

EXPLANATORY STATEMENT for
ASIC CORPORATIONS (REGULATORY CAPITAL SECURITIES)
INSTRUMENT 2016/71

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (**ASIC**) makes ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 under section 741 of the *Corporations Act 2001* (the *Act*).

Subsection 741(1) of the Act provides that ASIC may exempt a person from a provision of Chapter 6D of the Act or declare that the Chapter applies to a person as if specified provisions were omitted, modified or varied as specified in the declaration.

1. Background

Chapter 6D of the Act sets out the legislative framework for the offer of securities for issue or sale under a disclosure document. Within that framework, an offer of securities will require disclosure unless a specific exemption applies, and an offer for sale will only require disclosure in specific circumstances.

In relation to convertible securities, ASIC relevantly provides the following minor and technical class order relief (**existing class orders**):

- (a) Class Order [CO 00/195] *Offer of convertible securities under s713* to allow an entity to use a transaction-specific prospectus when offering convertible notes or convertible preference shares (**convertible securities**), where the underlying securities into which the convertible securities will convert are continuously quoted securities;
- (b) Class Order [CO 04/671] *Disclosure for on-sale of securities and other financial products* (in particular, Category 3) to permit securities that are issued on conversion of convertible securities to be freely on-sold (that is, without further disclosure being required at the time the convertible security converts), provided the convertible security itself was issued with disclosure; and
- (c) Class Order [CO 10/322] *On-sale for convertible notes issued to wholesale investors* to permit the use of an ‘enhanced cleansing notice’ for offers of convertible notes to wholesale investors (or otherwise without disclosure under Part 6D.2 of the Act—for example, to foreign retail investors under a disclosure document which complies with the laws of that jurisdiction), in order to permit the securities issued on conversion of those notes to be freely on-sold (that is, without further disclosure being required at the time the convertible security converts).

ASIC has recently reviewed the policy underlying Class Orders [CO 00/195], [CO 04/671] and [CO 10/322] as part of wider review of class orders relating to the fundraising provisions

in Chapter 6D and considers that the relief in these class orders is still both necessary and appropriate.

ASIC has therefore decided to reissue substantially the same relief underlying:

- (a) Class Order [CO 00/195] in ASIC Corporations (Offers of Convertibles) Instrument 2016/83;
- (b) Class Order [CO 04/671] in ASIC Corporations (Sale Offers That Do Not Need Disclosure) Instrument 2016/80; and
- (c) Class Order [CO 10/322] in ASIC Corporations (Sale Offers: Securities Issued on Conversion of Convertible Notes) Instrument 2016/82,

on the terms and for the reasons set out in the explanatory statements to those instruments (the *remade relief*).

In reviewing the existing class orders, ASIC identified a significant number of applications for individual relief made by banks or other prudentially regulated bodies. These applications sought relief to permit the use of a transaction-specific prospectus for offers of convertible securities, in circumstances where relief under the existing class orders was not available due primarily to current or proposed holding company structures. This individual relief has been granted routinely for many years, and approximately 10 to 15 individual applications are received and considered each year (*individual relief*).

ASIC considers such relief for offers of bank hybrids is appropriate because, broadly speaking:

- (a) given the features and risks of bank hybrids, and the way in which these determine the expected return to investors, prospectus disclosure needs to be focused to a great degree on the terms of the bank hybrids; and
- (b) issuers of bank hybrids (or their listed parent company) are subject to the continuous disclosure regime, compliance with which is informed by ongoing entity or group-level disclosure requirements regarding capital adequacy, capital instruments and risk exposure (required by the relevant prudential standards). Accordingly, investors in bank hybrids are able to access sufficient information to make an informed investment decision in relation to ordinary shares in the issuer (or its listed parent company where current or proposed holding structures are involved).

As was the case with the existing class orders, the remade relief would continue to be unavailable for many offers of convertible securities by banks and other prudentially regulated bodies. To remove the need for this routine individual relief, ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 provides relief on similar terms to the existing class orders and the remade relief.

2. Purpose of the instrument

Authorised deposit-taking institutions, general insurers and life insurers (i.e. banks and other prudentially regulated bodies) are regular issuers of convertible securities in the form of ‘capital instruments’, more commonly known as hybrid securities or bank hybrids (*bank hybrids*), which are used to meet the issuer’s regulatory capital requirements under the relevant prudential standards.

Those prudential standards prescribe that, in order to qualify as regulatory capital, bank hybrids must include a number of features; for example, the standards require that on the occurrence of certain trigger events, the bank hybrids must be written-off or converted into ordinary shares.

Transaction-specific disclosure and on-sale relief for retail offers of bank hybrids

Where bank hybrids are convertible into continuously quoted securities of the issuer, they could be offered to retail investors using a transaction-specific prospectus (in reliance on a broad reading of [CO 00/195]), and the securities issued on conversion then be freely on-sold without further disclosure (in reliance on Category 3 of [CO 04/671]).

In practice, however, this class order relief has not been available to banks and other prudentially regulated bodies because:

- (a) in many cases, the potential interposition of a non-operating holding company (which would become the listed parent company of the issuer) means the securities to be issued on conversion may be those of a non-operating holding company, rather than the issuer; and
- (b) in other cases, typically where such a holding company has already been established, it may be optimal from a capital management perspective for particular operating companies to issue bank hybrids directly, where those instruments are required to convert into securities in the listed parent company.

For many years, we have routinely granted relief to permit the use of a transaction-specific prospectus for offers of bank hybrids, which was considered to be broadly consistent with the policy underlying [CO 00/195] (on which the drafting of the individual instruments was based) and [CO 04/671] (on which the individual instruments relied to permit subsequent on-sale of the securities issued on conversion).

To remove the need for this routine relief, ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 provides disclosure relief for retail offers of bank hybrids by permitting the use of a transaction-specific prospectus, and on-sale relief for the underlying securities issued on conversion.

On-sale relief for offers of bank hybrids made without prospectus disclosure

For offers of bank hybrids made without prospectus disclosure, similar structural issues prevent reliance on [CO 10/322]. While offers of bank hybrids to wholesale investors (or foreign retail investors) do not require prospectus disclosure, in the absence of an exception or

relief, the on-sale of securities issued on conversion of those bank hybrids will require disclosure.

Since early 2014, ASIC has routinely granted individual relief based on the principles in [CO 10/322] for offers of bank hybrids where that class order was not available because of the position of the issuing bank within current or proposed holding structures.

ASIC has also granted relief on similar terms to facilitate offers of bank hybrids by the New Zealand subsidiaries of Australian banks, where those offers are made to investors in New Zealand with disclosure under New Zealand law, and where the securities issued on conversion of the bank hybrids are those of the Australian listed parent company.

To remove the need for this routine relief, ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 provides relief comparable to [CO 10/322] and ASIC Corporations (Sale Offers: Securities Issued on Conversion of Convertible Notes) 2016/82 to facilitate the use of an ‘enhanced cleansing notice’ to permit the subsequent on-sale of the underlying securities issued on conversion.

Third-party acquisition scenarios

Broadly speaking, ASIC considers providing disclosure and on-sale relief for retail offers of bank hybrids— in circumstances where the issuer of the ordinary shares on conversion may ultimately be a non-operating holding company of the issuer, interposed after the bank hybrids are issued—to be appropriate on the basis that any non-operating holding company so interposed would ‘be’ the issuer in a substantive sense.

Where the terms of bank hybrids permit the issuer of ordinary shares on conversion to be substituted not only with a potential non-operating holding company, but also with a third-party acquirer following a change of control transaction, the policy basis for providing disclosure relief and related on-sale relief is no longer satisfied.

Therefore, the disclosure and on-sale relief for retail offers of bank hybrids in ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 is not available where the terms of the bank hybrids contemplate such a third-party acquisition scenario.'

3. Operation of the instrument

Definition of regulatory capital security

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 inserts a definition of ‘regulatory capital security’ into s9, to mean a security that satisfies all of the following:

- (a) the security is issued by any of the following entities:
 - (i) an authorised deposit-taking institution, a subsidiary of an authorised deposit-taking institution or an authorised NOHC for the purposes of the *Banking Act 1959*;

- (ii) a general insurer, a subsidiary of a general insurer or an authorised NOHC for the purposes of the *Insurance Act 1973*; or
 - (iii) a life company, a subsidiary of a life company or a registered NOHC for the purposes of the *Life Insurance Act 1995*;
- (b) either:
- (i) under the terms of the security, it must or may be converted into, or exchanged for, ordinary shares in:
 - (A) the issuer of the security; or
 - (B) an entity that is both:
 - (I) an authorised deposit-taking institution, a general insurer, a life company, an authorised NOHC or a registered NOHC for the purposes of any of those Acts; and
 - (II) the ultimate holding company of the issuer; or
 - (C) an entity (including an entity that, at the time the security is issued, does not exist) that, as a result of a restructure (however described) will be, at the time of conversion or exchange, both:
 - (I) an authorised NOHC or a registered NOHC for the purposes of any of those Acts; and
 - (II) the ultimate holding company of the issuer;

in the circumstances permitted or required by prudential standards made for the purposes of any of those Acts; or
 - (ii) under the terms of the security, it must or may be converted into, or exchanged for, ordinary shares in any of the entities referred to in subparagraph (i), where the proceeds from the issue of the security is to be used to acquire a regulatory capital security of a subsidiary of the issuer the terms of which satisfy subparagraph (i);
- (c) if, at the time the security is issued, the conversion or exchange occurred, the ordinary shares to be issued on conversion or exchange would be in a class of continuously quoted securities.

For example, and at a high level omitting technical details, this definition of ‘regulatory capital security’ would likely apply to the bank hybrids offered in the following scenarios:

- (a) a listed Australian bank offers a bank hybrid that is convertible into ordinary shares in the bank, or a listed non-operating holding company if one is subsequently interposed;

- (b) an Australian bank, which is a subsidiary of a listed non-operating holding company, offers a bank hybrid that is convertible into ordinary shares in the listed non-operating holding company;
- (c) a New Zealand bank, which is a subsidiary of a listed Australian bank, offers a bank hybrid that is convertible into ordinary shares in the listed Australian bank, or a listed non-operating holding company if one is subsequently interposed; and
- (d) a listed Australian bank, acting through its London branch, offers a bank hybrid that is convertible into ordinary shares in the bank, or a listed non-operating holding company if one is subsequently interposed.

In addition to meeting the definition of ‘regulatory capital security’, the offer of bank hybrids must also meet certain other conditions for the disclosure and on-sale relief provided by this instrument to be available.

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 modifies two further definitions in s9:

- (a) the definition of ‘underlying securities’ is amended to mean, in relation to regulatory capital securities, the securities that are issued on conversion or exchange of the regulatory capital securities; and
- (b) a new definition of ‘notional underlying securities’ is inserted, to mean the securities that would be issued on conversion or exchange of a regulatory capital security *if that conversion or exchange occurred at the time the regulatory capital security is issued*.

Relief to permit transaction-specific disclosure

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 modifies s713 by inserting new paragraphs s713(1)(ab) and 713(2)(cb), to permit the use of a transaction-specific prospectus for offers of regulatory capital securities where that prospectus:

- (a) meets the requirements in s713 for the underlying securities that will be issued on conversion or exchange; and
- (b) discloses the information required by s713(2) for the regulatory capital securities.

The instrument further modifies s713 by inserting new subsection s713(2A), to clarify that:

- (a) if the issuer of the underlying securities is not the same as the issuer of the regulatory capital securities (for example, where the regulatory capital securities are being issued by an operating subsidiary of a listed non-operating holding company), the issuer of the underlying securities must consent to all statements in the prospectus about that body and the underlying securities; and
- (b) if the terms of the regulatory capital securities contemplate the potential interposition of a non-operating holding company as the issuer of underlying securities on conversion or exchange, but at the time the regulatory capital securities are issued, no

such holding company has been established, the issuer of the notional underlying securities is the body that must consent to all statements in the prospectus about that body and the notional underlying securities.

Relief to permit on-sale of underlying securities

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 modifies s708A by inserting new subsection s708A(12G), which provides on-sale relief for the underlying securities issued on conversion or exchange of regulatory capital securities, where the regulatory capital securities were issued under a prospectus, and the conversion or exchange did not involve any further offer.

This on-sale relief is available where the regulatory capital securities were issued under either a s713 prospectus (relying on the disclosure relief provided by this instrument), or a s710 prospectus (without relying on the disclosure relief provided by this instrument).

Third-party acquisition scenarios

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 further modifies s713 and 708A, by inserting new subsections s713(8) and 708A(12GA), to limit the disclosure and on-sale relief provided so that it is not available where certain third-party acquisition scenarios are contemplated.

The transaction-specific disclosure and on-sale relief for offers of regulatory capital securities under a prospectus does not apply where the terms of the regulatory capital securities permit, following a change of control involving a third-party acquirer, that third-party acquirer being substituted as the issuer of underlying securities on conversion or exchange of the regulatory capital securities: s713(8) and 708A(12GA).

More specifically, while a ‘third-party acquisition scenario’ is not specifically defined in the instrument, s713(8) and 708A(12GA) disapply the relief in s713 and 708A(12G) where the terms of the regulatory capital securities permit the issuer of the underlying securities to be substituted for another entity, where that substitution is the result of a restructure (however described) *initiated by persons other than the directors* of the issuer of the regulatory capital securities or the ultimate holding company of the issuer.

Subsections 713(8) and 708A(12GA) are intended to accommodate, to the extent possible, the terms of many regulatory capital securities which typically:

- (a) define a broad ‘change of control event’ (which will trigger a conversion or exchange of the regulatory capital securities, so that holders may participate in any control transaction as holders of the underlying securities); and
- (b) carve-out from this definition—by reference to whether or not the change of control event was *initiated by the directors*— a ‘NOHC event’ which relates to the potential interposition of a non-operating holding company (but which does not result in the transfer of control to a third party).

On-sale relief for offers of regulatory capital securities made without prospectus disclosure

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 further modifies s708A by inserting s708A(12H) and (12I), to provide relief to facilitate the use of an enhanced cleansing notice for offers of regulatory capital securities made without prospectus disclosure (for example, where offers are made only to wholesale investors), to permit the subsequent on-sale of the underlying securities issued on conversion or exchange.

Under new s708A(12I)(a) and (b), the notice must:

- (a) contain the information required by s713(2)–(5) for the underlying securities that will be issued on conversion or exchange;
- (b) contain the information required by s713(2) for the regulatory capital securities; and
- (c) be worded and presented in a clear, concise and effective manner.

Under new s708A(12H)(e), where the issuer of the underlying securities is:

- (a) the same as the issuer of the underlying securities, the notice must be given to the relevant market operator for the issuer of the regulatory capital securities; and
- (b) not the same as the issuer of the regulatory capital securities (for example, where the regulatory capital securities are being issued by an operating subsidiary of a listed non-operating holding company), the notice must be given jointly by the issuer of the notional underlying securities and the issuer of the regulatory capital securities to the relevant market operator for the issuer of the notional underlying securities.

Under new s708A(12I)(c), including in the notice any statement by a person requires the consent of that person, which must not be withdrawn before the notice is given to the relevant market operator.

Unlike the disclosure and on-sale relief provided for offers of regulatory capital securities made under a prospectus, the on-sale relief provided by this instrument in new s708A(12H) and (12I) also applies where the terms of the regulatory capital securities contemplate a third-party acquisition scenario.

4. Consultation

On 17 September 2015 ASIC released CP 239 *Disclosure documents: Update to ASIC instruments and guidance (CP 239)* seeking feedback on proposals to update and consolidate a number of regulatory guides relating to Ch 6D of the Act. CP 239 also sought feedback on proposals to reissue the legislative instruments associated with ASIC's updated guidance, and to make legislative instruments addressing some discrete policy issues (including ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71). The consultation period closed on 27 November 2015.

ASIC received four submissions in response to CP 239. Details of the submissions are contained in REP 473 *Response to submissions on CP 239 Disclosure documents: updates to ASIC instruments and guidance* which is available on ASIC's website at www.asic.gov.au.

Notwithstanding ASIC's consultation, ASIC considers that ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 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 Corporations (Regulatory Capital Securities) Instrument 2016/71

ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71 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

This legislative instrument modifies s9, 708A and 713 of the Act to allow the offer of regulatory capital securities (being certain types of convertible or converting notes or convertible or converting preference shares of a body, which if converted or exchanged at the time they are issued, would convert into or be exchanged for continuously quoted securities) to be made using a prospectus that complies with s713 of the Act rather than s710, and provides on-sale relief for the underlying securities issued on conversion or exchange.

This legislative instrument also modifies s9 and 708A of the Act to provide on-sale relief for the underlying securities issued on conversion or exchange of regulatory capital securities which were offered without disclosure under Part 6D.2 of the Act, where a notice containing prospectus-like disclosures was provided at the time the regulatory capital securities were issued.

Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.

Australian Securities and Investments Commission