The Senate

Standing Committee on Economics

Corporations Amendment (Short Selling) Bill 2008 [Provisions]

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Senate Standing Committee on Economics

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Introduction

Background

1.1 Global financial markets have come under severe stress in 2008. The problems originated in the United States, which in September effectively nationalised its largest mortgage institutions and one of the world's largest insurance companies. One of its large investment banks filed for bankruptcy, another was taken over and the remaining two announced their conversion to commercial banks. These events have had ramifications around the world, with equity prices falling and credit and liquidity tightening in a climate of unusual volatility in equity prices.

1.2 While Australian regulatory systems have not been found at fault, and Australian banks remain strong, the Australian financial system has not been immune from these pressures. As global commodity prices are particularly important for Australia, their decline has led to Australian equity prices and the exchange rate dropping considerably.

1.3 These global developments have led to governments and their agencies in most countries taking steps to strengthen their financial systems. This has also occurred in Australia with measures such as explicit guarantees being provided for bank deposits.

1.4 A response to the heightened volatility in equity markets has been to restrict short selling. The Government introduced the Corporations Amendment (Short Selling) Bill 2008 into the parliament on 13 November. The bill amends the *Corporations Act 2001* to 'address certain aspects about the regulation of short selling' so as 'to enhance the integrity, fairness and transparency of our markets'.[1] It 'fills a potentially dangerous gap in our corporate laws'.[2]

1.5 The bill aims to do three things: remove any doubt about the powers of the Australian Securities and Investments Commission to restrict short selling; ban 'naked' short selling; and improve disclosure of short selling. There will be no significant impact on government expenditure or revenue.[3]

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1 Hon Chris Bowen MP, Minister for Competition and Consumer Affairs, Second reading speech, 13 November 2008.

2 Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, Press release 081, 25 November 2008.

3 *Explanatory memorandum*, p. 3.

Conduct of the inquiry

1.6 On the recommendation of the Selection of Bills Committee, the Senate referred the provisions of the bill to the Economics committee on 13 November 2008 for inquiry and report by 27 November. Given the urgency of reducing uncertainty in jittery financial markets so as not to further damage the real economy, a long inquiry was not desirable.[4]

1.7 The committee advertised the inquiry in *The Australian* and on its website and wrote to many peak organisations inviting submissions. The committee received 15 submissions (see Appendix 1), which are available on its website; http://www.aph.gov.au/Senate/committee/economics_ctte/short_selling_08/submissions/sublist.htm.

1.8 A public hearing in Canberra on 24 November afforded the committee the chance to hear from the relevant regulatory agencies and some peak industry associations (see Appendix 2). The committee appreciates those who prepared submissions and appeared as witnesses at short notice.

4 The Senate considered a motion on 26 November that would have extended the reporting date of the inquiry to 6 February 2009, but rejected it.

Chapter 2

Background to the bill

What is 'short selling'?

2.1 A share owner who believes that a share is likely to fall in price may sell it in the hope of buying it back later at a lower price. This is a relatively low-risk activity, although of course if the investor is wrong she will miss out on the subsequent increase in the value of the share, and if she wishes to be a long-term investor in the stock would then be buying it back at a higher price.

2.2 To make markets more liquid and to aid in 'price discovery', it can be desirable to allow other traders who regard a share as overvalued to take a position where they can profit if their judgment is correct. One way of doing this is by 'short selling'.[1]

2.3 In a '*covered* short sale' a trader 'borrows' a share, sells it, and must later buy an equivalent share to return to the lender.[2] The difference from the earlier scenario is that the trader is now *obliged* to buy an equivalent share at a later date. If the share price has risen a large amount, a large loss will result. As there are no limits to how high share prices can go, there is correspondingly no limit to the risk being borne by the trader.

2.4 In an 'uncovered', or '*naked*' short sale, the seller neither owns nor has borrowed the stock, but plans to buy or borrow it in time to meet settlement obligations. This practice is not only risky for the seller but raises the possibility of settlement risk for the buyer.

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1 Another way would be by buying a 'put option'.

2 The precise legal form through which the share is 'borrowed' varies. The seller can be described as 'covered' if, at the time of contracting to sell, the seller has a 'presently exercisable and unconditional right to vest the products in the buyer' - that is, a legal title; *Corporations Act*,s1020B(2). ASIC, Regulatory Guide 196: *Short Selling: Overview of s1020B*, par. 8. Typical stock 'borrowing' agreements actually involve the so-called 'borrower' purchasing the stock from the lender subject to a contractual obligation to sell back to the lender at an agreed time or on demand. Shares are usually borrowed, for a premium, from fund managers or custodial managers holding shares on behalf of institutions.

The market impact of short selling

2.5 As noted above, short selling can allow more traders to enter the market and so potentially can allow prices to reflect available information more readily. This should in principle make the market more efficient and have a stabilising influence on prices.[3]

2.6 Short selling is argued to serve a number of legitimate purposes:

- arbitrage: it helps remove price anomalies in a timely way;
- market making: it facilitates trades between clients to provide continuous liquidity;
- risk management: it enables investors to hedge against price volatility in shares they own;
- capital raising: it facilitates underwriting of capital raisings; and
- funds management: it increases the range of investment strategies.[4]

2.7 However, short selling also raises some concerns. It creates an incentive for certain investors to try to drive down the price of a share, if only temporarily. This may be done by spreading unfounded rumours; a practice now known as 'rumourtrage'.[5] It may involve collusion. In these cases, rather than being a stabilising force making the market more efficient, short selling may make share prices more volatile. This is of particular concern at times like the present when the market is very skittish. Even a temporary fall in the share price caused by short sellers may prevent companies rolling over debt or push them into forced sales of assets.

2.8 There are also concerns about the lack of transparency and monitoring of short selling. Conflicts of interest may also arise with brokers producing research, and hedge funds being major clients of the same brokers. [6]

2.9 The *Explanatory Memorandum* expands on these concerns:

> Currently, when a security experiences a significant decline in price, it is unclear whether this is attributed to short selling activity or other factors, which is resulting in considerable rumour and speculation regarding short selling activity and potentially adding to price volatility. Speculation regarding the level of short selling activity in Australian securities is also having broader market implications. Confidence in the market, particularly among retail investors, is likely to be damaged as investors express concern

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3 The only quantitative evidence the committee received on this was analysis by Dr Hamson of IFSA who claimed that when short selling was banned, 'the spread went up by about eight basis points'; *Proof Committee Hansard*, 24 November 2008, p. 3.

4 Australian Bankers' Association, *Submission 12*, p. 2.

5 Australian Bankers' Association, *Submission 10*, p. 2.

6 Australian Bankers' Association, *Submission 12*, p. 2.

> about the perceived activity of short sellers in the market. A fall in market activity, and investor confidence about the integrity of Australian capital markets, will make it more difficult for companies to raise additional capital leading to an increase in the companies' overall cost of capital and a fall in investment activity.[7]

Rules governing short selling before the crisis

2.10 Prior to the crisis, naked short selling was restricted to a range of transactions by section 1020B of the *Corporations Act*. In particular naked short selling was allowed for a limited range of securities subject to conditions imposed by the Australian Securities Exchange (ASX).[8] There were far fewer restrictions on covered short selling.

2.11 As short selling was not controlled, there was no disclosure of it, although it is believed that covered short sales were much more common than naked short sales.[9] The Reserve Bank of Australia has reported that the value of stock loans outstanding was around $60 billion at the end of 2007, but this only provides an upper bound to the amount of short selling as borrowed stock can be used for purposes other than short selling.[10]

2.12 IFSA's opinion of the size of short selling was:

> …it has averaged round about 15 per cent of the volume. I think that overseas studies have put the line of shorting at somewhere between 10 and 20 per cent. Typically, the amount of short interest is of the order of four or five per cent.[11]

ASIC's recent actions

2.13 On 19 September 2008 the Australian Securities and Investments Commission (ASIC) introduced reporting requirements for covered short selling. Its stated reason was 'to maintain confidence in our markets in the face of current international turmoil and to complement moves made by other regulatory agencies'. At the same time the ASX removed all securities from its Approved Product List for naked short sales. This effectively banned naked short sales.[12]

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7 *Explanatory Memorandum*¸ p.25.

8 *Explanatory Memorandum*, p.25

9 *Explanatory Memorandum*, p.26. The Securities and Derivatives Industry Association argues that 'contrary to belief in some quarters, the volume of naked short sales is not significant'; *Submission 14*, p.4

10 *Explanatory Memorandum*, p.26. Discussion with a market participant suggested that short selling typically accounts for the majority of equity loans outstanding, but the proportion fluctuates over time.

11 Dr Justin Wood, IFSA, *Proof Committee Hansard*, 24 November 2008, p. 4.

12 ASIC announcement AD 08-204; Class Order 08/751.

2.14 On 21 September ASIC extended the ban to most covered short selling following overseas bans which, without an Australian ban, would have 'intensified the risk of unwarranted activity on the Australian market'.[13]

2.15 On 21 October ASIC extended the ban on covered short selling until 18 November for non-financial stocks and 21 January 2009 for financial stocks.[14]

2.16 On 19 November ASIC lifted the ban on covered short selling of non-financial stocks, subject to reporting and disclosure requirements which had been announced on 12 November.[15]

2.17 ASIC implemented these measures by issuing declarations, known as 'class orders', modifying the operation of the *Corporations Act*. Class orders are published on ASIC's website and the Federal Register of Legislative Instruments; and market participants are informed through the Australian Securities Exchange (ASX).

Related inquiry

2.18 On 19 November 2008 the Minister for Superannuation and Corporate Law, Senator the Hon. Nick Sherry, announced that the Corporations and Markets Advisory Committee (CAMAC) would inquire into the following market practices by 30 June 2009:

- margin lending by company directors;
- 'blackout' trading by company directors;
- spreading of false rumours; and
- potential disclosure of market sensitive information at analysts' briefings.[16]

13 ASIC announcement AD 08-205; Class Order 08/752.

14 ASIC announcement AD 08-210.

15 ASIC announcement AD 080-65; Class Order 08/824.

16 Senator the Hon, Nick Sherry, Minister for Superannuation and Corporate Law, *Action to Further Enhance Market Integrity*, press release 19 November 2008.

Chapter 3

Provisions of the bill

3.1 The bill aims to do three things: clarify ASIC's powers, ban naked short selling and improve disclosure.

Clarification of ASIC's powers

3.2 To avoid any uncertainty about ASIC's action in (temporarily) banning short selling, the bill expressly states that the declarations by ASIC banning short selling were within its powers. It also empowers ASIC to regulate market transactions that have a substantially similar market effect as short sales.

3.3 This clarification seems to have general support, although the Australian Financial Management Association (AFMA) is concerned that the legislation may be giving ASIC, whom they regard as sometimes 'capricious', excessively broad and discretionary powers:

> The rules under which a future prohibition of covered short selling should operate should be governed by regulations which are the subject of policy development and control by the Government.[1]

Ban on naked short selling

3.4 The bill will ban naked short selling. This will mean a seller will need a legally binding securities lending agreement, or an exemption from ASIC, before short selling. There should be a low compliance cost from this change given the 'limited occurrence of naked short selling on Australian financial markets'.[2]

3.5 The ban is supported by the Association of Superannuation Funds of Australia[3] and the Australian Investment Management Association[4], and not opposed by the Investment and Financial Services Association.[5] AFMA would like to see more

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1 Australian Financial Markets Association, *Submission 5*, p. 5. Similar concerns are raised by the Australian Bankers' Association, *Submission 10*, p. 8.

2 *Explanatory memorandum*, p. 4. See paragraph 2.11.

3 *Submission 3*, p. 1.

4 *The Age*, 13 November 2008. AIMA is described as representing the views of the hedge fund industry.

5 Investment and Financial Services Association, *Submission 9*, p. 2.

exemptions allowed for various types of arbitrage and market-making.[6] The Australian Bankers' Association thinks any ban on naked short selling should only last for the duration of the current crisis.[7] Some submissions argued that the bill should confirm ASIC's 'no action' position of 24 September 2008.[8]

3.6 Some organisations are concerned about the status of exemptions. The current rules in the *Corporations Act* allow five kinds of short selling: 'odd lot', 'arbitrage transaction', 'uptick rule', 'approved short sale' and 'contract to buy'.[9] Under the bill only the last of these will remain. Treasury said 'it is intended that ASIC will be able to use its exemption power to allow certain naked short sales. It is envisaged that ASIC will use this power to allow some non-speculative naked short selling necessary to ensure the ordinary operation of Australia's financial markets.' Treasury argued that 'given the dynamics of the market' it is better for exemptions to be facilitated by ASIC rather than by the law.[10]

3.7 Several submissions argued that exemptions to the ban should be included in the Act and not merely be a matter for ASIC's discretion. AFMA thought that this is needed to remove uncertainty about the scope of exemptions. The Securities and Derivatives Industry Association suggested exemption for honest mistakes (eg placing a sell order instead of a buy order by mistake), client facilitation (market making) and 'seller unaware that the sale is short'. [11]

3.8 On the other hand, the ASX approved leaving the exemptions to ASIC's discretion.[12]

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6 Australian Financial Markets Association, *Submission 5*, p. 7. There is some support for this view by the ASX, *Submission 8*, p. 4.

7 ABA, *Submission 10*, p. 4.

8 State Street Bank and Trust Company, *Submission 6*, p.1. Australian Custodial Services Association, *Submission 7*, p.1. ASIC's 'no action' position was that it would not take action against a breach of short selling requirements in the case of a bona fide transaction from a stock lending portfolio, on certain conditions. ASIC announcement AD08-23, 24 September 2008.

9 Australian Financial Management Association, *Submission 5*, p. 6. *Corporations Act (2001)*, s1020B(4). 'Uptick rule': a naked short sale is permitted on certain conditions providing the price is not less than the market price. 'Approved short sales': short sales of securities approved by the market operator.

10 Treasury, *Submission 4*, p.2

11 For example, AFMA, *Submission 5*, p.6. Securities and Derivatives Industry Association, *Submission 14*, p.8. 'Seller unaware that the sale is short' could arise because of information barriers between traders in the same entity for compliance reasons.

12 ASX Ltd, *Submission 8*, p.4. This was stated as by contrast with the present situation where the market operator has discretion with the 'approved list' approach.

Disclosure of covered short selling

3.9 Treasury believes:

> The disclosure …will reduce market speculation and rumour about the activity of short sellers, enhancing market confidence and integrity.[13]

3.10 Submissions generally supported greater disclosure in principle. For example, the Australian Institute of Company Directors supports the initiative, but add that 'those who act in a concerted way could be required to report aggregated short positions'.[14] Greater disclosure is also supported by the Association of Superannuation Funds of Australia and the Australian Securities Exchange.[15]

3.11 However, the devil may be in the details of the timing and manner of disclosure, which will be covered by regulations, expected in early 2009.[16] There are two broad concerns. Firstly, there are concerns that it would be better to set out the disclosure regime in the bill rather than leaving it to regulations. Secondly, there may be problems with the currently preferred disclosure regime.

Laws versus regulations

3.12 The bill sets out a currently preferred, or 'default', option for the disclosure regime but the *Explanatory Memorandum* discusses four other options as well. Treasury advised that the Government will further consult stakeholders in developing the regulations, and does not yet have a settled position on how the details of disclosure should operate.[17]

3.13 There is a perennial argument between the certainty of law versus the flexibility of regulations. On the one hand, embedding the disclosure regime into the bill would give more certainty. However, it would remove the scope to fine tune the rules quickly in response to market developments or in response to ongoing market consultation. It would also delay implementation of the overall bill.

3.14 IFSA wanted key aspects in law, but was content for lesser elements to be in regulations:

> …quite an amount of information and requirements will be placed in regulations.…It is important that we have a framework for disclosure, and certain features of that framework, one being certainly the confidentiality of information if it is passed through a broker is something that should specifically and expressly be in the law. Secondly, the type of information

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13 Treasury, *Submission 4*, p. 1.

14 AICD, *Submission 2*, p. 2.

15 ASFA, *Submission 3*, p. 1; ASX, *Submission 8*, p. 1.

16 Treasury, *Submission 4*, p. 2.

17 *Proof Committee Hansard*, 24 November 2008; Treasury, *Submission 4*, p.1.

> which is made publicly available should be specifically in the law…How that information is collected and put together can be a matter for the regulations…Thirdly, and importantly, we think that the public disclosure of this information also should be a requirement which is placed in the law explicitly.[18]

3.15 More generally, IFSA argued:

> Regulations are essentially there to fill in some of the detail and put flesh on a skeleton. The law itself should have the fundamental and basic requirements and give direction on what should be in regulations. Obviously, the House has the ability to change legislation, whereas when it comes to regulations, unfortunately, they are presented to the House and can be disallowed in whole but cannot be amended, which cuts down the level of debate on appropriate provisions which could be in the regulations.[19]

3.16 On the other hand, other witnesses seemed comfortable with considerable usage of regulations:

> The allocation of subject matter between legislation and regulation seems appropriate to us.[20]

> Our view is that the bill can be a principles based piece of legislation in which the mechanisms for the short selling rules can be developed through regulations.[21]

The disclosure regime

3.17 Under the preferred disclosure regime in the bill, known as option 2, a seller will be required to disclose covered short sales to their executing broker (and a broker must ask whether a sale is a short sale), who will be required to disclose it to the market operator (such as the Australian Securities Exchange). The market operator in turn will publicly disclose information on short sales in particular securities.

3.18 Groups supporting option 2 included ASX Ltd, the Australian Institute of Company Directors, the Association of Superannuation Funds of Australia and Chartered Secretaries Australia. The Australian Bankers' Association advocated a

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18 Mr David O'Reilly, Investment and Financial Services Association, *Proof Committee Hansard*, 24 November 2008, p. 2.

19 Mr David O'Reilly, Investment and Financial Services Association, *Proof Committee Hansard*, 24 November 2008, p. 5.

20 Mr Malcolm Starr, Australian Securities Exchange, *Proof Committee Hansard*, 24 November 2008, p. 7.

21 Mr David Love, AFMA, *Proof Committee Hansard*, 24 November 2008, p. 12.

mixture of reporting gross short sales by investors to their brokers, and net short sale positions by investors direct to the market operator.[22]

3.19 The other options canvassed in the commentary on the exposure draft released on 23 September and in the *Explanatory Memorandum* are:

- (1) No regulatory action;
- (3) Direct disclosure of covered short sales by investors to the market operator;
- (4) Disclosure of stock lending arrangements, on the grounds that this would be a sufficient proxy for the level of covered short selling;
- (5) Review existing short selling regime.[23]

3.20 The alternative option attracting most attention is option 3. The Investment and Financial Services Association preferred it due to concerns about maintaining confidentiality where information is disclosed to other market participants. Mr A. Rofe (former chairman of the Australian Shareholders' Association) argued that option 3 was likely to have lower implementation costs than option 2, and that investors will be in a better position than brokers to report their net short positions, particularly when they deal through more than one broker.[24] Similarly, AFMA suggested that rather than reporting through brokers, it would be better to collect information from custodians and clearing houses.[25]

3.21 On the other hand, the ASX opposes option 3 on the grounds that it would be impractical. The ASX would have to monitor compliance by tens of thousands of institutional investors rather than about 100 brokers.[26] ASX also objected to option 3 on the grounds that its supervisory obligations can only reasonably extend to those with whom ASX has a contractual relationship - and this does not necessarily include the end user.[27]

3.22 Chartered Secretaries Australia opposes option 3 on the grounds that it could result in non-compliance (not least because many offshore investors would be unlikely to be aware of the obligation); enforcement would be difficult; and confidentiality

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22 ASX Ltd, *Submission 8*, p.3; AICD, *Submission 2*, p.1; ASFA, *Submission 3*; CSA, *Submission 10*, p.2; IFSA, *Submission 9*, p.3; Australian Bankers' Association, *Submission 12*, p.6.

23 Treasury, *Exposure Draft of the Corporations Amendment (Short Selling) Bill 2008 - Commentary*, 23 September 2008.

24 A. Rofe, *Submission 13*, p.2. Similarly AFMA, *Submission 5*, p. 11.

25 AFMA, *Submission 5*, p. 10.

26 Mr Malcolm Starr, ASX, *Proof Committee Hansard*, 24 November 2008, pp 7-8. Dr Wood from IFSA suggested as a possible response to this problem only requiring data from the larger funds: *Proof Committee Hansard*, 24 November 2008, p.2.

27 ASX Ltd, *Submission 8*, p. 3.

would be at risk 'with individual notices rather than aggregated notices more likely to potentially disclose individual trading patterns'.[28]

3.23 The Investment and Financial Services Association, while seeing some advantages in option 2, sought assurances that confidentiality could be maintained:

> Disclosure through brokers has the advantage for the regulator and market supervisor of allowing real time tick-by-tick disclosure of all short selling with disclosure of the identity of the broker and the underlying investor. However it runs the risk of significant leakage of information to the market that could increase rumours and reduce market integrity. Reporting through brokers may be appropriate only if adequate technology solutions are in place to protect commercially sensitive information from market participants while ensuring full disclosure is available for the regulator and market supervisor.[29]

3.24 The Securities and Derivatives Industry Association (SDIA) opposes option 2 for practical reasons (uncertainty of relying on the client to advise; situations where a client uses several brokers), and because it regards the proposed obligation on brokers to inquire whether a sale is short as onerous. However SDIA agrees with arguments that option 3 is undesirable, and prefers option 4 (reporting of stock lending).[30]

What information should be reported?

3.25 Some submissions argued that the short selling information envisaged to be disclosed would not be the most useful to the market. The Investment and Financial Services Association, the Securities and Derivatives Industry Association, AFMA and the Australian Bankers' Association agreed that position data are more important than transaction data. AFMA submitted:

> In this context, information that is relevant to the market and regulators on an ongoing basis includes:
>
> • the amount of stock that is shorted at a given time;
>
> • the trend of short selling in short stock positions over time;
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> • the identity of entities that have substantial short positions.
>
> This type of information is not currently available in the Australian market.[31]

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28 Chartered Secretaries Australia, *Submission 10*, p. 3.

29 Mr David O'Reilly, Investment and Financial Services Association, *Proof Committee Hansard*, 24 November 2008, p. 1. Similar concerns about confidentiality are raised by the Australian Bankers' Association, *Submission 10*, p.5 and ASX, *Submission 8*, p. 2.

30 SDIA, *Submission 14*, pp 5, 7 and 10.

31 Australian Financial Management Association, *Submission 5*, p. 10.

3.26 AFMA argued that ASIC's current gross flow data collection does not capture intra-day close-outs, and gives an inaccurate representation of short selling. AFMA argues that it would be better to collect information directly from entities that hold short sale positions, and this is consistent with the approach taken in other countries.[32]

3.27 The Australian Bankers' Association recommended reporting of net short sales positions by investors directly to the market operators.[33]

3.28 Views differed about the timing of the release of information to the market. Some submissions argued that daily release may compromise asset managers' proprietary research, and could lead to free riding behaviour and greater market volatility. To prevent this, IFSA recommended disclosure to the market of aggregate short sale positions weekly or fortnightly (disclosure to the regulator would not be delayed).[34] The Australian Bankers' Association noted that 'this approach reflects that adopted in overseas markets such as the United States'.[35] The Australian Securities Exchange suggested different timing for different audiences:

> Real time would be good for investigative purposes; delay may make some sense for recirculation to market users.[36]

Compliance costs and consultation

3.29 Treasury reported that the proposed measures had been exposed for a month and they:

> …received submissions from a wide range of stakeholders including investors, brokers, the ASX and ASIC. The submissions broadly supported the disclosure of covered short sales subject to diversity of opinion on the mechanism for disclosure…certain industry groups have flagged concern about the direct disclosure of short sale information to executing brokers.[37]

3.30 Compliance costs will depends on the details of disclosure requirements. Some market participants have suggested necessary IT and administrative changes may take up to a year:

> We are talking in many hundreds of thousands of dollars, if not millions of dollars, for various brokerage houses to put in place the types of reporting

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32 Australian Financial Management Association, *Submission 5*, pp 10-11.

33 IFSA, *Submission 9*, p.4. SDIA, *Submission 14*, p.5. ABA, *Submission 12*, p. 6.

34 Mr David O'Reilly, Investment and Financial Services Association, *Proof Committee Hansard*, 24 November 2008, p. 22. IFSA, *Submission 9*, p.4.

35 ABA, *Submission 12*, p.7.

36 Mr Malcolm Starr, ASX, *Proof Committee Hansard*, 24 November 2008, p. 8.

37 Treasury, *Submission 4*, p. 1.

> and IT systems that are needed. The automation of the current reporting regime is going to take a number of months at least.[38]

3.31 Compliance costs may particularly be an issue for the quarter of trades generated by automated processes, and where the one company has a number of trading desks.[39] The ASX notes that in setting up the reporting regime, 'the challenge would be considerable'.[40]

3.32 The Government has indicated it will 'effectively engage with industry to ensure the preferred approach is implemented in a way that minimises regulatory costs and formally review the measures after they have been operational for two years'.[41]

Preventing manipulation of the market

3.33 Concern about possible manipulation of the market is one of the motives for improving disclosure of short selling. Submissions noted that the bill does not address this 'challenging issue' directly.[42] ASX advised that there has been a significant increase in the number of market manipulation referrals by ASX to ASIC this year, and 'both ASIC and ASX have been vigilant in monitoring the market in order to detect and prosecute this type of behaviour.'[43]

3.34 The Australian Institute of Company Directors suggested that where a person (or group acting in a concerted way) engages in short selling they should be subject to disclosure modelled along the lines of the substantial shareholder notice regime.[44]

3.35 On the other hand, the Securities and Derivatives Industry Association argued that the bill is correctly focussed on improving transparency of information about short selling, and its purpose is not to prevent market manipulation since 'market manipulation is already an offence, and there are in our view sufficient legislative tools available to deal with that offence.'[45]

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38 Mr David Love, Australian Financial Management Association, *Proof Committee Hansard*, 24 November 2008, p. 13. See also *Explanatory memorandum*, p. 5.

39 Australian Financial Management Association, *Submission 5*, p. 9.

40 ASX, *Submission 8*, p. 3.

41 *Explanatory memorandum*, p. 34.

42 Australian Financial Management Association, *Submission 5*, p.10. Similarly ABA, *Submission 12*, p.9.

43 ASX, *Submission 8*, p. 4.

44 AICD, *Submission 2*, p. 2.

45 SDIA, *Submission 14*, p.3.

3.36 The Committee notes that one of the terms of reference of the current inquiry into market integrity by the Corporations and Markets Advisory Committee is to review the regulatory regime governing market manipulation.[46]

Committee view

3.37 In other circumstances the committee could see some merit in awaiting further market consultation so as to embed the disclosure regime into the bill rather than allowing it to be determined by regulations. However, in the current market turmoil, it is important to reduce market uncertainty promptly by underpinning the power of ASIC to regulate short selling, banning naked short selling and giving a clear indication that the amount of short selling will be disclosed in future.

3.38 The committee notes that passing the bill does not preclude further consultation with market participants on the most effective means of achieving the third objective of the bill. On balance, it believes the preferred option in the bill for a disclosure regime is probably the best of those discussed, but regards this as a matter that could be usefully explored further.

Recommendation 1

3.39 The committee recommends that the Minister, through Treasury, should continue to liaise with ASIC to ensure general rules and laws around brokerage activities will continue to be reinforced and monitored, particularly in light of new legislative arrangements.

Recommendation 2

3.40 The committee recommends that the Senate pass the bill without delay.

Senator Annette Hurley

Chair

46 Senator the Hon. Nick Sherry, Minister for Superannuation and Corporate Law, 'Action to Further Enhance Market Integrity', press release 19 November 2008.

Coalition Senators' additional remarks: Short selling bill

The Corporations Amendment (Short Selling) Bill 2008 was referred to the Standing Committee on Economics for inquiry on the 13th of November and report by 27 November 2008.

Coalition Senators are concerned that insufficient time has been permitted for the Senate Economics Committee to conduct a proper inquiry into the implications of this Bill, and are disappointed that a motion to extend the reporting date for this Bill to 6th February 2009 was not supported by the Government.

The Government argued that they want this Bill through by the end of the year.

However in the opinion of Coalition Senators there is no need to rush this Bill through.

The Government has invented a deadline which will have the effect of limiting the inquiry of the Senate Economics Committee into short selling.

The government claims to have acted in this manner in order to confirm the powers of ASIC to regulate short selling. However Coalition Senators disagree with the Government on this point and are of the opinion that ASIC can continue to regulate covered short selling indefinitely.

The Coalition Senators believe the Committee needed more time to consider the positions of the key industry stakeholders, the impact of the legislation on the market, and an appropriate framework for the disclosure of covered short selling.

Coalition Senators believed it would have been beneficial had the reporting date been extended to provide key industry stakeholders and other groups who have significant interest in these matters time to develop considered positions and be given the opportunity to make submissions or appear before the Committee in further hearings.

For example a key stakeholder within the portfolio area, the Securities and Derivatives Industry Association (SDIA), were not provided with an opportunity to verbally present at the Senate hearings. This was despite the SDIA preparing a significant submission for the Committee.

This Bill will have a significant impact on the marketplace including an impact on regional markets as indicated by the submission from State Street Bank and Trust Co. Hong Kong.

Of great concern is the lack of detail presented in schedule 3 of this Bill which deals with short selling, as it provides no assurance to the institutional market participants or to Australian 'Mum and Dad' investors that the Government comprehends the significance of the reporting of covered short selling.

This Bill is in three parts:

Schedule 1: confirms the powers of ASIC
Schedule 2: bans naked short selling

The opposition sees no problems with schedules 1 & 2.

The problems lie with schedule 3 which relates to covered short selling.

The issue Coalition Senators have with schedule 3 is that it is just a shell with no content – in other words it contains no details of what the law governing covered short selling will be and, hence, no certainty for market participants.

The Government says that rather than permit the Senate to examine and debate the details of what this law might include, bureaucrats will draw up regulations, so in effect excluding any parliamentary input so limiting parliamentary scrutiny.

Coalition Senators believe that this approach to such important legislation effectively amounts to contempt of the parliament and its processes.

The Coalition Senators believe the Economics Committee should have been provided with additional time for this legislation so that examination of issues such as:

- Reporting requirements for example, who should report transactions, the investors or the broker, and to whom, the ASX or ASIC?

- How often should reporting occur, daily, 5 days after the transaction, monthly?

- What information on covered short selling should be made available to the public – aggregates or more detailed information about individual sales and the impact this might have on the market?

- International comparisons with practice in other jurisdictions such as the United States (New York stock exchange), UK (London), France (Paris), Germany (Frankfurt) and Tokyo.

The opposition believes that the role of the Senate as a house of review is being denigrated by the government's plan to have this legislation passed and the empty shell of schedule 3 filled in by bureaucrats, creating regulations not subject to any kind of prior parliamentary input.

Coalition Senators believe the correct procedure would have been for the Economics Committee to have been provided with the time to conduct a fuller examination of the issues relating to covered short selling.

Any extension of the reporting date would not have caused any disruption or other problems in the marketplace. There is no question that ASIC can continue to regulate or ban short selling indefinitely.

In addition, Treasury officials admitted at the hearing that the regulations giving effect to Schedule 3 would not be ready before February, suggesting that a delay allowing proper consideration of the bill would not have occasioned delay in the resolution of regulating covered short selling.

In conclusion the coalition senators strongly believe 12 days does not provide a reasonable amount of time for adequate consideration of such a significant and ambiguous Bill.

Senator Alan Eggleston
Deputy Chair

Senator David Bushby

Senator Barnaby Joyce

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Mr John Barke
2	Australian Institute of Company Directors (AICD)
3	The Association of Superannuation Funds of Australia (ASFA)
4	Treasury
5	Australian Financial Markets Association (AFMA)
6	State Street Bank and Trust Company, Hong Kong Branch
7	Australian Custodial Services Association (ACSA)
8	ASX Limited
9	Investment And Financial Services Association (IFSA)
10	Chartered Secretaries Australia Ltd (CSA)
11	Australian Council of Super Investors (ACSI)
12	Australia Bankers' Association (ABA)
13	Mr Ted Rofe
14	Securities & Derivatives Industry Association (SDIA)
15	Perpetual Ltd

Additional Information Received

- Received on 25 November 2008, from Investment & Financial Services Association (IFSA). Answers to Questions taken on Notice in Canberra on 24 November 2008.

APPENDIX 2

Public Hearings and Witnesses

MONDAY, 24 NOVEMBER 2008

- D'ALOISIO, Mr Tony , Chairman,
  Australian Securities and Investments Commission
- HAMSON, Dr Donald Frank, Member,
  Investment and Financial Services Association
- KLJAKOVIC, Ms Marian, Manager,
  Market Integrity Unit, Department of the Treasury
- LOVE, Mr David, Director,
  Policy, Australian Financial Markets Association
- LYNCH, Dr David, Head, Policy and Markets,
  Australian Financial Markets Association
- MILLER, Mr Geoff, General Manager,
  Corporations and Financial Services Division, Department of the Treasury
- NIPPITA, Ms Roslyn, Lawyer,
  Australian Securities and Investments Commission
- O'REILLY, Mr David, Director, Policy and Regulation,
  Investment and Financial Services Association
- PARKER, Miss Cherie, Analyst,
  Market Integrity Unit, Corporations and Financial Services Division,
  Department of the Treasury
- POWELL, Mr Stephen John, Analyst,
  Department of the Treasury
- STARR, Mr Malcolm, General Manager,
  Regulatory and Public Policy, Australian Securities Exchange Ltd
- TRAVERS, Mr David, Deputy Chairman,
  Australian Custodial Services
- WOOD, Dr Justin, Chair, Investment Board Committee,
  Investment and Financial Services Association
- YANCO, Mr Greg, Senior Executive,
  Market Participants and Stockbrokers; and New South Wales Regional
  Commissioner, Australian Securities and Investments Commission