

## Technical Note

### Class testing changes to an investment management agreement where there are unquantifiable benefits

LR 11.1.2G(2),  
LR 11.1.7R,  
LR 11.1.10R,  
LR 11.1.11R

The purpose of LR 11 is to guard against both the perception and the risk of a related party taking advantage of its position (LR 11.1.2G(2)).

Unless a transaction with a related party falls within LR 11.1.6R (“Transactions to which this chapter does not apply”), a premium listed issuer must comply with LR 11.1.7R to LR 11.1.10R. Fundamentally, this requires the issuer to apply the appropriate class tests to the transaction to determine the relevant percentage ratios. This will then determine the appropriate treatment of the transaction under the Listing Rules (including whether the transaction requires shareholder approval).

Occasionally, in the context of a change to an existing investment management agreement, the benefit of the transaction may be unclear and the class tests may be difficult to apply. If individual guidance is required, we would ask questions about the transaction to determine whether there is any form of benefit which may be quantified and, consequently, class tested. We may also ask questions to determine whether there are any unquantifiable benefits to the related party. The types of questions we may ask could include whether there is an incremental change in the total amount of fees receivable by the related party, whether the quality and levels of service prior to and following the transaction are equivalent, and whether there is any other impact (such as a change in regulatory status of either party).

Where there is a benefit to the related party, but this is not a financial benefit that is capable of being quantified, we accept that, in effect, the percentage ratio is zero. This means the transaction would be considered a small transaction within the meaning of paragraph 1 of the Annex to LR 11 and the related party transaction rules will not apply.

This is different to the situation where there *can* be a quantifiable benefit albeit only in certain circumstances (for example, where the new fee arrangements may lead to higher fees in comparison with the current arrangements, but only if a particular type of termination event occurs).

If the new fee structure is such that it cannot be directly compared with the previous structure and, consequently, the financial benefit to the related party from the change (i.e. the difference between the new and the old agreement) cannot be easily quantified, then we would expect the entire fee to be class tested afresh. Standard class test methodologies apply with market cap and the modified class test against NAV being the most appropriate measures.

We are occasionally asked for guidance where a change introduces or extends a minimum period of time before an investment management agreement may be terminated. We typically consider fees on an annual basis and so if there is no change to the level of fees, then the class test result may be zero. However, we are unlikely to challenge a more conservative approach to classifying the change if one is presented to us (e.g. aggregating the fee payable over a number of years).

We recognise that there is likely to be change over time in the way fee arrangements are structured within an investment entity. This includes both how the fees are calculated and how the fees due are settled (i.e. in methods other than in cash).

Where the only change relates to a direct substitution as a result of which payment of the fee will be made by something of the same value other than cash, we will still apply the class tests at the time of the change to the agreement, and therefore it is necessary to quantify any benefit at that time. In saying this, we recognise that there may be potential for future benefit depending on future value movements. However, any such potential benefit is speculative and, therefore, not quantifiable at the date of the amendment to the agreement.

It remains that, if an amendment leads to any identifiable and quantifiable benefit in any potential scenario where fees become payable, then that is the benefit to be tested.

The aggregation rules in LR 11.1.11R still apply even where a further related party transaction with the same related party has a percentage ratio of zero.