IFSA Standard No. 17.00

Incorrect Pricing of Scheme Units – Correction and Compensation

October 2006

Main features of this Standard are:

- **Specification of the principles that a Scheme Operator is expected to follow when dealing with the incorrect pricing of scheme units; and**
- **Specification of certain minimum requirements for a Scheme Operator when compensating on occasions when incorrect pricing takes place.**

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1 Title

1.1 This Standard may be cited as IFSA Standard No. 17.00 'Incorrect Pricing Of Scheme Units - Correction and Compensation'.

2 Standards and Commentary

2.1 The requirements set out in this Standard are shown in bold print. Commentary is shown in normal print immediately after the requirement to which it relates, as an aid to the interpretation of the requirement.

3 Date of Issue

3.1 Originally issued 19 July 1999 and updated October 2006

4 Effective Date

4.1 This Standard must be applied in relation to an IFSA Member's operations on or after 1 July 2007. Earlier application of this Standard is permitted and encouraged.

5 Application

5.1 This Standard must be applied by the Operator of a Scheme ("Scheme Operator") (whether offered for public subscription or otherwise) in relation to that Scheme.

5.2 Where there is a conflict between the requirements of this Standard, applicable legislation, and the Constituent Documents of a Scheme, the requirements of this Standard must, having regard to the purpose of the Standard, be modified appropriately so that, as far as practicable, the Scheme Operator complies with the requirements of this Standard. Any Scheme created on or after the Effective Date must comply with this Standard unless such compliance would conflict with applicable legislation, or the IFSA member's interpretation of that legislation.

6 Statement of Purpose

6.1 The purpose of this Standard is to set minimum requirements:

- **for occasions when incorrect prices have been calculated and transacted upon; and**
- **for determining when compensation is required that arises as a result of incorrect unit prices.**

This Standard has been designed with reference to the Joint ASIC and APRA Unit Pricing Guide to Good Practice issued November 2005.

6.2 IFSA Standard No. 8.00 "Scheme Pricing" covers the determination of Scheme prices following a valuation of scheme assets determined in accordance with IFSA Standard No. 9.00 'Valuation of Scheme Assets and Liabilities'.

6.3 The duty of the Scheme Operator extends to taking all reasonable steps, and exercising due diligence, to ensure the Scheme is correctly priced.

6.4 The appropriate treatment of incorrect pricing has been a recurring administrative problem amongst Scheme Operators.

6.5 The Scheme Operator has a fiduciary duty to act in the best interest of Scheme Investors, and must exercise discretion in accordance with this duty in any particular case. IFSA has issued this Standard to provide requirements for Scheme Operators to ensure that they act in the best interest of Scheme Investors on a consistent basis. However, the requirements are not intended to be exhaustive.

7 Application of Materiality

7.1 This Standard applies to the treatment of errors in the pricing of interests in a Scheme. In forming a policy for managing such errors, a Scheme Operator may choose to use a level of materiality to assess whether an error requires compensation to be considered for individuals in a Scheme, or the Scheme itself. For the purposes of this Standard, the materiality used for such an assessment must be no more than 0.3% of the price of a unit.

7.1.1 The size of a unit pricing error can be assessed by measuring the size of the variance between the incorrect unit price and the correct unit price, as a percentage of the correct unit price, at a particular point in time. The calculation must allow for all known errors present in the unit price at the time of assessment. Where the size of the unit pricing error is above the adopted materiality threshold, it is then necessary to look at the implications of the incorrect price to determine what compensation is required.

7.1.2 The Scheme Operator must also consider whether it is appropriate to apply a materiality test to the effect of the error on individual Investor benefits. This may be appropriate, for example, where the size and direction of a unit pricing error has been variable, but the error has not resulted in the Scheme's unit price being wrong by more than the adopted materiality threshold.

7.1.3 In setting materiality thresholds, the Scheme Operator must consider:

- The nature of the assets of the Scheme;
- The nature of the error; and
- Any other circumstances or obligations which may suggest that a lower materiality threshold is appropriate.

7.1.4 A situation where a lower materiality threshold may be appropriate is a fund that only holds cash assets, where a reasonable materiality threshold for a Scheme may be 0.05%.

7.2 Where the Scheme Operator has financially benefited from an error, the Scheme Operator must pay compensation such that the Scheme Operator does not retain the financial benefit.

7.2.1 Where compensation is payable under paragraph 7.2, the compensation may be payable to the Scheme, or to individual past and present Investors, based upon the materiality threshold adopted as per paragraph 7.1 and taking into account the legislative obligations of the Scheme Operator.

7.3 A sample Decision tree has been provided as Appendix 1 to this Standard to provide guidance to IFSA Members in managing and assessing pricing errors.

8 Definitions

8.1 In this Standard:

- **'Associate' has the same meaning as in IFSA Guidance Note No. 5.00 "Industry Terms and Definitions";**
- **'Compensatable Error' means a unit pricing error where the impact of the error on the price of a unit is greater than the materiality threshold adopted in accordance with paragraphs 7.1 and 7.2, and where compensation must be paid as described in section 12 of this standard;**
- **'Constituent Documents' of a Scheme means the rules and regulations under which the Scheme exists;**
- **'Entry Price' means the Scheme price at which an Investor acquires an equitable interest in a Scheme;**
- **'Exit Price' means the Scheme price at which a Scheme Holder realises an interest in the Scheme;**
- **'Interest' means an undivided portion of the equity of a Scheme;**
- **'Investors' has the same meaning as in IFSA Guidance Note No. 5.00 "Industry Terms and Definition";**
- **'IFSA Member' refers to a 'Full Member' as defined in IFSA's Articles of Association;**
- **'Non-Compensatable Event' means a unit pricing error where the impact of the error on the price of a unit is less than the materiality threshold adopted in accordance with paragraphs 7.1 and 7.2;**
- **'Operator' has the same meaning as in IFSA Guidance Note No. 5.00 "Industry Terms and Definitions".**
- **'Prices', in relation to a Scheme, together mean the Entry Price and the Exit Price of that Scheme;**
- **'Scheme' has the same meaning as in IFSA Guidance Note No. 5.00 "Industry Terms and Definitions";**
- **'Scheme Assets' means the assets and liabilities of the Scheme, the valuation of which is determined in accordance with IFSA Standard No.9.00 "Valuation of Scheme Assets and Liabilities"; and**

9 Principles for the Assessment and Compensation of Errors in the Pricing of Scheme Units

9.1 A Scheme Operator's processes for the assessment and compensation of errors in the pricing of scheme units must meet the following criteria:

- **they must be documented and transparent;**
- **they must individually rectify past and present Investors that have been affected by a materially incorrect unit price;**
- **they must consider the obligations of Scheme Operators under relevant legislation;**
- **they must not result in any residual benefit to Scheme Operators; and**
- **they must be regularly reviewed.**

9.1.1 This Standard may not cover every situation faced by a Scheme Operator where there has been an incorrect pricing of an interest in a Scheme. Where a situation is not covered, a Scheme Operator should have regard to these principles.

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10 Pricing Controls by Scheme Operators

10.1 It is required that the Scheme Operator complies with all IFSA Standards related to the valuation of scheme assets and liabilities and scheme pricing, in particular IFSA Standard No. 9.00 'Valuation of Scheme Assets and Liabilities' and IFSA Standard No. 8.00 'Scheme Pricing'.

10.1.1 Legislative and fiduciary responsibilities require Operators to operate a Scheme in a professional manner for the benefit of Scheme Investors.

10.1.2 These responsibilities include having adequate controls and systems in place to ensure that all elements of the valuation of Scheme assets and pricing of Scheme interests functions are conducted in an accurate, timely and consistent manner. Adequate documentation regarding source data, calculations and outputs must be maintained. Scheme Operators must also ensure that outputs from the valuation and pricing functions are monitored, with appropriate indicators and benchmarks in place which will signal any possible errors.

10.1.3 Where the pricing function is delegated to a third party ("the pricing agent"), the Scheme Operator will need to satisfy itself that the pricing agent's systems are robust and will procure accurate results. The Scheme Operator must continuously review the outputs from the pricing agent to satisfy itself that the pricing agent remains competent to carry out the function, and that it has taken reasonable care to ensure that the pricing agent has carried out its duties in a competent manner.

11 Documented and Transparent Assessment and Compensation of Errors in the Pricing of Scheme Units

11.1 IFSA Members must have a policy framework in place that documents the adoption of the Principles for the Assessment and Compensation of Errors in the Pricing of Scheme Units. The policy framework must include, at a minimum:

- **Delegated authorities for policy approval;**
- **Reporting requirements;**
- **Processes to confirm the completeness of and compliance with policies;**
- **Training requirements for policy awareness;**
- **The alignment of procedures to policies;**
- **Ongoing review of policies and procedures; and**
- **Outsourcing arrangements (where appropriate).**

11.2 The Scheme Operator's policies governing the assessment and management of errors in the pricing of scheme units must, at a minimum, include documentation of:

- **The Scheme Operator's definition of what constitutes an error in unit pricing;**
- **The principles adopted by the Scheme Operator in assessing and rectifying errors in unit prices;**
- **Error notification, recording and reporting protocols;**

- **Delegated authorities and approvals for compensation payments;**
- **The size of, and basis used to determine, any materiality thresholds used in assessing errors in Scheme unit prices; and**
- **Communication protocols regarding errors in Scheme unit prices to Investors and regulators.**

11.3 A Scheme Operator's error assessment process will include a determination of whether an error is a Compensatable Error or a Non-Compensatable Event, based on the materiality thresholds adopted in accordance with paragraphs 7.1 and 7.2 (also refer to Appendix 1 of this Standard).

11.3.1 From time to time, adjustments may need to be made to unit prices as a result of approximations or estimates being updated to actual figures as they become known, or due to a change in methodology or policy. Such an adjustment is not considered to be an error under this Standard where the adjustment to unit prices occurs as a result of the consistent application of sound policy. Conversely, if policy or estimates are found to be inappropriate, or application of policy has been deficient, adjustments to unit prices may be errors requiring compensation.

11.3.2 An example of a decision tree that may be used to differentiate between unit pricing adjustments, Compensatable Errors, and Non-Compensatable Events is included as an appendix to this Standard.

11.3.3 Scheme Operators may disclose information to Investors about how errors in Scheme unit prices would be assessed and managed in the event that they occur, including information about materiality thresholds that may be adopted in the error assessment and compensation process.

11.4 Errors must be reported to the appropriate level of management within the Scheme Operator. All errors must be recorded and action taken to minimise the risk of recurrence.

11.5 When an error in unit pricing occurs and compensation is payable to past and/or present Investors, the Scheme Operator must make reasonable efforts to communicate to affected Investors and describe the nature of the error, how the error will be rectified, and how the affected Investor will be compensated for the error.

12 Compensation of Errors in the Pricing of Scheme Units

12.1 Where a Compensatable Error has been identified, compensation to or from past and/or present Investors or the Scheme will be required where the Investors or the Scheme have been disadvantaged as a result of the Compensatable Error.

12.1.1 Where an application or redemption has taken place at a price which is incorrect by more than the materiality threshold adopted under paragraph 7.1, it is required that the Scheme and/or Investor be compensated to the extent that they have been disadvantaged.

12.1.2 The Scheme Operator may choose to recover amounts from Investors who have been advantaged by a Compensatable Error.

12.1.3 The Scheme Operator may conclude that an effective means of compensation is to re-book applicable transactions using the correct unit price. In doing this, Scheme Operators should have appropriate regard to any backdating implications of these amended entries, and should consult IFSA Standard No. 8.00 “Scheme Pricing” for further guidance.

12.1.4 Where there is more than one factor at any one time which causes an incorrect price to be calculated, compensation will be required whenever, and so long as, the combined effect on any one day results in a Compensatable Error.

12.2 Under certain circumstances, Scheme Operators may elect to set a minimum dollar compensation amount before compensation will be paid to an individual Investor. Where such a threshold is adopted, the maximum amount of such a threshold is $20.

12.2.1 In choosing whether to adopt a threshold for compensation payments, the Scheme Operator must consider:

- Legislative obligations;
- The possible effects on Investors in the Scheme of costs associated with the payment of small amounts of compensation; and
- The obligations of the Scheme’s Constituent Documents.

12.3 Where a Non-Compensatable Event has occurred, consideration must be given to whether any further action is required to correct the pricing of the Scheme.

12.3.1 Examples of further action that may need to be taken could include (but is not limited to) processing a transfer of funds between investment options in a superannuation fund, adjustment of an accrual within a unit price, or adjustment of a tax provision.

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Appendix 1