



AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
PO Box 6100
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Dear Mr Hawkins,

Corporations Amendment (Short Selling) Bill 2008

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments on the *Corporations Amendment (Short Selling) Bill 2008*.

Australia's financial and capital markets are well regarded for the strength of our regulatory regime and banking and finance sector. Sound practices increase investor confidence, promote market efficiency and enhance the competitiveness of Australia's banking and finance sector and economy as a whole. Therefore, it is important for Australia's markets to ensure it preserves a regulatory and governance framework that maintains the highest levels of market integrity and investor confidence, without compromising opportunities for adoption of new technologies, innovation in trading strategies, and international competitiveness.

The ABA makes the following comments:

- Any changes to laws, regulations or market rules regarding short selling and securities lending should seek to contribute to price discovery and remove uncertainty regarding the level and extent of short selling. Regulation should not necessarily decrease short selling activities, but rather remove uncertainty regarding short selling potentially being used for market abuse.
- Regulation needs to be cognisant of approaches being adopted in overseas markets - that is, Australia should not expose itself as a 'short selling haven', nor should it impose unduly burdensome regulation that results in investment going offshore.
- Any changes should recognise that market participants, financial intermediaries and investors will need some time to implement systems and processes and adjust to any new regulations or market rules, including IT infrastructure required to support reporting. A transitional period for compliance should be introduced along with any changes. A "no enforcement" position should be adopted provided that reasonable steps to comply have been taken. This will allow system and process changes to be designed and implemented.

1. General observations

1.1 The role of short selling

Short selling is a common market practice that is vital to market efficiency as it contributes to market liquidity, price discovery for securities and derivatives and a fully informed market. Short selling may be undertaken for a number of legitimate reasons, including:

- *arbitrage* - removing price anomalies across the markets and adjusting prices to the economic value of a company;
- *risk management* – enabling investors to hedge against price volatility in shares they own;
- *market making* – facilitating trades between clients to provide continuous liquidity;
- *capital raising* – facilitating the underwriting of capital raisings; and
- *funds management* - increasing the range of investment strategies.

The ABA recognises there has been significant market, media and public attention given to short selling over recent months, especially given the global financial crisis.

1.2 Banking sector views regarding short selling activities and regulation

There are mixed views across the banking sector as to the extent and concern of short selling in the Australian market (see Attachment 1).

The ABA believes there are a number of key considerations with recent market conditions and short selling activities that should be assessed, including:

- lack of transparency about short selling and securities lending practices;
- lack of meaningful disclosure and inaccuracy of reporting by brokers to the market operator;
- lack of market monitoring by the market operator;
- potentially collusive behaviour or predatory trading by large institutional investors, including hedge funds;
- 'rumourtrage' and false information being deliberately spread across the market; and
- conflicts of interest in brokers producing research, and hedge funds being major clients of these same brokers.

The ABA has been liaising with ASIC with regards to the banking sector's views about short selling and the ban on short selling and subsequent decisions, including exemptions, coverage and timing. The above key considerations are not just to do with short selling regulation, but raise issues which are much broader about potential regulatory and market failure. Therefore, we support these broader issues being given further consideration as part of a review. The ABA notes the Government has commissioned the Corporations and Markets Advisory Committee (CAMAC) to review a range of market practices with a view to further enhancing the integrity and transparency of the Australian market.

1.3 Options for short selling regulation

The sharp downward market cycle, price volatility and high level of trading volumes, especially in some financial stocks, has focused attention on short selling practices and resulted in various regulatory actions to restrict short selling in the Australian and overseas markets.

While the ABA acknowledges ASIC's regulatory action to impose a temporary ban on both 'naked'¹ and 'covered'² short selling as prudent, given the current market conditions and concerns that Australia's markets would be at risk of unwarranted activity, it is not our view that a permanent ban on short selling should be contemplated or introduced.

The ABA supported the continuation of the ban on all short selling for a limited period. The ABA notes that the ban on non-financial stocks was lifted on 19 November 2008. The ABA continues to support the ban for financial stocks remaining in force until January 2009, but being reviewed during this period³. In considering whether the ban should continue, the ABA and member banks have assessed the business, investor and market impacts of the ban. The ABA also notes that the Financial Services Authority (FSA) in the United Kingdom announced new provisions to prohibit short selling in publicly quoted financial companies⁴.

The ABA believes that if the Government were to ban short selling completely and permanently, this may have the effect of distorting prices and may hinder the ability of the market to discover correct prices. However, we also believe that the global market conditions remain difficult and there needs to be significant improvement in the disclosure regime around short selling. Furthermore, there also needs to be more effective supervision of compliance with disclosure of short sales by the ASX and ASIC.

1.3.1 Disclosure of covered short sales to brokers

This approach would place an obligation on investors to disclose covered short sale transactions to their broker, and the broker subsequently being responsible for reporting all short sales data (for its entire client base) to the market operator/ASX. While this approach is supported by the ASX and ASIC and is the preferred approach of the Government, some issues with this option includes whether reporting would be on a gross or net basis, whether there would be difficulties in brokers identifying data, and how the obligation to advise the broker of whether a sale is long or short would be applied to offshore investors. The ABA notes that there are some concerns with brokers being unaware of their client's intra-day closure of short positions and true calculation of end-of-trading day net short sale positions. Therefore, it may be necessary to create a centralised point for data collection administered by the market operator/ASX.

¹ "Naked" short selling is a sale where the seller does not own or has not borrowed or arranged to borrow securities at the time of a sale, but intends to purchase or borrow securities in order to meet their settlement obligations.

² "Covered" short selling is a sale where the seller has arranged to borrow securities in order to meet their settlement obligations. A security lending arrangement occurs where the seller enters into an arrangement with the lender to borrow the securities and at a future date the seller will replace the equivalent securities.

³ The ABA is pleased to note that ASIC has announced that the current ban will be extended until 27 January 2009 for financial stocks. [MR 08-210 ASIC extends ban on covered short selling].

⁴ On 18 September 2008, the FSA announced a new provision to the Code of Market Conduct prohibiting the active creation or increase of net short positions in publicly quoted financial companies. In addition, the FSA requires daily disclosure of all net short positions in excess of 0.25% of the ordinary share capital of the relevant companies held at market close on the previous working day. The FSA indicated that it will extend this approach to other sectors if necessary. These provisions will remain in force until 16 January 2009, although they will be reviewed after 30 days. A comprehensive review of the rules on short selling will be published in January.

1.3.2 Disclosure of covered short sales directly to the market operator

This approach would place an obligation on investors to disclose covered short sale transactions directly to the market operator/ASX. Some issues with this option include whether reporting is intended to be intra-day on a transaction basis or end-of-trading day basis representing aggregate short sale positions and the timing of subsequent disclosure by the market operator to the market. The ABA notes that there are some concerns with confidentiality of data, i.e. strategic and proprietary trading positions by institutional investors.

1.3.3 Disclosure of stock lending transactions

This approach would require the disclosure of all stock lending transactions as a proxy for short selling data. While there may be some advantages with this option, such as reliability and consistency of data, an issue with this option is that securities lending can happen for a variety of reasons and therefore may not identify short selling activities, other than an unusual increase in short selling activity. In addition, significant securities lending is undertaken offshore to Australia which is unlikely to be captured under the proposed disclosure regime and therefore may result in significant understating to the market of the volume of securities lending being carried out in Australian securities. The ABA notes that the RBA has released a consultation paper on disclosure of equities securities lending as part of its review of the financial stability standard for securities settlement facilities.

2. Specific comments

The Bill seeks to permanently ban naked short sales and enhance the disclosure of covered short sales for operation at such a time that ASIC determines that covered short selling can again be permitted in the Australian market. The disclosure regime will apply to sales made on a licensed market and sales that occur through on or off-market crossings. The Bill also expands ASIC's powers in relation to short selling and transactions with a substantially similar market effect as a short sale of financial products. The regulations will contain specific rules about the timing of disclosure and the manner in which the disclosure is to be made.

2.1 Naked short selling

While the ABA supports the short-term ban on naked short selling during the current turbulence in global financial markets, at this stage, we do not support permanently and completely banning naked short selling.

It is the ABA's view that in the short-term, temporarily banning naked short selling would have the effect of reducing market concerns, increasing financial stability and facilitating capital raising. Furthermore, in the short-term, naked short selling may impact share prices generating price volatility in circumstances where short sellers are incorrect about future demand for the relevant shares and generating prices that do not reflect current willingness of existing owners to sell the relevant shares.

However, even though there is limited naked short selling in the Australian market, in the medium to long-term, permanently and completely banning naked short selling may hinder the ability of the market to discover correct prices and for market makers to contribute to market liquidity.

The ABA notes that the Securities Exchange Commission (SEC) in the United States announced an interim final temporary rule to address abusive naked short selling in all equity securities⁵. In addition, the ABA understands that the International Organization of Securities Commissions (IOSCO), amongst others, is currently assessing short selling practices. We believe that a permanent and complete ban on naked short selling should not be introduced until international regulators indicate a view on the direction of global regulatory standards and approaches.

While the ABA is sympathetic to concerns regarding settlement risk that can accompany naked short selling, in the absence of a global regulatory standard or approach, we believe that it is premature to permanently and completely ban naked short selling in the Australian market.

Moreover, we believe that before a permanent and complete ban is introduced a number of issues should be given further consideration, including:

- permitting naked short selling in certain stocks approved for short sale by the ASX.
- clarifying a disclosure regime, based on existing legislative rules and exemptions, around naked short selling.
- introducing penalties for failure to deliver stock.
- introducing an authorisation process for market participants permitted to partake in naked short selling.

2.2 Covered short selling

The ABA supports clarifying the disclosure requirements for covered short selling and introducing an enhanced reporting obligation for short sales data. Legislation should clarify that covered short sales must be disclosed and by whom. Short sellers should be required to disclose when they have made a sale of securities subject to a lending arrangement. However, we do not support the permanent implementation of the disclosure regime as contained in the Bill.

It is the ABA's view there is some ambiguity surrounding short selling practices and securities lending arrangements that is impacting on the disclosure of short sales and therefore the quality of short sales data collected and disseminated by the ASX to the market. We believe an improved disclosure regime around covered short selling would facilitate monitoring of short selling activities and investigation of sudden and sharp declines in the value of a company's shares, correlated with high levels of trading volumes. Therefore, an improved disclosure regime may assist in identifying whether market manipulation and fraud is evident.

However, it is also the ABA's view that the reporting of gross short sales data via brokers may involve the disclosure of commercially sensitive information (i.e. information leakage), which potentially could result in disincentives for active investment, market distortions (i.e. front running and free rider behaviours) and artificial price volatility.

⁵ On 14 October 2008, the SEC announced a ruling requiring participants of a clearing agency to deliver securities by settlement date, or if participants have not delivered shares by settlement date, immediately purchase or borrow securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the day the participant incurred the fail to deliver position.

Subsections 1020AB(1) and 1020AC(1) of the Bill propose a disclosure regime that requires an investor (i.e. seller – whether the seller is inside or outside Australia) of securities under a securities lending arrangement to provide information as specified in the regulations to their financial services licensee (i.e. broker), which is subsequently to be disseminated to the market by the market operator or another entity specified in the regulations⁶. Subsection 1020AD(2) proposes that public disclosure of short sales data is required “on or before the time” specified in the regulations. Subsection 1020AE proposes that a seller must give information to their financial services licensee in relation to a “sale”.

This disclosure regime would result in gross data being reported by sellers to their broker and gross data being disseminated to the market on a daily basis by the ASX. The obligation on investors is to report data to their broker on a transaction basis. We believe this approach requires further consideration – that is, it is unlikely to result in the reporting of useful or usable information and is likely to result in the disclosure of commercially sensitive information. Importantly, transaction data is not as relevant as position data.

Therefore, the ABA supports:

- Development of a disclosure regime around covered short selling to enhance transparency and fairness taking into account operational factors and information integrity. ABA member banks have raised a number of practical and technical issues that should be given further consideration, including:
 - introducing a reporting obligation of gross short sales by investors to their broker, coupled with a reporting obligation of aggregate short sale positions in individual stocks by the market operator/ASX to the market (noting that the market operator/ASX would be responsible for capturing tagged data reported by brokers, consolidating/aggregating gross short sale data against positions and disseminating aggregate data on short sale positions in individual stocks)⁷;
 - introducing a reporting obligation of net short sale positions by investors directly to the market operator (noting that this will address concerns with commercially sensitive information)⁸;

⁶ The ABA notes that this approach reflects the new reporting mechanism announced by ASIC and the ASX. We are concerned that the manner in which disclosure is to be made and the timing of disclosure has been decided in advance of consultation on the regulations.

⁷ The ABA notes the advantage of this approach is that gross short sales data is aggregated and short sale position data is disclosed to the market. This approach will assist in addressing concerns with avoidance, e.g. where an investor shorts with one broker, buys from another broker, uses several legal entities and borrows from multiple lenders. We understand the IT infrastructure to undertake the necessary levels of disclosure between the selling broker and the market operator is generally already in place. However, short sellers, brokers and system suppliers would need to make modifications to current systems and processes to meet the disclosure and reporting requirements. The ASX would also need to make modifications to current systems and processes to consolidate and aggregate data. It will be important to ensure that technology is used effectively to address concerns with commercially sensitive information, such as blocking identification of short sales data (i.e. hide sell-type field). The ABA notes that AFMA has identified a number of operational factors and practical concerns with the new reporting mechanism that requires disclosure of gross short sales data.

⁸ The ABA notes the advantage of this approach is that it imposes an obligation on investors to disclose aggregate short sales positions on a stock by stock basis to the ASX and the ASX to capture and report short sale positions data on a periodic basis. While this approach will address concerns with commercially sensitive information, it may be difficult to monitor compliance by investors. It will be important to ensure that changes to existing systems and processes do not impose unnecessary compliance costs on market participants. However, the ABA notes that IFSA has indicated the willingness of fund managers/institutional investors to report short sales data in this manner.

- introducing a “substantial or significant” threshold for reporting short sale data on an end-of-trading day basis (noting that this would be useful from an efficiency perspective given there are current arrangements in place to capture and report substantial shareholder information)⁹;
 - incorporating a ‘de minimis’ reporting exception (noting that this would reduce data capture costs)¹⁰;
 - incorporating essential exemptions, such as arbitrage transactions, market maker and securities lending exemptions¹¹ (noting that this would clarify the short selling rules and minimise unintended consequences of the proposed legislation)¹²; and
 - incorporating protections for financial services licensees (i.e. brokers and custodians) against misreporting where a client (i.e. seller) submits false information about having in place an arrangement to cover their short sale.
- Implementation of a single reporting mechanism or collection point for short sale data. Any new rules must be streamlined to avoid unnecessary multiple data collection points and reporting systems, as such an approach would be inefficient, costly and potentially counter productive. For example, the law should not require real time tagging of orders and simultaneously require reporting of stock lending transactions. This approach will unnecessarily increase the regulatory burden on business.
 - Collection of data on an end-of-trading day basis should enable the market operator/ASX to be able to publish aggregate data on short sale positions in individual stocks prior to the next trading day¹³. Market operator/ASX should develop a system or enhance CHES to collect and report short sales data. Any new rules should enhance surveillance of the market and promote market integrity without imposing unduly burdensome obligations on market participants or implementing rules that have unintended consequences for a fully informed market.

⁹ The ABA notes that such an approach would be consistent with the current substantial shareholding provisions of the Corporations Act (Chapter 6C Corporations Act, sections 671B, 608(1), 609(6)). This would require the investor to report all “substantial or significant” short positions on an end-of-trading day basis in a similar way that the current substantial shareholder provisions require the investor to report long positions. The ABA recognises that further analysis needs to be performed to determine the appropriate threshold for reporting, but an appropriate threshold could be positions exceeding 5% of the underlying stock.

¹⁰ The ABA notes that further consideration should be given to implementing obligations that do not impose unnecessary regulatory burden on business, e.g. a ‘de minimis’ reporting exception. This approach reflects that adopted in overseas markets, e.g. United States.

¹¹ On 22 September 2008, ASIC released Class Order 08/752. The ABA notes that this instrument put in place a number of exemptions regarding arbitrage transactions and market maker transactions. If certain exemptions are unavailable in the law, this will seriously impact the efficient operation of the market. Exemptions will ensure that the legislation clarifies the short selling rules and minimises unintended consequences. In addition, on 24 September 2008, ASIC announced a “no action” position [*AD08 - 23 - No action position for owners selling from stock lending portfolios*]. The ABA notes that if a client’s securities that are made available in a securities lending arrangement are deemed to vest in the operator of the lending program rather than the remaining in the beneficial ownership of the client, this may lead to the result that any sale of the securities by the client or its agent constitutes a short sale in respect of those securities. An exemption will ensure custody clients that make securities available as part of a securities lending arrangement are not disadvantaged in their day-to-day trading activities.

¹² The ABA notes that the repeal of subsection 1020B(4) will remove critical market exemptions. We are concerned that essential exemptions are not being contained in the law, which will result in a myriad of relief instruments increasing the complexity associated with the rules. Given the Bill is seeking to clarify the short selling rules, it should contain explicit exemptions to ensure the efficient operation of the market.

¹³ The ABA notes that further consideration should be given to the implications of late trading (i.e. past 7pm) and sending late data to the ASX. In addition, further consideration should be given to the merit of periodic disclosure to the market (i.e. bi-monthly/fortnightly) as a way to address concerns with commercially sensitive information. This approach reflects that adopted in overseas markets, e.g. United States.

- Production of guidance to ensure consistency of reporting. ASIC and the ASX should ensure that guidance reflects the law and market rules regarding short selling. Guidance should be developed regarding the practical operation and interpretation of the provisions, for example, application of the provisions to the OTC markets, circumstances in which a "crossing" will arise, financial products covered by the provisions, circumstances when title is vested with the delivery of the financial products, etc. This will go to ensuring that market participants and investors are aware of their obligations.
- Removal of the 'up-tick' rule. This rule may have the effect of distorting prices and limiting sell orders. With the implementation of an improved disclosure regime around short selling, it seems that this rule is unnecessary.

It is the ABA's view that investors should assess the fundamentals of companies when making investment decisions. With this in mind, if short selling data is relevant to the assessment of the value of a company's shares, the level of short sale positions (not transactions) could provide useful and usable information (i.e. data on the amount of stock short and the trend in short selling activities).

Therefore, we recommend that the Bill be amended so that the disclosure and reporting requirements do not impose an obligation on a seller to give information "in relation to a sale". Furthermore, in the absence of technology that may protect (or hide) certain information while being reported, we recommend that the Bill be amended so that the reporting obligation is on a "periodic basis".

The regulations should contain specific rules about the manner in which disclosure is to be made and the timing of disclosure, following further consultation with industry representatives and market participants about concerns with conflicts of interest and commercially sensitive information. We are concerned that ASIC and the ASX have already determined the nature of these rules, before there has even been consultation on the regulations¹⁴.

2.3 ASIC's powers

Given recent experience with short selling regulation, we are concerned with this extension of discretionary powers as contained in the Bill¹⁵.

Subsection 1020F(8) of the Bill proposes a number of broad powers allowing ASIC to make omissions, modifications or variations to rules to suspend, prohibit or limit any form of short selling of financial products or any transaction that has the "same or similar market effect as a short sale of financial products"¹⁶.

¹⁴ On 12 November 2008, ASIC announced requirements for disclosure and reporting of short sales from 19 November 2008, following the lifting of the ban on short selling of non-financial stocks. Brokers are required to establish whether a client's sale is a long sale, short sale or an exempt covered short sale and clients are obliged to inform their broker whether their requested sale is a long sale, short sale or an exempt covered short sale. On 12 November 2008, the ASX released a Market Circular indicating that ASX Trading Participants are to report all daily gross short sales to ASX. The ASX is to then publish aggregate gross short sales to ASX Participants and the general public via a "Daily Gross Short Sale Report". On 13 November 2008, ASIC released an ASIC Advisory containing further key details of the reporting and disclosure obligations, including the manner in which disclosure is to be made and the timing of disclosure, such as Trading Participants are to submit a daily report by 9.00am of short sales executed up to 7.00pm the previous trading day.

¹⁵ The ABA is especially concerned due to the manner in which the recent short selling ban was implemented. ASIC did not consult adequately with market participants and industry representatives prior to introducing its temporary ban on 19 September 2008, or the sudden change of position as announced on 21 September 2008. The consequence of these announcements was numerous technical and practical problems, hurried amendments, and unnecessary disruption to the market. More effective consultation and adherence to due process prior to the announcement of initial actions would have alleviated the adverse impact on the market.

¹⁶ The ABA is concerned that "same or similar market effect as a short sale of financial products" may inappropriately extend ASIC's powers. It is unclear what type of transaction this may capture.

Short selling regulation and the rules directing any future prohibition of covered short selling should be explicitly contained in regulations. Short selling rules should be developed adhering to due process and consistent with the principles of "better regulation". Importantly, short selling regulation should only be varied in consultation with stakeholders so that technical and practical issues can be duly considered, including the implications for reporting systems and processes.

2.4 Regulation and market surveillance

The Bill does not attempt to address concerns regarding potentially collusive behaviour or predatory trading or 'rumourtrage' and false information being deliberately spread across the market. We recognise that these are challenging regulatory issues that require further consideration.

The ABA acknowledges that short selling may be a tool used to manipulate the market. Short selling itself is not manipulative. Short selling has been going on for some time and, in itself, does not necessarily raise issues. Similarly, securities lending in itself, does not raise issues, but it can be combined with other market manipulation practices.

The ABA is concerned about messages to the market made by various public commentators as having broader market implications, including potentially contributing to speculation and rumour and ultimately to a false market.

Therefore, the ABA believes that ASIC should undertake enforcement, regulation and consumer protection actions, including:

- Continue to investigate some recent trading activities to assess whether short selling has been used to manipulate the market. The investigation should be undertaken consultatively with the ASX. The findings of these investigations should be made publicly available. The findings should also inform whether any further review should be conducted of the existing offences and powers regarding market abuse. This will go to restoring confidence in the fair and orderly functioning of Australia's markets.
- Make every effort through its Memorandums of Understanding (MOUs) with offshore regulators to ensure that it is informed as soon as practicable of changes to regulations offshore, in particular the United States and the United Kingdom. This will ensure that ASIC has an opportunity for prompt consultation with industry before implementing any regulatory change in this jurisdiction.
- Prepare and release consumer information about short selling. Currently there is considerable media and public speculation and rumour about short selling, which is contributing to a misperception about the level, extent and role of short selling in the market. The ABA observes that it is common that in a downturn market cycle for short selling to become a focus of commentary. This will go to promoting a greater awareness of the facts and assist in addressing not just the lack of investor and public knowledge about short selling, but also in alleviating the potential for 'rumourtrage' and false information to generate a false market. The ABA notes that ASIC's FIDO website contains some information. This basic information could be built on and more broadly disseminated, including via different channels and communication methods.

3. Summary of ABA's position

It is the ABA's view that short selling should not be completely and permanently banned in Australia's markets. Short selling has a legitimate role within the market. In difficult market conditions, the liquidity it provides can be even more important. However, in difficult market conditions, short selling may undermine market confidence and may inhibit recapitalisations.

It is also the ABA's view that transparency of short selling practices and disclosure of short selling activities will enhance market efficiency and enable more effective supervision of market activities – that is, comprehensive, consistent and reliable data can promote market scrutiny and a fully informed market as well as reduce the risk of short selling being used to manipulate the market.

Information must be useful and usable by market participants and investors. Therefore, careful consideration should be given to how the disclosure regime around short selling can be improved, i.e. what are the objectives of enhanced disclosure, what information is useful and usable, and how information can contribute to price discovery and an efficient market.

With this in mind, the ABA believes a legislative and regulatory response to short selling needs to adopt an interim and long-term approach.

3.1 Interim approach

- (1) A number of changes to current short selling regulation are required to improve disclosure of covered short selling activities, including:
 - Clarification of the coverage of the law with regards to short selling, including unambiguous and commonly accepted understanding of what constitutes a covered short sale, transfer of title, etc;
 - Development of an improved disclosure regime around covered short selling, resulting in the disclosure of aggregate short sale positions to the market (see comments in section 2.2); and
 - Clarification of rules that apply to covered short selling, including exemptions.
- (2) ASIC and the ASX should conduct surveillance activities to monitor short selling activities to ensure compliance with the short selling rules.
- (3) ASIC should continue to use its existing regulatory powers to pursue incidents of market manipulation and fraud¹⁷.
- (4) ASIC should promote consumer awareness of short selling practices through an investor education campaign. Information should be targeted towards improving understanding about the level and extent of short selling and the role of short selling within and across markets, in both downward and upward market cycles.

¹⁷ It is the ABA's view that enforcement activities and existing offence powers should be targeted towards broker and other market participant practices that are illegal. Enforcement and surveillance activities should be targeted towards behaviours that are 'mischief' and concerns with practices that are 'questionable'.

- (5) The Government should not permanently or completely ban naked short selling in the absence of a global regulatory standard or approach. Alternatively, the existing ban announced by ASIC should continue.

3.2 Long-term approach

- (1) ASIC should review its existing ban on naked short selling taking account of developments in overseas markets and global regulatory standards and approaches. In this context, if it is decided to permanently and completely ban naked short selling, this should be reflected in legislation. If it decided to permit naked short selling, subject to certain prohibitions and conditions, the rules should be clarified in legislation.
- (2) The Government, in consultation with ASIC, should review the objectives of short selling regulation to ensure that regulation is appropriate and up-to-date reflecting current market conditions and trading behaviour, market capabilities and practices, and aligned and consistent with international regulatory standards and arrangements. Regulation should enhance investor protections and maintain orderly markets. A review should take account of historical data regarding the nature, effect and impact of short selling practices in Australia and be conducted after two years of the improved transparency and disclosure measures being in place.
- (3) The Government, in consultation with ASIC, should review the offences relating to market manipulation to ensure that the existing regulatory powers are adequate to investigate, gather evidence and prosecute such offences. A review should be conducted as part of the current review of sanctions.

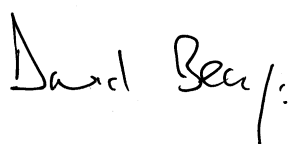
4. Concluding remarks

The ABA believes that improving transparency of short selling practices and disclosure of short selling activities will enhance confidence in the fair and orderly functioning of Australia's markets. In addition, improved transparency of short selling practices, disclosure of short selling activities and clarification of market rules will enhance market efficiency, ensure the market is fully informed, and ensure more effective supervision of market practices and activities. It will also go some way to help address concerns with regulatory risks, i.e. market manipulation and fraud.

Short selling regulation should seek to promote the disclosure of useful and usable information on short selling, ensuring that investors are aware of short selling activities in shares they own and companies are aware of the nature of trading activities that may affect their share price.

If you have any queries regarding the issues raised in this submission, please contact me or Diane Tate, Director, Corporate & Consumer Policy on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely



David Bell

Attachment 1: Overview of ABA and member banks reactions to recent short selling activities in Australia's market

There are mixed views across the banking sector as to the extent and concern of short selling in the Australian market.

Some member banks are not so concerned with the high level of trading volumes and short selling activity on Australia's market. High levels of trading volumes do not in itself indicate short selling activity. At times of market volatility it is understandable that trading volumes also increase as some traders tend to become even more active with the shares they own. Therefore, these banks are concerned about the uncertainty that temporary restrictions can create for the market, especially the potentially adverse and material impact on trading strategies as well as market liquidity.

Whereas, some other member banks are quite concerned, especially from the perspective of their own stocks potentially being targeted by predatory trading or aggressive trading strategies. Unwarranted price volatility and revaluation of assets can have an adverse and material impact on their business operations, including the ability to raise capital, manage liquidity and conduct investment activities.

Some member banks believe that some hedge funds have been targeting, in particular, bank stocks and aggressively share lending and short selling. The market can be open to abuse where collusive behaviour or predatory trading is able to be conducted because there is ambiguity as to what disclosure is required and when disclosure is required to be made to the broker and the market. For example, some short selling may be taking place and not being adequately reported because the securities lending arrangement is not in place before the trade is executed, the securities lending arrangement may not give rise to an economic interest or holding at settlement or the market rules on reporting of short sales are not being adhered to or simply broken.

Some member banks recognise that share lending/stock borrowing and short selling happens very quickly, i.e. within 48 hours. The market and/or particular stocks can be materially adversely affected before supervisors are able to take action or the market is able to correct the anomaly. For example, due to the lack of disclosure and the speed of trading, it is difficult to understand the market and the information available to the market. Informal messages may be disseminated across the market which facilitates predatory trading and collusive behaviour ("rumourage"). The sources of such messages and communications are difficult to trace to prove that this information directly and deliberately lead to a false market.

Some member banks believe that short selling has accentuated the sharp downward market cycle and contributed to unnecessary short-term price volatility, with prices based on economic fundamentals being overshot. For example, due to lack of disclosure and the speed of trading, it is difficult for investors to evaluate opportunities, contemplate market adjustments or make a judgement about the value of a company's shares. A false market may emerge further destabilising stocks and exacerbating disruption to the market. Whereas, some other member banks wonder whether the lack of short selling in the market has contributed in the short-term to price volatility.

Some member banks recognise that the reason the current ban was introduced was in part due to the extremes in the way the market was operating. Simply lifting the current ban in the absence of enhanced disclosure would run the risk of these extremes returning to the market.