

**The [Australian Treasury](#) released a consultation paper titled "Short Selling Regime" on Friday 6 March. The paper calls for comments no later than 3 April 2009.**

The [Treasury](#) paper follows the enactment of the Corporations Amendment (Short Selling) Act 2008 in December 2008 and presumably will assist in the drafting of regulations supporting the Act. Given the objective of the new legislation is to "enhance market confidence and integrity by providing greater transparency to both investors and regulatory bodies about short selling activity on Australian financial markets" its success will be dominated by the successful drafting of the regulations. So this is definitely a paper that is worth commenting on!

The paper refers to the improvement in confidence that might be generated by the short selling information and the reduced potential for rumour and speculation surrounding the activities of short sellers. The reporting should answer once and for all whether short selling really is a tool for market manipulators or not.

The paper makes the distinction between two methods of reporting of short sales; transactional (currently known as gross short sales and represented by the interim disclosure requirements imposed by [ASIC](#)) and positional (net short sales).

Positional reporting is more accurate than transactional reporting because it also takes into account transactions that close-out short positions. This is a very important difference. There is a high likelihood that transactional reporting can be misleading, making it unsuitable for reporting.

Treasury note that the [Reserve Bank of Australia](#) are pursuing additional disclosure of stock lending information as a complement to other short selling information, even though it is widely accepted that security lending data is a poor proxy for short selling. The risk here is that a second partial source of short selling data is added that also has a high likelihood of being misleading.

Layering ad hoc and partial measures of short selling is the worst of all worlds particularly, as will likely be discovered once sufficient information is collected, short selling is not so influential an impact on share prices as regulators and commentators believe. If we follow this course we will have constructed a costly and misleading infrastructure of reporting mechanisms that add little to market integrity. Transactional reporting should be dismantled once a superior method is in place, and the new [RBA](#) security lending reporting should not be pursued so that the focus can be on delivering the best possible solution.

While there will be difficulties in implementing a positional reporting regime, such difficulties are not sufficient reason to rely on poor and misleading proxies instead. [Treasury](#) refer to two such potential issues - implementing threshold reporting and dealing with investors in other jurisdictions.

Threshold reporting means excluding investors with only small short positions from the obligation to report. While in theory this would appear to be a sensible and practical initiative, and has been adopted in the UK, in practice it has serious shortcomings:

- It will not be as accurate as collecting total data and therefore risk being misleading as is the case for transactional and security lending reporting; and
- It is likely to be easier for investors to report total positions than to extract positions above a threshold, without significant system development

Positional reporting puts the onus on investors or their agents to provide short selling data. While in theory offshore investors may not be able to be easily compelled to provide information, they will operate with sub-custodians in the Australian market that may be able to be compelled to do so.

There is some discussion of the timing and frequency of reported data.

- On timing, fairness (and thus market efficiency) dictates that only aggregate security data is released, and is released with a lag so as not to encourage front running strategies (akin to encouraging trading on rumour) or discourage short selling activities.
- Cost is a major factor in determining frequency, although unless short sale positions are expected to be highly variable, frequent reporting would not be justified. (Note there is an expectation among regulators and commentators that short sale positions are highly variable. This is not borne out by experience overseas and should not be assumed without evidence in developing the Australian reporting regime.)

Discussion to date on short sale reporting, including this consultation paper, has generally assumed that short selling is a dominant influence on share price movements. Thus, greater transparency of reporting is warranted. However, this is not supported by any evidence. Consideration of the cost of implementing enhanced disclosure should also include the possibility that the additional information resulting from the short selling regime will not improve market effectiveness, because short selling has been dramatically overstated as a source of share price movements. (Note: while short selling has been under the spotlight for its potential to disrupt markets in fact it has been the ban on short sales itself that has been associated with reduced market confidence, reduced market liquidity and reduced market integrity.)

Nevertheless, there will be enhanced short sale reporting as this is what is dictated by the new legislation. The first benefit will be that if not already removed, the current ban on financials will finally be lifted. Then, if positional reporting is adopted, there will be the benefit that it will be clear for all to see what impact, if any, short selling might be having on a security price, rather than unfounded accusations that short sellers are the root cause of share price declines.

**In summary, we should work towards a single best method for reporting sales that is consistent with global practice (and dismantle current partial misleading reporting) that enables aggregate short sale positions to be reported periodically with a lag. For the record I expect this data to show that the impact of short selling on share price movements, and thus the need for this additional reporting, has been dramatically overstated.**

In answer to the issues for comment in the [Treasury](#) paper;

A. Positional reporting should be used in isolation because the current transactional reporting is misleading.

B. The stock lending reporting proposed by the [RBA](#) should not be pursued because it is likely to be a misleading source of short sale information.

C. Investors or their agents should be responsible for reporting short sale information because this information is already to hand and while it will take effort to effect the

resulting positional reporting will deliver best available short sale information.

D. Custodian/prime brokers carry sufficient information about client's short sale data. The majority of short sellers will have some custodian/prime broker relationship in place to effect settlements and hold securities.

E. Offshore investors will generally operate with custodians that in turn have sub-custodian arrangements in Australia to effect settlements and hold securities.

F. Market operator will carry other relevant information about securities such as market capitalisation and likely be in a position to add short sale information easier than the regulator.

G. I believe that a threshold for reporting will be more difficult to implement than full reporting and will be more accurate. The costs for full reporting could be minimised by appropriate periodic reporting.

H. Refers to number of short positions excluded if various thresholds applied. Will disadvantage large managers who will more likely have positions above the threshold.

I. Current US position is for fortnightly reporting via market operator. Adopt lag in keeping with global practice. If the lag is reduced to 1 week globally adopt 1 week otherwise retain fortnightly.

J. Banded disclosure is difficult and costly to administer and relates to the influence of individual investors. The key is influence at the aggregate security level.

K. There should be a delay to avoid front running and to respect the effort that short sellers have invested in the decision they are making on behalf of their clients. Otherwise short selling is likely to be discouraged to the detriment of market integrity.

L. The data should be disclosed on an aggregate basis. As with K. above disclosing investor positions will encourage front running, fan rumour and discourage investors from short selling on behalf of their clients to the detriment of market integrity.

M. I agree aggregate disclosure could be misleading if a threshold is applied. As stated in G above more accurate reporting will result if no threshold is applied.

N. The identity of short sellers should not be disclosed whether threshold approach is applied or not. As with K and L above such an approach will encourage front running, fan rumours and discourage the use of short selling on behalf of clients to the detriment of market integrity.

O. Transactional reporting is misleading and should be dismantled as soon as a superior method of reporting is implemented. It is not a complement to position reporting.

P. Transactional reporting is flawed from the perspective of data collection (by way of brokers who are in a position to trade and profit from the additional reporting provided) and output (increased/decreased reported short sale activity may not be associated with a net increase/decrease in short sale positions and thus is misleading).

Q. If positional reporting is made mandatory then all other misleading proxies should be removed.

R. The lag in reporting should reflect international practice. The lag should be sufficient to stem front running and fanning of rumour. Assuming data is aggregated the lag could be as short as 1 week.

S. It is difficult for individual investors to see evidence of front running from current reporting.

T. The current transactional reporting will mislead whenever material short sales are closed as these are not reported. It is also confusing to investors to see financials short sales reported when they are banned from being short sold.

U. - Z. seek responses on the cost of compliance. The two elements of cost will be system development and the cost of providing the data ongoing.

AA. The cost of compliance would be minimised if the best reporting approach was adopted and other misleading approaches dismantled or not pursued.