16 May 2025

Competition Taskforce
The Treasury
Langton Cres
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By email: CompetitionTaskforce@Treasury.gov.au

Dear Mr Guinane

Mergers reform – notification thresholds instrument – exposure draft

The Australian Financial Markets Association (AFMA) is responding to the Mergers Reform – notification thresholds instrument – exposure draft consultation on the exposure draft of the *Competition and Consumer (Notification of Acquisitions) Determination 2025* (Determination).

AFMA is the peak industry body for Australia's financial markets industry – including the capital, credit, derivatives, foreign exchange, and other specialist markets. AFMA represents more than 130 industry participants from Australian and international banks, leading brokers, securities companies, government treasury corporations to asset managers, energy firms, carbon market participants, and industry service providers.

AFMA promotes efficiency, integrity, and professionalism in Australia's financial markets enabling the markets to continue to support the Australian economy, a highly skilled job market and the energy transition.

1. General Comments

AFMA is seeking additional clear exclusions in the Determination for transactions used in wholesale financial markets. Approaching the Mergers Reform from a financial markets perspective AFMA is concerned that the drafting of the Determination does not sufficiently carve out financial market transactions unrelated to merger transactions from the new notification regime. The Determination requires further drafting refinement in order to properly reflect the intention of Parliament with the Mergers Reform and avoid disrupting financial market activity. The potential disruption would flow from

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regulatory uncertainty with the unintended application of the Mergers Reform. Legal certainty is fundamental to the proper functioning of financial markets and the purpose of these comments is to identify examples of transactions which are commonly entered into in the wholesale financial markets, which can involve acquisitions, and which would not be clearly covered by the existing exceptions in the draft Determination.

A broad range of market participants enter into derivatives and securities financing transactions, including special purpose vehicles (for example, in securitisations and project finance arrangements). Such transactions may be entered into for a variety of purposes, including:

a) hedging purposes – such as physically-settled commodity forward transactions;
b) liquidity purposes – such as securities loans or repurchase transactions; and
c) trading for profit.

It can be difficult to establish whether a transaction is "in the ordinary course of business," other than in a clear and natural application (for example, in the purchase of inventory). This is particularly the case in financing, securitisation, financial markets, or bespoke structured finance. Requiring a reasoned analysis regarding whether a transaction is in the "ordinary course of business" on a case-by-case basis (particularly in the absence of clear authority on its boundaries and its specific application to financing arrangements) is not realistic and leave market participants without the level of clarity and certainty needed.

Although section 4(4)(b) of the Competition and Consumer Act (CCA) provides that the acquisition of an asset does not include a reference to an acquisition in the ordinary course of business, determining whether a transaction is in the ordinary course of business can be complex, especially in financial markets. Clarity is needed to avoid market disruptions. There is a risk for any financial counterparty that any acquisition may be stayed or rendered void ab initio in the event of non-compliance with regulatory notification requirements. This will undermine the certainty that financial market participants need when undertaking transactions as to the validity of those transactions.

Accordingly, to avoid disruptions to markets, it will be important for market participants to have clarity regarding the scope of the ordinary course of business concept for these purposes and the benefit of specific exemptions.

We emphasise that we are seeking clarity and given the nature of regulatory compliance environment clear statements in legislative instruments are our strongly preferred way to address interpretation confusions.

AFMA has also had the benefit of discussions with ISDA and APLMA about their concerns. In addition, we have also considered the extensive Law Council of Australia submission and support its analysis of issues and problems. We endorse these other comments. In this submission we focus on financial markets concerns.

2. Examples

Set out in this section are examples of transactions commonly entered into by financial markets participants which may be construed as acquisition of assets but may not be expressly carved out by the exceptions under the Determination. We also explain the reasons for our concern.

2.1. Transactions which may be inadvertently caught

Physically settled over-the-counter derivatives and securities financing transactions (in the form of securities lending and repurchase transactions) can involve acquisitions of shares or other assets as they do not have the benefit of an exception. This could have a material adverse impact on financial markets in Australia and Australia's reputation internationally as a sound jurisdiction for trading. Banks trading with Australian clients require positive close-out netting legal opinions for trading agreements they enter into with those clients as a global regulatory requirement.

The ability of each party to a derivative or securities lending transaction to terminate, close-out net, enforce security and exercise set-off rights and similar rights, in each case in order to manage risk and crystallise exposures in default situations in the manner agreed by the counterparties at the outset of their trading relationship is critical to both parties' effective risk management and compliance with regulatory requirements. This has been acknowledged and supported by government and Australian regulators for many years. Such critical terms should not be considered to be an acquisition and not subject to the Mergers Reform in any way. The Government should clarify this in the Explanatory Statement to the Determination for clarity.

The following transactions may involve acquisitions of shares in the capital of a body corporate or assets:

- physically-settled derivatives (be they exchange-traded or over-the-counter (OTC), which may provide for the physical delivery of shares or a broad range of other assets including debt instruments (such as corporate or government bonds), shares, currencies, bullion or commodities or other assets; and
- securities financing transactions, including:
  - repurchase transactions, which can involve selling a security or other traded financial asset and agreeing to repurchase it in the future for an additional amount;
  - securities lending, which can involve lending a security or other traded financial asset for a fee in return for a guarantee in the form of financial instruments or cash given by the borrowed; or
  - sell/buy-back transactions.

Depending on its terms, a derivative or securities loan could, of itself, be an acquisition, and the transfer/settlement of any share or asset pursuant to the terms of that derivative or securities loan could itself be a separate acquisition.

The exchange traded derivatives exception would not apply to over-the-counter derivatives or securities financing transactions. In this context exemption of exchange traded derivatives in s 2-26 of the Determination is limited to:

a) an acquisition of an asset in the form of an exchange-traded derivative; and
b) if, at the time of that acquisition, the derivative confers an equitable interest in a share or asset—the acquisition of that equitable interest.

Excluding transfers/settlements of the assets which are the "underlying" for any derivative or securities financing transaction from the scope of the exception (as is done in the Explanatory Statement in respect of the exchange-traded derivatives exemption) is likely to cause difficulties for participation in financial markets, given the more limited exceptions currently available in the *Competition and Consumer Act (Cth)* CCA and draft Determination for financial assets commonly subject to derivatives and securities financing transactions as compared to shares.

2.2. Derivatives transactions

In respect of most derivative market transactions, there will be related hedging transactions used to offset risks inherent in the derivative transaction. Accordingly, if a derivative transaction or related acquisition were void ab initio, the derivative counterparty may be left with potentially significant market risk on their original hedge position as it would no longer be offsetting risk under the void derivative transaction. If those transactions inadvertently trigger any form of a breach due to imperfectly drafted exceptions, in our view they should not automatically be rendered void ab initio.

Equity derivatives and structured products are key risk management and hedging strategies for many Australian wholesale clients. Companies and other sophisticated investors (e.g. high net worth individuals and family offices) are also frequent users of equity derivatives and structured products for hedging, financing and other strategic purposes. It is key that a clear exception be included for these types of derivatives.

2.3. Financing arrangements

Similar risks may also exist for financial markets counterparties to other types of financing arrangements (e.g. securities financing transactions, asset financing transactions, etc…) where; (i) financing may enable one party to use funds to enter into subsequent transactions with another layer of financial market counterparties, or (ii) where the party providing the finance may have entered into interest rate hedging transactions through financial markets, etc… If there was a failure by one party to notify the ACCC and therefore void the transaction that triggered the breach, there can be multiple incidental transactions that will need to be reversed at a cost to potentially multiple innocent counterparties.

2.4. Cash-settled OTC derivatives

It is not clear whether cash settled over-the-counter derivatives are in-scope or not. They should be clearly excluded.

2.5. Acquisition of assets by way of charge only

There are collateral arrangements involving the acquisitions of shares or assets which are not necessarily secured by way of charge. Collateral arrangements could also include obtaining a security interest over the legal and beneficial interest to shares and bonds and a range of property including debt or cash. The security structure for a listed instalment warrants involves the granting of an equitable mortgage over the property of each separate trust and this structure may not necessarily be considered under law as a charge. The term ‘charge’ is not defined in the CCA, but the lending and financial accommodation acquisition exception in s 2-24 of the draft Determination refers to ‘security interest’ which is defined as having the meaning given by the Corporations Act.

2.6. Collateral arrangements other than by way of charge

Additionally, there are a range of collateral arrangements that may involve acquisitions of shares in the capital of a body corporate, or acquisitions of assets other than by way of charge only. Collateral in respect of derivatives, structured products, margin loans and securities financing transactions (including in relation to transactions cleared through a central clearing house) may be provided on either:

a) an absolute transfer basis, for example, under a Variation Margin Credit Support Annex (CSA) published by ISDA, which is the global approach to margining under the CSA; or
b) by way of security, which may be a charge or mortgage.

There are also a range of credit support arrangements where the mechanism by which the secured party takes credit support is not a “charge” as that term is understood in financial markets, but may be by way of a title transfer, or another form of security and/or may otherwise fall within the definition of ‘security interest’ in the *Personal Property Securities Act* (Cth) (PPSA).

Collateral in respect of derivatives and securities financing transactions (including in relation to transactions cleared through a central clearing house) may be provided on either:

- an absolute transfer basis, for example, under a Credit Support Annex published by ISDA; or
- by way of security, which may be:
  - a charge or mortgage;
  - where the security is granted under US law, a pledge.

Such collateral arrangements may involve the acquisition of security interests over, or legal and/or beneficial title to, high quality liquid assets (such as government bonds) as collateral to secure obligations under those arrangements, but may also include a broad range of property, including other debt or equity securities.

The ability for a notifiable acquisition to be stayed or be void would derogate from collateral arrangements in the financial markets, such that those arrangements may not achieve the credit risk mitigation objectives intended by market participants or required by the regulators of these markets (including prudential regulators of banks, including the Australian Prudential Regulation Authority under Prudential Standard CPS 226). Accordingly, it is important that collateral arrangements are able to operate without the overlay of these notification requirements which could conflict their purpose. This would be consistent with the manner in which Australian law (particularly the *Payment Systems and Netting Act (Cth)*) currently robustly protects these arrangements.

2.7. Custodians

It is common for custodians (including in collateral arrangements in respect of initial margin) and depositary nominees to hold on trust:

a) shares in the capital of a body corporate; and
b) assets that may not be 'securities' within the meaning given by subsection 92(3) of the Corporations Act, such as a CGS depositary interest or a simple corporate bonds depositary interest (each as defined in the Corporations Act) or other financial assets.
c) Initial margin arrangements required for non-cleared OTC derivatives collateral arrangements in respect of initial margin being held by custodians.

The bare trustee exception in s 2-25 of the Declaration provides that:

> *This Division covers an acquisition of an asset, that is an interest in securities, by a person as a bare trustee if a beneficiary under the trust has a relevant interest in the securities because of a presently enforceable and unconditional right of the kind referred to in subsection 608(8) of the Corporations Act.*

This exception is limited to the acquisition of an asset (and not to a share in the capital of a body corporate) that is an interest in securities, where 'securities' has the meaning given by subsection 92(3) of the Corporations Act. The limitation on the custodian exception to an acquisition of an asset needs to be widened where the interest is held as an interest in securities.

2.8. Debt Issuance

Debt instruments in the form of issued bonds should be excluded as assets under the notification regime. The successful issuance of a bond in the market is highly dependent on the market conditions and investor interest at a point of time. Success in this context means the issuer being able to issue the amount of bonds it requires at a price it is willing to bear (i.e. the interest on the bond).

For government, semi-government, and other frequent issuers, such as AOFM, it is typical that a bond is announced, priced, and issued within less than 5 business days. If bonds are subject to the notification and approval regime it is likely to give rise to a protracted process in issuing the bond (i.e. at least 30 business days), making it less certain that the issuer will be able to issue the amount of bonds it requires and at a price it is willing to tolerate.

If there is a protracted period between the marketing of a bond and its issuance (e.g. at least 30 business days after notification), it is highly likely to have a materially adverse impact on investor interest (reducing competitive pricing between investors) and those who are interested will price this extended period in, thereby increasing the cost of the bond to the issuer overall and also reducing the amount of bonds the issuer is seeking to issue.

Similar adverse impacts on investor interest and pricing of the bonds are also likely if the bond is issued before approval by the ACCC with the risk that the bond may be found to be void post issuance.

2.8.1. Repos

Connected to debt are repo transactions. There are similarities in economic terms between repo and securities lending discussed earlier with a key difference being that the repo market overwhelmingly uses bonds and other fixed-income instruments as collateral, whereas an important segment of the securities lending market is in equities.

Among other uses, for the primary debt market repo allows dealers to fund their bids at bond auctions and their underwriting positions in syndicated bond issues at reasonable cost, thereby providing cheaper and less risky access to the capital markets for issuers, both governments and corporates. Primary dealers and other underwriters also rely on the repo market to hedge the interest rate risk on a long position in a new issue while it is in the process of distribution to investors by taking an off-setting short position in an existing issue with similar risk. Also, investors in corporate bonds often seek to neutralize their exposure to general interest rate movements in order to target just the credit risk of these securities in the form of the credit spread. This can be done by taking a short position in the benchmark government bond with the closest duration to the corporate bond.

2.9. Distressed Debt

It is unclear how these reforms would operate for debt specific scenarios. Any loan would, in our view, be in the ordinary course of credit provision so it would not be notifiable under the Determination. However, there will be a point after a borrower shows signs of financial distress that this form of credit ceases to be provided in the ordinary course. We expect that existing lenders remain carved out but distressed debt funds picking up distressed debt to get themselves a seat on the board table when the assets are carved up. Any uncertainty regarding the specific point in time when notification may be required, could risk undermining secondary markets for distressed debt – e.g. as a traditional credit provider, a debt fund may be at risk of having the sale of distressed debt void ab initio because the purchaser failed to notify ACCC.

2.10. Hybrids

AFMA is concerned that 'hybrids' are not catered for in the exceptions and that they need to be accommodated.

Hybrid securities are used to describe a security that combines elements of debt securities and equity securities. Issuers of hybrid securities in Australia are typically either corporates or banks and insurance companies. Corporate hybrids can be issued by either listed or unlisted companies and are a means for corporates to borrow money from smaller investors. Examples include convertible/converting bonds (bonds that convert into shares or other securities under certain conditions), perpetual bonds (bonds that do not have a maturity date), subordinated bonds (bonds that are subordinated to the claims of other creditors) and knock-out bonds (bonds that give the issuer or a third party a right to extinguish them under certain conditions).

The Australian major banks have been major issuers of hybrids because they used to be able to constitute Alternative tier 1 (AT1) for APRA capital standards. APRA has recently started phase out of AT1 for banks although insurers can continue to make use of them. Despite this phase out there is a long tail of bank hybrids in the market, which should not be disturbed. In particular, bank hybrids have been a popular investment for retail investors. An example of a concern is a buyer of an AT1 need to think about what percentage of the shares of the issuer they might be buying rights in (which would be challenging to do prior to a conversion trigger), which could lead to uncertainty, delay, potential impact on the price of the securities in the market for these products.

Another common type of hybrid is a 'stapled security'. These involve two or more securities issued by the same or different entities being contractually bound together such that they cannot be traded separately. While there are many different types of structures, stapling together of units in a trust and shares in a company is a common practice. At the simplest level, the securities could be issued by the one entity, such as the debt security (loan note) and equity structure used in the spin-off. Another possibility is for one security, such as a preference share, to be issues by a parent company and the other, such as a loan note by a subsidiary. A third approach is for contractual operating agreements between a company and a "related" trust (or several trusts) to underpin the stapling of the securities. In the latter form, the trust might own physical assets and lease them to the company for use in generating income.

3. Way forward

As you will appreciate from the wide range of financial transactions that we can see being unsettled from Mergers Reform notification regime our objective is to seek a broad exemption that sufficiently carves out financial market transactions that are unrelated to mergers. Limited technical exemptions are subject to being overtaken by market innovation. AFMA believes that this approach is in keeping with Parliament's policy objective of regulating mergers but not interfering with the normal functioning of the financial markets for other purposes. AFMA would welcome the opportunity to explain our concerns to you with the participation of our members who are well acquainted with the mechanics and products involved.

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