



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Short selling) Amendment Instrument 2022/968

This is the Explanatory Statement for *ASIC Corporations (Short selling) Amendment Instrument 2022/968* (the *Amendment Instrument*).

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

Summary

1. Naked short selling of certain financial products is prohibited under subsection 1020B(2) of the *Corporations Act 2001* (*Corporations Act*). The *ASIC Corporations (Short Selling) Instrument 2018/745* (the *Principal Instrument*) provides legislative relief from this prohibition to permit, amongst other things, naked short sales:
 - (a) 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 (*Hedging Relief*); and
 - (b) during a deferred settlement trading period under a public offer or other corporate action (*Deferred Settlement Relief*).
2. The Amendment Instrument amends the Principal Instrument to:
 - (a) extend the Hedging Relief to permit the naked short sale by a market maker of an interest in one of the following exchange traded funds (*ETFs*) (together, the *approved ETFs*), for the purposes of hedging risks arising from market making activities in a European-style exchange traded option (*ETO*) whose underlying interest is in respect of one of the following approved ETFs:
 - (i) Vanguard MSCI Index International Shares ETF;
 - (ii) iShares Core S&P 500 ETF;
 - (iii) Betashares NASDAQ 100 ETF;
 - (b) extend the Deferred Settlement Relief to permit deferred settlement trading under or in connection with a public offer where there is a commitment to pay the application monies, or where there is an entitlement to be transferred

securities under or in connection with a corporate action such as a compromise or arrangement under Part 5.1 of the Corporations Act;

(c) make other minor changes to the Principal Instrument.

Purpose of the instrument

Background

3. Subsection 1020B(2) of the Corporations 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.
4. The Principal Instrument:
 - (a) provides legislative relief from the naked short selling prohibition in very specific circumstances, including but not limited to the Hedging Relief and the Deferred Settlement Relief;
 - (b) provides exemptions from the requirements to report short transactions in specific circumstances; and
 - (c) modifies the operation of requirements for short position reporting and disclosures.
5. The purpose of the Amendment Instrument is to amend the Hedging Relief and the Deferred Settlement Relief, as summarised below. The Amendment Instrument also makes other minor changes to reflect the change of name of Chi-X Australia Pty Ltd, and to remove the two notes within the Deferred Settlement Relief which specify that failure to comply with the subsections is an offence.

Hedging Relief

6. The Hedging Relief, which is set out in Section 6 of the Principal Instrument, permits a market maker to naked short sell a financial product which is a constituent of the S&P/ASX 300 Index or an interest in the STW, for the purposes of hedging risks arising from market making activities. This is achieved by notionally inserting subsections 1020B(5A) to (5J) after subsection 1020B(4) of the Corporations Act.
7. The Hedging 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 delivery. A market maker relying on the Hedging Relief is also required to provide particulars of its short position in relation to the shorted product.

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8. ASIC received an application to extend the Hedging Relief to permit a naked short sale by a market maker in an approved ETF for the purposes of hedging risks arising from market making activities in an ETO whose underlying security is an approved ETF.
 9. The Amendment Instrument extends the Hedging Relief to permit the naked short sale by a market maker of an interest in an approved ETF, where all the following circumstances apply:
 - (a) the short sale is made for the purposes of hedging risks arising from market making activities in European-style ETOs whose underlying security is an approved ETF (*approved ETO*); and
 - (b) the market maker has been appointed to make a market in the approved ETO by the operator of the market that the approved ETO is admitted to trading on.
 10. ASIC considers that risks of settlement failure for providing the legislative relief from s1020B(2) for ETO market makers is low as it is limited to the three approved ETFs which have demonstrated high liquidity. The approved ETOs are European style, meaning they can only be exercised on a specified expiry date, as opposed to American style, which can be exercised at any time prior to expiry.

Deferred Settlement Relief

11. 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 two business days after the trade. This is known as ‘normal settlement trading’.
12. This kind of ‘normal settlement trading’ typically will not contravene subsection 1020B(2) of the Corporations 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 or any of the matters specified in subsection 1020B(4) (e.g. payment of purchase consideration).
13. However, the circumstances of some kinds of trading will fall outside of subsection 1020B(4) of the Corporations 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 Corporations Act. These circumstances are known as ‘deferred settlement trading’ and should be distinguished from ‘normal settlement trading’.
14. The Deferred Settlement Relief, which is set out in Section 11 of the Principal Instrument, permits naked short sales of section 1020B products by a seller during a deferred settlement period by notionally inserting subsections

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- 1020B(7A) to (7F) after subsection 1020B(4) of the Corporations Act. This applies where the seller has an entitlement to the products under a public offer or other corporate action.
15. During deferred settlement trading, the obligation to settle trades is deferred until a time set by the operator of the listing market.
 16. Since implementation of the Principal Instrument, ASIC has on numerous occasions granted individual relief to allow deferred settlement trading for institutional investors. Institutional investors were not able to rely on the Deferred Settlement Relief in the Principal Instrument because it required payment of application monies before the commencement of the deferred settlement trading period.
 17. Unlike retail investors, who pay for shares under a public offer when they make their application, institutional investors commit to acquire the securities in advance of payment of the application monies, as the institutional settlement date generally occurs after the commencement of the conditional and deferred settlement trading period.
 18. To address this, the Amendment Instrument extends the Principal Instrument in Section 11 to those investors who agree to pay the application monies to acquire the products before commencement of the deferred settlement trading period. We do not consider the institutional arrangements for settlement increases the risk of settlement failure.
 19. The Amendment Instrument also extends the Deferred Settlement Relief in Section 11 to permit corporate actions such as compromises or arrangements under Part 5.1 of the Corporations Act where there is an entitlement to be transferred the section 1020B products under or in connection with the corporate action.
 20. ASIC has granted individual relief on a number of occasions involving an entitlement to be transferred securities under a scheme of arrangement. Deferred Settlement Relief in the Principal Instrument was not available on those occasions, as the entitlement related to securities being transferred rather than issued.
 21. The effect of the amendments to Section 11 reduces the regulatory burden of applying for individual relief for deferred settlement trading where there is an agreement to pay the application monies, or where there is an entitlement to be transferred securities in connection with a corporate action.
 22. The Amendment Instrument also removes the notes under notional subsections 1020B(7B) and 1020B(7H) stating that failure to comply with those subsections is an offence. A contravention of these subsections would still breach the general obligations in subsection 912A(1)(c) on financial services licensees to comply with the financial services laws.

Consultation

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23. ASIC conducted a targeted consultation with those parties directly affected by the amendments to the Hedging Relief, including the ETF issuers, market makers, a clearing participant and a market operator. The respondents were largely supportive of this proposal.
 24. In our consultation we invited feedback on the specifics of the relief, such as expressly limiting it to European style ETOs which reflect the approved ETOs that were proposed in the relief application, or broadening the relief to include any approved ETF with a listed ETO (ie, not just the three approved ETFs). While some respondents submitted it should be broadened to include American style ETOs, others submitted that there would be less settlement failure risks with European style ETOs. In relation to more broad relief, feedback submitted was that the approved ETFs permitted for short selling would need to meet certain criteria such as high liquidity. After considering the feedback, we decided to expressly limit the extended relief to the three approved ETFs with European style ETOs as the additional permitted shorted products. Any broader relief would need to be subject to a more formal market-wide consultation process.
 25. ASIC did not consult on the amendments to the Deferred Settlement Relief as the amendments are consistent with the individual relief that ASIC has granted on numerous occasions in recent years. The relief is considered to be minor and machinery in nature.
 26. The Office of Best Practice Regulation has confirmed that a regulation impact statement is not required because the Amendment Instrument will impose only minor and machinery impacts on business, community organisations or individuals.
 27. The background to the creation of the Hedging Relief and Deferred Settlement Relief is set out under ASIC [Consultation Paper 299: Short selling: Naked short selling relief, position reporting amendments and sunseting class orders](#).

Operation of the Amendment Instrument

Name

28. Section 1 of the Amendment Instrument provides that the instrument is the *ASIC Corporations (Short Selling) Amendment Instrument 2022/968*.

Commencement

29. Section 2 of the Amendment Instrument provides that instrument commences on the day after it is registered on the Federal Register of Legislation.

Authority

30. Section 3 of the Amendment Instrument provides that the instrument is made under section 1020F(1) of the Corporations Act 2001.

Schedules

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31. Section 4 of the Amendment Instrument provides that each instrument that is specified in a Schedule to this instrument is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this instrument has effect according to its terms.

Schedule 1 – Amendments

32. Items 1 to 10 and 12 to 15 in Schedule 1 make amendments to the Principal Instrument to modify the notional insertions to section 1020B of the Corporations Act as follows:
- (a) omitting “Chi-X Australia Pty Ltd”, and substituting “Cboe Australia Pty Ltd” in notional paragraphs 1020B(4A)(b) and (4D)(b), and in notional subsection 1020B(4D) of the Corporations Act.
 - (b) adding after notional subparagraph 1020B(5A)(c)(ii) of the Corporations Act:
 - “(iii) an interest in an approved ETF, where:
 - (A) the hedged product is an approved ETO in relation to that ETF;
and
 - (B) the market maker has been appointed to make a market in the approved ETO by the operator of the market that the approved ETO is admitted to trading on”
 - (c) defining the following terms in notional subsection 1020B(5J):
 - (i) approved ETF;
 - (ii) approved ETO;
 - (iii) ETO (or exchange traded option);
 - (iv) ETF (or exchange traded fund).
 - (d) omitting the note “Failure to comply with this subsection is an offence (see subsection 1311(1))” from notional subsections 1020B(7B) and 1020B(7H).
 - (e) inserting “(or agreement to pay)” into notional subparagraphs 1020B(7C)(a)(ii) and (7D)(a)(iii).
 - (f) inserting “or a listed scheme” at the end of paragraph (b) in the definition of public offer in notional paragraph 1020B(7F)(b).
 - (g) inserting “or transferred” after “having an entitlement to be issued with” into notional paragraph 1020B(7H)(b).
33. Items 11 and 16 amend the exemptions in the Principal Instrument as follows:

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- (a) omitting and substituting the definition of “exchange traded option”
 - (b) omitting and substituting “Chi-X Australia Pty Ltd” with “Cboe Australia Pty Ltd”

Legislative instrument and primary legislation

- 34. The subject matter and policy implemented by the Amendment Instrument is more appropriate for a legislative instrument rather than primary legislation. This is because the matters contained in the Amendment Instrument for the Hedging Relief only affect a relatively small subset of Australian financial services licensees, namely ETO market makers who have been appointed by the market operator to make a market in the approved ETOs. If the matters in the Amendment Instrument were to be inserted into the primary legislation, they would insert, into an already complex statutory framework, a set of specific provisions that would apply only to a relatively small group of entities. In relation to the Deferred Settlement Relief, the Amendment Instrument provides a technical fix to the Principal Instrument to address the logistics of Deferred Settlement Relief of institutional arrangements under an initial public offer.
- 35. In the absence of the notional modifications made by the Amendment Instrument to subsection 1020B(2) of the Corporations Act:
 - (a) ETO market makers appointed to generate liquidity in the approved ETOs will be unable to adequately hedge exposure risks during the course of their market making. This would act as a disincentive for ETO market makers to provide market making services.
 - (b) ETO market makers would need to apply for individual short selling relief for the approved ETFs, in order to efficiently make a market in the listed ETOs. Providing the relief in a legislative instrument is more transparent and allows ASIC to amend the relief, to respond in a flexible and timely way for additional suitable underlying products that are permitted to be short sold.
 - (c) institutional investors would not be able to rely on relief in the Principal Instrument, as institutional arrangements under an initial public offer typically involve the payment of application monies on the institutional settlement date, which occurs after the commencement of the conditional and deferred settlement trading period. Although the settlement process for institutional investors is a standard part of initial public offers, individual relief from ASIC would be required because the application monies will not have been paid at the time the application is made.
 - (d) ASIC considers that legislative relief from subsection 1020B(2) for deferred settlement trading and conditional and deferred settlement trading is warranted because such trading has commercial benefits and has not increased settlement failure. Likewise, extending the Hedging Relief to additional permitted products that can be short sold by a market maker during the course of its market making activities would have low

settlement risks due to the high liquidity of the products permitted and the conditions of the relief.

36. It will be a matter for the Government and for Parliament as to whether the Corporations Act or Regulations may be amended in future to include the relief in the Amendment Instrument.

Duration

37. The duration of the amendments made by this Amendment Instrument aligns with the duration of the Principal Instrument, which this Amendment Instrument amends. The Principal Instrument will automatically sunset on 1 October 2028, in accordance with section 50 of the *Legislation Act 2003*.

Legislative authority

38. The Amendment Instrument amends the Principal Instrument. Where an Act confers a power to make an instrument, the power is to be constructed 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, per section 5C of the Corporations Act)
39. ASIC makes this amending instrument under subsection 1020F(1) of the Corporations Act.
40. Subsections 1020F(1)(a) and (b) of the Corporations 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 Corporations Act.
41. Subsection 1020F(1)(c) of the Corporations 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.
42. The Amendment Instrument is a disallowable legislative instrument.

Statement of Compatibility with Human Rights

43. 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*.

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Overview

1. Naked short selling of certain financial products is prohibited under subsection 1020B(2) of the *Corporations Act 2001* (***Corporations Act***). The *ASIC Corporations (Short Selling) Instrument 2018/745* (the ***Principal Instrument***) provides legislative relief from this prohibition to permit, amongst other things, naked short sales:
 - (a) 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 (***Hedging Relief***); and
 - (b) during a deferred settlement trading period under a public offer or other corporate action (***Deferred Settlement Relief***).
2. This instrument amends the Principal Instrument to:
 - (a) extend the Hedging Relief to permit the naked short sale by a market maker of an interest in one of the following exchange traded funds (***ETFs***) (together, the ***approved ETFs***), for the purposes of hedging risks arising from market making activities in a European-style exchange traded option (***ETO***) whose underlying security is one of the following approved ETFs:
 - (i) Vanguard MSCI Index International Shares ETF;
 - (ii) iShares Core S&P 500 ETF;
 - (iii) Betashares NASDAQ 100 ETF;
 - (b) extend the Deferred Settlement Relief to permit deferred settlement trading under a public offer where there is a commitment to pay the application monies, or in connection with a corporate action (such as a compromise or arrangement under Part 5.1 of the *Corporations Act*) where there is an entitlement to be transferred securities;
 - (c) make other minor changes to reflect the change of name of Chi-X Australia Pty Ltd and to remove the two notes within the Deferred Settlement Relief which specify that failure to comply with the subsections is an offence.

Assessment of human rights implications

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

Conclusion

4. 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*.