FSC Guidance Note No. 28

Varied Redemption Arrangements

February 2010

The main purpose of this Guidance Note is:

- to encourage standard practice in the ***administration and communication*** of varied redemption arrangements for managed funds.

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1 Title

This Guidance Note may be cited as FSC Guidance Note No 28 - Varied Redemption Arrangements.

2 Date of Issue

February 2010.

3 Effective Date

This Guidance Note is effective from the date of issue.

4 Application

This Guidance Note has been published by FSC to all member organisations to encourage standard practice in the ***administration and communication*** of varied redemption arrangements for managed funds. This Guidance Note has specific relevance for:

- those responsible for making decisions on how redemption arrangements are to be varied (primarily Responsible Entities); and

- those charged with efficient implementation of those changes (primarily fund manger unit registries and platform administrators).

The key themes addressed in the Guidance Note include the practical administrative implications of rationing liquidity, managing redemption windows and ensuring effective communication.

The Guidance Note covers the scenario where a fund manager[1] places restrictions on redemptions:

- where this step represents a change from a previously unrestricted redemption environment; or

- for funds where varied redemption arrangements are already in place, and where further changes are required (for example, moving to permanently change the redemption rules for the fund, or to facilitate one-off liquidity events).

5 Scope

This Guidance Note does not offer views on what factors a fund manager should consider in deciding to vary redemption arrangements – although reference to fund constitutions, disclosure documents and relevant law is clearly needed once market and/or cash flow triggers for change have been assessed.

These are the ***why*** and ***what*** factors that drive the actual decision to freeze or modify redemption rules.

[1] Responsibility for determining how a fund operates rests, at law, with the Responsible Entity. However, to utilise accepted industry terminology, the term "fund manager" is used to indicate the decision-maker for the fund.

Rather, this Guidance Note focuses on the administration impact of implementation (the ***how*** and ***when***) that follows the primary decision by a fund manager to vary redemption arrangements – including Recommended Practice designed to minimise administrative impact across the value chain as a whole.

The impact on platform holdings is of particular importance, given both the dominant extent of this form of access to managed funds, and the potential for confusion to arise with investors and advisers if indirect (platform) holdings are not specifically considered by fund managers.

6 Objective

This Guidance Note seeks to *encourage a consistent industry approach to the administration of varied redemption arrangements* (Recommended Practice) and related operational changes.

Broad adoption of Recommended Practice offers the following benefits:

> *Service and Communication* - common and consistent practice across the industry makes understanding easier, and provides a sounder foundation for communicating with investors, advisers and other stakeholders.
>
> *Efficiency* – a more consistent approach allows parties in the value chain to leverage their investment in new processes and systems that are required to handle the reality of varied redemption arrangements across different fund managers. This is particularly important for funds that distribute via platforms[2];
>
> *Lower operational risk* – a more standardised approach allows procedures to be developed and staff trained within finite boundaries of practice, thus lowering the range of potential exceptions;
>
> *Equitable treatment* - the administrative implications of varied redemption arrangements should, where possible, apply equally both direct investors and those who are part of aggregate holdings through platforms (IDPS, super funds, master trusts and the like);

This Guidance Note recognises the diversity in the industry. Every fund is different in terms of constitution, underlying investment mix, liquidity and investor profile.

Notwithstanding investment diversity, however, there is an expectation that a consistent approach can be brought to the *administration* of varied redemption arrangements in the interests of all investors.

Accordingly, FSC members are strongly encouraged to implement the Recommended Practice contained in this Guidance Note.

7 Background

[2] In this context, a platform is any administrative structure that aggregates underlying individual investors into a single holding at the fund manager registry. See Annexure.

Such platform entities typically include IDPS, super wraps, fund-of-fund managers, master trusts, MDAs and the like.

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The Guidance Note is intended as a framework for discussion between peers - especially between fund managers and their major platform investors.

This Guidance Note replaces a prior FSC working guide circulated to members in November 2008, and is based on additional industry consultation and evolving market practice.

The Guidance Note is issued under the auspices of the FSC Service & Efficiency Board Committee.

8 Summary of Recommended Practice

The following table summarises recommended practice. Reference is made to sections in the attached detailed matrix that covers relevant factors in more detail.

Recommended Practice	Reference
Know your client – ensure that the varied redemption arrangements apply equally to unit holders (including awareness of how arrangements may be implemented by indirect holdings through platforms).	1
Planning – multi-lateral discussion between FSC members is encouraged to pre-empt implementation issues.	2
Communication – ensure that notification indicates who is affected, what has (and has not) changed, and from when.	3, 4 and 5
Consistency – adopt an approach that is in line with best practice.	6
Recommended practice for varied redemption arrangements - ➢ Set appropriate redemption windows (notice period, duration) ➢ Pre-advise available liquidity ➢ Apply equal proportional (pro-rata) treatment to all unit holders ➢ Ensure that confirmation reporting and payment is complete and timely	8 and 9
Pre-advised liquidity – within redemption windows	10
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9 Recommended Practice

In line with the purpose of this Guidance Note (and consistent with the comments above), the following outline of Recommended Practice applies AFTER the Responsible Entity has formed the view that operations of the fund must be varied, but BEFORE administrative implementation of the changes.

Ref	Factor	Recommended Practice	Comments
1	Know your client – direct and platform holdings	Ensure that varied redemption arrangements can be applied equally to all unit holders on a pro rata (proportional) basis. Pro rata (proportional) treatment should apply <u>whether investors hold units directly or through platforms</u>.	Fund managers should consider whether there are any platform aggregate holdings in their funds before initiating change. Administrative methods that treat unit holders differently (other than on a proportional basis) should be avoided.
2	Planning	Fund managers are encouraged to work together with stakeholders (including platforms) <u>prior to implementation</u> to understand any administrative or communication issues.	Significant problems can be avoided if administrative impact is discussed prior to implementation. Specifically, the approach should be discussed with key stakeholders if fund managers intend to diverge from the best practice outlined in this Guidance Note.
3	Communication – one source and certainty	Fund managers are encouraged to provide a single, authoritative <u>source of information</u> when changing redemption arrangements. They are also encouraged to ensure that the status of the fund and the detail of new operating procedures are communicated internally and that all key service points provide a consistent message to the market including investors, platform, advisers and media. Platforms will generally pass on information received from fund managers to advisers verbatim. Accordingly, fund managers should be aware of this approach and tailor their communications (in terms of clarity, format and tone) to be suitable for such use. In communicating funds in distress, use <u>language that is clear and unambiguous</u>. Avoid euphemisms.	It is recognised that there are a number of parties in the manufacturing chain including the Responsible Entity board, investment team, investment operations (unit pricing and registry), compliance, client service, marketing, communications and business management. Some or all of these functions may be outsourced. In communicating externally, however, the <u>fund will need to speak with one voice</u>. Fund managers and platforms may wish to co-ordinate contact with advisers, where appropriate, to provide additional information and background on their decisions. This may be particularly important for funds that have a major shared client or adviser base.

Ref	Factor	Recommended Practice	Comments
4	Original announcement -that varied redemption arrangements, or other operational changes, are being implemented.	A clear message on cause and effect. Specific reference to the actual fund(s) affected, including full name, and industry code. The timing of the announcement should be after cut-off for fund order processing (trading) on the value date, and provide clear guidance on those trades that will be processed and those that will not be accepted.	If not all information is known at the time of the original announcement, then a plan for ongoing communication (preferably regular, rather than only event driven) should be prepared. Encourage clear communications within the fund manager organisation. Platforms and dealer groups may have many touch points and need to receive a consistent message. The importance of cut-off times relates to the transition from normal arrangement to a varied state. Fund managers set the cut-off for the value date of orders for forward priced funds (normally in the PDS or as an operating procedure). Notifications of varied redemption arrangements should be made so as to avoid any ambiguity on what transactions are affected.
5	Advise on affected transactions	Clear communication on the transaction types that affected by change, specifically: • Applications • Redemptions • Switches • Transfers • Distributions • All or only some of the above? Clear communication on whether unit pricing is suspended, or will continue (and for what purpose). Specific communication should also be made on the effective date for new arrangements (including the cut-off date and/or time at which transactions will no longer be accepted).	Generally, fund managers should advise the exact extent of any change, and clearly set out which functions of the fund are affected, including whether regular valuation will still apply and the impact (if any) on all transaction types. For example, in cases where underlying assets are illiquid (and therefore redemption arrangements need to be varied), it may still be possible to value the fund. In such cases it may be possible to continue unit pricing for valuation (but not transaction) purposes.

Ref	Factor	Recommended Practice	Comments
6	Consistency	In general, the administrative approach applied by a fund manager across different redemption windows (and between funds) should be consistent and follow the practice set out in this Guidance Note.	Naturally, the administrative approach may need to be amended due to changed circumstances of the fund, or where a more effective or efficiency processes could be applied for the benefit of the manager, investors, platforms or advisers. The aim should be to minimise the extent of change between cycles, unless there are clear benefits.
7	Open redemption orders – open orders at the point of redemption freeze	Clear communication on how current open orders will be treated (that is, those orders received but not confirmed prior to the announcement of suspension). The communication should clearly deal with the treatment of open orders (that is, those redemption requests that have been received but remain unconfirmed and unsettled at the time of the closure announcement).	Where possible, notification that a fund is closing for redemptions should be prospective and made after the "close of trading" for that fund (normal operational trade cut-off). If investors are being asked to "cancel" withdrawal requests that are received on or near the closure announcement date, this should be clearly and consistently communicated.
8	Transfer of units – in the unit registry	Legal transfer of ownership of units in the fund should remain available for investors. In the interest of end investors, and for additional flexibility in platform administration, in specie transfers of units should remain open in all possible circumstances.	Note that this function relates to a transfer of legal ownership of units in the fund (as recorded in the fund registry) – not the in specie transfer of assets out of the underlying fund. The in specie transfer of units does not require liquidity in the fund (since they are implemented via a change in the unit registry records). This applies regardless of whether the transfer involves a change of beneficial owner or not.
9	Redemption request windows	Recommended practice in handling varied redemption arrangements is to set a window in which applications for redemption will be accepted, and that the level of liquidity is pre-advised (see below). Clear communication of key dates, particularly the exact start and end dates (and times if necessary) during which redemption requests will be accepted.	In general, the concept of a redemption window applies to funds where redemptions are currently suspended, the fund manager advises unit holders that the fund will accept redemption requests beginning and ending on certain dates (the "window"). Fund managers should communicate clearly on how redemption windows will be managed going forward. In setting the duration of redemption window, regard should be had for the needs of advisers and platforms in communicating

Ref	Factor	Recommended Practice	Comments
		The duration of the redemption window should be appropriate - generally set at 21 days. In setting the window, the fund managers should also pre-advise the available liquidity (see next point).	with end investors, and in processing their instructions. Adequate duration provides investors and their advisers time to consider their approach, and allows platforms with sufficient time to operate their own processes (this could include setting a slightly earlier date for order cut-off for their own clients).
10	Pre-advised liquidity – within redemption windows	Recommended practice in handling varied redemption arrangements is for fund managers to <u>pre-advise the liquidity that will be available in the redemption window</u>. For example, "unit holders can apply to redeem up to 5% of their holding".	In practice, the majority of fund managers appear to be taking this approach, and it has the advantage of providing certainty for investors, advisers and platforms. Pre-advised liquidity also means that investors, platforms and advisers can all utilise a "single stage" process to record keeping. That is, the redemption request is for a known amount (up to the pre-advised limit) and will be (except in exceptional circumstances) confirmed in full by the fund manager. Fund managers would be expected to highlight in their communication that the level of pre-advised liquidity level may not be available for redemptions in some (extreme) circumstances.
11	Approaches to be avoided	No "look through" for aggregate holdings. All unit holders, big and small, direct and indirect, should be treated equally and on a proportional (pro-rate) basis. Avoid "multi stage" processes. For example, a number of fund managers have elected to seek "expressions of interest" from investors to nominate a requested redemption amount in one stage, and then either part-fill orders or ask investors to re-submit with the new "real" redemption request once these "expressions of interest" have been collated.	Prior to implementing any specific administrative approach, it is strongly recommend that fund managers consult with their major platform supporters and dealer group administrators to ensure that the implications are understood up front. Problems generally do not arise in circumstances where the outcome for the aggregate holding is the same for each underlying investor (that is, proportional to the value of their investment). In some cases "look through" is essential – for example, in processing of hardship relief for mortgage fund investors. In this instance the relief links to the underlying

Ref	Factor	Recommended Practice	Comments
		The approach of pre-advised liquidity removes these additional steps, simplifies the process and improves end-to-end efficiency. Accordingly, it should be used unless there are compelling fund specific reasons to adopt a different process. Avoid "special forms" – the standard redemption process should apply to processing within each window. Two stage processes generally involve the use of new "special" forms to capture expressions of interest. This introduces a new area of inefficiency and operational risk in that these one-off forms cannot be pre-filled from adviser or platform systems (as is the case with a normal redemption request). No "partial" or "deferred" settlement. Redemption should be processed in one stage (that is, not a drip-feed of payments representing partial fulfilment of the same order). The fund should pre-advise available liquidity within a window, and only invite orders up to this level. As new liquidity becomes available, it should be utilised in a subsequent and discrete redemption window. The roll-forward of part filled orders should be avoided. An alternative is for fund manager registries to accept a "standing instruction" from unit holders to apply for available liquidity in each window.	investor, not the aggregate holding of a platform (see below). For practical purposes, some fund managers may include an offer to provide redemption for "small balances" – typically under $1,000. Such offers should consider the level of platform holding before communication to decide whether this approach can also be offered on a "look through" basis.
12	Hardship Relief	Fund managers can elect to request specific relief from ASIC (on a fund by fund basis) to process redemptions for investors experiencing hardship. Significant market variation has arisen in how different fund managers deal with indirect investors (those invested in aggregate holdings through platforms) in hardship scenarios. Recommended practice:	Hardship relief refers to arrangements that allow fund managers to favour redemption requests from some investors before others on the basis of specific hardship criteria. In the absence of such relief, such actions would generally breach obligations to treat unit holders equally. The need to assist investors in cases of genuine hardship is self-evident.

Ref	Factor	Recommended Practice	Comments
		Procedures put in place by fund managers to validate hardship claims (and thus meet compliance requirements) should focus on: ➢ seek validation of the circumstances that apply to the end investor from that investor (usually facilitated by their adviser); ➢ not seek further assurance as to the circumstances of the investor from custodians or platforms; Generally, the only requirement for certification from a platform would be that the investor's interest in the fund actually forms part of the platform's aggregate holding.	

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ANNEXURE

In this context of this Guidance Note, a platform is any administrative structure that aggregates underlying individual investors into a single holding at the fund manager registry.

Such platform entities typically include:

- Investor Directed Portfolio Services (IDPS) and like schemes – where decisions to apply or redeem must be made by the end investor, and

- Super wraps, fund-of-fund managers, master trusts, some Managed Discretionary Accounts and other aggregators – where decisions to apply or redeem are made by the trustee or RE (potentially with reference to the end investor).

For some transaction types, especially offers of limited liquidity, the majority of platform systems are designed to treat each end (indirect) investor in proportion to the value of their holding, not "look-through" on an individual basis.

The key point is that fund managers and platforms should recognise the administrative challenges that could arise from different approaches to implementing varied redemption arrangements, and seek outcomes that reflect the specific nature of their fund and its direct and indirect investor base.