

## Funds Management & Financial Services Alert

### Scheme constitutions: ASIC updates its policy

August 2013

#### In brief:

- ASIC has updated its policy on registered scheme constitutions.
- From 1 October 2013, applications to register schemes will need to comply with the new requirements.
- Provided existing scheme constitutions comply with ASIC's old policy, ASIC will not take action to de-register the schemes if they do not comply with the new policy from 1 October onwards.
- The new policy provides greater flexibility in unit pricing and removes some unnecessary regulatory duplication.

The Australian Securities and Investments Commission (**ASIC**) has completed its review of its policy on the content requirements for the constitutions of registered schemes by releasing an updated version of Regulatory Guide 134 *Managed investments: Constitutions* (**RG 134**).

#### Important features to note about the updated policy

The following are some of the key policy matters now covered in the updated RG 134:

##### **Transaction costs**

Responsible entities may continue to add and deduct transaction costs from unit pricing formulae and still comply with the content requirements. The obligation to maintain a unit pricing policy and offer to provide it to prospective investors in product disclosure statements (**PDSs**) has not changed.

##### **Rights issues**

ASIC has removed the obligation that the record date for

rights issues be no longer than 20 business days before the date of the offer. It is now up to the responsible entity to determine the record date.

ASIC has also removed the current requirement that the constitution must set out the maximum percentage discount at which an interest can be issued under a rights issue and instead allows the responsible entity to determine the issue price.

In addition, the issue of interests no longer has to be made to all members (other than foreign members), the interests offered do not have to be in the same class, the price does not need to be the same and the offer does not need to be made at substantially the same time.

##### **Distribution reinvestment plans**

ASIC has also removed some of the restrictions around distribution reinvestment plans. Gone are the requirements under ASIC class order 05/26 *Constitutional provisions about the consideration to acquire interests* (**CO 05/26**) that the issue of interests under a distribution reinvestment plan must be made to all members. Also gone are requirements that the price offered needs to be the same

and that the interests offered are in the same class. ASIC also no longer requires a scheme's constitution to set out the maximum percentage discount at which an interest can be issued under a distribution reinvestment plan.

## Negotiated fees

ASIC has removed the unnecessary duplication of the relief in ASIC class order 03/217 *Differential fees (CO 03/217)* and elements of CO 05/26 which permits a responsible entity to negotiate lower fees with wholesale clients. Responsible entities are now only required to comply with CO 03/217.

## Stapled securities

Responsible entities will no longer have to apply for individual relief to allow them to allocate the issue price of a stapled security between its component parts because of amendments made by ASIC to the operation of CO 05/26.

## Powers and rights of the responsible entity

ASIC has confirmed that it is not necessary for the investment strategy of a fund to be set out in the scheme's constitution. In line with current commercial practice, ASIC expects that responsible entities will set out the investment strategy for the scheme in the PDS for the offer of interests in the scheme.

In respect of a responsible entity's right to be paid fees and receive an indemnity from scheme property, ASIC has reconfirmed its current position that a constitution ought expressly state that any right to be paid fees or receive indemnification from scheme property is subject to proper performance by the responsible entity. ASIC states that as an alternative, a constitution which includes a provision to the effect that where there is an inconsistency between the constitution and the *Corporations Act 2001 (Cth)* (**Corporations Act**), the *Corporations Act* prevails, will satisfy the requirement under the law that any right to be paid fees or to be indemnified must be specified in the constitution.

Importantly, ASIC is of the view that the law does not permit the payment of fees in advance because such a provision would be inconsistent with the right to a fee being only available for proper performance of the duty to which it relates.

## Complaints handling

ASIC considers that a scheme's constitution needs to address complaints handling for both retail and wholesale clients. Whilst acknowledging that AFS licensees (including responsible entities) who provide services to retail clients are required under section 912A(2) of the *Corporations Act* to have in place an internal dispute resolution procedure that complies with ASIC's requirements, ASIC believes that a responsible entity's obligation to include in a scheme's constitution the method by which complaints may be made by members extends to wholesale as well as retail client members. To avoid unnecessary duplication, ASIC says that a scheme constitution can include a provision that the responsible entity will comply as an AFS licensee with the dispute resolution requirements in section 912A(2). However, such a provision will only satisfy the content requirements in part because the procedure for dealing with wholesale clients needs to be included also.

## Withdrawal rights

ASIC considers that the following key information about the withdrawal process must be set out in the constitution:

- how the withdrawal rights are exercised;
- any amount that will be paid or given to members;
- restrictions on dealing with withdrawal requests; and
- ceasing to be a member.

Importantly, ASIC believes that a scheme constitution should not contain a provision that has the effect of allowing the responsible entity to set out the circumstances in which it may suspend the right to withdraw in another document (such as a PDS).

## Winding up

ASIC considers that the following key steps in the winding up process should be included in a scheme constitution:

- dealing with assets, liabilities and scheme property;
- the distribution of proceeds;
- costs of winding up; and
- additional payments by members.

ASIC says that the constitution should identify the party who will bear the costs of a winding up and in what priority this will be paid.

Whilst CP 188 contained a proposal that the constitution of a scheme can include a provision that permits the responsible entity to postpone the realisation of assets of the scheme on winding up for as long as it thinks fit, provided the provision is made subject to the responsible entity's duties to act in the best interests of members etc, the updated RG 134 does not quite go that far. The final policy just makes an acknowledgement that a responsible entity may need to sometimes legitimately postpone the realisation of the scheme's assets on winding up to maximise the net proceeds of realisation attributable to members.

## **Independent audit and incorporation by reference**

ASIC has continued its current policy that a scheme constitution needs to include a provision that provides for an independent audit of the final accounts to be conducted by a registered company auditor after a scheme is wound up. It has also reinforced its unpublished policy that a constitution should not include references to documents that can modify or replace the provisions of the constitution, thereby undermining the consideration of the constitution by ASIC.

Responsible entities who wish to rely on CO 13/655 must publish and maintain on their websites a notice that they have elected to rely on that instrument.

## **Application of the policy to existing schemes**

ASIC says it will only apply updated RG 134 when assessing constitutions lodged as part of an application to register a scheme from 1 October 2013. It will not deregister an existing scheme or take any action against the responsible entity or its officers on the basis the constitution of an existing scheme does not comply with the Corporations Act (as it might for schemes registered after 1 October 2013), as long as the constitution meets the requirements of the old RG 134.

Thomsons Lawyers can assist you comply with ASIC's new requirements, including the circumstances where you may wish to apply to new policy to your existing scheme constitutions. Please contact Chris Mee for further information.

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