16 January 2025

Beneficial Ownership and Transparency Unit
Market Conduct and Digital Division
Treasury
Langton Cres
Parkes ACT 2600

By email: beneficialownership@treasury.gov.au

Dear Beneficial Ownership Team

Enhanced beneficial ownership disclosure for listed entities

The Australian Financial Markets Association (AFMA) is supplementing its response to the Enhanced beneficial ownership disclosure for listed entities consultation on draft legislation submitted on 13 December 2024.

A. Endorsement of Law Council comments

AFMA has reviewed the comments made by the Law Council of Australia, Business Law Division on 13 December 2024. AFMA endorses the comments made in their submission and will not repeat those views here. The comments in this submission provide a market impact perspective view on the draft legislation based on member feedback.

B. Key Points

The changes that are proposed are complex in their implications and considered to be most significant. Australia's current shareholder reporting regime for listed companies provides a reliable and transparent framework for investors, regulators and the general public to understand the level of ownership in Australian listed companies.

The proposed amendments to the current regime extend beyond FATF recommendations relating to beneficial ownership and beyond listed company disclosure requirements in other jurisdictions.

They are likely to have a significant negative impact on Australia's equity derivatives market and the financial services industry and investors more generally. Further explanation is provided below, however in summary, the changes will:

- Introduce significant complexity without an informational (or other) benefit.
- Require the publication of information that is likely to confuse or mislead market participants in general.
- Be misleading.
- Be impractical to implement.

C. Questions

1. The draft Bill proposes the repeal of s609(6) and redefines 'derivatives' in s608A. What impact would the expanded definition of relevant interests in s608A and 608B have on ownership transparency and regulatory burden?

1.1. What impact will the removal of this exclusion have?

1.1.1. Definition

The most significant change proposed is the deemed inclusion of a cash-settled equity derivative interest in the definition of relevant interest for Chapter 6, 6C and other purposes. This presumes there is a functional equivalence between cash-settled equity derivatives and shares. There is not.

It also presumes that takers of cash-settled equity derivatives necessarily have a control motive. Again, that is not the case. There are multiple reasons why a person may acquire a cash-settled equity derivative interest unrelated to control of a company. It is a characteristic of the market that the great majority of derivative activity relates to transactions which impact less than 5% of any one company's issued capital and unrelated to corporate control. AFMA members indicate that over 90% of such activity relates to inter-bank equity derivatives dealings impacting less than 5% and are unrelated to corporate control. The fundamental driver of many dealings is hedging to manage risk.

There is a fundamental difference between a traditional relevant interest and a non-physically settleable equity derivative interest – the latter does not confer any power or control over voting or disposal which is what Chapter 6 regulates. The existing law adequately governs the control aspects of equity derivatives – whether on an unwind (through the 20% rule) or because they already give rise to a relevant interest (in the case of a physically settleable equity derivative).

Importantly, the Takeovers Panel can declare circumstances to be unacceptable even if there is no contravention (as expressly provided for by Takeovers Panel GN20 on Equity Derivatives (GN20)).

The inclusion of listed equity derivatives including ETOs, futures contracts and basket/portfolio derivatives in the relevant interest definition is a significant change as they do not confer control or voting rights over the underlying shares. For example, an index futures contract provides economic exposure to every share in the index but no right to vote or control any of the underlying shares. Additionally, the components and weighting of an index change over time make administrative compliance very onerous.

GN20 is well understood, and widely supported, by the market. The industry consensus view is that it is operating effectively to ensure there is adequate disclosure of equity derivative interests where there is a long position of 5% or more.

The proposal would add significant compliance burden to market participants with marginal market benefit. This includes the need to track three sub-categories of "derivative-based holding percentage", and the need to lodge a change in substantial holding notice not only if there is 1% or more change in the overall "holding percentage" but also intra-derivative movements of 1% or more.

1.1.2. Tracking

Tracking and reporting all cash settled derivatives regardless of whether they are hedged is likely to introduce more noise into substantial shareholder reporting that is likely to make it more difficult to understand who actually beneficially owns or controls the voting shares of a listed company, thus making the regime less transparent. The current GN20 regime that requires reporting of a 5% long position operates alongside the substantial shareholding regime, so does not currently have this effect.

1.1.3. Aggregation of additional positions across financial institutions

The proposed change to incorporate cash settled derivative positions into the relevant interest definition may result in many more positions being aggregated for reporting across investment banks and their trading divisions. As investment banks and their trading divisions are required to aggregate their positions with other lines of business and group entities, the proposed changes may mean regulatory thresholds such as the takeovers compulsory bid level will be met more easily. Trading divisions who are facilitating client activity are not interested in acquiring control of companies but are rather facilitating the diverse activities of their clients, so the expansion of the definition of a relevant interest to capture cash settled positions may unnecessarily constrain the activities of financial institutions.

By capturing such positions, the proposals also have the potential to create a misleading picture of the control of listed entities, causing confusion amongst market participants and investors.

1.1.4. International considerations

The consultation papers states that part of the reasons for the changes is international consistency (e.g. Hong Kong and United Kingdom). Therefore, the statutory exemptions that have been granted in those markets should be studied and applied here. For instance, in Hong Kong there is an exemption for broad based indices/baskets i.e. greater than 5 stocks where the relevant share comprises more than 30% of the basket/index. Members advise us that nature of the material that needs to be disclosed in other jurisdictions, such as Hong Kong is much less than what is required in Australia. This supports the need to require a detailed comparative analysis before the justification of international consistency can be assessed as a justifiable policy basis for such a substantive change. Further, given the additional breadth of relationships and instruments covered and the more detailed disclosure required in Australia, this is likely to impose changes to global reporting processes to comply with the Australian rules with no benefit and no international consistency.

The extra-territorial reach will impose an unreasonable burden. An Australian dual listed stock (e.g. Rio Tinto) that might be incorporated into an international basket/index or in some other exchange traded product would need to be tracked and incorporated into reporting here. There seems to be limited regulatory benefit from this disclosure and there are generally not the kind of trade that is entered into when looking at control transactions, yet there will be significant cost incurred in ensuring such products feed into the substantial shareholding monitoring of positions and tracking when exchanges include new products. Such products would warrant exemption consideration.

1.1.5. Overreporting of sensitive client specific transaction terms

The overreporting of sensitive client specific transaction terms creates two types of problem.

- *Problem 1: Confidential client information*

  Confidential client information including full unredacted copies of cash settled instruments in substantial filings may causes significant issues for market integrity and client confidentiality. For example, a cash-settled equity collar disclosed with a complete tranching schedule contains exact maturity dates and strikes which is information market participants (hedge funds, quant funds) can potentially use to their advantage and front-run actual market activity. AFMA suggests that an appropriate level of market transparency could be achieved by simply disclosing that the position / delta is hedged, as it gives a satisfactory approximation on the overall economic position.

- *Problem 2: Over-disclosure*

  The Corporations Act requirement to disclose ‘all relevant documentation which gave rise to a relevant interest’ is very broad and onerous. Cash-settled swaps/instruments are very common in the market, and having to upload all documentation related to the instrument would require ISDAs/confirmations/etc to be shared across a huge volume of transactions. In practice, this would mean substantial filings by banks and market participants who are commonly ‘holders’ of derivatives which will be hundreds of pages long.

1.1.6. Beneficial tracing notices

For the same reasons noted above, we do not think the application of beneficial tracing notices should be extended to equity derivatives and certainly not where the interest is below 5% Tracing all cash-settled derivative exposures below 5% is a material departure from current practice and without clear policy support. Aside from our strong assertion that the vast majority of derivative activity do not have a control purpose and relates to shares representing less than 5% of issued capital, it is also unclear that it would be a net benefit to trace the transactions where a strategic investor is “stakebuilding” in a target. More policy discussion needs to occur on this point as it is an important feature of Australian takeover practice. In practice, a market maker’s hedge books are typically co-mingled, so it is also unclear how increased tracing requirements relating to specific parcels of shares would be followed as there is rarely a one to one correspondence between shares and derivatives.

1.1.7. Access to tracing notices

The extension of free access to journalists and academics is an additional cost being imposed on industry. There is no reason why the industry should be under a statutory obligation to bear the cost of facilitating the work of journalists and academics.

1.1.8. Timeline to implement

A six-months transition time is too short for such wholesale changes to disclosure requirements. We expect other banks and other market participants would need to upgrade their relevant interest monitoring system / controls to comply with the requirements to categorise and disclose a much greater number of transactions.

AFMA regularly reminds the Government that an 18-months transition period at a minimum are needed for changes that involve IT upgrades.

2. Subsection 608(8) is key in defining one of the categories of derivate-based interests that must be disclosed under the proposed amendments to Chapter 6C. The draft Bill assumes subsection 608(8) operates as outlined in ASIC Regulatory Guide 5 (RG 5) Relevant interests and substantial holding notices, at (RG 5.163-5.166) where ASIC observes in effect that the provision:

- ***is not intended to be limited to arrangements regarding designated parcels of underlying securities; and***
- ***should be applied on the basis that the person who has a relevant interest in underlying securities will satisfy their relevant obligations by applying the securities they have a relevant interest in (even for example if they have less than the number held at the time).***

AFMA approaches the law on the basis that the law on its face should be clear about obligations, especially where they are subject to severe criminal penalties.

2.1. Is the operation of the provision outlined in the regulatory guidance sufficiently clear and followed in practice?

The premise of this question is problematic and impliedly supports our fundamental proposition that we are dealing with complex products which are not easily forced into an inflexible statutory reporting regime.

2.2. Would the legislation benefit from expressly clarifying the operation of subsection 608(8) in any way – for example, specifying the relevant assumption to be made regarding how a counterparty will satisfy their obligations for the purposes of applying the provision?

Yes.

2.3. If it were to do so, should the assumption depend on the reason the relevant interest arises?

As we indicated above there are more fundamental problems with relying on "relevant interest" as the trigger for this disclosure requirements.

3. In relation to the disclosure of non-physically settled derivatives, the draft Bill proposes ASIC be empowered to make a legislative instrument to determine either:

- **_the number of issued securities in which the other person is taken to have a relevant interest; or_**
- **_the method of working out the number of issued securities the other person is taken to have a relevant interest in._**

The ability for ASIC to determine a specific number is intended to cover the situation whereby ASIC may need to remove certain derivatives from consideration and thereby determine the value to be zero.

AFMA is opposed to this matter being dealt with by an ASIC legislative instrument because giving ASIC power to determine the degree of relevant interest, either as a numerical output or through a prescribed calculation method, would create a significant amount of uncertainty and potential divergence from the economic reality of a derivative arrangement. This is particularly pertinent in the case of non-linear derivatives where calculating key measures such as 'delta' necessarily rely on highly changeable inputs and forward-looking estimates which are intrinsically uncertain and inherently cannot be appropriately captured in a static framework.

3.1. Is this approach preferable to enabling ASIC to exclude particular kinds of derivatives from the beneficial ownership disclosure requirements? If not, what alternative approach would be better?

No. These fundamental matters need to be dealt with at the level of the law, or at a minimum in regulations made under the law.

3.2. ***Should ASIC have additional flexibility in the way it prescribes, or allows parties to a derivative to determine, the number of underlying securities a person is deemed to have an interest in?***

This again introduces scope for uncertainty. The law itself should make clear what the thresholds are. Our preference is for an exemption-based approach rather than ASIC deeming the relevant interest to be zero, as this may create statutory interpretation uncertainty. Moreover, it is not clear how the proposal for ASIC to determine the number of issued shares that a person has a relevant interest would work in practical terms. For instance, OTC derivatives can be very bespoke. This could result in parties needing to apply for an instrument before entering the trade, which is an absurd outcome.

4. ***The draft Bill includes provisions intended to ensure that arrangements and interests that simultaneously meet the definition of more than one category of derivative-based relevant interest are not double counted.***

Are all instances of potential double counting effectively avoided under current drafting?

The flaw lies in using relevant interest.

5. ***The draft Bill intends to attribute the new deemed relevant interests to the party to the transaction that is in the bought position. Is that intention achieved, or is further clarity required?***

An "economic interest" under an equity derivative should not be deemed to give rise to a "relevant interest" for Chapters 6 or 6A purposes.

6. ***The draft Bill proposes providing ASIC with the power to approve the form in which substantial holder notices are lodged, removing a legislative obstacle to moving towards machine readable lodgements.***

6.1. ***What processes would be involved in meeting a requirement that substantial holder notices be lodged in machine readable format?***

6.2. ***What impact would carrying-out these processes have on businesses?***

6.3. ***What impact would requiring substantial holder notices to be lodged in machine readable format have on transparency of market operations?***

Let's get the regime right first then we can look at machine readable reporting formats, which is an issue that is wider than just this area.

7. ***Freezing orders***

The Explanatory Memorandum outlines relevant considerations regarding how ASIC should balance the rights of third parties with the desire to ensure compliance with the disclosure obligations in exercising its expanded freezing powers.

7.1. Does the guidance strike the right balance?

There is concern about the potential significant consequences of the freezing powers proposed to be granted to ASIC in relation to any contravention of substantial holder notice disclosures and tracing notice provisions.

Under the proposals, ASIC will be able to make orders against “specified persons” which may be third parties. These third parties may be equity derivative providers, putting them in a position where they cannot adequately hedge their exposures under equity derivative transactions and are prevented from exercising their rights in relation to these transactions.

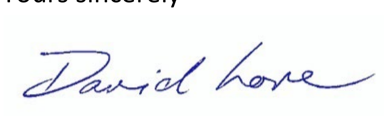
Because the freezing order proposal results in the writer of an equity derivative being subject to a freezing order due solely to the actions of the taker (i.e. no fault of writer). This increased risk for practitioners could result in an attempt to shift the risk and burden back to counterparties, which creates economic inefficiency and may even meaningfully limit the amount of equity derivatives activity in the Australian market as the risk and cost of equity derivatives in Australia may deter market makers from providing these services.

7.2. Is the guidance in the Explanatory Memorandum sufficient or should ASIC be required to give preference to a particular approach by the legislation?

This regime, as we noted in relation to international consistency, is another factor that would make Australia too complex a jurisdiction because of its quirky rules driving international participants away.

Any questions on this letter should be directed to myself, David Love, at dlove@afma.com.au or on 0415 903 412.

Yours sincerely



David Love
General Counsel