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Dear Ms Hamad

Need for continuation of margin lending relief

The Australian Financial Markets Association (AFMA) is making comment on the need to continue the relief provided in the ASIC Class Order *Margin lending relief for ASX-traded instalment warrants* (CO 10/1034), which is due to sunset on 1 April 2021.

The purpose of CO 10/1034 is to exempt certain types of instalment warrants from the additional obligations imposed on margin lenders under Part 7.8 of the *Corporations Act 2001* (Cth) (Corporations Act).

Following legislative amendments made to regulate margin loans in 2009, AFMA made a request for ASIC to declare that a particular kind of facility is not a *margin lending facility* under its power in subsection 761EA(9) of the Corporations Act. CO 10/1034 was introduced in response to new margin lending provisions that were enacted under the Corporations Act, recognising that the policy intent behind the regulation of margin loans was not to encompass instalment warrants.

Accordingly, CO 10/1034 enables issuers of ASX-traded instalment warrants to issue ASX-traded instalment warrants to investors, including investors buying in the time-critical secondary trading market, without having to comply with the new additional obligations on margin lenders.

The relief was needed as instalment warrants may contain features which result in instalment warrants coming within the definition of margin loans (e.g., where the loan-to-value ratio of the underlying share reaches a certain level, the lender becomes entitled to take certain action).

For example, in the case of a “resetting” instalment warrant, the loan amount is adjusted (or reset) periodically (e.g. each 12 months or 24 months). The objective of adjusting the

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loan amount is to keep the level of gearing within the levels initially specified in the disclosure document. On the reset date, the investor may choose to:

1. terminate the instalment (no further payment by the investor is required); or
2. continue with the instalment for the next period, with a reset loan amount by making, or receiving any required payments.

Whether the loan is reset to a higher or lower level (or remains the same) depends on the performance of the underlying security. While the terms of issue of instalments may differ, the reset loan is often treated as a new loan by the issuer to the investor.

In general terms, if the underlying security has increased in value, the loan amount will be increased, and the investor may be entitled to receive a cash payment from the issuer. Conversely, if the underlying security has decreased in value, the loan amount will be reduced and the investor will be required to make a payment to the issuer in order to continue with the instalment for the next period.

One way in which instalment warrants particularly differ to margin loans is that the borrower can elect to not make any payments, in which case:

- the instalment warrant will terminate;
- the lender's recourse against the borrower is limited to the value of the share (that is the lender cannot pursue the borrower for any further money); and
- the borrower cannot lose more than their initial investment amount.

An important explanation for the relief from regulatory coverage as margin loans is that there exists long-standing regulation of instalment warrants as financial products under the Corporations Act, meaning there was no need for the additional overlay of requirements for margin loans that were introduced into the Chapter 7 Corporations Act regulatory regime. Instalment warrants are covered by the PDS disclosure requirements regardless of the margin lending provision, and the current approach to instalment warrant disclosure and regulation is effective in communicating the features and risks of the product and does not require change.

Furthermore, instalment warrants do not have margin calls in the sense that they are a feature of conventional margin loans and thus, the margin loan notification requirements in section 985M of the Corporations Act are unnecessary and could impose additional regulatory costs for no benefit.

Instalment warrants are also subject to the general periodic reporting requirements in the Corporations Act. The additional specific reporting requirements for margin loans through the regulations are not appropriate to instalment warrants, are unnecessary from a regulatory perspective and create an additional compliance burden and cost for the product.

The reasons articulated by AFMA in 2010 and in the Explanatory Statement accompanying CO 10/1034 remain valid to justify a roll-over of the relief. AFMA is advised that the

market for instalment warrants has been less active than it was in times past, but this is due to general economic circumstances and there may be more activity as conditions evolve. The consensus view of AFMA members involved with instalment warrant products is that the roll-over of the CO 10/1034 is strongly supported. AFMA strongly recommends that the relief provided by CO 10/1034 be continued for the good of economic activity.

We note that in the form the relief was provided in CO 10/1034, it is limited to instalment warrants as defined in the class order traded on the financial market operated by ASX. Although we are not aware of any plans for instalment warrants being traded for example on Chi-X or SSX, there is no reason in principle why different rules should apply depending on which Australian licensed financial market they are traded on. In the interests of competitive neutrality, we suggest that ASIC considers revising the language of the relief to cover defined instalments warrants that are traded on an Australian licensed financial market.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive, flowing style.

David Love
General Counsel & International Adviser