



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Amendment) Instrument 2019/784

This is the Explanatory Statement for ASIC (Amendment) Instrument 2019/784 (the *amending instrument*).

The Explanatory Statement is approved by the Australian Securities and Investments Commission (*ASIC*).

Summary

1. ASIC makes the amending instrument under subsections 601QA(1) and 1020F(1) of the *Corporations Act 2001* (the *Act*).
2. The amending instrument amends:
 - (a) ASIC Corporations (Short Selling) Instrument 2018/745;
 - (b) ASIC Class Order [CO 13/655];
 - (c) ASIC Class Order [CO 13/721]; and
 - (d) ASIC Class Order [CO 13/1200],(collectively the '*principal instruments*') to grant exemptions from certain provisions of the Act to facilitate the quotation and trading of managed funds on the financial market operated by Chi-X Australia Limited (*Chi-X*).

Purpose of the instrument

3. Chi-X holds an Australian market licence (*AML*) which enables it to operate a market through which participants may trade securities and financial products that relate to a managed investment scheme.
4. In the principal instruments, ASIC has granted relief to market-makers and responsible entities from certain obligations under the Act in respect of:
 - (a) exchange traded funds (*ETFs*) and managed funds that are able to be traded on the financial market operated by ASX Limited (*ASX*); and
 - (b) ETFs that are able to be traded on the financial market operated by Chi-X.

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5. Chi-X is proposing to expand its services to include the quotation and trading of managed funds on the Chi-X market.
 6. The amending instrument extends the relief in the principal instruments to facilitate the quotation and trading of managed funds on the Chi-X market.
 7. ASIC exercised its powers to grant relief from the requirements of certain provisions of the Act to facilitate the appropriate operation of the AQUA market by ASX. The AQUA market is the ASX market segment dedicated to the quotation and trading of interests in managed funds, ETFs and structured products.
 8. The principal instruments extended the relief to ETFs traded on the Chi-X market because the proposed framework for its ETFs was broadly equivalent to that offered by the ASX for ETFs on the AQUA market. Managed funds are more complex than ETFs as they are not designed to passively track an index. The framework for Chi-X managed funds was not available to be assessed when the principal instruments were made.
 9. The managed fund framework now proposed by Chi-X, including conditions precedent to quotation of new products in this class, are broadly equivalent to that offered by the ASX. As a result, it is important that regulatory neutrality applies so that one market is not materially disadvantaged over the other market. Inconsistent regulatory settings across the two markets in relation to substantially the same product would result in differing compliance costs to industry participants and hinder competition.
 10. ASIC considers it appropriate to extend the existing relief to facilitate the quotation and trading of interests in managed funds on the Chi-X market.

Consultation

11. Before making the amending instrument, ASIC consulted with the ASX Group, the Australian Financial Markets Association (AFMA), the Reserve Bank of Australia (RBA) and the Securities Exchanges Guarantee Corporation (SEGC). No issues or concerns were raised by any of these parties.
12. In making the amending instrument, ASIC considered feedback provided by Chi-X.
13. The Office of Best Practice Regulation has assessed that a Regulatory Impact Statement is not required in relation to the making of the Amending Instrument.

Operation of the instrument

ASIC Corporations (Short Selling) Instrument 2018/745

“Naked” short selling relief for ETF market makers

14. Subsection 1020B(2) of the Act prohibits the “naked” short selling of certain financial products. A “naked” short sale is a sale of a financial product made in

circumstances where the seller does not have a presently exercisable and unconditional right to vest the financial product in the buyer at the time of the sale. The prohibition against “naked” short selling operates to prevent disruption 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.

15. Paragraph 5 of the ASIC Corporations (Short Selling) Instrument 2018/745 currently provides relief from subsection 1020B(2) of the Act to permit eligible ETF market makers to make “naked” short sales of interests in an ETF or managed fund on ASX, or in an ETF on Chi-X, by inserting notional subsections 1020B(4A) to (4D) into the Act. An ETF market maker is eligible for relief if the ETF market maker is required to make a market in the financial products by agreement with the market operator or the issuer.
16. The relief is subject to conditions that the ETF market maker:
 - (a) give notice to ASIC of its intention to rely on the relief;
 - (b) before making an offer to sell the shorted product, make (and keep for 12 months) a record stating that the proposed sale will be a short sale;
 - (c) as soon as practicable but before the time for delivery of the shorted product, acquire or apply for a sufficient number of financial products to enable the market maker to fulfil their delivery obligations under the sale;
 - (d) if the sales of shorted products by the market maker during a reporting period exceed the settlement failure limit, give a settlement failure notice to ASIC within 28 days after the end of the reporting period;
 - (e) if the relevant market operator has given a notice of suspension or cancellation to the market maker, give a copy of the notice to ASIC within 28 days of receiving the notice;
 - (f) if the operator of the scheme or the foreign company has given a notice of suspension or cancellation to the market maker, in relation to the managed fund, give a copy of the notice to ASIC within 28 days of receiving the notice; and
 - (g) if the market maker no longer seeks to rely on the relief, give a notice of cessation to ASIC.
17. 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 provides more certainty and efficiency for ETF market makers when performing their market making obligations.
18. The relief has been given to ETF market makers in circumstances where 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.

19. The amending instrument amends notional paragraph 1020B(4A)(b) of the Act to extend the relief to ETF market makers that make “naked” short sales of interests in managed funds on Chi-X.

Short Selling instrument – short selling reporting

20. A person who makes a “covered” short sale of certain products on a licensed Australian market must comply with the short sale transaction reporting requirements in subsection 1020AB(3) of the Act. A “covered” short sale is a sale of a financial product made in circumstances where the seller has a presently exercisable and unconditional right to vest the financial product in the buyer at the time of the sale, such as under a securities lending arrangement.
21. Paragraph 13 of the ASIC Corporations (Short Selling) Instrument 2018/745 exempts an ETF market maker from the obligation in subsection 1020AB(3) of the Act to the extent it requires the seller to give particulars specified in paragraphs 7.9.100(1)(a) to (c) of the of the *Corporations Regulations 2001*.
22. The relief currently applies where the covered short sale is made in the course of an ETF market maker performing its function as an eligible market maker of:
 - (a) an ETF quoted on the ASX or Chi-X market; or
 - (b) a managed fund quoted on the ASX market.
23. 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. ASIC considers that the benefits of facilitating market making outweigh any effect upon published reports.
24. The amending instrument amends paragraph 13(2)(b) of the ASIC Corporations (Short Selling) Instrument 2018/745 to extend the short sale transaction reporting relief to ETF market makers that make covered short sales of units of managed funds quoted on a financial market operated by Chi-X.

[CO 13/655] Constitution – consideration to acquire an interest

25. Paragraph 601GA(1)(a) of the Act requires that the constitution of a registered managed investment scheme make adequate provision for the consideration that is to be paid to acquire an interest in the scheme.
26. ASIC Class Order [CO 13/655] modifies the application of Chapter 5C of the Act as it applies to a responsible entity, by inserting notional 601GAE. Notional subsection s601GAE(1) allows the constitution of a registered scheme to provide a formula or method that is to be used to determine the amount of the

consideration to acquire interests in the scheme, that complies with notional subsection 601GAE(2) but gives the responsible entity a discretion to do one or more of the following:

- (a) decide a matter that affects the value of a factor included in the formula;
- (b) decide a matter that is an aspect of the method;
- (c) determine the amount of an adjustment to the amount determined by the formula for the costs in acquiring or disposing of scheme property, for assets of the scheme that are not scheme property or otherwise.

24. Notional subsection 601GAE(2) provides that the formula or method, if it applies when the interests in the scheme:
- (a) for exchange traded funds—are in a class of interests that are able to be traded on a financial market operated by ASX or Chi-X; or
 - (b) for managed funds—are in a class of interests that are able to be traded on a financial market operated by ASX,

must be based on the value of scheme property less liabilities, rather than market price.

25. The amending instrument amends notional subsection 601GAE(2) of the Act so that the formula or method that may be used to determine the amount of consideration to acquire interests in managed funds traded and quoted on the Chi-X market, must also be based on the value of scheme property less liabilities, rather than market price.

[CO 13/721] Ongoing disclosure of material changes

26. Section 1017B of the Act requires an issuer of a financial product, when the product is acquired by a retail investor, to notify the holder of the product of the following changes:
- (a) any material change to, or significant event that affects, a matter that would have been required to be specified in the financial product's PDS, had the PDS been prepared the day before the change or event occurred; and
 - (b) any other change, event or other matter of a kind specified in regulations made for the purposes of paragraph 1017B(1A)(b) of the Act.
27. However, an issuer does not need to give a notice under section 1017B of the Act if the financial product is a managed investment product that is an ED security. ASIC considers that there is uncertainty regarding the classification of certain ETF and managed funds products traded on the ASX and Chi-X markets as ED securities under section 111AFA of the Act. Because of this, there is also uncertainty as to whether the issuers of those products are required to give notices under section 1017B of the Act.

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28. Paragraph 9 of ASIC Class Order [CO 13/721] currently provides relief to a responsible entity of:
- (a) an ETF whose interests are in a class of interests that are able to be traded on a financial market operated by ASX or Chi-X; and
 - (b) a managed fund whose interests are in a class of interests that are able to be traded on ASX,
- from the requirement to comply with section 1017B of the Act on the condition that the responsible entity:
- (c) complies with section 675 of the Act as if the scheme were an unlisted disclosing entity; and
 - (d) includes statements in any Product Disclosure Statement for interest in the scheme to the effect that it will comply with the continuous disclosure requirements of the act as if the scheme were an unlisted disclosing entity.
29. The amending instrument extends the relief in paragraph 9 of ASIC Class Order [CO 13/721] to a responsible entity of a managed fund whose interests are in a class of interests that are able to be traded on a financial market operated by Chi-X.

[CO 13/1200] Periodic statements

30. Subsection 1017D(1) of the Act imposes an obligation on issuers of financial products that have an investment component to give retail investors periodic statements. The financial products covered include interests in listed or quoted managed investment schemes. Specific requirements for the content that must be included in a periodic statement are prescribed under subsection 1017D(5).
31. However, the issuers of interests in listed or quoted managed investment schemes face practical difficulties when preparing periodic statements that comply with subsection 1017D(5). These difficulties arise mainly as a result of issuers and their service providers not knowing the transaction price that an investor bought or sold their interest in the scheme on market.
32. The declaration in paragraph 8 of [CO 13/1200] modifies the application of section 1017D to such a financial product by changing the information required in the periodic statement.
33. The amending instrument modifies paragraph 8(b) of [CO 13/1200] to extend the declaration to managed funds that are able to be traded on a financial market operated by Chi-X.

Commencement

34. The amending instrument commences on the day after the instrument is registered on the Federal Register of Legislation.

Legislative authority

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35. The amending instrument amends the principal instruments. Where an Act confers a power to make an instrument, the power is to be construed as including a power exercisable in the like manner and subject to the like conditions to amend the instrument: see subsection 33(3) of the *Acts Interpretation Act 1901* (as in force as at 1 January 2005 and as applicable to the relevant powers because of section 5C of the Act).
 36. ASIC makes this amending instrument under subsections 601QA(1) and 1020F(1) of the Act.
 37. Subsection 601QA(1) of the Act provides that ASIC may, among other things, declare that Chapter 5C applies to a person as if specified provisions were omitted, modified or varied as specified in the declaration.
 38. Paragraphs 1020F(1)(a) and (b) of the Act provide that ASIC may exempt a person, a class of persons, a financial product or class of financial products from provisions of Part 7.9 of the Act.
 39. Paragraph 1020F(1)(c) of the Act provides that ASIC may declare that Part 7.9 of the Act applies in relation to a person or a financial product or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.
 40. The amending instrument is a disallowable legislative instrument.
 41. ASIC considered the effects that the exercise of its powers in making the amending instrument will have on competition in the financial system, as required by section 1(2A) of the *Australian Securities and Investments Commission Act 2001*.

Statement of Compatibility with Human Rights

This Statement of Compatibility with Human Rights is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

ASIC Corporations (Amendment) Instrument 2019/784

Overview

1. The *ASIC Corporations (Amendment) Instrument 2019/784* amends:

- (a) ASIC Corporations (Short Selling) Instrument 2018/745;
- (b) ASIC Class Order [CO 13/655];
- (c) ASIC Class Order [CO 13/721]; and
- (d) ASIC Class Order [CO 13/1200],

to grant exemptions from certain provisions of the Act to facilitate the quotation and trading of quoted managed funds (*QMFs*) on the financial market operated by Chi-X Australia Limited (*Chi-X*).

Assessment of human rights implications

2. This instrument does not engage any of the applicable rights or freedoms.

Conclusion

3. This 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*.