



## CONSULTATION PAPER

### Guidance Note 20 – Equity Derivatives

**Why is the Panel consulting?**

Guidance Note 20 was issued on 11 April 2008.

The Panel considers that disclosure of all long positions in equity derivatives (and any relevant interest in the underlying voting shares) over 5% promotes an efficient competitive and informed market. The Panel proposes to revise Guidance Note 20 to provide clearer guidance about the Panel's approach to Equity Derivatives.

**What is the Panel proposing?**

Attached is a draft Guidance Note. The main proposed changes 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.

**Questions**

Comments are sought on the draft Guidance Note, in particular:

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 Are there any other changes you would make to the draft Guidance Note?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

**Submissions**

Comments on the draft Guidance Note are due by **Friday, 31 May 2019**.

Please send any submissions (which will be made public) or queries to [takeovers@takeovers.gov.au](mailto:takeovers@takeovers.gov.au).

Wednesday, 10 April 2019



## Guidance Note 20 - Equity Derivatives

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### Background

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1. This Guidance Note has been prepared to assist market participants understand the Panel’s approach to disclosure of equity derivatives. Equity derivatives are valuable trading and risk management products. There is a significant market for them and the Panel does not want to interfere with that market where equity derivatives are not used in ways that undermine the policy of Chapter 6.
2. If an equity derivative gives the taker a relevant interest in any underlying securities, the disclosure regime in Chapter 6C applies.<sup>1</sup> This note applies to equity derivatives that may not require disclosure under Chapter 6C.
3. The examples are illustrative only and nothing in the note binds the Panel in a particular case.
4. In this note the following definitions apply:

| Term                          | Meaning  |
|-------------------------------|--|
| cap and/or collar arrangement | Arrangements that operate to limit the taker’s upside and/or downside exposure |

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<sup>1</sup> All statutory references are to the *Corporations Act 2001* (Cth) (as modified by ASIC) unless otherwise indicated. Disclosure of equity derivatives may also be required under Chapter 6C if the writer and taker are associates. ASIC has provided guidance regarding the requirements of Chapter 6C in Regulatory Guide 5, Relevant interests and substantial holding notices, including in relation to options ([5.152]-[5.185]) and warrants ([5.186]-[5.242]), and Regulatory Guide 222: Substantial holding disclosure: Securities lending and prime broking.

| Term          | Meaning  |
|---------------|--|
| entity        | A listed company, listed body or listed registered managed investment scheme                           |
| long position | Either a long equity derivative position or a relevant interest in securities or a combination of both |
| taker         | Person who 'acquires' an equity derivative, usually the client   |
| writer        | Person who 'provides' the equity derivative, usually an investment bank                                |

### Equity derivatives and hedging

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5. Equity derivatives, in the hands of the taker, may be long (ie, the taker is to benefit from an increase in the price of the underlying security) or short (ie, the taker is to benefit from a decrease in the price of the underlying security). In either case, the terms may provide that they are cash-settled or "exchanged for physical" (ie, the underlying security is transferred).
6. Equity derivatives may be hedged. The writer usually has an economic incentive to hedge its position, regardless of whether the derivative is cash-settled or exchanged for physical. The hedge is often established by acquiring the underlying securities. The writer is not ordinarily contractually obliged to hedge (or else a relevant interest may arise). Nevertheless, even if the derivative is hedged, the long position may not confer voting power on the taker. On the unwinding of the position, the writer has an economic incentive to unwind any hedge.
7. By creating the economic incentive to hedge and then by controlling the unwinding, the taker of a long equity derivative position (even one that is cash-settled) may affect the market in the underlying securities, for example by bringing about a reduction in the "free float" of the entity. Such an effect on the supply (and perhaps therefore the price) of the securities may, in turn, affect:
  - (a) control or potential control of the entity
  - (b) the acquisition or proposed acquisition of a substantial interest in the entity or
  - (c) the efficient, competitive and informed market for control of the entity's voting securities.

8. Non-disclosure of equity derivative transactions in the above circumstances may give rise to unacceptable circumstances.<sup>2</sup>

## Disclosure of equity derivatives

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9. The Panel expects disclosure to be made where the long position of a person and their associates:
- (a) is 5% or more and
  - (b) if so, changes by at least 1% or falls below 5%
- of the voting rights in an entity.<sup>3</sup> Failure to disclose in accordance with paragraphs 11 to 17 below may give rise to unacceptable circumstances.<sup>4</sup>
10. There may also be circumstances in which the Panel would consider non-disclosure of equity derivatives to be unacceptable where the taker does not have a long position of 5% or more. For example, where purchase of physical securities to which the equity derivatives relate would have required disclosure by a bidder under s636(1)(h), the Panel may consider that the policy underpinning this requirement would warrant equivalent disclosure of the equity derivatives.
11. Disclosure of equity derivatives should allow the market to understand fully the nature of the taker's long position. This may require disclosure of any cap and/or collar arrangements and (if the information is known or readily available) the extent to which the counterparty has hedged.<sup>5</sup>
12. The Panel considers that the following information should be disclosed (as applicable):
- (a) identity of the taker (but not the writer)
  - (b) relevant security
  - (c) price (including reference price, strike price, option price etc as appropriate)
  - (d) entry date

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<sup>2</sup> The acquisition of a long position that would contravene s606 if it were comprised entirely of a physical holding may also give rise to unacceptable circumstances (even if the acquisition does not result in a person acquiring a relevant interest in contravention of s606).

<sup>3</sup> The Panel expects that this will usually apply to holders of equity derivative positions, not the counterparties or writers (who, in the case of long positions, may already be required to disclose relevant interests in shares that they hold as a hedge).

<sup>4</sup> In determining whether non-disclosure of equity derivatives gives rise to unacceptable circumstances, the Panel may have regard to the factors noted (in relation to contraventions of the substantial holding provisions) in *Tribune Resources Limited* [2018] ATP 18 at [67]-[68] and *Auris Minerals Limited* [2018] ATP 7 at [23].

<sup>5</sup> The taker may not know the hedge status, or be able to ascertain it, or the hedge status might change frequently, or the hedge may not be the underlying security (for example it may be another equity derivative).

- (e) number of securities to which the derivative relates
  - (f) type of derivative (e.g. contract for difference, cash settled put or call option)
  - (g) any material changes to information previously disclosed to the market
  - (h) long equity derivative positions held by the taker and its associates, its relevant interests and its associates' relevant interests (and the identity of all associates referred to)
  - (i) short equity derivative positions that offset physical positions<sup>6</sup>
    - Example 1: A taker "rents" voting power by acquiring physical securities and simultaneously taking offsetting short equity derivative positions.*
    - Example 2: A substantial holding of, say, 10% that is disclosed but subsequently a short equity derivative contract is entered for, say, 5%.*
  - (j) short positions of more than 1% that have been acquired after a long position is disclosed, whether by notice or substantial holder notice (ie, the taker should update its disclosure with reference to the short position).
13. The Panel is unlikely to consider that:
- (a) the information needs to be in the form of a formal substantial holder notice (ASIC Form 603 and 604), unless required by Chapter 6C or
  - (b) standard ISDA documentation needs to be provided.
14. Disclosure may be made:
- (a) as a note annexed to a substantial holder notice, if one is given or
  - (b) by written notice to the entity.
15. In considering whether timely and adequate disclosure has been made, the Panel will have regard to the requirements for substantial holder notices – that is, within 2 business days of becoming aware or, in a bid period, by 9.30 am on the next trading day.<sup>7</sup>
16. The Panel expects that the entity will disclose any written notice it receives to ASX.
17. Entry into an equity derivative may be a multi-stage process, especially if the writer is providing exposure to the taker only after it has established adequate hedging. If so, disclosure may be required as it is progressively increased, regardless of when the formalities are completed.

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<sup>6</sup> However it will not normally be appropriate to net long and short positions, unless the derivatives being netted are exchange traded equity derivatives that are exactly offsetting in nature, period and price.

<sup>7</sup> Section 671B(6).

## Remedies

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18. If the Panel finds unacceptable circumstances it can make any order (including remedial orders) it thinks appropriate to (among other things):
  - (a) if it is satisfied that the rights or interests of any person, or group of persons, have been or are being affected, or will be or are likely to be affected, by the circumstances - protect those rights or interests, or any other rights or interests, of that person or group of persons or
  - (b) ensure that a takeover bid or proposed takeover bid in relation to securities proceeds (as far as possible) in a way that it would have proceeded if the circumstances had not occurred.<sup>8</sup>
19. In considering what orders to make, the Panel may consider:
  - (a) any effect on the control or potential control of an entity (including the effect on any control transaction or proposed control transaction)
  - (b) the nature of the equity derivative and
  - (c) the period for which the equity derivative is held and the timing of any disclosure made.
20. The Panel may order:
  - (a) disclosure of the derivatives
  - (b) disposal of any securities and
  - (c) cancellation of agreements.
21. If a person has benefitted or gained an advantage from non-disclosure or inadequate disclosure of a long position of 5% or more, the Panel make seek to make orders to reverse that benefit or advantage.
22. If non-disclosure or inadequate disclosure of a long position of 5% or more has an effect on control, potential control or the acquisition (or proposed acquisition) of a substantial interest, the Panel make seek to make orders to reverse that effect.

## Publication History

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First Issue: 11 April 2008

Second Issue:

## Related Material

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Equity Derivatives – Discussion Paper and Draft Guidance Note (10 September 2007)

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<sup>8</sup> Section 657D.