

# ASIC CLASS ORDER [CO 10/111]

## 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 10/111] under s1020F(1)(a) of the *Corporations Act 2001* (the **Act**).

Section 1020F(1)(a) provides that ASIC may exempt a person or a class of persons from specified provisions of Part 7.9 of the Act.

### 1. Background

#### Deferred purchase agreements

A deferred purchase agreement (**DPA**) is a structured product.

Under a DPA, an investor agrees to purchase from the DPA issuer nominated ‘**delivery products**’, typically, listed securities or managed investment products. The investor pays the purchase price to acquire the delivery products at the time they enter the DPA but the delivery products are not delivered until a later date (**maturity**), being at least 12 months after the date the investor entered into the DPA.

The number of delivery products the investor will receive at maturity (and therefore, the value of the DPA) is determined by reference to the performance of a nominated ‘**reference asset**’. The reference asset may be some other financial product (other than a derivative that relates to the delivery product), an asset, a rate, an index or a commodity.

At maturity, to meet its obligations under the DPA, the issuer acquires sufficient delivery products to deliver to the investor. After maturity, and until the investor accepts delivery of and sells the delivery products, the investor has a long exposure to the delivery products.

#### Naked short sale prohibition: s1020B(2)

Section 1020B of the Act regulates the short selling of certain financial products. ‘Naked’ short selling is prohibited in Australia. As such, a person selling section 1020B products must, at the time of sale, have ‘a presently exercisable and unconditional right to vest’ the products in the buyer.

A person is taken to sell section 1020B products if they purport to sell the products: s1020B(7). Accordingly, a DPA issuer is taken to sell delivery products to an investor at the time a DPA is agreed, even though the products are not delivered until after maturity of the DPA.

The sale of delivery products under a DPA would contravene s1020B(2) if, at the time of the sale, the DPA issuer does not have a presently exercisable and unconditional right to vest the delivery products in the investor.

## 2. Purpose of the class order

The purpose of the class order is to provide limited relief to DPA issuers from s1020B(2) of the Act in relation to a sale of delivery products under a DPA. The class order relief does not extend to DPA issuers' hedging activities in relation to their exposures to reference assets.

In order to comply with the current law, DPA issuers would be required to hold an inventory of delivery products at the time of sale and for the full term of the DPA. DPA issuers say this would be impractical and commercially unviable for them because:

- DPA investments generally have a term of over 12 months;
- the exact number of delivery products required to be delivered to the investor cannot be calculated until maturity of the arrangement; and
- the cost of holding an inventory of delivery products in long anticipation of the deferred delivery date of the DPA would be prohibitive.

Relief is limited to circumstances designed to reduce the risk of delivery failure or any market impact that would damage market confidence or integrity in a way that is inconsistent with the policy behind the naked short selling prohibition. In this regard, relief would only apply where the issuer has the ability to substitute the delivery product with another in specified circumstances (thereby addressing the risk of the delivery failure). In addition, relief is limited so that it would not apply where the reference asset is the same as the delivery product, or where the reference asset is a derivative that relates to the delivery product.

## 3. Operation of the class order

Class Order [CO 10/111] exempts persons from having to comply with subsection 1020B(2) of the Act in relation to the sale of a security (**delivery product**) or managed investment product (**delivery product**) that is able to be traded on the financial market operated by ASX Limited and where there is an agreement specifying that:

- the delivery products sold will be delivered at least 12 months after entering into the agreement;
- the number and value of the delivery products to be delivered are to be ultimately determined or derived from the value or amount of one or more of other financial products (other than a derivative that relates to the delivery products), or an asset, a rate (including an interest rate or exchange rate), an index or a commodity;
- the DPA issuer has the right, in circumstances set out in the agreement, to instead deliver other securities or managed investment products where the securities or

products are, at maturity, in a class of financial products that is a constituent of the index known as the S&P/ASX 200.

The exemption commences on the date the instrument is registered.

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

No documents are incorporated by reference.

#### **5. Consultation**

ASIC informally consulted with the Australian Financial Markets Association before making this instrument. Given the minor and technical nature of the exemption, no general public consultation was undertaken.