

ASIC MARKET INTEGRITY RULES (ASX MARKET) AMENDMENT 2012 (NO. 2) EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (**ASIC**) makes the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 2)* (the **Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Act**).

1. Enabling legislation

Subsection 798G(1) of the Act provides that ASIC may, by legislative instrument, make rules that deal with the following:

- (a) the activities or conduct of licensed markets;
- (b) the activities or conduct of persons in relation to licensed markets;
- (c) the activities or conduct of persons in relation to financial products traded on licensed markets.

The *ASIC Market Integrity Rules (ASX Market) 2010 (Rules)* were made under subsection 798G(1) of the Act on 1 August 2010. The Rules deal with the activities or conduct of the licensed market operated by ASX Limited (the **ASX Market**).

2. Background

Under Part 7.2A of the Act, ASIC has the function of supervising financial markets the operators of which are licensed under subsection 795B(1) of the Act. ASIC performs this function by, among other things:

- (a) supervising trading activities through market surveillance; and
- (b) supervising conduct of business by participants of those markets.

Short selling is an activity where a person enters into an agreement to sell a security that the person does not currently own. Short sellers need to make arrangements to cover their delivery obligations to the buyer before they fall due (usually three trading days after the transaction is executed).

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

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

- Short sale transaction reporting is the reporting of daily volumes of section 1020B products that are short sold in the market. These volumes are aggregated for all short sale transactions in the market and made available to the public.
- Short position reporting is the reporting of instances where the quantity of a product that a person has is less than the quantity of the product that the person has an obligation to deliver.

These obligations apply to short sales of section 1020B products made on a licensed market, irrespective of whether the seller is in Australia.

Disclosure of short-selling information enhances market confidence and integrity by providing greater transparency to both investors and regulatory bodies about the short selling activity on Australian financial markets. In particular, the effective and timely disclosure of short selling activity:

- (c) indicates the level of short selling in particular stocks;
- (d) explains certain share price movements;
- (e) provides an early signal that individual securities may be overvalued;
- (f) indicates that a proportion of the sales in an individual security will need to be reversed by new purchases (to cover the short seller's settlement obligations);
- (g) enhances investors' willingness to participate in the market by removing uncertainty surrounding the level of short selling; and
- (h) deters market abuse, or reduces the opportunities for market abuse, by enabling the market regulator to better identify instances of market manipulation.

3. Purpose of the legislative instrument

The purpose of the Instrument is to amend the *ASIC Market Integrity Rules (ASX Market) 2010* to impose obligations on an ASX Market Participant that short-sells section 1020B products (as defined in the Corporations Act) to specify the quantity of a sell order that is short at the time the sale order is placed or the quantity of an off-market trade that is short at the time the trade is reported (known as **Short Sale Tagging**).

The purpose of this Instrument is to create a framework to facilitate:

- (a) the efficient collection of transactional (rather than aggregated) short selling information from ASX Market Participants; and

- (b) the accurate and timely dissemination of short selling information to ASIC and the market.

ASIC, in its surveillance function, will be able to use the information as an audit trail to ascertain which parties are making short sales in the market.

The purpose of this instrument is described in more detail in the Regulation Impact Statement attached to this Explanatory Statement.

Details of the Instrument are contained in the Attachment.

4. Consultation

ASIC has consulted on its proposal to introduce Short Sale Tagging through:

- (a) ASIC Consultation Paper 145 *Australian equity market structure: Proposals* (CP 145), released on 4 November 2010, canvassed at Proposal II the issue of real-time short sale tagging and proposed for consultation draft market integrity rules to impose a real-time short sale tagging requirement on market participants;
- (b) Discussions with the industry advisory group to the ASIC, made up of representatives from market participants that service both retail and institutional clients, investment management businesses, and the legal profession, on ASIC's intentions to real-time short sale tagging requirement, since early 2010;
- (c) Meetings with at least 10 market participants, the Australian Financial Markets Association (AFMA), and the Stockbrokers Association of Australia (SAA), since CP 145 was released.

5. Penalties

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

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

6. Commencement of the Instrument

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

7. Statement of Compatibility with Human Rights

This statement is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny)*

Act 2011.

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

8. Regulation Impact Statement

ASIC has prepared a Regulatory Impact Statement for this Class Order, which is attached to this Explanatory Statement.

ATTACHMENT A

Paragraph 1 – Enabling Legislation

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

Paragraph 2 – Title

This paragraph provides that the title of the Instrument is the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 2)*.

Paragraph 3 – Commencement

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

Paragraph 4 – Amendments

This paragraph provides that the *ASIC Market Integrity Rules (ASX Market) 2010* are amended as set out in items [1] to [3].

Items [1] and [2] – Rule 1.4.3

Rule 1.4.3 provides definitions for terms used in the Rules.

Items [1] and [2] of paragraph 4 of the Instrument amend Rule 1.4.3 to insert new definitions for:

- “Reportable Short Sale Order”;
- “Reportable Short Sale Transaction”;
- “Section 1020B Products”;
- “Securities Lending Arrangement”.

These definitions are included for the purposes of terms used in new Part 5.12.

Item [3] - After Part 5.11

Item [3] of paragraph 4 of the Instrument inserts a new Part 5.12 into the Rules.

Obligation to identify short sales

Rule 5.12.1 is the core Short Sale Tagging obligation. Rule 5.12.1 provides that an ASX Market Participant must:

- (a) include in a Reportable Short Sale Order transmitted to the Market, the number of Section

1020B Products that the seller will vest in the buyer under the relevant Securities Lending Arrangement; and

- (b) include in a report of a Reportable Short Sale Transaction, provided to the Market Operator under Rule 5.1.1 of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011*, the number of Section 1020B Products that the seller will vest in the buyer under the relevant Securities Lending Arrangement.

Compliance start date

Rule 5.12.2 provides that an ASX Market Participant is not required to comply with Rule 5.12.1 until 10 March 2014.