

### WARRANT AND AQUA PRODUCT LIQUIDITY REQUIREMENTS

<p><b>The purpose of this Guidance Note</b></p>	<ul style="list-style-type: none"> <li>• To assist warrant issuers to understand their obligation to ensure that each warrant series admitted to trading status has an initial spread of warrant-holders which, in the opinion of ASX, is adequate and reasonable or else that a reasonable bid and volume is maintained in the market for each warrant series</li> <li>• To assist AQUA product issuers to understand their obligation to ensure that a reasonable bid and volume is maintained in the market for each AQUA product series or that other arrangements are in place to ensure sufficient liquidity in the AQUA product series</li> </ul>
<p><b>The main points it covers</b></p>	<ul style="list-style-type: none"> <li>• The requirement for some warrant and AQUA product issuers to ensure that a reasonable bid and volume is maintained in the market for each warrant series and AQUA product series</li> <li>• The purpose of those requirements</li> <li>• The criteria ASX uses to assess whether a bid is reasonable</li> <li>• The permitted circumstances when a reasonable bid or market making is not required</li> <li>• The enforcement action ASX can take if a reasonable bid or market making is not maintained</li> <li>• Appeals against enforcement action by ASX</li> </ul>
<p><b>Related materials you should read</b></p>	<ul style="list-style-type: none"> <li>• ASX Operating Rules Guidance Note 11 <i>Obligations on the Expiry of a Warrant</i></li> </ul>

**History:** Guidance Note 12 issued 27/02/15. Previous versions of this Guidance Note were issued as Guidance Note 17 under the ASX Market Rules in 05/04 and 09/06 and Guidance Note 7/03 under the ASX Business Rules in 11/03.

**Important notice:** ASX has published this Guidance Note to assist participants to understand and comply with their obligations under the ASX Operating Rules. It sets out ASX's interpretation of the ASX Operating Rules and how ASX is likely to enforce those rules. Nothing in this Guidance Note necessarily binds ASX in the application of the ASX Operating Rules in a particular case. In issuing this Guidance Note, ASX is not providing legal advice and participants should obtain their own advice from a qualified professional person in respect of their obligations. ASX may withdraw or replace this Guidance Note at any time without further notice to any person.

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## 1. Introduction

This Guidance Note is published by ASX Limited ("ASX") to assist:

- warrant issuers to understand their obligation to ensure that each warrant series admitted to trading status has an initial spread of warrant-holders which, in the opinion of ASX, is adequate and reasonable or else that a reasonable bid and volume is maintained in the market for each warrant series; and
- AQUA product issuers to understand their obligation to ensure that a reasonable bid and volume is maintained in the market for each AQUA product series or that other arrangements are in place to ensure sufficient liquidity in the AQUA product series.<sup>1</sup>

## 2. Liquidity requirements

Under ASX Operating Rules Schedule 10.3.11, a warrant-issuer must either:

- ensure each warrant series admitted to trading status has an initial spread of warrant-holders which, in the opinion of ASX, is adequate and reasonable; or
- on an ongoing basis ensure a reasonable bid and volume is maintained in the market for each warrant series admitted to trading status for at least 90% of the time between 10:15 am and the commencement of the pre-CSPA session state (normally 4:00 pm) on each trading day,<sup>2</sup> unless there are "permitted circumstances".

To meet the first of these alternatives, the warrant-issuer must satisfy ASX that there will be a level of investor interest that will facilitate a liquid market for buyers and sellers of the warrant series. As a rule of thumb, this will generally involve having at least 1,000 holders having a minimum aggregate holding of not less than \$10 million at the time the warrant series is admitted to trading status. Otherwise the warrant-issuer must comply with the second alternative in paragraph (b) above and ensure that a reasonable bid and volume is maintained in the market for each warrant series.

Under ASX Operating Rules Schedule 10A.3.6, subject to certain exceptions,<sup>3</sup> an AQUA product issuer must either:

- on an ongoing basis ensure a reasonable bid and volume is maintained in the market for each AQUA product series admitted to trading status for at least 90% of the time between 10:15 am and the

<sup>1</sup> References to an AQUA product series include a single AQUA product if there is only one product in the series.

<sup>2</sup> ASX Operating Rules Procedure 10.3.11. References to time in this Guidance Note are to Sydney time.

<sup>3</sup> These requirements do not apply to AQUA products that are admitted only to the AQUA Quote Display Board or for settlement through the Managed Fund Settlement Service (ASX Operating Rules Procedure 10A.3.6). They also cease to apply to other AQUA products if the AQUA product has, and continues to have, a spread of at least 1,000 AQUA Product holders and the net asset value of the underlying instruments is at least \$10 million (ASX Operating Rule and Procedure 10A.3.6).

commencement of the pre-CSPA session state on each trading day,<sup>4</sup> unless there are “permitted circumstances”; or

- (b) have in place other arrangements which meet the requirements set out in the Procedures and, in the opinion of ASX, provide a mechanism for sufficient liquidity in the AQUA product series.

To meet the second of these alternatives, the AQUA product issuer may enter into a written agreement (a “market maker agreement”) with ASX to ensure reasonable bids and offers are maintained in the market for each AQUA product series for a nominated percentage of the trading day, with agreed parameters as to the minimum quantity of each bid and offer and the maximum spread between the offer price and the bid price. The minimum quantity and maximum spread must be agreed with ASX prior to admission of the AQUA product series and may only be varied with the agreement of ASX.<sup>5</sup> Otherwise, if the AQUA product issuer has not entered into a market maker agreement with ASX, it must comply with the first alternative in paragraph (a) above and ensure that a reasonable bid and volume is maintained in the market for each AQUA product series.

If an AQUA product issuer enters into a market maker agreement with ASX, it must comply with the terms of that agreement and the balance of this Guidance Note regarding reasonable bid requirements is not applicable.

A list of market makers for specific AQUA products and maximum spreads is available online from:

<http://www.asx.com.au/products/etf/market-making.htm>

### 3. The purpose of the liquidity requirements

The purpose of the liquidity requirements is to provide liquidity in the market for warrant and AQUA products and to ensure that the holders of those products have an opportunity to exit their investment at a reasonable price.

### 4. The criteria ASX uses to assess the reasonableness of a bid

In assessing whether a bid by a warrant-issuer or AQUA product issuer is reasonable for the purposes of ASX Operating Rules Schedules 10.3.11(b) or 10A.3.6(a), ASX applies two sets of criteria – one objective and the other qualitative.

If the objective criteria are met, ASX will consider the bid to be reasonable without any further regard to the qualitative criteria. If the objective criteria are not met, ASX will consider the qualitative criteria to determine whether, in its opinion, the issuer has been complying with its reasonable bid obligations.

If neither set of criteria is satisfied, ASX may exercise its enforcement powers referred to in section 6 below.

#### 4.1. Objective criteria for assessing reasonableness

ASX will consider a warrant-issuer’s bid for a warrant series or an AQUA product issuer’s bid for an AQUA product series<sup>6</sup> to be reasonable for the purposes of ASX Operating Rules Schedules 10.3.11(b) and 10A.3.6(a) respectively if, for 90% of the time during the obligation period (ie, between 10:15 am and the commencement of the pre-CSPA session state), it satisfies the following criteria:

- in relation to price, the issuer posts both bids and offers and the spread between the bid price and the offer price is:
  - when the bid price is 10 cents or greater, no more than 10% of the bid price; or
  - when the bid price is less than 10 cents, no more than 1 cent; and

<sup>4</sup> ASX Operating Rules Procedure 10A.3.6.

<sup>5</sup> ASX Operating Rules Procedure 10A.3.6.

<sup>6</sup> This is only relevant in the case of an AQUA product issuer if it has not entered into a market maker agreement with ASX under ASX Operating Rules Schedule 10A.3.6(b). If the AQUA product issuer has entered into a market maker agreement with ASX, it must comply with the bid and offer obligations in the market maker agreement.

- in relation to volume, the minimum bid value is:
  - when the bid price is 5 cents or greater, \$1,000; or
  - when the bid price is less than 5 cents, \$500.

ASX monitors the bids made by warrant-issuers and AQUA product issuers against the objective criteria mentioned above<sup>7</sup> and may contact an issuer if it fails to meet those criteria to discuss whether it is in compliance with its reasonable bid obligations.

#### 4.2. Qualitative criteria for assessing reasonableness

In determining whether a warrant-issuer or AQUA product issuer is in compliance with its reasonable bid obligations, if the issuer fails to meet the objective criteria mentioned above, ASX will have regard to any qualitative factors it considers relevant to such a determination. These factors may include:

- whether there is evidence of consistent pricing over time and a correlation between the price and volume of the bids displayed by the issuer in the relevant warrant series or AQUA product compared to the price and volume of the bids available in the market for the underlying product or the underlying hedge product, having regard to:
  - the terms and features of the warrant series or AQUA product series, including its gearing or delta;
  - time and/or interest decay;
  - the liquidity of the underlying instrument or underlying hedge instrument and the transaction costs involved in hedging or unhedging positions;
  - the normal application of sound risk limits around execution, liquidity and other market risks; and
  - a reasonable margin for the costs of issuing and administering the warrant series or AQUA product;
- where the warrant series or AQUA product series has derivative characteristics, the application of generally accepted derivative pricing models to the bid and offer prices in the market for the underlying product or the underlying hedge product;<sup>8</sup>
- whether any pricing inconsistency or lack of correlation can be explained by events affecting the market for the underlying instrument or underlying hedge instrument, such as:
  - an announced takeover, scheme, merger or other control transaction;
  - an impending corporate action; or
  - a temporary lack of liquidity, an unusual spike in volatility, unusually wide spreads or other market anomalies;
- whether, at the time, there were any holders in the warrant series or AQUA product series;
- any explanations from the issuer as to why a particular bid was reasonable; and
- any advice from a warrants product committee or AQUA product committee regarding the range of prices they would consider to be a reasonable bid.<sup>9</sup>

<sup>7</sup> In the case of an AQUA product issuer that has entered into a market maker agreement with ASX under ASX Operating Rules Schedule 10A.3.6(b), ASX monitors the bids and offers made by the issuer for compliance with its obligations under the market maker agreement.

<sup>8</sup> This may involve the use of a range of generally accepted market assumptions regarding key derivative pricing variables such as expected dividends, expected dividend payment dates, volatility of the underlying instrument, interest rates, exchange rates, etc.

<sup>9</sup> See note 16 below and the accompanying text.

### 5. Permitted circumstances when a reasonable bid is not required

A warrant-issuer or AQUA product issuer is not required to maintain a reasonable bid for a warrant series or AQUA product series in certain “permitted circumstances”. Those circumstances are when:

- (a) the underlying instrument or the underlying hedge instrument<sup>10</sup> of the series is placed in pre-open session state or is subject to a suspension or trading halt or is otherwise unavailable for trading;
- (b) the series itself is subject to a suspension or trading halt or is placed in pre-open session state or is otherwise unavailable for trading;
- (c) the theoretical value of the series is below the relevant minimum price step of the ASX trading platform (currently \$0.001);
- (d) the issuer has advised the market that it (or its market making agent) would breach laws, regulatory rules or similar constraints (whether in Australia or elsewhere) by fulfilling its market making obligations, provided that:
  - where appropriate, it endeavours to obtain any necessary regulatory relief that will enable it to continue to make a market in that series; and
  - it advises the market upon being able to continue to make a market in that series;
- (e) the issuer of the warrant or AQUA product has advised the market that it (or its appointed market making agent) continues to experience an interruption to its normal operating environment that substantially prevents the timely and accurate entry of market making orders into the trading platform within 30 minutes of the interruption occurring;<sup>11</sup> and
- (f) any other circumstances set out in the Procedures<sup>12</sup> and notified to ASIC.

For the purposes of circumstance (d) above, a legal, regulatory or other constraint will be taken to prevent an issuer from fulfilling its market obligations not only if it directly has that effect but also if it prevents the issuer from acquiring or disposing of the underlying instrument or underlying hedge instrument for the relevant warrant series or AQUA product series.<sup>13</sup> This recognises (consistently with circumstance (a) above) that it is integral to an issuer making a market in a warrant series or AQUA product series that it is able hedge and unhedge its exposures.

Examples of the types of interruptions that meet circumstance (e) above include, but are not limited to:

- a loss of power, telecommunication lines or market data feeds;
- the malfunction of an automated market making system or other IT system upon which the operation of issuer's market making activities are dependent;
- a temporary unavailability of key systems of because of a need to shut down and re-boot those systems; and
- a loss of access to or need to evacuate premises.

<sup>10</sup> An underlying hedge instrument is any product (other than the underlying instrument itself) in which an issuer takes positions as part of its genuine hedging arrangements for the warrant series or AQUA product series in question. Whether a hedging arrangement is genuine is a matter of fact to be determined on a case by case basis having regard to all relevant circumstances.

<sup>11</sup> ASX Operating Rules Procedures 10.3.11 and 10A.3.6. There is no need to make an announcement if the interruption is resolved within 30 minutes.

<sup>12</sup> Nothing is presently specified in the Procedures.

<sup>13</sup> This might apply, for example, where foreign ownership restrictions prevent the issuer from acquiring or holding the underlying instrument or underlying hedge instrument.

In addition to permitted circumstances set out above, ASX recognises that various transient events may result in an issuer not being able to provide a reasonable bid for a short period of time. Examples of such events include:

- temporary interruptions to the issuer's normal operating environment that last for less than 30 minutes;
- large offers being executed that match all existing bids and result in a temporary absence of bids from the trading platform; and
- an adjustment to pricing models as part of appropriate risk management processes.

Provided these transient events only last a short time, ASX generally will not take enforcement action against a warrant-issuer or AQUA product issuer for failing to have reasonable bids in the market for the duration of these events.

## 6. Enforcement action and appeals

As mentioned above, ASX monitors the bids made by warrant-issuers and AQUA product issuers to assess whether they are complying with their reasonable bid obligations.

If ASX has any concerns in that regard, it may request the issuer to provide details of how it has determined the value and volume of the bids it has been making for the purposes of complying with its reasonable bid obligations.<sup>14</sup> The issuer must respond to that request within one trading day, or such other period as ASX may specify.<sup>15</sup>

If ASX considers that an issuer has not complied with its reasonable bid obligations, ASX may initiate enforcement action against the issuer for breaching the ASX Operating Rules. Alternatively, it may convene a Warrants Committee or AQUA Products Committee (as the case may be) for the purposes of advising it on the reasonableness of the issuer's bids.<sup>16</sup>

If ASX does find an issuer has breached its reasonable bid obligations (whether of its own accord or with the advice of a Warrants Committee or AQUA Products Committee), ASX may take any action and give any directions it considers appropriate including (but not limited to):

- releasing an announcement to the market to the effect that the issuer failed to maintain a reasonable bid in accordance with rule 10.3.11(b) or 10A.3.6 (as applicable);
- issuing a warning letter to the issuer;
- notifying the issuer that ASX will take the issuer's failure to maintain a reasonable bid in accordance with rule 10.3.11(b) or 10A.3.6 into account when considering future applications for admission of new warrant series or AQUA products series to trading status;
- suspending trading in the relevant warrant series or the AQUA product series; or
- determining that future warrant series or AQUA product series issued by the issuer may not be admitted to trading status for a specified period of time not exceeding 12 months.<sup>17</sup>

Before taking any such enforcement action, ASX is required to give the issuer an opportunity to make submissions with respect to the proposed action.<sup>18</sup>

<sup>14</sup> ASX Operating Rules Schedules 10.14.3(a) and 10A.10.3(a).

<sup>15</sup> ASX Operating Rules Procedures 10.14.3 and 10A.10.3.

<sup>16</sup> ASX Operating Rules Schedules 10.14.3(b)(ii) and 10A.10.3(b)(ii). For more information about the role, powers and constitution of a Warrants Committee and AQUA Products Committee, see respectively ASX Operating Rules 10.14.3(c)-(f) and 10.10A.3(c)-(f).

<sup>17</sup> ASX Operating Rules Schedules 10.14.3(g) and 10A.10.3(g). If the issuer is a participant of the ASX market, ASX may also take enforcement action against the participant for breaching its obligations under the ASX Operating Rules: see ASX Operating Rule 5100 and ASX Operating Rules Schedules 10.14.3(l) and 10A.10.3(l).

An issuer may appeal a decision by ASX to take any such enforcement action to the ASX Appeal Tribunal, in accordance with the provisions of the ASX Enforcement and Appeals Rulebook.<sup>19</sup> If it wishes to appeal, the issuer must pay an appeal fee of \$5,000 (exclusive of GST) to, and lodge written notice of the appeal with, the ASX Appeals Tribunal no later than one trading day after receipt of the reasons for ASX's decision.<sup>20</sup>

ASX generally will not implement a decision to take enforcement action against an issuer for breaching its reasonable bid obligations until the appeal period has expired or, where there is an appeal, the appeal has been determined.<sup>21</sup>

Further information about the appeal process can be found in ASX Enforcement and Appeals Rulebook Guidance Note 1 *Enforcement Action and Appeals from Enforcement Decisions*.

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<sup>18</sup> ASX Operating Rules Schedules 10.14.3(h) and 10A.10.3(h) (although see also note 21 below).

<sup>19</sup> Rules 3.1.1(c) and (d) of the ASX Enforcement and Appeals Rulebook. Subject to that right of appeal, the exercise by ASX of its enforcement powers under ASX Operating Rules Schedules 10.14.3(g) or 10A.10.3(g) is final and binding on the issuer: ASX Operating Rules Schedules 10.14.3(i) and 10A.10.3(j).

<sup>20</sup> Rule 3.1.1 of the ASX Enforcement and Appeals Rulebook and the accompanying Procedure.

<sup>21</sup> ASX Operating Rules Schedules 10.14.3(j) and 10A.10.3(j) – although ASX can implement and announce a decision to suspend trading in a warrant series or AQUA product series before giving the issuer an opportunity to make submissions, before the expiry of the appeal period or before the determination of any appeal if ASX considers it appropriate to do so: see ASX Operating Rules Schedules 10.14.3(k) and 10A.10.3(k).