Australian Government

Takeovers Panel

Guidance Note 20 - Equity Derivatives

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Background

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.[1] 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. The Panel may consider the principles in this guidance note for dealing with other financial instruments that provide economic exposure to an entity's securities.

4. In this note the following definitions apply:

[1] 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
cap and/or collar arrangement	Arrangements that operate to limit the taker's upside and/or downside exposure
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

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.

Disclosure of equity derivatives

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.[2] Failure to disclose in accordance with paragraphs 12 to 18 below may give rise to unacceptable circumstances, irrespective of whether a control transaction has commenced.

10. In considering whether failure to disclose in the circumstances described above gives rise to unacceptable circumstances, the Panel will consider the effect of non-disclosure on the control or potential control of an entity and the acquisition or proposed acquisition of a substantial interest, and whether non-disclosure is contrary to an efficient, competitive and informed market.[3]

    Example 1: A Panel is more likely to find unacceptable circumstances if the taker with a long position over 5% (which has not been disclosed) has attempted to exercise control or influence over the entity or proposes a control transaction after the time that disclosure should have been made in accordance with paragraph 16.

    Example 2: The Panel is more likely to find that non-disclosure of an equity derivative gives rise to unacceptable circumstances if someone other than the taker proposes a control transaction and is unaware of the equity derivative.

    Example 3: The Panel would not normally expect a market maker to disclose a long position to hedge another equity derivative it has written. This includes long positions which are acquired from entities within the same group of companies for the purpose of transferring risk management responsibility.

11. 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.

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[2] The Panel expects that this will 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).

[3] See s657A(2) and s602(a). See also the factors discussed relating to the Panel's consideration of whether contraventions of the substantial holding provisions are unacceptable in *Tribune Resources Limited* [2018] ATP 18 at [67]-[68].

12. 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.[4]

13. The Panel considers that, in cases when it expects disclosure, 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

    (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 long positions[5] and

    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).

14. 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 (for example ISDA) documentation needs to be provided.

15. Disclosure may be made:

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[4] 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).

[5] Long and short positions should not be netted for the purposes of disclosure, unless the derivatives being netted are exchange traded equity derivatives that are exactly offsetting in nature, period and price.

(a) as a written notice annexed to a substantial holder notice, if one is required at the time of disclosure or

(b) otherwise, by a written notice to the entity.[6]

16. 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.[7]

17. The Panel expects that the entity will disclose any written notice it receives to ASX.

18. 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.

Long positions over 20%

19. 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.[8] Factors the Panel may take into account in determining whether such an acquisition is unacceptable include:

(a) if the taker has attempted to exercise control or influence over the entity

(b) if and when the long position was disclosed and

(c) whether the acquirer of the long position could have relied on an exception in s611 if the acquirer had made the acquisition as a physical holding. [9]

Remedies

20. If the Panel finds unacceptable circumstances it can make any order (including remedial orders) it thinks appropriate to (among other things):

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[6] The written notice should be made in a form that is suitable for immediate release to the market without the need for substantial alteration or summation by the listed entity. It should also include a statement that disclosure is made under this Guidance Note and request that it be provided to the ASX. In cases where a substantial holder notice is not required, details of any acquisitions of physical securities (that have not already been disclosed) should be disclosed in the same level of detail as is required under the substantial holder provisions. Such disclosure would need to be repeated in a further substantial holder notice if one is required.

[7] Section 671B(6).

[8] The Panel will take into account the exemption in s609(6) in such circumstances. See for example the Panel's approach for rights issues in *Guidance Note 17, Rights Issues*, at [3] to [5].

[9] However, it may be unacceptable if the terms of an equity derivative, or any other material, suggests that an acquirer intends to lock in the price at which the acquirer makes future acquisitions in reliance on the exception in item 9 of s611, see *John Fairfax Holdings* [1997] ATP.

(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.[10]

21. 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.

22. The Panel may order:

    (a) disclosure of the derivatives

    (b) disposal of any securities and

    (c) cancellation of agreements.

23. 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 may seek to make orders to reverse that benefit or advantage.

24. 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 may seek to make orders to reverse that effect.

Publication History

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Related Material

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

[10] Section 657D.