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

Email: shortsellingbill@treasury.gov.au

Dear Sir/Madam

Re: Corporations Amendment (Short Selling) Bill exposure draft

The Australian Council of Superannuation Investors (“ACSI”) is a not for profit member-based organisation that provides corporate governance advice and research on behalf of its 42 member superannuation funds that collectively manage over \$250 billion in superannuation fund investments on behalf of over 5 million superannuation fund members.

ACSI welcomes the opportunity to respond to the draft exposure legislation “Corporations Amendment (Short Selling) Bill” (“Draft Exposure Legislation”) that considers a number of proposals aimed at facilitating improved transparency and governance with respect to short selling.

ACSI supports the Federal Government’s review of regulations that apply to these activities and legislative reform that effectively promotes efficiency and transparency in the market.

Promoting improved transparency in short selling and securities lending

Superannuation funds allow their managers to short stocks, mostly these are within long/short mandates however some funds also short to maintain market neutrality in a stock. Whilst long/short mandates are a small but growing part of any superannuation investment portfolio in these circumstances, fund managers are able to take short as well as long positions in order to gain returns from stocks falling as well as rising in price.

ACSI considers that short selling is a legitimate and worthwhile trading technique which contributes to market liquidity, efficiency and price discovery.

Superannuation Funds, and ultimately superannuation fund members, benefit from covered short selling and from stock lending. In this submission, references to short selling means covered short selling unless otherwise indicated.

ACSI supports transparency with respect to both stock lending and short selling.

Superannuation funds undertake stock lending in order to earn additional income from the stock that they hold in conventional long portfolios.

In this regard, superannuation funds typically lend securities to (or through) their custodians on a fully secured basis, they generally:

- lend a small percentage of their holding in any one stock for a relatively short period of time;
- provide for the recall of their stock for any vote required;
- preserve their rights to any dividends, franking credits, bonus issues or any other rights which might accrue to the stock during the loan period.

ACSI supports all reasonable measures to eliminate market manipulation, but believes that the process by which manipulators achieve illicit profits should be distinguished from the activity which has been manipulated itself.

Just as in the case of insider trading, it is not share trading which is the problem but the abuse of fiduciary duty. ACSI believes market manipulation is the problem, not short selling.

Super fund portfolios containing short positions in Australian equities are externally managed by Australian based fund managers. For that reason, ACSI has conferred with the Investment Financial Services Association Limited (“IFSA”) to consider the practical implications of each of the options outlined in the commentary to the draft exposure legislation and has had the benefit of considering our position on a range of issues in light of IFSA’s submission dated 14 October 2008.

Improved Disclosure of Short Selling activities

In relation to short selling, ACSI supports measures that keep the market operator, the Australian Stock Exchange (“ASX”) informed of the extent of these activities.

In our previous submission to the ASX, ACSI indicated its support for improved transparency on short selling activity being facilitated through an investor’s broker who would report gross and covered short sales and report net short positions at the end of each day to the market operator.

ACSI’s position communicated to the ASX was therefore consistent with option 2 as outlined in the commentary to the draft exposure legislation which provides that investors disclose covered short sale transactions to their broker who will then be responsible to report this information to the market operator.

The range of options contained in the commentary to the draft exposure legislation raise a number of advantages and disadvantages, particularly in respect to better safeguarding market integrity. The relevant fund managers who obtain short selling mandates from super funds, do so on the basis of their proprietary research. We are concerned about the real risk of information leakage and the potential loss of confidentiality of trading activities arising out of option 2 contained in the commentary.

Accordingly, ACSI now supports the introduction of option 3 which provides for the full disclosure of covered short sales by the investor directly to the market operator. Whilst we recognize that this could impose some additional requirements on investors, we would urge the Federal Government avoid making these disclosure requirements too technically cumbersome.

We regard the disclosure and identification of short selling directly to the market operator as appropriate, in light of our concerns that trading information passing through a third party is open to leakage. This would raise the prospect of distorting market outcomes, including by aggravated short selling by “free riders”.

Furthermore, ACSI supports the establishment of an effective system of surveillance to be adopted by the market operator in order to effectively investigate and detect unusual behaviour, and minimize the incidence of market manipulation. ACSI supports a regime that gives the market operator and the Australian Securities and Investments Commission (“ASIC”) the ability to impose punitive penalties for proven market manipulation. In these circumstances, we also support the public naming of market participants who receive punitive penalties.

In addition to the abovementioned disclosures to the market operator, ACSI supports the 'lagged' disclosure to the broader market of aggregated short positions that apply to each company. A possible lag of a fortnight of these disclosures to the market minimizes the risk of leaked information being abused by other participants and used on a 'free rider' basis.

As previously mentioned, ACSI has had the benefit of reviewing the IFSA submission. Whilst we understand IFSA's reasons for applying a "de minimus exemption" for reporting we would query the practical ability of all investors to be aware when a defined percentage in a company has in fact been exceeded.

ACSI supports the establishment of a disclosure regime that requires the public registration of all market participants who engage in short selling. The registration requirements would also require participants to disclose their respective short selling positions.

In addition to endorsing option 3, ACSI also supports amendments to the Corporations Act coupled with the introduction of systems to facilitate the disclosure of all stock lending transactions in accordance with option 4 of the commentary. We concur with the IFSA submission that supports "developing a system where aggregated lending data is disclosed by custodians directly to the ASX."

Naked short selling

Superannuation funds do not have a direct interest in naked short selling. We understand naked short selling to be a very small part of trading activity and accordingly should it be banned outright, there would be little direct impact on investment activities of superannuation funds. However, we make no submissions to discontinue short selling, expecting that if it is permitted to continue, it should be subject to the maximum disclosure regime.

Transitional reporting period

ACSI supports the thrust of the IFSA submission on this item as outlined on page 4 of the IFSA submission including IFSA's observations with respect to the transition between the lifting of the existing ban and the introduction of the legislation arising from this review.

Continued application of the "tick test"

ACSI accepts that the role of the "tick test", so far as it acted to prevent manipulation, may be redundant.

However, it does not seem to be an impediment to the price discovery effect of short selling, so that removing it in the midst of the present fragile position of equity markets does not seem to be necessary to this reform. ACSI would support a sunset clause for its removal when these reforms have settled.

Conclusion

ACSI supports reforms that provide a balanced approach to the improved disclosure of short selling activities. It is our submission that such reforms must raise standards of behaviour and disclosure through improved legislation aimed at minimizing market manipulation.

Should you have any questions in relation to the ACSI submission, please do not hesitate to contact me on (03) 8677 3895.

Yours Sincerely



Ms Ann Byrne
Chief Executive Officer
Australian Council of Superannuation Investors

Cc: Senator the Hon. Nick Sherry