CHARTERED SECRETARIES AUSTRALIA

*Leaders in governance*

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Senate Economics Committee
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# Senate Committee Inquiry into Corporations Amendment (Short Selling) Bill 2008

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We represent over 8,000 governance professionals working in public and private companies. Our members have primary responsibility in listed companies to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our members have a thorough working knowledge of the operations of the markets, the needs of investors and the Listing Rules, as well as compliance with the Corporations Act (the Act). We have drawn on their experience in our submission on the Exposure Draft of the Corporations Amendment (Short Selling) Bill 2008 (the Bill) and in this submission to the Senate Committee Inquiry into the Bill.

Earlier in 2008, CSA had lodged a submission with the Australian Securities Exchange (ASX) noting that there are two risks which need to be addressed by the regulatory framework for short-selling:

1. the risk of settlement failing
2. the risk of an uninformed market and potentially market manipulation.

It was the second matter that most concerned CSA members, as at the time of the ASX consultation in March this year, concerns had been raised about the risk of settlement failing, but not about the risk of an uninformed market. CSA recommended to the ASX that:

- with respect to market disclosure, the same regulations should apply to covered short selling as to naked short selling
- naked short selling should continue to be allowed subject to existing regulations to address the risk of settlement failure
- any regulatory response in relation to short selling should not be undertaken in isolation, but should include appropriate regulatory attention to the disclosure of margin loans to executives and directors who individually or collectively are substantial shareholders, and stock lending.

In light of our comments to the ASX, CSA welcomed the release of the Bill by the government. We support the government's proposal to legislate to increase transparency surrounding the activity of covered short sellers in Australian securities. We also note the decision by the government to ban naked short selling altogether given the further information in relation to that practice since our submission to ASX in May this year.

CSA agrees with the government that appropriately regulated short selling has a role to play in creating an efficient marketplace, providing liquidity, driving down overpriced securities and generally increasing the efficiency of price formation, *provided there is full and prompt disclosure*.

CSA believes that higher levels of information to the market concerning covered short sales will assist in keeping the market informed, which in turn may reduce the opportunities for market abuse, as well as enhance investor willingness to participate in the market by removing uncertainty surrounding the level of short selling.

The recent ban on short selling has also clarified that short selling facilitates a number of important strategies such as market making, arbitrage, and the underwriting of capital raisings and CSA agrees with the government that there is no need to ban covered short selling at this time.

## CSA recommendations

CSA agrees with the government that legislative reform should place an obligation on investors to disclose covered short sale transactions to their broker, with the broker in turn being responsible to report this information to the market operator. We believe that the disclosure should be made on the following day.

CSA believes this is the right model. We know that some investors have expressed concern that they could potentially lose confidentiality in relation to their trading activities, but we believe that the aggregation of this information forestalls the risk of investors' trading patterns being identified. Given that we do not believe that confidentiality will be breached with this option, we are opposed to delayed disclosure but think that the more 'real time' the disclosure, the more certainty there is that the market will be fairly informed. We certainly do not support any proposition that information be released weekly, or even fortnightly, as has been advocated in some quarters.

CSA notes that the proposed legislative reform will involve some regulatory costs, particularly for brokers and large investors that are required to update their existing systems to facilitate reporting of covered short sale transactions. CSA therefore recommends that financial intermediaries are provided with adequate time to implement the systems and processes that will need to be made to introduce the additional disclosure requirements.

CSA notes that brokers currently have duties not to use client information in their own principal trading or to pass client information to other clients.

CSA recommends that the Bill clarify that these current obligations extend to any information received by brokers in relation to short selling.

We were particularly pleased to see that the government intends to formally review the new legislative measures once they have been in operation for two years. Sunset clauses like this should form part of all legislative reform so that an assessment can be made of whether the legislative changes have achieved their objectives and whether the benefits outweigh the costs.

In a recent column in our national journal, *Keeping good companies*, I commented that:

> We think that there is an opportunity in two years for a more holistic review of the short selling regime to also examine stock lending arrangements to ensure that markets are fully informed, transparent and free of market manipulation. With the importance of superannuation to the Australian economy and the retirement incomes of the Australian population, there needs to be certainty that stock lending arrangements do not unduly place at risk the long-term value of that investment.
>
> We think that there is also an opportunity for the government to protect shareholders from a lack of information concerning margin loans on shares held by directors. We have advocated for some time that directors should be obliged to notify the company of security and other third-party interests affecting shares in which they have a substantial relevant interest and for the company to notify the market of those interests. When good governance is about keeping the market fully informed, now is the time to address this issue too.

CSA does not believe that any consideration of the regulatory framework in relation to short selling can be undertaken without consideration of the regulatory framework in relation to the disclosure of shareholdings subject to security interest or other third-party rights, such as margin loans. CSA believes that a holistic solution is required, given the degree to which these issues are meshed.

CSA recommends that s 205G of the Corporations Act be amended to impose a statutory obligation on directors to notify the company of security and other third-party interests affecting shares in which they have a substantial relevant interest and for the company to notify the market of those interests.

CSA notes that on 19 November, the Minister for Superannuation and Corporate Law, the Hon Senator Nick Sherry referred to the Corporations and Markets Advisory Committee (CAMAC) the issue of the use and disclosure of margin lending by company directors. CSA welcomes this review, as we have been calling for reform in relation to the disclosure of margin loans held by directors for some time.

### Direct disclosure of covered short sales to the market operator

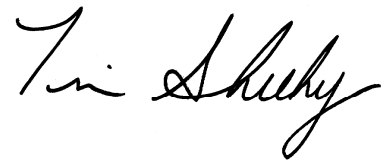
CSA notes that a number of submissions have called for the direct disclosure of covered short sales to the market operator.

Given the volume of trading on the Australian market, CSA contends that this could result in the market operator being swamped with such a significant number of notices that the market operator could not digest the disclosure sufficiently quickly to ensure an informed market. Moreover, CSA believes that this option could result in non-compliance. CSA notes that many offshore investors would be unlikely to be aware of the disclosure obligation, and that enforcement, particularly in relation to offshore investors, would prove difficult. CSA also has strong concerns that individual investor confidentiality is at risk of being breached under this option, with individual notices rather than aggregated notices more likely to potentially disclose individual trading patterns.

## Conclusion

When preparing this submission, CSA drew in particular on the expertise of its national Legislation Review Committee, comprising members working in listed companies with the responsibility to interpret the Listing Rules and ensure that continuous disclosure obligations are met.

Yours sincerely



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