



20 October 2008

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

Dear Sir/Madam

Thank you for the invitation to provide comments on the 'Corporations Amendment (Short Selling) Bill'.

We believe that covered short selling plays an important role in maintaining market efficiency and promoting liquidity, and we know of no evidence that there is market failure due to short selling. We find statistically significant evidence that the current ban on short selling has reduced liquidity/trading volumes (refer attached paper "Has the Short Selling Ban Reduced Liquidity in the Australian Stock Market?"). As a very rough guide we estimate the impact of the short selling ban has been to reduce trading by around half the impact of the NSW Labour day holiday. That is, it is like having half of the largest state in Australia on holidays. In fact, in times when liquidity is most needed, we find liquidity as measured by trading volumes has significantly reduced. We also find evidence that stock spreads and stock volatility have significantly increased since the ban on short selling has been implemented.

Whilst it is easy for media and corporate management to blame falling share prices on short selling, the reality is that share prices have fallen due to deteriorating economic conditions, with over geared companies falling the most due to the current credit squeeze. Companies such as ABC Learning, Allco and its related vehicles, Babcock and Brown and its related vehicles, Centro Properties and MFS (now Octaviar) have all fallen due to fundamentals, not short selling. Share prices have not miraculously rebounded since the short selling ban has been implemented, but rather have continued to fall. We do, however, applaud the ban on naked short selling.

Leading asset or investment consultants support, and Australian superannuation funds invest in, a number of legitimate investment strategies which incorporate some degree of short selling. These strategies include short extension or 130/30 style strategies and market neutral strategies (refer attached Worked Example for more details of these strategies). It is noted that whilst these styles of strategies involve some degree of short selling, this short selling is offset by at least the same proportion of long

investing, and in the case of 130/30 strategies by a further 100% long positions. The current temporary short selling ban has not only stopped the short selling side of these strategies, but has also impacted the long side, thus leading to significant declines in market trading volumes. The short selling ban has impeded the ability of these legitimate investment strategies to meet their financial objectives, and these investment strategies ultimately impact the returns on Australian superannuation funds and their constituent members who represent Australian working families.

Whilst we see no market failure with respect to the previous short selling regime, we favour option two: Disclosure of covered short sales to brokers, and we favour the recommendations of IFSA in terms of how this disclosure regime would work. We particularly hope that any disclosure regime is as simple as possible to minimise the costs of reporting on an industry that is currently struggling due to market conditions. To that effect we would encourage the disclosure to be made at the time of trade booking, rather than at the time of initially providing the order to brokers (please refer attached Worked Example for reasoning).

Finally, we strongly recommend that the current temporary covered short selling ban be removed immediately in order to boost liquidity, improve market efficiency and to enable legitimate investment strategies which incorporate short selling to meet their objectives. Australia is the only developed market to have instituted a ban on short selling of all listed securities, rather than financial securities, and we do not understand why this is the case. What we do know is that liquidity has been significantly impacted by this ban. Australia's more extensive ban has also impacted its reputation as a leading financial market and is likely to hamper Australia's ambitions to grow and export our financial services industry.

Yours sincerely

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cc: Mr Tony D'Aloisio
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