

# EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

The Australian Securities and Investments Commission (*ASIC*) makes *ASIC Corporations (Amendment) Instrument 2017/571* (the ***amending instrument***) under subsection 1075A(1) of the Corporations Act 2001 (the *Act*)

Under subsection 33(3) of the *Acts Interpretation Act 1901*, where an Act confers a power to make, grant or issue any instrument (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.

Subsection 1075A(1) of the Act provides that ASIC may, among other things, declare that Part 7.11 of the Act applies to a specified class of financial products as if specified provisions were omitted, modified or varied as specified in the declaration.

Subsection 1075A(2) of the Act requires ASIC to be satisfied in relation to the following two matters before it may make a declaration under subsection 1075A(1) in relation to financial products:

- the interests of the holders of the financial products or of financial products in that class, would continue to have adequate protection; and
- the declaration would make the transfer of those financial products or of financial products in that class, more efficient.

## 1. Background

ASIC Corporations (Division 4 Financial Products) Instrument 2015/1030 (the ***principal instrument***) is a declaration under section 1075A of the Act that, among other things, regulates and facilitates the transfer through ASX Settlement Pty Ltd (ASX Settlement) of certain classes of financial products. The principal instrument has the effect that the following financial products are Division 4 financial products:

- warrants traded on the market operated by ASX Limited (***ASX***) or Chi-X Australia Pty Ltd (***Chi-X***);
- warrants admitted to the AQUA Quote Display Board;
- interests in unregistered managed investment schemes traded on ASX or Chi-X or admitted to the AQUA Quote Display Board;
- certain shares and debentures quoted on ASX issued by entities that are not companies under the Act, and by foreign companies; and

- depository interests in relation to securities issued by a foreign company or foreign scheme products.

ASIC has decided to extend the policy underlying the principal instrument to include transferable custody receipts that are able to be traded on the market operated by Chi-X in the classes of financial products that may be transferred through ASX Settlement.

This will enable transferable custody receipts to be transferred through a prescribed clearing and settlement facility.

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

The purpose of the amending instrument is to:

- apply the provisions that regulate and facilitate transfers of products through ASX Settlement to transferable custody receipts; and
- remove the application to transferable custody receipts, of certain subregulations that deal with circumstances under which transferable custody receipts would be taken to have ceased quotation on a financial market.

## **3. Operation of the legislative instrument**

Division 4 of Part 7.11 of the Act, and regulations under the *Corporations Regulations 2001* (the **Regulations**) made for the purposes of that Division, regulate and facilitate the transfer of certain classes of financial products — “Division 4 financial products” — effected through a prescribed clearing and settlement facility.

As at the commencement date of the amending instrument, ASX Settlement was the only clearing and settlement facility that had been prescribed by the regulations. ASX Settlement was previously known as ASX Settlement and Transfer Corporation Pty Limited (**ASTC**). As at the commencement date of the amending instrument, the Regulations continue to refer to ASTC.

ASIC considers that subsection 1075A(2) is satisfied in relation to making the declaration that transferable custody receipts are Division 4 financial products because of the advantages of effecting a transfer of financial products in accordance with Division 4 of Part 7.11 of the Act through ASX Settlement. The main advantages are as follows:

- legal certainty in relation to the effectiveness of the transfer, for example:
  - a transfer effected through ASX Settlement in accordance with its operating rules is valid and effective for the purposes of any law or instrument governing or relating to the way in which the financial product may be transferred (see section 1074D of the Act);
  - a transfer effected through ASX Settlement in accordance with its operating rules may be made or received by a trustee or legal representative (executor or administrator) despite any law or anything in

- the relevant instrument appointing the trustee or legal representative (see subsection 1074G(7) of the Act);
- (iii) the authority of a participant to effect a disposal of a financial product is continued notwithstanding that the client has died (see regulations 7.11.25 and 7.11.26 of the Regulations);
- (b) legal certainty in relation to the determination of the holder of Division 4 financial products for the purposes of meetings, and of the conferral of benefits, such as dividends or distributions, on holders of such products (see regulation 7.11.37 – 7.11.39 of the Regulations);
- (c) various warranties and obligations apply in relation to the transfer, for example:
- (i) a participant effecting a transfer warrants that it has the authority and be legally entitled to transfer the financial products (see regulation 7.11.29 of the Regulations);
- (ii) an indemnity to various persons, including the transferor and the transferee, if the warranty made under regulation 7.11.29 is not true (see regulation 7.11.32 of the Regulations).

The kinds of financial products that are Division 4 financial products include:

- shares in a company;
- debentures of a company;
- interests in a registered scheme;
- rights to acquire any of the above by way of issue;
- Commonwealth Government Security (**CGS**) depository interests; and
- simple corporate bonds depository interests.

Where ASIC declares under section 1075A of the Act that the transfer of a class of financial products will be effected through ASX Settlement, these financial products are also Division 4 financial products. The amending instrument modifies the declaration under section 1075A of the Act in the principal instrument to have the effect that transferable custody receipts are Division 4 financial products.

The amending instrument modifies the principal instrument by inserting a definition of transferable custody receipts. Transferable custody receipts are defined to mean units of beneficial ownership in foreign quoted shares where the units:

- arise from a custodial and sub-custodial arrangement under which:
  - a custodian holds, directly or indirectly, the foreign quoted shares on behalf of, or in trust for, a financial services licensee that holds an

Australian financial services licence that covers the provision of a custodial or depository service; and

- the financial services licensee holds their equitable rights or interests in the shares arising from the custodial arrangement mentioned above on behalf of, or in trust for a person; and
- are issued without the involvement of the issuer of the foreign quoted shares; and
- are able to be traded on the financial market operated by Chi-X.

The amending instrument inserts a definition of foreign quoted shares in the principal instrument as follows. Foreign quoted shares, in relation to transferable custody receipts, are defined to mean shares of a foreign company that is listed on the New York Stock Exchange, NASDAQ Global Market or NASDAQ Global Select Market, where the shares are in a class of shares that is able to be traded on at least one of those financial markets.

The amending instrument also removes the application of subregulations 7.11.03(4) and (5) in relation to transferable custody receipts. The application of these subregulations to transferable custody receipts is inappropriate because the issuers of transferable custody receipts will not be the same entity as the issuer of the underlying financial product to which the transferable custody receipts relates.

Transferable custody receipts are Division 4 financial products as a result of the amendments made by the amending instrument to the principal instrument. Subregulations 7.11.03(4) and (5) provide that if a Division 4 financial product is suspended from quotation (which does not, of itself, mean that the financial product has ceased being quoted – see regulation 7.11.03(3)) and, during the suspension, the issuer in relation to the product ceases to be included in the official list of the market on which the product is traded, then the product is taken to have ceased being quoted when the issuer ceases to be included in the official list. Transferable custody receipts are defined as being able to be traded on the financial market operated by Chi-X. The financial market operated by Chi-X is not a listing market. ASIC considers that subsection 1075A(2) is satisfied in relation to this part of the declaration because it removes uncertainty in the operation of the law.

#### **4. Consultation**

In October and November 2016, ASIC conducted targeted consultation with key stakeholders on the proposed amendments to the principal instrument. ASIC has taken this feedback into account in finalising the amending instrument.

Some submissions referred to a concern raised in 2015, in response to Consultation Paper 236 *Remaking ASIC class orders on dematerialised and CHESS units of foreign securities (CP 236)*.

The relevant submissions in 2015 expressed concern that extending the coverage of the underlying policy in the principal instrument to specific classes of financial products that are only tradeable on Chi-X may mean that those products may be the subject of

compensation claims on the National Guarantee Fund (*NGF*), in circumstances where Chi-X is not yet a member of the Securities Exchanges Guarantee Corporation (*SEGC*). The respondents requested that ASIC confirm its view in response to that concern, as expressed in the explanatory statement to the principal instrument in 2015.

ASIC confirms its view that extending the underlying policy in the principal instrument to cover specific classes of financial products that are only tradeable on Chi-X, such as transferable custody receipts, will not have any impact on claims that may be made against the NGF under Division 4 of Part 7.5 of the Act, until Chi-X becomes a member of the SEGC.

The basis of ASIC's view is that:

- section 887A of the Act (as modified by Schedule 8C to the Regulations) provides that Division 4 of Part 7.5 applies to a financial market that is operated by a body corporate that is a member of the SEGC or a subsidiary;
- consequently, until Chi-X is a member of the SEGC, Division 4 of Part 7.5 of the Act will not apply to the market operated by Chi-X market;
- section 888A of the Act provides that:
  - the situations in which compensation may be claimed in respect of a loss that is connected with a financial market to which Division 4 applies are as specified in the Regulations; and
  - without limitation, a loss is connected with a financial market if it is caused by a participant, or past participant, in the market;
- currently, the only member of the SEGC is ASX;
- accordingly, while Chi-X is not a member of the SEGC, compensation may only be claimed in respect of a loss in relation to Chi-X products if the loss is connected to ASX;
- a loss will not be connected to ASX if:
  - it is caused by a person undertaking a transaction in relation to products that are only tradeable on the market operated by Chi-X and that are not tradeable on the market operated by ASX; and
  - it is caused by a participant in the market operated by Chi-X acting solely in that capacity (and not acting in the capacity of a participant in the market operated by ASX).

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

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

### **ASIC Corporations (Amendment) Instrument 2017/571**

The ASIC Corporations (Amendment) Instrument 2017/571 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**

ASIC Corporations (Amendment) Instrument 2017/571:

- (a) broadens the class of financial products to include transferable custody receipts that can be traded on the Chi-X market for the purposes of provisions that regulate and facilitate transfers of products through ASX Settlement; and
- (b) removes the application to transferable custody receipts of certain provisions that deal with circumstances under which such transferable custody receipts would be taken to have ceased quotation on a financial market.

#### **Human rights implications**

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

#### **Conclusion**

The legislative instrument is compatible with human rights as they do not raise any human rights issues.

**Australian Securities and Investments Commission**