
REPLACEMENT EXPLANATORY STATEMENT

for

ASIC Corporations (Short Selling) Instrument 2018/745

and

ASIC Corporations (Repeal) Instrument 2018/746

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (ASIC) makes ASIC Corporations (Short Selling) Instrument 2018/745 (**Legislative Instrument**) under subsection 1020F(1) of the *Corporations Act 2001* (the **Act**).

The purpose of the Legislative Instrument is to:

- (a) permit “naked” short selling in very specific circumstances where there is a benefit to the market;
- (b) provide exemptions from the requirements to report short transactions in specific circumstances; and
- (c) modify the operation of requirements for short position reporting and disclosures.

ASIC makes ASIC Corporations (Repeal) Instrument 2018/746 (**Repeal Instrument**) under subsection 1020F(1) of the Act.

The purpose of the Repeal Instrument is to repeal the following instruments which have been remade and incorporated into the Legislative Instrument:

- (a) ASIC Class Order [CO 09/774] (remade to be section 6 of the Legislative Instrument);
- (b) ASIC Class Order [CO 08/764] (remade to be section 7 of the Legislative Instrument);
- (c) ASIC Class Order [09/1051] (remade to be sections 8 and section 9 of the Legislative Instrument);
- (d) ASIC Class Order [10/111] (remade to be section 10 of the Legislative Instrument);

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- (e) ASIC Class Order [10/288] (remade to be sections 13 and 14 of the Legislative Instrument);
 - (f) ASIC Class Order [10/135] (remade to be section 15 of the Legislative Instrument); and
 - (g) ASIC Class Order [10/29] (remade to be section 17 of the Legislative Instrument).

(the **Sunsetting Instruments**)

ASIC has power under paragraph 1020F(1)(a) of the Act to exempt a class of persons or a class of financial products, from the provisions in Part 7.9 of the Act. Subsection 1020F(4) provides that these exemptions may be conditional.

ASIC has the power under paragraph 1020F(1)(c) of the Act to declare that the provisions in Part 7.9 of the Act apply as if specific provisions were omitted, modified or varied. This instrument may apply to a class of persons.

1. Background

A short sale occurs when a person sells a financial product that they do not currently own in the expectation that they can purchase the financial product later at a lower price.

Short sales may be either ‘naked’ short sales or ‘covered’ short sales. In general:

- (a) a *covered* short sale is where a person executes a short sale and relies on an existing “securities lending arrangement” to have a ‘presently exercisable and unconditional right to vest’ the products in the buyer at the time of sale. A *securities lending arrangement* is essentially a contract to borrow securities and return identical securities at a later date; and
- (b) a *naked* short sale is the practice of short selling securities without a securities lending arrangement in place.

Naked short sales are prohibited in Australia. Covered short sales are permitted.

Under subsection 1020B(2) of the Act, a person can only sell ‘section 1020B products’ if they have a presently exercisable and unconditional right to vest the products in the buyer at the time of sale. ‘Section 1020B products’ is defined under subsection 1020B(1) of the Act, and it includes securities and managed investment products.

A person who makes a covered short sale of section 1020B products on a licensed Australian market must comply with the short sale transaction reporting and “short position” reporting requirements. A *short position* arises where the quantity of the product that a person has is less than the quantity of the product they have an obligation to deliver. The reporting obligations apply to short sales made on a licensed market, whether or not the seller is in Australia.

Sunsetting instruments

Under the Legislative Instruments Act 2003, all legislative instruments, such as class orders, are repealed automatically, or ‘sunset’, after 10 years, unless ASIC takes action to exempt or preserve them. Sunsetting ensures that legislative instruments are kept up to date and only remain in force while they are fit for purpose, necessary and relevant.

ASIC has determined that the Sunsetting Instruments are operating effectively and efficiently. Therefore, they will be repealed by the Repeal Instrument and then remade without significant amendments into the Legislative Instrument.

2. Purpose of the Legislative Instrument

Naked short selling

The Legislative Instrument provides legislative relief from the naked short selling prohibition in subsection 1020B(2) of the Act to permit:

- (a) naked short sales (subject to certain conditions) by eligible market makers (**ETF market maker**) who make a market in certain exchange traded funds (**ETF**) and managed funds, (section 5 of the Legislative Instrument).
- (b) naked short sales by a market maker of a financial product which is a constituent of the S&P/ASX 300 Index or an interest in the SPRD S&P/ASX 200 Fund (**STW**) for the purposes of hedging risks arising from market making activities (section 6 of the Legislative Instrument).
- (c) naked short sales that comprise of the exercise of exchange traded options (**ETOs**) in certain cases (section 7 of the Legislative Instrument).
- (d) naked short sales that comprise of the giving or writing of certain ETOs and naked short sales in circumstances where the seller can obtain sufficient financial products to settle the sale by the execution of ETOs (section 8 of the Legislative Instrument).
- (e) naked short sales in specific circumstances of:
 - (i) government bonds; or
 - (ii) bonds and debentures of a body corporate where the total amount of such bonds or debentures on issue is valued at over \$100 million (section 9 of the Legislative Instrument).
- (f) naked short sales of a security or managed investment product able to be traded on the ASX where the sale arises under a deferred purchase agreement (**DPA**) in certain circumstances (section 10 of the Legislative Instrument).
- (g) naked short selling during a deferred settlement trading period under a public offer or other corporate action (section 11 of the Legislative Instrument).

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- (h) naked short sales that may occur in the context of certain initial public offer (IPO) sell downs by a special purpose company (**saleco**) (section 12 of the Legislative Instrument).

Exemptions from short selling reporting

The Legislative Instrument provides exemptions from having to report certain covered short sale transactions as required under subsection 1020AB(3) of the Act in the following circumstances:

- (a) an ETF market maker selling interests or securities of an ASX quoted exchange traded fund or managed fund, or a Chi-X quoted exchange traded fund does not need to give particulars specified in subregulation 7.9.100 (1)(a) to (c) of the Regulations (section 13 of the Legislative Instrument);
- (b) a market maker selling a product as a bona fide transaction to manage the financial consequences of the market making activities is exempt from giving particulars specified in subregulation 7.9.100 (1)(a) to (c) of the Regulations (section 14 of the Legislative Instrument); and
- (c) a short seller is exempt from giving particulars specified in either subregulation 7.9.100(1)(d) or regulation 7.9.100A of the Regulations where the short seller's position is the lesser of the value limit (\$100,000) or the volume limit (0.01% of the total quantity of the products in the class for that day) (section 15 of the Legislative Instrument).

Short position reporting of covered short sales

Sections 16 and 17 of the Legislative Instrument modifies Division 15 of Part 7.9 of the Regulations and notionally inserts new definitions under subsection 1020B(1) of the Act to make several operational changes to the disclosure and short position reporting of listed section 1020B financial products. Chief among these is the option for global firms to calculate their short positions on the basis of a “global end calendar time”.

Sunsetting

The Legislative Instrument provides that the relief in section 11 will cease to have effect at the end of 30 September 2021.

3. Operation of the instrument

The Legislative Instrument is set out as follows:

Part 2 – Short selling exemptions: market participants

- Section 5 – Market makers: exchange traded funds and managed funds.
- Section 6 – Market makers: Bona fide hedging.
- Section 7 – Exchange traded options: sales effected by exercising options.
- Section 8 - Exchange traded options: other scenarios.
- Section 9 - Debentures: Clearing and settlement participants.

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- Section 10 – Deferred purchase agreements.

Part 3 – Short selling exemptions: capital markets

- Section 11 – Deferred settlement trading arrangements on licensed markets.
- Section 12 – Initial public offers: Sale offers through special purpose vehicles.

Part 4 – Exemptions from short selling reporting

- Section 13 – Market makers: exchange traded funds and managed funds.
- Section 14 – Market makers: bona fide hedging.
- Section 15 – Low volume and low value positions.

Part 5 – Definitional and other changes

- Section 16 - Definitional changes.
- Section 17 – Short position reporting and short sale transaction reporting.

Part 6 – Sunseting

- Section 18 – Deferred settlement trading arrangements on licensed markets.

Part 2 - Short selling exemptions: market participants

Section 5 - Market makers: exchange traded funds and managed funds

Section 5 of the Legislative Instrument permits an ETF market maker to make naked short sales of units in an ETF or managed fund (**shorted product**). To effect this, section 5 notionally inserts subsections 1020B(4A) to (4D) after subsection 1020B(4) of the Act.

The relief applies to ETF market makers which are required to make a market in the shorted products by agreement with the market operator or the issuer of the shorted product. The relief is subject to certain conditions, including that the ETF market maker must:

- (a) notify ASIC of its reliance on the relief and the name of the shorted product.
- (b) before making an offer to sell the shorted product, keep a record that states that the proposed sale will be a short sale, and preserve the record for 12 months after the day on which the last entry was made in the record.
- (c) as soon as reasonably practicable after the sale of the shorted product but before the time for delivery of the shorted product, acquire or apply for a sufficient number of financial products in the same class as the shorted product to enable the ETF market maker to fulfil their delivery obligations under the sale.

(d) notify ASIC where more than 1% of the volume or value of the market maker's short sales in the previous 12-month period have failed to settle on time.

(e) notify ASIC if its appointment as a market maker for a shorted product is suspended or cancelled or if it no longer needs to rely on the relief.

The relief is intended to provide more certainty and efficiency for ETF market makers when performing their market making obligations.

ETF market makers provide benefits of liquidity to the market by ensuring that a reasonable bid and offer price are available at agreed timeframes as well as a minimum quantity of products for each bid and offer. During their market making activities, ETF market makers may acquire short positions if demand for ETFs or managed funds are high.

The relief is appropriate because the benefits to the market of market making activities outweigh the risk to the market of settlement failure of the short sale. ETF market makers have the capacity to apply for new units in the ETF or managed fund to be created in time for settlement of any short sales. The risk of settlement failure is therefore low.

Section 6 - Market makers: Bona fide hedging

Section 6 of the Legislative Instrument permits a market maker to hedge the risk of a long exposure acquired in its market making activities by making naked short sales of a financial product (**shorted product**). This is achieved by notionally inserting subsections 1020B(5A) to (5J) after subsection 1020B(4) of the Act.

The shorted product must be either a constituent of the S&P/ASX 300 or a unit in the SPRD S&P/ASX 200 Fund (**STW**).

The relief is subject to conditions to mitigate the risk of settlement failure that arises from naked short selling and to ensure that the financial product can be unconditionally vested in the purchaser at the time of the time of delivery.

The relief is appropriate because the benefits of market making activity outweigh the risks of settlement failure (which are low because of the highly liquid nature of the permitted shorted products).

A market maker relying on the relief is required to provide particulars of its short position in relation to the shorted product.

This relief was previously provided (excluding the extension of the relief to naked short selling of STWs) under ASIC Class Order 09/774 but was due to expire.

Section 7 – Exchange traded options: sales effected by exercising options

Section 7 of the Legislative Instrument permits naked short selling resulting from the exercise of ETOs by notionally inserting subsections 1020(B)(6A) to (6E) after subsection 1020B(4) of the Act. Specifically it applies in the following cases:

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- (a) a person buys and later elects to exercise a put option (which gives the buyer the right to sell the underlying share to another person at a specified price) and does not have a presently exercisable and unconditional right to vest the underlying product at the time the option is exercised; and
 - (b) a person sells a call option (which gives the buyer the right to buy the underlying share from the seller at a specified price) which is later exercised and the person does not have a presently exercisable and unconditional right to vest the underlying product at the time the option is exercised.

A person relying on the relief must give to ASIC particulars of their short position in relation to the shorted product.

The relief is consistent with established market practices in options markets internationally.

This relief was previously provided under ASIC Class Order [CO 08/764] which was due to expire. ASIC Class Order [CO 08/764] has operated without incident.

Section 8 – Exchange traded options: sales effected by issuing options

Section 8 of the Legislative Instrument provides relief from the prohibition against naked short selling in the following circumstances:

- (a) giving or writing of certain ETOs; and
- (b) the sale of unobtained financial products in circumstances where the seller is able to obtain sufficient financial products to settle the sale by the execution of ETOs.

These exemptions are appropriate because the risk of settlement failure arising from these situations is low. In particular:

- (a) issuing or selling options would not pose a settlement risk until the options are exercised; and
- (b) the risk of settlement failure in relation to unobtained financial products is not significant if, at the time of sale, the person is able to obtain at least the number of financial products of the same class by exercising the ETO.

The Legislative Instrument remakes ASIC Class Order 09/1051 which was due to expire.

Section 9 – Debentures: Clearing and settlement participants

Section 9 of the Legislative Instrument provides relief from the prohibition against naked short selling, in specified circumstances, to a person acting as principal in the sale of the following products:

- (a) government bonds; or

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- (b) bonds or debentures of a body corporate where the total amount of such bonds or debentures on issue is valued at over \$100 million.

The relief applies where the person is entitled to use the clearing and settlement facilities of a CS facility licensee or the Reserve Bank Information and Transfer System.

Settlement risk is low in the context of these products because of their naturally high levels of liquidity.

This relief was previously provided under [CO 09/1051] which was due to expire.

Section 10 – Deferred purchase agreements

Section 10 of the Legislative Instrument permits naked short selling of a security or managed investment product that is able to be traded on the ASX market where the sale arises under a deferred purchase agreement (**DPA**).

A DPA is a structured product by which an investor agrees to purchase nominated ‘delivery products’ from the issuer (DPA issuer) of the DPA. 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), typically at least 12 months after the date the investor entered into the DPA. At maturity, to meet its obligations under the DPA, the issuer acquires sufficient delivery products to deliver to the investor. The number and value of delivery products is ultimately determined or derived from the value or amount of a ‘reference’ (being another financial product, an asset, a rate, an index or a commodity).

The DPA issuer is taken to sell delivery products to an investor at the time the DPA is agreed (because of the operation of subsection 1020B (7)) even though the products are not to be delivered until after the maturity of the DPA.

The relief only applies in circumstances designed to reduce the risk of delivery failure or other adverse market impacts. Specifically, the relief applies where:

- (a) the maturity date of the DPA is at least 12 months after the date the investor entered into the DPA;
- (b) the reference is not the delivery product itself, nor is it a derivative that relates to the delivery product; and
- (c) the DPA issuer has the right, in circumstances specified under the DPA, to deliver other securities or managed investment products in substitution for the delivery product (thereby addressing the risk of the delivery failure).

Without the relief, DPA issuers would need to hold an inventory of delivery products at the time of sale. These requirements would make DPAs impractical and commercially unviable because:

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- (a) DPA investments generally have a term of over 12 months;
 - (b) the exact number of delivery products required to be delivered to the investor cannot be calculated until maturity of the arrangement; and
 - (c) the cost of holding an inventory of delivery products at the time of sale where the deferred delivery date of the DPA is more than 12 months would be prohibitive.

The relief was previously provided under ASIC Class Order 10/111 which was due to expire.

Part 3 - Short selling exemptions: capital markets

Section 11– Deferred settlement trading arrangements on licensed markets

The trading that usually occurs on licensed markets in Australia is done on a deferred settlement basis, currently T + 2. This means that the settlement of the trade (i.e. payment by the buyer, and delivery of the product by the seller) occurs 2 business days after the trade. This is known as ‘normal settlement trading’.

This kind of ‘normal settlement trading’ typically will not contravene subsection 1020B(2) of the Act. For example, a person that has purchased products on the market on Day 0 is able to sell those products on the market on Day 1 even though the purchase of those products has not yet settled. These circumstances do not contravene s1020B(2) because the vesting of the products will be expected to be conditional only on all of any of the matters specified in subsection 1020B(4) (e.g. payment of purchase consideration).

However the circumstances of some kinds of trading will fall outside of subsection 1020B(4) of the Act. These include circumstances where products are traded even though the products have not yet been issued or where the seller’s right to have the products vested in them is conditional on matters other than those set out in subsection 1020B(4) of the Act. These circumstances are known as ‘deferred settlement trading’ and should be distinguished from ‘normal settlement trading’.

Section 11 of the Legislative Instrument permits naked short sales of section 1020B products by a seller during a deferred settlement trading period. This applies where the seller has an entitlement to the products under a public offer or other corporate action.

During deferred settlement trading, the obligation to settle trades is deferred until a time set by the operator of the listing market.

Public offers - Conditional deferred settlement trading arrangements

Section 1020B products offered under a public offer like an IPO often commence trading on a deferred settlement basis.

Larger IPOs may also have a period of conditional trading where ASX Limited has declared a conditional market pursuant to its operating rules. The relevant conditions usually correspond to the conditions the offeror has imposed on the IPO itself. Under the ASX operating rules, if the conditions are not fulfilled within a specified time, all trading is cancelled.

Arguably deferred settlement trading of unissued section 1020B products contravenes subsection 1020B(2). This is because the seller does not have a presently exercisable and unconditional right to vest the products in a buyer.

Where the seller's entitlement to section 1020B products offered under a public offer is also conditional on completion of certain events specified in the offer document (such as completion of an underwriting agreement), trading will arguably contravene subsection 1020B(2) because the conditions exceed those permitted by subsection 1020B(4).

The Legislative Instrument covers deferred settlement trading that follows a public offer by adding s1020B(7A) to (7F). Subsection 1020B(7B) provides that a person must only sell section 1020B products during a deferred settlement trading period if the person has (or believes on reasonable grounds the person has) *an entitlement to be issued or sold the products under or in connection with an initial public offer*.

Subsection 1020B(7C) deals with the type of entitlement the seller must have where the public offer involves unissued products:

- (a) the entitlement must arise under an IPO in connection with a listing on ASX or an offer of products that will be quoted by a listed corporation, where the seller has applied for products under the offer document, including payment of application monies; and
- (b) the entitlement may be conditional on specific standard events set out in the offer document (such as completion of an underwriting agreement or corporate transaction): see notional paragraphs 1020B(7C)(b).

Subsection 1020B(7D) covers the type of entitlement the seller must have where there is an IPO sell down of existing shares. The entitlement must arise under an IPO in connection with a listing on ASX and the entitlement may be conditional on standard events set out in the offer document: see notional paragraph 1020B(7D)(b).

Additionally, the listing body must make an offer of section 1020B products for issue that are in the same class as the products offered by the sale offeror: paragraph 1020B(7D)(a)(ii). This requirement is to ensure that the entity with the requisite knowledge about the products being offered has responsibility for the offer document

In this way, subsections 1020B(7C) and (7D) operate as an exemption from the requirement in subsection 1020B(2) that the seller have a presently exercisable and unconditional right to vest products in a buyer by substituting a more flexible form of entitlement to the products in the relevant circumstances.

Due to the definition of ‘deferred settlement trading arrangements’ in notional subsection 1020B(7F), the exemptions apply during the conditional market phase following an IPO and deferred settlement trading that is not subject to conditions.

Notional subsection 1020B(7E) provides an exemption from both subsection 1020B(2) and notional subsection 1020B(7B) for persons who purchase section 1020B products on market during a deferred settlement period following a public offer.

Deferred settlement trading for other corporate actions

The Legislative Instrument modifies section 1020B of the Act by adding notional subsections 1020B(7G) to (7J). Notional subsections 1020B(7G) – (7J) effectively contain an exemption from subsection 1020B(2) for deferred settlement trading that follows corporate actions. A *corporate action* means a proposed issue of section 1020B products under or in connection with a compromise or arrangement under Part 5.1 of the Act, a rights issue, a dividend or distribution reinvestment plan, a bonus issue, a conversion of convertible notes or convertible securities, or a conversion of shares under s254H of the Act.

Various corporate actions can result in investors having an unconditional entitlement to section 1020B products that may commence trading on a licensed market before they are issued. In such cases, trading occurs on a deferred settlement basis.

Notional subsection 1020B(7H) provides that a person must only sell section 1020B products during a deferred settlement trading period, if that person is in a class of persons who, because they hold financial products in a particular class, have an entitlement to be issued with the section 1020B products under or in connection with a corporate action.

Notional subsection s1020B(7I) provides relief where a person has purchased the unissued section 1020B products on market and then on-sells them.

Naked short sales during deferred settlement trading

The arguable operation of the prohibition against naked short selling to deferred settlement trading creates uncertainty and inefficiencies in the market. The exemptions are appropriate because the risk of settlement failure during a deferred settlement scenario is not significantly greater than the risk of settlement failure during normal trading. Furthermore, the Legislative Instrument imposes controls that seek to ensure that short sales are only made when the seller has a clear entitlement to ultimately receive the financial products.

Expiry of relief for deferred settlement trading

In the CHESS Replacement Consultation Paper (April 2018) ASX indicated that as part of the Corporate Actions STP Phase 2 Project, they will review deferred settlement trading processes to assess whether there are any opportunities for simplification and more streamlined timetables.

The relief for deferred settlement trading in Section 11 of the Legislative Instrument will expire at the end of 30 September 2021 (see section 18 of the Legislative

Instrument). We will reconsider at that time whether it is appropriate for the relief to be remade in light of ASX's project to streamline the deferred settlement trading process.

Section 12– Initial public offers: Sale offers through special purpose vehicles

Section 12 of the Legislative Instrument provides an exemption from subsection 1020B(2) in the context of common IPO sell downs by a saleco.

IPOs sometimes involve the sale of shares by existing shareholders. A 'saleco' will usually be incorporated to manage this process and the shareholders will agree to sell their shares to saleco (or to IPO investors nominated by saleco) conditional on ASX granting approval for the admission of the listing company to the official list. The saleco invite applications from IPO investors in the prospectus. These invitations will also be conditional on ASX granting admission.

Depending on the arrangements between the existing shareholders and saleco, the saleco's invitation to IPO investors may contravene subsection 1020B(2). The relief only applies if the company seeking listing also makes an offer to issue shares that are in the same class as the shares offered by the saleco. This requirement is to ensure the saleco does not have sole responsibility for the prospectus.

An IPO sell-down by a saleco does not involve the type of settlement or market integrity risks that s1020B was intended to prevent. The risks relating to settlement of IPOs are adequately dealt with in Ch 6D, including s723, 724 and 737.

Part 4 - Exemptions from short selling reporting

Section 13 – Market makers: exchange traded funds and managed funds

Section 13 of the Legislative Instrument provides exemptions from the short sale transaction reporting requirements. It exempts a market maker from the requirement to give particulars specified in paragraphs 7.9.100(1)(a) to (c) of the Regulations.

The relief applies where the covered short sale is made in the course of:

- (a) performing its function as an eligible market maker of an ETF quoted on the ASX or Chi-X market; or
- (b) performing its function as an eligible market maker of a managed fund quoted on the ASX market.

The relief promotes liquidity and confidence in Australian financial markets by facilitating market making activities. Short selling by market makers is not generally indicative of a directional view and accordingly is less informative to the market. We consider that the benefits of facilitating market making outweigh any effect upon published reports.

This relief was previously provided for market makers of ETFs under [CO 10/288] which was due to expire.

Section 14 – Market makers: bona fide hedging

Section 14 of the Legislative Instrument provides exemptions from the short sale transaction reporting requirements. It exempts a market maker from the requirements to give particulars specified in paragraphs 7.9.100(1)(a) to (c) of the Regulations. The relief applies where the covered short sale is made in the course of hedging risks arising from its market making activities.

This relief promotes liquidity and confidence in Australian financial markets by helping market makers to efficiently hedge particular financial products. Short selling by market makers for the purposes of hedging is not generally indicative of a directional view of the price of financial products. The cost of reporting this information outweighs any benefit to the market in receiving this data.

This relief was previously provided under ASIC Class Order [CO 10/288] which was due to expire.

Section 15– Low volume and low value short positions

The Legislative Instrument exempts short sellers from having to report ‘small’ short positions (i.e. where the short position is the lesser of the value limit (\$100,000) or the volume limit (0.01% of the total quantity of the products in the class of that day).

The disclosure of minimal short positions is not required for the short position disclosure framework to be effective. Since the introduction of the short position framework, it has been accepted that small positions would be exempted from the disclosure requirements.

This relief was previously provided under ASIC Class Order [CO 10/135] which was due to expire.

Part 5 - Definitional and other changes

Section 16 – Definitional and other changes

This section of the Legislative Instrument modifies Part 7.9 of the Act in relation to section 1020B products by inserting the following definitions that are applicable to the Legislative Instrument:

- global end calendar time;
- nominated time;
- opt-out nomination;
- reporting day;
- securities lending arrangement;
- short position;
- value limit; and
- volume limit.

Section 17 – Short position reporting and short sale transaction reporting

Section 17 of the Legislative Instrument modifies section 1020B(1) of the Act and Part 7.9 of the Regulations to:

- (a) amend the methodology for calculating a short position:
 - (i) to reflect circumstances where a person holds section 1020B financial products in more than one capacity;
 - (ii) to require a person (such as the responsible entity for a managed investment scheme) who holds a product on behalf of another person (except where that other person has the sole discretion to decide whether the product will be sold) to include the product in calculating its short position; and
 - (iii) to clarify that, if another person (such as a bare trustee) is holding a product on a person's behalf (and the person has the sole discretion to decide whether the product will be sold), the person must include the product in calculating its short position;
- (b) extend the short position reporting obligations to positions arising from naked short sales entered into with the benefit of an exemption from the prohibition against naked short selling;
- (c) extend the application of the short selling reporting and disclosure regime to short sales of 'CGS depository interests';
- (d) clarify the application of the short position reporting obligations in circumstances where a securities lending arrangement is contingent upon the lender recalling the product;
- (e) amend the definition of 'reporting day' in subregulation 7.9.99 (1) of the Regulations to mean 'a day that a licensed market that has admitted to quotation the section 1020B product is open for trading;'

These modifications operate to clarify a range of matters and provide greater certainty for the operation of the short selling reporting and disclosure regime.

The modifications were previously provided under ASIC Class Order [CO 10/29] which was due to expire.

Short position calculation time

In addition, section 17 of the Legislative Instrument modifies subsection 1020B(1) of the Act and regulation 7.9.100 (1)(d) to provide two options for the timing of the calculation of short positions:

- (a) 7pm Australian Eastern time on the day of the short transaction; or

(b) A “global end calendar time.”

A short position arises where the quantity of the product that a person has is less than the quantity of the product they have an obligation to deliver: see regulation 7.9.99.

The global end calendar time is the end of the trading day in the location in which the relevant transaction is booked in the short sellers’ accounts. This option is of particular relevance to global firms.

The modification is provided in recognition of the time required to report short position. The introduction of the option to use a global calendar end time recognises the practical difficulties global firms may have in calculating and providing these reports while operating in different time zones.

The modification of the calculation time to 7pm Australian Eastern Time previously applied under ASIC Class Order [CO 10/29] which was due to expire.

Part 6 - Sunsetting

Section 18 – Deferred settlement trading arrangements on licensed markets

Section 11 of the Legislative Instrument ceases to have effect at the end of 30 September 2021.

Prescribing matters by reference to other instruments

The Legislative Instrument makes references to foreign statutes, official lists of operators of financial markets, timetables published by operators of financial markets and certain financial market indices.

However, the Legislative Instrument does not apply, adopt or incorporate matter contained in those statutes, lists, timetables and indices, within the meaning of section 14 of the *Legislation Act 2003*. Section 14 of that Act is not engaged because the content of those statutes, lists, timetables and indices does not affect the operation of the Legislative Instrument.

The references are further explained as follows:

- (a) in the definition of ‘exchange traded fund’—the reference to the *Investment Company Act 1940* (US).

Certain kinds of foreign companies can satisfy the definition of ‘exchange traded fund’, namely a foreign company which has the economic features of a managed investment scheme and is an open-ended investment company registered with the U.S. Securities and Exchange Commission (SEC) under the Investment Company Act 1940.

The Investment Company Act is the primary source of regulation of mutual funds and closed-end funds in the United States. The Investment Company Act can be accessed via the SEC’s website at www.sec.gov.

Whether a foreign company satisfies the definition of ‘exchange traded fund’ turns on whether, as a matter of fact, the company was registered under the Investment Company Act. The Legislative Instrument does not apply, adopt or incorporate matter in that US statute, on either a fixed or ambulatory basis, because nothing in the US statute affects the operation of the instrument.

- (b) in the definition of ‘deferred settlement trading arrangements’—the reference to a timetable published by ASX.

Deferred settlement trading arrangements are trading and settlement arrangements that determined by the ASX in relation to certain kinds of activities that occur on the financial market operated by it.

The timetables are published on the ASX website at www.asxonline.com.

Whether deferred settlement trading arrangements exist turns on whether, as a matter of fact, ASX permits such arrangements to occur. The Legislative Instrument does not apply, adopt or incorporate matter in the timetables, on either a fixed or ambulatory basis, because nothing in the timetables published by ASX affects the operation of the instrument.

- (c) in the definitions ‘listed corporation’, ‘listing body’ and ‘listing scheme’—references to official list of ASX Limited

The reference to the official list of ASX Limited is made in the definitions of ‘listed corporation’, ‘listing body’ and ‘listing scheme’.

Section 75 of the Act describes when a body corporate or other person is included in an official list of a body corporate, such as ASX Limited.

The official list of ASX Limited is published on the ASX website at www.asx.com.au.

In relation to the definitions of ‘listing body’ and ‘listing scheme’, the references are to a ‘[body corporate/registered scheme] that is seeking inclusion in the official list of ASX Limited’. These definitions turn on what the respective body or scheme is seeking to achieve, rather than on the content of the official list.

The definition of ‘listed corporation’ in the Legislative Instrument is modelled on the definition of ‘listed corporation’ in s9 of the Corporations Act but is limited to being listed on ASX. Whether a body corporate satisfies the definition of ‘listed corporation’ turns on whether, as a matter of fact, the ASX has granted listing status to the body corporate. The Legislative Instrument does not apply, adopt or incorporate matter, on either a fixed or ambulatory basis because nothing in the official list of ASX affects the operation of the instrument.

- (d) References to S & P / ASX 200 and S & P / ASX 300 indices

The reference to the ‘S & P / ASX 200’ index occurs in the context of describing a class of financial products that can be delivered in relation to

deferred purchase agreements. The reference to the ‘S & P / ASX 300’ index occurs in the context of describing a class of financial products in relation to hedging activities by market makers.

These indices are compiled and calculated by Standard and Poor’s, a division of The McGrath-Hill Companies, Inc.

The S & P / ASX 200 is described by Standard and Poor’s as follows:

‘The S & P / ASX 200 is recognised as the institutional investable benchmark in Australia. Index constituents are drawn from eligible companies listed on the Australian Securities Exchange. The S&P/ASX 200 is designed to measure the performance of the 200 largest index-eligible stocks listed on the ASX by float-adjusted market capitalization. Representative, liquid, and tradable, it is widely considered Australia’s preeminent benchmark index.’

The S & P / ASX 300 is described by Standard and Poor’s as follows:

‘The S&P/ASX 300 is designed to provide investors with broader exposure to the Australian equity market. The index is liquid and float-adjusted, and it measures up to 300 of Australia’s largest securities by float-adjusted market capitalization. The S&P/ASX 300 index covers the large-cap, mid-cap, and small-cap components of the S&P/ASX Index Series. This index is designed to address investment managers’ needs to benchmark against a broad opportunity set characterized by sufficient size and liquidity.’

The constituents of the indices can be found via www.standardandpoors.com.au. The list of constituents is not made publicly available free of charge by Standard and Poor’s. The list is available via that website on payment of a fee. The list of constituents is also made available without payment by several third-party providers.

Whether a financial product falls within those classes of financial products at any particular time turns on whether, as a matter of fact, the class of product is a constituent of the index. The Legislative Instrument does not apply, adopt or incorporate the indices for the purposes of s14 of the LIA on either a fixed or ambulatory basis because nothing in the indices affects the operation of the ASIC instrument.

4. Consultation

In Consultation Paper 299: *Short selling: Naked short selling relief, position reporting amendments and sunseting class orders (CP 299)*, ASIC consulted on proposals to make new exemptions from the prohibition against naked short sales for:

- (a) market makers of exchange traded funds and managed funds;
- (b) deferred settlement trading arrangements on licensed markets; and
- (c) initial public offers: sale offers through special purpose vehicles.

We also consulted on modifying the time for calculation of short positions and on our proposal to remake and continue the Sunsetting Instruments in the Legislative Instrument.

In addition, we engaged in informal consultation with the Australian Financial Markets Association (**AFMA**) and ASX Limited.

Consultation feedback was generally supportive of ASIC's proposals. Where appropriate, we have incorporated relevant feedback in finalising the Legislative Instrument.

Statement of Compatibility with Human Rights

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

ASIC Corporations (Short Selling) Instrument 2018/745

and

ASIC Corporations (Repeal) Instrument 2018/746

The ASIC Corporations (Short Selling) Instrument 2018/745 (**Legislative Instrument**) and the ASIC Corporations (Repeal) Instrument 2018/746 (**Repeal Instrument**) are 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

People sometimes sell (short sell) financial products they do not own with a view to repurchasing them later at a lower price.

Short selling is regulated by the *Corporations Act 2001(CTH)* (the **Act**) and the *Corporations Regulations 2001* (the **Regulations**).

Short sales may be either ‘naked’ short sales or ‘covered’ short sales. In general:

- (a) A *covered short sale* is where a person executes a short sale and relies on an existing securities lending arrangement to have a ‘presently exercisable and unconditional right to vest’ the products in the buyer at the time of sale. A *securities lending arrangement* is essentially a contract to borrow securities and return identical securities at a later date; and
- (b) A *naked short sale* is the practice of short selling securities without a securities lending arrangement in place.

In Australia, naked short sales are prohibited. Covered short sales are permitted.

If a person makes a short sale on a licensed market, they must comply with the short sale transaction reporting and short position reporting requirements. These obligations apply to covered short sales of section 1020B products made on a licensed market, whether or not the seller is in Australia.

ASIC has the power to exempt persons from the short selling provisions of Pt 7.9 of the Act. The exemption may be subject to conditions.

ASIC may also declare that short selling provisions, including those relating to the calculation of short positions, apply as if specific provisions were omitted, modified or varied.

Exemptions from the prohibition against naked short selling

The prohibition against naked short selling operates to prevent disturbance to the markets which may arise if a seller is unable to deliver the products that have been sold when the sale is due to settle. ASIC has granted a range of exemptions in circumstances where the risk of settlement failure is deemed to be low. An example of such circumstances is a short sale by a market maker (**ETF Market Maker**) of an exchange traded fund (**ETF**). Market makers of ETFs have the ability to apply for new units of the fund to be created in time to settle the sale. This greatly reduces the risk of settlement failure. In such low risk circumstances, it is appropriate to permit short selling to promote market efficiency and also to facilitate activities which provide a benefit to the market, such as market making.

The exemptions apply in the following circumstances:

- (a) naked short sales (subject to certain conditions) by eligible market makers (**ETF market maker**) who make a market in certain exchange traded funds (**ETF**) and managed funds (section 5 of the Legislative Instrument).
- (b) naked short sales by a market maker where the financial product to be sold is a constituent of the S&P/ASX 300 Index or an interest in the SPRD S&P/ASX 200 Fund (**STW**). This exemption applies where the sale is for the purposes of hedging risks arising from market making activities (section 6 of the Legislative Instrument).
- (c) naked short sales which comprise of the exercise of ETOs in certain cases (section 7 of the Legislative Instrument).
- (d) naked short sales which comprise of the giving or writing of certain ETOs and naked short sales in circumstances where the seller can obtain sufficient financial products to settle the sale by the execution of ETOs (section 8 of the Legislative Instrument).
- (e) naked short sales in specific circumstances of government bonds or bonds and debentures of a body corporate where the total amount of such corporate bonds or debentures on issue is valued at over \$100 million (section 9 of the Legislative Instrument).
- (f) naked short sales of a security or managed investment product able to be traded on the ASX where the sale arises under a deferred purchase agreement (**DPA**) in certain circumstances (section 10 of the Legislative Instrument).
- (g) naked short selling of products during a deferred settlement trading period (section 11 of the Legislative Instrument).
- (h) naked short sales that may occur in the context of certain IPO sell downs by a special purpose company (**saleco**) (section 12 of the Legislative Instrument).

Modifications of the short selling reporting regime

The Legislative Instrument provides exemptions from the requirement to report certain covered short sales as required under subsection 1020AB (3) of the Act. These exemptions are granted in circumstances where the omission of data from the published reports is less likely to be significant. For instance, trading by market makers is less likely to reflect a directional view of the price of the relevant financial products. Another example is when the short position held is too small to be significant. The Legislative Instrument includes exemptions in the following circumstances:

- (d) an ETF market maker selling interests or securities of an ASX quoted exchange traded fund or managed fund, or a Chi-X quoted exchange traded fund does not need to give particulars specified in regulation 7.9.100 (1)(a) to (c) of the Regulations (section 13 of the Legislative Instrument);
- (e) a market maker selling a product as a bona fide transaction to manage the financial consequences of the market making activities is exempt from giving particulars specified in subregulation 7.9.100 (1)(a) to (c) of the Regulations (section 14 of the Legislative Instrument); and
- (f) a short seller is exempt from giving particulars specified in either subregulation 7.9.100(1)(d) or subregulation 7.9.100A of the Regulations where the short seller's position is the lesser of the value limit (\$100,000) or the volume limit (0.01% of the total quantity of the products in the class for that day) (section 15 of the Legislative Instrument).

Short position reporting of covered short sales

The Legislative Instrument modifies Division 15 of Part 7.9 of the Regulations and notionally inserts new definitions under subsection 1020B(1) of the Act to make several operational changes to the disclosure and short position reporting of listed section 1020B financial products. These increase the clarity and effectiveness of the regime. Chief among these is the option for global firms to calculate their short positions on the basis of a “global end calendar time.”

The global end calendar time is the end of the trading day in the location in which the relevant transaction is booked in the short sellers' accounts. This option is of particular relevance to global firms and recognises the practical difficulties that arise from an arbitrary cut off time during global trading.

Sunsetting instruments

Under the Legislative Instruments Act 2003, all legislative instruments, such as class orders, are repealed automatically, or ‘sunset’, after 10 years, unless ASIC takes action to exempt or preserve them. Sunsetting ensures that legislative instruments are kept up to date and only remain in force while they are fit for purpose, necessary and relevant.

The provisions of the Legislative Instrument, as set out above, includes a range of exemptions and modifications which were previously contained in instruments which were due to expire. ASIC has determined that the following sunsetting instruments are operating effectively and efficiently and will be continued in the Legislative

Instrument:

- ASIC Class Order 09/774 (now section 6 of the Legislative Instrument);
- ASIC Class Order 08/764 (now section 7 of the Legislative Instrument);
- ASIC Class Order 09/1051 (now sections 8 and 9 of the Legislative Instrument);
- ASIC Class Order 10/111 (now section 10 of the Legislative Instrument);
- ASIC Class Order 10/29 (now section 17 of the Legislative Instrument);
- ASIC Class Order 10/135 (now section 15 of the Legislative Instrument); and
- ASIC Class Order 10/288 (now section 13 and 14 of the Legislative Instrument).

All sunseting instruments were repealed by the Repeal Instrument at the same time as being remade and continued in the Legislative Instrument.

All the sunseting instruments, except [CO 10/29] and [CO 09/774], were remade without significant change.

Human rights implications

This legislative instrument does not affect 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