Consultation questions

Disclosure of information about ownership of listed entities – Derivative based interests

1. The draft Bill proposes the repeal of s609(6) and redefines 'derivatives' in s608A. What impact would the expanded definition of relevant interests in s608A and 608B have on ownership transparency and regulatory burden?

    1.1. What impact will the removal of this exclusion have?

As Custodians are not the registered holders of derivatives, whether physically settled or not physically settled, we have no view regarding this change to include derivatives in the definition of relevant interests. However we want to provide the following context again, regarding the role Custodians play within the industry and the important considerations to factor in concerning this policy change.

The implementation of a beneficial ownership register could result in an excessive burden of compliance for custodians and their clients. It is critical that the laws and regulations accompanying this regime explicitly acknowledges the role of custodians in the Australian market and the global financial system. When custodians receive a beneficial ownership information request they should be required to provide the legally necessary details of their customers to enable a regulated entity to continue their beneficial ownership investigation.

ACSA has published a guide to custody on its website, which can be accessed here: https://cdn.ymaws.com/acsa.com.au/resource/resmgr/website_images/website_documents/institutional_investor_servi.pdf.

The guide describes the role of custodians in the Australian market and their role in Australia as its relates to inbound international investment.

In relation to this consultation, the custody guide gives context to custodians being recognised as the largest shareholders of Australian listed (and some unlisted) companies, it further notes these shareholdings are held as a nominee or bare trustee and not as the beneficial owner. The custodian has no beneficial rights to the shares it holds and as a "bare trustee" acts on the authorised instructions of its clients pursuant to the contractual arrangements agreed between custodian and client.

The custodian cannot vote, sell, or seek to influence the company's business or participate in any corporate event without instruction from its client (who has control of their actions as owner of the shares). Custodians act purely as a clients' agent in the local market and support clients through connectivity to market infrastructure, expertise in laws and regulations, and a general understanding of the market environment and how to navigate it.

When it comes to substantial shareholder declarations, custodians and nominees are not considered to have a relevant interest in the securities they hold on behalf of their clients for the purpose of determining a substantial shareholding. Section 609 of the CORPORATIONS ACT 2001 states that "a

financial services licensee does not have a relevant interest in securities merely because they hold securities on behalf of someone else in the ordinary course of their financial services business".

There is no circumstance in which a custodian's holding in a company will meet the definition of beneficial ownership by the custodian in its own right. The laws and regulations put in place to support the public beneficial owner register should not require a custodian to provide its list of owners or shareholders for a public beneficial owner register as the custodian does hold an interest recognised as a beneficial owner.

Financial markets seek ongoing efficiency which has resulted in custodians acting in capacities where they will have both direct beneficial owner client relationships and have other interposed relationships where a custodian's direct client may not be the ultimate beneficial owner. For example, a custodian may act as nominee in Australia on behalf of a client of who themselves are a custodian (in Australia or internationally), and the relationships may go many layers deep as outlines in our 2022 response.

2. Subsection 608(8) is key in defining one of the categories of derivate-based interests that must be disclosed under the proposed amendments to Chapter 6C. The draft Bill assumes subsection 608(8) operates as outlined in ASIC Regulatory Guide 5 (RG 5) *Relevant interests and substantial holding notices*, at (RG 5.163-5.166) where ASIC observes in effect that the provision:

   - is not intended to be limited to arrangements regarding designated parcels of underlying securities; and
   - should be applied on the basis that the person who has a relevant interest in underlying securities will satisfy their relevant obligations by applying the securities they have a relevant interest in (even for example if they have less than the number held at the time).

   As Custodians are not subject to substantial holding notices, and not registered holders of derivatives, we have no view regarding questions 2.1 to 2.3.

   ASIC Regulatory Guide 5 - Relevant interests and substantial holding notices recognises the nature of a custodian when taking into account who has a relevant interest. The Treasury bill needs to be aligned with the understanding of the custodian as per RG5.

   2.1. Is the operation of the provision outlined in the regulatory guidance sufficiently clear and followed in practice?

   2.2. Would the legislation benefit from expressly clarifying the operation of subsection 608(8) in any way – for example, specifying the relevant assumption to be made regarding how a counterparty will satisfy their obligations for the purposes of applying the provision?

   2.3. If it were to do so, should the assumption depend on the reason the relevant interest arises?

3. In relation to the disclosure of non-physically settled derivatives, the draft Bill proposes ASIC be empowered to make a legislative instrument to determine either:

   - the number of issued securities in which the other person is taken to have a relevant interest; or
   - the method of working out the number of issued securities the other person is taken to have a relevant interest in.

   The ability for ASIC to determine a specific number is intended to cover the situation whereby ASIC may need to remove certain derivatives from consideration and thereby determine the value to be zero.

   As Custodians are not registered holders of derivatives, we have no view regarding questions 3.1 to 3.2

   3.1. Is this approach preferable to enabling ASIC to exclude particular kinds of derivatives from the beneficial ownership disclosure requirements? If not, what alternative approach would be better?

   3.2. Should ASIC have additional flexibility in the way it prescribes, or allows parties to a derivative to determine, the number of underlying securities a person is deemed to have an interest in?

4. The draft Bill includes provisions intended to ensure that arrangements and interests that simultaneously meet the definition of more than one category of derivative-based relevant interest are not double counted.

   Are all instances of potential double counting effectively avoided under current drafting?

   As Custodians are not registered holders of derivatives, we have no view regarding this question

5. The draft Bill intends to attribute the new deemed relevant interests to the party to the transaction that is in the bought position. Is that intention achieved, or is further clarity required?

   As Custodians are not registered holders of derivatives, we have no view regarding this question

Substantial holding information (including disclosure of derivative-based holdings)

6. The draft Bill proposes providing ASIC with the power to approve the form in which substantial holder notices are lodged, removing a legislative obstacle to moving towards machine readable lodgements.

   6.1. What processes would be involved in meeting a requirement that substantial holder notices be lodged in machine readable format? As mentioned in ACSA's response to question 20 in the 2022 consultation paper, regulations should allow for electronic lodgement of beneficial ownership information through secure apps or websites. Furthermore, Custodians have connectivity and operating processes to transfer information via SWIFT messaging or API messaging. Utilizing these industry standard

platforms ensures standardization of responses across all Custodians. We strongly support the adoption of international standards such as those introduced as part of the European Shareholder Rights Directive II (SRD II) which has enabled participants to automate the disclosure process. Adoption of these standards in Australia may also increase the response times and quality of information provided by entities based in the EU.

6.2. What impact would carrying-out these processes have on businesses? As mentioned in ACSA's response to question 21 in the 2022 consultation paper, rolling out this change may have an impact on regulated entities depending on the company size. Initial phase of this implementation should be more targeted to key industries and of a certain size. Furthermore if businesses need to design, implement, and maintain registers they would require a standard format of information required which has been directed by the relevant government agency, especially considering the inclusion of a machine readable format lodgement process.

6.3. What impact would requiring substantial holder notices to be lodged in machine readable format have on transparency of market operations? Once the initial phase of implementation is bedded down within the industry, lodging and then reading that information will provide a lot of upside in terms of efficiencies to businesses and relevant interest holders. This should translate into faster rates of transparency in beneficial owner registers, especially before key company events such as AGMs and EMGs (this is not an exhaustive list).

Freezing orders

7. The Explanatory Memorandum outlines relevant considerations regarding how ASIC should balance the rights of third parties with the desire to ensure compliance with the disclosure obligations in exercising its expanded freezing powers.

In support of Australia's continued safety and soundness as an investment destination, ACSA seeks to ensure that a party who has fully complied with Australia's legislative requirements is not affected by another party's non-compliance. ACSA's response to question 23 in the 2022 consultation paper explains the challenges and un-intended impact to those players within the chain of custody.

Blocking of positions for, as examples, local and foreign pension funds, local and foreign asset managers, or foreign sovereign wealth funds could lead to significant negative press, and reassessment of the risk profile of investing in the Australian market if the legal and regulatory environment is perceived to be designed in a way that creates the possibility of a party having their assets frozen despite having fully complied with the law.

ACSA notes that Custodians are obligated by law to provide the information requested by regulated entities and when issued with tracing notices and that this will continue to be the case under the new proposed legislation.

To that end, ACSA recommends that the concept of custodians, nominees, and bare trustee structures is catered for in the legislation in respect to freezing powers. The legislation should recognise beneficial versus legal ownership and the specific role played by licenced custodians

in Australia, addressing the dimensions of how freezing notices are to be applied, and how requests for information from related parties / associates are to be treated.

Freezing Notices

- While ACSA cannot envisage a scenario where a local custodian could not respond to a tracing notice, in the event this were to occur there should be no capability for assets held via a registry, CSD, or by other similar means to be blocked or held due to that custodian's failure to comply.
- Likewise, in the event that a custodian has responded to a tracing notice and a party underlying the custodian then does not do so, the freezing notice with regard to custodial holdings should always be applied by the party servicing the non-complying party, rather than via the company or registry.

  A licenced custodian's holdings should never be frozen via a registry, CSD, or other similar venue. Rather the party facing the party who is not complying should be required to freeze the holdings on their books and records. This ensures that only parties who are not complying with the notices are impacted by that non-compliance, with no risk of contagion to the holdings of other parties. Applying a freezing notice on the registered holder, when non-compliance with a tracing notice to an entity "down the custody chain" may resulting in the freezing of assets for Australian Superannuation fund and Foreign Sovereign funds creating unintended market and sovereign risk

Related Parties / Associates

In regards to "associates", Custodians may have other lines of business within the parent company that deal with the same asset. For example:

- Parent company A, has a Custody business and holds asset X for client B (who is the beneficial owner)
- Parent company A, also has an Investments business and may also hold asset X on behalf of Parent company A (who is the beneficial owner)
- Additionally, Parent company A may have other business lines who hold assets on their own behalf.

ACSA recommends that the recognition of custodial, nominee, and bare trustee structures in the legislation also cater for this, so that where a licenced custodian is responding to a tracing notice they are only replying regarding holdings on their books and records, noting that where an associate or related party is using the services of the custodian, their holdings would be included.

Likewise, if other parts of a parent business are issued with tracing notices, the custodian should be excluded from that tracing notice.

A tracing notice can always be issued to both parties where both are to respond, but key to note is they are responding in different capacities and requiring a response from all related entities by default would create noise in the response.

Lastly, the system employed to collect information should take the nature of custody relationships into account and the high number of transactions performed each day by the clients of custodians. The regulated entity should be the entity tasked with gathering this information, and they should be required to follow the chain of custody to the end to determine who the beneficial owners are. As it's possible that one beneficial owner may directly or indirectly use multiple custodians, only the regulated entity will be able to collate a total view of who might meet the beneficial ownership criteria.

7.1. Does the guidance strike the right balance?

7.2. Is the guidance in the Explanatory Memorandum sufficient or should ASIC be required to give preference to a particular approach by the legislation?