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23 October 2008

Corporations Amendment (Short Selling) Bill 2008
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email to: shortsellingbill@treasury.gov.au

Dear Sir/Madam

Exposure Draft: Corporations Amendment (Short Selling) Bill 2008

The Australian Institute of Company Directors (AICD) welcomes the opportunity to make a submission to the Treasury on the regulation of and the disclosure regime applying to short selling.

The AICD is a member institute for directors that is dedicated to making a positive impact on the economy and society by promoting professional directorship and good governance. AICD delivers education, information and advocacy to enrich the capabilities of directors, influence the corporate governance environment in Australia and promote understanding of the role of directors. With offices in each state and more than 23,000 members, AICD represents a diverse range of corporations, from the top 200 publicly listed companies to not for profits, public sector entities and smaller private family concerns.

AICD is concerned about the potential to circumvent the proposed disclosure arrangements in the Exposure Draft of the Corporations Amendment (Short Selling) Bill 2008.

With respect to 'covered' short sales, we understand the object of the Bill is to require disclosure by the covered short selling client to its broker, or other financial services licensee, that it is undertaking a covered short sale and to ensure that the broker in turn discloses that to the market, or where there is an intermediary licensee between the client and a broker, that the disclosure be shown to the broker, being the trading participant of the ASX.

Of course, disclosure of a covered short sale has been required by the ASX Market Rules and before them the Business Rules for decades. While, if the broker knew, it has been obliged by the ASX to disclose in a report at the end of the day, the ASX has not had jurisdiction over the client, and clients simply did not tell their brokers, or at least that is the concern. Thus the main object of the Bill as we understand it is to mandate disclosure by the clients to the brokers.

This information has always been thought important, especially because in order to avoid capital gains tax payable by the lender (as the securities are truly transferred beneficially to the borrower), under section 26BC of the Tax Act, equivalent actual

securities must be transferred back to the borrower within 12 months. That creates, so it is thought, potential pressure from those who must buy the stock to redeliver it.

The ASX aggregates the covered short sale information reported to it and on a daily basis issues a release which discloses the aggregates by listed stock. Naked sales are reported to the market by brokers as they occur by marking them 'S' and the aggregate of naked short sales is separately included in the same daily report. One problem with the reporting of covered short sales is that in the course of trading during a day, the reporting system does not tell the market that there may be a lot of covered short selling going on.

It is also true that short selling in concert is not required to be disclosed, although dealing with such concerted action is not the stated purpose of the Bill. The Bill, we note, has a fairly simple object in this regard. Further quite often the 'lender' is a substantial shareholder and it loses the beneficial ownership of the shares it lends. It may then have to put in a notice of change by 1% to its substantial holding – or of ceasing to be a substantial shareholder.

Thus AICD is concerned that the information elicited via these proposals may have limited usefulness, since while aggregate short sale information is to be provided, the information will not show how much of the aggregated short sale position disclosed has subsequently been covered (ie how 'short' the market is on a net basis), nor the identity of large short sellers or persons acting in concert who have large short positions on an aggregated basis (as might occur where hedge funds are 'attacking' a stock).

Accordingly AICD proposes that where a person (or group of persons who are acting in a concerted way) has engaged in short selling they should be subject to disclosure modelled along the lines of a substantial shareholder notice regime, in the same way as any other party engaged in the purchase or sale of securities. If anyone has 5 percent of a company's stock and are long, they must disclose. The same should be true for those who hold 5 percent and are short. The appropriate level for disclosure could be considered further – it might be set lower than the 5% applying under the substantial shareholding regime, as a 5% short represents a very significant risk position.

Also, those who act in a concerted way could be required to report aggregated short positions, as occurs under the substantial shareholder regime (or, if this was not practicable, to at least disclose that they were acting in concert), so as to alert the market if a concerted 'attack' on a company was occurring. Any reporting regime would of course have to cover any form of economic short position since otherwise short sellers could avoid the requirements by going short by non-physical sale means (for instance through the use of derivatives).

Alternatively, a 'tracing notice' regime (again, like that applying to long holdings), entitling a company to uncover the 'beneficial' seller in a trade which had been reported as short, could be considered.

If the short sellers are acting in concert wilfully that is a crime of conspiracy in all likelihood, but a prosecutor or investigator really has only at its disposal the general criminal law of conspiracy (R. v de Berenger 105 ER 536), perhaps in the form of a conspiracy to manipulate – the manipulation being a breach of the manipulation provisions in section 1041A - creating an 'artificial' price (the meaning of the term 'artificial' being unclear), section 1041B – doing an act likely to create a misleading appearance with respect to the price and/or s 1041C – engaging in an artificial transaction or device that results in the price being depressed.

The manipulation provisions need reform. The provisions of sections 1041 D to F deal with conduct such as the spreading of false rumours, but there is no special provision to deal with sellers acting in concert (assuming no 'matched orders to buy and sell to create an artificial appearance of active trading). So far as civil actions are concerned we draw attention to the famous old precedent Scott v. Brown, Doering, McNab &Co., [1892] 2 QB 724 which accepted a civil liability for the conspiracy to defraud.

These issues do not appear to have been addressed in the proposed legislation.

In Summary, AICD is concerned that:

- there is great potential to circumvent the proposed disclosure arrangements in the Bill, and
- the information elicited via these proposals may have limited usefulness.

Accordingly **AICD proposes** that:

- where a person (or group of persons who are acting in a concerted way) has engaged in short selling they should be subject to disclosure modelled along the lines of a substantial shareholder notice regime, and
- those who act in a concerted way could be required to report aggregated short positions, as occurs under the substantial shareholder regime, so as to alert the market if a concerted "attack" on a company was occurring.

Thank you for providing an opportunity for AICD to comment after the deadline for submissions has closed. If you require further information on any of our views please contact me or Jennifer Stafford at jstafford@companydirectors.com.au.

Yours faithfully,

John H C Colvin
Chief Executive Officer