

# ASIC CLASS ORDER [CO 13/526]

## EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

The Australian Securities and Investments Commission (*ASIC*) makes ASIC Class Order [CO 13/526] under sections 655A and 673 of the *Corporations Act 2001* (the *Act*).

Paragraph 655A(1)(b) provides that ASIC may declare that Chapter 6 of the Act applies as if specified provisions were omitted, modified or varied as specified in the declaration.

Paragraph 673(1)(b) provides that ASIC may declare that Chapter 6C of the Act applies as if specified provisions were omitted, modified or varied as specified in the declaration.

### 1 Background

- 1.1 Warrants are financial products, primarily issued by financial institutions, which provide a level of exposure to an underlying asset, instrument or index. The terms of warrants vary as they are agreed between the issuer and holder. A warrant series that meets certain criteria may be admitted to trading on the ASX.
- 1.2 In some cases a person who issues, holds or acts a trustee in relation to a warrant that relates to an underlying security (such as a share in a company or an interest in a managed investment scheme) can have a ‘relevant interest’ in the underlying security as a result of the warrant. A relevant interest typically arises when a person holds securities, can control voting rights attached to the securities, or can control the disposal of the securities: section 608.
- 1.3 Relevant interests of this kind need to be taken into account when determining a person’s obligations under the provisions in the Act relating to, amongst other things:
  - (a) the takeover provisions in Chapter 6—which regulate the acquisition of interests by a person and their associates above 20% voting power; and
  - (b) the substantial holding provisions in Chapter 6C—which require a person who has obtained a substantial holding (principally voting power of 5% or more) in a listed entity to provide certain information about their holding to the entity and relevant market operators.
- 1.4 ASIC recognises that, in certain cases, the rights and obligations in relation to underlying securities under a warrant that give rise to a relevant interest are sufficiently remote or tenuous that they are unlikely to be used as a means of gaining control of a company. For this reason, ASIC provided class order relief allowing warrant issuers, holders and, where applicable, warrant trustees, to disregard, in some cases, a relevant

interest in underlying securities arising from warrants quoted on the market operated by the ASX. This relief was historically embodied in the following class orders:

- (a) Class Order [CO 02/924] *Call warrant holder takeovers relief*
- (b) Class Order [CO 02/925] *Call warrant takeovers relief*
- (c) Class Order [CO 02/926] *Put warrant takeovers relief*
- (d) Class Order [CO 02/927] *Warrant trustees takeovers relief*

- 1.5 ASIC has recently reviewed the policy underlying these class orders as part of a wider review of class orders relating to the takeover and substantial holding provisions in Chapters 6–6C and considers that the relief provided in these class orders is still both necessary and appropriate. ASIC has decided to reissue the relief underlying the class orders in Class Order [CO 13/526] substance to those in the previous class orders.
- 1.6 The *Legislative Instruments Act 2003* (the *LIA*) provides for the periodic expiry of legislative instruments (‘sunsetting’) to ensure that they are kept up to date and only remain in force for so long as they are needed. The four class orders that have been reissued are legislative instruments and were scheduled to eventually expire under the sunsetting provisions of the LIA. They have been revoked by Class Order [CO 13/518]. ASIC’s reissuing of the substantive relief underlying them has given it the opportunity to deal with their eventual expiry.

## 2 Purpose and operation of the class order

### *Call warrant holders relief*

- 2.1 Call warrants generally give the holder of a warrant the right, but not the obligation, to acquire the underlying securities under the terms of the warrant agreement. Therefore, a call warrant holder has a relevant interest in the securities that are the subject of the warrant agreement and in which the warrant issuer has a relevant interest. Even if the warrant or the right is only exercisable in the future, the holder is taken to have a relevant interest when they enter into the warrant agreement (see subsection 608(8) of the Act).
- 2.2 There are a number of situations which will not give rise to a relevant interest in securities (under section 609) (***Excluded Situations***), including one related to market traded options and derivatives (see subsection 609(6)) (***Derivatives Exclusion***). With regard to derivatives, a person does not have a relevant interest merely because they have a right to acquire the securities given by a derivative (see paragraph 609(6)(b)). Some warrants are derivatives—however, others may not be because they are securities (see paragraphs 761D(3)(c), 764A(1)(a), regulation 7.1.04(7) and the definition of ‘security’ in section 761A. See also the definition of ‘warrant’ in regulation 1.0.02).
- 2.3 The class order provides relief to the holders of call warrants that may be securities, or otherwise fall outside the Excluded Situations on their terms, so that the holders are

able to disregard a relevant interest arising from a warrant in a similar way that relevant interests are disregarded when the Derivatives Exclusion applies.

- 2.4 The class order gives effect to the relief by extending the statutory Derivatives Exclusion to a person in circumstances where a prima facie relevant interest arises from a right under a call warrant to acquire securities, or to require securities to be held in trust. The exclusion applies for the period that a person holds the call warrant (i.e. until they exercise their right to acquire the underlying securities), provided that the call warrant satisfies the definition notionally inserted in new subsection 609(6F)—specifically (and exclusively), a security or derivative that:
- (a) confers on the holder a right, but not the obligation, to acquire securities by way of a transfer; and
  - (b) is issued under a Product Disclosure Statement; and
  - (c) is admitted to quotation on the financial market operated by ASX Limited.
- 2.5 The result of the relief is that no relevant interest arises for the purposes of the takeover provisions, as a consequence of holding a call warrant. However, any relevant interest that would arise, but for the relief, must still be taken into account for the purposes of the substantial holding provisions. This is consistent with the treatment of relevant interests arising under market traded options and derivatives (see the definition of ‘substantial holding’ in section 9 and subsection 671B(7)).
- 2.6 The extension of the Derivatives Exclusion continues in substance similar relief provided in Class Order [CO 02/924].

*Call warrant issuer relief*

- 2.7 The issuer of a covered call warrant normally retains a relevant interest in securities that it holds as cover for its obligations under the warrant—even when it places underlying securities in trust for holders. This is because the warrant is only a conditional agreement. If the holder does not exercise the warrant, or defaults in some way, the effect of the basic warrant agreement is that the securities remain the property of the issuer, or return to the issuer out of the trust arrangements.
- 2.8 The class order enables issuers of covered call warrants to disregard any relevant interest that may arise in relation to underlying securities held in trust as cover against the rights of the holders and the obligations of the issuer.
- 2.9 The class order gives effect to the relief by notionally inserting new subsection 609(6A) to extend the statutory Excluded Situations to an issuer of a call warrant. Under new subsection 609(6A) the exclusion only applies if:
- (a) the underlying securities are held in trust under the terms of the call warrant; and
  - (b) the call warrant issuer does not have the power to control voting or disposal of the securities—other than to enforce the terms of the trust, or to retain ownership if the call warrant expires unexercised or the call warrant holder defaults.

- 2.10 In these circumstances, any relevant interest that the call warrant issuer may have in the underlying securities is sufficiently remote for it to be disregarded.
- 2.11 Consequential on the introduction of the exception in subsection 609(6A) the class order also clarifies that when the exception ceases to apply the call warrant issuer is taken to acquire a relevant interest in the underlying securities by a transaction occurring in relation to the underlying securities. (see new subsection 609(6B)).
- 2.12 The inclusion of new subsections 609(6A) and (6B) continues in substance similar relief provided in Class Order [CO 02/925].

*Put warrant issuer relief*

- 2.13 Put warrants give the holder the right, but not the obligation, to sell the underlying securities to the issuer. A put warrant issuer has a relevant interest in the securities that are the subject of the warrant agreement—even if the warrant or the right is only exercisable by the warrant holder, and only at some time in the future (see subsection 608(8) of the Act).
- 2.14 Moreover, a put warrant issuer may also have a relevant interest because, under the terms of the warrant or a trust securities that parties' obligations, the issuer has rights in relation to the securities—such as a right to dispose of the securities held in trust if the holder does not exercise the put option (see subparagraph 608(8)(b)(ii)). This may arise in particular in relation to instalment or endowment warrants with a loan component.
- 2.15 The class order addresses these circumstances by inserting a new subsection 609(6C) which ensures that the put warrant issuer does not have a relevant interest in securities underlying the put warrant merely because:
- (a) the put warrant holder has an option to require the issuer to acquire the securities; or
  - (b) the put warrant issuer can exercise power to control voting or disposal of the underlying security under a put warrant (or a trust securing obligations under a put warrant) in certain circumstances following exercise, expiry, default of the holder or enforcement of the trust by the issuer.
- 2.16 This exception recognises that:
- (a) as a result of the secondary trading of quoted warrants, issuers of quoted put warrants will not be able to trace the relevant interests or intentions of the warrant holders; and
  - (b) issuers have no present control over the underlying securities.
- 2.17 Consequential on the introduction of the exception in subsection 609(6C) the class order also clarifies that when the exception ceases to apply the put warrant issuer is taken to acquire a relevant interest in the underlying securities by a transaction occurring in relation to the underlying securities. (see new subsection 609(6D)).
- 2.18 The inclusion of new subsections 609(6C) and (6D) continues in substance similar relief provided in Class Order [CO 02/926].

*Warrant trustees relief*

- 2.19 In certain circumstances, a warrant agreement may make provision for the creation of a trust, the deed for which vests in the relevant trustee certain discretions pertaining to the underlying securities that may be exercised in order to satisfy the obligations of an issuer or holder of the warrant.
- 2.20 One of the statutory situations not giving rise to a relevant interest relates to bare trustees (in broad terms, a trustee which merely holds property on behalf of the beneficiary without exercising active discretions) see subsection 609(2) (***Bare Trustee Exception***). A warrant trustee may be unable to rely on the Bare Trustee Exception however, and may therefore have a relevant interest in the underlying securities held in trust because:
- (a) the discretions conferred under the relevant trust deed may mean that the trustee is not a bare trustee; or
  - (b) although they are a bare trustee—the warrant holder does not have a presently enforceable or unconditional right of the kind referred to in subsection 608(8) of the Act.
- 2.21 The class order provides relief to warrant trustees by inserting new subsection 609(6E) which operates by applying the Bare Trustee Exception to the relevant interests a warrant trustee may have because they either hold the securities underlying the warrant or would hold them but for having lent them under a securities lending arrangement. In cases where the warrant trustee is not a bare trustee, subsection 609(6E) applies when the reason the trustee is not a bare trustee is due to certain specific discretions which may only be exercise on ordinary commercial terms or in an ordinary commercial manner, being discretions:
- (a) available on default or insolvency of the issuer or holder;
  - (b) in relation to certain transactions affecting share capital (e.g. rights issues);
  - (c) relating to takeover bids or schemes of arrangement (other than discretions relating to voting or disposal) and
  - (d) discretions to lend the securities under a securities lending arrangement.
- 2.22 The class order recognises that the purpose of the trust may be to secure the obligations of the warrant holder under the warrant as well as those of the warrant issuer. It recognises that, under the terms of the warrant, a trustee may exercise a range of discretionary powers over the securities in trust and that:
- (a) it is unlikely that these powers would be used as a means of gaining control of a company; and
  - (b) in the circumstances in which the relief applies, the trustee’s power is tenuous and information about any substantial holding resulting from the trustee’s role would likely be immaterial to the market.

2.23 The inclusion of new subsections 609(6E) continues in substance similar relief provided in Class Order [CO 02/927].

Associations

2.24 The class order also, for the purposes of certainty, provides relief in certain circumstances in respect of any ‘association’ that may arise between the issuer of a warrant and the holder of a warrant merely because of the terms of the warrant.

2.25 Under section 12(2) of the Act, an associate in relation to an entity is (where a person is a body corporate) another body corporate that controls, is controlled by, or is under common control with the person or another persons with whom the person has, or proposes to enter into, an agreement, arrangement or understanding for the purpose of influencing or controlling the affairs of the relevant entity or the composition of its board, or with whom the person is acting in concert in relation to the relevant entity’s affairs.

2.26 If the warrant issuer and the warrant holder are associates, this has implications for determining their voting power in the issuer of the securities underlying the warrant. It may also potentially mean that under paragraph 608(3)(a) the issuer or holder of a warrant is taken to have a relevant interest in the same securities in which the other party has relevant interests.

2.27 The class order introduces a new subsection 16(1A) which provides an exception from the associate concept in subsection 12(2) in relation to warrant holders and issuers. This modification recognises that, for quoted warrants, the aggregation of voting power of issuers and holders by paragraph 608(3)(a) is inappropriate because:

- (a) most warrant issuers are financial institutions with widespread and diverse shareholdings, and have funds management arms that trade actively in securities—making monitoring the issuer’s holdings very difficult for warrant holders;
- (b) most warrant issuers have a wide spread of holders, who are likely to have portfolios of their own, and these would need to be aggregated with the issuer’s holdings—make monitoring the holders’ entitlements very difficult for warrant issuers; and
- (c) the association between warrant issuers and holders that arises solely because of a warrant agreement is sufficiently remote that it should not be recognised for the purposes of aggregation under paragraph 608(8)(a).

2.28 The inclusion of new subsection 16(1A) continues in substance similar relief provided in Class Order [CO 02/925] and Class Order [CO 02/926].

### **3 Consultation**

3.1 On 14 November 2012, ASIC released Consultation Paper 193: *Takeovers, compulsory acquisitions and substantial holdings: Update to ASIC guidance (CP 193)* seeking feedback on proposals to update and consolidate a number of regulatory guides relating

to Chapters 6–6C of the Act. CP 193 also sought feedback on proposals to reissue the class orders (including Class Order [CO 02/924], Class Order [CO 02/925], Class Order [CO 02/926] and Class Order [CO 02/927]) associated with ASIC’s updated guidance and to make new class orders addressing a number of discrete policy issues. The consultation period closed on 22 February 2013.

- 3.2 While CP 193 invited general feedback on the renewal of ASIC’s class orders, the process did not include any specific consultation on the specific relief in Class Order [CO 02/924], Class Order [CO 02/925], Class Order [CO 02/926] and Class Order [CO 02/927] because the relief raised no new policy considerations.
- 3.3 ASIC received 7 submissions in response to CP 193. Details of the submissions received are contained in REP 350 *Response to submissions on CP 193 Takeovers, compulsory acquisitions and substantial holdings* which is available on ASIC’s website at [www.asic.gov.au](http://www.asic.gov.au).
- 3.4 Notwithstanding ASIC’s general consultation on the re-issue and update of its takeovers class orders, ASIC considers that Class Order [CO 13/526] is of a minor or machinery nature and does not substantially alter existing arrangements.

## **Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

### **ASIC Class Order [CO 13/526]**

This class order is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview of the class order**

The class order relates to warrants. The terms of warrants can vary as they are agreed between the issuer and holder. Warrants can give rise to a relevant interest in underlying securities. These relevant interests may need to be taken into account when determining a person's obligations under the provisions in the *Corporations Act 2001* relating to takeovers (Chapter 6) and substantial holdings (Chapter 6C).

For many warrants, the rights and obligations in relation to underlying securities are sufficiently remote or tenuous that they are unlikely to be used as a means of gaining control of a company. The class order provides relief allowing call warrant holders, call warrant issuers, put warrant issuers and warrant trustees to disregard, in some cases, a relevant interest in securities underlying a warrant quoted on the financial market operated by ASX. The relief under the class order extends to ASX quoted warrants where the underlying asset is an interest in a listed registered scheme.

#### **Human rights implications**

This class order does not engage any of the applicable rights or freedoms.

#### **Conclusion**

This class order is compatible with human rights as it does not raise any human rights issues.