



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Securities Lending Arrangements) Instrument 2021/821

This is the Explanatory Statement for *ASIC Corporations (Securities Lending Arrangements) Instrument 2021/821*.

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

Summary

1. This instrument provides relief to persons engaged in securities lending in relation to the substantial holding provisions of Ch 6C of the *Corporations Act 2001 (Act)*.
2. ‘Securities lending’ is a term used to describe a market transaction where securities are transferred from the owner (the ‘lender’) to another party (the ‘borrower’) where the borrower has an obligation to return the securities or equivalent securities to the lender either on demand or at the end of the loan term.
3. Securities lending usually occurs between professional investors (such as institutions) in the market and usually involves securities held by custodians. Securities lending may be undertaken to cover potential failed trades, dividend-driven transactions or other transactions relating to corporate actions, including voting. It can also occur as part of short selling activity.
4. Securities lending on standard terms will usually result in the lender and the borrower having a relevant interest in the lent securities under section 608 of the Act. They may also have a relevant interest in securities delivered as collateral for the loan. When a borrower on-lends the securities to a third party, provided the borrower retains a relevant interest in the securities, the lender will continue to have a relevant interest in the securities under subsection 608(8) of the Act. Intermediaries involved in the transaction may also have certain relevant interests. In this way, securities lending transactions can result in a chain of people having a relevant interest in the same securities.
5. Persons involved in securities lending may be required to give substantial holding notices under section 671B of the Act due to these relevant interests

(including when combined with their other interests). This instrument declares that sections 608 and 609 are modified for the purposes of section 671B. The relief does not apply for the purposes of Chapter 6 of the Act, including the takeovers prohibition in section 606.

Purpose of the instrument

6. The purpose of this instrument is to make substantial holding disclosure by persons involved in securities lending more practical and meaningful to the market. Disclosure of substantial holdings, including for interests arising from securities lending, is important for maintaining an efficient, competitive and informed market.
7. ASIC's policy on substantial holding disclosure and securities lending is further explained in Regulatory Guide 222: *Substantial holding disclosure: securities lending and prime broking (RG 222)*.
8. The instrument provides relief for lenders and prime brokers (which was previously provided in ASIC Class Order [CO 11/272]) and relief for intermediaries who act as agents for lenders (**agent lenders**).

Lenders

9. A lender who transfers securities (**lent securities**) to another party (the **borrower**) through a securities lending transaction will usually retain a relevant interest in the lent securities through its right to recall the securities from the borrower: see RG 222.27(b). However, the lender's relevant interest technically may cease if the borrower subsequently disposes of the lent securities to a third party, even though the lender retains rights to recall the securities from the borrower.
10. The subsequent actions of the borrower can therefore complicate the lender's ability to monitor its relevant interests. It is prudent for the lender to presume that it retains a relevant interest in lent securities and the instrument has this effect: notional subsection 608(8A). See RG 222.34.

Prime brokers

11. Prime brokers usually have the right to borrow their client's securities and therefore obtain a relevant interest in those securities upon entering into the prime broking agreement. This is not necessarily an exclusive right. Other market participants, such as custodians operating a securities lending program, may also have a broad mandate to borrow their client's securities.
12. We consider that a prime broker's or custodian's more substantive control over the securities arises once they exercise their borrowing right. The instrument therefore provides that for the purposes of substantial holding disclosure, a prime broker or custodian with borrowing rights must defer the time at which it takes into account its relevant interest to when it exercises the borrowing right: notional subsection 609(10A). This aims to ensure that the timing of any

substantial holding notice will be aligned with the intermediary's more substantive control over the client's securities: RG 222.62.

13. The relief only defers the relevant interest arising from the borrowing right for the purposes of substantial holding disclosure:
 - a) where the borrowing right is obtained in the ordinary course of business; and
 - b) where the client is not restricted in how it can deal with the securities (other than a permissible restriction).

Agent lenders

14. Agent lenders arrange securities lending transactions pursuant to authorisation agreements with their client lender. An agent lender would generally obtain a relevant interest in the client's securities upon entry into the authorisation agreement (and when securities are added to the lending pool). This is because the agent has the power to exercise control over the disposal of the client's lending pool securities.
15. Lending pool securities tend to be matched to appropriate borrowers in an automated way and we consider that the agent has more substantive control over the securities once they have been lent out. It is at this point the agent lender usually has the discretion to terminate securities lending transactions and recall the lent securities.
16. The instrument therefore provides that for the purposes of Part 6C.1 of the Act, the agent lender does not acquire a relevant interest until the securities are lent out: notional subsection 609(10C). As with the deferral relief provided for prime brokers, this relief aims to ensure any disclosure obligation under Part 6C.1 is aligned with the agent lender's more substantive control over the securities.
17. The relief is conditional on:
 - a) the lender not being subject to any restriction with the agent (other than a 'permissible restriction') in how the lender can deal with the securities; and
 - b) the agent acquired the lending authority in the ordinary course of carrying on an agency lending business.
18. As with principal lenders, agent lenders generally have a relevant interest in securities that have been transferred to a borrower through a securities lending arrangement. This is due to the agent lender's right to terminate securities lending arrangements (which results in recall of the lent securities). Subsection 608(8B), as notionally inserted by the instrument, provides that an agent lender retains a relevant interest in lent securities (for the purposes of the agent lender's substantial holding disclosure under Part 6C.1 of the Act) regardless of the borrower's dealings with the lent securities.

Relief from disclosing consideration

19. The prescribed forms for notification of substantial holdings require disclosure of consideration for the acquisition or disposal of relevant interests. In the context of securities lending, this may include benefits and fees that are irrelevant for the purposes of Part 6C.1. The instrument therefore declares that section 671B is modified as if it did not require this consideration to be disclosed: notional subsection 671B(3A).

Relief from having to attach agreements

20. Securities lending agreements are long and complex documents. Parties may also enter into several securities lending agreements within a short period of time. Attaching all these agreements to a substantial holding notice is not useful for the market, especially as most of the terms are irrelevant for the purposes of Part 6C.1. The instrument therefore declares that section 671B applies as if it was modified so that securities lending agreements do not need to be attached to substantial holding notices: notional subsection 671B(4A).
21. For similar reasons, the instrument also provides that authorisation agreements between an agent lender and client do not need to be attached to a substantial holding notice: notional subsection 671B(4B).
22. This relief is given on condition that specified key information about the agreement is provided as an alternative to attaching the securities lending or authorisation agreements.

Consultation

Original consultation on relief for prime brokers and other custodians

23. In 2009, ASIC sought feedback on specific relief proposals and the application of the substantial holding provisions to securities lending and prime broking in Consultation Paper 107 *Securities lending and substantial holding disclosure (CP 107)*. ASIC obtained further industry feedback following this consultation in 2010. The purpose of CP 107 was to provide a strong compliance message to the market of ASIC's expectations and consult on limited disclosure relief.
24. ASIC received 14 submissions in response to CP 107, mostly from those involved in securities lending. Industry participants argued for a broad exemption from the relevant interest provisions on the basis that securities lending is not relevant to control of listed entities. ASIC did not accept this argument because the disclosure of substantial holdings, including those acquired through securities lending, is important for an efficient, competitive and informed market in quoted securities: see RG 222 at paragraph 9.
25. The submissions also revealed that the nature of securities lending presents challenges for full compliance with the substantial holding provisions in Part 6C.1 of the Act. Industry participants also argued that strict compliance with these provisions resulted in confusing disclosure of irrelevant information to the market.

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26. ASIC accepted that disclosure of substantial holdings needs to take place in a way that provides useful and accessible information to the market. ASIC Class Order [CO 11/272] therefore provided relief to make compliance with section 671B more practical for securities lending participants while also providing more useful disclosure to the market.

Consultation on relief for agent lenders

27. In July 2019 ASIC consulted on extending the type of deferral relief provided by ASIC Class Order [CO 11/272] to include agent lenders in Consultation Paper 319 *Substantial holding disclosure and agent lenders (CP 319)*. We consulted on providing class relief because we had received individual relief applications from multiple agent lenders.
28. We received 5 submissions in response to CP 319 and decided to grant deferral relief to agent lenders that is analogous to the original relief given to prime brokers in [CO 11/272].
29. The CP 319 submissions and our response will be covered in a feedback report published shortly. In brief:
- a) The Australian Shareholders Association was not supportive of the proposed relief, partly because information about the potential for securities to be on-lent is important. We considered that it was more consistent with the aims of Ch 6C to provide agent lenders with deferral relief rather than refuse relief. We note deferral relief does not affect the disclosure that lenders should give underlying beneficial holders about their securities lending practices: see RG 222.17.
 - b) Industry stakeholders were supportive of deferral relief but argued that agent lenders should have a broad exemption from section 608 due to the limited nature of their relevant interest. However, ASIC does not generally grant a broad exemption from section 608 if a person has active discretion over securities: see Regulatory Guide 5 *Relevant interests and substantial holding notices* at paragraphs 84-85. We also consider that compliance with Pt 6C.1 is important for all intermediaries involved in securities lending for the reasons explained in RG 222.9.

Consultation for remaking ASIC Class Order [CO 11/272]

30. In July 2021, ASIC contacted several industry groups and other organisations seeking feedback on our proposal to remake relief on substantially similar terms to ASIC Class Order [CO 11/272], incorporating the proposed extension of the relief to agent lenders as outlined in CP 319. ASIC also sought feedback from these persons about the specific instrument to which this explanatory statement relates.
31. As with ASIC's original consultation, most respondents agreed that the relief provided by [CO 11/272] made compliance with substantial holding disclosure more efficient and effective but some respondents again argued in favour of a broader exemption. ASIC will shortly publish a feedback report providing

further detail on the submissions received in response to CP 319 and the targeted industry consultation conducted in July 2021.

Operation of the instrument

Retention of relevant interest

32. Section 6 of the instrument declares that Part 6C.1 of the Act applies as if section 608 were modified or varied by inserting notional subsections (8A), (8B) and (8C) after subsection (8). These notional subsections define the parties and transactional mechanisms involved in securities lending arrangements to which the instrument applies. As explained in more detail below, notional subsection 608(8A) ensures that lenders retain a relevant interest in securities subject to a securities lending arrangement (irrespective of the subsequent actions of the borrower) and notional subsection 608(8B) has a similar effect for agent lenders.

Lender's retention of relevant interest: notional subsection 608(8A)

33. Notional subsection 608(8A) provides that if securities are subject to a securities lending arrangement (of the types described in paragraphs (a) and (b)) and the securities are subsequently disposed of by the borrower (or their nominee) which results in the borrower (or their nominee) ceasing to have a relevant interest in the securities, the lender of the securities under the securities lending arrangement is taken to retain a relevant interest in the securities (or equivalent securities) that the borrower has agreed to return.
34. Paragraph (a) of notional subsection 608(8A) describes the first kind of securities lending arrangement, where:
- the lender agrees that it will deliver and vest title in the securities to the borrower (or their nominee); and
 - the borrower agrees that it will subsequently deliver the and vest title in securities (or equivalent securities) to the lender (or the lender's nominee).
35. Paragraph (b) of notional subsection 608(8A) describes the second kind of securities lending arrangement, where the borrower on-lends the securities and would then be in the position of a lender: see RG 222 at paragraph 36. This is where:
- the securities are held by the borrower (or their nominee) on behalf of the lender; and
 - the lender agrees that the borrower may deal in the securities (either on its own behalf or on behalf of another person); and
 - the borrower agrees that it will at some future time deliver and vest title in the securities (or equivalent securities) to the lender (or their nominee).

Agent lender's retention of relevant interest: notional subsection 608(8B)

36. Notional subsection 608(8B) provides that an agent lender will retain a relevant interest in securities that are subject to a securities lending arrangement even though the borrower (or the borrower's nominee) disposes of the securities. The agent lender is deemed to retain a relevant interest where:
- the agent lender is authorised under an authorisation agreement to act on behalf of a lender in relation to a securities lending arrangement between the lender and a borrower: notional paragraph 608(8B)(a);
 - the agent lender, acting under the authorisation agreement, delivers and vests title in securities (which are the subject of the securities lending arrangement) to the borrower (or an entity nominated by the borrower): notional paragraph 608(8B)(b);
 - the securities are subsequently disposed of by the borrower (or their nominee) resulting in that entity (i.e. the borrower or the borrower's nominee) ceasing to have a relevant interest in the securities.
37. Notional subsection 608(8C) defines a number of terms for the purposes of notional subsection 608(8B). Of note is the definition of **authorisation agreement**, which means an agreement under which a lender authorises the agent lender to act on the lender's behalf in relation to securities lending arrangements, including:
- a) negotiating and arranging securities lending arrangements (including where the agent itself acts in the capacity of a borrower);
 - b) transferring securities held by or on behalf of the lender to the borrower on the terms of a securities lending arrangement without giving further notice of such transfer to the lender; and
 - c) terminating securities lending arrangements (including without prior instructions from the lender).

Note: The authorisations referred to in paragraphs (a) and (b) above are relevant for the deferral relief provided by notional subsection 609(10C) explained below.

Deferral relief

38. Section 7 of the instrument declares that Part 6C.1 of the Act applies as if section 609 were modified or varied by inserting notional subsections 609(10A), (10B), (10C), (10D) and (10E).
39. Notional subsection 609(10E) defines several terms for the purposes of notional subsections 609(10A) to (10D). Of note is the definition of **prime broking business**, which describes the package of services, all of which must be provided for the definition to apply. Also of note are the definitions of **permissible restriction**, **agency lending business** and **custodial business**.

Prime brokers and custodians

40. Notional subsection 609(10A) provides deferral relief to persons who carry on a prime broking or custodial business (each a ‘service provider’). This deferral relief means that a service provider does not have a relevant interest in securities for the purposes of substantial holding disclosure merely because, in the course of providing services to a person (*client*) as part of carrying on a prime broking business or custodial business, the client has, under a securities lending arrangement, given certain borrower rights to the service provider.
41. The type of borrowing rights covered are:
 - a) where the service provider (or their nominee) holds the securities on behalf of the client (or that person’s nominee), and the service provider has a present borrowing right to deal in the securities on its own (or another’s) behalf at some future time: notional paragraph 609(10A)(a).
 - b) where the service provider has a present borrowing right to have the securities held by or on behalf of the client delivered to the service provider (or their nominee) at some future time and to have the title in those securities vested in the entity to whom they are delivered: notional paragraph 609(10A)(b).
42. This deferral relief in notional subsection 609(10A) is conditional on both of the following:
 - a) the client is not subject to any restriction (other than a ‘permissible restriction’) under any relevant agreement between the client and service provider (or associate of the provider) in how the client can deal with the securities; and
 - b) the borrowing right is acquired by the service provider as part of a bona fide arrangement entered into in the ordinary course of carrying on the prime broking or custodial business.
43. Notional subsection 609(10B) makes it clear that notional subsection 609(10A) stops applying in respect of particular securities when the service provider exercises the borrowing right in respect of those securities. It is at this point the service provider would take into account the relevant interest arising from borrowing the securities in assessing whether substantial holding disclosure is required: see RG 222.59.

Agent lenders

44. Notional subsection 609(10C) provides that an agent lender does not have a relevant interest in securities for the purposes of Pt 6C.1 merely because the agent lender has been given certain rights (*lending authority*) under an authorisation agreement to (a) negotiate and arrange securities lending arrangements for a lender or (b) the right to transfer securities on behalf of a lender pursuant to a securities lending arrangement.

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45. This deferral relief for the agent lender's lending authority is conditional on the following:
- a) lender is not subject to any restriction (other than a permissible restriction) in how it can deal with the securities under the lending authority; and
 - b) the lending authority is given to the agent lender as part of a bona fide authorisation agreement entered into in the ordinary course of carrying on an agency lending business.
46. Notional paragraph 609(10D)(b) makes it clear that the deferral relief in notional subsection 609(10C) stops applying when the agent lender transfers securities to a borrower. It is at this point the agent lender would take their relevant interests into account for the purposes of assessing whether substantial holding disclosure is required.

Content of substantial holding notices

47. Section 8 of the instrument declares that Chapter 6C of the Act applies as if section 671B were modified or varied by inserting notional subsections 671B(3A), 671B(4A), (4B), and (4C). These notional provisions affect the information that needs to be provided for substantial holdings that relate to securities lending arrangements.
48. Notional subsection 671B(4C) defines a number of terms for the purposes of notional subsections 671B(4A) and (4B) including:
- The definition of ***prime broking***, which must include all elements of the package of services described.
 - ***master securities lending agreement***, which lists three *pro-forma* agreements commonly used by service providers, and permits other agreements which are on substantially similar terms.

Note on incorporation by reference: The definition of ***master securities lending agreement*** in notional subsection 671B(4C) contains references to publicly available, published documents. These are mere references which do not affect the operation of the instrument and are therefore not incorporated by reference within the meaning of section 14 of the *Legislation Act 2003*.

Relief regarding disclosure of consideration

49. The prescribed forms for the purposes of compliance with subsection 671B would require extensive disclosure regarding the consideration payable for the acquisition or disposal of relevant interests comprising a substantial holding. However, in the securities lending context, this requirement extends to borrowing fees and other benefits that relate to factors such as counter-party risk rather than control factors: see RG 222.78-83. Therefore, notional subsection 671B(3A) provides that, where a relevant interest arises, changes or ceases because of either a ***securities lending arrangement*** or an ***authorisation agreement***, information about the consideration paid in relation to the relevant interest does not need to be given.

Relief regarding attaching lengthy agreements

50. Section 671B(4) of the Act requires a copy of any agreement that contributed to the substantial holding to accompany the substantial holding notice. In the context of securities lending, this would extend to a number of lengthy, complex agreements that do not relate to control of the listed entity: RG 222.74-75.
51. Notional subsection 671B(4A) substitutes the need to attach a copy of any **master securities lending agreement** with a requirement to provide a statement with key information about the securities lending transaction that is specified in notional paragraph 671B(4A)(a). Notional paragraph 671B(4A)(b) requires a statement that the person will give a copy of masters securities lending agreement to ASIC or the listed entity. If there is such a request, the person must give a certified true copy of the agreement to ASIC or the listed entity within 2 business days.
52. Notional subsection 671B(4B) provides similar relief for agent lenders. It provides that authorisation agreements and master securities lending agreements do not need to accompany the substantial holding notice provided the notice is accompanied by:
 - in relation to the **securities lending arrangement**—a statement by the person addressing the same particulars in notional paragraph 671B(4A)(a); and
 - in relation to the **authorisation agreement**—a statement by the person addressing the particulars listed in notional paragraph 671B(4B)(b); and
 - the statement in notional paragraph 671B(4B)(c) that the person will give a copy of the authorisation agreement upon request.
 - Notional subsection 671B(4B) also provides that the person must give a certified true copy of the agreement within 2 business days if requested.

Legislative authority

53. ASIC makes **ASIC Corporations (Securities Lending Arrangements) Instrument 2021/821** under subsection 673(1), of the Act.
54. The instrument commences on the day after it is registered on the Federal Register of Legislation and continues in force for five years until 30 September 2026.
55. This legislative instrument is disallowable under section 42 of the *Legislation Act 2003*.

Why the measure is in delegated legislation rather than primary legislation

56. The relief provided by [CO 11/272] and this instrument aims to improve the quality of substantial holding disclosure by those involved in securities lending:

see RG 222.15 and 65. As set out at paragraph [25] above, feedback from public consultation revealed that strict compliance with section 671B resulted in anomalous outcomes where the substantial holding was derived from securities lending. Most importantly, without the modifications made by the instrument:

- (a) A prime broker may be required to give substantial holding disclosure at the time they enter into agreement with a client (or when the client acquires new securities) when the prime broker has very limited interests in the client's securities (and are only one of many parties who may have such an interest): see RG 222.52-53. If the prime broker gives substantial holding disclosure at this point, there is likely no need to give substantial holding disclosure when the prime broker actually exercises a borrowing right and has more substantive control over the securities: see RG 222.58 and 60.
 - (b) Similarly, an agent lender may need to give a substantial holding disclosure over the whole of a lending pool of securities when they first enter into an authorisation agreement – but no need to give any further disclosure when securities are lent out and the agent has more substantive control via their right to terminate the transaction and recall securities.
 - (c) A lender's substantial holding disclosure may be affected by the subsequent actions of the borrower and the lender's right of recall may not be recognised consistently: see RG 222.34-35
57. ASIC considers that the modifications notionally made by the instrument are more appropriate in a legislative instrument rather than primary legislation at this time because:
- (a) The instrument deals with confined circumstances (that is, securities lending transactions) where the strict operation of the primary law in Pt 6C.1 has anomalous outcomes that would be inconsistent with the intent of those provisions.
 - (b) The instrument primarily affects a small number of financial service providers who operate as prime brokers, custodians or agent lenders. We estimate that there are less than 50 of these entities (although a larger number of institutional asset managers and asset owners who may make their securities available to lending programs may be impacted by part of the relief).

The appropriate duration of the instrument

58. ASIC considers that the appropriate sunset period for the instrument is five years due to the confined circumstances, the relatively small number of affected entities and business uncertainty that would result if there was a shorter sunset period. Intermediaries involved in securities lending and professional investors need to have in place complex systems and other controls in order to comply with their substantial holding obligations, including as modified by this instrument (and formerly [CO 11/272]). Significant investment would be required to change these systems if the relief ceased or changed.
59. ASIC considered a shorter duration for the instrument but determined this would impose unnecessary costs on those affected by the instrument – primarily costs associated with engaging with the consultation process for a lengthy, complex instrument of this nature. Further, the original relief provided by [CO 11/272] operated effectively for ten years with industry stakeholders providing minimal feedback on required changes.
60. ASIC understands that the Government will consider making future amendments to the Act as part of the review process before the instrument sunsets in 2026. This type of review is likely to be complicated and may need to commence up to two years before the instrument sunsets. A shorter sunset period may also increase business uncertainty.

Statement of Compatibility with Human Rights

61. The Explanatory Statement for a disallowable legislative instrument must contain a Statement of Compatibility with Human Rights under subsection 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*. A Statement of Compatibility with Human Rights is in the Attachment.

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 (Securities Lending Arrangements) Instrument 2021/821

Overview

1. This instrument provides relief to persons engaged in securities lending in relation to the substantial holding provisions of Ch 6C of the *Corporations Act 2001 (Act)*. The purpose of this instrument is to make substantial holding disclosure by persons involved in securities lending more practical and meaningful.
2. A lender who transfers securities through a securities lending transaction will usually retain a relevant interest in those securities through its right to recall the securities from the borrower. This may cease to be the case if the borrower subsequently disposes of the securities and the rights over them. This instrument has the effect of presuming that the lender retains a relevant interest in lent securities.
3. The instrument provides relief from the requirement to disclose any consideration for the acquisition or disposal of relevant interests, which, in the context of securities lending and agent lending, may include benefits and fees that are irrelevant for the purposes of Part 6C.1.
4. Securities lending agreements are long and complex documents. Parties may also enter several them within a short period of time. Attaching all these relevant agreements to a substantial holding notice is not useful for the market, especially as most of the terms are irrelevant for the purposes of Part 6C.1. The instrument therefore declares that section 671B applies as if it was modified so that securities lending agreements do not need to be attached to substantial holding notices. For similar reasons, the instrument also provides that authorisation agreements between an agent lender and client do not need to be attached to a substantial holding notice. This relief is given on condition that specified key information about the agreement is provided as an alternative to attaching securities lending or authorisation agreements.

Assessment of human rights implications

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

Conclusion

6. 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*.