

# ASIC CLASS ORDER [CO 08/824]

## 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 08/824] under s1020F(1) of the *Corporations Act 2001* (the *Act*).

Subsection 1020F(1) of the Act relevantly provides that ASIC may exempt a person from specified provisions of Part 7.9 or declare that Part 7.9 applies in relation to a person as if specified provisions were omitted, modified or varied.

### 1. Background

People sometimes sell (*short sell*) securities which they do not own with a view to repurchasing them later at a lower price. One approach to facilitating this practice is for the people (the *borrowers*) to have in place an arrangement whereby another person (the *lender*) makes securities available to settle the short sale. Under the arrangement, the borrower will have an obligation to transfer equivalent securities to the lender at a later time. The practice of short selling securities with an arrangement of this kind in place is a form of *covered short selling*. The practice of short selling securities without such an arrangement is known as *naked short selling*.

In September 2008, ASIC responded to turmoil in international and Australian financial markets by introducing measures aimed at limiting the potential for Australian markets to become disorderly due to short selling. Under ASIC Class Order [CO 08/751] (as amended by ASIC Class Orders [CO 08/752], [CO 08/753], [CO 08/763] and [CO 08/801]), ASIC prohibited covered short selling of all securities, managed investment products and stapled securities quoted on licensed markets in Australia, subject to certain exceptions. ASIC also provided relief under ASIC Class Order [CO 08/764] for a person from having to comply with s1020B(2) in relation to the naked short sale of a security or managed investment product that results from the exercise of an ASX exchange traded option.

Where covered short selling is permitted, the short selling transaction is subject to a reporting regime in accordance with ASIC Class Order [CO 08/751].

The prohibition on covered short selling came into effect on 22 September 2008. On 21 October 2008, ASIC announced it expected to lift the ban on covered short selling of non financial stocks from 19 November 2008. The ban on covered short selling of financial stocks will remain in place at least until 27 January 2009.

## 2. Purpose of the class order

This instrument:

- relaxes the prohibition on covered short selling so that it is permitted in relation to non financial securities; and
- sets out the reporting regime for all short sales that take place in Australia (*amended reporting regime*).

The securities (*non financial securities*) for which covered short selling will be permitted are those which are not constituents of the S&P/ASX 200 Financials index or one of the five entities named in the instrument.

We used the index (which is objectively compiled using internationally accepted methodology and widely used as a benchmark for financial securities) and specified particular listed entities with prudentially supervised businesses to clearly identify the securities for which short selling may not be relaxed at this time.

The ban on financial securities will remain in place consistent with many other jurisdictions. In the circumstances, it is appropriate to relax the short selling prohibition on financial securities in a gradual and measured way over an extended period of time and having regard to systemic issues.

The changes made to the existing reporting regime (in notional s1020BC of ASIC Class Order [CO 08/751]) are necessary to ensure appropriate disclosure of short sales continues to be made to the marketplace after the prohibition on covered short selling is lifted for non financial securities.

Under this instrument, the reporting regime under ASIC Class Order [CO 08/764] for naked short sales resulting from the exercise of ASX exchange traded options is subsumed by the amended reporting regime. The new provisions in the amended reporting regime are aimed at ensuring that the requirements better fit in with how sales are conducted as the result of option exercises.

## 3. Operation of the class order

This instrument:

- varies ASIC Class Order [CO 08/751] by amending notional s1020BD to include proposed subsections (1A) and (7A) and replacing the reporting requirements in notional s1020BC with the amended reporting regime; and
- varies ASIC Class Order [CO 08/764] by replacing the conditions of relief set out in that instrument with requirements under the amended reporting regime.

A covered short sale of non financial securities will be allowed under proposed s1020BD(1A). For the avoidance of doubt, the exemptions provided from the prohibition in s1020BD(1) in s1020BD(2) to (6) will not by implication affect the

scope of the exemption for covered short sales of non financial securities: proposed s1020BD(6A).

The proposed s1020BC in the instrument applies to all sales of s1020B products made on a licensed market or off-market by market participants (generally known as *crossings*). The proposed s1020BC imposes the following disclosure requirements:

- a participant in the market (*broker*) who receives a request to sell s1020B products is to be informed and record whether the sale is a long sale, a short sale or an exempt covered short sale;
- a person (the *client*) asking a broker to sell s1020B products must inform the broker of the type of sale being requested; and
- if a client does not volunteer the type of sale being requested, the broker is required to ask for this information.

For the avoidance of doubt, a client who informs their broker that the sale is a short sale in accordance with their obligation under s1020B(5) is taken to have complied with their disclosure obligations under this instrument.

In relation to short sales of a security or managed investment product where the transaction affecting the sale of the product is the result of the exercise of an ASX exchange traded option, brokers must ask what type of sale is requested at the time of a request to exercise the option (if made) or as soon as practicable after finding out about the sale. The latter covers situations where options are exercised via an automated system on expiry date and other instances where the seller of the underlying security or product has not made a specific request for the exercise of the option. A client is required to provide information about the type of sale requested on exercise of the option at the relevant time. For the avoidance of doubt, a request to exercise does not include a contingent request to exercise on expiry date if the option is in money (this kind of request is typically implemented by an automated system).

The instrument defines a "short sale" as a covered short sale of a non financial security or a short sale to which paragraphs 1020B(4)(b), (d) or (e) apply. An "exempt covered short sale" is a covered short sale of a financial security executed in reliance on one of the exemptions in place under s1020BD(2) to (6).

**Reportable short sales** are short sales, exempt covered short sales and naked short sales that occur as a result of the exercise of an ASX exchange traded option. Brokers are required to report each day's reportable short sales by total number of products short sold in the same class to the ASX by 9am the following day.

#### **4. Documents incorporated by reference**

No documents are incorporated by reference.

#### **5. Consultation**

Before making this instrument ASIC consulted with various parties including the ASX, providers of widely used electronic trading systems and market participants.

ASIC continues to consult various industry bodies and participants in relation to the effect of the short selling measures on the licensed financial markets in Australia.