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Mr Stephen Powell
Market Integrity Unit
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Department of the Treasury
Langton Crescent
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By email: spowell@treasury.gov.au

Dear Mr Powell

SUBMISSION ON SHORT SELLING DISCLOSURE REGIME CONSULTATION PAPER

Introduction

The Securities & Derivatives Industry Association (SDIA) is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. It has 66 members accounting for 98% of market turnover by value. SDIA is pleased to provide this submission to Treasury on the Short Selling Disclosure Regime Consultation Paper of March 2009 ("the Consultation Paper").

SDIA's members have a strong commitment to maintaining the integrity and high standing of Australia's securities market. SDIA welcomes the thorough and fundamental review of the issues relating to Sort Selling Disclosure manifest in the specific questions set out for comment in the Consultation Paper.

In our view, the Australian market has suffered as a result of the uncertainty surrounding the regulatory requirements applying to short selling since September 2008. There has been a significant loss of liquidity as institutional investors have vacated this market whilst this uncertainty exists. It is critical that the regulatory landscape be settled as soon as possible in order to encourage the return of active investors.

It is also critical that as far as possible any disclosure obligations in Australia be commensurate with global approaches in other jurisdictions. Our market will suffer if the regulatory regime is regarded as "an outlier" or as having an overly complex regulatory framework, as investors may decide to concentrate on markets that are seen as more efficient.

Set out below are comments addressing the specific questions in the Consultation Paper.

A. Do you support the disclosure of positional information in relation to short sales? If you support disclosure of positional information, do you believe the disclosure should be in addition to or in place of transactional information? Please explain why.

In SDIA's view, the present regulatory landscape regarding short selling disclosure (and the accompanying area of stock lending disclosure) is heading towards a situation where there are multiple concurrent reporting requirements, each of which contains an inherent shortcoming as to the accuracy or value of the data, but each of which is adding an extra layer of cost to market participants in terms of implementation cost and also the cost of ongoing reporting. This is an inefficient and undesirable outcome. The Consultation Paper provides a good opportunity to step back and rationalize the layers of reporting as far as possible.

For reasons later set out more fully in response to O. below, SDIA believes there is no value in the existing transactional disclosure regime, and that this could be discontinued without any detriment to the market (aside from the cost and expense already incurred to date).

Having regard to the features of the Stock Lending Disclosure regime that has finally been settled on by the Reserve Bank, SDIA does not consider that the information as to the overall stock-on-loan positions for individual listed stocks that is likely to result from the RBA regime will be of assistance in informing the market about the likely outstanding short position in that stock. SDIA has previously supported the use of accurate stock lending data as a sufficient proxy for the outstanding short position in a stock.

However, the limited reach of the obligations imposed by the RBA via Settlement Rules applicable only to local ASX Settlement Participants means that there are likely to be gaps in the information that will result from this regime. Hence, whilst SDIA would ideally prefer that there were not parallel reporting regimes for stock lending and short selling, the opportunity to utilize the RBA regime to assist with short selling is presently limited.

The need has been identified for a clearer picture of the outstanding net short position in listed stocks to assist the market in interpreting the weight of selling, particularly in volatile periods such as the present. In view of this, and the limitations on the value of transactional and stock lending data, the inevitable conclusion is that some form of short position reporting is needed.

However, it is imperative that any short position reporting regime be efficient in terms of the time and resource costs necessary for implementation and ongoing compliance. Set out below in response to the relevant Questions in the Consultation Paper are SDIA's submissions in relation to the features of any position reporting regime.

There is also the question of whether the data produced by short position reporting will similarly be subject to inaccuracies if there is significant non-compliance by offshore investors who are outside the effective jurisdictional reach of the Australian regulatory system. If this is the case, then the cost-benefit of position reporting would also be questionable. It is essential that the regime be sufficiently robust to ensure that the information is accurate so that the cost of reporting is considered worthwhile.

B. Does the disclosure regime for stock lending established by the RBA reduce or remove the need for reporting of short positions? Please explain why.

We refer to our response to A. above.

C. Do you agree that investors should hold ultimate responsibility for the reporting of short positions? If not, please explain why and where you think this responsibility should lie.

The obligation to report long substantial shareholding positions falls on investors, and it follows logically that the obligation to report short positions should likewise also fall on investors. There is no reason in our view why the two obligations should be dealt with in different ways.

Placing the obligation to report solely on the shoulders of brokers is not a rational outcome. Brokers are only able to report what they are told by their clients, and therefore a potential gap in the reporting regime would be created if brokers were not advised by clients that their selling was in fact short.

The actual reporting could be carried out by the investor directly or via their broker, custodian or agent, as agreed between them.

D. Do custodians/prime brokers have sufficient access to information about their clients' short positions to enable them to accurately report this information? If so, what proportion

of investors are likely to use custodians/prime brokers to report positional information? Do you think there are potential issues with reporting of short positions through custodians/prime brokers? If so, what are they?

We refer to the answer to C. above. As stated, a custodian or prime broker could only report what they are aware of, either through positions under their custody or control, or as advised by the underlying client. However, the client could utilize the services of one or more other custodians and/or prime brokers, and therefore the custodian or prime broker may only know the full picture if told by the client.

If reporting is done via brokers or custodians, the investor would need to ensure that their positions were not doubly reported by multiple brokers acting for them.

E. Do you have any views on ways to make enforcing the disclosure requirements (particularly against foreign investors) more effective?

Enforcement of disclosure obligations against offshore persons could be based on some form of attachment to property in the jurisdiction or some form of prohibition on the investor's ability to continue to trade. Whilst a short position cannot by definition be the subject of forfeiture, as the stock has been sold, Parliament could consider forfeiture of profits of a short selling transaction, compulsory close-out of the position, or some such remedy that could be applied within the jurisdiction. There may be scope for international regulatory co-operation to be invoked in the investor's place of domicile via international memoranda of understanding between regulators.

F. Who should collect and disseminate the information: market operators or ASIC? Please explain why.

We believe that Market Operators would be generally better-placed to deal with the task of receiving, aggregating and publishing information of this nature. However, in the event that additional market licences are granted, then this may mean that ASIC may be regarded as the logical single entity, as this would address the issue of how the aggregation of data by multiple market operators would be achieved in an efficient manner.

We support keeping the reporting obligation on investors as simple and efficient as possible. The obligation should be limited to investors reporting their overall short position once only, and should not require reporting separate data to each market about the short position established or unwound purely on that market.

G. Do you support the introduction of a threshold to exclude the reporting of small short positions? If so, what level do you consider to be the appropriate threshold for reporting of short positions? Please explain why.

Reporting of all short positions would create an unnecessary administrative burden and would prove extremely costly in resource terms. A reporting threshold is essential in order to keep the burden and cost of reporting to an efficient and manageable level. In SDIA's view, the aggregate short position in a listed company does not become a material issue to the market for the company's securities until it reaches about 5% of issued capital, and therefore there ought be no detriment to the market if a reporting threshold were to be introduced.

The reporting threshold should not be set so low as to cause an unacceptable reporting burden. We note that the UK has recently announced that its threshold of 0.25% is to be increased to 0.5% to address this, having regard to their experience with the earlier level.

We would submit that, rather than starting at a minimal reporting level and continually ratcheting it up, to the inconvenience of the market, the preferable approach would be to set the reporting threshold at an individual level at 2%, with the relevant authority (whether ASIC or the market operator) to aggregate figures and report to the market when the combined figure reaches 5%. This should maintain reported data in the material range, and not cloud the market with unnecessary data which could have the potential to confuse sections of the market.

H. What percentage of your total short positions would be excluded from reporting if the threshold was set at 0.25, 0.5, 0.75 and 1 per cent? Please explain why.

We are not in a position to capture this data from all of our members across all listed stocks. In any event, we refer to our submission as to the appropriate reporting threshold of 2% in the answer to G. above.

I. How frequently should positional information be provided to ASIC or the market operator:
*** on a daily basis (with an exclusion from reporting if your positions have not changed)?**
*** on a weekly basis?**
*** on a fortnightly basis?**
Please explain why.

In order to keep the reporting obligation manageable, any obligation to report changes in short positions should also be subject to a threshold, otherwise investors could potentially be required to continually report changes amounting to only a small number of shares. We submit that obligation ought to be to further report once the position has changed by +/- 1% of the issuer's issued capital.

We would support the information being required to be reported within 2 business days of the Trade date, in order to give investors adequate time in order carry out

their calculations of their positions. This would be commensurate with the time allowed for invetors to calculate their long substantial shareholding positions.

Weekly and fortnightly reporting would not in our view be sufficiently timely to satisfy the market's expressed need for information about the true level of short positions in listed securities.

J. Do you support banded disclosure requirements so that changes to positions within a prescribed band are not required to be reported? If so, what do you consider the range of the band should be? Please explain why.

See our preferred position in the answer to I. above.

K. Once the information is reported to ASIC or the market operator, should there be a delay before the information is then released to the public? Please explain why and how long you consider any delay should be.

We note that investors have previously made strong arguments that short position reporting should be subject to an appropriate delay in order to protect short trading strategies which may have been developed after investing significant research costs. Accordingly, we would support such an appropriate delay.

We note that no clear consensus appears to have emerged as to the length of the delay, but we would argue that it would be highly desirable for a globally consistent standard to be applied in order to keep markets in the region and globally on a similar level.

We note that, if SDIA's submissions under I. above were accepted, there would be an in-built delay of Trade date + 2 days, as this would be the earliest that the market operator/ASIC would receive information about the position.

L. Do you support the disclosure of the information on an aggregated or disaggregated basis? Please explain why.

In our view, the only information that is relevant to the market is the overall net short position in a security. Therefore, it is the aggregate position above the materiality threshold that should be disclosed.

M. If you support aggregated disclosure, are you concerned that aggregated disclosure could be misleading if a reporting threshold is also adopted? Please explain your reasons.

Please see our answer to G. above. Whilst there is potential that the aggregate of positions not reported because they are below the reporting threshold could add up to a more sizeable figure, we believe that the potential for the market to

misled will in reality be remote. As mentioned, the aggregate short position in a listed company is not, in our view, material until it reaches about 5% of issued capital of the company. Also, from our members' observation, the number of entities following short strategies in a particular stock at any point in time will not be great. In our submission, the small risk of the market being misled in this instance is counterbalanced by the benefit that the thresholds offer in making a reporting regime cost-efficient and workable.

N. Should the identity of holders of short positions be publicly disclosed? Please explain why. If you support the identity of the short sellers being publicly disclosed, do you believe this should apply to all short positions or only 'substantial' short positions? Please explain why and what you consider to be a substantial short position.

In our view, it would be prejudicial to individual investors to disclose their identity to the market. As mentioned earlier, the only information that is relevant to the market is the overall net short position in a security, across all parties. The market can then make an assessment of the market for the security on the basis of that data. Individual investors could suffer by reason of their trading strategies being revealed, and there is no justification or benefit to the market that in our view would warrant identities being revealed.

Whilst the identity of holders of substantial long positions is publicly disclosed, there are issues of control over voting and disposal of shares in relation to substantial shareholdings that are absent in relation to short positions, and hence, the rationale for disclosure of identities is not present.

O. Do you support the disclosure of transactional information in relation to short sales? If you support disclosure of transactional information, do you believe the disclosure should be in addition to or in place of positional information? Please explain why.

Our members have reported that they are not aware of any instance when the daily gross short sale reporting introduced following September 2008 has been referred to in any analysis of either the market generally or for any particular stocks. The overwhelming view is that the information being reported is worthless to the market, given that it does not include information about the short sales and positions that have been closed out. In fact, the publication of the information is potentially quite dangerous, given that an unsophisticated investor could mis-read what the information in fact represents, and could make an erroneous decision based on that information.

We understand that ASIC has stated that it derives benefit from the daily gross short sale information. We would question whether this justifies the costs of the gross short sale reporting regime being continued and the potential danger of that information, and question whether ASIC could obtain this or similar information for its purposes in other ways using the powers that it has.

We therefore submit that the daily gross short sale reporting obligation be dispensed with, regardless of whether a separate short position reporting obligation is introduced.

P. Do you have any suggestions to improve the operation of the transactional reporting regime currently in place (excluding the public disclosure of reports discussed below)?

See response under O above.

Q. If positional reporting is made mandatory, would you support the continued public disclosure of transactional information? Please explain why.

See response under O above.

R. What do you consider to be the appropriate lag period before the information is made available to the public (for example, 1 day, 5 days)? Please explain why.

We assume that this Question relates to transactional information. Leaving aside our response regarding the value of this data, we are not aware of any issue in making the data available on the following business day as is currently the case.

S. Are you aware of any instances where the daily publication of transactional information has resulted in front-running or any other damaging consequences to the short seller? If so, please provide details.

See response under O. above. We are not aware of the transactional information being relied on in any way.

T. Are you aware of any instances where the daily publication of transactional information relating to short selling has misled anyone or been of benefit to anyone? If so, please provide details.

See response under O. above. We do not have individual instances which can be named. Our views are based on our members' assessment of the tendency of the data to be misleading to investors.

U. How much would it cost you to comply with the current ASIC interim disclosure regime if it was made permanent (both in terms of initial costs and ongoing costs)? Please reply without including any costs already incurred.

See response to W. below.

For brokers:

W. How much would it cost you to comply with the current ASIC interim disclosure regime if it is made permanent (both in terms of initial costs and ongoing costs)? Please reply without including any costs already incurred.

SDIA has a range of stockbroking and dealing entities of differing size and business volume within in its membership. The costs would differ between members, and we have not been provided with precise costs for each member. We have been advised that for a large entity operating Automated Trading Platforms on a global basis, the total cost of implementing the short sale flagging requirements introduced after September 2008 will be in the range of $AUD500,000 to $1 million. As all brokers are part way through this process, it is impossible to say generally how much of this spend has been already incurred and how much remains to be spent.

V, X, Y, Z – Not Applicable.

All stakeholders:

AA. Given that this measure will impose some compliance costs, are there any other regulations in this area that you would like to see improved or removed to reduce your compliance costs? If so, please explain what they are and why they need to be improved or removed.

No additional comments.

We would be happy to discuss any issues relating to this matter at your convenience. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@sdia.org.au .

Yours sincerely,

David W Horsfield
Managing Director/CEO