

# ASIC MARKET INTEGRITY RULES (ASX MARKET) AMENDMENT 2014 (NO. 3) EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

## 1. Enabling legislation

The Australian Securities and Investments Commission (ASIC) makes the *ASIC Market Integrity Rules (ASX Market) Amendment 2014 (No. 3)* (the **Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Corporations Act**). The Instrument amends the *ASIC Market Integrity Rules (ASX Market) 2010* (the **ASIC Market Integrity Rules (ASX)**).

The ASIC Market Integrity Rules (ASX) apply to:

- (a) the activities or conduct of a Market;
- (b) the activities or conduct of person in relation to a Market; and
- (c) the activities or conduct of persons in relation to Financial Products

as specified in each Chapter, Part or Rule.

## 2. Interpretation

Capitalised terms used in this Explanatory Statement (e.g. “Market Participant”) are defined in the ASIC Market Integrity Rules (ASX).

## 3. Background

*Short selling and its regulation in Australia*

“Short selling” is the sale of financial products that the seller does not own at the time of the sale.

“Covered short selling” is when the seller relies on a securities lending arrangement to “borrow” the financial products in order to ensure that they can be delivered to the buyer when settlement is due. The Instrument primarily applies to covered short selling which is permitted in Australia.

Short selling is regulated by the *Corporations Act 2001* and the *Corporations Regulations 2001* (*Corporations Regulations*). Division 5B of Part 7.9 of the *Corporations Act* and Division 15 of Part 7.9 of the *Corporations Regulations* set out the reporting and disclosure requirements for persons making covered short sales on a licensed market such as the ASX Market.

There are two separate short selling disclosure requirements under the *Corporations Act*:

- a) “short sale transaction reporting” is the reporting of daily volumes of section 1020B products that are short sold in the market (*Corporations Regulation 7.9.100*); and
- b) “short position reporting” is the reporting of instances where the quantity of a product that a person has is less than the quantity of the product that the person has an obligation to deliver (*Corporations Regulation 7.9.100A*).

The Instrument relates to short sale transaction reporting. It does not relate to short position reporting.

#### *Introduction of short sale tagging obligation*

On 12 July 2012, ASIC made the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 2)*. That instrument amended the ASIC Market Integrity Rules (ASX) by inserting a new Part 5.12.

Part 5.12 imposes the “Short Sale Tagging Obligation”.

The Short Sale Tagging Obligation applies to a Market Participant that places a short order for (or reports a short sale of) Section 1020B Products on a market, including the ASX market. Section 1020B products include securities, managed investment products and certain other financial products. The Short Sale Tagging Obligation requires the Market Participant to include an electronic ‘tag’ in the sell order (or report) which specifies the quantity of Section 1020B Products that is short at the time the order is placed.

The Short Sale Tagging Obligation has not yet commenced. Market Participants are currently meeting their obligation to provide short sale transaction reporting by manually recording the number of products that they short sell for each transaction and aggregating this number at the end of each trading day (***End of Day Reporting***). The daily volume of short sales by product is sent to the market operator.

The Short Sale Tagging Obligation was intended to enable more efficient collection of short selling information from sellers and Market Participants. It was also intended to ensure that the information was more accurate.

#### *Delay of implementation of Short Sale Tagging*

Part 5.12 was originally due to commence on 10 March 2014. In discussions with ASIC, Market Participants requested that ASIC delay the commencement of this obligation to provide them with additional time to make the necessary system changes. ASIC consulted market operators and Market Participants on a proposed delay of the commencement date. There was broad support for this proposal.

On 7 February 2014 ASIC made the *ASIC Market Integrity Rules (ASX Market) Amendment 2014 (No.1)*. That instrument amended the ASIC Market Integrity Rules (ASX) by delaying the commencement of the Short Sale Tagging Obligation from 10 March 2014 to 28 July 2014.

#### *Issues identified ahead of commencement of Short Sale Tagging Obligation*

In the lead up to the 28 July 2014 commencement date, industry raised concerns about the complexities of categorising certain types of orders on a real time basis. These complexities particularly arise for Market Participants trading as Principal who operate multiple trading desks and a central department with responsibility for determining if there are sufficient products for a sale. In this environment, it is not always possible for traders to determine in real time whether a particular sale is long or a covered short sale.

Concerns about a breach occurring as a result of a technical failure or an inadvertent failure of categorisation are heightened by the maximum penalty for breach of the Short Sale Tagging

Obligation, which is \$1,000,000. In addition, Market Participants raised concerns that the difficulties in categorisation will result in inaccuracies in the reported data. Further, there was a concern that resolving the complexity in the way certain orders are treated will increase the latency of trading and therefore affect a Market Participant's ability to obtain the best outcome.

#### *ASIC consideration of issues*

In discussions with Market Participants, industry bodies and market operators, ASIC explored options to address the Market Participants' concerns including the possibility of a class rule waiver. A class rule waiver would allow Market Participants the flexibility to determine the most efficient method of complying with the short sale transaction reporting obligations under the Corporations Act being to either:

- (a) provide real time short sale tagging;
- (b) continue to manually record the number of products that they short sell for each transaction and aggregate this number at the end of each Market day reporting; or
- (c) a combination of both depending on the transaction or line of business.

However, in ongoing discussions with industry concerning a possible class rule waiver, ASIC identified a significant risk that the short sale information available to the market (which is based on reporting by Market Participants) is likely to be further compromised under a class rule waiver due to:

- (a) double counting of short sales; and
- (b) inaccuracies arising from the aggregation of information relating to:
  - (i) **orders** under the Short Sale Tagging Obligation; and
  - (ii) **transactions** under the current regime for End of Day Reporting.

#### *Repealing the Short Sale Tagging Obligation resolves issues*

As noted above, it has become apparent that the issues identified ahead of the commencement of the Short Sale Tagging Obligation on 28 July 2014 may result in a further compromise of the accuracy of information of short selling than that currently provided to the market. ASIC is also concerned about the risks that these issues pose to the efficient reporting of the information. Ultimately, ASIC determined that there was a significant risk that the scheduled commencement of the Short Sale Tagging Obligation would not result in the expected benefits and may, in fact, be counter-productive.

The Short Sale Tagging Obligation was also intended to assist ASIC in its role of supervising the financial markets. ASIC's ability to monitor short selling activity in the market, including in times of market volatility, has improved and will continue to develop substantially. The two main developments driving this improvement since the Short Sale Tagging Obligation was conceived are:

- (a) the introduction of ASIC's new markets surveillance system, MAI; and
- (b) the forthcoming commencement of Chapter 5A of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011*, requiring Market Participants to provide regulatory data, including the origin of an order or transaction.

Having explored the available options, including a class rule waiver, ASIC has decided to repeal the Short Sale Tagging Obligation. A repeal of the Short Sale Tagging Obligation:

- (a) ensures that the short sale information available to the public is less likely to be compromised;
- (b) offers significant cost savings for industry;
- (c) provides Market Participants with certainty in relation to their short sale transaction reporting obligations under the Corporations Act.

Following the repeal, the statutory requirement for Market Participants to provide short sale transaction reporting will continue to be met by End of Day Reporting.

The repeal of the Short Sale Tagging Obligation has been applied to ASIC market integrity rules across all relevant markets to ensure consistency. Therefore Part 5.12 of *ASIC Market Integrity Rules (APX Market) 2013* and *ASIC Market Integrity Rules (Chi-X Australia) 2011* have also been repealed.

#### **4. Purpose of the legislative instrument**

The purpose of the Instrument is to repeal Part 5.12 of the ASIC Market Integrity Rules (ASX). Accordingly, Part 5.12 will not commence as scheduled on 28 July 2014 and the Short Sale Tagging Obligation will not be imposed. ASIC may consider a re-introduction of the Short Sale Tagging Obligation (or similar requirement) in the future after further appropriate consultation.

This change will mean that Market Participants will not be required to comply with the Short Sale Tagging Obligation and that they will continue with End of Day Reporting as required under the current law.

As a result, the information available to the market will be the same as the information currently provided by Market Participants through End of Day Reporting and published by market operators.

Details of the Instrument are contained in [Attachment A](#).

#### **5. Consultation**

ASIC engaged in targeted consultation and ongoing discussions with Australian Financial Markets Association, the Stockbrokers Association of Australia, market participants and market operators during 2014. These discussions focused on:

- (a) concerns raised by industry as noted above;
- (b) working with industry to overcome these concerns and provide market participants with ongoing certainty; and
- (c) striking an appropriate balance between the expected benefits of the Short Sale Tagging Obligation and the compliance costs to industry.

As noted above, ASIC responded to industry concerns with further consultation on a proposed class waiver which would relieve Market Participants of the Short Sale Tagging Obligation.

In the course of consultations about the proposed class waiver, industry raised new concerns about the short sale information available to the market. In particular, industry raised the possibility that the short sale information available to the market is likely to be compromised under the proposed waiver.

ASIC's discussions with market participants and market operators have revealed general support for the proposed repeal.

## **6. Penalties**

Subsection 798G(1) of the Corporations Act provides that market integrity rules are legislative instruments for the purposes of the *Legislative Instruments Act 2003*.

Subsection 798G(2) of the Corporations Act provides that market integrity rules may include a penalty amount for a rule. A penalty amount must not exceed \$1,000,000. The penalty amount set out below a rule is the penalty amount for that rule. The Instrument repeals a rule imposing a penalty.

## **7. Commencement of the Instrument**

The Instrument will commence on the day after the day on which the Instrument is registered under the *Legislative Instruments Act 2003*.

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

A Statement of Compatibility with Human Rights is included in this Explanatory Statement at **Attachment B**.

## **7. Regulation Impact Statement**

A Regulation Impact Statement is attached to this Explanatory Statement.

## **ATTACHMENT A**

### **Paragraph 1 – Enabling Legislation**

This paragraph provides that the Instrument is made under subsection 798G(1) of the *Corporations Act 2001*.

### **Paragraph 2 – Title**

This paragraph provides that the title of the Instrument is the *ASIC Market Integrity Rules (ASX Market) Amendment 2014 (No. 3)*.

### **Paragraph 3 – Commencement**

This paragraph provides that the Instrument commences on the day after the day on which this instrument is registered under the *Legislative Instruments Act 2003*.

### **Paragraph 4 – Amendments**

This paragraph provides that Schedule 1 amends the *ASIC Market Integrity Rules (ASX Market) 2010*.

## **Schedule 1 - Amendments**

### **Item [1] Part 5.12**

Item [1] of Schedule 1 to the Instrument repeals Part 5.12.

## **ATTACHMENT B**

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

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

#### **ASIC Market Integrity Rules (ASX Market) Amendment 2014 (No. 3)**

This Legislative Instrument 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*.

##### **A. Overview of the Instrument**

1. The Legislative Instrument is made under subsection 798G(1) of the *Corporations Act 2001 (Corporations Act)*. The Legislative Instrument amends the *ASIC Market Integrity Rules (ASX Market) 2010 (ASIC Market Integrity Rules (ASX))* which apply to:
  - (a) the activities and conduct of a financial market operated by ASX Limited (ACN 008 624 691) (*ASX*);
  - (b) the activities or conduct of persons in relation to ASX; and
  - (c) the activities or conduct of persons in relation to financial products traded on ASX.
2. The purpose of the Legislative Instrument is to repeal Part 5.12 of the ASIC Market Integrity Rules (ASX).
3. Part 5.12 of the ASIC Market Integrity Rules (ASX) imposes the “Short Sale Tagging Obligation”. In general terms the Short Sale Tagging Obligation applies to a Market Participant that places a “short” order for (or reports a “short” sale of) specified products on the ASX market. The obligation requires the Market Participant to include an electronic ‘tag’ in the sell order (or report) which specifies the quantity of products that is “short” at the time the order is placed. An order is “short” if it is an order to sell financial products that the seller does not own at the time of the sale. Short sellers need to make arrangement to cover their delivery obligations to the buyer before they fall due.
4. Part 5.12 is due to commence on 28 July 2014. The Legislative Instrument repeals Part 5.12 so that it will not commence and the Short Sale Tagging Obligation will not be imposed.
5. Accordingly, Market Participants will not be required to comply with the Short Sale Tagging Obligation and that they will continue the current obligation to provide “End of Day Reporting” Under “End of Day Reporting”, Market Participants manually record the number of products that they short sell for each transaction and aggregate this number at the end of each trading day.
6. As a result, the information available to the public will be the same as the information currently provided by Market Participants through End of Day reporting and published by market operators.

##### **B. Human rights implications**

7. The Legislative Instrument does not engage any of the applicable human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

##### **C. Conclusion**

8. The Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

#### **D. Consultation**

9. ASIC engaged in targeted consultation and ongoing discussions with Australian Financial Markets Association, the Stockbrokers Association of Australia, market participants and market operators during 2014. These discussions focused on:
  - (a) concerns raised by industry in relation to the Short Sale Tagging Obligation. These include concerns about the complexity of categorising trades in real time and the substantial penalties imposed for breaching the Short Sale Tagging Obligation;
  - (b) working with industry to overcome these concerns and provide market participants with ongoing certainty; and
  - (c) striking an appropriate balance between the expected benefits of the Short Sale Tagging Obligation and the compliance costs to industry.
10. ASIC responded to industry concerns by consulting further on a proposed class rule waiver which would relieve Market Participants of the Short Sale Tagging Obligation.
11. In the course of consultations about the proposed class rule waiver, industry raised further issues relating to the short sale information available to the market. In particular, the possibility that the short sale information available to the market is likely to be compromised under the proposed waiver due to:
  - (a) double counting of short sales; and
  - (b) inaccuracies arising from the aggregation of
    - (i) information relating to **orders** under the Short Sale Tagging Obligation; and
    - (ii) information relating to **transactions** under the current regime.
12. ASIC's discussions with Market Participants and market operators have revealed general support for the proposed repeal.

#### **Australian Securities and Investments Commission**