

ASIC CLASS ORDER [CO 08/751]

EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (*ASIC*) makes ASIC Class Order [CO 08/751] under s1020F(1)(c) of the *Corporations Act 2001* (the *Act*).

Section 1020F(1)(c) relevantly provides that ASIC may declare that Part 7.9 of the Act applies in relation to a person as if specified provisions were omitted modified or varied.

1. Background

People sometimes sell securities which they do not own with a view to profiting by repurchasing them later at a lower price. This practice is known as *short selling*.

Section 1020B regulates the short selling of certain financial products. That provision has the effect of prohibiting a person from selling a financial product unless they have a “presently exercisable and unconditional right to vest” the product in the buyer. There are some exceptions to the short selling prohibition. These include where the seller:

- has in place before the time of the sale an arrangement that will enable delivery of the product within 3 business days; or
- effected the sale in accordance with the ASX Market Rules.

In both of these cases a person selling through a financial services licensee must tell the licensee that the sale is of this kind. Licensees (*brokers*) who are participants in the financial market operated by ASX must give the ASX certain aggregated information about such sales on a daily basis.

There is a practice in the Australian market for persons (*borrowers*) to enter into arrangements (*securities lending arrangements*) whereby the borrower acquires securities (*borrowed securities*) from another person (the *lender*) subject to an obligation to return similar securities at a later date. The borrowed securities are sold (a *covered short sale*) by the borrower with a view to repurchasing similar securities at a later stage to be returned to the lender under the securities lending arrangement. There is a view in the market that securities acquired under at least some of these arrangements give rise to a “presently exercisable and unconditional right to vest” those securities for the purposes of s1020B. In these circumstances, the securities may in substance be short sold without complying with the reporting and other requirements applying to some of the exceptions to the short selling prohibition.

At the time of releasing the instrument, ASIC also released Regulatory Guide 196 *Short Selling: Overview of s1020B* setting out its views on, among other things, what constitutes a “presently exercisable and unconditional right to vest” financial products for the purposes of s 1020B.

2. Purpose of the class order

Financial institutions around the globe are currently experiencing difficulties due to exposures to certain non performing loans in the United States. Global securities markets are, as a result, subject to abnormal levels of volatility. This appears to be contributed to by significant levels of short selling particularly in financial stocks.

It is inconsistent with the maintenance of an orderly and transparent market in Australia for covered short selling to take place without appropriate disclosure to the market place. The purpose of this instrument is to ensure that aggregate information about covered short selling is disclosed to the market in the same manner as the forms of short selling provided by s1020B.

Various overseas regulatory agencies including those in the United States and United Kingdom took action in relation short selling in the period immediately before the issue of the instrument.

3. Operation of the class order

This instrument provides that Part 7.9 of the Act has effect as if it included a new s1020BC. That section applies to covered short sales: s1020B(1). It has the following effect:

- a person (the *client*) asking a broker to sell securities in circumstances that make the sale a covered short sale must tell the broker that it is such a sale: s1020B(2);
- before selling securities on behalf of a client, a broker must ask the client whether the sale would be a covered short sale: s1020B(3).
- a broker must report to the ASX on each trading day the total of the covered short sales which have been made which have yet been settled: s1020B(4).

The instrument commences on the date it is registered. This is expected to be 22 September 2008.

4. Documents incorporated by reference

No documents are incorporated by reference.

5. Consultation

ASIC informally consulted with the ASX before making the instrument. No further consultation was undertaken given the urgency of the matter.

The issue of the instrument was announced after trading in Australia had ceased on 19 September 2008, the date of instrument. Major brokers have been contacted over the weekend of 20 and 21 September 2008 to ensure that they are aware of their obligations from the opening of trading on 22 September 2008. They have generally indicated that they are taking steps to comply with their obligations.

The obligations on brokers are substantially similar to those imposed on many of their international counterparts.