' price [PS 134.19]. In relation to a unit's withdrawal price, ASIC says that a constitution must include a method for calculating the exit price, in a way that is fair to all members and, again, 'independently verifiable' [PS 134.25].

ASIC's position

In order to comply with the above requirements, a constitution for a registered managed investment scheme will normally include a formula for calculating both the issue and withdrawal price of units. For units not quoted on the ASX or other recognised stock exchange, this formula will normally include a 'transaction costs' component that will, in turn, be defined as the responsible entity's estimate of the total expenses that would be incurred if all of the scheme's assets were to be acquired (or, if applicable, disposed of) at the relevant time.

While ASIC has, in the past, accepted constitutions with these types of provisions, it has now indicated that it is no longer prepared to do so.

In ASIC's view, the responsible entity's ability to estimate the expenses for the transaction costs component of the issue price, or the withdrawal price, means that the prices are not 'independently verifiable' and, therefore, the provisions do not comply with the law and ASIC's requirements (as set out in PS 134).

ASIC has also said that it considers that the Investment & Financial Services Association's Standard on scheme pricing, which supports a transaction costs factor, does not accord with the Act.

The prescriptive approach suggested by ASIC will cause practical difficulties for a responsible entity of unlisted registered managed investment schemes and is likely to cause inequities between incoming, outgoing and continuing investors.

It is still not clear what ASIC will require but, so far, ASIC has indicated that the transaction costs

component of the issue price or the withdrawal price must either:

- a. be determined with reference to actual expenses; or
- b. if the transaction costs are to be determined with reference to the responsible entity's estimate of expenses:
 - i. each individual expense item must be identified in the constitution (eg in the definition of 'transaction costs'); and
 - ii. a specific percentage must be allocated to each individual expense item. In this regard, ASIC has indicated that a range of percentages will not be acceptable.

Conclusion

The prescriptive approach suggested by ASIC will cause practical difficulties for a responsible entity of unlisted registered managed investment schemes and is likely to cause inequities between incoming, outgoing and continuing investors.

The Investment & Financial Services Association has written to, and met with ASIC to express concerns about ASIC's revised policy and to request industry consultation. However, for the moment, registration of new schemes is likely to be a more challenging process than usual.

For further information, please contact:

Derek Heath

Partner, Sydney
Ph: +61 2 9230 4233
Derek.Heath@aar.com.au

Mark Cerché

Partner, Melbourne
Ph: +61 3 9613 8869
Mark.Cerche@aar.com.au

John Beckinsale

Partner, Brisbane
Ph: +61 7 3334 3520
John.Beckinsale@aar.com.au

Steven Cole

Partner, Perth
Ph: +61 8 9488 3743
Steven.Cole@aar.com.au

Anna Lenahan

Senior Associate, Sydney
Ph: +61 2 9230 4132
Anna.Lenahan@aar.com.au

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