

CORPORATIONS AMENDMENT (SHORT SELLING) BILL 2008

Second Reading

Mr ROBERT (Fadden) (1.05 p.m.)—The [Corporations Amendment \(Short Selling\) Bill 2008](#) seeks to enhance market stability by outlawing naked short selling and increasing disclosure for covered short sales. The bill gives effect to a number of measures: clarification of ASIC's powers to regulate and ban short selling of financial products, amendment of the Corporations Act 2001 to prohibit naked short selling, and increasing disclosure requirements. The bill is presented in the form of three schedules. The first two schedules deserve support; the third schedule deserves to be thrown in the bin.

First of all: what is short selling? When individuals invest in shares, they generally want to buy low and sell high. No-one likes to sell things for less than they paid for them—that is, they are purchasing shares for the long haul and are buying long, as any profit will be delivered down the track. Short sellers do the opposite: they want to gain from a fall in price. They are looking for shares they think will go down in price or they are looking to hedge a position against a fall in price. Unlike other share traders, short sellers generally do not own the stock they sell. They sell them hoping that the price will fall below what they purchased them for.

In a conventional short sale, an investor—and large investors are generally large super funds, investment banks or private investment funds; we may know them as hedge funds—takes the view that shares in a particular company may fall, or they wish to hedge a position in a company that may fall. They borrow shares in that company from someone who does own them, and in other cases, called naked short selling, they just sell shares they do not own. If they borrow shares on a covered short sell—most often the owner will be very large pension funds, insurance companies, super funds—the investor sells the shares in the market once the shares have fallen in value and the investor buys them back at the lower price and returns them to the original owner. If all goes well the investor pays less to buy back the shares and pockets the difference. Clearly, there is some cost involved in covered selling.

The current regulation of short selling in both the covered and the naked types is section 1020B of the Corporations Act, which regulates the short selling of certain financial products. Under current provisions, while short selling is technically prohibited, there are exceptions provided in the legislation that allow covered and some naked short selling to occur. These include where the seller has in place before the time of sale an arrangement that will enable delivery of the product within three business days or has effected the sale in accordance with the Australian stock market rules. In both of these cases a person selling through a financial services licensee must tell the licensee that the sale is of this kind. Licensees or brokers who are participants in the financial market operated by ASIC must give ASIC certain aggregated information about such sales on a daily basis.

In response to the global financial crisis, in September 2008 the Australian Securities and Investment Commission, ASIC, responded to turmoil in international and Australian financial markets by introducing measures aimed at limiting the potential for markets to become disorderly. The problem here is that when the ban on short selling was introduced, the market was deferred from an opening of 10 to 11 because the government bungled its advice and the direction it took. Indeed, the Treasurer, our nervous man, had three positions in three days. The member for Oxley has just finished saying that the government got this spot on, that you cannot change your mind three times in three hours, that the market needs certainty—and I agree with him. The market needs certainty. You cannot go around changing your position every second day, but that is exactly what this government did. It put a lack of confidence into the market, so consumer confidence is the lowest it has been since recorded levels, and that was before

the crest of the wave of the financial crisis hit us. Indeed, changing the government's position three times in three days does not imbue anyone with confidence.

The issue of short selling was considered by the Parliamentary Joint Committee on Corporations and Financial Services in June 2008. The member for Oxley, who chairs that committee, was just speaking about it, and I also sit on that committee. Before the stock market crash in September, which sparked governments to temporarily ban or limit short selling, the committee was examining trade practices in equity markets and we remarked that there was a widespread view that short selling activities are not subject to sufficient rigorous disclosure requirements to ensure that shareholders are adequately informed. In our inquiry the disclosure requirements for the practice of short selling attracted considerable attention. The committee reported that it was our view that:

... while short selling is a legitimate trading tool, it is necessary to ensure it is appropriately disclosed to the market to ensure that undesirable practices that potentially accompany short sales can be identified by regulators. Further, the committee does not oppose institutional investors lending their stocks to maximise returns, but considers that funds should be required to disclose their stock lending practices or policies to members.

We in the committee were concerned about the lack of disclosure, that upwards of five, six and seven per cent of a company's stock on issue was being borrowed from large funds to short the market and drive the price down. We were concerned that somewhere between 1.7 and two per cent of the market were naked sales—large hedge funds using billions of dollars to short a stock, to force it down and pocket the difference with no thought to the long-term wellbeing of the company or developing productivity out of what the company was doing.

The government has now introduced legislation which contains three schedules. The first schedule inserts new section 1020F(8) into the Corporations Act. The new section clarifies that the power to make a declaration under existing section 1020F(1) can be used to restrict or change the rules relating to short selling on the stock exchange. The purpose of the section is to remove any doubt of the authority to make such declarations under the Corporations Act.

Of particular note is new paragraph 1020F(8)(c), which clarifies that a declaration by ASIC under existing paragraphs can exempt a transaction from the rules against short selling, thereby allowing short selling to occur once a declaration has been made. The coalition supports the implementation of schedule 1 as it is a measure to enhance market transparency by providing certainty to both ASIC and industry regarding the scope of ASIC's powers. As an aside, I commend the government on moving towards transparency in this schedule. It would be nice if they decided to move towards transparency in other funds in other bills, like the nation building bill.

Schedule 2 of this bill clarifies that a person can sell products previously purchased under agreement, even though they have not yet acquired the rights to vest the products—that is, due to conditions of the purchase agreement, they have not yet acquired full rights in that regard. The explanatory memorandum makes it clear that the existence of the prior purchase agreement means that the transaction falls short of true naked short selling. The coalition supports the implementation of schedule 2 since such financial transactions—naked short selling—do distort the operation of financial markets by causing increased price volatility. Naked sales can potentially facilitate market manipulation and can damage market confidence. Naked short selling is estimated to represent less than two percent of all short sales.

Schedule 3 deserves to be thrown soundly in the bin. It attempts to deal with disclosure. It outlines a number of new disclosure requirements for allowable—that is,

covered—short sales. The Joint Committee on Corporations and Financial Services looked widely at the issue of disclosure and addressed it in its report in June this year. I can only assume that the government has failed to read the committee's report. The coalition does not support schedule 3. This amendment is essentially a shell which will be fleshed out without the intervention of the parliament, essentially circumventing the parliament. The complete lack of detail in this schedule not only means that regulations will be relied upon to provide any such detail but also that key issues and concerns for industry stakeholders, who are not in support of this amendment, will remain unresolved.

The government has not done any work on this schedule despite its extensive consultation process. Not only has it not provided any detail but it has also decided not to implement any suggestions or concerns raised. This schedule is inept, it is unclear and it will not lead to the complete disclosure that is needed, and one has to question why the government consults at all if it is going to ignore everything that it is told.

There is a complete lack of detail in relation to how the disclosure requirements will work. This means that key issues and concerns of industry remain unresolved. There are no legislative provisions on how disclosure would take place in terms of time, regularity, whether it is by aggregate or daily totals and what type of stock measure would be used. There are no principles espoused to underpin the disclosure regime; therefore we have no idea at all as to how regulations would be approached or how they are meant to operate.

A lack of transparency arising from this circumvention of parliament removes any capacity for scrutiny and consultation. Surprise, surprise—this government is trying to move away from appropriate scrutiny by the opposition. It allows the government to ignore consultation with key stakeholders and simply table binding regulations in parliament, regardless of consequence and what it does to the market. Key industry groups—including IFSA, FCIA, AFMA and the SDIA—do not agree with the government's preferred option 2 in the exposure draft. The ASX supports only a modified model of option 2.

There is broad opposition to the disclosure of covered short sales to other brokers as proposed in option 2. Industry advocates that positions should be disclosed to the ASX, as the market operator, and not to other brokers to protect commercial advantage and prevent price distortion. Industry largely has a preference for disclosure of positions one to two weeks after a short sale—not on the following day, as proposed by option 2 of the exposure draft. The government has already held an extensive consultation process but has chosen not to implement suggestions with respect to this. Once again, it begs the question: why bother consulting if you are going to ignore everything you have heard? Treating industry with this degree of contempt is beneath you.

Why rush, if the consultation process has not occurred—particularly where there is a lack of consensus amongst industry groups? Government has invented a deadline but ASIC can continue to regulate short selling indefinitely. There is no need to rush and there is no imperative because ASIC has the power to regulate in the short term. And we know what happens when this government rushes, like when it rushed its bank guarantee. The rest of the world was going with \$100,000 to \$200,000 caps, but when the Leader of the Opposition proposed a \$100,000 cap on 12 October, our Prime Minister—not to be outdone—proposed an unlimited bank guarantee. I think it was the only unlimited one on the planet, bar perhaps Ireland. What we saw was massive market distortion because he rushed. Thirteen of the top 20 cash and property management funds stopped redemptions for six months and 270,000 Australians had their money and assets frozen because this government rushed. There was no need to rush.

In fact, the great irony of this government's rushing is that this is the only country on the planet where the government's intervention has made things worse for the nation. Every other nation would appear, on the surface, to be more prudent. They took time and actually had all the regulators in the room when decisions were made, as opposed to just one. They trod carefully and considerately—but not this government. Not wanting to be outdone by the Leader of the Opposition, who had been calling the shots well ahead of the government, they rushed. And they are rushing again now, when there is absolutely no need because of the regulatory powers of ASIC. This is a significant change to the functioning of the Australian equities market. An unsound hastening of the process is concerning and, looking at this government's track record, it will lead to grief because that is all this government has given in response to the financial crisis for this country. This is the only country on the planet where things are worse because of government intervention.

Any further ill-conceived market reforms, such as the bungled bank guarantee, may produce further haemorrhaging in the share market. The coalition supports enhanced market stability, The first two schedules of the bill deserve our support, but the last schedule is highly ambiguous. It is a hollow shell that is designed to circumvent parliament and it deserves to be thrown in the bin, where it truly belongs.