



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 196

Short selling: Overview of s1020B

September 2008

About this guide

This guide explains the regulation of short selling in Australia under s1020B of the *Corporations Act 2001* (Cth) (Corporations Act). It gives an overview of these provisions as they relate to securities, managed investment products and certain other financial products.

This guide is particularly relevant to institutional investors who typically engage in short selling activity.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This version was issued on 19 September 2008 and is based on legislation and regulations as at 19 September 2008.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Overview of s1020B

Key points

Section 1020B of the Corporations Act prohibits a person from short selling in Australia: see RG 196.1–RG 196.3.

To avoid breaching this prohibition, a person selling products must, at the time of sale, have ‘a presently exercisable and unconditional right to vest’: see RG 196.4–RG 196.13.

There are exceptions to the short selling prohibition, some of which require the short seller to comply with certain additional obligations: RG 196.14–RG 196.15.

The short selling prohibition

- RG 196.1 In Australia, a person must only sell ‘section 1020B products’ to a buyer if, at the time of sale:
- (a) the person has, or
 - (b) the person or their representative believes on reasonable grounds that the person has,
- a presently exercisable and unconditional right to vest the products in the buyer: s1020B(2).

- RG 196.2 By ‘section 1020B products’, the Corporations Act means securities, managed investment products, financial products under s764A(1)(i), and other kinds of financial products ‘prescribed by the regulations’.

Note: For the definition of ‘section 1020B products’, see s1020B(1) of the Corporations Act. For financial products ‘prescribed by the regulations’ for the purposes of s1020B(2), see reg 7.9.79, 7.9.80A and 7.9.80B of the Corporations Regulations.

- RG 196.3 A sale of these products other than as described in RG 196.1 would be a short sale under s1020B (thus the ‘short selling prohibition’).

What is ‘at the time of sale’?

- RG 196.4 ‘At the time of sale’ includes when an offer for sale is placed.
- RG 196.5 A person is taken to sell ‘section 1020B products’ if they purport to, offer to, hold themselves out as entitled to, or instruct the holder of an Australian financial services licence (a financial services licensee) to, sell those products: s1020B(7).
- RG 196.6 ‘At the time of sale’, for the purposes of s1020B(2), is at the point of sale and not at the close of the trading day. A person who has a net no sale position at the close of trading would still need to have a ‘presently exercisable and

unconditional right to vest' at the point in time when the sale is made (in addition to the times referred to at s1020B(7)).

What is a 'presently exercisable and unconditional right to vest'?

- RG 196.7 To have a 'presently exercisable and unconditional right to vest', a person must, at the time of the sale, have power to direct a transfer of the product. The transfer must also provide the person with the absolute ability to give the buyer title to the product.
- RG 196.8 A person who holds legal title to the product at the time of sale would have a 'presently exercisable and unconditional right to vest' for the purposes of s1020B.
- RG 196.9 We understand it is common market practice to rely on securities obtained under a securities lending arrangement to satisfy the need to have a 'presently exercisable and unconditional right to vest' the securities in the buyer.
- RG 196.10 In Australia, securities lending arrangements typically involve the transfer of securities from the owner (lender) to another party (the borrower), with the borrower obliged to return the securities (or its equivalent) either on demand or at the end of the loan term. The borrower usually gives the lender collateral as security for the loan.

Note: While securities lending is a sale with an undertaking to return the sold property, this guide uses the common market terminology to describe the transaction and parties. For detailed analysis on the legal characterisation of securities lending arrangements, see *Beconwood Securities Pty Ltd v ANZ Group Limited* [2008] FCA 594.

- RG 196.11 We consider that 'a presently exercisable and unconditional right to vest' would involve the lender giving the borrower (or a third party as the borrower may direct or procure), at the time of sale, a firm commitment to deliver the products. By 'firm commitment', we mean a legally binding commitment.
- RG 196.12 The best evidence of that firm commitment would be written confirmation for delivery into settlement. In contrast, an agreement made at the time of the sale for a lender to provide the borrower with securities on a 'best endeavours basis' cannot provide a 'presently exercisable and unconditional right to vest' the financial product.
- RG 196.13 We recognise that arrangements between lenders and borrowers will vary. Whether the arrangements are sufficient to reflect 'a presently exercisable and unconditional right to vest' will depend on the particular circumstances of these arrangements.

Exceptions to the short selling prohibition

RG 196.14 There are exceptions under the Corporations Act to the general prohibition on short selling: see Table 1. A person seeking to rely on these exceptions may have to comply with certain additional obligations, including:

- (a) informing the financial services licensee that the sale is a short sale (s1020B(5)); or
- (b) selling at a higher price than the previous trade (known as the 'up-tick rule', s1020B(4)(d)(iii)).

RG 196.15 If the sale is made on a licensed market, the operating rules may impose additional requirements.

Table 1: Summary of exceptions to the short selling prohibition and related obligations

Exception	Corp Act reference	Description	Report to licensee	Up-tick rule
Odd lot transactions	s1020B(4)(a)	A short sale for an odd lot transaction by a financial services licensee who: <ul style="list-style-type: none"> • is a participant in a licensed market; and • specialises in odd lot transactions. 	No	No
Arbitrage transactions	s1020B(4)(b)	A short sale that is part of an arbitrage transaction as defined in s9 of the Corporations Act.	Yes	No
Prior purchasing arrangements	s1020B(4)(c)	A short sale by a person who: <ul style="list-style-type: none"> • before the time of sale, has entered into a contract to buy those products; and • has a right to have those products vested in the person that is conditional on: <ul style="list-style-type: none"> – the payment of consideration; or – receipt of the proper instrument of transfer; or – receipt of the title documents. 	No	No
Prior borrowing arrangements	s1020B(4)(d)	A short sale by a person: <ul style="list-style-type: none"> • who is not an associate of the body corporate issuer • where arrangements are made before the sale for the product to be delivered to the buyer within 3 business days after the sale. 	Yes	Yes

Exception	Corp Act reference	Description	Report to licensee	Up-tick rule
Operator approved short sale product transactions	s1020B(4)(e)	<p>A short sale by a person (or their representative):</p> <ul style="list-style-type: none"> • who is not an associate of the body corporate issuer • of products in a class of products declared by the operator of a licensed market as provided by the operating rules of that market. <p>Note: For example, Market Rule 19 of Australian Securities Exchange Limited (ASX) permits the short sale of products declared to be an approved short sale product.</p>	Yes	Yes, for short sales of ASX approved short sale products (see ASX Market Rule 19.3)

Note 1: See s1020B(4) of the Corporations Act for specific requirements for each exception.

Note 2: These obligations are not affected by the *Corporations Amendment (Short Selling) Bill 2008*, which proposes additional reporting obligations over and above the provisions in s1020B.

Note 3: ASX has advised that it proposes to temporarily remove all securities from the approved list with effect from 19 September 2008.