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To: Takeovers Panel Secretariat

Guidance Note 20 Equity Derivatives Consultation

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on the Takeover Panel's consultation on Guidance Note 20 Equity Derivatives.

AFMA welcomes the review of Guidance Note 20 Equity Derivatives as an opportunity to increase the clarity of guidance and thereby better serve companies, bidders and the market.

The aims of the revised draft according to the Consultation Paper are to:

- "rewrite the Guidance Note with the aim of providing shorter and clearer guidance;
- state the Panel's expectation that all long positions over 5% should be disclosed (irrespective of whether there is a control transaction); and
- provide guidance on the matters the Panel will take into account in considering what orders should be made if the Panel finds that non-disclosure of equity derivatives is unacceptable."

AFMA would agree that the current Guidance Note could well be expected to benefit from a revision that aims to increase clarity.

AFMA also considers it is appropriate that guidance be provided by the Panel on the matters it would take into account when considering what orders should be made if the Panel finds that non-disclosure of equity derivatives is unacceptable.

1. Do you agree that the Panel should expect disclosure of all long positions over 5%? If not, what do you consider should be the Panel's policy position on disclosure of equity derivatives?

We note some reservations around the second point – to state the Panel's expectation that all long positions over 5% should be disclosed irrespective of whether there is a control transaction.

To the extent a derivative writer acquires shares to hedge the option positions, the writer remains subject to substantial shareholder disclosure requirements.

As a general principle AFMA recommends against public reporting of equity derivative positions when there is no control transaction, as reporting of these positions could discourage market activity and positions that have no connection to takeovers.

Reporting, whether it be by a writer or a taker of an equity derivative, could expose the writer of the derivative to trading risk around the derivative. This could discourage investment and liquidity in the markets. AFMA queries whether disclosure in the absence of a control transaction delivers any additional relevant informational value to justify these risks.

The current in force Guidance Note 20 states "The Panel is generally not concerned with transactions that have little to do with control"[1], but notes that the Panel may examine circumstances where there is no control transaction in certain circumstances depending on *inter alia* "the type of equity derivative, the parties involved and the relationship of the derivative transaction to a control transaction".

The approach of the existing Guidance note 20 is broadly consistent with the legislative framework and the expectations of Parliament. The Corporations Act at 659AA states "The object of sections 659B and 659C is to make the Panel the main forum for resolving disputes about a takeover bid until the bid period has ended." This intention was acknowledged by the Panel in Auris Minerals Limited [2018] ATP 7 footnote 10 "We note, for example, that there is no takeover bid on foot or proposed and accordingly this is not a dispute that Parliament intended the Panel to be the "main forum" to resolve (see sections 659AA, 659B and 659C)".

However, in Tribune Resources Ltd, [2018] ATP 18 at 67 the Panel held that while in deciding on whether to make a declaration it would need to consider "s602, the provisions of Chapter 6 and, more broadly, the role Parliament intended the Panel to perform". In footnote 18 it held that "It does not follow, however that we are precluded from considering whether circumstances are unacceptable on the basis of a contravention of Chapter 6C merely because the Court also has jurisdiction or there is no control transaction on foot".

The proposed draft of Guidance Note 20 would appear to suggest that the Panel is minded to extend this reasoning to require, in the absence of a control transaction, general reporting requirements that go beyond those that have been set by the Corporations Act. That is where there is no control transaction and an equity derivative exposure (where the securities to which the derivative relates exceeds the 5% level).

It is not clear that this reporting direction is soundly-based in a guidance note of the Panel. If it is the case that the Panel is within its powers to consider circumstances outside of

[1] Guidance Note 20, p. 3.

control transactions it does not necessarily follow that it is within scope to create reporting directions for the market more generally merely because substantial equity derivative positions are established.

While it may be appropriate for Panel guidance to inform market practices during a takeover period, this is a period of direct relevance to the Panel. When there is no control transaction the broader market activity might be harmed by reporting directions from Panel guidance.

For situations where there is no control transaction different parties may take different views on the applicability and relevance of Panel guidance, and if even only some market participants and investors hold that matters outside of control transactions might not be within the mandate of the Panel (given its primary purpose as a dispute resolution body for takeover bid disputes during the takeover period) then investors will not be able to be sure that derivative positions are being included and reported.

For these reasons we would suggest that the Panel restrict any guidance around directions to report equity derivative positions by the taker of equity derivatives to periods where there is a control transaction.

2. Do you agree with footnote 2? What further guidance (if any) do you think the Panel should provide in cases when a person obtains a long position of over 20%?

It would be helpful if the Panel provided more clarity on which particular circumstances they would view a transaction of that nature to be unacceptable circumstances.

3. Should there be more guidance provided in relation to what information is required to be disclosed (see paragraphs 11-17)? If yes, what guidance would assist? Should the taker of an equity derivative be expected to disclose the identity of the writer(s) of that derivative? Please explain.

We note the risks for gaming of derivative positions around the strike price in the event that they exposed either by the writer or taker of the derivative. Increasing risks of gaming decreases interest in providing these financial services and increases their cost.

The writers of equity derivatives should not be required to report the derivative. We find the 'usually apply' wording in footnote 3 creates uncertainty and should be removed. We suggest that the wording be moved to the body of the guidance (such as in the current GN20 paragraph 15) so that it is clearer the writer is carved out of the directions.

Writers of equity derivatives do not necessarily have a view of all of the holdings of a bidder which may be held with multiple counterparties and through other market participants. The taker is the party with the view of their total exposure. Further, writers of derivatives might accumulate significant derivative exposures as part of a market making or flow business that would not be related to a control bid. It may create a

misleading impression and detract from the clarity of information around equity derivative reporting if these positions are required to be reported.

AFMA queries the removal of the exception for market makers that is the current version of the guidance. Market makers are not concerned with control transactions and any net positions that they gain (in the circumstances outlined in the previous guidance) should be excluded from any reporting direction.

4. Are there any other changes you would make to the draft Guidance Note? Please explain.

AFMA seeks clarity that the writer is not obliged to disclose to the taker its hedge positions. This is proprietary information of the writer that is not customarily shared with external parties and as stated in footnote 5, the hedge status might change frequently or the hedge may not be the underlying security.

AFMA also seeks clarity around whether the 5% holding is just for one derivative or also includes aggregate derivatives for disclosure, where a person may accumulate small positions across a number of derivative providers. It is not clear how this would apply for institutional clients who may be managing a portfolio of derivatives and positions and inadvertently gaining a net 5% exposure and not taking on one derivative which results in an exposure to 5% of the company.

Conclusion

We thank you for the opportunity to comment on the proposed revisions to Guidance Note 20 Equity Derivatives. AFMA supports efforts to bring greater clarity to the panel's expectations around equity derivatives and their interactions with takeovers. As discussed above we do have concerns about guidance changes that would seek to reform reporting practices where there is no control transactions, and seek a clearer carve out for writers of derivatives.

We trust our comments are of assistance, and would be pleased to provide further information if desired. In this regard please contact me at djeffree at afma.com.au.

Yours sincerely

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Director of Policy