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SUBMISSION ON DRAFT SHORT SELLING REGULATIONS AND ACCOMPANYING COMMENTARY

Introduction

The Securities & Derivatives Industry Association (SDIA) is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. SDIA is pleased to provide this submission to Treasury on the Draft Short Selling Regulations ("the Draft Regulations") and accompanying Commentary ("the Commentary").

SDIA commends Treasury on the thorough consultation process that has been undertaken in order to arrive at the Draft Regulations. The drafting process has no doubt required some careful balancing of competing views on some of the regulatory issues at stake, and the overall outcome embodied in the Draft Regulations is in our view a good one.

There are however some matters on which the SDIA would like to address some comments, both generally and in respect of the specific questions posed in the Commentary.

Schedule 1 – Transactional Reporting

Preliminary comments

As a preliminary matter, the overwhelming consensus within the stockbroking industry remains that the daily gross short sale transactional data presently being captured and reported under the interim ASIC arrangements is not utilized by any participants or investors and is of very little value to the market. Hence, there is little value in our view in the Schedule 1 transactional reporting requirements which establish those arrangements on a permanent basis.

Addressing the specific issues for comment in the Commentary (which we have numbered for ease of reference):-

(i) Schedule 1 aims to replicate the existing ASIC interim disclosure regime without introducing any new requirements or removing any requirements. Do you consider any changes to Schedule 1 are necessary to achieve this? If so, please explain.

The terms of Schedule 1 reflect the terms of the existing ASIC interim arrangements.

However, there is one detail of the current ASIC Class Order 08/751 which does not appear in the Draft Regulations. At present, section 1020BC(5) as implemented by the CO 08/751 requires disclosure of details of reportable short sales made before 7pm on a trading day, with sales made after that time being taken to have been made on the following trading day and so reported. This provision should be carried over into the Regulations, because of the practical difficulties involved in ensuring reporting of transactions which might occur after that time of day.

(ii) Are the requirements of schedule 1 compatible with any systems changes that you have already implemented to comply with the ASIC interim disclosure regime? If not, please explain why.

As the Schedule 1 requirements reflect the current interim arrangements, most brokers would be well positioned to implement the new obligations. Given that it was not certain prior to now that the interim arrangements would in fact become permanent, or would ultimately become permanent in the same form as the interim arrangements, some of the steps put in place by brokers would have put in place would have been temporary ones. These arrangements will now need to be finalized and made permanent, which may require system changes or finalization of temporary changes.

There remains an issue as to whether real-time tagging will now be required to be introduced, whether by ASIC or by ASX, as a mandatory requirement to facilitate the Schedule 1 changes. This has previously been proposed, subject to the final regulations being released. Real-time tagging will require quite substantial and costly changes in stockbrokers' order management and execution systems, and a large section of the stockbroking industry remains opposed to compulsory real-time tagging of orders. Real-time tagging is also challenging on practical grounds, and contains potential for material inaccuracy. Large institutional investors may also

be required to carry out substantial internal system changes as well in relation to real-time tagging.

Given the view of the market referred to above, that the Schedule 1 gross short sale data is of very little value, then the substantial cost burden which would be imposed by the introduction of compulsory real-time tagging in order to facilitate the capture of the Schedule 1 information would not in our view be justified.

(iii) In situations where companies have multiple trading desks, would it be more appropriate for transactions to be reported under schedule 1 where an individual trading desk responsible for the transaction is short in a section 1020B product or only where the company as a whole is short in the section 1020B product?

In most instances, it is impossible for entities with multiple trading desks to be in a position to determine whether the company as a whole is short at the time of sale. The only practical solution therefore is for this disclosure to be done at the level of each individual trading desk.

We note that ASIC has advised SDIA that it has recognized this and has developed a policy of granting relief to entities to permit reporting at the desk level subject to specified conditions, namely:

(a) clearly segregated desks with information barriers that are formally documented including in organisational charts
(b) each desk maintains its own long/short position records and reports its short sales separately
(c) individuals do not work across the different desks; and
(d) individuals do not work on strategies for more than one desk

In our submission, this approach is sensible and appropriate, and should be continued. However, it would be preferable for this to be incorporated as an express provision in the Short Selling Regulations, thereby removing the cost, expense and delay of parties lodging individual relief applications and ASIC having to process them. It would also remove the potential uncertainty that the policy could easily be discontinued at some future point, for whatever reason.

Schedule 2 – Positional Reporting

Preliminary comments

Level of reporting threshold. One of the key ingredients of the Positional reporting regime is the threshold level for individual reporting.

SDIA notes that a reporting threshold has not been set in the Draft Regulations. Instead, it is noted in the Commentary that it is envisaged that ASIC will use its powers under the Corporations Act to specify a threshold that will "exclude small short positions from being reported".

SDIA has argued in support of the introduction of an appropriate reporting threshold. This will ensure an appropriate balance of the burden of reporting, and also ensure that only material positions (and material data) is reported. This should avoid unnecessary "noise", which has the potential to confuse sections of the market. In a previous submission to Treasury, SDIA noted that market opinion was that the aggregated short position in a listed issuer does not become a material issue to the market for the issuer's securities until the position were to reach about 5% of the issuer's securities.

SDIA does not have any concerns with ASIC setting the level of the reporting threshold. ASIC is close to the markets, and in a very good position to determine the level of the threshold.

However, in order to form a concluded view on the position reporting regime, it is vital that the level of the reporting threshold be made known as soon as possible. The threshold should not be set so low as to cause an unacceptable reporting burden.

We note that the UK may have experienced some difficulty in arriving at the appropriate level of their corresponding threshold for individual reporting. The initial level of 0.25% has recently been doubled to 0.50%, which we believe was at least in part due to initial experiences with the volume and burden of reporting at the lower level.

In our view, the level of 0.50% is also likely to lead to a level of over-reporting, and that the appropriate level for the reporting threshold should set at not less than 1%.

Daily reporting where no change. We note that the Draft Regulations require daily position reports to be filed even where there has been no change to the position. This is an unnecessary and potentially costly administrative burden, which SDIA submits should be reconsidered. It also contrasts with long position (substantial share holding) reporting obligations, where reporting is only required in the case of further change.

There should be no compulsion to report daily if there has been no change in net short position, and there should be an assumption that a position which has been reported remains on foot until a change is notified. If a person wishes to report daily even where there has been no change, for instance if that is easier from the point of view of their particular systems or circumstances, then this should remain permissible.

Further procedural detail needed. The Draft Regulations make provision for the Net Position Reporting particulars to be provided "in the form prescribed by ASIC" (see Schedule 2 [4] and [5]).

Details of the mechanism which ASIC will implement as the pipeline for reporting, and the prescribed form of the particulars, will need to be made available before significant steps can be made by entities to implement the proposed reporting requirements. It is not feasible to commence making any changes to systems until this is available. If there is any significant time lag in the release of these details, then potentially the feasibility of the proposed commencement date of the net position regime could be called into question.

Embarking on system changes in a piecemeal way before all of the detail is known is not only impractical, but also inefficient on an economic level. The nature of broker systems is such that it is exponentially more expensive to make a series of ongoing changes, and significantly more efficient to roll up all necessary changes into the one package and make these all at the one time.

SDIA is aware that there is some discussion that the mechanism that ASIC may propose for reporting Schedule 2 data may involve the use of the FICS protocol. Initial feedback we have received from industry is that this may involve a significant IT spend, and that there may be simpler and more cost effective alternatives. There will also be potential issues of how sellers without access to the FIX protocol will carry out reporting. Whilst these are practical issues for ASIC to resolve, rather than Treasury, they are indicative of the sort of issues that will need to be dealt, and which may cast doubt on the achievability of the proposed commencement date.

Turning to the specific questions set out in the Commentary (also numbered following on from above):

(iv) The definition of short position in schedule 2 aims to provide an accurate indication of the short position that a person has that resulted from a covered short sale transaction. Do you consider that any amendments to the definition are necessary to achieve this? If so, please explain.

We do not propose any amendments.

(v) The requirements in Schedule 2 apply to persons. In some situations, a person (for example, a company) may act in its own capacity as well as some other capacity (for example, as responsible entity for a registered scheme). In this situation, the company would need to take into account both capacities when reporting short positions. Is it appropriate for reporting of short positions to be done at the company level or some lower level (for example, at the individual fund level)?

It would seem clear that an entity would need to take into account all the different capacities in which it has established short positions for the purpose of complying with reporting obligations. The appropriate level for reporting would, in our view, in the absence of compelling arguments to the contrary, be at the company/entity level.

The objective of the net position reporting regime is to provide the market with a better picture of the extent of short positions in each listed security, and hence, the market pressure on the price of the security. This objective is satisfied by reporting information at the company/entity level. The objective is not furthered by a requirement to descend further and report at the level of underlying funds. There is also the likelihood that reporting down to this lower level would significantly add to the cost and administrative burden of reporting.

If a company or entity for some reason were to find it easier to report at a fund level, then it may be appropriate for this to be an option available under the Regulations. However, it should not be mandatory.

(vi) It is envisaged that a person may wish to report the information required by schedule 2 via an agent (for example, a settlement participant). Do you consider that any changes to schedule 2 are necessary to allow for this to occur? If so, please explain.

The drafting of Schedule 2 appears to be adequate to allow for reporting by an agent for the investor.

(vii) Schedule 2 aims to provide comprehensive information to ASIC on all short positions that result from a covered short sale transaction. Do you consider that any changes to schedule 2 are necessary to allow for this to occur? If so, please explain.

Other than the comments made elsewhere under this Section, no.

(viii) Are there changes that you consider could be made to schedule 2 to allow the reporting requirements to be better integrated with your computer systems or to allow you to meet the requirements more efficiently?

Other than the comments made elsewhere under this Section, no.

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,

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